PROPOSED EXTENSION OF THE SURCHARGE AND REPEAL OF THE INVESTMENT TAX CREDIT

1947-4

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-FIRST CONGRESS

FIRST SESSION

ON

H.R. 12290

TO CONTINUE THE INCOME TAX SURCHARGE AND THE EXCISE TAXES ON AUTOMOBILES AND COMMUNICATION SERVICES FOR TEMPORARY PERIODS, TO TERMINATE THE INVESTMENT CREDIT, TO PROVIDE A LOW-INCOME ALLOWANCE FOR INDIVIDUALS, AND FOR OTHER PURPOSES

JULY 8, 9, 11, 14, AND 15, 1969

Printed for the use of the Committee on Finance

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PROPOSED EXTENSION OF THE SURCHARGE AND REPEAL OF THE INVESTMENT TAX CREDIT

TUESDAY, JULY 8, 1969

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

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

Present: Senators Long, Anderson, Gore, Talmadge, McCarthy, Hartke, Fulbright, Harris, Byrd, Jr., of Virginia, Williams, Bennett, Curtis, Dirksen, Miller, Jordan, and Fannin.

OPENING STATEMENT OF THE CHAIRMAN

The CHAIRMAN. The hearing will come to order.

This is the first of a two-part hearing with respect to H.R. 12290, a bill passed by the House of Representatives to extend the income tax surcharge and to repeal the 7 percent investment tax credit. The bill also continues for another 1-year period the present 10 percent excise tax on telephone service and the 7 percent tax on passenger automobiles. In addition, it provides a special low-income allowance which relieves millions of poverty-level wage earners from the tax rolls. Finally, it allows air and water pollution control devices to be amortized over a 5-year period.

During this first portion, the committee will receive testimony from the Secretary of the Treasury and the Director of the Bureau of the Budget with respect to the need for the legislation.

We will also hear public witnesses with respect to the provisions in the House bill. If the Secretary concludes his testimony today, we will begin hearing public witnesses tomorrow.

In the second phase of the hearing, the committee will take testimony with respect to tax reform.

There will be no tax hearing on Thursday, July 10, because of a prior commitment to the Subcommittee on Veterans' Legislation which will be inquiring into several matters relating to the veterans statutes.

Before recognizing the Secretary of the Treasury, let me make an announcement with respect to the committee's schedule for considering tax reform.

TAX REFORM HEARINGS

In our Committee on Finance it has been the practice to hold hearings on specific bills and amendments that Senators are interested in. This procedure differs from that followed by the Committee on Ways and Means where hearings often precede the introduction of a bill.

In keeping with this practice of the committee, I plan to announce to the Senate that our tax reform hearings are going to be just as broad and comprehensive as the Senators want them to be. All we ask is that the Senators indicate all of the tax reform proposals they desire to offer to H.R. 12290 so that we can conduct hearings on them before we take the bill up in executive session.

I know most Senators will agree with me that we should not take taxpayers by surprise and take up amendments which may affect them without giving them an opportunity to state their side of the question. That is what the hearing process is all about.

Similarly, a Senator should be entitled to state to the Senate that his tax reform suggestions have been through the hearing process in the Committee on Finance and thus prevent that procedural argument from being used as a device to build up opposition to his amendment. He should be entitled to have a vote on the merits of his tax reform suggestions in connection with this legislation.

IDENTIFICATION OF TAX REFORM PROPOSALS

So to be fair to them and to the Senators who want to propose tax reform amendments to the surtax bill, I urge that Senators who have introduced bills in the Senate identify to the Committee on Finance those which they intend to call up as amendments during Senate consideration of H.R. 12290.

If Senators have tax reform suggestions in mind that they intend to propose but which have not yet been introduced, I urge that they introduce them and identify them as matters they would like to have considered during discussion of H.R. 12290.

If Senators will cooperate with the Committee on Finance in this way, we can publish all these tax reform suggestions in a committee print and make them the basis for the tax reform phase of our hearings.

No Senator will be deprived of the right to a hearing on his tax reform ideas. But in order to advance these hearings in an orderly manner, it is necessary that we know within a specified time exactly what the Senators want to propose in the wav of tax reform.

Therefore, I urge Senators to let us know by Friday of next week—July 18, 1969—what they plan to offer in the way of tax reform. Then we can schedule our tax reform hearings to begin promptly the following week—the week of the 21st.

I believe this procedure recognizes the right of every Senator to offer whatever tax reform amendment his conscience dictates, and at the same time, enables the Committee on Finance to carry out its responsibility to the Senate.

SENATE DEMOCRATIC POLICY COMMITTEE POSITION

I might add that in my opinion this procedure also fully conforms to the announcement made on June 25 by the distinguished majority leader that the Democratic Policy Committee had voted unanimously:

> That any proposal to extend the income tax surcharge be considered simultaneously with recommendations on meaningful tax reform, and
> That the present income tax withholding rates be continued after June 30, 1969 for a period of one quarter to permit full consideration and disposition of the reform and extension of the surtax.

The majority leader elaborated on the policy committee resolution in a letter to me dated July 1. In his letter he emphasized that the debate on the floor prior to passage of the 31-day extension of the surtax withholding rates "clearly specifies that additional extensions will be forthcoming if necessary to afford the ordinary processing of intended tax reform through the Senate Finance Committee."

I might add that the 30-day extension that was granted with regard to the withholding rate was for the convenience of the House. That was not a date that was picked by the Senate, and we anticipate that we may have to ask the House to grant us an extension for the convenience of the Senate.

It is my purpose today to implement the majority leader's announcements by again urging that Senators identify their tax reform proposals to us by July 18 so that the Committee on Finance can proceed with the ordinary processing of intended tax reform.

There is a release available to the press this morning which repeats what I have stated.

I believe, Mr. Secretary, it would be best for you to proceed as you desire. I had asked that your statement as well as the Director of the Budget be summarized and that we print the statement in its entirety in order to move ahead, but I understand that you have a brief statement and that being the case you would prefer to read it.

Now before you proceed I believe it would be well to include in the record at this point a copy of H.R. 12290, a copy of a summary of the bill, prepared by the staff, and our press release announcing these hearings.

(The material referred to follows: testimony begins at p. 59:)

PRESS RELEASE, JULY 2, 1969.

COMMITTEE ON FINANCE, U.S. SENATE

HEARINGS SET ON BILL TO EXTEND THE INCOME TAX SURCHARGE, AND TO REPEAL THE INVESTMENT TAX CREDIT

The Honorable Russell B. Long (D., La.), Chairman of the Committee on Finance, announced today that the Committee would begin hearings at *9:00 a.m., on Tuesday, July 8, 1969*, on H.R. 12290. The bill would extend the 10 percent income tax surcharge, postpone for one year the scheduled reduction in the present 7 percent excise tax on passenger automobiles and the 10 percent excise tax on communications services, repeal the 7 percent investment tax credit, provide for a five-year amortization of air and water pollution control facilities, and provide a special "low income allowance" to relieve poor people from paying Federal income tax.

Administration Witnesses.—The Chairman advised that the hearing would be held in Room 2221, New Senate Office Building, and that the Secretary of the Treasury, the Honorable David M. Kennedy, would be the lead-off witness, and will present the Administration's case for the bill. Accompanying him will be the Director of the Bureau of the Budget, Honorable Robert P. Mayo.

Public Witnesses.—Senator Long further reported that unless the Committee invites the Secretary back for a second day of questioning, public witnesses desiring to testify on provisions *contained in the House bill* would be heard beginning Wednesday, July 9. He also stated that because of prior commitments, the Committee *would not* hold hearings on the tax bill on Thursday, July 10.

He recalled that on June 25 the Committee on Finance had voted to recommend to the Senate that the 7 percent investment tax credit be repealed as of April 18, 1969, the same date specified in the House bill.

Chairman Long advised that any interested organization or individual who desires to appear before the Committee to testify on any of the subjects *contained in the House bill* should immediately contact Tom Vail, Chief Counsel, Committee on Finance, Room 2227 New Senate Office Building. The request should be made not later than Tuesday, July 8, and should specify to which provision of the bill the testimony will relate. Those organizations and individuals who have already requested to testify, need not submit a new request.

Chairman Long noted that in lieu of receiving oral testimony the Committee would be pleased to receive written reports from interested persons regarding provisions *contained in the House bill.* Persons desiring to submit such a statement for the record should do so no later than Friday, July 18, 1969.

Tax Reform.—Further, Chairman Long indicated that the Committee soon would issue an announcement relating to hearings on tax reform subjects other than those contained in H.R. 12290.

91st CONGRESS
1st Session

H. R. 12290

IN THE SENATE OF THE UNITED STATES

July 1, 1969

Read twice and referred to the Committee on Finance

AN ACT

To continue the income tax surcharge and the excise taxes on automobiles and communication services for temporary periods, to terminate the investment credit, to provide a low income allowance for individuals, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. AMENDMENT OF EXISTING LAW.**
4 Except as otherwise expressly provided, whenever in
5 this Act an amendment is expressed in terms of an amend-
6 ment to a section or other provision, the reference shall be
7 considered to be made to a section or other provision of
8 the Internal Revenue Code of 1954.

II

SEC. 2. EXTENSION OF TAX SURCHARGE.

(a) SURCHARGE EXTENSION.—Section 51 (a) (relating to imposition of tax surcharge) is amended—

(1) by striking out so much of paragraph (1) (A) as follows the table heading "CALENDAR YEAR 1969" and inserting in lieu thereof the following:

"TABLE 1.—SINGLE PERSON (OTHER THAN HEAD OF HOUSEHOLD) AND MARRIED PERSONS FILING SEPARATE RETURN

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than		At least	But less than	
0	$148	0	$273	$278	$26	$515	$525	$52
$148	153	$1	278	283	27	525	535	53
153	158	2	283	288	28	535	545	54
158	163	3	288	295	29	545	555	55
163	168	4	295	305	30	555	565	56
168	173	5	305	315	31	565	575	57
173	178	6	315	325	32	575	585	58
178	183	7	325	335	33	585	595	59
183	188	8	335	345	34	595	605	60
188	193	9	345	355	35	605	615	61
193	198	10	355	365	36	615	625	62
198	203	11	365	375	37	625	635	63
203	208	12	375	385	38	635	645	64
208	213	13	385	395	39	645	655	65
213	218	14	395	405	40	655	665	66
218	223	15	405	415	41	665	675	67
223	228	16	415	425	42	675	685	68
228	233	17	425	435	43	685	695	69
233	238	18	435	445	44	695	705	70
238	243	19	445	455	45	705	715	71
243	248	20	455	465	46	715	725	72
248	253	21	465	475	47	725	735	73
253	258	22	475	485	48	735 and over, 10% of the adjusted tax		
258	263	23	485	495	49			
263	268	24	495	505	50			
268	273	25	505	515	51			

TABLE 2.—HEAD OF HOUSEHOLD

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than		At least	But less than	
0	$223	0	$343	$348	$25	$495	$505	$50
$223	228	$1	348	353	26	505	515	51
228	233	2	353	358	27	515	525	52
233	238	3	358	363	28	525	535	53
238	243	4	363	368	29	535	545	54
243	248	5	368	373	30	545	555	55
248	253	6	373	378	31	555	565	56
253	258	7	378	383	32	565	575	57
258	263	8	383	388	33	575	585	58
263	268	9	388	393	34	585	595	59
268	273	10	393	398	35	595	605	60
273	278	11	398	403	36	605	615	61
278	283	12	403	408	37	615	625	62
283	288	13	408	413	38	625	635	63
288	293	14	413	418	39	635	645	64
293	298	15	418	423	40	645	655	65
298	303	16	423	428	41	655	665	66
303	308	17	428	433	42	665	675	67
308	313	18	433	438	43	675	685	68
313	318	19	438	445	44	685	695	69
318	323	20	445	455	45	695	705	70
323	328	21	455	465	46	705	715	71
328	333	22	465	475	47	715	725	72
333	338	23	475	485	48	725	735	73
338	343	24	485	495	49	735 and over, 10% of the adjusted tax		

TABLE 3.—MARRIED PERSONS OR SURVIVING SPOUSE FILING JOINT RETURN

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—	If the adjusted tax is		The tax is —
At least	But less than		At least	But less than		At least	But less than	
0	$293	0	$418	$423	$26	$548	$553	$52
$293	298	$1	423	428	27	553	558	53
298	303	2	428	433	28	558	563	54
303	308	3	433	438	29	563	568	55
308	313	4	438	443	30	568	573	56
313	318	5	443	448	31	573	578	57
318	323	6	448	453	32	578	585	58
323	328	7	453	458	33	585	595	59
328	333	8	458	463	34	595	605	60
333	338	9	463	468	35	605	615	61
338	343	10	468	473	36	615	625	62
343	348	11	473	478	37	625	635	63
348	353	12	478	483	38	635	645	64
353	358	13	483	488	39	645	655	65
358	363	14	488	493	40	655	665	66
363	368	15	493	498	41	665	675	67
368	373	16	498	503	42	675	685	68
373	378	17	503	508	43	685	695	69
378	383	18	508	513	44	695	705	70
383	388	19	513	518	45	705	715	71
388	393	20	518	523	46	715	725	72
393	398	21	523	528	47	725	735	73
398	403	22	528	533	48	735 and over, 10% of the adjusted tax		
403	408	23	533	538	49			
408	413	24	538	543	50			
413	418	25	543	548	51			

CALENDAR YEAR 1970

TABLE 1.—SINGLE PERSON (OTHER THAN HEAD OF HOUSEHOLD) AND MARRIED PERSONS FILING SEPARATE RETURN

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than		At least	But less than	
0	$155	0	$340	$380	$9	$700	$740	$18
$155	175	$1	380	420	10	740	780	19
175	195	2	420	460	11	780	820	20
195	215	3	460	500	12	820	860	21
215	235	4	500	540	13	860	900	22
235	255	5	540	580	14	900	940	23
255	275	6	580	620	15	940	980	24
275	300	7	670	660	16	980 and over, 2.5% of the adjusted tax		
300	340	8	660	700	17			

TABLE 2.—HEAD OF HOUSEHOLD

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than		At least	But less than	
0	$230	0	$390	$410	$9	$700	$740	$18
$230	250	$1	410	430	10	740	780	19
250	270	2	430	460	11	780	820	20
270	290	3	460	500	12	820	860	21
290	310	4	500	540	13	860	900	22
310	330	5	540	580	14	900	940	23
330	350	6	580	670	15	940	980	24
350	370	7	620	660	16	980 and over, 2.5% of the adjusted tax		
370	390	8	660	700	17			

TABLE 3.—MARRIED PERSONS OR SURVIVING SPOUSE FILING JOINT RETURN

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than		At least	But less than	
0	$300	0	$460	$480	$9	$700	$740	$18
$300	320	$1	480	500	10	740	780	19
320	340	2	500	520	11	780	820	20
340	360	3	520	540	12	820	860	21
360	380	4	540	560	13	860	900	22
380	400	5	560	580	14	900	940	23
400	420	6	580	620	15	940	980	24
420	440	7	620	660	16	980 and over, 2.5% of the adjusted tax",		
440	460	8	660	700	17			

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1 (2) by striking out the table in paragraph (1)(B)
2 and inserting in lieu thereof the following table:

"Calendar year	Percent	
	Estates and trusts	Corporations
1968	7.5	10.0
1969	10.0	10.0
1970	2.5	2.5",

3 (3) by striking out "July 1, 1969" the first time it
4 appears in paragraph (2)(A) and inserting in lieu
5 thereof "July 1, 1970", and
6 (4) by striking out paragraph (2)(A)(ii) and
7 inserting in lieu thereof the following:
8 "(ii) a fraction, the numerator of which is
9 the sum of the number of days in the taxable
10 year occurring on and after the effective date of
11 the surcharge and before January 1, 1970, plus
12 one-half times the number of days in the taxable
13 year occurring after December 31, 1969, and
14 before July 1, 1970, and the denominator of
15 which is the number of days in the entire tax-
16 able year."
17 (b) RECEIPT OF MINIMUM DISTRIBUTIONS.—The last
18 sentence of section 963(b) (relating to receipt of minimum
19 distributions by domestic corporations) is amended by strik-
20 ing out "June 30, 1969" and inserting in lieu thereof "June
21 30, 1970".

1 (c) EFFECTIVE DATES.—

2 (1) IN GENERAL.—The amendments made by sub-
3 sections (a) and (b) shall apply to taxable years end-
4 ing after June 30, 1969, and beginning before July 1,
5 1970.

6 (2) DECLARATIONS OF ESTIMATED TAX.—If any
7 taxpayer is required to make a declaration or amended
8 declaration of estimated tax, or to pay any amount or
9 additional amount of estimated tax, by reason of the
10 amendments made by this section, such amount or
11 additional amount shall be paid ratably on or before each
12 of the remaining installment dates for the taxable year
13 beginning with the first installment date on or after the
14 30th day after the date of enactment of this Act. With
15 respect to any declaration or payment of estimated tax
16 before such first installment date, sections 6015, 6154,
17 6654, and 6655 of the Internal Revenue Code of 1954
18 shall be applied without regard to the amendments made
19 by this section. For purposes of this paragraph, the
20 term "installment date" means any date on which,
21 under section 6153 or 6154 of such Code (whichever is
22 applicable), an installment payment of estimated tax
23 is required to be made by the taxpayer.

1 SEC. 3. CONTINUATION OF EXCISE TAXES ON COMMUNI-
2 CATION SERVICES AND ON AUTOMOBILES.

3 (a) PASSENGER AUTOMOBILES.—

4 (1) IN GENERAL.—Section 4061 (a) (2) (A) (re-
5 lating to tax on passenger automobiles, etc.) is amended
6 to read as follows:

7 "(A) Articles enumerated in subparagraph
8 (B) are taxable at whichever of the following rates
9 is applicable:

"If the article is sold—	The tax rate is—
Before January 1, 1971	7 percent.
During 1971	5 percent.
During 1972	3 percent.
During 1973	1 percent.

10 The tax imposed by this subsection shall not apply
11 with respect to articles enumerated in subparagraph
12 (B) which are sold by the manufacturer, producer,
13 or importer after December 31, 1973."

14 (2) CONFORMING AMENDMENT.—Section 6412
15 (a) (1) (relating to floor stocks refunds on passenger
16 automobiles, etc.) is amended by striking out "Janu-
17 ary 1, 1970, January 1, 1971, January 1, 1972, or
18 January 1, 1973", and inserting in lieu thereof "Janu-
19 ary 1, 1971, January 1, 1972, January 1, 1973, or
20 January 1, 1974".

21 (b) COMMUNICATIONS SERVICES.—

22 (1) CONTINUATION OF TAX.—Section 4251 (a)

1 (2) (relating to tax on certain communications serv-
2 ices) is amended by striking out the table and inserting
3 in lieu thereof the following table:

"Amounts paid pursuant to bills first rendered—	Percent—
Before January 1, 1971	10
During 1971	5
During 1972	3
During 1973	1".

4 (2) CONFORMING AMENDMENT.—Section 4251
5 (b) (relating to termination of tax) is amended by
6 striking out "January 1, 1973", and inserting in lieu
7 thereof "January 1, 1974".
8 (3) REPEAL OF SUBCHAPTER B OF CHAPTER 33.—
9 Section 105 (b) (3) of the Revenue and Expenditure
10 Control Act of 1968 (82 Stat. 266) is amended to read
11 as follows:
12 "(3) REPEAL OF SUBCHAPTER B OF CHAPTER
13 33.—Effective with respect to amounts paid pursuant to
14 bills first rendered on or after January 1, 1974, sub-
15 chapter B of chapter 33 (relating to the tax on com-
16 munications) is repealed. For purposes of the preceding
17 sentence, in the case of communications services ren-
18 dered before November 1, 1973, for which a bill has
19 not been rendered before January 1, 1974, a bill shall
20 be treated as having been first rendered on Decem-
21 ber 31, 1973. Effective January 1, 1974, the table of

1 subchapters for chapter 33 is amended by striking out
2 the item relating to such subchapter B."

3 **SEC. 4. TERMINATION OF INVESTMENT CREDIT.**

4 (a) IN GENERAL.—Subpart B of part IV of subchapter
5 A of chapter 1 (relating to rules for computing credit for
6 investment in certain depreciable property) is amended by
7 adding at the end thereof the following new section:

8 **"SEC. 49. TERMINATION OF CREDIT.**

9 "(a) GENERAL RULE.—For purposes of this subpart,
10 the term 'section 38 property' does not include property—
11 "(1) the physical construction, reconstruction, or
12 erection of which is begun after April 18, 1969, or
13 "(2) which is acquired by the taxpayer after April
14 18, 1969,
15 other than pre-termination property.

16 "(b) PRE-TERMINATION PROPERTY.—For purposes of
17 this section—
18 "(1) BINDING CONTRACTS.—Any property shall be
19 treated as pre-termination property to the extent that
20 such property is constructed, reconstructed, erected, or
21 acquired pursuant to a contract which was, on April 18,
22 1969, and at all times thereafter, binding on the tax-
23 payer.
24 "(2) EQUIPPED BUILDING RULE.—If—
25 "(A) pursuant to a plan of the taxpayer in

1 existence on April 18, 1969 (which plan was not
2 substantially modified at any time after such date
3 and before the taxpayer placed the equipped build-
4 ing in service), the taxpayer has constructed, re-
5 constructed, erected, or acquired a building and the
6 machinery and equipment necessary to the planned
7 use of the building by the taxpayer, and
8 "(B) more than 50 percent of the aggregate
9 adjusted basis of all the property of a character sub-
10 ject to the allowance for depreciation making up
11 such building as so equipped is attributable to either
12 property the construction, reconstruction, or erection
13 of which was begun by the taxpayer before April 19,
14 1969, or property the acquisition of which by the
15 taxpayer occurred before such date,
16 then all property comprising such building as so equipped
17 (and any incidental property adjacent to such building
18 which is necessary to the planned use of the building)
19 shall be pre-termination property. For purposes of sub-
20 paragraph (B) of the preceding sentence, the rules of
21 paragraphs (1) and (4) shall be applied. For purposes
22 of this paragraph, a special purpose structure shall be
23 treated as a building.
24 "(3) PLANT FACILITY RULE.—

1 "(A) GENERAL RULE.—If—

2 "(i) pursuant to a plan of the taxpayer in
3 existence on April 18, 1969 (which plan was
4 not substantially modified at any time after
5 such date and before the taxpayer placed the
6 plant facility in service), the taxpayer has con-
7 structed, reconstructed, or erected a plant fa-
8 cility, and either

9 "(ii) the construction, reconstruction, or
10 erection of such plant facility was commenced
11 by the taxpayer before April 19, 1969, or

12 "(iii) more than 50 percent of the aggre-
13 gate adjusted basis of all the property of a
14 character subject to the allowance for deprecia-
15 tion making up such plant facility is attributable
16 to either property the construction, reconstruc-
17 tion, or erection of which was begun by the tax-
18 payer before April 19, 1969, or property the
19 acquisition of which by the taxpayer occurred
20 before such date,

21 then all property comprising such plant facility shall
22 be pre-termination property. For purposes of clause
23 (iii) of the preceding sentence, the rules of para-
24 graphs (1) and (4) shall be applied.

25 "(B) PLANT FACILITY DEFINED.—For pur-

poses of this paragraph, the term 'plant facility' means a facility which does not include any building (or of which buildings constitute an insignificant portion) and which is—

"(i) a self-contained, single operating unit or processing operation,

"(ii) located on a single site, and

"(iii) identified, on April 18, 1969, in the purchasing and internal financial plans of the taxpayer as a single unitary project.

"(C) SPECIAL RULE.—For purposes of this subsection, if—

"(i) a certificate of convenience and necessity has been issued before April 19, 1969, by a Federal regulatory agency with respect to two or more plant facilities which are included under a single plan of the taxpayer to construct, reconstruct, or erect such plant facilities, and

"(ii) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such plant facilities is attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before April 19, 1969, or prop-

1 erty the acquisition of which by the taxpayer
2 occurred before such date,
3 such plant facilities shall be treated as a single plant
4 facility.
5 "(D) COMMENCEMENT OF CONSTRUCTION.—
6 For purposes of subparagraph (A) (ii), the con-
7 struction, reconstruction, or erection of a plant facil-
8 ity shall not be considered to have commenced until
9 construction, reconstruction, or erection has com-
10 menced at the site of such plant facility. The preced-
11 ing sentence shall not apply if the site of such plant
12 facility is not located on land.
13 "(4) MACHINERY OR EQUIPMENT RULE.—Any
14 piece of machinery or equipment—
15 "(A) more than 50 percent of the parts and
16 components of which (determined on the basis of
17 cost) were held by the taxpayer on April 18, 1969,
18 or are acquired by the taxpayer pursuant to a bind-
19 ing contract which was in effect on such date, for
20 inclusion or use in such piece of machinery or equip-
21 ment, and
22 "(B) the cost of the parts and components of
23 which is not an insignificant portion of the total cost,
24 shall be treated as property which is pre-termination
25 property.

1 "(5) CERTAIN LEASE-BACK TRANSACTIONS, ETC.—
2 Where a person who is a party to a binding contract de-
3 scribed in paragraph (1) transfers rights in such con-
4 tract (or in the property to which such contract relates)
5 to another person but a , arty to such contract retains a
6 right to use the property under a lease with such other
7 person, then to the extent of the transferred rights such
8 other person shall, for purposes of paragraph (1), suc-
9 ceed to the position of the transferor with respect to such
10 binding contract and such property. In any case in
11 which the lessor does not make an election under sec-
12 tion 48(d)—
13 "(A) the preceding sentence shall apply only
14 if a party to the contract retains the right to use the
15 property under a lease for a term of at least 1 year;
16 and
17 "(B) if such use is retained, the lessor shall be
18 deemed for the purposes of section 47 as having
19 made a disposition of the property at such time as
20 the lessee loses the right to use the property.
21 For purposes of subparagraph (B), if the lessee transfers.
22 the lease in a transfer described in paragraph (7), the
23 lessee shall be considered as having the right to use of
24 the property so long as the transferee has such use.

1 "(6) CERTAIN LEASE AND CONTRACT OBLIGA-
2 TIONS.—
3 "(A) Where, pursuant to a binding lease or
4 contract to lease in effect on April 18, 1969, a lessor
5 or lessee is obligated to construct, reconstruct, erect,
6 or acquire property specified in such lease or con-
7 tract, any property so constructed, reconstructed,
8 erected, or acquired by the lessor or lessee shall be
9 pre-termination property. In the case of any project
10 which includes property other than the property to
11 be leased to such lessee, the preceding sentence shall
12 be applied, in the case of the lessor, to such other
13 property only if the binding leases and contracts
14 with all lessees in effect on April 18, 1969, cover
15 real property constituting 25 percent or more of
16 the project (determined on the basis of rental
17 value). For purposes of the preceding sentences of
18 this paragraph, in the case of any project where one
19 or more vendor-vendee relationships exist, such
20 vendors and vendees shall be treated as lessors and
21 lessees.
22 "(B) Where, in order to perform a binding
23 contract or contracts in effect on April 18, 1969,
24 (i) the taxpayer is required to construct, recon-
25 struct, erect, or acquire property specified in any

1 order of a Federal regulatory agency for which
2 application was filed before April 19, 1969, (ii)
3 the property is to be used to transport one or more
4 products under such contract or contracts, and (iii)
5 one or more parties to the contract or contracts are
6 required to take or to provide more than 50 percent
7 of the products to be transported over a substantial
8 portion of the expected useful life of the property,
9 then such property shall be pre-termination prop-
10 erty.

11 "(7) CERTAIN TRANSFERS TO BE DISREGARDED.—

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

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

15 "(ii) a transaction as a result of which
16 the basis of the property in the hands of the
17 transferee is determined by reference to its basis
18 in the hands of the transferor by reason of the
19 application of section 332, 351, 361, 371 (a),
20 374 (a), 721, or 731,

21 and such property (or the property acquired under
22 such contract) would be treated as pre-termination
23 property in the hands of the decedent or the trans-
24 feror, such property shall be treated as pre-termina-
25 tion property in the hands of the transferee.

1 "(B) If—

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

5 "(ii) the stock of the distributing corpora-
6 tion was acquired before April 19, 1969, or
7 pursuant to a binding contract in effect April 18,
8 1969, and

9 "(iii) such property (or the property ac-
10 quired under such contract) would be treated
11 as pre-termination property in the hands of the
12 distributing corporation,

13 such property shall be treated as pre-termination
14 property in the hands of the distributee.

15 "(8) PROPERTY ACQUIRED FROM AFFILIATED COR-
16 PORATION.—For purposes of this subsection, in the case
17 of property acquired by a corporation which is a member
18 of an affiliated group from another member of the same
19 group—

20 "(A) such corporation shall be treated as hav-
21 ing acquired such property on the date on which it
22 was acquired by such other member,

23 "(B) such corporation shall be treated as hav-
24 ing entered into a binding contract for the construc-
25 tion, reconstruction, erection, or acquisition of such

1 property on the date on which such other member
2 entered into a contract for the construction, recon-
3 struction, erection, or acquisition of such property,
4 and

5 "(C) such corporation shall be treated as hav-
6 ing commenced the construction, reconstruction, or
7 erection of such property on the date on which such
8 other member commenced such construction, re-
9 construction, or erection.

10 For purposes of this subsection and subsection (e),
11 a contract between two members of an affiliated group
12 shall not be treated as a binding contract as between such
13 members. For purposes of the preceding sentences, the
14 term 'affiliated group' has the meaning assigned to it by
15 section 1504 (a), except that all corporations shall be
16 treated as includible corporations (without any exclusion
17 under section 1504 (b)).

18 "(9) BARGES FOR OCEAN-GOING VESSELS.—In the
19 case of any ocean-going vessel which is—

20 "(A) pre-termination property,

21 "(B) constructed under a binding contract
22 which was in effect on April 18, 1969, to which
23 the Maritime Administration, Department of Com
24 merce, is a party, and

1 "(C) designed to carry barges,

2 then the barges specified in such contract (not in excess
3 of the number specified in such contract) constructed,
4 reconstructed, erected, or acquired for use with such
5 vessel, together with the machinery and equipment to
6 be installed on such barges and necessary for their
7 planned use, shall be treated as pre-termination property.

8 "(10) CERTAIN NEW-DESIGN PRODUCTS.—
9 Where—

10 "(A) on April 18, 1969, the taxpayer had
11 undertaken a project to produce a product of a new
12 design pursuant to binding contracts in effect on
13 such date which—

14 "(i) were fixed-price contracts (except
15 for provisions for escalation in case of changes
16 in rates of pay), and

17 "(ii) covered more than 60 percent of the
18 entire production of such design to be delivered
19 by the taxpayer before January 1, 1973, and

20 "(B) on or before April 18, 1969, more than
21 50 percent of the aggregate adjusted basis of all
22 property of a character subject to the allowance
23 for depreciation required to carry out such binding
24 contracts was property the construction, reconstruc-
25 tion, or erection of which had been begun by the

1 taxpayer, or had been acquired by the taxpayer
2 (or was under a binding contract for such con-
3 struction, reconstruction, erection, or acquisition),
4 then all tangible personal property placed in service by
5 the taxpayer before January 1, 1972, which is re-
6 quired to carry out such binding contracts shall be
7 deemed to be pre-termination property. For purposes of
8 subparagraph (B) of the preceding sentence, jigs, dies,
9 templates, and similar items which can be used only for
10 the manufacture or assembly of the production under the
11 project and which were described in written engineering
12 and internal financial plans of the taxpayer in existence
13 on April 18, 1969, shall be treated as property which
14 on such date was under a binding contract for construc-
15 tion.
16 "(c) LEASED PROPERTY.—In the case of property
17 which is leased after April 18, 1969 (other than pursuant
18 to a binding contract to lease entered into before April 19,
19 1969), which is section 38 property with respect to the
20 lessor but is property which would not be section 38 prop-
21 erty because of the application of subsection (a) if acquired
22 by the lessee, and which is property of the same kind which
23 the lessor ordinarily sold to customers before April 19, 1969,
24 or ordinarily leased before such date and made an election

1 under section 48 (d), such property shall not be section 38
2 property with respect to either the lessor or the lessee.
3 "(d) RATE OF CREDIT WHERE PROPERTY IS PLACED
4 IN SERVICE AFTER 1970.—In the case of property placed
5 in service after December 31, 1970, section 38 and this
6 subpart shall be applied by reducing the 7 percent figure
7 of section 46 (a) (1) by one-tenth of 1 percent for each
8 full calendar month between November 30, 1970, and the
9 date on which the property is placed in service, except
10 that in the case of property placed in service after December
11 31, 1974, 0 percent shall be substituted for 7 percent."
12 (b) LIMITATIONS ON USE OF CARRYOVERS AND
13 CARRYBACKS.—Section 46 (b) (relating to carryback and
14 carryover of unused credits) is amended by adding at the
15 end thereof the following new paragraph:
16 "(5) TAXABLE YEARS BEGINNING AFTER DECEM-
17 BER 31, 1968, AND ENDING AFTER APRIL 18, 1969.—
18 The amount which may be added under this subsection
19 for any taxable year beginning after December 31,
20 1968, and ending after April 18, 1969, shall not exceed
21 20 percent of the higher of—
22 "(A) the aggregate of the investment credit
23 carrybacks and investment credit carryovers to the
24 taxable year, or
25 "(B) the highest amount computed under sub-

1 paragraph (A) for any preceding taxable year
2 which began after December 31. 1968, and ended
3 after April 18, 1969."

4 (c) RULES RELATING TO CERTAIN CASUALTIES AND
5 THEFTS.—Section 47 (a) (4) (relating to rules with respect
6 to section 38 property destroyed by casualty, etc.) is
7 amended by adding at the end thereof the following:

8 "Subparagraphs (B) and (C) shall not apply with
9 respect to any casualty or theft occurring after April 18,
10 1969. In the case of any casualty or theft occurring
11 on or before April 18, 1969, to the extent of any
12 replacement after such date (with property which would
13 be section 38 property but for section 49) this part
14 shall be applied without regard to section 49."

15 (d) CONFORMING AMENDMENT.—The table of sections
16 for subpart B of part IV of subchapter A of chapter 1
17 (relating to rules for computing credit for investment in
18 certain depreciable property) is amended by adding at the
19 end thereof the following new item:

"Sec. 49. Termination of credit."

20 **SEC. 5. AMORTIZATION OF POLLUTION CONTROL FACILI-**
21 **TIES.**

22 (a) ALLOWANCE.—Part VI of subchapter B of chapter
23 1 (relating to itemized deductions for individuals and corpora-

1 tions) is amended by striking out sections 168 and 169 and
2 by inserting after section 167 the following new section:
3 "SEC. 168. AMORTIZATION OF POLLUTION CONTROL FA-
4 CILITIES.

5 "(a) ALLOWANCE OF DEDUCTION.—Every person, at
6 his election, shall be entitled to a deduction with respect to
7 the amortization of the adjusted basis (for determining gain)
8 of any certified pollution control facility (as defined in sub-
9 section (d)), based on a period of 60 months. Such amortiza-
10 tion deduction shall be an amount, with respect to each month
11 of such period within the taxable year, equal to the adjusted
12 basis of the pollution control facility at the end of such month
13 divided by the number of months (including the month for
14 which the deduction is computed) remaining in the period.
15 Such adjusted basis at the end of the month shall be com-
16 puted without regard to the amortization deduction for such
17 month. The amortization deduction provided by this section
18 with respect to any month shall be in lieu of the depreciation
19 deduction with respect to such pollution control facility for
20 such month provided by section 167. The 60-month period
21 shall begin, as to any pollution control facility, at the elec-
22 tion of the taxpayer, with the month following the month
23 in which such facility was completed or acquired, or with
24 the succeeding taxable year.

25 "(b) ELECTION OF AMORTIZATION.—The election of

1 the taxpayer to take the amortization deduction and to begin
2 the 60-month period with the month following the month
3 in which the facility is completed or acquired, or with the
4 taxable year succeeding the taxable year in which such facil-
5 ity is completed or acquired, shall be made by filing with
6 the Secretary or his delegate, in such manner, in such form,
7 and within such time, as the Secretary or his delegate may
8 by regulations prescribe, a statement of such election.
9 "(c) TERMINATION OF AMORTIZATION DEDUCTION.—
10 A taxpayer which has elected under subsection (b) to take
11 the amortization deduction provided in subsection (a) may,
12 at any time after making such election, discontinue the
13 amortization deduction with respect to the remainder of the
14 amortization period, such discontinuance to begin as of the
15 beginning of any month specified by the taxpayer in a notice
16 in writing filed with the Secretary or his delegate before
17 the beginning of such month. The depreciation deduction
18 provided under section 167 shall be allowed, beginning with
19 the first month as to which the amortization deduction does
20 not apply, and the taxpayer shall not be entitled to any
21 further amortization deduction under this section with respect
22 to such pollution control facility.
23 "(d) DEFINITIONS.—For purposes of this section—
24 "(1) CERTIFIED POLLUTION CONTROL FACILITY.—

1 The term 'certified pollution control facility' means so
2 much of any new property of a character subject to the
3 allowance for depreciation provided in section 167 which
4 is used to abate or control water or atmospheric pollution
5 or contamination, respectively, by removing, altering,
6 disposing, or storing of pollutants, contaminants, wastes,
7 or heat, as—
8 "(A) the State certifying authority has certi-
9 fied to the Federal certifying authority as having
10 been constructed, reconstructed, erected, or acquired
11 in conformity with the State program or require-
12 ments for abatement or control of water or atmos-
13 pheric pollution or contamination; and
14 "(B) the Federal certifying authority has cer-
15 tified to the Secretary or his delegate (i) as meeting
16 the minimum performance standards described in
17 subsection (e), (ii) as being in compliance with
18 the applicable regulations of Federal agencies, and
19 (iii) as being in furtherance of the general policy
20 of the United States for cooperation with the States
21 in the prevention and abatement of water pollution
22 under the Federal Water Pollution Control Act, as
23 amended (33 U.S.C. 466 et seq.), or in the pre-
24 vention and abatement of atmospheric pollution and

1 contamination under the Clean Air Act, as amended
2 (42 U.S.C. 1857 et seq.).
3 "(2) STATE CERTIFYING AUTHORITY.—The term
4 'State certifying authority' means, in the case of water
5 pollution, the State water pollution control agency as
6 defined in section 13 (a) of the Federal Water Pollution
7 Control Act and, in the case of air pollution, the air pol-
8 lution control agency as defined in section 302 (b) of
9 the Clean Air Act.
10 "(3) FEDERAL CERTIFYING AUTHORITY.—The
11 term 'Federal certifying authority' means, in the case of
12 water pollution, the Secretary of the Interior and, in the
13 case of air pollution, the Secretary of Health, Education,
14 and Welfare.
15 "(4) NEW PROPERTY.—For purposes of paragraph
16 (1), the term 'new property' means property—
17 "(A) the construction, reconstruction, or erec-
18 tion of which is completed by the taxpayer after
19 December 31, 1968, or
20 "(B) acquired after December 31, 1968, if the
21 original use of the property commences with the tax-
22 payer and commences after such date.
23 In applying subsection (f) in the case of property
24 described in subparagraph (A), there shall be taken

1 into account only that portion of the basis which is prop-
2 erly attributable to construction, reconstruction, or erec-
3 tion after December 31, 1968.

4 "(e) AUTHORIZATION OF SECRETARIES OF INTERIOR
5 AND OF HEALTH, EDUCATION, AND WELFARE TO SET
6 STANDARDS, ETC.—

7 "(1) PERFORMANCE STANDARDS.—The Federal
8 certifying authority shall from time to time promulgate
9 minimum performance standards for purposes of sub-
10 section (d) (1) (B), taking into account advances in
11 technology and specifying the tolerance of such pol-
12 lutants and contaminants as shall be appropriate.

13 "(2) PROFITMAKING ABATEMENT WORKS, ETC.—
14 The Federal certifying authority shall not certify any
15 property under paragraph (2) or (3) to the extent it
16 appears that (A) by reason of profits derived through
17 the recovery of wastes or otherwise in the operation of
18 such property, its costs will be recovered over its actual
19 useful life, or (B) such property would be constructed,
20 reconstructed, erected, or acquired without regard to the
21 need to abate or control water or atmospheric pollution
22 or contamination.

23 "(f) ALLOCATION OF BASIS.—In the case of property
24 with respect to which an election has been made under sub-
25 section (a) but only a portion thereof is certified under

1 subsection (d), the adjusted basis of such property shall,
2 under regulations prescribed by the Secretary or his dele-
3 gate, be properly allocated between the portion which is so
4 certified and the portion which is not so certified.

5 "(g) LIFE TENANT AND REMAINDERMAN.—In the
6 case of property held by one person for life with remainder
7 to another person, the deduction shall be computed as if
8 the life tenant were the absolute owner of the property and
9 shall be allowable to the life tenant.

10 "(h) CROSS REFERENCE.—

"For special rule with respect to certain gain derived from the disposition of property the adjusted basis of which is determined with regard to this section, see section 1245."

11 (b) INVESTMENT CREDIT NOT TO BE ALLOWED.—
12 Section 48(a)(1) (relating to definition of "section 38
13 property") is amended by adding at the end thereof the
14 following new sentence: "Such term does not include any
15 property in respect of which an election under section 168
16 (relating to amortization of pollution control facilities) has
17 been made."

18 (c) CONFORMING, ETC., AMENDMENTS.—

19 (1) The table of sections for part VI of subchapter
20 B of chapter 1 is amended by striking out the items
21 relating to sections 168 and 169 and inserting in lieu
22 thereof the following new item:

"Sec. 168. Amortization of pollution control facilities."

1 (2) The heading and the first sentence of section
2 642 (f) (relating to special rules for credits and deduc-
3 tions of estates and trusts) are amended to read as
4 follows:
5 "(f) AMORTIZATION OF POLLUTION CONTROL FACIL-
6 ITIES.—The benefit of the deductions for amortization of
7 pollution control facilities provided by section 168 shall be
8 allowed to estates and trust in the same manner as in the
9 case of an individual."
10 (3) Section 1082 (a) (2) (B) (relating to basis
11 for determining gain or loss) is amended by striking out
12 "or 169".
13 (4) Section 1238 (relating to amortization in ex-
14 cess of depreciation) is amended by striking out "emer-
15 gency facilities" and inserting in lieu thereof "certified
16 pollution control facilities".
17 (5) Section 1245 (a) of such Code (relating to
18 gain from disposition of certain depreciable property) is
19 amended—
20 (A) by striking out "or" at the end of para-
21 graph (2) (A);
22 (B) by inserting "or" at the end of paragraph
23 (2) (B) and by inserting after such paragraph the
24 following new subparagraph:

1 "(C) with respect to any property referred to
2 in paragraph (3)(D), its adjusted basis recom-
3 puted by adding thereto all adjustments, attributable
4 to periods beginning with the first month for which
5 a deduction for amortization is allowed under sec-
6 tion 168,";
7 (C) by striking out "or" at the end of para-
8 graphs (3)(A) and (B);
9 (D) by striking out the period at the end of
10 paragraph (3)(C) and inserting in lieu thereof
11 ", or"; and
12 (E) by adding at the end of paragraph (3)
13 the following new subparagraph:
14 "(D) so much of any real property (other than
15 any property described in subparagraph (B)) as
16 is a certified pollution control facility which has
17 an adjusted basis in which there are reflected ad-
18 justments for amortization under section 168."
19 (d) EFFECTIVE DATE.—The amendments made by
20 this section shall apply with respect to taxable years ending
21 after December 31, 1968.
22 **SEC. 6. LOW INCOME ALLOWANCE.**
23 (a) ALLOWANCE OF DEDUCTION.—
24 (1) IN GENERAL.—Section 141(c) (relating to

1 minimum standard deduction) is amended to read as
2 follows:
3 "(c) Low Income Allowance.—
4 "(1) In general.—The low income allowance is
5 an amount equal to the sum of—
6 "(A) the basic allowance, and
7 "(B) the additional allowance.
8 "(2) Basic allowance.—For purposes of this
9 subsection, the basic allowance is an amount equal to the
10 sum of—
11 "(A) $200, plus
12 "(B) $100, multiplied by the number of
13 exemptions.
14 The basic allowance shall not exceed $1,000.
15 "(3) Additional allowance.—
16 "(A) In general.—For purposes of this sub-
17 section, the additional allowance is an amount equal
18 to the excess (if any) of $900 over the sum of—
19 "(i) $100, multiplied by the number of
20 exemptions, plus
21 "(ii) the income phase-out.
22 "(B) Income phase-out.—For purposes of
23 subparagraph (A) (ii), the income phase-out is an
24 amount equal to one-half of the amount by which
25 the adjusted gross income for the taxable year ex-
26 ceeds the sum of—

1 "(i) $1,100, plus

2 "(ii) $600, multiplied by the number of

3 exemptions.

4 "(4) MARRIED INDIVIDUALS FILING SEPARATE

5 RETURNS.—In the case of a married taxpayer filing a

6 separate return—

7 "(A) the low income allowance is an amount

8 equal to the basic allowance, and

9 "(B) the basic allowance is an amount (not in

10 excess of $500) equal to the sum of—

11 "(i) $100, plus

12 "(ii) $100, multiplied by the number of

13 exemptions.

14 "(5) NUMBER OF EXEMPTIONS.—For purposes of

15 this subsection, the number of exemptions is the number

16 of exemptions allowed as a deduction for the taxable

17 year under section 151."

18 (2) AMENDMENT OF SUBSECTIONS (a) AND (b)

19 OF SECTION 141.—Subsections (a) and (b) of section

20 141 (relating to standard deduction) are amended to

21 read as follows:

22 "(a) STANDARD DEDUCTION.—Except as otherwise

23 provided in this section, the standard deduction referred to

24 in this title is the larger of the 10-percent standard deduction

25 or the low income allowance.

26 "(b) 10-PERCENT STANDARD DEDUCTION.—The 10-

1 percent standard deduction is an amount equal to 10 percent
2 of the adjusted gross income. The 10-percent standard de-
3 duction shall not exceed $1,000, except that in the case of
4 a separate return by a married individual such deduction shall
5 not exceed $500."

6 (3) AMENDMENT OF SUBSECTION (d) OF SEC-
7 TION 141.—Section 141 (d) is amended by striking out
8 "minimum standard deduction" each place it appears
9 and inserting in lieu thereof "low income allowance".

10 (4) DETERMINATION OF MARITAL STATUS.—Sec-
11 tion 143 (relating to determination of marital status)
12 is amended—

13 (A) by striking out "For purposes of this
14 part—" and inserting in lieu thereof "(a) GENERAL
15 RULE.—For purposes of this part—"; and

16 (B) by adding at the end thereof the following
17 new subsection:

18 "(b) CERTAIN MARRIED INDIVIDUALS LIVING
19 APART.—For purposes of this part, if—

20 "(1) an individual who is married (within the
21 meaning of subsection (a)) and who files a separate
22 return maintains as his home a household which con-
23 stitutes for more than one-half of the taxable year the
24 principal place of abode of a dependent (A) who
25 (within the meaning of section 152) is a son, stepson,

1 daughter, or stepdaughter of the individual, and (B)
2 with respect to whom such individual is entitled to a
3 deduction for the taxable year under section 151,
4 "(2) such individual furnishes over half of the cost
5 of maintaining such household during the taxable year,
6 and
7 "(3) during the entire taxable year such indi-
8 vidual's spouse is not a member of such household,
9 such individual shall not be considered as married."
10 (5) CONFORMING AMENDMENT.—Section 1304
11 (c) (5) (relating to special rules for income averaging)
12 is amended by striking out "section 143" and inserting
13 in lieu thereof "section 143 (a)".
14 (b) OPTIONAL TAX.—
15 (1) IN GENERAL.—Section 3 (relating to optional
16 tax if adjusted gross income is less than $5,000) is
17 amended to read as follows:
18 **"SEC. 3. OPTIONAL TAX IF ADJUSTED GROSS INCOME IS**
19 **LESS THAN $6,100.**
20 "In lieu of the tax imposed by section 1, there is here-
21 by imposed for each taxable year beginning after December
22 31, 1969, on the taxable income of every individual whose
23 adjusted gross income for such year is less than $6,100 and
24 who has elected for such year to pay the tax imposed by this
25 section, a tax as follows:

"Table I—Single Person—NOT Head of Household

If adjusted gross income is—		And the number of exemptions is—								
At least	But less than	1	2	3	4	5	6	7	8	9 or more
		The tax is—								
$0	$1,700	$0	$0	$0	$0	$0	$0	$0	$0	$0
1,700	1,725	3	0	0	0	0	0	0	0	0
1,725	1,750	8	0	0	0	0	0	0	0	0
1,750	1,775	13	0	0	0	0	0	0	0	0
1,775	1,800	18	0	0	0	0	0	0	0	0
1,800	1,825	24	0	0	0	0	0	0	0	0
1,825	1,850	29	0	0	0	0	0	0	0	0
1,850	1,875	34	0	0	0	0	0	0	0	0
1,875	1,900	39	0	0	0	0	0	0	0	0
1,900	1,925	45	0	0	0	0	0	0	0	0
1,925	1,950	50	0	0	0	0	0	0	0	0
1,950	1,975	55	0	0	0	0	0	0	0	0
1,975	2,000	60	0	0	0	0	0	0	0	0
2,000	2,025	66	0	0	0	0	0	0	0	0
2,025	2,050	71	0	0	0	0	0	0	0	0
2,050	2,075	77	0	0	0	0	0	0	0	0
2,075	2,100	82	0	0	0	0	0	0	0	0
2,100	2,125	88	0	0	0	0	0	0	0	0
2,125	2,150	93	0	0	0	0	0	0	0	0
2,150	2,175	99	0	0	0	0	0	0	0	0
2,175	2,200	105	0	0	0	0	0	0	0	0
2,200	2,225	110	0	0	0	0	0	0	0	0
2,225	2,250	116	0	0	0	0	0	0	0	0
2,250	2,275	122	0	0	0	0	0	0	0	0
2,275	2,300	127	0	0	0	0	0	0	0	0
2,300	2,325	133	3	0	0	0	0	0	0	0
2,325	2,350	138	8	0	0	0	0	0	0	0
2,350	2,375	144	13	0	0	0	0	0	0	0
2,375	2,400	150	18	0	0	0	0	0	0	0
2,400	2,425	156	24	0	0	0	0	0	0	0
2,425	2,450	162	29	0	0	0	0	0	0	0
2,450	2,475	168	34	0	0	0	0	0	0	0
2,475	2,500	174	39	0	0	0	0	0	0	0
2,500	2,525	180	45	0	0	0	0	0	0	0
2,525	2,550	186	50	0	0	0	0	0	0	0
2,550	2,575	192	55	0	0	0	0	0	0	0
2,575	2,600	198	60	0	0	0	0	0	0	0
2,600	2,625	204	66	0	0	0	0	0	0	0
2,625	2,650	210	71	0	0	0	0	0	0	0
2,650	2,675	216	77	0	0	0	0	0	0	0
2,675	2,700	222	82	0	0	0	0	0	0	0
2,700	2,725	228	88	0	0	0	0	0	0	0
2,725	2,750	235	93	0	0	0	0	0	0	0
2,750	2,775	241	99	0	0	0	0	0	0	0
2,775	2,800	247	105	0	0	0	0	0	0	0
2,800	2,825	254	110	0	0	0	0	0	0	0
2,825	2,850	260	116	0	0	0	0	0	0	0
2,850	2,875	266	122	0	0	0	0	0	0	0
2,875	2,900	273	127	0	0	0	0	0	0	0
2,900	2,925	279	133	3	0	0	0	0	0	0
2,925	2,950	286	138	8	0	0	0	0	0	0
2,950	2,975	292	144	13	0	0	0	0	0	0
2,975	3,000	298	150	18	0	0	0	0	0	0
3,000	3,050	308	159	26	0	0	0	0	0	0
3,050	3,100	322	171	37	0	0	0	0	0	0
3,100	3,150	330	183	47	0	0	0	0	0	0
3,150	3,200	350	195	58	0	0	0	0	0	0
3,200	3,250	365	207	68	0	0	0	0	0	0
3,250	3,300	376	219	79	0	0	0	0	0	0
3,300	3,350	385	231	91	0	0	0	0	0	0
3,350	3,400	393	244	102	0	0	0	0	0	0
3,400	3,450	402	257	113	0	0	0	0	0	0
3,450	3,500	410	270	124	0	0	0	0	0	0
3,500	3,550	419	282	136	5	0	0	0	0	0
3,550	3,600	427	295	147	16	0	0	0	0	0
3,600	3,650	436	308	159	26	0	0	0	0	0
3,650	3,700	444	322	171	37	0	0	0	0	0
3,700	3,750	453	334	183	47	0	0	0	0	0
3,750	3,800	462	343	195	58	0	0	0	0	0
3,800	3,850	470	353	207	68	0	0	0	0	0
3,850	3,900	479	362	219	79	0	0	0	0	0
3,900	3,950	487	372	231	91	0	0	0	0	0
3,950	4,000	496	381	244	102	0	0	0	0	0
4,000	4,050	504	390	257	113	0	0	0	0	0
4,050	4,100	513	399	270	124	0	0	0	0	0
4,100	4,150	521	407	280	136	5	0	0	0	0
4,150	4,200	530	416	289	147	16	0	0	0	0
4,200	4,250	538	424	297	159	26	0	0	0	0
4,250	4,300	547	433	306	171	37	0	0	0	0
4,300	4,350	556	442	315	183	47	0	0	0	0
4,350	4,400	564	450	324	195	58	0	0	0	0
4,400	4,450	573	459	334	207	68	0	0	0	0
4,450	4,500	581	467	343	219	79	0	0	0	0
4,500	4,550	590	476	353	229	91	0	0	0	0
4,550	4,600	598	484	362	238	102	0	0	0	0
4,600	4,650	607	493	372	246	113	0	0	0	0
4,650	4,700	615	501	381	255	124	0	0	0	0
4,700	4,750	624	510	391	263	136	5	0	0	0
4,750	4,800	633	519	400	272	147	16	0	0	0

"Table I—Single Person—NOT Head of Household—Continued

If adjusted gross income is—		And the number of exemptions is—								
At least	But less than	1	2	3	4	5	6	7	8	9 or more
		The tax is—								
$4,800	$4,850	$641	$527	$410	$280	$159	$26	$0	$0	$0
4,850	4,900	650	536	419	289	171	37	0	0	0
4,900	4,950	658	544	429	297	180	47	0	0	0
4,950	5,000	667	553	438	306	189	58	0	0	0
5,000	5,050	675	561	447	315	197	68	0	0	0
5,050	5,100	684	570	456	324	205	79	0	0	0
5,100	5,150	693	578	464	334	213	91	0	0	0
5,150	5,200	703	587	473	343	221	102	0	0	0
5,200	5,250	713	595	481	353	229	113	0	0	0
5,250	5,300	722	604	490	362	238	124	0	0	0
5,300	5,350	732	613	499	372	246	134	5	0	0
5,350	5,400	742	621	507	381	255	141	16	0	0
5,400	5,450	752	630	516	391	263	149	26	0	0
5,450	5,500	762	638	524	400	272	157	37	0	0
5,500	5,550	772	647	533	410	280	165	47	0	0
5,550	5,600	782	655	541	419	289	173	58	0	0
5,600	5,650	792	664	550	429	297	181	68	0	0
5,650	5,700	802	672	558	438	306	189	79	0	0
5,700	5,750	812	681	567	448	315	197	89	0	0
5,750	5,800	821	690	576	457	324	205	98	0	0
5,800	5,850	831	699	584	467	334	213	104	0	0
5,850	5,900	841	709	593	476	343	221	111	0	0
5,900	5,950	851	719	601	486	353	229	119	5	0
5,950	6,000	861	729	610	495	362	238	126	16	0
6,000	6,050	871	739	618	504	372	246	134	26	0
6,050	6,100	881	749	627	513	381	255	141	37	0

"Table II—Head of Household

If adjusted gross income is—		And the number of exemptions is—								
At least	But less than	1	2	3	4	5	6	7	8	9 or more
		The tax is—								
$0	$1,700	$0	$0	$0	$0	$0	$0	$0	$0	$0
1,700	1,725	3	0	0	0	0	0	0	0	0
1,725	1,750	8	0	0	0	0	0	0	0	0
1,750	1,775	13	0	0	0	0	0	0	0	0
1,775	1,800	18	0	0	0	0	0	0	0	0
1,800	1,825	24	0	0	0	0	0	0	0	0
1,825	1,850	29	0	0	0	0	0	0	0	0
1,850	1,875	34	0	0	0	0	0	0	0	0
1,875	1,900	39	0	0	0	0	0	0	0	0
1,900	1,925	45	0	0	0	0	0	0	0	0
1,925	1,950	50	0	0	0	0	0	0	0	0
1,950	1,975	55	0	0	0	0	0	0	0	0
1,975	2,000	60	0	0	0	0	0	0	0	0
2,000	2,025	66	0	0	0	0	0	0	0	0
2,025	2,050	71	0	0	0	0	0	0	0	0
2,050	2,075	76	0	0	0	0	0	0	0	0
2,075	2,100	81	0	0	0	0	0	0	0	0
2,100	2,125	87	0	0	0	0	0	0	0	0
2,125	2,150	92	0	0	0	0	0	0	0	0
2,150	2,175	97	0	0	0	0	0	0	0	0
2,175	2,200	102	0	0	0	0	0	0	0	0
2,200	2,225	108	0	0	0	0	0	0	0	0
2,225	2,250	113	0	0	0	0	0	0	0	0
2,250	2,275	118	0	0	0	0	0	0	0	0
2,275	2,300	123	0	0	0	0	0	0	0	0
2,300	2,325	129	3	0	0	0	0	0	0	0
2,325	2,350	134	8	0	0	0	0	0	0	0
2,350	2,375	139	13	0	0	0	0	0	0	0
2,375	2,400	145	18	0	0	0	0	0	0	0
2,400	2,425	151	24	0	0	0	0	0	0	0
2,425	2,450	157	29	0	0	0	0	0	0	0
2,450	2,475	163	34	0	0	0	0	0	0	0
2,475	2,500	169	39	0	0	0	0	0	0	0
2,500	2,525	175	45	0	0	0	0	0	0	0
2,525	2,550	181	50	0	0	0	0	0	0	0
2,550	2,575	187	55	0	0	0	0	0	0	0
2,575	2,600	193	60	0	0	0	0	0	0	0

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"Table II—Head of Household—Continued

If adjusted gross income is—		And the number of exemptions is—								
At least	But less than	1	2	3	4	5	6	7	8	9 or more
		The tax is—								
$2,600	$2,625	$199	$66	$0	$0	$0	$0	$0	$0	$0
2,625	2,650	205	71	0	0	0	0	0	0	0
2,650	2,675	211	76	0	0	0	0	0	0	0
2,675	2,700	217	81	0	0	0	0	0	0	0
2,700	2,725	223	87	0	0	0	0	0	0	0
2,725	2,750	229	92	0	0	0	0	0	0	0
2,750	2,775	235	97	0	0	0	0	0	0	0
2,775	2,800	241	102	0	0	0	0	0	0	0
2,800	2,825	247	108	0	0	0	0	0	0	0
2,825	2,850	253	113	0	0	0	0	0	0	0
2,850	2,875	259	118	0	0	0	0	0	0	0
2,875	2,900	265	123	0	0	0	0	0	0	0
2,900	2,925	271	129	3	0	0	0	0	0	0
2,925	2,950	277	134	8	0	0	0	0	0	0
2,950	2,975	283	139	13	0	0	0	0	0	0
2,975	3,000	289	145	18	0	0	0	0	0	0
3,000	3,050	298	154	26	0	0	0	0	0	0
3,050	3,100	311	166	37	0	0	0	0	0	0
3,100	3,150	325	178	47	0	0	0	0	0	0
3,150	3,200	338	190	58	0	0	0	0	0	0
3,200	3,250	352	202	68	0	0	0	0	0	0
3,250	3,300	363	214	79	0	0	0	0	0	0
3,300	3,350	371	226	89	0	0	0	0	0	0
3,350	3,400	379	238	100	0	0	0	0	0	0
3,400	3,450	387	250	110	0	0	0	0	0	0
3,450	3,500	395	262	121	0	0	0	0	0	0
3,500	3,550	403	274	131	5	0	0	0	0	0
3,550	3,600	411	286	142	16	0	0	0	0	0
3,600	3,650	419	298	154	26	0	0	0	0	0
3,650	3,700	427	311	166	37	0	0	0	0	0
3,700	3,750	435	323	178	47	0	0	0	0	0
3,750	3,800	444	332	190	58	0	0	0	0	0
3,800	3,850	452	341	202	68	0	0	0	0	0
3,850	3,900	460	350	214	79	0	0	0	0	0
3,900	3,950	468	359	226	89	0	0	0	0	0
3,950	4,000	476	368	238	100	0	0	0	0	0
4,000	4,050	484	376	250	110	0	0	0	0	0
4,050	4,100	492	384	262	121	0	0	0	0	0
4,100	4,150	500	392	272	131	5	0	0	0	0
4,150	4,200	508	400	280	142	16	0	0	0	0
4,200	4,250	516	408	288	154	26	0	0	0	0
4,250	4,300	525	417	296	166	37	0	0	0	0
4,300	4,350	533	425	305	178	47	0	0	0	0
4,350	4,400	541	433	314	190	58	0	0	0	0
4,400	4,450	549	441	323	202	68	0	0	0	0
4,450	4,500	557	449	332	214	79	0	0	0	0
4,500	4,550	565	457	341	224	89	0	0	0	0
4,550	4,600	573	465	350	232	100	0	0	0	0
4,600	4,650	581	473	359	240	110	0	0	0	0
4,650	4,700	589	481	368	248	121	0	0	0	0
4,700	4,750	597	489	377	256	131	5	0	0	0
4,750	4,800	606	498	386	264	142	16	0	0	0
4,800	4,850	614	506	395	272	154	26	0	0	0
4,850	4,900	622	514	404	280	166	37	0	0	0
4,900	4,950	630	522	413	288	176	47	0	0	0
4,950	5,000	638	530	422	296	184	58	0	0	0
5,000	5,050	646	538	430	305	192	68	0	0	0
5,050	5,100	654	546	438	314	200	79	0	0	0
5,100	5,150	663	554	446	323	208	89	0	0	0
5,150	5,200	672	562	454	332	216	100	0	0	0
5,200	5,250	681	570	462	341	224	110	0	0	0
5,250	5,300	690	579	471	350	232	121	0	0	0
5,300	5,350	699	587	479	359	240	130	5	0	0
5,350	5,400	708	595	487	368	248	137	16	0	0
5,400	5,450	717	603	495	377	256	144	26	0	0
5,450	5,500	726	611	503	386	264	152	37	0	0
5,500	5,550	735	619	511	395	272	160	47	0	0
5,550	5,600	744	627	519	404	280	168	58	0	0
5,600	5,650	753	635	527	413	288	176	68	0	0
5,650	5,700	762	643	535	422	296	184	79	0	0
5,700	5,750	771	651	543	431	305	192	88	0	0
5,750	5,800	780	660	552	440	314	200	95	0	0
5,800	5,850	789	669	560	449	323	208	102	0	0
5,850	5,900	798	678	568	458	332	216	109	0	0
5,900	5,950	807	687	576	467	341	224	116	5	0
5,950	6,000	816	696	584	476	350	232	123	16	0
6,000	6,050	825	705	592	484	359	240	130	26	0
6,050	6,100	834	714	600	492	368	248	137	37	0

"Table III—Married Persons Filing JOINT Returns

If adjusted gross income is—		And the number of exemptions is—							
At least	But less than	2	3	4	5	6	7	8	9 or more
		The tax is—							
$0	$2,300	$0	$0	$0	$0	$0	$0	$0	$0
2,300	2,325	3	0	0	0	0	0	0	0
2,325	2,350	8	0	0	0	0	0	0	0
2,350	2,375	13	0	0	0	0	0	0	0
2,375	2,400	18	0	0	0	0	0	0	0
2,400	2,425	24	0	0	0	0	0	0	0
2,425	2,450	29	0	0	0	0	0	0	0
2,450	2,475	34	0	0	0	0	0	0	0
2,475	2,500	39	0	0	0	0	0	0	0
2,500	2,525	45	0	0	0	0	0	0	0
2,525	2,550	50	0	0	0	0	0	0	0
2,550	2,575	55	0	0	0	0	0	0	0
2,575	2,600	60	0	0	0	0	0	0	0
2,600	2,625	66	0	0	0	0	0	0	0
2,625	2,650	71	0	0	0	0	0	0	0
2,650	2,675	76	0	0	0	0	0	0	0
2,675	2,700	81	0	0	0	0	0	0	0
2,700	2,725	87	0	0	0	0	0	0	0
2,725	2,750	92	0	0	0	0	0	0	0
2,750	2,775	97	0	0	0	0	0	0	0
2,775	2,800	102	0	0	0	0	0	0	0
2,800	2,825	108	0	0	0	0	0	0	0
2,825	2,850	113	0	0	0	0	0	0	0
2,850	2,875	118	0	0	0	0	0	0	0
2,875	2,900	123	0	0	0	0	0	0	0
2,900	2,925	129	3	0	0	0	0	0	0
2,925	2,950	134	8	0	0	0	0	0	0
2,950	2,975	139	13	0	0	0	0	0	0
2,975	3,000	145	18	0	0	0	0	0	0
3,000	3,050	153	26	0	0	0	0	0	0
3,050	3,100	164	37	0	0	0	0	0	0
3,100	3,150	176	47	0	0	0	0	0	0
3,150	3,200	187	58	0	0	0	0	0	0
3,200	3,250	198	68	0	0	0	0	0	0
3,250	3,300	209	79	0	0	0	0	0	0
3,300	3,350	221	89	0	0	0	0	0	0
3,350	3,400	232	100	0	0	0	0	0	0
3,400	3,450	243	110	0	0	0	0	0	0
3,450	3,500	254	121	0	0	0	0	0	0
3,500	3,550	266	131	5	0	0	0	0	0
3,550	3,600	277	142	16	0	0	0	0	0
3,600	3,650	288	153	26	0	0	0	0	0
3,650	3,700	300	164	37	0	0	0	0	0
3,700	3,750	310	176	47	0	0	0	0	0
3,750	3,800	318	187	58	0	0	0	0	0
3,800	3,850	326	198	68	0	0	0	0	0
3,850	3,900	334	209	79	0	0	0	0	0
3,900	3,950	342	221	89	0	0	0	0	0
3,950	4,000	350	232	100	0	0	0	0	0
4,000	4,050	358	243	110	0	0	0	0	0
4,050	4,100	365	254	121	0	0	0	0	0
4,100	4,150	372	264	131	5	0	0	0	0
4,150	4,200	379	271	142	16	0	0	0	0
4,200	4,250	386	279	153	26	0	0	0	0
4,250	4,300	394	286	164	37	0	0	0	0
4,300	4,350	401	294	176	47	0	0	0	0
4,350	4,400	408	302	187	58	0	0	0	0
4,400	4,450	415	310	198	68	0	0	0	0
4,450	4,500	422	318	209	79	0	0	0	0
4,500	4,550	430	326	219	89	0	0	0	0
4,550	4,600	437	334	226	100	0	0	0	0
4,600	4,650	444	342	234	110	0	0	0	0
4,650	4,700	451	350	241	121	0	0	0	0
4,700	4,750	459	358	249	131	5	0	0	0
4,750	4,800	467	366	256	142	16	0	0	0
4,800	4,850	474	374	264	153	26	0	0	0
4,850	4,900	482	382	271	164	37	0	0	0
4,900	4,950	490	390	279	174	47	0	0	0
4,950	5,000	497	398	286	181	58	0	0	0
5,000	5,050	505	406	294	189	68	0	0	0
5,050	5,100	512	413	302	196	79	0	0	0
5,100	5,150	520	420	310	204	89	0	0	0
5,150	5,200	528	427	318	211	100	0	0	0
5,200	5,250	535	434	326	219	110	0	0	0
5,250	5,300	543	442	334	226	121	0	0	0
5,300	5,350	551	449	342	234	130	5	0	0
5,350	5,400	558	456	350	241	137	16	0	0
5,400	5,450	566	464	358	249	144	26	0	0
5,450	5,500	574	472	366	256	151	37	0	0
5,500	5,550	581	479	374	264	159	47	0	0
5,550	5,600	589	487	382	271	166	58	0	0
5,600	5,650	597	495	390	279	174	68	0	0
5,650	5,700	604	502	398	286	181	79	0	0
5,700	5,750	612	510	406	294	189	88	0	0
5,750	5,800	620	518	414	302	196	95	0	0
5,800	5,850	628	525	422	310	204	102	0	0
5,850	5,900	637	533	430	318	211	109	0	0
5,900	5,950	645	541	438	326	219	116	5	0
5,950	6,000	654	548	446	334	226	123	16	0
6,000	6,050	662	556	454	342	234	130	26	0
6,050	6,100	671	563	461	350	241	137	37	0

"Table IV—Married Persons Filing SEPARATE Returns

"10 PERCENT STANDARD DEDUCTION

If adjusted gross income is—		And the number of exemptions is—									
At least	But less than	1	2	3	4	5	6	7	8	9	10 or more
		The tax is—									
$0	$675	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
675	700	3	0	0	0	0	0	0	0	0	0
700	725	6	0	0	0	0	0	0	0	0	0
725	750	9	0	0	0	0	0	0	0	0	0
750	775	12	0	0	0	0	0	0	0	0	0
775	800	15	0	0	0	0	0	0	0	0	0
800	825	18	0	0	0	0	0	0	0	0	0
825	850	22	0	0	0	0	0	0	0	0	0
850	875	25	0	0	0	0	0	0	0	0	0
875	900	28	0	0	0	0	0	0	0	0	0
900	925	31	0	0	0	0	0	0	0	0	0
925	950	34	0	0	0	0	0	0	0	0	0
950	975	37	0	0	0	0	0	0	0	0	0
975	1,000	40	0	0	0	0	0	0	0	0	0
1,000	1,025	44	0	0	0	0	0	0	0	0	0
1,025	1,050	47	0	0	0	0	0	0	0	0	0
1,050	1,075	50	0	0	0	0	0	0	0	0	0
1,075	1,100	53	0	0	0	0	0	0	0	0	0
1,100	1,125	56	0	0	0	0	0	0	0	0	0
1,125	1,150	59	0	0	0	0	0	0	0	0	0
1,150	1,175	62	0	0	0	0	0	0	0	0	0
1,175	1,200	66	0	0	0	0	0	0	0	0	0
1,200	1,225	69	0	0	0	0	0	0	0	0	0
1,225	1,250	72	0	0	0	0	0	0	0	0	0
1,250	1,275	75	0	0	0	0	0	0	0	0	0
1,275	1,300	79	0	0	0	0	0	0	0	0	0
1,300	1,325	82	0	0	0	0	0	0	0	0	0
1,325	1,350	86	0	0	0	0	0	0	0	0	0
1,350	1,375	89	4	0	0	0	0	0	0	0	0
1,375	1,400	92	7	0	0	0	0	0	0	0	0
1,400	1,425	96	10	0	0	0	0	0	0	0	0
1,425	1,450	99	13	0	0	0	0	0	0	0	0
1,450	1,475	102	16	0	0	0	0	0	0	0	0
1,475	1,500	106	19	0	0	0	0	0	0	0	0
1,500	1,525	109	23	0	0	0	0	0	0	0	0
1,525	1,550	113	26	0	0	0	0	0	0	0	0
1,550	1,575	116	29	0	0	0	0	0	0	0	0
1,575	1,600	119	32	0	0	0	0	0	0	0	0
1,600	1,625	123	35	0	0	0	0	0	0	0	0
1,625	1,650	126	38	0	0	0	0	0	0	0	0
1,650	1,675	129	41	0	0	0	0	0	0	0	0
1,675	1,700	133	45	0	0	0	0	0	0	0	0
1,700	1,725	136	48	0	0	0	0	0	0	0	0
1,725	1,750	140	51	0	0	0	0	0	0	0	0
1,750	1,775	143	54	0	0	0	0	0	0	0	0
1,775	1,800	146	57	0	0	0	0	0	0	0	0
1,800	1,825	150	60	0	0	0	0	0	0	0	0
1,825	1,850	154	64	0	0	0	0	0	0	0	0
1,850	1,875	157	67	0	0	0	0	0	0	0	0
1,875	1,900	161	70	0	0	0	0	0	0	0	0
1,900	1,925	164	73	0	0	0	0	0	0	0	0
1,925	1,950	168	77	0	0	0	0	0	0	0	0
1,950	1,975	172	80	0	0	0	0	0	0	0	0
1,975	2,000	175	83	0	0	0	0	0	0	0	0
2,000	2,025	179	87	2	0	0	0	0	0	0	0
2,025	2,050	182	90	5	0	0	0	0	0	0	0
2,050	2,075	186	93	8	0	0	0	0	0	0	0
2,075	2,100	100	97	11	0	0	0	0	0	0	0
2,100	2,125	193	100	14	0	0	0	0	0	0	0
2,125	2,150	197	104	17	0	0	0	0	0	0	0
2,150	2,175	200	107	20	0	0	0	0	0	0	0
2,175	2,200	204	110	24	0	0	0	0	0	0	0
2,200	2,225	208	114	27	0	0	0	0	0	0	0
2,225	2,250	211	117	30	0	0	0	0	0	0	0
2,250	2,275	215	120	33	0	0	0	0	0	0	0
2,275	2,300	218	124	36	0	0	0	0	0	0	0
2,300	2,325	222	127	39	0	0	0	0	0	0	0
2,325	2,350	226	131	43	0	0	0	0	0	0	0
2,350	2,375	229	134	46	0	0	0	0	0	0	0
2,375	2,400	233	137	49	0	0	0	0	0	0	0
2,400	2,425	237	141	52	0	0	0	0	0	0	0
2,425	2,450	241	144	55	0	0	0	0	0	0	0
2,450	2,475	245	148	58	0	0	0	0	0	0	0
2,475	2,500	249	151	61	0	0	0	0	0	0	0
2,500	2,525	252	155	65	0	0	0	0	0	0	0
2,525	2,550	256	158	68	0	0	0	0	0	0	0
2,550	2,575	260	162	71	0	0	0	0	0	0	0
2,575	2,600	264	166	74	0	0	0	0	0	0	0
2,600	2,625	268	169	78	0	0	0	0	0	0	0

"Table IV—Married Persons Filing SEPARATE Returns—Continued

"10 PERCENT STANDARD DEDUCTION—Continued

If adjusted gross income is—		And the number of exemptions is—									
At least	But less than	1	2	3	4	5	6	7	8	9	10 or more
		The tax is—									
$2,625	$2,650	$272	$173	$81	$0	$0	$0	$0	$0	$0	$0
2,650	2,675	275	176	84	0	0	0	0	0	0	0
2,675	2,700	279	180	88	3	0	0	0	0	0	0
2,700	2,725	283	184	91	6	0	0	0	0	0	0
2,725	2,750	287	187	95	9	0	0	0	0	0	0
2,750	2,775	291	191	98	12	0	0	0	0	0	0
2,775	2,800	294	194	101	15	0	0	0	0	0	0
2,800	2,825	298	198	105	18	0	0	0	0	0	0
2,825	2,850	302	202	108	22	0	0	0	0	0	0
2,850	2,875	306	205	111	25	0	0	0	0	0	0
2,875	2,900	310	209	115	28	0	0	0	0	0	0
2,900	2,925	314	212	118	31	0	0	0	0	0	0
2,925	2,950	318	216	122	34	0	0	0	0	0	0
2,950	2,975	323	220	125	37	0	0	0	0	0	0
2,975	3,000	327	223	128	40	0	0	0	0	0	0
3,000	3,050	333	229	133	45	0	0	0	0	0	0
3,050	3,100	342	236	140	51	0	0	0	0	0	0
3,100	3,150	350	244	147	58	0	0	0	0	0	0
3,150	3,200	359	252	154	64	0	0	0	0	0	0
3,200	3,250	367	259	161	70	0	0	0	0	0	0
3,250	3,300	376	267	169	77	0	0	0	0	0	0
3,300	3,350	385	275	176	84	0	0	0	0	0	0
3,350	3,400	393	282	183	91	5	0	0	0	0	0
3,400	3,450	402	290	190	97	12	0	0	0	0	0
3,450	3,500	410	298	197	104	18	0	0	0	0	0
3,500	3,550	419	305	205	111	24	0	0	0	0	0
3,550	3,600	427	313	212	118	30	0	0	0	0	0
3,600	3,650	436	322	219	124	37	0	0	0	0	0
3,650	3,700	444	330	226	131	43	0	0	0	0	0
3,700	3,750	453	339	234	138	49	0	0	0	0	0
3,750	3,800	462	348	242	145	56	0	0	0	0	0
3,800	3,850	470	356	249	152	62	0	0	0	0	0
3,850	3,900	479	365	257	159	68	0	0	0	0	0
3,900	3,950	487	373	265	166	75	0	0	0	0	0
3,950	4,000	496	382	272	173	82	0	0	0	0	0
4,000	4,050	504	390	280	181	88	3	0	0	0	0
4,050	4,100	513	399	287	188	95	9	0	0	0	0
4,100	4,150	521	407	295	195	102	16	0	0	0	0
4,150	4,200	530	416	303	202	109	22	0	0	0	0
4,200	4,250	538	424	310	209	115	28	0	0	0	0
4,250	4,300	547	433	319	217	122	35	0	0	0	0
4,300	4,350	556	442	328	224	129	41	0	0	0	0
4,350	4,400	564	450	336	231	136	47	0	0	0	0
4,400	4,450	573	459	345	239	142	54	0	0	0	0
4,450	4,500	581	467	353	247	149	60	0	0	0	0
4,500	4,550	590	476	362	254	157	66	0	0	0	0
4,550	4,600	598	484	370	262	164	73	0	0	0	0
4,600	4,650	607	493	379	270	171	79	0	0	0	0
4,650	4,700	615	501	387	277	178	86	0	0	0	0
4,700	4,750	624	510	396	285	185	93	7	0	0	0
4,750	4,800	633	519	405	293	193	100	14	0	0	0
4,800	4,850	641	527	413	300	200	106	20	0	0	0
4,850	4,900	650	536	422	308	207	113	26	0	0	0
4,900	4,950	658	544	430	316	214	120	33	0	0	0
4,950	5,000	667	553	439	325	221	127	39	0	0	0
5,000	5,050	676	562	448	334	229	134	46	0	0	0
5,050	5,100	685	571	457	343	238	141	53	0	0	0
5,100	5,150	696	581	467	353	246	149	60	0	0	0
5,150	5,200	707	590	476	362	255	157	67	0	0	0
5,200	5,250	718	600	486	372	263	165	74	0	0	0
5,250	5,300	729	609	495	381	272	173	81	0	0	0
5,300	5,350	740	619	505	391	280	181	89	4	0	0
5,350	5,400	751	628	514	400	289	189	96	11	0	0
5,400	5,450	762	638	524	410	297	197	104	18	0	0
5,450	5,500	773	647	533	419	306	205	111	25	0	0
5,500	5,550	784	657	543	429	315	213	119	32	0	0
5,550	5,600	795	666	552	438	324	221	126	39	0	0
5,600	5,650	806	676	562	448	334	229	134	46	0	0
5,650	5,700	817	685	571	457	343	238	141	53	0	0
5,700	5,750	828	696	581	467	353	246	149	60	0	0
5,750	5,800	839	707	590	476	362	255	157	67	0	0
5,800	5,850	850	718	600	486	372	263	165	74	0	0
5,850	5,900	861	729	609	495	381	272	173	81	0	0
5,900	5,950	872	740	619	505	391	280	181	89	4	0
5,950	6,000	883	751	628	514	400	289	189	96	11	0
6,000	6,050	894	762	638	524	410	297	197	104	18	0
6,050	6,100	905	773	647	533	419	306	205	111	25	0

"Table V—Married Persons Filing SEPARATE Returns

"LOW INCOME ALLOWANCE

If adjusted gross income is—		And the number of exemptions is—									
At least	But less than	1	2	3	4	5	6	7	8	9	10 or more
		The tax is—									
$0	$800	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
800	825	2	0	0	0	0	0	0	0	0	0
825	850	5	0	0	0	0	0	0	0	0	0
850	875	9	0	0	0	0	0	0	0	0	0
875	900	12	0	0	0	0	0	0	0	0	0
900	925	16	0	0	0	0	0	0	0	0	0
925	950	19	0	0	0	0	0	0	0	0	0
950	975	23	0	0	0	0	0	0	0	0	0
975	1,000	26	0	0	0	0	0	0	0	0	0
1,000	1,025	30	0	0	0	0	0	0	0	0	0
1,025	1,050	33	0	0	0	0	0	0	0	0	0
1,050	1,075	37	0	0	0	0	0	0	0	0	0
1,075	1,100	40	0	0	0	0	0	0	0	0	0
1,100	1,125	44	0	0	0	0	0	0	0	0	0
1,125	1,150	47	0	0	0	0	0	0	0	0	0
1,150	1,175	51	0	0	0	0	0	0	0	0	0
1,175	1,200	54	0	0	0	0	0	0	0	0	0
1,200	1,225	58	0	0	0	0	0	0	0	0	0
1,225	1,250	61	0	0	0	0	0	0	0	0	0
1,250	1,275	65	0	0	0	0	0	0	0	0	0
1,275	1,300	68	0	0	0	0	0	0	0	0	0
1,300	1,325	72	0	0	0	0	0	0	0	0	0
1,325	1,350	76	0	0	0	0	0	0	0	0	0
1,350	1,375	79	0	0	0	0	0	0	0	0	0
1,375	1,400	83	0	0	0	0	0	0	0	0	0
1,400	1,425	87	0	0	0	0	0	0	0	0	0
1,425	1,450	91	0	0	0	0	0	0	0	0	0
1,450	1,475	94	0	0	0	0	0	0	0	0	0
1,475	1,500	98	0	0	0	0	0	0	0	0	0
1,500	1,525	102	2	0	0	0	0	0	0	0	0
1,525	1,550	106	5	0	0	0	0	0	0	0	0
1,550	1,575	109	9	0	0	0	0	0	0	0	0
1,575	1,600	113	12	0	0	0	0	0	0	0	0
1,600	1,625	117	16	0	0	0	0	0	0	0	0
1,625	1,650	121	19	0	0	0	0	0	0	0	0
1,650	1,675	124	23	0	0	0	0	0	0	0	0
1,675	1,700	128	26	0	0	0	0	0	0	0	0
1,700	1,725	132	30	0	0	0	0	0	0	0	0
1,725	1,750	136	33	0	0	0	0	0	0	0	0
1,750	1,775	139	37	0	0	0	0	0	0	0	0
1,775	1,800	143	40	0	0	0	0	0	0	0	0
1,800	1,825	147	44	0	0	0	0	0	0	0	0
1,825	1,850	151	47	0	0	0	0	0	0	0	0
1,850	1,875	155	51	0	0	0	0	0	0	0	0
1,875	1,900	159	54	0	0	0	0	0	0	0	0
1,900	1,925	163	58	0	0	0	0	0	0	0	0
1,925	1,950	167	61	0	0	0	0	0	0	0	0
1,950	1,975	171	65	0	0	0	0	0	0	0	0
1,975	2,000	175	68	0	0	0	0	0	0	0	0
2,000	2,025	179	72	0	0	0	0	0	0	0	0
2,025	2,050	183	76	0	0	0	0	0	0	0	0
2,050	2,075	187	79	0	0	0	0	0	0	0	0
2,075	2,100	191	83	0	0	0	0	0	0	0	0
2,100	2,125	195	87	0	0	0	0	0	0	0	0
2,125	2,150	199	91	0	0	0	0	0	0	0	0
2,150	2,175	203	94	0	0	0	0	0	0	0	0
2,175	2,200	207	98	0	0	0	0	0	0	0	0
2,200	2,225	211	102	2	0	0	0	0	0	0	0
2,225	2,250	215	106	5	0	0	0	0	0	0	0
2,250	2,275	219	109	9	0	0	0	0	0	0	0
2,275	2,300	223	113	12	0	0	0	0	0	0	0
2,300	2,325	227	117	16	0	0	0	0	0	0	0
2,325	2,350	231	121	19	0	0	0	0	0	0	0
2,350	2,375	236	124	23	0	0	0	0	0	0	0
2,375	2,400	240	128	26	0	0	0	0	0	0	0
2,400	2,425	244	132	30	0	0	0	0	0	0	0
2,425	2,450	248	136	33	0	0	0	0	0	0	0
2,450	2,475	253	139	37	0	0	0	0	0	0	0
2,475	2,500	257	143	40	0	0	0	0	0	0	0
2,500	2,525	261	147	44	0	0	0	0	0	0	0
2,525	2,550	265	151	47	0	0	0	0	0	0	0
2,550	2,575	270	155	51	0	0	0	0	0	0	0
2,575	2,600	274	159	54	0	0	0	0	0	0	0
2,600	2,625	278	163	58	0	0	0	0	0	0	0

"Table V—Married Persons Filing SEPARATE Returns—Continued

"LOW INCOME ALLOWANCE—Continued

If adjusted gross income is		And the number of exemptions is—									
At least	But less than	1	2	3	4	5	6	7	8	9	10 or more
		The tax is—									
$2,625	$2,650	$282	$167	$61	$0	$0	$0	$0	$0	$0	$0
2,650	2,675	287	171	65	0	0	0	0	0	0	0
2,675	2,700	291	175	68	0	0	0	0	0	0	0
2,700	2,725	295	179	72	0	0	0	0	0	0	0
2,725	2,750	299	183	76	0	0	0	0	0	0	0
2,750	2,775	304	187	79	0	0	0	0	0	0	0
2,775	2,800	308	191	83	0	0	0	0	0	0	0
2,800	2,825	312	195	87	0	0	0	0	0	0	0
2,825	2,850	317	199	91	0	0	0	0	0	0	0
2,850	2,875	322	203	94	0	0	0	0	0	0	0
2,875	2,900	327	207	98	0	0	0	0	0	0	0
2,900	2,925	331	211	102	2	0	0	0	0	0	0
2,925	2,950	336	215	106	5	0	0	0	0	0	0
2,950	2,975	341	219	109	9	0	0	0	0	0	0
2,975	3,000	346	223	113	12	0	0	0	0	0	0
3,000	3,050	353	229	119	18	0	0	0	0	0	0
3,050	3,100	362	238	126	25	0	0	0	0	0	0
3,100	3,150	372	246	134	32	0	0	0	0	0	0
3,150	3,200	381	255	141	39	0	0	0	0	0	0
3,200	3,250	391	263	149	46	0	0	0	0	0	0
3,250	3,300	400	272	157	53	0	0	0	0	0	0
3,300	3,350	410	280	165	60	0	0	0	0	0	0
3,350	3,400	419	289	173	67	0	0	0	0	0	0
3,400	3,450	429	297	181	74	0	0	0	0	0	0
3,450	3,500	438	306	189	81	0	0	0	0	0	0
3,500	3,550	448	315	197	89	4	0	0	0	0	0
3,550	3,600	457	324	205	96	11	0	0	0	0	0
3,600	3,650	467	334	213	104	18	0	0	0	0	0
3,650	3,700	476	343	221	111	25	0	0	0	0	0
3,700	3,750	486	353	229	119	32	0	0	0	0	0
3,750	3,800	495	362	238	126	39	0	0	0	0	0
3,800	3,850	505	372	246	134	46	0	0	0	0	0
3,850	3,900	514	381	255	141	53	0	0	0	0	0
3,900	3,950	524	391	263	149	60	0	0	0	0	0
3,950	4,000	533	400	272	157	67	0	0	0	0	0
4,000	4,050	543	410	280	165	74	0	0	0	0	0
4,050	4,100	552	419	289	173	81	0	0	0	0	0
4,100	4,150	562	429	297	181	89	4	0	0	0	0
4,150	4,200	571	438	306	189	96	11	0	0	0	0
4,200	4,250	581	448	315	197	104	18	0	0	0	0
4,250	4,300	590	457	324	205	111	25	0	0	0	0
4,300	4,350	600	467	334	213	119	32	0	0	0	0
4,350	4,400	609	476	343	221	126	39	0	0	0	0
4,400	4,450	619	486	353	229	134	46	0	0	0	0
4,450	4,500	628	495	362	238	141	53	0	0	0	0
4,500	4,550	638	505	372	246	149	60	0	0	0	0
4,550	4,600	647	514	381	255	157	67	0	0	0	0
4,600	4,650	657	524	391	263	165	74	0	0	0	0
4,650	4,700	666	533	400	272	173	81	0	0	0	0
4,700	4,750	676	543	410	280	181	89	4	0	0	0
4,750	4,800	685	552	419	289	189	96	11	0	0	0
4,800	4,850	695	562	429	297	197	104	18	0	0	0
4,850	4,900	707	571	438	306	205	111	25	0	0	0
4,900	4,950	718	581	448	315	213	119	32	0	0	0
4,950	5,000	729	590	457	324	221	126	39	0	0	0
5,000	5,050	740	600	467	334	229	134	46	0	0	0
5,050	5,100	751	609	476	343	238	141	53	0	0	0
5,100	5,150	762	619	486	353	246	149	60	0	0	0
5,150	5,200	773	628	495	362	255	157	67	0	0	0
5,200	5,250	784	638	505	372	263	165	74	0	0	0
5,250	5,300	795	647	514	381	272	173	81	0	0	0
5,300	5,350	806	657	524	391	280	181	89	4	0	0
5,350	5,400	817	666	533	400	289	189	96	11	0	0
5,400	5,450	828	676	543	410	297	197	104	18	0	0
5,450	5,500	839	685	552	419	306	205	111	25	0	0
5,500	5,550	850	695	562	429	315	213	119	32	0	0
5,550	5,600	861	707	571	438	324	221	126	39	0	0
5,600	5,650	872	718	581	448	334	229	134	46	0	0
5,650	5,700	883	729	590	457	343	238	141	53	0	0
5,700	5,750	894	740	600	467	353	246	149	60	0	0
5,750	5,800	905	751	609	476	362	255	157	67	0	0
5,800	5,850	916	762	619	486	372	263	165	74	0	0
5,850	5,900	927	773	628	495	381	272	173	81	0	0
5,900	5,950	938	784	638	505	391	280	181	89	4	0
5,950	6,000	949	795	647	514	400	289	189	96	11	0
6,000	6,050	960	806	657	524	410	297	197	104	18	0
6,050	6,100	971	817	666	533	419	306	205	111	25	0

1 (2) HUSBAND OR WIFE FILING SEPARATE RE-
2 TURN.—Section 4 (c) is amended to read as follows:
3 "(c) HUSBAND OR WIFE FILING SEPARATE RE-
4 TURN.—
5 "(1) A husband or wife may not elect to pay the
6 optional tax imposed by section 3 if the tax of the other
7 spouse is determined under section 1 on the basis of
8 taxable income computed without regard to the stand-
9 ard deduction.
10 "(2) Except as otherwise provided in this subsec-
11 tion, in the case of a husband or wife filing a separate re-
12 turn the tax imposed by section 3 shall be the lesser of
13 the tax shown in Table IV or Table V of section 3.
14 "(3) Table V of section 3 shall not apply in the
15 case of a husband or wife filing a separate return if the
16 tax of the other spouse is determined with regard to the
17 10-percent standard deduction; except that an individual
18 described in section 141 (d) (2) may elect (under regu-
19 lations prescribed by the Secretary or his delegate) to
20 pay the tax shown in Table V of section 3 in lieu of the
21 tax shown in Table IV of section 3. For purposes of this
22 title, an election under the preceding sentence shall be
23 treated as an election made under section 141 (d) (2).
24 "(4) For purposes of this subsection, determina-
25 tion of marital status shall be made under section 143."

1 (3) CONFORMING AMENDMENT.—Section 144 is
2 amended by striking out "$5,000" each place it appears
3 therein and inserting in lieu thereof "$6,100".
4 (4) CLERICAL AMENDMENT.—The table of sections
5 for part I of subchapter A of chapter 1 is amended by
6 striking out "$5,000" in the item relating to section 3
7 and inserting in lieu thereof "$6,100".
8 (c) TAX NOT COMPUTED BY TAXPAYER.—
9 (1) The first sentence of section 6014 (a) (relat-
10 ing to election by taxpayer) is amended by striking out
11 "less than $5,000" and inserting in lieu thereof "less
12 than $6,100". The last sentence of section 6014 (a) is
13 repealed.
14 (2) Section 6014 (b) (relating to regulations) is
15 amended—
16 (A) by striking out "$5,000 or more but not
17 more than $5,200" at the end of the first sentence
18 and inserting in lieu thereof "$6,100 or more", and
19 (B) by inserting after the first sentence the
20 following: "Such regulations may provide that the
21 credit provided for by section 37 shall be allowed
22 in determining the amount payable and that the Sec-
23 retary or his delegate shall compute the tax with
24 regard to a taxpayer's status as a head of house-
25 hold or as a surviving spouse in the case of a head

1 of household (as defined in section 1(b)) or a
2 surviving spouse (as defined in section 2(b)) elect-
3 ing the benefits of subsection (a)."

4 (d) EFFECTIVE DATE.—The amendments made by this
5 section shall apply to taxable years beginning after Decem-
6 ber 31, 1969.

7 **SEC. 7. COLLECTION OF INCOME TAX AT SOURCE ON**
8 **WAGES.**

9 (a) PERCENTAGE METHOD.—Section 3402(a) (relat-
10 ing to requirement of withholding) is amended—

11 (1) by striking out "exceed the number of with-
12 holding exemptions claimed, multiplied by the amount
13 of one such exemption as shown in the table in subsec-
14 tion (b)(1)" and inserting in lieu thereof "exceed the
15 sum of (i) the number of withholding exemptions
16 claimed, multiplied by the amount of one such exemp-
17 tion as shown in the table in subsection (b)(1)(A),
18 and (ii), with respect to wages paid after December
19 31, 1969, the amount of the additional low income
20 allowance determined in accordance with subsection
21 (b)(1)(B)";

22 (2) by striking out "June 30, 1969" in paragraph
23 (1) and inserting in lieu thereof "June 30, 1970";

1 (3) by striking out "July 1, 1969" in paragraph
2 (2) and inserting in lieu thereof "January 1, 1970";
3 and
4 (4) by inserting after paragraph (2) the following
5 new paragraph:
6 "(3) In the case of wages paid after December 31,
7 1969, and before July 1, 1970:

"Table 1—If the payroll period with respect to an employee is WEEKLY

8 "(a) Single Person—Including Head of Household:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $4	$0.
Over $4 but not over $13	14% of excess over $4.
Over $13 but not over $23	$1.26, plus 15% of excess over $13.
Over $23 but not over $85	$2.76, plus 18% of excess over $23.
Over $85 but not over $169	$13.92, plus 21% of excess over $85.
Over $169 but not over $212	$31.56, plus 26% of excess over $169.
Over $212	$42.74, plus 31% of excess over $212.

9 "(b) Married Person:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $4	$0.
Over $4 but not over $23	14% of excess over $4.
Over $23 but not over $58	$2.66, plus 15% of excess over $23.
Over $58 but not over $169	$7.91, plus 18% of excess over $58.
Over $169 but not over $340	$27.89, plus 21% of excess over $169.
Over $340 but not over $423	$63.80, plus 26% of excess over $340.
Over $423	$85.38, plus 31% of excess over $423.

"Table 2—If the payroll period with respect to an employee is BIWEEKLY

1 "(a) Single Person—Including Head of Household:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $8	$0.
Over $8 but not over $27	14% of excess over $8.
Over $27 but not over $46	$2.66, plus 15% of excess over $27.
Over $46 but not over $169	$5.51, plus 18% of excess over $46.
Over $169 but not over $338	$27.65, plus 21% of excess over $169.
Over $338 but not over $423	$63.14, plus 26% of excess over $338.
Over $423	$85.24, plus 31% of excess over $423.

2 "(b) Married Person:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $8	$0.
Over $8 but not over $46	14% of excess over $8.
Over $46 but not over $115	$5.32, plus 15% of excess over $46.
Over $115 but not over $338	$15.67, plus 18% of excess over $115.
Over $338 but not over $681	$55.81, plus 21% of excess over $338.
Over $681 but not over $846	$127.84, plus 26% of excess over $681.
Over $846	$170.74, plus 31% of excess over $846.

"Table 3—If the payroll period with respect to an employee is SEMIMONTHLY

3 "(a) Single Person—Including Head of Household:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $8	$0.
Over $8 but not over $29	14% of excess over $8.
Over $29 but not over $50	$2.94, plus 15% of excess over $29.
Over $50 but not over $183	$6.09, plus 18% of excess over $50.
Over $183 but not over $367	$30.03, plus 21% of excess over $183.
Over $367 but not over $458	$68.67, plus 26% of excess over $367.
Over $458	$92.33, plus 31% of excess over $458.

1 “(b) Married Person:

“If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $8	$0.
Over $8 but not over $50	14% of excess over $8.
Over $50 but not over $125	$5.88, plus 15% of excess over $50.
Over $125 but not over $367	$17.13, plus 18% of excess over $125.
Over $367 but not over $738	$60.69, plus 21% of excess over $367.
Over $738 but not over $917	$138.60, plus 26% of excess over $738.
Over $917	$185.14, plus 31% of excess over $917.

“Table 4—If the payroll period with respect to an employee is MONTHLY

2 “(a) Single Person—Including Head of Household:

“If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $17	$0.
Over $17 but not over $58	14% of excess over $17.
Over $58 but not over $100	$5.74, plus 15% of excess over $58.
Over $100 but not over $367	$12.04, plus 18% of excess over $100.
Over $367 but not over $733	$60.10, plus 21% of excess over $367.
Over $733 but not over $917	$136.96, plus 26% of excess over $733.
Over $917	$184.80, plus 31% of excess over $917.

3 “(b) Married Person:

“If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $17	$0.
Over $17 but not over $100	14% of excess over $17.
Over $100 but not over $250	$11.62, plus 15% of excess over $100.
Over $250 but not over $733	$34.12, plus 18% of excess over $250.
Over $733 but not over $1,475	$121.06, plus 21% of excess over $733.
Over $1,475 but not over $1,833	$276.88, plus 26% of excess over $1,475.
Over $1,833	$369.96, plus 31% of excess over $1,833.

"Table 5—If the payroll period with respect to an employee is QUARTERLY

1 "(a) Single Person—Including Head of Household:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $50	$0.
Over $50 but not over $175	14% of excess over $50.
Over $175 but not over $300	$17.50, plus 15% of excess over $175.
Over $300 but not over $1,100	$36.25, plus 18% of excess over $300.
Over $1,100 but not over $2,200	$180.25, plus 21% of excess over $1,100.
Over $2,200 but not over $2,750	$411.25, plus 26% of excess over $2,200.
Over $2,750	$554.25, plus 31% of excess over $2,750.

2 "(b) Married Person:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $50	$0.
Over $50 but not over $300	14% of excess over $50.
Over $300 but not over $750	$35, plus 15% of excess over $300.
Over $750 but not over $2,200	$102.50, plus 18% of excess over $750.
Over $2,200 but not over $4,425	$363.50, plus 21% of excess over $2,200.
Over $4,425 but not over $5,500	$830.75, plus 26% of excess over $4,425.
Over $5,500	$1,110.25, plus 31% of excess over $5,500.

"Table 6—If the payroll period with respect to an employee is SEMIANNUAL

3 "(a) Single Person—Including Head of Household:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $100	$0.
Over $100 but not over $350	14% of excess over $100.
Over $350 but not over $600	$35, plus 15% of excess over $350.
Over $600 but not over $2,200	$72.50, plus 18% of excess over $600.
Over $2,200 but not over $4,400	$360.50, plus 21% of excess over $2,200.
Over $4,400 but not over $5,500	$822.50, plus 26% of excess over $4,400.
Over $5,500	$1,108.50, plus 31% of excess over $5,500.

1 "(b) Married Person:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $100	$0.
Over $100 but not over $600	14% of excess over $100.
Over $600 but not over $1,500	$70, plus 15% of excess over $600.
Over $1,500 but not over $4,400	$205, plus 18% of excess over $1,500.
Over $4,400 but not over $8,850	$727, plus 21% of excess over $4,400.
Over $8,850 but not over $11,000	$1,661.50, plus 26% of excess over $8,850.
Over $11,000	$2,220.50, plus 31% of excess over $11,000.

"Table 7—If the payroll period with respect to an employee is ANNUAL

2 "(a) Single Person—Including Head of Household:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $200	$0.
Over $200 but not over $700	14% of excess over $200.
Over $700 but not over $1,200	$70, plus 15% of excess over $700.
Over $1,200 but not over $4,400	$145, plus 18% of excess over $1,200.
Over $4,400 but not over $8,800	$721, plus 21% of excess over $4,400.
Over $8,800 but not over $11,000	$1,645, plus 26% of excess over $8,800.
Over $11,000	$2,217, plus 31% of excess over $11,000.

3 "(b) Married Person:

"If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $200	$0.
Over $200 but not over $1,200	14% of excess over $200.
Over $1,200 but not over $3,000	$140, plus 15% of excess over $1,200.
Over $3,000 but not over $8,800	$410, plus 18% of excess over $3,000.
Over $8,800 but not over $17,700	$1,454, plus 21% of excess over $8,800.
Over $17,700 but not over $22,000.	$3,323, plus 26% of excess over $17,700.
Over $22,000	$4,441, plus 31% of excess over $22,000.

"Table 8—If the payroll period with respect to an employee is a DAILY payroll or a MISCELLANEOUS PERIOD

1 "(a) Single Person—Including Head of Household:

"If the amount of wages, divided by the number of days in the payroll period, is:	The amount of income tax to be withheld shall be the following amount multiplied by the number of days in such period:
Not over $0.50	$0.
Over $0.50 but not over $1.90	14% of excess over $0.50.
Over $1.90 but not over $3.30	$0.20, plus 15% of excess over $1.90.
Over $3.30 but not over $12.10	$0.41, plus 18% of excess over $3.30.
Over $12.10 but not over $24.10	$1.99, plus 21% of excess over $12.10.
Over $24.10 but not over $30.10	$4.51, plus 26% of excess over $24.10.
Over $30.10	$6.07, plus 31% of excess over $30.10.

2 "(b) Married Person:

"If the amount of wages, divided by the number of days in the payroll period, is:	The amount of income tax to be withheld shall be the following amount multiplied by the number of days in such period:
Not over $0.50	$0.
Over $0.50 but not over $3.30	14% of excess over $0.50.
Over $3.30 but not over $8.20	$0.39, plus 15% of excess over $3.30.
Over $8.20 but not over $24.10	$1.13, plus 18% of excess over $8.20.
Over $24.10 but not over $48.50	$3.99, plus 21% of excess over $24.10.
Over $48.50 but not over $60.30	$9.11, plus 26% of excess over $48.50.
Over $60.30	$12.18, plus 31% of excess over 60.30."

3 (b) ADDITIONAL LOW INCOME ALLOWANCE.—Section
4 3402(b)(1) (relating to percentage method of withhold-
5 ing) is amended by inserting "(A)" after "(1)" and by
6 adding at the end thereof the following new subparagraph:
7 "(B) The additional low income allowance referred

1 to in subsection (a) is the amount shown in column 1
2 of the following table—
3 "(i) increased by an amount equal to the num-
4 ber of exemptions claimed multiplied by the amount
5 shown in column 2 of the following table, and
6 "(ii) reduced (but not below zero) by one-
7 half of the wages (as defined in section 3401 (a))
8 for the payroll period.

"Payroll period	Additional low income allowance	
	Col. 1	Col. 2
Weekly	$27.90	$3.80
Biweekly	55.80	7.70
Semimonthly	60.40	8.30
Monthly	120.80	16.70
Quarterly	362.50	50.00
Semiannual	725.00	100.00
Annual	1,450.00	200.00
Daily or miscellaneous (per day of such period)	4.00	.55"

9 (c) WAGE BRACKET WITHHOLDING.—Section 3402
10 (c) (relating to wage bracket withholding) is amended—
11 (1) by striking out paragraph (1) and inserting
12 in lieu thereof the following:
13 "(1) WAGE BRACKET WITHHOLDING.—At the
14 election of the employer with respect to any employee,
15 the employer shall deduct and withhold upon the wages
16 paid to such employee a tax (in lieu of the tax required
17 to be deducted and withheld under subsection (a))
18 determined in accordance with tables prescribed by the
19 Secretary or his delegate. The tables so prescribed shall

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1 be the same as the tables contained in this subsection as
2 in effect before June 1, 1969, except the amounts set
3 forth as amounts and rates of tax to be deducted and
4 withheld shall be computed on the basis of table 7 con-
5 tained in paragraph (1), (2), or (3) (whichever is ap-
6 plicable) of subsection (a) and of the additional low in-
7 come allowance provided in subsection (b) (1) (B).";
8 and
9 (2) by striking out paragraph (6).
10 (d) EFFECTIVE DATE.—The amendments made by sub-
11 sections (a) and (c) shall apply with respect to wages paid
12 after June 30, 1969. The amendments made by subsection
13 (b) shall apply with respect to wages paid after Decem-
14 ber 31, 1969.

Passed the House of Representatives June 30, 1969.

Attest: W. PAT JENNINGS,

Clerk.

SUMMARY OF H.R. 12290—EXTENSION OF THE SURTAX, REPEAL OF THE INVESTMENT TAX CREDIT AND OTHER MATTERS

(Prepared by the Staff of the Committee on Finance, U.S. Senate)

IN GENERAL

This bill (H.R. 12290) has five basic provisions as follows:

(1) It continues the existing income tax surcharge of 10 percent (computed on an annual basis) until January 1, 1970. On January 1, 1970, the surcharge is reduced to five percent (on an annual basis) and then terminated as of July 1, 1970.

(2) It postpones for one year the scheduled reduction in the present excise taxes of 7 percent on passenger automobiles and 10 percent on communications services.

(3) It provides for a five year amortization of certified air and water pollution control facilities which are completed or acquired in 1969 and subsequent years.

(4) It adopts a new "low income allowance" for calendar year 1970 and later years.

(5) It repeals the investment credit as of the end of April 18, 1969, but makes provision for construction begun and binding contracts in effect on or before that date, as well as certain other situations where there has been a substantial commitment.

EXTENSION OF THE INCOME TAX SURCHARGE (SECTION 2 OF THE BILL)

The bill provides that the income tax surcharge is to be continued from June 30, 1969 until December 31, 1969, at the full 10 percent annual rate. From January 1, 1970, the surcharge would be continued at an annual rate of five percent until June 30, 1970, when it would be terminated. Thus, in the case of a calendar year taxpayer, the rate of the surcharge would be 10 percent for all income received in 1969, and two and one-half percent applied to all income received in 1970.

The bill provides that the wage withholding tables presently in effect (that is, which include the surcharge at a 10 percent annual rate) will continue in effect until December 31, 1969. New withholding wage tables for the period from January 1, 1970, to June 30, 1970, are included in the bill to reflect the reduction in the surcharge to five percent for that period.

CONTINUATION OF PRESENT EXCISE TAX ON PASSENGER AUTOMOBILES AND COMMUNICATIONS SERVICES (SECTION 3 OF THE BILL)

The present excise tax rates of 7 percent on passenger automobiles and 10 percent on communications services are scheduled to be reduced on January 1, 1970. Further reductions (and eventual repeal) are also scheduled in later years. This section of the bill would extend the scheduled reductions for one year. The following table illustrates the scheduled reductions under present law, and the changes provided by the bill:

[In percent]

	Automobile excise tax		Telephone service	
	Present law	H.R. 12290	Present law	H.R. 12290
Current rate	7	7	10	10
Jan. 1, 1970	5	7	5	10
Jan. 1, 1971	3	5	3	5
Jan. 1, 1972	1	3	1	3
Jan. 1, 1973	0	1	0	1
Jan. 1, 1974	0	0	0	0

REPEAL OF THE INVESTMENT TAX CREDIT (SECTION 4 OF THE BILL)

General Purpose

The general purpose of section four of H.R. 12290 is to repeal the 7 percent investment tax credit. Under present law, a credit may be taken against a taxpayer's income tax with respect to certain qualified investments. The amount of the investment credit which may be taken in any year may not exceed the first $25,000 of tax liability plus 50 percent of the tax liability in excess of $25,000. Investment credits which are not used in the current year may be carried back to the three years prior to the current year and may then be carried forward to the succeeding seven taxable years.

Effective date of repeal

The bill provides that the investment credit will not be available with respect to property, the physical construction, reconstruction or erection of which is begun after April 18, 1969. Nor will it be available with respect to property which is acquired by the taxpayer after that date. Further, the investment credit is not to be available for property acquired after April 18, 1969, even though the construction of the property began before that date. However, the bill provides certain exceptions to this general rule under which the investment credit is to be available in the case of property which is constructed or acquired under a binding contract which was entered into before April 19, 1969.

Binding contract rule

Under the bill the investment credit is available with respect to property which is constructed or acquired pursuant to a contract that was binding on the taxpayer at the close of April 18, 1969. In order to qualify under this rule the contract must be binding on the taxpayer at all times thereafter. Generally, a contract, which is binding on a taxpayer on April 18, will not be considered binding at all times thereafter, if it is substantially modified or altered after that date. The bill also contains several transitional rules so that if certain

plans and conditions were in existence before April 19, 1969, then property, which would otherwise qualify for the investment tax credit, would continue to be eligible for the credit even though such property was placed in service after April 18, 1969. These transitional rules are referred to as the equipped building rule, plant facility rule, machinery or equipment rule, new design product rule, ocean-going vessel rule, death rule, and rules relating to leases.

Phase out of credit

Under present tax law, the investment credit is available at the time the property is placed in service. The House bill provides that the 7 percent investment credit which would otherwise be available in the case of property which is placed in service after 1970 (generally because the property qualified under the binding contract rule or a similar exception) is to be reduced by one-tenth of one percentage point for each full calendar month after November, 1970, and before the time when the property is placed in service, except that no credit will be allowed for property placed in service after 1974. Thus, a taxpayer who places property in service in 1975 will not receive any investment credit even though the property was acquired by the taxpayer under a binding contract which had been entered into before April 19, 1969.

Carryover of unused credits

The bill provides a limit on the amount of unused credits which may be carried over to 1969 and subsequent years. Under this special limitation not more than 20 percent of the aggregate amount of the taxpayer's unused credits may be taken in any year after 1968. This special limitation on the use of carryovers and carrybacks is in addition to the general 50 percent of tax liabilities limitation under present law.

AMORTIZATION OF AIR AND WATER POLLUTION CONTROL FACILITIES (SECTION 5 OF THE BILL)

The bill provides that the cost of facilities for the control of air and water pollution may be amortized over a five-year period, rather than being depreciated over their longer useful lives. The amortization deduction would be in lieu of the regular deprecia ion deduction which would normally be allowed for the facility. In no event how ver would the investment credit be available for any facility with respect to which the five year amortization deduction is in effect. (For instance if the binding contract rules under the provisions repealing the investment credit preserved the credit as to any taxpayer with respect to these types of facilities, he would have to elect whether to take the credit or the amortization deduction). However, a taxpayer could take the amortization deduction with respect to such a facility and still be eligible to receive the additional first year depreciation allowance presently in the tax law.

The amortization deduction would be available only with respect to a facility which was completed after 1968 or which is acquired after 1968 if the original use of the property commences with the taxpayer after that time. The amortization deduction would be available only with respect to pollution control facilities which have been certified. In the case of water pollution, the property must be certified by the state water pollution control agency as defined in the Federal Water Pollution Control Act and by the Secretary of the Interior. In the case of air pollution, the facility must be certified by the state air pollution control agency as defined in the Clean Air Act and by the Secretary of Health, Education, and Welfare.

The bill provides for the recapture of any excess amortization deduction if the property is later sold at a gain. If a gain arises in the disposition of a pollution control facility, the gain is to be treated as ordinary income to the extent that amortization deductions have been allowed on the facility. The amortization deduction may be discontinued by a taxpayer at any time. If the amortization deduction is discontinued, then the taxpayer may depreciate the property under the regular rules, starting with the first month to which the amortization is not applicable. Further, a taxpayer who discontinues the amortization deduction would not be entitled to any further amortization deduction with respect to that facility.

LOW-INCOME ALLOWANCE (SECTION 6 OF THE BILL)

The bill has a provision designed to provide tax relief to low income individuals by supplementing the "minimum standard deduction." The provision supplements the "minimum standard deduction" so that the minimum amounts of exempt income, for a family unit of 8 or less, is $1100, plus $600 times the number of personal exemptions presently available to the family unit. (Thus, a married couple which today pays tax on income in excess of $1700, would be tax free on income of up to $3300.) This additional allowance would be "phased out" as the income of the taxpayer increases. For each $2 of additional adjusted gross income above the non-taxed "poverty level" ($1100 plus $600 for each personal exemption) the additional allowance would be decreased by $1.

The bill provides that the low income allowance would be built into the optional tax tables, and would be available to a taxpayer only if he uses these tables. In addition, the optional tax tables (which today are available only if the taxpayer's income is under $5000) would be expanded to include adjusted gross income levels up to $6100, because of the phase out feature of the low income allowance. Also, the level below which taxpayers may request the Internal Revenue Service to compute their tax would similarly be raised from $5000 to $6100.

This section of the bill would be applicable to the calendar year 1970 and later years, and the withholding tables would be revised to take the low income allowance into account for periods beginning on and after January 1, 1970.

The CHAIRMAN. Secretary Kennedy?

STATEMENT OF HON. DAVID M. KENNEDY, SECRETARY OF THE TREASURY; ACCOMPANIED BY ROBERT P. MAYO, DIRECTOR OF THE BUREAU OF THE BUDGET; MAURICE MANN, ASSISTANT DIRECTOR; SAMUEL COHN, ASSISTANT DIRECTOR FOR BUDGET REVIEW; CHARLS WALKER, UNDER SECRETARY OF THE TREASURY; AND EDWIN S. COHEN, ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY

Secretary KENNEDY. Mr. Chairman and members of the committee, I am grateful for this opportunity to testify in behalf of H.R. 12290—a bill which contains the anti-inflation measures proposed by the President.

Specifically, H.R. 12290 would:

1. Extend the surcharge at 10 percent to December 31, 1969, and at 5 percent thereafter to June 30, 1970, producing a revenue yield of $7.6 billion in fiscal year 1970.

2. Defer for 1 year the reduction in the excise taxes on automobiles and on telephone and teletypewriter exchange services, producing a revenue increase of $540 million in fiscal year 1970.

3. Repeal the investment credit, producing a revenue increase of $1.35 billion in fiscal year 1970 and more than $3 billion in annual revenue in later years. The House bill incorporates certain transition rules for repeal of the credit, similar generally to those used in the 1966 suspension of the credit, reducing the revenue yield in fiscal year 1970 from the President's recommendation by about $150 million.

In addition, the President had recommended as a part of his initial reform proposals the adoption of the low income allowance to remove the burden of the income tax from persons with incomes below the poverty level and to reduce the tax burden on persons with incomes just above this level.

The low income allowance was incorporated by the House in H.R. 12290 with minor changes, effective January 1, 1970. It involves a

revenue reduction of $270 million for fiscal year 1970 and $625 million for a full year. Since it had been recommended by the President as a reform measure and had been taken into account in revised budget estimates for fiscal year 1970, its insertion in the bill did not affect the revenue estimates.

Mr. Chairman, I submit that the economic case for speedy action on these tax proposals is overwhelming. During 1969 consumer prices—the significant shopping basket indicator—have risen at an annual rate of 6.1 percent and wholesale prices at a rate of 6.3 percent.

It is not necessary to point out to this panel the very real dangers our country faces if inflation is allowed to continue unchecked. Inflation of this magnitude could lead to a series economic readjustment accompanied by a painfully high level of unemployment.

Failure to extend the surcharge would amount to a cut in taxes at a time of accelerating inflation. The consequences of failing to pass this legislation are unthinkable.

Even delay poses serious risks.

Delay contributes to a loss of confidence by our people in the determination of government to bring an orderly halt to inflation.

Delay feeds inflationary expectations and thus makes inflation even more difficult to control.

Delay weakens ouor balance of payments and foreign confidence 'n the integrity of the dollar and contributes to unsettled conditions 'n the international monetary markets.

In view of the clear need to continue to fight against inflation, we must not contemplate delay.

Let me turn to an argument that many raise for opposing this bill. These people feel that passage of the tax surcharge must be linked with tax reform in order to insure enactment of significant reform.

I understand the sense of frustration of those who hold this position. However, we must remember that essentially there are two separate and distinct problems before us. One, the control of inflation, is immediate and urgent. The other, tax reform, is vitally important, highly complex, and requires careful action both by the Congress and the executive branch.

Linking these two problems may mean that we fail in both of our objectives.

I agree with those who believe the wait for meaningful tax reform has been "too long." But I would point out that the Ways and Means Committee has met in lengthy public hearings and executive sessions to consider tax reforms. On May 27, the committee announced tentative decisions on tax reform subjects, and the chairman of the committee has announced that reform would be before the House prior to the August recess.

Moreover, President Nixon fully supports these efforts and is determined to bring equity to our Federal tax system.

On April 21 the President submitted to the Congress a major tax reform package, including the low-income allowance which has become a part of the bill before you. In addition, it contained these broad proposals:

A limit on tax preferences, which puts a limit of 50 percent on that portion of a person's income which could enjoy a preferred status, and

an allocation of deductions proposal preventing double benefits from tax preferences. In addition to these proposals, the President's initial proposals include meaningful reforms dealing with mineral production payments, private foundations, charitable contribution deductions, business income of tax-exempt organizations, tax treatment of corporate securities frequently used by conglomerates, multiple corporate surtax exemptions, stock dividends, dividends out of accelerated depreciation reserves, restricted stock plans, farm losses, multiple trusts, moving expenses, and a number of other important items.

With the consent of the committee, I would like to ask that a summary of the administration's interim tax reform proposals of April 22, 1969 be inserted in the record of the hearings at the conclusion of my statement.

The CHAIRMAN. That will be done.[1]

Secretary KENNEDY. In that April 21 message, President Nixon said:

> Fairness calls for tax reform now; beyond that, the American people need and deserve a smplified Federal tax system, and one that is attuned to the 1970's,

He has repeatedly pledged—and in a letter to the House of Representatives just last week stated again—that he supports and is determined that there shall be significant, meaningful, and fair tax reform.

His letter is in the Congressional Record of June 30 on page H-5461.

The CHAIRMAN. I think it might be well simply to make it a part of the hearings also so that they will be complete.[2]

Secretary KENNEDY. Very good, Mr. Chairman. In addition, House and Senate leaders on both sides of the aisle have pledged to themselves and to their constituents that there will be tax reform this year.

Gentlemen, there is no need to hold up the extension of the tax surcharge pending enactment of tax reform. The commitment to tax reform has been made to the American people, and I pledge to you that this administration will honor that commitment. I feel confident that the Congress will respond in like spirit. I know that the American people will accept nothing less.

Before concluding, I would like to mention several areas where the House-passed bill differs from the President's recommendations. Then I would be happy to answer any questions you may have about those changes or any other aspect of the legislation.

It might be well, Mr. Chairman, to have Mr. Mayo give his statement before we get into the discussion.

First, as I noted earlier, the low-income allowance recommended by the President as a part of his interim tax reform proposals, has been included in this bill. Action on this measure should be recognized as a commitment to tax reform, and we endorse adding it to this bill on the assumption that reform will be enacted.

Secondly, the transition rules adopted by the House in connection with the repeal of the investment credit will reduce the revenue yield from repeal of the credit by about $150 million in fiscal year 1970 as compared with the rules initially recommended by the Treasury.

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[1] See p. 64.
[2] See p. 63.

The transition rules in the bill would allow the credit for certain expenditures after April 18, 1969, even though there was no binding contract on that date. They are, however, generally the same rules adopted in 1966 on suspension of the investment credit to deal with cases in which there is an economic commitment evidenced by expenditures constituting more than half the cost of a facility prior to the cutoff date.

There are some extensions of the 1966 rules to cases of generally similar nature. However, any further extension beyond these rules would be a mistake. The binding contract rule and these additional rules provide equitable treatment in the most deserving cases, and they represent the most reasonable cutoff point.

Finally, the House bill provides that certain capital facilities acquired to reduce air or water pollution may be amortized over 5 years instead of their normal useful lives. This acceleration of cost recovery will provide an incentive for installation of antipollution facilities. While we did not recommend it, it is reasonable if the committee agrees that such an incentive is justified.

However, we have serious reservations about the scope of the House provision, as I will indicate. The provision as contained in the House bill will result in no substantial short-term revenue loss but will result in a long-term revenue loss which will reach $300 to $400 million annually by 1975.

A revenue loss of this magnitude deserves careful scrutiny. We have concluded on further study of the House provision that the 5-year amortization provision need not be made available to new plants constructed in the future which install antipollution control facilities.

Technological advances which are occurring in the control of pollution will greatly reduce the burden on industry in designing new plants to meet antipollution standards. In these cases, a major tax concession to provide incentive and achieve cost-sharing is not nearly so important as in the case of existing plants where the burden is much clearer.

It is also our conclusion on further study of the provision as passed by the House that it provides too great a benefit to property which has a long useful life. Thus, antipollution property qualifying under the bill which has a useful life of 50 years would receive a tax concession equivalent to an investment credit of approximately 20 percent.

The rapid amortization provision is intended to replace the investment credit for antipollution facilities, but an increased benefit of this magnitude is not warranted. The Treasury therefore proposes that a limitation be placed on the rapid write-off so that its benefits would be available only for the first 15 years of the life of any property. Thus, property with a 50-year useful life could obtain the benefit of the rapid amortization permitted for emergency facilities constructed during World War II.

Finally, the definition of a pollution control facility needs to be tightened so that the rapid amortization provisions will apply only to treatment facilities which are clearly identifiable as serving only antipollution purposes.

Under the present broad definition, a smokestack or sewer pipe might qualify for the rapid write-off, even though these facilities

would be installed in any event and perform functions other than pollution abatement of the type this tax concession is designed to give special encouragement.

I urge this committee to take prompt action on this bill. The existing 31-day temporary extension of current withholding rates will expire on July 31. As you know, business payrolls are a complicated matter. An enormous burden would be imposed upon American business—not to speak of the administrative nightmare for the Internal Revenue Service—if they were required to reprogram their payroll systems to withhold at tax rates without a surcharge and then were required in a month or so to reprogram again to include the surcharge.

You have stated today that you will seek a further temporary extension of the current withholding rates if the legislation is not complete by July 31, so that will alleviate the problem I have just mentioned.

(The material referred to previously follows:)

[From the Congressional Record, June 30, 1969]

THE WHITE HOUSE,
Washington, D.C., June 30, 1969.

Hon. GERALD FORD,
House of Representatives,
Washington, D.C.

DEAR MR. FORD: As the House nears a decision on the surtax, I want to remove any vestige of doubt as to the commitment of this Administration to prompt and meaningful tax reform.

I first made this commitment publicly on February 6. I reaffirm it today.

Clearly the record supports that commitment. On April 21, after less than three months in office, this Administration submitted 16 substantive tax reforms to the Congress. They included a minimum income tax to help ensure that people with high incomes will not fail to share the tax burden. We suggested a Low Income Allowance to remove poverty-level people from the tax rolls and reduce the taxes of some eight million others. We also recommended repeal of the seven percent investment credit.

It is due in part to those initiative that the measure before the House today includes significant tax reform. Your colleagues will recall that repeal of the investment credit, ultimately releasing over $3 billion in revenue, was singled out only three months ago by the majority of the Senate-House Joint Economic Committee as the "first priority in tax reform."

The Low Income Allowance is also a high-priority reform. We should delay no longer the elimination of the social paradox of poverty-stricken people paying a federal tax on their meager incomes.

Important as these two reforms are, much more is needed and will be done. On May 27, the House Ways and Means Committee published a list of tax reform measures which it had tentatively approved. On my direction Treasury officials and staff have been working closely with the Committee. They will continue to do so.

There is no reason why a far-reaching tax reform bill cannot be put before the House of Representatives this summer. This is the announced goal of the Ways and Means Committee; it is also the goal of this Administration.

While these complex measures are being prepared, there must be no question as to this Government's determination first to slow and then to stop inflation. This requires Congressional action *now*. It requires extension of the phased surtax, and it requires enactment now of the other tax measures proposed by the Administration and approved by the tax committee of the House.

The goals of fiscal responsibility and tax reform are not mutually exclusive. We can have both; we *must* have both. I trust and believe that the House will move responsibly toward both by voting today to extend the surtax.

Sincerely,

RICHARD NIXON.

TREASURY DEPARTMENT, WASHINGTON, D.C., SUMMARY OF TAX REFORM PROPOSALS

The President has recommended repeal of the 7% investment credit effective April 21, 1969. This means the credit will not be allowable for orders placed on April 21, 1969. This repeal permits his further recommendation of extension of the surcharge at a reduced rate of 5% for the period January 1, 1970, to June 30, 1970, instead of the 10% rate that is being recommended for the balance of the current year. The repeal will provide additional federal revenues for other important tax measures in the planning stage.

The following material is a brief summary of the tax reform proposals presented by the Treasury Department to the House Ways and Means Committee on April 22, 1969.

The net revenue change of the entire package will be small—the revenue increases of reform measures will be largely offset by the revenue losses from the relief measures. A table showing the overall revenue effects of the entire package for the first full year and in the long run (1970 and 1975) is included.

THE PROPOSALS

I.

The Treasury recommends a general restriction on the net value of certain tax preferences in two respects:

Limit on Tax Preferences (*LTP*). A 50 percent ceiling would be imposed on the amount of an individual's total income which could enjoy tax preferred status. Total income for this purpose would be determined—

(1) By including appreciation in value of property given to charity;

(2) Before deducting intangible drilling expenses and percentage depletion in excess of cost depletion;

(3) Before deducting certian excessive farm losses;

(4) Before deducting the excess of accelerated over straight line depreciation on real estate.

The four preferences could not exceed half of total income. There would be a $10,000 minimum amount of allowance preferences. Thus, an individual with $100,000 of net business income, which reflects a deduction of $200,000 of accelerated depreciation on real estate in excess of straight line depreciation, would have adjusted gross income of $150,000 (in effect, $50,000 of the excess depreciation would become taxable).

A five-year carryover of disallowed tax preferences (an averaging device) would restrict the effect of this limit to persons who consistently have an excessive amount of these preferences. A three-year transition period, establishing the ceiling at 70 percent, 60 percent, and 50 percent, respectively, would phase in the limit gradually. When fully phased in, the revenue increase will be $80 million.

Allocation of Deductions. An individual with more than 10,000 of tax preferences would also be required to allocate his itemized (non-business) deductions between taxable income and the non-taxed or "allowable" portion of tax preference amounts. For this purpose, tax preferences would also include interest in state and municipal bonds and the excluded portion of long-term capital gains (50%). Thus, all itemized deductions could no longer be applied entirely against taxable income where there is also substantial non-taxable income.

The allocation will be phased in generally over a two year period. Thus, in the first year, only one-half total itemized deductions would be required to be allocated. When fully phased in, the revenue increase will be $500 million.

To provide essential relief to persons in poverty, we recommend a:

Low Income Allowance. An additional allowance would be granted to generally insure that families at the poverty level would not be required to pay any Federal income tax. This allowance, which would be automatically built into the tax tables, would completely exempt more than 2 million families from tax payments, effective at the following income levels:

Number of exemptions:	*Income*	Number of exemptions—Con.	*Income*
Family of 1	$1,700	Family of 5	$4,100
Family of 2	2,300	Family of 6	4,700
Family of 3	2,900	Family of 7	5,300
Family of 4	3,500	Family of 8	5,900

The allowance would be phased out as income exceeded the above poverty levels at the rate of $.50 for each dollar of income over the levels. Thus, for a single person the allowance would not exempt income over $3,300; for a family of eight, it would phase out at $6,100. The allowance would be effective for 1970 and thereafter. The revenue loss from this change would be $700 million.

III.

The Treasury also recommends the following reforms:

Mineral Production Payments. The tax treatment of mineral production payments would be changed. These "production payments," sold by oil companies and other mineral producers, represent in effect advance payment for future extraction of the minerals, and they are sold to accelerate income to avoid the statutory limitations on credits and deductions, such as the depletion allowance. Henceforth, these production payments will be treated as loans, which is their true substance. Similarly, the duplication of tax benefits by such persons in retaining and selling production payments in so-called ABC transactions will be dealt with in the same way. Bona fide production payments pledged for exploration or development will not be affected. The revenue increase after the first year will be $200 million.

Private Foundations and Exempt Organizations. Certain specific abuses by private foundations would be prohibited:

—self-dealing between the foundation and related parties
—failure to distribute real income annually to charity
—the control of operating business corporation (with a 5-year transition period for existing holdings)
—engaging in certain political activities, such as voter registration drives.

Penalties for these abuses would be imposed, and power would be given the United States District Courts, acting at the instance of the Justice Department in the absence of state action, to impose appropriate sanctions.

Foundations would also be required to make available for public inspection information as to grants to individuals, the activities of these individuals, and their work product.

Certain specific administrative changes would be made to provide much closer scrutiny and audit of foundation activities.

Present law taxing income from the direct operation of a business by certain tax-exempt organizations would be extended to churches and other tax-exempt organizations not currently covered. The investment income of social clubs and certain similar organizations, now untaxed, would be taxed. All tax-exempt organizations would be taxed on the income of any investment assets acquired with borrowed funds and not related to their tax-exempt functions (so-called *Clay Brown* bootstrap cases). The revenue increase from these various provisions cannot be estimated.

Charitable Contribution deduction:

The 30 percent limitation on charitable contribution deductions would be increased to 50%, to apply to all taxpayers beginning in 1969.

The unlimited charitable deduction available to certain persons who qualify in at least 8 out of any 10 years would be cut down. Thus, charitable contributions taken together with all other itemized non-business deductions could not exceed 80% of adjusted gross income.

In addition, a number of situations which allow different tax benefits for contributions depending on features of the property given or the method of gift require attention. Under present law, deductions for contributions to charity may be in the form of cash or property, taken at its fair market value.

Except with respect to donations of installment obligations, gain is not recognized to the donor on the making of the charitable gift. Treasury recommends that the deduction for charitable gifts of property, the sale of which would result in reducing income, be restricted to the cost or other basis of the property in the donor's hands. The effect is similar to taxing the appreciation of ordinary income assets in a charitable gift.

Treasury also recommends that no deduction be allowed for the rental value of property leased rent-free to a charity; and that no charitable deduction be allowed for gifts of stock rights unless the shareholder allocates the basis of his old stock in part to the rights which are given to charity.

Treasury also recommends that the special two-year charitable trust rule be repealed. The repeal will mean that in all cases a grantor will be taxed on trust income where a reversionary interest will or may be expected to take effect within ten years. Similarly, in the case of gifts of short term income interests to charity, the donor should not get a deduction unless he is taxable on the income.

Corporate Securities. In recent years there has been a rapid increase in the number and the size of members or other consolidations among corporations, paticularly in the area of so-called "conglomerate" combinations. While the reasons for this development are principally non-tax, there are tax aspects which require change.

Treasury recommends legislative action on a number of issues, including the installment sales reporting treatment of capital gain recognized on the receipt of bonds, the treatment of original issue discount on bonds, and the interest deduction on the repurchase by a corporation of its own convertible bonds at a premium. In addition, Treasury is seeking to develop a regulation to distinguish debt from equity for purposes of the interest deduction. We consider this distinction is at the heart of the problem of the increased use of debt securities in these transactions.

While the measures recommended by the Treasury at this time are not specifically directed at acquisitions, whether of a conglomerate nature or otherwise, we believe that they will attack some of the basic tax problems involved in combinations and decrease the impetus toward creation of unusual security interests that are difficult for investors to evaluate. The Treasury is also undertaking a basic study of the general treatment of tax free corporate reorganizations.

Multiple Corporations. The advantage taken by a number of large corporations of certain tax relief provisions for small business, whereby a reduced corporate tax rate of 22 percent is applied to the first $25,000 of taxable income, would be ended. Corporate groups ranging up to hundreds of corporations would be consolidated into one for this purpose. The change would be phased in gradually over five years. The revenue increase from this change, when fully effective, will be $235 million.

Farm Income. Various provisions whereby farm deductions, frequently representing the cost of assets acquired, are offset against ordinary income, but the sale of farm assets is taxed only as capital gain, will be amended. The capital gain will be taxed as ordinary income to an appropriate extent. The hobby (gentleman farmer) loss rules preventing the consistent deduction of very large losses by individuals from certain enterprises would be strengthened. The revenue increase from these proposals has not been determined.

Accelerated Depreciation: Public Utilities and Others. Tax-free dividends presently being paid out of accelerated depreciation reserves, principally by public utilities but also by some other corporations, would be made taxable after a three-year adjustment period.

Federal and state regulatory commissions would be prevented from requiring a public utility to compute net income after tax from rate making purposes as if accelerated depreciation had been taken unless the utility voluntarily elects accelerated depreciation. Utilities are forced by the position of some commissions to claim accelerated depreciation to reduce their taxes, and the benefits are flowed through to the consumers at the expense of the Federal revenues generally. This rule will preserve the status quo and prevent further adoption by regulatory commissions of the "flow-through" concept except where the utility itself elects accelerated depreciation. This change will prevent an annual revenue loss which could reach $1.5 billion if this limitation were not imposed.

Stock dividends. The practice of a number of corporations issuing dividends in stock which increase the stockholder's interest in such a way that they are a substitute for cash dividends, rather than simply being a larger number of shares for the same interest, would be discouraged by making such dividends taxable. The Treasury proposal substantially follows the recommendation of the Advisory Group on Subchapter C, established by the House Ways and Means Committee in 1956. This provision will prevent a substantial future loss of revenue.

Capital Losses. Net long-term capital gains are in general taxed by including only one-half of the gain in ordinary income. A net long-term capital loss, how-

ever, may be deducted up to on annual limit of $1,000 in full against ordinary income. This is not only inconsistent but leads to tax planning of asset sales to separate gains and losses into alternate years. We recommend that each dollar of net long-term capital loss be permitted to offset only 50 cents of ordinary income. The limit of the annual deduction should be kept at $1,000 with the present unlimited carryover. In addition, married persons filing separate returns should be subjected to an annual limit of $500 each. In the long run this change will increase revenues by $100 million.

Restricted Stock Plans. During the past few years, there has been a rapid growth in the number of restricted stock plans. Under these plans, an employee receives stock or other property subject to restrictions, on sale or other limitations. Because of these restrictions, tax is not imposed under existing rules until the employee sells the stock, and the amount then subject to tax is limited to the value of the stock when the employee received it. In effect, any increase in value during the period the restrictions are in effect is taxed only if the stock is sold, and then as a capital gain.

Treasury proposes that, as a general matter, where an employee receives stock or other property as compensation, he should be subject to tax when his rights in that property become nonforfeitable. When an employee receives nonforfeitable rights in property subject to restrictions on sale, these restrictions would be ignored, and the amount taxed would be the unrestricted full current fair market value of the property, unless the restrictions are bona fide limitations which continue for the life of the property.

Multiple or Accumulation Trusts. Under present law, income may be accumulated in trust and distributed to the beneficiary without tax to the beneficiary, with certain exceptions, even though that beneficiary pays higher tax than the trust itself. This enables creation of multiple trusts for the same beneficiaries to avoid the progressive rate structure.

Treasury proposes that all income accumulated in trust will be taxed at the beneficiary's regular rates when the income from the trust is received by the beneficiary. In addition, income accumulated in trust for the benefit of the grantor's spouse will be taxed to the grantor as earned, as it is under present law when it is accumulated for the grantor's own benefit. This provision will increase revenues by $70 million.

Moving Expenses. The deduction for moving expenses would be substantially liberalized to include certain indirect costs, (house hunting trips, temporary living expenses at the new location and the cost of selling or buying a house) up to a maximum of $2,500, of which no more than $1,000 could be for the indirect costs. The higher limit would be available for the direct costs (the costs of buying or selling a house and lease breaking costs.) The revenue loss from this change would be $100 million.

Small Business Subchapter S Corporations. The existing rules permitting small business corporations to be taxed similar to partnerships to avoid the double tax on corporate earnings would be substantially liberalized by expanding existing size and types of income limitations, eliminating technical requirements and simplifying their operation.

Extension of Special Treatment of Banks Holding Foreign Deposits

Interest earned on U.S. bank deposits owned by foreigners not resident in the United States and not connected with a trade or business conducted here is exempt from income tax, and the bank deposits themselves are exempt from estate tax. However, existing law provided that these exemptions shall not continue beyond 1972. The expiration date was enacted in 1966 as part of the Foreign Investors Tax Act. At the time, the Congress was concerned that termination of the exemption would have an adverse impact on foreign balances in the United States and therefore deferred the effective date for terminating the exemption for five years.

The balance of payments continues to be a matter of concern. While we cannot forecast what the situation will be by 1973, it is clear that the scheduled termination will make a solution to the problem much more difficult to achieve. Accordingly, Treasury recommends that the Congress take action in accordance with the President's recommendation of April 4 that the scheduled termination of the exemption be repealed.

TABLE 1.—TAX REFORM PROPOSALS—ESTIMATED INCREASE OR REDUCTION (−) IN CALENDAR YEAR TAX LIABILITIES [1]

[In millions of dollars]

	1969	1970	Longrun effect, 1975
1A. Limitation on tax preferences	20	40	80
1B. Allocation of deductions	275	500	500
2. Low-income allowances	0	−665	−665
3. Mineral production payments	95	140	200
4. Foundations and exempt organizations	(2)	(2)	(2)
5. Charitable deduction changes	−10	−10	−10
6. Corporate securities	(2)	(2)	(2)
7. Multiple surtax exemptions	10	25	235
8. Farm income rules	0	10	50
9. Tax-free dividends from accelerated depreciation	0	0	80
10. Stock distributions	(2)	(2)	(2)
11. Capital loss limitation	65	80	100
12. Restricted stock plans	(2)	(2)	(2)
13. Multiple trusts	55	70	70
14. Moving expenses	−110	−100	−100
15. Subchapter S changes	(2)	(2)	(2)
Net increase (+) or reduction (−)	+400	+90	+540

[1] Based on current income levels with no provision made in longrun estimates for effect of income growth. Estimates include a 10-percent surcharge for 1969 and a 2½-percent surcharge for 1970.

[2] No basis for estimating revenue effect. In some cases, however, these measures will prevent substantial future revenue loss.

The CHAIRMAN. Do you wish for the Director of the Budget to proceed now?

Secretary KENNEDY. I think it might be better if Mr. Mayo gives a report on the budget.

The CHAIRMAN. All right.

Mr. MAYO. Thank you.

Mr. Chairman and members of the committee:

Our current economic predicament—characterized by persistent inflation, exceedingly tight money markets, and historically high interest rates—reflects past miscalculations in managing the Nation's economic affairs. These miscalculations set in motion a series of events that produced a pervasive and deeply imbedded inflationary psychology, which makes continued and even increasing inflation a distinct possibility. This situation will not be changed easily. But change it we must. To do so, we need the economc restraint that would be provided by H.R. 12290, together with appropriate monetary restraint and the spending reductions in the budget for fiscal year 1970 already announced.

Movements in the general price level are caused by many things, not the least of which is the Federal fiscal position. Outlays for military programs increased sharply after the escalation of our activities in Vietnam in the summer of 1965. This increase was not offset by lower outlays for other programs. Nor was it offset by higher taxes until fiscal year 1969. The budget deficit rose from $1.6 billion in fiscal 1965 to $25.2 billion in fiscal year 1968, stoking an already overheated economy. Excessive demand was generated and price rises became progressively greater.

We should not be surprised or dismayed by the difficulties we are now having in bringing inflation under control. An extended inflationary period such as we are experiencing engenders expectations of fur-

ther inflation and, therefore, has a major impact on wage and price setting.

The CHAIRMAN. I thought we had an understanding you were going to summarize your statement.

Senator WILLIAMS. He is skipping.

Mr. MAYO. Yes, I am reading only about half of it.

The CHAIRMAN. I promise you I will read every word faithfully.

Mr. MAYO. Thank you, Mr. Chairman.

An extended inflationary period such as we are experiencing engenders expectations of further inflation and, therefore, has a major impact on wage and price setting. It also provides an incentive for not postponing buying for consumption or investment purposes. The resulting continued strong demand helps neutralize the influence of the restraining forces at work in the economy. For this reason, we need time to root out the inflation that has invaded our economy.

We need time and we need coordinated and complementary economic policies:

Continued restraint on demand, which would result from the President's tax program for fiscal year 1970.

Continued vigorous efforts by the Congress and by the Administration to control Federal spending, and

Appropriate monetary restraints.

Each is important in its own right, but none can be fully effective except as part of a coordinated set of policies.

The Federal budget reflects the Nation's priorities as perceived by the President and by the Congress. At any point in time—and for at least 1 year into the future—it consists largely of "uncontrollable" programs, whose levels are determined by existing laws and previous commitments. For this reason, substantial reductions in individual elements of the budget do not often occur from one budget to the next.

President Nixon knew the strength of this momentum in the budget when he took office in January. He did not expect major reductions in the 1969 budget but has determined to begin, with the 1970 budget, the difficult task of bringing Federal outlays under control and of trying to shift the course of Federal programs toward his administration's objectives. These efforts did not cease when the April 15 Review of the 1970 Budget was published. Indeed, they are being intensified now that we have begun the 1970 budget process.

The intensive review of the January budget was concluded and a report summarizing the results was issued in April. Revised estimates for both 1969 and 1970 were contained in my May 20 testimony before the House Ways and Means Committee on the President's tax program.

For the fiscal year we have just entered, the January budget estimated receipts to be $198.7 billion and outlays to be $195.3 billion, resulting in a projected surplus of $3.4 billion. On May 20, we estimated that receipts will be $199.2 billion, up a half billion dollars, and outlays will be $129.9 billion, down $2.4 billion, with a surplus of $6.3 billion. Of course, a most important influence on the budget will be congressional action, both on the expenditure and the revenue side.

As our May 20 statement indicates, increases in uncontrollable items raised January budget outlays for 1970 from $195.3 to $196.9 billion, and budget authority from $210.1 to $211.4 billion, or before we apply the cuts, I should say.

However, this administration's review of the 1970 budget produced reductions in outlays from the corrected January budget totaling $4 billion. Budget authority at the same time was reduced $5.5 billion.

Since May 20, interest rates have risen even higher and the pace of rising costs under the medicare program has been more rapid than anticipated. These and similar other factors will probably lift outlays at least $1 billion above the May 20 estimate.

To be sure, there will be some offsetting decreases. On the other hand, the net effect of congressional action to date on fiscal year 1970 appropriation requests has been to increase estimated outlays.

The House actions are expected to reduce Treasury, Post Office, and Executive Office spending by $36 million and Independent Offices and Housing and Urban Development outlays by $43 million, but to increase Agriculture Department outlays by $173 million—a net increase on the three appropriation bills of nearly $95 million. Senate actions up to date would reduce Treasury, Post Office, and Executive Office outlays by $31 million, but increase Agriculture outlays by nearly $570 million—a net increase of nearly $540 million. Obviously, these actions are still incomplete.

There are a number of uncertainties concerning 1970 outlays. These include the fact that congressional decisions on many appropriation requests and on a possible outlay limitation are yet to be made. For now, we are inclined to hold to the $192.9 billion estimate of May 20, but recognizing, for the moment at least, that pressures for higher outlays seem greater than prospects for additional reductions by the Congress. I hope that is incorrect, but that is my appraisal at the moment.

Indeed, the $192.9 billion outlay estimate is a tight one, despite the fact that it will be about $7 billion higher than 1969 outlays. The $7 billion increase includes:

Social security benefit payment increases of $3.4 billion;

Civilian and military pay raises, effective July 1, 1969, under existing pay comparability legislation, of $2.8 billion;

Interest on the public debt, reflecting refinancing at the currently higher rates of interest, amounting to about $1 billion; and

Public assistance grants to States, including medicaid and the removal of the aid to dependent families program freeze, of $1.1 billion.

The above four items alone account for more than the $7 billion increase in the total from 1969–70, which means that there is a net reduction for all other programs.

Our current economic situation is primarily the product of past decisions. Similarly, the future will be largely the product of what is done now.

It takes time for fiscal policy and monetary policy to take hold. We will need a period of balanced, reduced growth to turn the forces of inflation, for throughout much of the economy, supply factors—

labor and material costs—keep pressure on prices for some time after demand pressures ease.

This administration has no desire that the income tax surcharge be extended a day longer than is necessary. The proposed reduction of the surcharge on January 1 is in line with the President's intention to propose complete elimination of the surcharge as soon as military and economic conditions permit.

In our budgetary planning for fiscal year 1971, we will take this intention into account. It will provide a brake on the growth of the budget in that year. The restraint that characterizes the 1970 budget cannot be regarded as transitory. It will also characterize the 1971 budget.

Failure to adopt the President's tax program runs the risk of boom and bust at home and deterioration of the value of the dollar both here and abroad. Stop-and-go economic policy has never worked in the past—in this country or anywhere else; there is no reason to expect that it would work in the period ahead.

I urge your early support of H.R. 12290 to provide the restraint needed to return the economy to balanced and sustainable noninflationary growth.

(Mr. Mayo's prepared statement follows:)

STATEMENT OF ROBERT P. MAYO, DIRECTOR, BUREAU OF THE BUDGET

INTRODUCTION

Mr. Chairman and Members of the Committee, Secretary Kennedy's statement properly emphasizes the urgent need for passage of H.R. 12290 to help bring inflation under control.

Our current economic predicament—characterized by persistent inflation, exceedingly tight money markets, and historically high interest rates—reflects past miscalculations in managing the Nation's economic affairs. These miscalculations set in motion a series of events that produced a pervasive and deeply imbedded inflationary psychology, which makes continued and even increasing inflation a distinct possibility. This situation will not be changed easily. But change it we must. To do so, we need the economic restraint that would be provided by H.R. 12290, together with appropriate monetary restraint and previously announced spending reductions in the budget for fiscal year 1970.

Bringing inflation under control and restoring the economy to a balanced and sustainable rate of economic growth are, together, the primary domestic task of this Administration. We must bring inflation under control to eliminate the distortions that have developed in the economy. We must restore balanced and sustainable economic growth, or the inflation will inevitably lead to painful economic consequences.

We can achieve our anti-inflationary objectives only if we maintain a restrictive fiscal policy in the year ahead. The consequences of relying on overly restrictive monetary policy, in the absence of an appropriate fiscal policy, should be clear to us now. The "credit crunch" of the late summer of 1966 forced housing to bear the brunt of economic restraint, but the swift run-up in interest rates during that period reflected more widespread dislocation in financial markets. The economy did not recover quickly from these disruptions. In short, we cannot leave the task of controlling inflation to monetary policy alone because this course compounds the task of achieving balanced and sustainable growth.

LESSONS OF THE RECENT PAST

Movements in the general price level are caused by many things, not the least of which is the Federal fiscal position. The delayed influence of fiscal policy on the behavior of prices during recent years is suggested by Table 1.

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TABLE 1. BUDGET TOTALS AND CHANGES IN THE GNP IMPLICIT DEFLATOR AND THE CONSUMER PRICE INDEX, FISCAL YEARS 1965-70

[Dollar amounts in billions]

Fiscal year	Budget receipts	Budget outlays	Budget surplus or deficit (−)	Percentage change in GNP implicit deflator	Percentage change in Consumer price index
1965	$116.8	$118.4	−$1.6	1.8	1.3
1966	130.9	134.7	−3.8	1.9	2.2
1967	149.6	158.4	−8.8	3.1	3.1
1968	153.7	178.9	−25.2	3.4	3.3
1969 (eastern standard time)	186.5	185.6	.9	4.0	4.8
1970 (eastern standard time)	199.2	192.9	6.3	(1)	(1)

[1] Not available.

Outlays for military programs increased sharply after the escalation of our activities in Vietnam in the summer of 1965. This increase was not offset by lower outlays for other programs. Nor was it offset by higher taxes until fiscal year 1969. The budget deficit rose from $1.6 billion in fiscal year 1965 to $25.2 billion in fiscal year 1968, stoking an already overheated economy. Excessive demand was generated and price rises became progressively greater.

Modest fiscal restraint was exercised through changes in tax collection regulations, but the primary instrument of restraint was monetary policy. Increasingly restrictive monetary policy produced the credit crunch of 1966, gross inequities in the degree of restraint imposed on the economy, and a fear of "overkill" that led to subsequent errors of judgment.

Legislation imposing fiscal restraint—through an income tax surcharge and expenditure control—was adopted in June 1968, about two years after it was first needed. With it came a shift in expectations both at home and abroad. It was generally anticipated that the U.S. economy would experience a slowing in its rate of growth and that less stringent financial market conditions would result and would permit an easing of monetary policy. For a few weeks these expectations were borne out as interest rates declined. But prices did not slacken their pace. Moreover, in a short time, interest rates turned up again. By the end of the year, it was clear that the economy was still overheated. The fiscal restraint imposed in June of last year was partially offset by a monetary policy that became too accommodating—largely because of the fear of "overkill" and because the strength of the inflationary pressures was underestimated. Monetary policy shifted back toward restraint late in the year. Nevertheless, doubt lingered that fiscal and monetary policymakers meant business about curbing inflation. Consequently, a new surge of inflationary psychology developed. Our task today is difficult primarily because of the depth and strength of this psychology.

We should not be surprised or dismayed by the difficulties we are now having in bringing inflation under control. An extended inflationary period such as we are experiencing engenders expectations of further inflation and, therefore, has a major impact on wage and price setting. It also provides an incentive for not postponing buying for consumption or investment purposes. The resulting continued strong demand helps neutralize the influence of the restraining forces at work in the economy. For this reason, we need time to root out the inflation that has invaded our economy.

We need time and we need coordinated and complementary economic policies:

- continued restraint on demand, which would result from the President's tax program for fiscal year 1970,
- continued vigorous efforts by the Congress and by the administration to control Federal spending, and
- appropriate monetary restraint.

Each is important in its own right, but none can be fully effective except as part of a coordinated set of policies.

THE BUDGET OUTLOOK

This administration recognizes that rapid growth of Federal spending has been a major cause of inflation since 1965, and that expenditure control is essential to sound fiscal policy and responsible management of Government activities. Accord-

ingly, soon after taking office, President Nixon directed his agency heads to undertake an intensive review of the January budget of the prior administration.

The Federal budget reflects the Nation's priorities as perceived by the President and by the Congress. At any point in time—and for at least 1 year into the future—it consists largely of "uncontrollable" programs, whose levels are determined by existing laws and previous commitments. For this reason, substantial reductions in individual elements of the budget do not often occur from one budget to the next.

President Nixon knew the strength of this momentum in the budget when he took office in January. He did not expect major reductions in the 1969 budget but was determined to begin, with the 1970 budget, the difficult task of bringing Federal outlays under control and of trying to shift the course of Federal programs toward his administration's objectives. These efforts did not cease when the April 15 Review of the 1970 Budget was published. Indeed, they are being intensified now that we have begun the 1971 budget process.

The intensive review of the January budget was concluded and a report summarizing the results was issued in April. Revised estimates for both 1969 and 1970 were contained in my May 20 testimony before the House Ways and Means Committee on the President's tax program.

Fiscal year 1969

For the year that ended a week ago yesterday, the budget published in January estimated receipts at $186.1 billion and outlays at $183.7 billion, with a surplus of $2.4 billion. Our May 20 estimate indicated receipts of $186.5 billion and outlays of $185.6 billion, reducing the projected surplus to $0.9 billion. Preliminary data on actual receipts and outlays for the year will be published in the *Monthly Treasury Statement* late this month. When those data are published, we expect them to show that both receipts and outlays will be somewhat higher than our May 20 estimates.

Fiscal year 1970

For the fiscal year we have just entered, the January budget estimated receipts to be $198.7 billion and outlays to be $195.3 billion, resulting in a projected surplus of $3.4 billion. On May 20, we estimated that receipts will be $199.2 billion and outlays will be $192.9 billion, with a surplus of $6.3 billion. Of course, a most important influence on the budget will be congressional action.

Receipts

The net increase of $0.5 billion in estimated receipts over the January budget figure—from $198.7 billion to $199.2 billion—results from: (a) a combined increase of $2.5 billion due to higher than anticipated tax yields and economic activity and accompanying higher prices and wages, (b) a downward revision of $0.4 billion in estimated receipts from corporation income taxes and customs duties, and (c) a net decrease of $1.6 billion due to changes in proposed legislation and the anticipated dates of enactment, largely in proposed employment taxes associated with social security legislation. One of the reasons for being conservative about higher receipts in 1970 is that the January budget contemplated some receipts based on the assumption that the necessary legislation would become effective by June 30. No such legislation has yet cleared the Congress.

Outlays

As our May 20 statement indicated, increases in uncontrollable items raised January budget outlays for 1970 from $195.3 billion to $196.9 billion and budget authority from $210.1 billion to $211.4 billion. However, this Administration's review of the 1970 budget produced reductions in outlays from the corrected January budget totaling $4.0 billion. Budget authority was reduced $5.5 billion.

Since May 20, interest rates have risen even higher and the pace of rising costs under the Medicare program has been more rapid than anticipated. These and similar other factors will probably lift outlays at least $1 billion above the May 20 estimate. To be sure, there will be some offsetting decreases. On the other hand, the net effect of congressional action to date on fiscal year 1970 appropriation requests has been to increase estimated outlays. The House actions are expected to reduce Treasury, Post Office, and Executive Office spending by $36 million and Independent Offices and Housing and Urban Development outlays

by $43 million, but to increase Agriculture Department outlays by $173 million—a net increase of nearly $95 million. Senate actions to date would reduce Treasury, Post Office, and Executive Office outlays by $31 million but increase Agriculture outlays by nearly $570 million—a net increase of nearly $540 million.

There are a number of uncertainties concerning 1970 outlays. These include the fact that congressional decisions on many appropriation requests and on a possible outlay limitation are yet to be made. For now, we are inclined to hold to the $192.9 billion estimate of May 20, but recognizing, for the moment at least, that pressures for higher outlays seem greater than prospects for additional reductions by the Congress.

Indeed, the $192.9 billion outlay estimate is a tight one, despite the fact that it will be about $7 billion higher than 1969 outlays. The $7 billion increase includes:

—Social security benefit payment increases of $3.4 billion;

—Civilian and military pay raises, effective July 1, 1969, under existing pay comparability legislation, of $2.8 billion;

—Interest on the public debt, reflecting refinancing at the currently higher rates of interest, amounting to about $1 billion; and

—Public assistance grants to States, including Medicaid and the removal of the Aid to Dependent Families program freeze, of $1.1 billion.

The above four items account for more than the $7 billion increase in the total, which means that there is a net reduction for all other programs.

Conclusion

Our current economic situation is primarily the product of past decisions. Similarly, the future will be largely the product of what is done now.

It takes time for fiscal policy and monetary policy to take hold. We will need a period of balanced, reduced growth to turn the forces of inflation, for throughout much of the economy, supply factors (labor and material costs) keep pressure on prices for some time after demand pressures ease.

Economic restraint cannot be successful if it is applied only intermittently. This is the lesson of the recent past. We need now a further, gradual slowing of the rate of economic expansion in the months ahead if we are really to bring inflation under control. Failure by the Senate to act favorably and quickly on H.R. 12290 will result in either more inflation or too heavy reliance on monetary restraint—and a loss of confidence by persons at home and abroad in the seriousness of our Government's determination to bring an orderly halt to inflation.

It is crucial in the months ahead that we continue the coordination of monetary and fiscal policy that we have had since the first of this year. Only if a fiscal program is adopted that will keep these policies in concert for the current fiscal year, are we likely to have a balanced and reasonably even slowing of growth rates across major sectors of the economy.

The question has been raised as to why the President's tax program is necessary in view of the projected budget surplus of $6.3 billion for fiscal year 1970. The answer is that there would be no surplus unless there is an extension of the surcharge, for the extension would produce $7.6 billion in receipts. Without the surcharge extension, we would shift from the surplus we are now running to a deficit—a strongly expansionary move that is clearly not appropriate in the current economic environment. It would also be inappropriate in that it would shift the Federal Government from being a net supplier of funds to being a net demander of funds during the full course of the fiscal year, which would put an additional burden on the Nation's financial markets at a time when they are already under heavy pressure. Thus, the President's tax program will provide the fiscal restraint that is synonymous with responsible economic policy.

This Administration has no desire that the income tax surcharge be extended a day longer than is necessary. The proposed reduction of the surcharge on January 1 is in line with the President's intention to propose complete elimination of the surcharge as soon as military and economic conditions permit.

In our budgetary planning for fiscal year 1971, we will take this intention into account. It will provide a brake on the growth of the budget in that year. The restraint that characterizes the 1970 budget cannot be regarded as transitory. It will also characterize the 1971 budget.

In coming years, the Nation will be facing a whole new set of problems and challenges. In that environment, we will be constantly reevaluating our priori-

ties and reallocating resources. To have a healthy economy growing at a reasonable, sustainable, and noninflationary rate, and to protect the dollar at home and abroad, we must maintain prudent and responsible economic policies. The appropriate first step was taken in the coordination of fiscal and monetary policy toward the end of last year; and the second step was the $4 billion reduction of expenditures in the 1970 budget; the third step should be the passage of the President's tax program, including continuation of the surcharge. Only in this way, can we have a well balanced mix of monetary and fiscal policy.

Failure to adopt the President's tax program runs the risk of boom and bust at home and deterioration of the value of the dollar both here and abroad. Stop-and-go economic policy has never worked in the past—in this country or anywhere else; there is no reason to expect that it would work in the period ahead.

I urge your early support of H.R. 12290 to provide the restraint needed to return the economy to balanced and sustainable noninflationary growth.

The CHAIRMAN. Thank you.

This morning with the agreement of the committee, I would prefer to start the questioning at the far end of the desk and work up. I want to call on Senator Byrd of Virginia for 10 minutes.

Senator BENNETT. We are under the 10-minute rule?

The CHAIRMAN. Yes.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Mayo, the figures that you submit deal entirely I believe with the unified budget?

Mr. MAYO. That is correct, Senator Byrd.

Senator BYRD. May I get from you, so that I can get a clear understanding, some figures which will reflect the budget outside of trust funds. Let me put it this way. Could you give me the receipts and outlays for the trust funds for the years that you have indicated here, 1965 through 1970?

Mr. MAYO. I happen to have them right in front of me for 1968, 1969, and 1970, Senator, and I will get the others in a moment.

Senator BYRD. Thank you.

Mr. MAYO. For the trust funds, let us take the current year first, if you don't mind. I cited, a figure of $192.9 billion for outlays for the unified budget, which is the way the books are kept. That consists of Federal funds outlays, Senator Byrd, of $153.7 billion and trust fund outlays of $47.1 billion.

The receipts on the Federal funds approach are $149.4 billion as our current estimate, $57.7 billion for trust funds. This means then that the $6.3 billion budget surplus indicated for this year, if the President's tax program is approved, consists of a deficit in the Federal funds of $4.3 billion and a surplus in trust funds of $10.6 billion.

Senator, would you like to have me read the same figures for the other years?

Senator BYRD. I would like for you to put the other figures if you will, Mr. Mayo, in the record, because I don't want to take the time now.

Mr. MAYO. I will be glad to.

Senator BYRD. If you will submit for the record the figures going back including 1965.

Mr. MAYO. Yes, sir.

Senator BYRD. On the same basis.

(The information requested follows:)

FEDERAL FUNDS AND TRUST FUNDS—RECEIPTS AND OUTLAYS, FISCAL YEARS 1965-70

[In billions of dollars]

	1965 actual	1966 actual	1967 actual	1968 actual	1969 estimate	1970 estimate
Receipts:						
Federal funds	90.9	101.4	111.8	114.7	141.7	149.4
Trust funds	29.3	33.1	43.1	44.7	52.4	57.7
Intragovernmental	−3.5	−3.7	−5.4	−5.8	−7.5	−8.0
Budget	116.8	130.9	149.6	153.7	186.5	199.2
Outlays:						
Federal funds	94.8	106.5	126.8	143.1	150.2	153.7
Trust funds	27.1	31.8	36.9	41.5	42.9	47.1
Intragovernmental	−3.5	−3.7	−5.4	−5.8	−7.5	−8.0
Budget	118.4	134.7	158.4	178.9	185.6	192.9
Surplus or deficit (−):						
Federal funds	−3.9	−5.1	−14.9	−28.4	−8.6	−4.3
Trust funds	2.2	1.3	6.2	3.2	9.5	10.6
Budget	−1.6	−3.8	−8.8	−25.2	.9	6.3

Note: Totals may not add due to rounding.

Senator BYRD. Am I correct that the expenditures for the what do you call it, the Federal budget——

Mr. MAYO. The Federal funds.

Senator BYRD. The Federal funds, which is the old accounting method, the expenditures for 1968, fiscal 1968, were $135 billion, is that right?

Mr. MAYO. I have a figure for fiscal 1968 of $143.1 billion. The figures that I read earlier were all for fiscal 1970, and that was $153.7 billion.

Senator BYRD. What do you have then for expenditures, outlays for fiscal 1969 on the old accounting method?

Mr. MAYO. $150.2 billion.

Senator BYRD. What do you estimate for 1970 on that basis?

Mr. MAYO. $153.7 billion.

Senator BYRD. You estimate an increase then of only $3 billion, a little less?

Mr. MAYO. Yes, $3.5 billion.

Senator BYRD. An increase of $3.5 billion. Let me see if I understand that now. Then you estimate your expenditures on the Federal budget basis for 1970 will be $3.5 billion more than 1969?

Mr. MAYO. Yes, sir.

Senator BYRD. $153.5 compared with 150?

Mr. MAYO. Yes.

Senator BYRD. May I ask this, Mr. Secretary. If the surtax, 10-percent surtax, were continued through December 31, and then the entire surtax program were discontinued, how much revenue would be obtained from the surtax during that 6-month period?

Mr. MAYO. To work backward, the figure for the entire year, 10 percent through December and 5 percent through June yields $7.6 billion. I would defer to Mr. Cohen as to what it would yield if it expired December 31, which I take it is your question.

Senator BYRD. Thank you, that is correct.

Mr. COHEN. Yes, it would yield in $5.6 billion if continued until

December 31, 1969, as contrasted with $7.6 billion if continued until June 30, 1970. It would yield $2 billion less.

Senator BYRD. Then may I ask this question. The 10-percent surtax would bring in $5.6 billion between now and December 31, if it is continued for another 6 months at 5 percent it would bring in, the total would be 7.6?

Mr. COHEN. Yes.

Senator BYRD. Fiscal year 1970, so it is a difference of $2 billion. You could obtain the same result, could you not, by reducing your expenditures by $2 billion and bringing the surtax to a termination date on December 31?

Mr. MAYO. Theoretically yes. This is possible, and I am not one to say that we have exhausted all channels of cutting Federal spending. We believe, however, Senator Byrd, that in proposing a budget of $192.9 billion for the fiscal year 1970, we have proposed a budget which is at a prudent minimum. We feel that although further cuts could be made in that budget, the area in which those cuts could be made is becoming increasingly limited just by the passing of time. We are already in the fiscal year, and the number of items that are readily controllable gets narrower and narrower.

Senator BYRD. Be that as it may, you can achieve the same results in regard to helping to bring inflation under control by reducing expenditures by $2 billion as you can by increasing or continuing your 5-percent surtax for 6 months, which produces the equivalent of $2 billion.

Mr. MAYO. In terms of dollars that is correct, Senator. I think there is another point though, that should be made here, the psychological impact. The President having indicated the necessity in his mind of a continuation of the surtax at least at half speed during the second half of the year, a termination of the surtax on December 31, despite any further cuts in the budget that we could achieve, would be broadly interpreted as a defeat for inflation control.

Senator BYRD. I don't quite follow that theory, why it should be interpreted as a defeat, when you are accomplishing the purpose by reducing expenditures rather than increasing taxes.

Mr. MAYO. Yes.

Senator BYRD. You could do this whole thing, assuming you could reduce expenditures by $7.6 billion, you would not need the surtax; would you?

Mr. MAYO. I am speaking of two facets of the problem, Senator Byrd. On the first you are quite correct, in dollar equivalents; that is correct. There is no argument about that.

The other facet though, that I believe is important, is the psychological factor throughout the world of an earlier termination of the surtax. I say that with the recognition that a termination of the surtax on December 31 would be a definitive event. The question of cutting budget expenditure, even if we were to announce an equivalent cut, I think would be, as the lawyers say, not free from doubt until later into the year, as it became apparent whether we were actually able to do this or not.

Senator BYRD. Are you firm in your conviction that the surtax will not be, that you will not recommend a continuation of the surtax after July 1 of next year?

Mr. MAYO. I certainly hope that we won't have to recommend it.

Senator BYRD. Of course we all hope that, but are you firm in your conviction that you will not recommend a continuation of the surtax?

Mr. MAYO. From the Budget Director's standpoint, if we are so unfortunate that the inflation is not brought under control, and Vietnam is still continuing at a high level, I am not sure that I can sit here today and tell you that I would not recommend it. But at the moment I am firm in my conviction that it won't be necessary next year.

Senator BYRD. Let me ask you this. You have in your statement that the NOA for fiscal 1970 is $211.4 billion minus 5.5?

Mr. MAYO. Yes.

Senator BYRD. Which you have reduced it, making it in round figures $205 billion NOA.

Mr. MAYO. Right.

Senator BYRD. Are you firm in your conviction that that figure can be adhered to?

Mr. MAYO. Well, yes. I am firm in my conviction that that can be adhered to, if the Congress acts in accordance with the President's budget requests. If the Congress, on the other hand, increases NOA for a large number of items, the achievement of that $5.5 billion reduction becomes somewhat more difficult.

Senator BYRD. What I guess I am really getting at is this. That the $5.5 reduction that you contemplate, you feel that is a realistic reduction?

Mr. MAYO. Oh, yes, sir.

Senator BYRD. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Mr. Chairman. In your statement, Mr. Secretary, you say that you feel the best credit in the recommendations of the administration is the investment credit which will produce a revenue increase of $1.35 billion in fiscal year 1970 and more than $3 billion in annual revenue in later years. Does that mean that you look forward then to the continuance of the policy of not having investment credit?

Secretary KENNEDY. We propose a complete and final termination of the investment credit.

Senator FANNIN. In other words, you feel that the problems we have in competing with the other countries of the world, do not make it necessary to have the investment credit again?

Secretary KENNEDY. I think, Senator, conditions have changed. There has been tremendous building of plant and improvement of capacity and equipment, and our problem now is a different allocation of our basic resources. We do have a long-run problem of competition in world markets. Our labor costs are relatively higher than the other developed countries. Thus, we have to have the most modern plant, the most modern equipment which needs capital, and we have to have an economy to produce the capital.

An important aspect of trade competition is that other countries, particularly European countries in the Common Market area, have a different form of taxation, which gives them an advantage from a tax standpoint. The investment tax credit does not solve this kind of a problem.

In reviewing our whole tax structure, at some point we must consider what could or should be done in our tax system to make us competitive with other nations. The investment tax credit is not a viable solution to this problem.

Senator FANNIN. There perhaps is another vehicle that could be used?

Secretary KENNEDY. Yes, there are other ways of doing that job better, particularly since a large part of the investment tax credit does not go to those segments of business that are engaged in world competition.

Senator FANNIN. Do you feel that some program of that nature will be proposed in the near future?

Secretary KENNEDY. We are taking a careful look at this whole question of world trade, trying to break down barriers, not only tariff but nontariff barriers. We are studying the incentives that the other countries utilize as compared with ours, particularly in the tax field. However, this is a very difficult area, and I do not think it should be part of the tax reform package to be done this year.

Senator FANNIN. I am concerned because if something is not done, finished goods import may continue to increase much more rapidly than our finished goods exports. I do not know exactly what the percentage increase has been in the past, but I know it has been substantial.

Secretary KENNEDY. It has been a very substantial increase, and it is largely a result of the inflation we are experiencing in the last few years here. In an economy growing at 4 or 5 percent a year, which is a more sustainable rate of growth, imports tend to reflect about that kind of an increase.

In the kind of inflation we have had, our imports have gone up 23, 24, 25 percent on an annual basis, and that is a pretty high increase that cannot be sustained.

Senator FANNIN. And the only incentive you have had so far has been this investment tax credit?

Secretary KENNEDY. The incentive there was more long run than merely to modernize our plants and equipment for purposes of exports.

Senator FANNIN. I understand that. It is to offset the import side. What I am concerned about is whether our ability to compete will be reduced because the investment credit has been dropped, or will it be enhanced?

Secretary KENNEDY. In my judgment at the present time, it does not assist us. In the long run we have got to take a look at other devices.

Senator FANNIN. There are so many of our industries that we are supporting with this investment credit which are seemingly able to do a better job of competing. They have made their long-range projections. With that in mind, although of course we have changed the credit, I was just wondering if you did have any thought in mind. I hope that you do pursue the investment credit program, because I think we are in a very precarious position as far as competing with some of these other countries.

Secretary KENNEDY. Your point is well taken.

Senator FANNIN. Thank you.

The CHAIRMAN. Senator Harris?

Senator HARRIS. Mr. Secretary, you mentioned on page 2 of your statement that during 1969 there has been an annual rate of increase in inflation on consumer prices of 6.1 percent, and wholesale prices at a rate of 6.3 percent, and then you ask for the extension of the surtax to try to hold that rate down. I take it that you feel that the reason why the extension of the surtax would hold the rate down is that it would take more money out of the economy and help build up a governmental surplus? Is that basically why it would?

Secretary KENNEDY. Yes. It would reduce at least the Government's part in increasing inflationary pressures further. If we have a deficit and have to borrow more money in markets that are already congested, then we are pushing inflation rather than preventing it.

Senator HARRIS. Aside from the rather obvious question of how important the extension of the tax is to hold down inflation, would not your position be served just as well by a temporary extension of the surtax? In other words, you are not asking for anything new here that we did not have during the past years. As a matter of fact, you are asking for less. You are asking not for the full 10 percent, but 10 percent for 6 months and 5 percent for 6 months thereafter. This is not a new attack on inflation, it is a continuation of the same with a little less. Is that not so?

Secretary KENNEDY. Not with less, Senator, because we have the investment tax credit ending in about——

Senator HARRIS. I want to ask you about that also, but from a surtax standpoint.

Secretary KENNEDY. From the surtax standpoint I think you have to include the investment tax credit because the termination of the investment tax credit helps balance the revenue when we cut down the surcharge from 10 to 5 at the end of the year.

Senator HARRIS. I am for the repeal of the 7-percent credit. I was for it a week before the administration was.

Secretary KENNEDY. It is continuing the same tax burden really.

Senator HARRIS. That is right.

Secretary KENNEDY. That was in force a year ago, and my point which I wish to emphasize, is that the Government should not reduce taxes in an inflationary period which would be the result if we let this expire.

Senator HARRIS. You of course are asking——

Secretary KENNEDY. We would like to continue the same tax burden.

Senator HARRIS. You are asking for a reduction in the surtax. The full 10 percent for the first 6 months and 5 percent the second 6 months.

Secretary KENNEDY. Precisely.

Senator HARRIS. You postulate the last 6 months of the fiscal year will allow that kind of reduction?

Secretary KENNEDY. For the full fiscal year as I indicated we have approximately the same tax burden as before, because of the repeal of the investment tax credit. Our proposal provides for an orderly phase-out of the surtax which no one wants as a continuing proposition. The surtax is not the best way to carry forward a permanent tax system, and that is why I want to see it phased out at the earliest possible time. But at this time I think it would be too much of a blow, too much pressure on inflation to have it totally ended at this early date.

Senator HARRIS. The House has already passed the repeal of the 7 percent investment credit. The Finance Committee as you know has voted for the same position and adopted the House date by majority vote. Now if we just extended the withholding as we are presently doing, would not that have the same kind of fiscal effect that you are asking for?

Secretary KENNEDY. Dollarwise it does, Senator. It does not psychologically, because there are bets on the market that the surtax will not be extended and that this will be refunded.

Senator HARRIS. Is that what has caused this 6 percent increase in price generally in 1969, the thought that we may take off the withholding?

Secretary KENNEDY. No, I think it is a combination of factors. For several years we have had an increasing amount of inflation. We have had a tremendous budget deficit a year ago of $25 billion, and I think we are paying the price now of that kind of fiscal mismanagement.

Senator HARRIS. What precisely is causing the inflation, Mr. Secretary? Is it a too heavy demand on the money market?

Secretary KENNEDY. Well, it is an overuse of our resources, labor and materials to borrow money. There is also an inflationary psychology that has developed over this period of time, where people instead of waiting have decided they had better move now to build their plant or to buy anything they want, because the price will be higher later on.

Senator HARRIS. I think you would say there are about three ways you can go about doing something about inflation. One would be in the fiscal field.

Secretary KENNEDY. Right.

Senator HARRIS. That would be either through spending or increased taxes. The second would be in monetary policy, such as an increase in the discount rate and so forth. Third would be price controls. I think you do not foresee recommending wage and price controls in the immediate future?

Secretary KENNEDY. No, I am opposed to wage and price controls as a principle and as a matter of administration. It is very difficult to administer. I think what we need is a balanced fiscal and monetary program. I do not think any one will do the job alone.

Senator HARRIS. You have knocked out wage and price controls, so leave that for the moment. Go back then to interest rates or monetary policy. It seems to me that interest rates have arrived at a really outrageous and scandalous level. The attitude of the financial community, which is partially reflected in your testimony here, sounds like don't throw me in the briar patch, that if you don't do something on the fiscal side, you will require us to raise the interest rates more, which is an awful thing for us to contemplate.

Now did the administration oppose in any way privately or otherwise, the last increase of the interest rate; and if so, what was the outcome of your recent meeting with bankers in that regard?

Secretary KENNEDY. You mentioned a lot of things here.

Senator HARRIS. Take the interest rates and what the administration position is on that.

Secretary KENNEDY. I made my position clear on interest rates. I think that they are high, at the highest level since the Civil War. They

reflect the heavy demand for credit that we have seen. We have had to put too much pressure on the monetary policy side and not enough on the fiscal budget side. Budget and fiscal policy have gotten out of hand. With the result that too much pressure was exerted on the interest rates. I do not think that setting interest rates at a given level by regulation or otherwise is the solution in light of these pressures.

Senator HARRIS. Do you feel nothing can be done?

Secretary KENNEDY. Something can be done. I think that you could pass this tax bill, and I think that we can cut budget expenditures and continue monetary policy at about the present level. Once the public gets the message that we do mean business in controlling inflation, interest rates can quickly react ahead of the general movement of the economy as we have seen in the past.

I have said that I don't think that the banks can ration their credit by interest rates alone because of the inflationary pressures. I think just to create the money to validate all the commitments that have been made would create an inflationary situation that we could not stand; so you have to cut credit back. You have to have a way to bring it down.

Senator HARRIS. Do you think that we——

Secretary KENNEDY. We may have to move to voluntary credit restraints. We may have to move then to more severe restraints.

Senator HARRIS. As a matter of voluntary credit restraints in addition to interest rises——

Secretary KENNEDY. That is right.

Senator HARRIS. Are you opposed to interest rises? Have you made that clear to the bankers?

Secretary KENNEDY. I have not said "Thou Shalt Not." I have no legal or——

Senator HARRIS. You have some moral suasion it seems to me?

Secretary KENNEDY. I may have used a little of that, I do not know.

Senator HARRIS. Lastly spending and taxing of course are the other elements. Senator Byrd has talked about doing something on the spending side. As far as increasing your revenue, would not tax reform measures, which would bring in additional revenues, have the same dollar or fiscal effect as the increase in the surtax to the degree that they were the same?

Secretary KENNEDY. That is correct dollarwise, provided you can obtain sizable additional revenues through tax reform. However, when people say tax reform they generally mean tax reduction, not tax increases.

Senator HARRIS. I take it the administration though is going to recommend some tax reform that would bring in additional money in substantial amounts by the August recess.

Secretary KENNEDY. Not in substantial amounts, it is about a balanced program.

Senator HARRIS. Not in substantial amounts?

Secretary KENNEDY. No.

Senator HARRIS. That is all I have.

The CHAIRMAN. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Secretary, some critics of the 10 percent surtax claim it has failed of its purpose. They point to the record of higher and higher

prices and interest rates. What would happen, Mr. Secretary, if this bill were defeated? You had a very narrow squeak in the House. What would happen if this bill were defeated?

Secretary KENNEDY. I think we would be in very serious economic condition. We have an inflation that is very pervasive and very strong. We have an inflation that has to be brought under control. Defeat of the bill would be a step in the wrong direction, because it would put the Federal Government on the side of encouraging inflation.

To offset that we would have to move to other areas. One, of course, would be stronger monetary policy—that transfers the pressure to that field which has taken about all the pressure it can take at the present time. We would move our economy from one of a free market economy over to a completely controlled economy. I don't think the public wants that.

Senator JORDAN. Are you suggesting that if this bill fails, we might have to look to wage and price controls?

Secretary KENNEDY. My view is we have got to bring inflation under control and we would have to take such actions as would be necessary to accomplish this objective. If we should move to controls, we, of course, would review all alternatives, and in that context wage and price controls, in my judgment, would have to be considered.

I repeat that I am not advocating them because I do not think that they work. They build up black markets and effect all kinds of bad allocations of resources.

Senator JORDAN. Do you think that we can have full employment and zero inflation?

Secretary KENNEDY. Depending on what you mean by full employment. Relatively full employment; yes. There is a movement of labor back and forth for seasonal purposes and other things.

Senator JORDAN. There is an irreducible floor there of say 3 percent?

Secretary KENNEDY. Some percentage. I do not think in this period of changing technology and limited supply of labor in the technological fields that we can continue to grow at the same pace because we have been overusing our resources. Moreover, I think that the full employment concept tends to have an inflation bias. I think that we ought to find a way to utilize our labor force so that we can operate on a sustainable growth basis. I am impressed by the fact that we have large numbers of our people that need to be trained and need to move over into the skilled or semiskilled fields to add to the force there.

Senator JORDAN. What do you regard as a tolerable limit on inflation?

Secretary KENNEDY. Well, I would like to reduce it to the level we had in the 1960-64 period. There, of course, we had a 1- or 2-percent increase of prices, but if you consider the price increase due to improvement in products, there was a relatively stable price level. I think we could return to that kind of stability and that is where I would like to go.

Senator JORDAN. From the present level of the rate of about 6 percent, what reductions do you anticipate in the next year if this tax bill is adopted?

Secretary KENNEDY. Shortly, a reduction in the rate of price increase, but not down to the levels we were talking of unless we were

to cause heavy unemployment which is not part of our program. Our program is to slowly, persistently, and continually pull inflation down. I also think that we would see the signs of effectiveness of the program in various business indexes ahead of the price movements. Prices tend to go up even when business is tending to go down, and we are maybe seeing a little of that now. It would be the end of the year or early next year when I would expect to see the rate of increase of prices start to move down.

Senator JORDAN. Mr. Mayo, under our present tax structure, what is the amount of the annual increment that we can expect for an increase in receipts without a change in the tax rate?

Mr. MAYO. With a high level of employment, Senator Jordan, this could run in the area of $12 billion a year or thereabouts. I have used a figure on occasion as high as $15 billion for 1972 or 1973, but this requires that we have a high level of employment.

Senator JORDAN. What do you mean by a high level, under 4 percent?

Mr. MAYO. Oh, you mean in terms of unemployment?

Senator JORDAN. Yes.

Mr. MAYO. Yes; I think that is a fair statement. It depends on its composition and so forth, but I am talking of an economy that is going fairly close to capacity, but is not going over capacity.

Senator JORDAN. All right, in terms of industrial capacity, what do you regard as being a reasonably full use of the industrial capacity of the Nation?

Mr. MAYO. Well, there are statistical measures of industrial capacity which are still quite crude, and I hesitate to put much reliance on a digit. We are only in the 80-percent area now, but it is a peculiar combination of circumstances. In recent years, we have gotten as high as 91 to 92 percent using that measure of capacity, but as I say, I do not put a great deal of reliance on the measure, because these are figures that are quite nebulous.

Senator JORDAN. What I was getting at, Mr. Mayo, when you calculated that the annual increment to our receipts is likely to be in the order of $12 to $15 billion predicated on a level of unemployment not to exceed 4 percent we will say and a level of plant capacity usage of approximately 90 percent?

Mr. MAYO. Well, roughly in that area. I would put it the other way around, that it would visualize an increase in real production in this country of 4 percent or so a year. If you had 1 to 2 percent for what you might call a normal increase in prices, as the Secretary mentioned. you do have an increase in gross national product that I think would sustain 12 to 15. Of course that would grow, if you pick 1980 it would obviously be a bigger figure.

Senator JORDAN. It would compound from year to year?

Mr. MAYO. Oh, yes; that is right. I would hasten to add that we also have built-in increases in the other side of this budget of ours for social security benefit increases just because there are more people 65 years and older who are eligible for benefits. This is true on so many different Federal programs. There are increases in Federal spending because of other elements of workload increase. and one of the things that plagues us on this inflation cycle is we have to have pay increases

in the Federal Government for pay comparability with private industry. Our raise just the other day cost us close to $3 billion. So these are in the area of offsets to 12 to 15.

Senator JORDAN. Yes; the 4 percent growth in constant dollars then is not altogether free from offsetting factors on the other side?

Mr. MAYO. That is true. Spending will be rising because of these more or less automatic factors, Senator, so you have not the 12 to 15 as a nice little fiscal dividend that you can allocate without considering the spending side.

Senator JORDAN. Thank you.

The CHAIRMAN. Senator McCarthy?

Senator MCCARTHY. Mr. Mayo, I note in your testimony that you use the position taken by President Johnson's January recommendation on the surtax. Why not the recommendation taken by Mr. Nixon during the campaign which was that he would repeal it?

Mr. MAYO. Senator McCarthy, I believe that President Nixon's position was always one of fiscal responsibility with regard to the surtax, and that his statements have urged from the very beginning that he did not want to see the surtax continued any longer than was necessary for defense and economic reasons.

Senator MCCARTHY. As I recall it was an issue between him and the Democratic candidate, the one saying he would have to continue but Mr. Nixon saying he would not. Did you advise him on that?

Mr. MAYO. I was not involved in the advice; no.

Senator MCCARTHY. Both you and Secretary Kennedy said that is not the best tax. If it is not the best tax, you must have in mind one that would be better for these purposes?

Secretary KENNEDY. Senator, I would seek an orderly phaseout of this surtax that is on the books now.

Senator MCCARTHY. What is so wrong about it?

Secretary KENNEDY. Well, it was a temporary tax put in just for an emergency situation.

Senator MCCARTHY. You recommended the excise tax be continued. These are temporary. All taxes are temporary I hope.

Secretary KENNEDY. I am not sure of that.

Senator MCCARTHY. You change them around but no particular one has to remain. Taxes are more or less permanent but not particular taxes.

Secretary KENNEDY. Yes.

Senator MCCARTHY. What would be the better way to raise the revenue, if you had a choice right now? If you could rewrite it and administer it, what would you like?

Secretary KENNEDY. I would continue the surtax for the period we have recommended and then see what revenues could be raised by tax reform.

Senator MCCARTHY. Let us assume when this temporary tax runs out we still need $7 or $8 billion more per year, what would you recommend?

Secretary KENNEDY. I would have no recommendation at this time on that.

Senator MCCARTHY. Meaning full reform?

Secretary KENNEDY. I think on the reform package you would take a look at wherever you could get revenue that is needed.

Senator McCARTHY. Do you have any recommendations about capital gains?

Secretary KENNEDY. We have a number of recommendations which we have already announced and we have a number of proposals under consideration.

Senator McCARTHY. Of any significance I mean. It would amount to $9 or $10 billion in revenue let us say. I know you have recommendations that amount to $100 million perhaps, but not anything significant.

Secretary KENNEDY. Not at this time.

Senator McCARTHY. You would let it stand pretty much the way it is?

Secretary KENNEDY. At the moment; yes.

Senator McCARTHY. Say we can cut taxes with reference to split income, which is I think the great inequity in the tax program, do you have any views on that?

Secretary KENNEDY. Mr. Cohen will answer that.

Senator McCARTHY. We are talking about inequities now, not justice necessarily. You cannot do much about justice. We can do a lot about inequities.

Mr. COHEN. Senator, we do have under consideration recommendations with respect to single persons, particularly those who maintain their own households, because we think there is an inequity that requires consideration in the relative burden on single persons. I do not think that we have in prospect at the moment any recommendation for change in the joint return provisions that have been in effect since 1948.

Senator McCARTHY. Not taking them away but perhaps extending rates to people who are single?

Mr. COHEN. Yes; to certain categories, such as those persons who maintain their own household, or as has been suggested, those above a certain age, such as age 30 or age 35.

Senator McCARTHY. Thirty-five?

Mr. COHEN. Thirty-five is the one that we have under consideration.

Senator McCARTHY. Thirty. You are giving that some thought?

Mr. COHEN. Yes, sir.

Senator McCARTHY. Mr. Kennedy, assuming that we do not extend the surtax, what action could you take, if the threat of inflation is as great as you say it is? I assume you would have to take some action. What authority do you have or is there existing in the Federal Government, the Federal Reserve and in the Treasury or in other areas, authority that you might use to try to bring about a better balance in the economy? Obviously the Federal Reserve could raise interest rates.

Secretary KENNEDY. They could make credit even more scarce.

Senator McCARTHY. Would you recommend that?

Secretary KENNEDY. I think they are carrying as heavy a burden today, Senator, as they should be required to carry, and I think it is putting a lot of pressure on various segments of our market.

Senator McCARTHY. They could cut back the money supply, could they not?

Secretary KENNEDY. They are doing that. They are cutting down on the money supply, through an increased rate of about 2½ percent.

Senator McCARTHY. Do you recommend more of that?

Secretary KENNEDY. Not at the present time. I think if you do not pass this bill, then we have to take another look at various controls.

Senator McCARTHY. What about credit controls? What authority is there available now by way of direct credit controls that are not being used?

Secretary KENNEDY. In the direct end, of course, the Federal Reserve can change reserve requirements, increasing them. They also can do more in the way of discount rate changes.

Senator McCARTHY. That is indirect.

Secretary KENNEDY. However, the Federal Reserve Board has no authority to regulate consumer credit. They have to get authority to do that. They have no authority to control various individual lines. They would have to ask for that.

Also, if you get into a voluntary system of credit controls, I think it may be necessary to obtain an exemption for a temporary period from certain antitrust laws.

Senator McCARTHY. If you are reduced to choose between wage and price controls and direct credit controls, which would you prefer? Which would you ask for?

Secretary KENNEDY. It is a Hobson's choice; neither choice is good.

Senator McCARTHY. I know that.

Secretary KENNEDY. I don't know which one I would ask for if such dire circumstances arose. I would have to consider it. I think it is really unthinkable that we would have to turn to that kind of an alternative where we have the power of the Congress——

Senator McCARTHY. Where do you think the greater pressure is coming from now, from wages and profits, from dividends, or from the expansion of credit?

Secretary KENNEDY. It is coming from a combination, Senator, but most of it from credit. Look at the increase in credit; it has been terrific over the past several years, both the Federal Government trend and the private trend.

Senator McCARTHY. If you want to get closer to the root, then, rather than deal with wages, profits, and prices, you would, I suspect rather deal with the credit which is the more immediate force; is it not?

Secretary KENNEDY. Yes. It depends on how effectively you can do any of that and get the kind of an economy that we want. A good share of the wage increases, of course, has been in the bu'lding trades where there has been an overbuilding of plants. There is just not enough labor to go around. The prices in the building trades and the building wage settlements have been fantastically high.

Senator McCARTHY. Thank you very much.

The CHAIRMAN. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Mr. Secretary, in fiscal 1968, I believe, the Federal Government incurred a deficit of upward of $25 bill on.

Secretary KENNEDY. That is right.

Senator MILLER. And in years previous to that there were substantial budget deficits. Do you have any figures or do any of your people there have any figures as to how much this total Federal deficit has amounted to over, let us say, the last 8 years?

Secretary KENNEDY. Yes; we can give you that, Senator. Do you have it, Mr. Mayo?

Mr. MAYO. Yes. Taking the period, Senator Miller, starting with—how far would you like me to go back, 1961?

Senator MILLER. Starting with fiscal year 1961.

Mr. MAYO. In fiscal 1961, we had a budget deficit of $3.4 billion, in 1962——

Senator MILLER. Do you have the tabulated total, say, running through fiscal year 1968?

Mr. MAYO. I can add it up: $4.4 billion for 1963, $5.9 billion for 1964, $1.6 billion for 1965, $3.8 billion for 1966, $8.8 billion for 1967, and do you want me to include the $25.2 billion also for 1968? Slightly over $60 billion.

Senator MILLER. And how about adding on fiscal 1969?

Mr. MAYO. Fiscal 1969 we expect to have a small surplus.

Senator MILLER. In other words, roughly, we have got a $60 billion budget deficit for that per'od. Now, how much of that deficit had to be financed by the Federal Government going out into the money market?

Mr. MAYO. A very substantial part of it was so financed. We have a Treasury bulletin. The debt held by the public during that period increased from $237 billion at the end of fiscal 1960 to——

Senator MILLER. I believe we have started with fiscal 1961.

Mr. MAYO. Yes. Well, I am taking the end of 1960 to the beginning of this period; $237.1 bill'on to the end of fiscal 1968, when it was $290.6 billion. That is an increase of $53.5 billion.

Senator MILLER. So for the $60 billion of deficit the Federal Government had to go into the money market to the extent of $53 billion?

Mr. MAYO. Some small part of this was Federal Reserve which is included in these figures. The rest of it was in the money market or savings bonds or one way or another.

Senator MILLER. Now, Mr. Secretary, would that not have caused a tremendous amount of competition by the Federal Government for money from the private citizens and private business?

Secretary KENNEDY. Precisely. The Federal Government has to compete in the money market with all other users of funds; yes.

Senator MILLER. Would that not have had a substantial bearing upon the increase in interest rates that we have been bothered about?

Secretary KENNEDY. It has a disproportionate share, particularly in periods of tight money, like now. Over the whole period when money was fairly free, it had, of course, less of an impact, but it did have some.

Senator MILLER. In fiscal 1968, had that budget deficit of $25 billion——

Secretary KENNEDY. It would have an effect.

Senator MILLER. I assume that had a very great impact on the competition for money?

Secretary KENNEDY. That is correct.

Senator MILLER. And would you say that the Federal Government's competition for money as a result of these budget deficits, plus inflation—which means that people who loan their money are actually concerned about being repaid in cheaper dollars—are the main reasons for the unusually high interest rates that we are suffering from today?

Secretary KENNEDY. That is right.

Senator MILLER. Now if this 10-percent surcharge is not continued rather promptly, do you believe that this would aggravate the inflationary psychology that exists in this country?

Secretary KENNEDY. Very seriously; yes.

Senator MILLER. If the Congress does rather promptly continue the surcharge, and also does a pretty good job of controlling Federal spending generally in line with the administration's policy, is it your position that the inflationary psychology will begin to die down and the inflation problem and the high interest problem will begin to die down and go out?

Secretary KENNEDY. That is right.

Senator MILLER. If we do not do this—that is, either if we do not continue the surcharge and work on the tax side of the ledger, or if we do not do a job in controlling Federal spending—is it your expectation that we are in for another financial crisis such as we had about a year and a half ago, in which we had to reach an agreement with some of our international monetary authorities so as not to draw down our gold supply any further?

Secretary KENNEDY. I think it would be more serious now, Senator, because it is more aggravated. We are in a more difficult position. It has been going on for a longer period of time, and the rates of inflation are increasing, so it would be a more difficult time interval.

Senator MILLER. I believe a number of us were told last year that we were not out of the woods on this financial crisis, that we had temporarily bridged the gap when the Congress enacted the surcharge and the $6-billion-expenditure reduction. I seem to recall that we were warned that the international bankers and other monetary authorities overseas would be watching very carefully to see whether or not we were going to continue to keep our fiscal house in order, and it is your opinion that they are continuing to keep a sharp eye on that; is that so?

Secretary KENNEDY. That is correct. I have had a number of contacts with them myself and Under Secretary Volpe just got back from a trip abroad where he met with a group of them. They feel that if we go ahead with the tax program, the budget program, the monetary restraint program that we have, we are charting the right course. Today there is confidence in what we are doing. The question in their minds is whether we have the will and the ability to carry forward these programs. If we do not, then I think we will be in the same problem or more difficult problem than they were in 1966.

Senator MILLER. When you say there is the question of whether we have the will, I take it that that means whether the Congress has the will?

Secretary KENNEDY. That is right.

Senator MILLER. Now, in your statement you indicated that the transition roles with respect to the repeal of the investment tax credit were reasonably equitable but that they went as far as they should go.

Secretary KENNEDY. That is right.

Senator MILLER. I am thinking of a situation where a business has, before the April 18 deadline, made or negotiated a fixed-price contract with one of the Federal Government agencies, and in the negotiation of that fixed-price contract it was understood by both parties that the 7-percent investment tax credit was going to continue.

Now if Congress, which is another arm of the Federal Government, comes along and repeals that investment tax credit, does it not seem to you that the Federal Government has come along and undercut the understanding that existed in making that fixed-price contract and that perhaps a transitional rule in that particular case should be allowed too?

Secretary KENNEDY. I will turn that question to Mr. Cohen, if I may.

Mr. COHEN. Senator Miller, the administration recommended to the Congress when we presented the proposals to the House of Representatives that the only exception to the rule be made for binding contracts for the purchase of equipment. There is great difficulty knowing at exactly what point one should cut off the investment credit. We finally accepted in the Ways and Means Committee generally the same provisions that had existed in the 1966 suspension. Several new situations which were comparable to those rules were added, but without changing the fundamental thesis.

Now if you go down this path too far, you do not know exactly where to stop, because everyone has plans that to some extent took into account the allowance of the investment credit. Without knowing more about the facts of the case you posit, I cannot tell how analogous it would be to some of those that had been taken into account in previous years. We have had exceptions where the contract in question represented substantially the entire output of the company, and where the plans had been specific and the amount of the equipment that was to be bought could be identified.

On the other hand, many businesses could have a fixed-price contract that might cover many years.

Senator MILLER. I understand that there are different situations, but my real question is this. When the contract is made with the Federal Government itself, and the Federal Government comes along after that contract has been made, and through the actions taken by the Congress undercuts the understanding that existed at the time the contract was made, does not that seem to be sort of an abridgement of contract on the part of the Federal Government which ought to be covered by a transitional rule?

Mr. COHEN. Senator, at the same time we are recommending reducing the surcharge and the business could not clearly tell whether it would be subject to the surcharge or not subject to the surcharge. So you would have to take into consideration a number of factors.

Senator MILLER. The only thing that concerned me was that the Secretary has indicated an almost absolute cutoff limited to what the House has done. There is no question but what there is some controversy over what the House has done on transitional rules, and I would suggest that there might be a little controversy over whether there were some transitional rules that might have been overlooked. I would hope that the Treasury Department might keep an open mind in the event a really inequitable situation arose.

Mr. COHEN. I can assure you we would keep an open mind, Senator, because some things may be analogous to the rules that have been adopted, and some might extend it too far, but we would certainly view it with a open mind.

Senator MILLER. Thank you. My time is up.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. Thank you, Mr. Chairman.

Mr. Secretary, I want to compliment you on your statement about the need for tax reform. I think it is long overdue. I think the American people expect it. In fact, I think they demand it, and I hope the Finance Committee can insure at least some practical reforms in this bill, before it goes to the floor of the Senate.

I am somewhat concerned as I am sure most people of America are, about our abnormally high interest rates. We know the prime rate is 8½ percent. The reports I get from many of my constituents indicate that in many instances capital is not available at any rate of interest, and then when it is available, they usually require some compensatory balance that brings the true interest rate to something on the order of 10 percent or even 11 percent.

My question is this. Do you think there is any chance that these abnormal monetary policies, together with an extension of these high tax rates, may result in an overkill and throw this country into a serious recession or depression. I ask that question in light of some of the reports that I see indicating there is a slowdown in our economy, a lessening of profits, a rising rate of unemployment, not only in this country but in Europe and other parts of the world at the same time. They state that is the first time that a slowdown has occurred in this country and in Europe simultaneously since the conclusion of World War II. I would like to have your reaction to that.

Secretary KENNEDY. My own view, Senator, is that there is very little danger of an overkill or a serious recession in this movement. I think a real danger is on the other side, overexpansion, further increases. I think that basically we have a very strong economy. There is great demand for everything. New products are on the drawing board and are actually on the assembly line. We are in a world of high expectations rather than in a time when there was defeatism.

There is need for capital all over the world. At the same time when they talk about a turnback in Europe and a reduction here, surely we should have a reduction from the kind of overinflationary policies we have had. That is where the reduction is coming, not from a matter of recession or heavy unemployment. Germany, for example, is now faced with an overexpansion and an inflationary situation. They are trying to cool their economy. Some of the other countries are faced with a turndown, but generally speaking as far as I can see there is no serious concern of a turndown among the ministers of finance or the central bankers of the world.

Senator TALMADGE. I read in the morning paper where yesterday you met with some 25 to 30 bankers. Did they indicate what their views would be or what their actions might be with reference to increasing the prime interest rates?

Secretary KENNEDY. We had a meeting at Treasury yesterday with the 25 largest banks in the country, where we were discussing the problem of inflation, and what should be done in this inflationary environment, both in the banking system and in the corporate, municipal and various business fields.

Now they recognize, as we do, the importance of the Federal Government's role in budget control, requesting that we cut budget ex-

penditures even further realizing the heavy burden on monetary policy.

I was concerned as to whether some parts of our economy, such as small business, were under too severe pressure now, and I was encouraged by the fact that the large banks each have a committee dealing with the problem.

Senator GORE. A what?

Secretary KENNEDY. A committee of senior officers that meet daily on the use of funds in every credit category, even if the credit is A-1. They consider whether they have the money for a particular loan.

Senator TALMADGE. In other words, they are rationing credit?

Secretary KENNEDY. They are rationing credit and they gave figures of cutbacks as high as $1 billion since the first of the year in total credits that have been turned down. These committees do not have to approve smaller credits of under a half million dollars; rather the lending officer has the authority in those banks to make the smaller credits. Well, that is encouraging, because if they put the small ones to the same test we might be creating pressure on the small businesses, too heavy a pressure there. The indication was that they are making those smaller loans without regard to monetary restraint.

On the question of interest rates, I indicated as I had earlier that in this inflationary period of escalating interest rates, they could not and should not rely solely on interest rates to ration credit.

They are under pressure, of course, from the commercial paper market. This financing is outside the banking system and is not controlled by the Federal Reserve, and those rates get pretty high. As the rate equals or exceeds the prime rate, those credits will bend to the commercial banking system, and they are all accounts of the major banks. This is one of the factors that caused the increase to 8½ percent recently and we gave a great deal of consideration to the problem yesterday.

Senator TALMADGE. Am I to understand then, Mr. Secretary, from your answer thus far that they have no present intention of increasing the prime rate further?

Secretary KENNEDY. It was not indicated that they had any intention of increasing the prime rate.

Senator TALMADGE. I read also recently in some publication that the tax take now, local, county, State, and Federal has gotten to 36 percent of the income of the people of the country. During the height of World War II it was only 28 percent.

Secretary KENNEDY. That is correct.

Senator TALMADGE. While we were fighting a world war. It is some 8 percent higher than it was in World War II. How much higher can taxes go? How long can they stay as high as they are without destroying the private sector of our economy?

Secretary KENNEDY. Taxes, of course, Senator, are a burden and there is a limit on how far they can go. I would not be presumptuous to say that they are at the limit that we can afford to pay for what we want and desire if the public will accept the burden.

Senator TALMADGE. I have one further question, and perhaps this should be addressed to Secretary Cohen.

As you know you are recommending the repeal of the investment credit and I think Congress is going to do it and I think it should

be done. But I have also read other articles where you are considering raising the depreciation schedule as a compensatory matter in that regard. Would you enlighten us on that?

Mr. COHEN. Senator Talmadge, we have undertaken to review depreciation policy as a part of our study in the light of the President's directive to us to make a thorough review of all the tax laws and to report back to him before November 30. We thought that this was in order because it is an extremely important phase of the income-tax structure.

We did not, however, undertake this as a compensation for the investment credit. We indicated at the hearings on this bill on the House side that there was no intention to invoke some liberalization of depreciation provisions the moment the investment credit went off, but we do intend to have a thoroughgoing review of it, and we may make recommendations to the Congress with respect to it later on.

Senator TALMADGE. Would you make recommendations for legislation or couldn't you do it administratively? That is the way it was done during the Kennedy administration, was it not?

Mr. COHEN. We are considering both of those alternatives. In the depreciation revisions made in 1962, the principal change was in regard to the useful life. The indications are that in general the useful lives have been reduced as far as they can be in the light of the test in the statute of useful life.

There are some changes that we think could be made administratively, but there may be other changes that would require a statutory revision. In any event, I advised the Ways and Means Committee on the House side that we would inform them beforehand of any changes of a major nature that we propose to make administratively, and we would, of course, do the same thing to the Senate Finance Committee.

Senator TALMADGE. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

The CHAIRMAN. The Chair recognizes the senior Senator from Illinois.

Senator DIRKSEN. Mr. Chairman, I would like to direct a question to the Secretary.

Mr. Chairman, I would like to have you listen very carefully, because the timetable begins to not only intrigue me but it begins to concern me some. The old preacher in Ecclesiastes said there was a time for every purpose and a season for everything.

Now I note, Mr. Chairman, in your statement this morning that you expressed the hope that those who had tax reform proposals should submit them by the 18th of July, so they could become part of the committee print, and then it would be your purpose to hold the hearings on the committee print, so that all Senators, and I presume all others who might be interested, would have a free and open chance to testify. Is that substantially what you have in mind?

The CHAIRMAN. Yes.

Senator DIRKSEN. Now, of course, it is difficult to say how many witnesses there will be and how long it will take, but when the witnesses have completed their testimony, it then becomes necessary to sort of finalize everything and put it in form for the committee, and then prepare for a markup of the bill. That is the usual custom. Now

that may take a little time, because comment has a way of getting chewed up here in legislative laws.

What I am thinking about, Mr. Chairman, is that the official late summer recess, which the leadership agreed on in January, will begin at the end of business on August 13. There will be that period from August 13 to September 3 which the Senate will not be in session, so that regardless of what committee may do, they can sit if they like and they can take testimony, but there will be no Senate action of any kind until the day after Labor Day. That will be the 3d of September.

Mr. Secretary, that is taking us pretty deep into the year 1969, and I am thinking in terms of urgency here. I fully appreciate the problem which confronts the chairman of the committee, and I know also that he has to be properly responsive to the hopes and the desires of the policy committee on his side of the aisle, so I just wanted to get a reading here as to when we are likely to get a tax bill, and how deep this is going to go into this fiscal year. We are in a new fiscal year now.

The CHAIRMAN. I think the question was directed as much to the chairman as it was to the witness.

Senator DIRKSEN. It was.

The CHAIRMAN. So I will try to answer it. It seems to me that we should keep in mind, and I personally favor it, that this is a reform bill as well as a revenue bill to begin with. There are two kinds of reform. One involves tax relief to someone whom we think is paying too much taxes. Now the administration puts its own tax reform into the bill recommending relief to low-income taxpayers. The bill also has a reform that some of us think is justified in the current circumstances to repeal the investment tax credit. Now that is a reform in terms of making someone pay more taxes. So those would be probably the two big items. Whether we embellish them or modify them dollarwise I think they are likely to be two of the biggest items in the reform package anyway.

Now this committee and this Senate does not operate under a closed rule as does the House. Any Senator can offer his proposals. The Senator from Indiana; for example, has informed us that he is going to offer his version of what the social security laws ought to be as an amendment to this bill and we had better be ready to vote on it because he is going to insist on a vote, and we have no power to prevent it.

Senator Harris over there has a proposal for a minimum income tax on favored taxpayers. He thinks they ought to pay something. It has been drafted. He has a proposal he proposes to offer. He may change it around a bit between now and then but I suspect we will vote on it. Notwithstanding that, it will be my hope that we could report this bill before the 1st of August from this committee. Maybe we cannot, and if we cannot, then we will just report it as soon as we can, at least by the first week in October, and hope to pass it with a week of debate. But if it is possible I would hope we can report this bill by the 1st of August or some time within the first week in August.

Senator DIRKSEN. Mr. Chairman, I would utter the hope that it might be reported before that time, and considered by the Senate before that time. But when you have a committee bill obviously the sky is the limit as to the number of amendments and proposals that will

be offered, and so we will be confronted with the old story that we are coming forth with a Christmas tree, all the good things are on it, and of course that is going to take time. You cannot dispose of those just overnight or in a summary fashion either in the committee or on the Senate floor, but August 13 is our deadline that has been fixed, and it is rather immutable and we either get in under the wire or we go over until after the 3d of September.

Now then, you still have another problem. There are not only two Houses around here, there are three. The conference committee is the third house. Obviously there are differences, and then it must go to conference, and I know from past experience that it has required time to work a bill out of the conference committee and get it back to the House and Senate floors for final approval.

So, Mr. Secretary, we will be later and later here. Meanwhile the inflationary fever continues to strike its fitful flames into the economy.

Secretary KENNEDY. I think it is urgent, Senator, and we must move. As the chairman indicated, we would move aggressively on this as we must move.

Senator DIRKSEN. I felt that the timetable ought to be explored a little, and if anybody else wants to put in on this discussion he may do so. But we owe it to the country, we owe it to business and industry, and we owe it to the committee to at least charter our course a little and see about where we expect this, and all of this is of no avail unless it gets on the books, and book law and forceful law.

Secretary KENNEDY. There is great uncertainty in the public mind.

Senator DIRKSEN. I would gather so.

The CHAIRMAN. I will be happy to discuss the procedure with the minority leader of the Senate, the Senator from Illinois. He certainly has a heavy responsibility and I realize the problem.

Now as far as this chairman is concerned, he will seek to cooperate in trying to move as rapidly as we can.

Senator DIRKSEN. May I say the chairman always has cooperated.

The CHAIRMAN. I am satisfied that we are doing what we ought to be doing today. Maybe we will want to change our proposed schedule at a later time, and I will be glad to consider any suggestions that someone might offer. It was my hope, however, in the statement that I made, that it would help us to expedite procedure because we were hopeful to avoid witnesses coming and testifying to something that they just take off the tops of their heads. We would like to see something in writing that Senators would like to see done in terms of an amendment actually drafted. Don't let someone just testify vaguely on his general theory of taxation and things of that sort. The whole purpose here was to try to expedite these proceedings. I would hope that we can report this bill this month, but if we cannot do it, then I would hope that we would move as rapidly as we can.

Now that is something that the committee will have to decide. The chairman cannot do it for the committee. It is a matter for every Senator to think about and see what we can do.

If we cannot report prior to the end of July then certainly we will have to ask for another 30 days at a minimum. I would imagine the House would cooperate in passing another extender if need be to continue the withholding rates until such time as we can act on this bill.

Recognizing how the House insists on its prerogatives to initiate revenue bills, and recognizing also that some people object to a Christmas tree bill—not that I do particularly—I always thought a Christmas tree bill was a little bill that would pick up amendments; this would be a big bill picking up amendments. It is a big enough horse to carry almost any rider I would think, and if the Senators wanted to they could offer anything except a constitutional amendment on this bill.

Senator Gore?

The CHAIRMAN. As the Senator knows, I withheld calling on him prior to this time at his request.

Senator GORE. Either way is all right with me.

The CHAIRMAN. Go ahead.

Senator GORE. Mr. Secretary, the hearing this morning and the events of the past few days leave me greatly disturbed. Earlier in the year I urged President Nixon to recommend repeal of the investment credit and extension of the surtax. I announced my support in that regard, but I must say your inaction and the President's inaction in abandoning responsibility for the monetary policy of the country shakes me.

I guess I have been characterized by a bit of stubbornness in the Senate. I have been leaning toward consistency. I do recall that Emerson said that consistency was the hobgoblin of little minds. But I am about to suggest to you that the inaction of the administration in any realistic steps to bring inflation under control and to stop the disastrous spiral of interest rates shakes me in my view as to the rectitude of my position in supporting this bill.

I do not know the cure. From what you have said and what the President has said, and what neither of you has done, leads me to the conclusion that the only real cure for the runaway monetary policy now in effect is to put another Harry Truman in the White House.

Now, no one can tell me that the interest rate structure of this country cannot be controlled. Roosevelt and Truman did so through two wars, but I find now an utter abandonment of responsibility in the executive branch for the monetary policy of the country—the very idea of meeting with a group of top bankers and leaving to them the responsibility of controlling inflation.

They are promoting inflation, Mr. Secretary, in the interest rate structure.

I know what interest rates do to me and to my small business. It causes me to raise prices, the only way we can keep our doors open. When our interest rate on what we carry, to carry stock, to carry accounts, is raised from 5 to 9 percent, we have no choice but to raise prices. Attempting to control inflation by raising interest rates is like throwing gasoline on a fire.

So you shake me as to whether I am taking the right course in supporting this bill, and unless you shake yourself out of your indolence and do something about inflation and high interest rates——

Senator BENNETT. Mr. Chairman, I object to the use of this kind of language. This man is our guest, and I think he should be treated with respect.

Senator GORE. Mr. Chairman, I am not attempting to show any disrespect. I would apologize if I had done so. I am talking about policies

of the Government or the lack of policies, the lack of action. One small business after another is headed for bankruptcy. Bankers in my State tell me that many people are coming in for extension of their loans and they must increase the amount of their note in order to pay their interest. This is the route to bankruptcy for thousands of small businessmen.

Secretary KENNEDY. Is it your suggestion, Senator, that monetary policy be eased and that they validate these commitments and permit the expansion to go ahead? Is that your program?

Or is it your program to foster additional controls to direct the credit not only in the banks but in other places? In other words, setting up a complete credit mechanism as we did in the World War period?

Senator GORE. Mr. Secretary——

Secretary KENNEDY. We are in a free market economy. We are suggesting programs here and policies that will bring inflation under control consistent with our free market economy. We are suggesting that the Congress act responsibly and keep the tax burden where it is in a period where it is needed. We recommended that early in the year, immediately after taking office.

Now we have to decide whether ve are going to have a system of Federal regulations up and down the line, either voluntary or forcibly, or whether we permit the market system to function on a supply-and-demand basis. I think that is the crucial question we have to decide. The reason we are in the present situation, as I see it, is that we have been creating too much credit, spending too fast. Unfortunately, the Federal Government through its large budget deficit of a year ago and the previous years of budget deficit contributed more than its share to the situation we are in.

Senator GORE. Do you advocate a laissez-faire policy?

Secretary KENNEDY. I advocate an open and free market policy. We do have some regulations. We have reserve requirements on banks. We have a Federal Reserve system that is charged with the responsibility of handling the availability and the cost of credit.

However, the Federal Reserve's tools are for a general market situation and not for specific controls. We have not moved into specific controls, but if the inflation continues as indicated, we may have to move in that direction.

Senator GORE. Mr. Secretary, would you please indicate precisely what action either you or the President has taken to prevent the rise in interest rates? This is not disrespectful. I want to know what has been done, if anything has been done, and if nothing has been done, why?

Secretary KENNEDY. The reason interest rates are where they are is the fact that we have been going too fast and we have to slow the economy down. It is not just a question of fixing an interest rate. It is a question of supply and demand. There are many rates outside of the banking system. Look at what has happened in the money markets, the Federal borrowing, public borrowing, all interest rates have gone up. They are all at high levels. For instance, we paid the highest rate on Treasury bills the other day that we have paid in history.

Senator GORE. You just made a statement that we have to slow the economy down.

Secretary KENNEDY. That is right. That will turn the corner on interest rates pretty fast.

Senator GORE. What have you done to slow the economy down?

Secretary KENNEDY. The budget has been cut and we are recommending to you that you take action on the surcharge.

Senator GORE. Extending the surcharge?

Secretary KENNEDY. That is right.

Senator GORE. We have the surcharge tax now. That has not prevented acceleration.

Secretary KENNEDY. Yes; but the effect of that was offset by prior commitments and by the effect of monetary policy after the tax passed, in the latter part of last year.

Since the first of the year monetary policy has been restricted, budget cuts have been made, and we have recommended that the surtax be extended.

Senator GORE. Then the only thing you——

Secretary KENNEDY. And I think those are the orthodox, the normal ways of handling inflation as most economists will tell you.

Senator GORE. The only thing you have said that either you or the President has done then is to recommend this bill. Is that the sum total of the actions you have taken to control inflation and to prevent the rise in interest rates?

Secretary KENNEDY. I did not say that. I said we have cut budget expenditures and monetary policy has been restricted to control inflation; three things—taxes, budget cuts, monetary policy.

Senator GORE. What have you done about monetary policies?

Secretary KENNEDY. It is restrictive.

Senator GORE. What do you mean by that?

Secretary KENNEDY. Credit is not being provided or the money supply is not being increased to validate all the commitments and demands that the economy has. The money supply has been increasing since the first of the year at about 2 to 3 percent.

Senator GORE. Does restrictive monetary policy——

Secretary KENNEDY. Compared to the previous rate of 7, 8, or 10 percent.

Senator GORE. Does restrictive monetary policy include the raising of interest rates?

Secretary KENNEDY. That is a function—it is a result of the other actions.

Senator GORE. I know, but you said that one of the three things——

Secretary KENNEDY. We have no authority to fix interest rates.

Senator GORE. If I may proceed, you named three things.

Secretary KENNEDY. We have no authority to fix the rate of interest.

Senator GORE. Then what authority do you have with respect to restricting monetary policy?

Secretary KENNEDY. Reserve requirements, open-market operations.

Senator GORE. Do you have that authority?

Secretary KENNEDY. No; that is in the Federal Reserve. That is part of the Government, and we have been consulting with the Federal Reserve continuously over this period, and it is consistent with the policy of the administration of controlling inflation.

Senator GORE. You have yourself testified to the eloquent failure of policy when you say that interest rates are now the highest since the

Civil War. I say to you, Mr. Secretary, that this is a path to bankruptcy for hundreds of thousands of small businessmen.

Secretary KENNEDY. You should have been thinking of that, Senator, a couple of years ago when expenditures and the budget were getting out of control.

Senator GORE. Mr. Secretary——

Secretary KENNEDY. We are paying the price now of past sins.

Senator GORE. That is hardly appropriate for me because I opposed the tax reduction bill in 1964. It seemed to me an utterly——

Secretary KENNEDY. I was speaking generally of the Congress, Senator, not of you personally.

Senator GORE. Well, thank you. I appreciate that.

Secretary KENNEDY. I was thinking in terms of the whole Congress.

Senator GORE. If I have made any reference——

Secretary KENNEDY. I do not know what your voting record has been.

Senator GORE. I understand. I accept that. If I may have made any comments that in any way cast any personal reflections on you or were in any way disrespectful to you, I apologize.

Secretary KENNEDY. Thank you.

Senator GORE. I certainly did not have that in mind. I am deeply concerned. I announced my support of this bill, but now the inaction of the administration in these two fields shakes me, and I just may not support it unless you can give me some indication of some willingness for the use of power of the people's Government to bring this economy into order. It is wildly out of order and it is dangerous.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. Mr. Secretary, I shall vote for this bill.

Secretary KENNEDY. Thank you.

Senator CURTIS. To extend the surtax and to repeal the investment credit. I hope I have an opportunity to do so rather early.

Mr. Mayo, I want to ask you a question or two about your statement.

Mr. MAYO. Yes, sir.

Senator CURTIS. I have read your statement as well as Secretary Kennedy's statement. On page 2, the table you have, in reference to the deficit for fiscal 1968, $25.2 billion, does that take into account trust funds?

Mr. MAYO. Yes, sir; it does.

Senator CURTIS. If it disregarded trust funds, what would the deficit be?

Mr. MAYO. I believe $28.4 billion, Senator.

Senator CURTIS. There was about a $3 billion-plus surplus in trust funds?

Mr. MAYO. That is right, Senator Curtis.

Senator CURTIS. Do you regard those trust funds as available for general expenditures of Government?

Mr. MAYO. Those trust funds as individual trust funds are invioable. In the construction of a unified budget we feel that, despite this fact, allocation of resources by the Federal Government must take into account what is paid out of the trust fund just as what is paid out of Federal funds. The highway fund is a good illustration.

Senator CURTIS. I agree the question of trust funds, receipts and expenditures should be called to public attention, so that we know

what the total picture in Government is. I also think that it has an impact on the matter of inflation or deflation.

Mr. MAYO. Yes.

Senator CURTIS. But when we have done that, I do not think that we are justified in including trust funds which show that there is an absence of a deficit in the general operating expenses of the Government.

Now, I would like to ask you about the estimated surplus of $0.9 billion for 1969. Does that include trust funds?

Mr. MAYO. The deficit would probably be about $8.6 billion, there being a surplus of $9.5 billion in trust funds.

Senator CURTIS. So this table, then, that you have incorporated does not disclose the fact that so far as the general funds of the Treasury, so far as the taxes imposed to pay the general cost of Government, there will be a deficit of over $8 billion in fiscal 1969?

Mr. MAYO. As you defined it, that is correct.

Senator CURTIS. And your statement does not show that.

Mr. MAYO. It does not show that. I am very happy to give you those figures. We feel the emphasis, though, in terms of looking upon the budget as an instrument of economic policy and fiscal policy is better constructed, Senator Curtis, to include both the Federal funds and the trust funds facets of it, with no attempt to hide the detail, but merely to simplify the presentation and eliminate the reason that we had to have a budget commission on concepts in the first place—we had three concepts in use, and people were using each of the three depending on what they wanted to prove. We wanted to get away from that.

Senator CURTIS. Now you have estimated a surplus of $6.3 billion for fiscal 1970?

Mr. MAYO. Yes, sir.

Senator CURTIS. If you disregard trust funds, do we have a surplus or do we have a deficit and, if so, how much?

Mr. MAYO. We would have a deficit of $4.3 billion, there being a surplus of $10.6 billion in the trust funds.

Senator CURTIS. What is the bonded debt now?

Mr. MAYO. The debt of the United States at the present time is in the neighborhood of—do we have to update the figure? This is the June 30 figure for total debt subject to the limit is $356.9 billion.

Senator CURTIS. You raised my hopes, Mr. Secretary, momentarily. When I read your statement, I assumed its accuracy and we were going to have a $6 billion surplus. We could then pay off the debt in 60 years. But if we operate forever like we propose in 1970, we will have a bonded debt of about $618 billion in 60 years. I doubt very much that it is in accord with the Budget Act of 1921. The Budget Act of 1921 says the estimate "shall be included in the budget estimated expenditures and proposed appropriations necessary in the judgment for the support of the Government."

Mr. MAYO. Yes, sir.

Senator CURTIS. For the ensuing fiscal year. And it was not intended as a document for economic theory or control.

Secretary Cohen, I would like to ask you something about the investment credit. I voted against it. I think it was subsidized inflation.

I am interested in having a full measure of justice in the phaseout. Would you explain to us how the recapture provisions work for someone who disposes of property upon which he has obtained the investment credit?

Mr. COHEN. Yes, sir. Under existing law the credit is given in full at the rate of 7 percent of the cost of the property, only if the property has a life of 8 years or more. If it has a life of between 6 and 8 years, it is given on two-thirds of the cost, and from 4 to 6 years it is based upon one-third of the cost of the property. If it has a life less than 4 years, there is no credit allowed, so the taxpayer in effect has to establish what the useful life of the property is and that it is at least 4 years. If he establishes that it is more than 8 years, he gets the full credit.

The problem arises where a person estimates, for example, a life of 10 years for property, and then disposes of it 1 year after he purchased it. If he bought a $100,000 machine, existing law would give him a credit of $7,000, but if he disposed of it 1 year later, which was less than the 4-year minimum period, the recapture provisions would require him to add to his tax for this following year the $7,000 that he had saved in the earlier year.

Senator CURTIS. I do not have too many constituents that buy $100,000 machines. I do have some that maybe buy a $10,000 machine. If they bought a machine in the early part of this year or last year of $10,000 they have a tax credit of $700.

Mr. COHEN. Yes, sir.

Senator CURTIS. We will say it was last year.

Mr. COHEN. If it had an estimated life of more than 8 years.

Senator CURTIS. Yes; we will assume 10 years.

Mr. COHEN. 10 years, yes.

Senator CURTIS. Suppose that man is a farmer. He buys a machine for $10,000. He takes the tax credit of $700. Next year, because of age or physical disability, he leaves his farm and he sells the tractor. How much will he have to repay to the Federal Government by reason of having obtained a $700 tax credit or investment credit?

Mr. COHEN. If he took the investment credit this year and then he retired next year?

Senator CURTIS. No; I put it last year, because this year it is presumably different.

Mr. COHEN. If he sold the equipment in less than 4 years after he bought it, he would have to repay the entire $700.

Senator CURTIS. Yes. So if this happened to a farmer in 1968, he bought a $10,000 tractor, took the $700 investment credit this coming year, because of age or failing health or otherwise he has to stop farming and he sells it, and only 2 years elapse and we will assume the tractor had a life expectancy of 10 years, he would have to repay the full $700.

Mr. COHEN. Yes, sir; that is right.

Senator CURTIS. Now suppose that he had an operating loss in the year he sold his tractor. Will he still be billed for the $700 recapture, I mean the $700——

Mr. COHEN. I think he would be billed for the recapture of the tax. On the other hand, the operating loss could be carried back 3 years, and

he could get a refund of income taxes paid in the prior years, which might offset the recapture.

Senator CURTIS. If he had an operating loss or if his income ceased he would have a carryback?

Mr. COHEN. For 3 years. He could offset it against taxes in the previous 3 years, and of course if he had any income in the following 5 years, he could also offset his loss. After he carried it back 3 years he could carry it forward 5 years.

Senator CURTIS. I think we are going to have some very real practical problems among small taxpayers in this regard, and I think that the total recovery to the Treasury is going to amount to not very much at all. It will have a greater nuisance value than it will a revenue value. In the area of farm machinery a salesman urges a farmer to buy a certain machine and points out what the investment credit is. A few years later he comes along and he says, "We have a new machine that is more efficient, has got more power, can do more things," and so there is a trade-in. The new machine has a greater investment credit, and so the farmer does not notice the fact that there is a recapture clause involved. But now when we come to the end of the road, it might be a very serious problem.

In the light of the fact that there won't be much revenue involved with these smaller taxpayers, it would be my hope that some attention might be given by the technical people on any easing of the phaseout period so far as the recapture procedures are concerned.

The CHAIRMAN. Senator Hartke.

Senator HARTKE. Mr. Secretary, Senator McCarthy asked you about your meeting yesterday with the bankers and as I understood your reply, you said that they did not indicate if there would be a further increase in the prime rate. David Rockefeller stated, and I give him some credence, that interest rates must still go higher and that the prime rate must increase. In your opinion at this moment, what are the real indications? Are they going to increase the prime rate or not? What is going to happen?

Secretary KENNEDY. My guess is that it will not increase, but I have no indication that someone along the line won't raise the rate. There is no——

Senator HARTKE. You have no assurances that they will not increase them, is that what you are saying?

Secretary KENNEDY. That is right, no one there indicated they were going to raise the rate, and no one said they could not raise the rate. We did not talk about that. I merely made the statement to them that they had better be looking into ways and means of rationing their credit without increasing rates, because interest rates did not seem to be reducing the demand.

Senator HARTKE. I did not hear that. I am sorry.

Secretary KENNEDY. I reiterated the statement that I made before the Banking and Currency Committee of the House, that I was of the opinion that interest rates alone in this present inflationary climate do not aid in rationing credit, and that they must find other ways within their own shops of rationing credit.

Senator HARTKE. Let us discuss interest rates for a moment. An increase in interest rates, whether artificial or necessary is a form of restraint.

Secretary KENNEDY. Yes; to an extent. Interest rates are high and some people will decide that they are too high and will defer or decline, so there is an element of rationing, but I do not think it is a serious one in the large business concerns that the prime rate covers.

Senator HARTKE. That is right.

Secretary KENNEDY. You have to bear in mind that the prime rate covers only the large national corporations or international corporations who have multiple loans in various banks.

Senator HARTKE. If interest rates go much higher we will have a banana republic style of interest rates; is that not true?

Secretary KENNEDY. Our interest rates are very high relative to others in the world today.

Senator HARTKE. That is right, and the point still remains that as of this moment you have no assurance whatsoever that they have hit their peak?

Secretary KENNEDY. That is right.

Senator HARTKE. All right. Now then, in line with that, is it your idea that this type of restrictive monetary policy should end?

Secretary KENNEDY. No; I think the monetary policy that is being pursued at the present time must continue for some time until we have dampened the inflationary pressures. Otherwise we have not turned the tide in the demand.

Senator HARTKE. In the past we assumed that the formation of monetary policy was the result of coordinated cooperation, in other words, you have four groups and they consulted with each other. Frankly sometimes we do not know what they consult about but they did consult. Are they in agreement now or is there a basic disagreement? It appears to me that the Federal Reserve Board is heading in one direction, and that the Treasury and the other parts of the administration are headed in another. The Federal Reserve Board is now going to continue to be more restrictive, and frankly even decrease the reserve requirements if necessary, to go ahead and continue their policies of increasing the amount of the negative reserve requirement, to go ahead with a reduction in the amount of the money supply, and also if necessary to increase interest rates.

Isn't that the policy of the Federal Reserve Board at the present time?

Secretary KENNEDY. The policy at the present time, Senator, is one of restriction. It is not an increase of restriction. It is carried forward at about the same level. I do not know of any discussion of further increases of reserve requirements by the Federal Reserve at this time.

Senator HARTKE. At this time?

Secretary KENNEDY. Yes.

Senator HARTKE. I understand.

Secretary KENNEDY. There is a question in their mind.

Senator HARTKE. Yes; I am not——

Secretary KENNEDY. If this tax bill does not go through.

Senator HARTKE. I am asking you whether or not there is a difference in opinion as between——

Secretary KENNEDY. The answer is, "No."

Senator HARTKE. There is no difference of opinion?

Secretary KENNEDY. No.

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Senator HARTKE. But the Federal Reserve Board does continue to insist upon keeping interest rates at this high level, do they not?

Secretary KENNEDY. They insist upon keeping credit restrained, and they do not say anything about the interest rate.

Senator HARTKE. You are a good banker and you know as well as I do that basically interest is the price we pay for money.

Secretary KENNEDY. Right.

Senator HARTKE. The price of that money is going to fluctuate with the supply and demand?

Secretary KENNEDY. Right.

Senator HARTKE. For the commodities; is that correct?

Secretary KENNEDY. That is right.

Senator HARTKE. And as a net result this policy then necessarily includes the Federal Reserve Board's ideas that interest rates will at least continue as high as they are, if not go higher. They are certainly not anticipating a reduction; isn't that true?

Secretary KENNEDY. That is right at the present time.

Senator HARTKE. In light of all of that, then, is there not really a difference of opinion, and isn't this really the source of the concern that the Treasury has exhibited and the reason that you have been meeting with these bankers is in an attempt to bring to their attention the fact that this country really cannot continue to operate with an increasing rate of interest? Isn't that true? Aren't you opposed to that? Aren't you opposed to an increase in the interest rates?

Secretary KENNEDY. I think that the interest rate at the present time is high and any further increases will not accomplish the rationing of credit that they desire. I think they have to do it otherwise.

Senator HARTKE. Would you actively oppose any further increase in interest rates?

Secretary KENNEDY. By "actively oppose," what do you mean, get up and say I don't like it?

Senator HARTKE. That is what some people do, you know.

Secretary KENNEDY. Oh, I know.

Senator HARTKE. It has been done by the Government in the past.

Secretary KENNEDY. What effect do you think that might have?

Senator HARTKE. Pardon?

Secretary KENNEDY. What effect do you think that might have, to get on a high horse?

Senator HARTKE. I am just asking whether you would or would not. I guess you are telling me you would not; is that correct? I am trying to get back to what some of us in Indiana call arithmetic, trying to find out just exactly what happened as things go on.

Senator GORE. Or the principle of laissez-faire.

Senator HARTKE. What I am asking you is this. Can I assume then, and I know it is a cardinal sin of anybody in Government to make any assumption, but can I assume that you would not take any active role in voicing your objections publicly against any further increase in interest rates? Is that a fair assumption?

Secretary KENNEDY. Well, I would reiterate the statement I previously made, that I see no reason for an increase in interest rates. I do not say that in an individual situation that whether it is a bank or whether it is another lender that they cannot increase their interest rates. They can. They are free agents.

Senator HARTKE. In your discussion you have indicated that you do favor the basic policy of rationing credit; isn't that true?

Secretary KENNEDY. Right.

Senator HARTKE. And you have just indicated a moment ago that in the question of high interest rates, that the big borrower really does not have to worry about that; does he?

Secretary KENNEDY. No. I think that they have a cost that enters the planning and all their decisions, but they can get money.

Senator HARTKE. That is right.

Secretary KENNEDY. They have various sources of money.

Senator HARTKE. That is right.

Secretary KENNEDY. Capital markets, money markets.

Senator HARTKE. And big government does not have any problem either; do they?

Secretary KENNEDY. They have problems, yes; but they get their money.

Senator HARTKE. My time is up.

The CHAIRMAN. If Jesse did not give you the note, Senator, you can go right on ahead.

Senator HARTKE. He gave me the note. Let me ask you; are we done?

The CHAIRMAN. We are making our first round under the 10-minute rule, and thereafter you can just ask all the questions you want to. We can come back at 2:30.

Senator HARTKE. I thought maybe Senator Dirksen had imposed his limitation on us.

The CHAIRMAN. He asked less questions than everybody. If you have other questions, go ahead.

Senator HARTKE. That is all right. I have several questions I would like to ask.

The CHAIRMAN. If you can come back at 2:30 you can ask all the questions you would like to ask.

Senator Fulbright, the most senior junior Senator in the Senate is now recognized.

Senator FULBRIGHT. Thank you, Mr. Chairman. I am very sorry that I could not be here earlier, but we had a committee hearing on Latin America, and I had to go there for a while.

Mr. Secretary, of course my constituents are extremely concerned. That is not news to you. They are extremely concerned about high interest rates and especially inflation. Some of them think that the high interest rates are in themselves inflationary. Would you comment on that?

Secretary KENNEDY. I think to some extend they are. At the same time, they are high because of a restrictive policy, and somebody is being shut off from credit through that restrictive policy. To that extent, it is deflationary.

Senator FULBRIGHT. So it does have an inflationary aspect, however?

Secretary KENNEDY. To some extent.

Senator FULBRIGHT. As long as they do make the loans, it does go into increased prices. I noticed in a Washington paper especially, but it has been true for several papers, that local banks, I believe the Riggs Bank, Suburban Trust, and several others, are reporting un-

precedented profits during this last quarter. What would be your view toward an excess profits tax comparable to the one put on during World War II to recapture for the Government these excessive profits due to this unusual situation, which really is a result of a governmental policy seeking to curb inflation? Would you support an amendment to this bill recapturing excess profits from banks or from other financial institutions?

Secretary KENNEDY. I do not know, Senator, just how much excess profits there are. Nor what is the definition of excess corporate profits. You would have to be in a period as we were in the war where they jumped up very substantially.

Senator FULBRIGHT. According to the morning paper, they have. I just read it a few minutes ago, as a matter of fact.

Secretary KENNEDY. If you are talking about the bank profits, the figures are starting to come in for the first half of the year. The large major banks of the country, the ones that are affected by the prime rate, they were up in the first part of the year, but in June they are down.

Senator FULBRIGHT. I do not want to argue whether they are up or down. Let me put a hypothetical to you. Assuming they are substantially higher than normal in this period, would you favor or would you oppose a bill, an amendment recapturing excess profits? Would you be for or against it?

Secretary KENNEDY. I would have to see what the bill did and what the definition of excess profits is.

Senator FULBRIGHT. I am giving you a hypothetical. You surely ought to be for or against it.

Secretary KENNEDY. I would be, I think, against it.

Senator FULBRIGHT. You would be against it. That is all I wanted to know. What is your view, Mr. Secretary, assuming this inflationary spiral continues, as it has in the last 6 months, toward wage and price controls, to prevent inflation, assuming these high interest rates do not bring down or stop inflation?

Secretary KENNEDY. I think if we do not have a control of inflation, we will have to look at other methods of control. Control of wages and prices will be one. You cannot have one without the other.

Senator FULBRIGHT. That is something that we used during World War II, is it not?

Secretary KENNEDY. Yes.

Senator FULBRIGHT. We are in a war now, are we not?

Secretary KENNEDY. We surely are.

Senator FULBRIGHT. Do you think, Mr. Secretary, that we really can control inflation so long as we spend $80 billion on making war and other military activities? This is not considered to be a very constructive or productive way to invest your money, is it?

Secretary KENNEDY. I think we can control inflation.

Senator FULBRIGHT. Do you?

Secretary KENNEDY. Yes.

Senator FULBRIGHT. How?

Secretary KENNEDY. Well, I think by having the Government take in more than its total spending and by the other methods of restraints.

Senator FULBRIGHT. Well, but you have no program that is going to bring this about, do you?

Secretary KENNEDY. I think the program we have advocated will bring it about, and I think it is bringing it about. I think it is starting to take hold. We see a few signs. They are very hazy and they are not very clear.

Senator FULBRIGHT. What are those signs? I would be very interested in that.

Secretary KENNEDY. The rate of GNP growth is subsiding. It has gone down some quarter by quarter. We are seeing some signs in the retail trade area. We are seeing it mainly in some of the municipal areas where deferrals have taken place. We are seeing a few now on the corporate side where they are making deferrals of activity, but it is not very clear.

Senator FULBRIGHT. What is the actual report from the Census Bureau with regard to the price index? Is it going up?

Secretary KENNEDY. On the prices they are up. There is no question on the prices.

Senator FULBRIGHT. They are continuing to go up. Is there any indication of a downturn?

Secretary KENNEDY. Not yet, no; on prices, no. In fact the pressure is the other way, Senator.

Senator FULBRIGHT. But I thought prices were the most significant index of inflation.

Secretary KENNEDY. But they fall.

Senator FULBRIGHT. What?

Secretary KENNEDY. There is a lead and a lagtime. Prices tend to go up after the rate of economic activity tends to go down, and I think we are in that crossroad period right now. My guess is that prices will tend to go [illegible] for a considerable period.

Senator FULBRIGHT. How long?

Secretary KENNEDY. Three to 6 months.

Senator FULBRIGHT. Further beyond now?

Secretary KENNEDY. That is right. Reduction in price increases will start to show up toward the latter part of this calendar year under the policies we are pursuing.

Senator FULBRIGHT. If I understand correctly, you would be opposed to an arbitrary ceiling on interest rates?

Secretary KENNEDY. Yes.

Senator FULBRIGHT. You have said that I thought.

Secretary KENNEDY. Yes.

Senator FULBRIGHT. But you believe that you can control the inflationary spiral, even though we continue to spend $80 billion on war?

Secretary KENNEDY. That is right, Senator, although I would like to see those expenditures reduced.

Senator FULBRIGHT. What?

Secretary KENNEDY. At the same time I would like to see those expenditures reduced, and I think that an effort is being made to reduce expenditures in the Defense Department.

Senator FULBRIGHT. Efforts are being made?

Secretary KENNEDY. Yes; and with some success.

Senator FULBRIGHT. Do you know what the current problem in the Senate is? An effort is being made to stop deployment of the ABM, which is a symbol; but the administration has not proposed a signifi-

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cant reduction in the Defense Department's budget this year. You are aware of that. Mr. Mayo, is that not correct?

Mr. MAYO. In our $4 billion of cuts in budget spending this spring, Senator Fulbright, there was a $1 billion cut in Defense spending. There was also——

Senator FULBRIGHT. Mr. Mayo——

Mr. MAYO. May I finish?

Senator FULBRIGHT. It all depends on where you started from. I mean there is no real cut, is it?

Mr. MAYO. Yes.

Senator FULBRIGHT. From what level?

Mr. MAYO. From $81.1 to $80.1 billion. That is $1 billion.

Senator FULBRIGHT. Didn't that consist of reduction in the number of flights by theh B-52's which really was an estimated cut in that—wasn't that it primarily?

Mr. MAYO. I understand there was some of that in the budget, and a cut of $1 billion. There were some other things that were more significant. There are two other points I should like to make. First of all, we cut budget authority requested for the whole Government by $5.5 billion, of which $3 billion is defense.

Senator FULBRIGHT. The authority for future commitments?

Mr. MAYO. Yes. This is what determines spending.

Senator FULBRIGHT. The expenditures for the coming year are still estimated at $80 billion approximately, isn't that right?

Mr. MAYO. Yes, that is correct.

Senator FULBRIGHT. In the fiscal year 1970 budget?

Mr. MAYO. Yes.

Senator FULBRIGHT. I do not mean to tax you, Mr. Mayo. I realize there have been many articles that the Budget Bureau has no real influence over the DOD. I would not for a moment suggest that you have not done your duty, because you cannot do anything about it. The only agency of the Government that can do anything about it is the Senate, and that is what we are presently engaged in. This is an effort to restrain the expenditure of another, anywhere from $6 to $12 billion estimated over the next several years in the form of ABM, and I am not taxing you with it, but I do think that you should admit that the expenditure of $80 billion on a nonreproductive activity, such as making war, is inflationary. Would you not agree to that?

Mr. MAYO. Yes, and you can be sure, Senator Fulbright, that we are doing something. You say we cannot do anything about it in the executive branch.

Senator FULBRIGHT. No, I did not say executive. I said the Bureau of the Budget has no real authority over the Defense Department.

Mr. MAYO. The Bureau of the Budget has the same relationship to the Defense Department—by a recent directive of the President as it has with any other agency.

Senator FULBRIGHT. Mr. Mayo, this is something very new then, because it certainly was not so up until the last week or so, was it?

Mr. MAYO. Oh, yes.

Senator FULBRIGHT. You have a very different procedure, with DOD than you do with all other departments. Last year Mr. Schultz was here sitting in that chair and I asked him if they had gone over the

research projects in the Department of Defense, and he said oh, no, and as a matter of fact the Budget Bureau does not have the same relationship. They do not come to you in the same way Agriculture and Treasury and others do. You go down to them, and you ask them for some document and if they do not want to give it to you, there is nothing you can do about it. I have had the same experience in the Congress. If they do not want to give you a document, you can go whistle for it, unless the President intervenes. Now isn't that so?

Mr. MAYO. I have found no difficulty getting any documents that I have asked for.

Senator FULBRIGHT. You are the first one, the first Director of the Budget who has ever had such experience since World War II.

Mr. MAYO. I just wanted to let you know I am trying.

Senator FULBRIGHT. All right. I wish you luck, better luck than we have had, because when they do not wish to give us a document, paid for by public funds, originated in either the Hudson Institute, or the Rand Corp., or the IDA, they just say, "No, this is an internal working document and it is not for your information." That is what they have done.

Mr. MAYO. I just want to be sure that you understand, Senator Fulbright, that the President has directed me to treat all departments equally in the budget process.

Senator FULBRIGHT. Has he directed the Secretary of Defense to respond to all your requests?

Mr. MAYO. Oh, he has a copy of the President's directive, Senator.

Senator FULBRIGHT. That is not a direct answer. I do not think he has.

Thank you, Mr. Chairman. My time is up.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. Thank you, Mr. Chairman.

Just for a minute I would like to get back to the purpose of the hearing, which is to consider whether or not we should pass the tax bill, whether that tax bill should contain simply revenue-raising provisions or revenue adjusting provisions or reform. Which in your opinion has the greatest priority, Mr. Secretary, the control of inflation or the writing of tax reform?

Secretary KENNEDY. I think that the urgent need right now is the revenue under the tax extension of the surcharge. At the same time we are pursuing tax reform and we will come up very quickly with that.

Senator BENNETT. Has anybody made a study of the gamut of proposed reforms to see whether they would have the effect of increasing or decreasing revenue, and if so by approximately how much?

Mr. COHEN. Senator Bennett, there are many proposals that would increase revenue and many that would reduce it. Mr. Mills said on the floor of the House in debate on this bill that reform legislation in his view would not be expected to net any additional revenue, because what you gain from one reform you would offset by reductions in other areas.

Senator BENNETT. So that that will contribute nothing on balance to the solution of the problem of inflation?

Secretary KENNEDY. That is correct.

Senator BENNETT. Has the problem of inflation increased in intensity in the last 6 months?

Secretary KENNEDY. Yes; I think it has, Senator. It has been a cumulative increase. As you will notice from the indexes of price increases, that the rate has been going up.

Senator BENNETT. And haven't we added another dimension which is the expectation of inflation to the actual economic results?

Secretary KENNEDY. We have a built-in psychology of inflation in the public mind, the consumer and the businessman.

Senator BENNETT. Are there any weapons which the Government has with which to fight inflation that it is not using or seeking to use?

Secretary KENNEDY. I am not sure on the answer to that.

Senator BENNETT. Are there any major weapons?

Secretary KENNEDY. No, not on the major ones. You get into the question of controls there, and whether you should be imposing controls at this stage. No one has decided that should be done at this stage.

Senator BENNETT. But that would be kind of a weapon of the last resort; would it not?

Secretary KENNEDY. In our kind of economy, yes. It does not work well. The administration of it is difficult. There is black-market buildup. You have a distortion of allocation of resources.

Senator BENNETT. We have had limited discussion here this morning about control of expenditures. We have also had a great deal of discussion about interest rates. I think I heard you say earlier that during the last half of last year the volume of the money supply was allowed to rise at a rate of about 8 or 10 percent a year. Did I hear correctly?

Secretary KENNEDY. I think that is right. Do you know?

Mr. WALKER. Closer to 7 percent.

Secretary KENNEDY. Seven percent.

Senator BENNETT. All right, let us say 7 percent, then. Holding that in abeyance for a minute, at what rate is the economy growing, if you take out the inflationary factors?

Secretary KENNEDY. About two and a half percent, 2.3 is the figure they gave me, but it is around 2½ percent.

Senator BENNETT. And the balance is inflationary?

Secretary KENNEDY. Right.

Senator BENNETT. Woud we actually increase the tangible production of the economy if we were to increase the money supply again so that the interest rates would return to what they were say a year ago?

Secretary KENNEDY. No; it would go into prices I think.

Senator BENNETT. It would go into prices?

Secretary KENNEDY. Yes.

Senator BENNETT. So in other words the classic rule exists, and if we were to try and take the pressure off interest rates by increasing the money supply, we would actually increase the inflation but not actually increase the tangible production of the country?

Secretary KENNEDY. It would be a disproportionate affair too. It would increase maybe even more than these exact amounts.

Senator BENNETT. Are there any reputable economists who disagree with your approach to the control of the inflationary cycle? Maybe that is a little bit too broad.

Secretary KENNEDY. That is pretty broad.
Senator BENNETT. I will change it.
Secretary KENNEDY. But I should say this. That a majority of the economists that we have talked to have endorsed generally the anti-inflation program, and quite a number have joined in asking for extension of the surcharge as an item of control of inflation.
Senator BENNETT. Is there any substantial group of economists, recognied and reputable, who offer an alternative solution to the control of inflation?
Secretary KENNEDY. I know of none. Do you, Dr. Walker?
Mr. WALKER. No.
Senator BENNETT. You have testified in answer to Senator Fulbright that you think these prices will continue to rise, but at a slower rate for another 3 to 6 months?
Secretary KENNEDY. That is right, and even after that there will be increases in prices, but the rate goes down, the rate of increase. We won't get down to zero.
Senator BENNETT. What is your goal in terms of control of inflation? If you reduce the rate of increase, at what level will you be satisfied or will you feel you have made progress? Are you hoping to cut it out completely?
Secretary KENNEDY. Well, it is at a level where you can get down to a sustainable basis of growth, and it seems to me that we have that longer period of the early 1960's where we had grown with stability of prices, that we should try to achieve, which is one-half percent or 2 percent of inflation, in that area, which with the increase value of products means that you have got a fairly stable level.
Senator BENNETT. If we continue to delay the passage of this bill, will this have a dampening effect or an increasing effect on this psychological factor we call the expectation of inflation?
Secretary KENNEDY. I think from a psychological standpoint that it would be very bad to delay, because it is not a question of whether the medicine will be stronger. It is a question of whether the bill will pass or not, and I think we should end that uncertainty, and let the public know that as far as the Federal Government's affairs are concerned, that they will be on a consistent anti-inflationary basis. In other words, our receipts will exceed our expenditures.
Senator BENNETT. Mr. Chairman, I appreciate the time. I have used eight minutes and I am happy to give you the rest back. Thank you very much.
The CHAIRMAN. Senator Anderson?
Senator ANDERSON. I have no questions.
The CHAIRMAN. I think I will avail myself of the opportunity and ask you one or two questions, Mr. Secretary.
I am one of those who believes with the David Kennedy concept of the Federal budget. I used to go down to the White House for those Tuesday morning breakfasts talking to the President and I urged the same consolidated budget concept that you recommended when you were part of a commission at the request of President Lyndon Johnson. I think you were chairman of that commission at the time, were you not?
Secretary KENNEDY. That is right.

The CHAIRMAN. If you look at the budget the way you suggested and the way I suggest, we are actually looking—assuming that we pass that bill before us—at a budget surplus of about $3.5 billion initially. What is the last count if you look at it from a consolidated budget point of view?

Mr. MAYO. The official estimate as of May 20, Mr. Chairman, was $6.3 billion. The Secretary's testimony today reduces that slightly for the changes that have been made in the bill passed by Ways and Means, but our figure is still $6.3 billion subject to those changes.

The CHAIRMAN. Looking at the bill the way it stands before us now, what do you think it would be?

Mr. MAYO. I believe we have taken $400 million off.

Mr. COHEN. 150.

Mr. MAYO. $150 million only? You have got the low-income thing, too. Isn't that $250 million?

Mr. COHEN. But the low-income allowance I believe has already been included in your May 20 figures, and projected to the extent that it would be effective January 1. I think the only change has been in the transition rules in the investment credit. They are drafted and are included in the present bill in roughly the same way as they were included during the 1966 suspension, whereas I think the May 20 estimate assumed that we would not have those 1966 transition rules. They represent a difference of $150 million. I think the figure would be instead of 6.3, Mr. Mayo, 6.15. Approximately the same.

The CHAIRMAN. I heard President Lyndon Johnson stand up before the Congress in his state of the Union address and say in presenting his budgets, "If you look at this budget the way the ordinary family keeps their records and keeps their budget, it would provide for a surplus on a cash-in, cash-out basis."

Now that is what you recommended, Mr. Kennedy, when you were chairman of that board, suggesting to him how that budget should be kept and that is how I always thought it should have been kept I am speaking for Harry Byrd over there. I understand that.

Now if we are taxing out of circulation $6 billion more than we are putting back into circulation, then we are not the culprit in the inflation, are we?

Secretary KENNEDY. That is right, from the standpoint of dollar amounts, yes.

The CHAIRMAN. If we do not pass this bill, of course——

Secretary KENNEDY. Then we are.

The CHAIRMAN. It would be in the amount of $4 billion and we would be one of the culprits.

Secretary KENNEDY. And we would be turning the corner on retarding inflation.

The CHAIRMAN. Right. One of your predecessors in the job you presently hold, Mr. Secretary, once told me that he just didn't think that you could finance this war and carry out the war on poverty and all the other things that were going on by taking it all out of the market, that you had to find something else to do in addition to that. Now it seems to me if we have inflationary pressures that it is being built up by the deficit somewhere else. How much did the public and private debt structure go up during the last year.

Secretary KENNEDY. A substantial amount, but we will have to get the figure.

Mr. MAYO. The net public and private debt at the end of 1968, which is the last figure available, December 1968, was $1,547 billion, which represented an increase of $122.6 billion during the calendar year 1968.

The CHAIRMAN. All right. Now how much of that was the Federal deficit?

Mr. MAYO. The Federal deficit rose by $6 billion during that period. The other $110 odd billion is either State and local or Federal agency or private.

The CHAIRMAN. And how much of that was in the private sector?

Mr. MAYO. The private sector was an increase of $92.4 billion.

The CHAIRMAN. Insofar as the Federal budget is the culprit, that would account for 5 percent of it and the other fellow accounts for 90 percent in the private sector. It would seem to me that if we are going to do something to reduce inflationary pressures, we ought to be thinking about more than just this tax bill. We cannot do it with just the tax bill, not if the private sector is going to run deficits at the rate of perhaps $100 billion a year.

Secretary KENNEDY. The tax bill, Senator, will slow down the private sector, because it will have to pay the taxes.

The CHAIRMAN. It will help, there is no doubt about that. Now some people may not like it, but I know that I personally am on record in what I have suggested to you. Here is the statement that I made, the pertinent paragraph:

> "President Nixon is standing at the crossroads. He can move in one direction and demand that the bankers rescind their interest rate increases just as President Johnson forced the steel companies to roll back their price hike 2 years ago."

I want to apologize to the steel companies about the speech I made supporting President Johnson at that time. I think I referred to them as the "s" "t" "e" "a" "l" companies, and I have since felt that was a little bit intemperate. I should have referred to them in some other way, more politely. But he was successful in making them roll the prices back when they moved with that big increase. The rest of what I said was:

> "Or President Nixon can take the other road and concede publicly that he has more sympathy for money-lenders than he has for money borrowers." It seems to me you are trying to follow a milder path. You are trying to approach these fellows in a very gentle, polite way and say, "Fellows, I want you to please restrain your appetites. Please do not raise the interest rates any more."

Senator GORE. Will the Senator yield?

The CHAIRMAN. Yes.

Senator GORE. It wasn't quite that. They didn't even excuse it. I would like to change, in view of your terminology, the term I used, "laissez-faire," to "hands off."

The CHAIRMAN. My impression, Mr. Secretary, was that you had met with about 24 prominent bankers on yesterday and urged them

not to increase interest rates. Did you urge them to try to hold them back?

Secretary KENNEDY. No.

The CHAIRMAN. You just said don't increase them?

Senator GORE. Did he say that? I thought he said they did not discuss it.

Secretary KENNEDY. Well, Senator, they saw from what I said that interest rates were not doing it.

The CHAIRMAN. As I understand it, you do not like it?

Secretary KENNEDY. That is right.

The CHAIRMAN. And you are trying to do something about it, but maybe it is not what some members of the committee would have you do, but you would like to see them come down?

Secretary KENNEDY. That is right.

The CHAIRMAN. Now, Mr. Secretary, I really think that anything you would recommend to us this committee would vote for, whether it is an excess profits tax or a tax on any interest income that a bank collects over 8 percent gross or anything you recommend. The last time I was in Baton Rouge, which was a couple of weeks ago, my hometown of which I am very proud, I found that not a single bank there was going for the 8½ percent for their regular customers. They were taking the attitude that 8 percent is high enough, and they were not going to go above that.

Secretary KENNEDY. That is true in many areas of the country.

The CHAIRMAN. Now, if they can do that, it would seem to me that some of those bigger banks could do it. I have seen some of these so-called voluntary efforts to do something, and usually you wind up with a compulsory regulation. I would think, Mr. Secretary, that if you told these bankers either they had to put these interest rates down to 8 or below or else you are going to have to ask the Congress to give you some authority to make them come down or tax it away from them, that they would give you some cooperation, a lot more than you are getting so far I should think. That is something that as you know we are concerned about. We were told by President Johnson when we passed this tax that we are now being asked to extend, that this was going to be an antidote to high interest rates. So far we just have not seen the results, if that is the case.

Secretary KENNEDY. That is right.

The CHAIRMAN. Can we anticipate anything on that?

Secretary KENNEDY. I should think we could now. I think that consistent policy here will bring them down.

The CHAIRMAN. Mr. Secretary, I am sure that most Members of the Congress, and I am certain most Members of the Senate from time-to-time send people to talk to Mr. Cohen or talk to someone over there in the Department about problems they have, inequities in the tax laws and things of that sort. A great number of those probably would not involve much money but do involve inequities. I would hope that you and Mr. Cohen would run through your files and pick out these situations where somebody is being treated inequitably under these laws that exist so that we can provide some relief in these hardship situations. I am sure you know some of them and others will come to your attention as we move along with this legis-

lation. I would hope that on the so-called reforms that we can vote on the downside as well as the upside. Somebody who is being crucified—let's give him a break; and somebody who is not paying enough—let's give him a chance to pay more.

Secretary KENNEDY. That is equity, and I am sure we can follow through on these complaints we have.

The CHAIRMAN. I am sure when the man on the street hears us talking about tax justice and reform he thinks he is going to have his taxes cut. He is not thinking about a tax increase. Some people are going to be very surprised to find tax reform means they have to pay more taxes. I am sure you recognize that in the public mind tax reform, tax equity, tax justice, means to the average guy, "I will get a tax cut; I am paying too much already." That is what most Americans think; is that not correct?

Secretary KENNEDY. That is right.

The CHAIRMAN. I see that my time is up. I simply want to pose one further question. In the time we have available to us would you study what proposals might be available to you with regard to providing some tax relief to the persons who are actually paying that 77 percent tax rate. I have in mind the fellow who has practically no deductions. He finds himself in a situation where, after working for many years, suddenly his ship comes home and he has had no advance tax planning and no tax counsel. As a result, the Government actually taxes him at the 77-percent rate—70 percent plus the surtax. It seems to me that while we are talking about making everybody pay 10 percent extra, we ought to see if we cannot find some way to provide some tax equity for this fellow. Insofar as we are raising money from those who are favored taxpayers why not provide some sort of fairness and justice, by giving some of that back to the disfavored taxpayers, the ones who are actually suffering from tax injustice, paying so much rather than paying very little.

If you can help work out something along that line that will provide a simpler, more equitable tax system for those who are being punished by these high rates, maybe we could do that along with putting some more taxes on those who are paying very little. Have you been studying some of those suggestions down there?

Mr. COHEN. Yes, sir, yes, we have.

The CHAIRMAN. You might be able to offer some suggestion as we go along, because this bill is going to receive a number of major amendments. While these minor ones do not involve a great deal of money, they involve lots of people who are being taxed far more than their neighbors, they should have their cases considered too.

Senator Williams was not able to be here to take his turn. It was at his suggestion that we start at the far end of the table, and he will be here at 2:30 when we come back. He is on the floor right now participating in debate over there, and if it is at your convenience I would suggest that we now recess until 2:30 this afternoon.

AFTERNOON SESSION

The CHAIRMAN. During the morning session Senator Williams suggested that the junior members should have an equal chance to interrogate the witnesses. He had to be on the floor. His turn came

to address the Secretary of the Treasury, and therefore he will be called upon first.

Senator Williams?

Senator WILLIAMS. Mr. Secretary, I have very few questions here. The suggestion has been made that this tax bill may be in slight difficulty in getting it enacted. I noticed in some of the early colloquy the suggestion was made that the surcharge as enacted last year had been somewhat of a failure in combating inflation. I was just wondering if would care to comment as to why perhaps the tax bill enacted last year maybe had not accomplished just what we thought it would.

Secretary KENNEDY. I would be glad to comment on that, Senator. There is no question but what the economy continued to have inflation, and that it did not bring about the anticipated reaction, although as we look at it now we don't know what would have happened if the tax bill hadn't been passed. It would have been much worse than it is, so I guess it is not a clear case. It was not completely effective.

I think one of the factors is the leads and the lags; the delays in action. It has only really been since the first of the year that fiscal policy and monetary policy have been going hand in hand. First, there was delay in enacting the surtax. Then when it was finally passed, its effect was offset by a loosening of monetary policy.

Senator WILLIAMS. That was my opinion. There were reasons for it. It was not exactly a failure. As you will remember, it was around the first of July before we got the bill on the President's desk. That was 6 months later, and any segment of the money taken out of the economy through this tax bill did not begin until the month of July. Also is it not true that the Federal Reserve loosened monetary restraints, and the the money supply was increased substantially higher than it had been even in the months preceding or in this year?

Secretary KENNEDY. That is right. They eased their policy to partly compensate for the surtax, feeling that there might be overkill, as it was called, in the economy.

Senator WILLIAMS. They almost offset completely the effects the tax bill would have of siphoning the money out of the economy.

Secretary KENNEDY. In some part, yes.

Senator WILLIAMS. And there was a third part of this package, the so-called expenditure control, and the Congress, after approving it, diluted that somewhat with the cooperation and support of the administration, but do you not think that the fact that the failure to hold tighter control over expenditures, as we had started out, likewise was a contributing factor?

Secretary KENNEDY. I think the expenditure side was a contributing factor. Expenditures do have an inflationary impact. We have been pushing to reduce expenditures since the first of the year.

Senator WILLIAMS. That gets to the point that we would have this year a package now before us in this tax bill. I am personally just a little bit concerned that maybe we are placing too much emphasis on just monetary policies—that is, the tax bill and higher interest rates—and a little less emphasis on expenditure controls. Would you care to comment on that?

Secretary KENNEDY. I think Mr. Mayo has covered the budget side, but I do feel that they have made rather substantial cuts in the fiscal

1970 figures, and that again there is a leadtime and a lagtime, and many of those expenditures are already almost commitments. They are at least authorized by the Congress, and it is a difficult thing to do, but I think it needs to be done even further. I think they have got to make further budget cuts.

Senator WILLIAMS. I think Director Mayo would agree that the expenditure control provisions of the bill, as it passed either the House or the Senate, are rather flexible as far as having any effect, is that not true?

Mr. MAYO. "Flexible" may be too happy a word. The House version is shall we say ambiguous. On the Senate version as it passed, it would require a specific cut, if I remember correctly, of at least $1,900 million to meet the requirements of that version. If the House version were to pass, we would also have to make some cuts, because of the ambiguity in it.

It is in conference now, as we both know, and I am not so sure of what is coming out of conference. It could be slightly different from either of those, but I am not just sure.

Senator WILLIAMS. They can't be too far different, because as I understand it neither House put much in conference, and you can't bring out of conference what you don't put in.

Mr. MAYO. I would say that either version would require a further budget cut.

Senator WILLIAMS. Is it not true that under either version congressional action or inaction automatically raises the ceiling as it is projected, and that it is theoretically possible to end up with expenditures substantially higher than the figure in either of the bills without ever going back and referring to the change in the ceiling?

Mr. MAYO. As I understand it on the House version, as it passed the House, the ceiling would rise if Congress added things that the President did not ask for, or if there were congressional inaction say on the postal rate increase.

The Senate version, however, the ceiling would not budge for controllable items. You would have an exemption, however, for any increase in uncontrollables like social security, interest on the debt, and so forth, 1970 over 1969, but neither of them gives us an out in terms of, in effect, giving blanket endorsement by the Congress of the 192.9. Both of them would require some cut.

Senator WILLIAMS. I hope you are right. I agree with you about the two uncontrollable items that you mentioned, trust fund payments and the interest on the debt. It is that "so forth" that bothers me.

Mr. MAYO. I will define the "and so forth" if you like.

Senator WILLIAMS. I know, I have seen the definition over there in the Congress. It covers the waterfront. The Commodity Credit Corporation, much of which is paid under Agriculture, as you know, they are controllable items, and in your own statement this morning, you called attention to the fact that yesterday the Congress, in passing this bill, had added about $600 million to the bill. That is not very good control.

But, using that as an example, and assuming that the conferees accept the Senate version and the President signs it, that $600 million automatically raises the ceiling by that much, and your expenditure level by that much, does it not?

Mr. MAYO. Yes. In the case of the Senate version, the increase in CCC—now there are other parts of Agriculture that are involved, but just in the case of the CCC—that would be exempt from the calculation of the ceiling.

Senator WILLIAMS. That is correct, and so it is theoretically possible that while we have a figure of $191 billion I think you could end up with $195 or $196 billion in expenditures even under that ceiling.

Mr. MAYO. Theoretically. I hope our estimates aren't that far off.

Senator WILLIAMS. I hope not, too, but I have seen Congress and the administration act too many times. Sometimes it is one, sometimes it is the other. That is what disturbs some of us a little bit.

Mr. Secretary, to go back, don't you agree that while it is important that we enact this tax measure—and I concur in that point, as you know, I have recommended this a long time ago—don't you think that it is equally important that we place just as much emphasis on the need to control expenditures and make sure that the revenue derived as a result of this tax does not just flow out as additional spending?

Secretary KENNEDY. I agree 100 percent.

Senator WILLIAMS. I noticed, I think you recommended it, too, that we repealed the limitation over the number of Federal employees. What is the plan of the administration? Do you think that we are going to add to the number of employees substantially now, or how do you think that is going to work?

Mr. MAYO. No, we do not plan to add to the number of employees, Senator Williams. In our April 15 budget review, we proposed that instead of a ceiling, hiring only 3 out of 4 as required by the Expenditures Control Act, we be permitted to exercise good management techniques in the Federal Establishment, and to reduce the number of Federal employees from the projections that President Johnson had in his budget in January. Those projections showed Federal employment, full-time permanent employment of 2,693,500, I believe it was for June 30, 1970.

We are using a figure of 2,643,000, which would be below by more than 5,000 the level that President Johnson had estimated for June 30, 1969, so our plan is to reduce Federal employment, not to increase it.

Senator WILLIAMS. You say that would be 5,000 below President Johnson's projections?

Mr. MAYO. Yes.

Senator WILLIAMS. For June of 1969. How will that compare with the actual employment on June 1, 1969?

Mr. MAYO. The actual employment on June 30, 1969, is going to turn out slightly below what President Johnson projected for June 30, 1969.

Senator WILLIAMS. How much?

Mr. MAYO. I am not sure that the figures are all in yet.

Senator WILLIAMS. Approximately?

Mr. MAYO. It would be, Sam, would you say 20,000 or do we know yet? Probably between 10,000 and 20,000 below.

Senator WILLIAMS. That was my understanding, it would be close to 20,000. You are going to hold it to 5,000 below the projection. Does that mean you are going to increase by 15,000 Federal employment?

Mr. MAYO. No.

Senator WILLIAMS. Are you going to hold it below the figure? That is what I am trying to establish.

Mr. MAYO. That is exactly what we are trying to do.

Senator WILLIAMS. I have seen too many of these projections. We project that figure up in the sky, and then we cut halfway down and boast that we have saved a lot. I want to know from the actual figures what are you contemplating in employment as based on the actual employment as of June 30, 1969?

Mr. MAYO. My intention, Senator Williams, is still to cut employment by 5,000.

Senator WILLIAMS. Below June 30, 1969?

Mr. MAYO. Yes.

Senator WILLIAMS. And do you think you can do that and not make this Government very inefficient?

Mr. MAYO. I think so.

Senator WILLIAMS. And even though that June 30, 1969, figure may be 15,000 to 20,000 below President Johnson's, do you think you can cut it another 5,000?

Mr. MAYO. I think I can. That is a step which hasn't been taken yet since again June 30 just happened, but I am confident that we will do just what we are talking about.

Senator WILLIAMS. How do you feel about that, Mr. Secretary?

Secretary KENNEDY. I think that it can be done and should be done.

Senator WILLIAMS. Then you would have no objections to a little amendment in this bill that would nail that down solid?

Mr. MAYO. Well, Senator Williams——

Senator WILLIAMS. I am just trying to cooperate.

Mr. MAYO. I know you are very cooperative. We prefer the administrative flexibility of doing it ourself, doing it ourselves, so to speak.

Senator WILLIAMS. I am going to let you do it, but I am just going to help you.

Mr. MAYO. We appreciate your help. I am not sure that it is really the best way to approach the problem to put in the form of legislation.

Senator WILLIAMS. I will be very frank with you. The reason I raise that point is not to be facetious at all. I agree very much with your statement, Mr. Secretary, that action on this bill is important—early action is important. I think the uncertainty in the private sectors as to what we will or will not do creates a problem with industry and in disturbance to our economy more so than the act itself.

I think it is this uncertainty, and I think it is very important that we act and eliminate this uncertainty. But in selling this to the Congress, and in selling this to the American people, I think that it is equally as important that we have in as a part of this package some assurance that we could go before not only the Congress but the American people, and assure them that these things are going to be done.

I am not questioning your word. I am just questioning the fact that we are a democratic form of government. Our constituents do have something to say, and they expect us to listen, but there is a lot of disturbance in this country over the fact that they are fearful that we are placing more emphasis on raising money than we are in controlling expenditures.

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I think that perhaps one of the problems that we are confronting right now—and maybe it has put us in the dilemma which we are facing right now—is the fact that we haven't recognized these points and haven't placed enough emphasis in the proper places.

I say that as one who helped steer a bill through the Senate last year. I know what problems we had then, and I know that we had to couple this together in somewhat of a package before we could get the support of the people back home. After getting the support of the people back home we got it in the Congress. I am just saying this constructively. Can't you come up with some kind of a proposal, both on this employment, and at the same time I think that we need a more rigid control over expenditures, something that will not just be flexible at the whim of every Member of Congress. What do you think of that?

Secretary KENNEDY. I think, Senator, that it is very important that we get our own house in order, and reduce and hold the expenditure line. I think it is also important that we show the way on employee control. I just question whether legislation is needed or how it is to be done. I do feel that certainty on the part of everyone that this is being done and will be done is very important.

Senator WILLIAMS. I don't question the sincerity of the administration, as to doing this, but I just point out the fact that we are passing a bill, and I am convinced that it would be much easier to put this package through the Congress, if you had one that the American people could understand and know that this was really an effort to control expenditures, and that we are not just piling up the money to expand these programs.

Having been in the Senate and in the Congress—and we will accept our responsibility too—it is much easier to spend the money than it is to control the spending, as you know from suggestions. When you speak here of surplus next year of $6.3 billion, you understand my position about this surplus.

Mr. MAYO. Yes.

Senator WILLIAMS. And what a farce it is if they want to use that with the trust funds. But really, that figure alone makes it harder to get this tax bill through the Congress. I get letters a lot of times, and I know other Members do, that if you have got a $6.3 billion surplus, why don't you let this tax bill lapse, repeal the investment credit, and you have got a balanced budget.

Mr. MAYO. We would have a deficit.

Senator WILLIAMS. Yes, but would you, if they cut this $192 billion as they are cutting it in the House, assuming that is true, and proceeding on that premise, you would have a balanced budget.

Mr. MAYO. You would still have a deficit.

Senator WILLIAMS. I agree with you, you would have a deficit under your figures.

Mr. MAYO. Yes.

Senator WILLIAMS. But I am talking about the arguments that you can get advanced on this.

Mr. MAYO. I think it is important that in replying to such letters and inquiries, and we have had them, too, that it is almost begging the question, because without the surtax and without the investment credit repeal, we would have a deficit any conceivable way.

Senator WILLIAMS. I agree with you. The reason I raised this question, I want you to get on my side because you have been talking about surpluses this morning, and I think it is just a figment of the imagination. Isn't it true that you are operating the Government today and have been for the last 7 months at a deficit, spending about half a billion dollars more than you have taken in?

Mr. MAYO. In terms of the Federal funds?

Senator WILLIAMS. Federal funds, yes.

Mr. MAYO. Yes.

Senator WILLIAMS. And you are trying to use trust funds such as social security and railroad retirement funds. Just use that as one example. The increase in the railroad retirement fund, to the extent that you have any, you are counting that toward the reduction of the deficit of the Federal Government, aren't you?

Mr. MAYO. It in effect adds up that way.

Senator WILLIAMS. Yes.

Mr. MAYO. Of course it doesn't disturb the real meaning of that individual trust fund.

Senator WILLIAMS. I agree. It just helps fool the people. Now being realistic, is there a single dime of public money belonging to the Federal Treasury—tax money—in the trust fund of the railroad retirement fund?

Mr. MAYO. In railroad retirement I don't believe that there is.

Senator WILLIAMS. Not a dime, and yet you count it for accounting purposes as though it belonged to the Federal Government, in order to reduce the deficit as reported to the American people.

Now, Mr. Secretary, as a banker, would you loan money to any corporation in America that counted in its financial statement the accumulation in its pension trust fund as though it belonged to that corporation for purposes of establishing and reporting to you a financial statement?

Secretary KENNEDY. No. In making a credit analysis for lending purposes, you take a look at——

Senator WILLIAMS. You disregard that.

Secretary KENNEDY. You look at the balance sheet, the expenditures, the liquid assets, the long-term assets, and so on. You take a look at the reserves, too. I don't think, Senator, that this is the best of comparisons. I think you have a very good point, on the general ledger side we would be in a deficit even with this package.

Senator WILLIAMS. The reason that I mention this——

Secretary KENNEDY. I think that that should be explained.

Senator WILLIAMS. Yes, I think it should be explained. In fact, in our committee we always had before us, when we were considering a tax measure, the accumulation in these various trust funds, so that we could relate that to the amount that was being taken out of the economy as a whole. You have to.

Secretary KENNEDY. That is right; from an economic standpoint you have to take a look.

Senator WILLIAMS. Now, in these proposed figures that you presented to us this morning, you are assuming, as I understand it, that the postage rates would be increased as of July 1.

Mr. MAYO. Yes, it is late for that.

Senator WILLIAMS. It is kind of late, so there is $519 million off of that, isn't there, if we don't do it?

Mr. MAYO. If you don't do it at all.

Senator WILLIAMS. Yes, that is right.

Mr. MAYO. That is correct. Actually I think it is $600 million.

Senator WILLIAMS. Yes, but that automatically would raise your debt ceiling that much higher by inaction under this House proposal.

Mr. MAYO. Yes, under the House version. I don't believe it would under the Senate version.

Senator WILLIAMS. It would in the Senate, too, because just before they finished in the Senate they also adopted the language of the House bill, which puts it in both bills. That is the reason I say I think you would come out with, I guess "flexibility" is the word. Now you also have $410 million counted there for users' taxes, do you not?

Mr. MAYO. Yes.

Senator WILLIAMS. And with no action to enact those, you automatically raise the ceiling another $400 million, don't you?

Mr. MAYO. Yes, that is correct. Wait a minute, user charges are receipts, so they are not offsets to expenditures.

Senator WILLIAMS. Except that part of them, as I understood it, that you were planning to set up in a trust fund under the transportation system.

Mr. MAYO. They would be earmarked taxes, that is correct, but just as highway is, and gasoline tax receipts count as budget receipts.

Senator WILLIAMS. Therefore it would move over in that category.

Mr. MAYO. No, no more than gas tax would for the highway fund, Senator Williams.

Senator WILLIAMS. On social security tax increases, what do you plan in this budget on that?

Mr. MAYO. We have an increase implicit in the $6.3 billion surplus of six-tenths of $1 billion in outlays in the fiscal year 1970 for a 7-percent increase in social security benefits effective February 1, 1970.

Senator WILLIAMS. I understand. And if they are extended at the 10 percent on the basis of the recommendations in the Johnson budget that would add another $1 billion, wouldn't it?

Mr. MAYO. Yes, it would. They had an earlier effective date, too.

Senator WILLIAMS. An earlier effective date, too. That would automatically raise this ceiling another $1 billion.

Mr. MAYO. If the Congress so chose, yes.

Senator WILLIAMS. If it did. Now, the budget also took into consideration raising social security taxes, did it not?

Mr. MAYO. The Johnson budget did. We erased that tax increase. There is no tax increase for social security in this $6.3 billion.

Senator WILLIAMS. Mr. Secretary, I understand that you are coming out with a new savings bond.

Secretary KENNEDY. That is right, Senator.

Senator WILLIAMS. As you know, I think that that is equally important and should be a part of the overall plan, as you stated this morning. I don't think that we can look at any one item as being effective by itself.

Secretary KENNEDY. We should have that out this week.

Senator WILLIAMS. I don't think that we can figure that we can con-

trol this inflation by taxes alone, or that we can do it by reducing expenditures alone. I think it is going to take a combination of all. Raising the interest under the savings bond program is a matter that should be enacted in fairness and in the spirit of equity for these small investors, and also as an instrument of drawing money out of this spending stream. At this time that is very important. What are your plans on that? Would you give us those now?

Secretary KENNEDY. We hope this week to present to the Congress combined recommendations to increase the savings bond rate and to eliminate the 4¼-percent statutory ceiling.

Senator WILLIAMS. Could you tell us what rate you are planning on that?

Secretary KENNEDY. We are proposing a 5-percent rate.

Senator WILLIAMS. A 5-percent rate. That is on the outstanding bond and all?

Secretary KENNEDY. That is right. It will be on new sales, but it will also be effective on the outstanding bonds.

Senator WILLIAMS. The suggestion is made, and I have discussed this with you before, about the desirability of a new type of bond that maybe could be put out on a temporary basis—while we need it—that would pay a higher rate of interest, and siphon more of this money out of the spending stream.

I suggested going to 6 percent, and that it be limited to $2,400 a year, or $3,000. It could be limited on a quarterly basis to make sure that this is available only to the small investor type. What do you think of that proposal?

Secretary KENNEDY. We have taken a look at that, and in this proposal we are not recommending that. We are recommending just the E and H bond extension of 5 percent.

There are some problems with it, and one is disintermediation from other savings institutions, and the impact it might have. There is the question, too, of the limitations you put on it, and how you would effectuate them and what effect this bond would have on the other sales, whether they would cancel out. We are not prepared at this time to make that recommendation.

Senator WILLIAMS. What is the Government paying on the average today for a 7-months maturity bond?

Secretary KENNEDY. It is over 7 percent, right now 7¼ percent or approximately that.

Senator WILLIAMS. Do you think it is fair to pay 7 or 7¼ percent to the investor that has $100,000 on a Government bond, or he can buy a Government-guaranteed bond that is paying around 8 percent?

Secretary KENNEDY. One is a money market instrument that fluctuates in value. The other has a fixed value that is almost like cash in a bank.

No saving institution that I know of has a rate in that area. That would be a completely larger rate and unless you had very severe controls, would channel money out of savings and loan association banks, savings banks, insurance companies, and other areas of savings.

Senator WILLIAMS. We could put some controls on it. I just wondered if it is quite fair to expect, because it is true the savings bonds are guaranteed as to principal, whereas the other investors are not

guaranteed on the principal. But the investor in the thousand dollar bond does get his interest, if he keeps it 6 months or a year he gets that 7-percent interest, whereas the small investor has to keep a savings bond the full 7 years in order to get his full rate of interest. If he cashes it in the first year or two, he gets little or no interest, so there are penalties both ways.

Secretary KENNEDY. That is right. There is a cut back for early redemption. You are right, Senator.

The CHAIRMAN. I think Senator Williams will want to ask a few more questions, but meanwhile I think it would be good that the other committee members have a further chance to explore their thoughts.

Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

Mr. Mayo, this morning as I understand it you said that the Federal spending, that is apart, separate from the trust funds, that the Federal spending will be $153.7 billion for fiscal 1970.

Mr. MAYO. That is correct.

Senator BYRD. And then the trust fund spending will be $47.1 billion.

Mr. MAYO. Yes.

Senator BYRD. Now if you add those two together, it gives you a little over $200 billion as the total spending for fiscal 1970.

Mr. MAYO. Yes; but that includes $8 billion of intergovernmental transactions between the general funds and the trust fund.

Senator BYRD. What is the role of the intragovernmental expenditure?

Mr. MAYO. Pardon?

Senator BYRD. What is the role of the intragovernmental expenditure?

Mr. MAYO. These are primarily transfers of interest on the trust fund investments. That is one of the principal ones. There are a number of others.

Senator BYRD. What I am getting at is if you plan to spend, if the Government plans to spend $153.7 billion for the general operations of the Government, and then it plans to spend $47.1 billion in the trust funds, then you get a total of $200 billion.

Mr. MAYO. Yes; but you are counting $8 billion of it twice, Senator, because it would be in there as spending of the Federal funds and again of the trust funds. The same thing is true on the receipt side. You have $149.4 billion of Federal funds receipts, you have $57.7 billion of trust fund receipts, which totals $207.1 billion. There is $8 billion difference there, too. The intergovernmentals balance out.

Senator BYRD. We are not spending then $153.7 billion plus $47.1 billion.

Mr. MAYO. That is correct; we are not. We are spending $192.9 billion, which is those two figures less $8 billion that is double counted.

Senator BYRD. But in response to me this morning, and in your response to me this afternoon for that matter, you say that the general fund spending will be $153.7 billion.

Mr. MAYO. Yes.

Senator BYRD. And then you say the trust fund spending will be $47.1 billion.

Mr. MAYO. That is right, just standing on their own feet, so to speak, but the two together would be $8 billion less than that, because you cant' add them. They are not additive.

Senator BYRD. That is one reason I am not inclined toward Senator Long's method.

The CHAIRMAN. Let's call it Dave Kennedy's method.

Mr. MAYO. There is transfer from the general to the trust funds. That is one of the reasons we thought it would be important to put them together, because of the very confusion that is concerning you at the moment.

Senator BYRD. What I want to know, and I don't say I can find it out, what I want to know is how much is the Government to spend for general fund purposes?

Mr. MAYO. Literally for general fund purposes?

Senator BYRD. For general fund purposes.

Mr. MAYO. Including transfers to the trust fund, $153.7 billion.

Senator BYRD. All right, it is going to spend $153.7 billion.

Mr. MAYO. Now if you want me to I can just deduct the $8 billion from the $47.1 billion, and say that the trust funds are going to spend $39.1 billion, since almost all of the intragovernmental transfers are from Federal funds to trust funds.

Senator BYRD. Is that what they will spend?

Mr. MAYO. That is what they will spend if you take out the Federal funds share, yes, sir.

Senator BYRD. Then we have established, have we——

Mr. MAYO. Sam Cohn here has an illustration that I think may clarify this a bit.

Mr. COHN. Senator Byrd, to cite an example—in the social security and medicare field, the Congress has enacted the Prouty amendment to social security, and in medicare we match the premiums paid by the aged for doctors' fees and similar insurance.

Now these expenditures are Federal funds expenditures, because they are not financed from trust fund revenues, so for the Prouty amendment, which gave people 72 or over social security benefits, even though they had not paid into the trust fund, the Federal Treasury has to bear that cost.

The way we do it is: the Federal Treasury pays into the trust fund, and that becomes a Federal fund expenditure. Then, the trust fund pays the same money out to those 72 or over—or the doctor bills under medicare. Thus, the trust fund makes the expenditure and the Federal fund makes the expenditure. When you include the expenditure in each separately, a correct total for each is produced. But when you add them together, the total include the same money twice; first, the Federal funds pay the trust funds, and then the trust funds pay the doctors or to the aged. So we just count this item once, when we put the two funds together in a unified budget.

Senator BYRD. Let me ask you this then. So far as the general fund expenditures are concerned, the 153.7 is the correct figure. Now so far

as the trust funds are concerned, then the figure is not 47.1 but 39 something, is that it?

Mr. COHN. Yes, if you don't count the money that you have already included in the Federal funds as an expenditure.

Senator BYRD. But the money that you are speaking of as a practical matter is money that comes from the general fund into the trust fund, not vice versa?

Mr. COHN. That is right.

Senator BYRD. So on the expenditure side, for the general fund, the 153.7 is the figure I would want to use.

Mr. COHN. Yes.

Senator BYRD. And if you are going to add it together to get the total outlay, then you would reduce your trust funds by roughly $8 billion.

Thank you very much. I think I understand it, at least I think I understand it.

I noticed there has been a change in the receipts from the trust fund. You are estimating $57.7 billion as receipts in fiscal 1970 from the trust fund.

Mr. MAYO. Yes.

Senator BYRD. In the original budget that was submitted, the figure was substantially less than that, was it not?

Mr. MAYO. The original budget in January, Senator Byrd, had $58.7 billion. There was a decline in the estimate of $1 billion which refers to the item that Senator Williams just referred to, namely a reduction in the Johnson suggestion that we pull up more social security taxes.

Senator BYRD. Let me get clear several other figures. I am taking these from memory so I would appreciate it if you would correct me if I am in error. As I recollect the interest for fiscal 1968 was $14.5 billion.

Mr. MAYO. Just a second. I can give you that figure.

The net figure that is in the budget for the fiscal year 1968 is $13.7 billion, which is made up of 14.7 of gross interest outlays less interest that is collected by the Treasury from the public and from other governmental accounts. This item called interest is not just interest on the public debt.

Senator BYRD. Then to get to fiscal 1970, what do you estimate your interest charges will be for fiscal 1970?

Mr. MAYO. The figure that we have been using is 17.3 comparable to 14.7.

Senator BYRD. So the interest charges have increased in round figures by $3 billion in 2 years.

Mr. MAYO. Yes, $2.6 billion.

Senator BYRD. It is more than that; isn't it?

Mr. MAYO. 14.7 to 17.3 is plus 2.6.

Senator BYRD. In other words, the interest charges on the national debt have increased by $2.6 billion, almost 3 billion in a period of 2 years.

Mr. MAYO. Yes, sir.

Senator BYRD. How much do we have, does the Government have, in the pipeline as of June 30?

Mr. MAYO. I don't think we have an up to date figure on June 30. I will be glad to give you our latest estimate, however. By pipeline you mean the amount that has been appropriated.

Senator BYRD. Appropriated.

Mr. MAYO. By the Congress but not yet spent?

Senator BYRD. But not yet spent; yes.

Mr. MAYO. Our estimate for June 30, 1969, is the total unexpended balances total $226.1 billion, of which $99.6 billion are trust funds and $126.5 billion Federal funds.

Senator BYRD. What is that last figure?

Mr. MAYO. $126.5 billion for Federal funds.

Senator BYRD. Thank you.

Now I note that from the period October through February 15 that the Government sold, in round figures, $23.4 billion in short term bonds. That was a period of about 4 months or 3½ months. I assume that is a very unusual amount of short term governments to be issuing in that short period of time.

Mr. MAYO. This must include refunding.

Senator BYRD. That is refunding, yes; that includes refunding.

Mr. MAYO. Yes.

Senator BYRD. That includes refunding. But in any case it makes that much less funds available for the private sector, doesn't it?

Secretary KENNEDY. That is precisely right, and it doesn't even there tell the full story, Senator, because we are in the market every week, rolling over Treasury bills. That is just a weekly rollover.

Mr. MAYO. I should make the point though that much of this money, to the extent it was maturing debt, it was already in the market.

Senator BYRD. Yes.

Mr. MAYO. The rollover, of course, is not painless. You don't have full usage, but there is basically a substitution here, not a raising of money, new money.

Senator BYRD. Do you happen to know, it isn't necessary, but do you happen to know, how much of that $23 billion is new money and how much is renewals?

Secretary KENNEDY. We can give you that figure. I don't know it offhand.

Senator BYRD. That will be fine. If you could supply it for the record.

Secretary KENNEDY. Yes. This is from October until when?

Senator BYRD. February 15.

Secretary KENNEDY. February 15. That is a heavy borrowing period for new money.

Mr. MAYO. This is the seasonally high period of the year. There has been debt reduction since then.

(The information referred to follows:)

TREASURY FINANCING, SEPT. 30, 1968-FEB. 15, 1969

[In millions of dollars]

REFUNDINGS

Date of financing	Maturing issues	Amount	New issues	Amount	Net cash
Nov. 15, 1968	5 1/4 percent note, Nov. 15, 1968	$8,984	5 3/4 percent note, May 15, 1970	$7,793	
	3 7/8 percent bond, Nov. 15, 1968	1,158	5 5/8 percent note, Nov. 15, 1974	2,329	
	2 1/2 percent bond, Dec. 15, 1968	1,787			
	Total	11,929		10,122	−$1,807
Feb. 15, 1969	5 5/8 percent note, Feb. 15, 1969	10,738	6 3/8 percent note, May 15, 1970	8,759	
	4 percent bond, Aug. 15, 1969	3,727	6 1/4 percent note, Feb. 15, 1976	3,726	
	Total	14,466		12,485	−1,981
Total refunding		26,395		22,607	−3,788

NEW MONEY FINANCING

		Amount	Net cash
Increase in regular weekly bills:			
Oct. 3, 1968		$100	+$100
Oct. 10, 1968		100	+100
Tax anticipation bills:			
Oct. 24, 1968	Maturing June 23, 1969	3,010	+3,010
Dec. 2, 1968	do	2,001	+2,001
Jan. 20, 1969	do	1,750	+1,750
Total new money		6,971	+6,971

Source: Office of the Secretary of the Treasury, Office of Debt Analysis, July 14, 1969.

Senator BYRD. Maybe you could give me a statement in reply to this question that has been put to me by a great many. How do you help inflation, help control inflation, or stop inflation, by taking money out of the pockets of the individual citizens so they can't spend it, and putting it into the hands of Government so it can spend it?

Secretary KENNEDY. That is a $64 question. To the extent they spend it I am sure you have the answer, but what we are trying to do is to have the Government pay its own way in this period, and reduce the ability of the public to have money to spend. We will send you at least an answer, which might not satisfy you, but we will send you one.

Senator BYRD. I have been asked that question a good many times.

Secretary KENNEDY. It is a good one.

(The information referred to follows:)

JULY 11, 1969.

This is in response to the question: "How do you help control inflation, or stop inflation, by taking money out of the pockets of the individual citizens so they can't spend it, and putting it into the hands of Government so it can spend it?"

The answer is that the Government expenditure is not going to change because of the surcharge. We are faced with a set of laws and general policies that obligate the Government to do certain things like defend South Viet Nam, pay veterans' benefits, and so forth. We are trying to achieve every feasible economy in carrying out these obligations, but we estimate they will involve expenditures of $192.9 billion in fiscal year 1970, which is $2.4 billion below the figure in the January Budget. If the surcharge is extended, private expenditures will be reduced and Government expenditures will still be $192.9 billion, so total outlays will be reduced and there will be less pressure toward inflation.

Mr. MAYO. That is one of the reasons we are asking for the extension of this surtax, Senator Byrd, so that we won't have to borrow quite so much this coming year.

Senator BYRD. But you still spend the money. In other words, instead of the individual spending the money the Government is spending the money.

Secretary KENNEDY. That is right.

Senator BYRD. This is more of a philosophical view, I guess, but one thing that concerns me about extending the surtax is it was enacted as a temporary tax. The public, I think, gets more and more cynical about Government, when Government makes one statement one year and then repudiates that statement the next year. Of course, I am not speaking of the officials involved now, because they were different officials last year than they are this year, but it is the same Government, and when the Government leads the people to believe that they are having a temporary tax, and then consistently turns a temporary tax into a more permanent tax, I think it leads to cynicism on the part of the public toward Government. I think it also causes uncertainty in the minds of the business community as well as the individual citizen, but that is perhaps more of a philosophical question than one that would meet the needs of the Government at the present time.

Mr. MAYO. We are quite conscious, deeply conscious of this, and that is why both of us have pledged that we want to make sure that this is a temporary tax, as soon as we can get past the reasons that caused it to be enacted in the first place.

Senator BYRD. I think it is very important, it seems to me it is very important that it be eliminated at the earliest possible opportunity, to let the people know that the Government is playing fair with them, and when we say the tax is temporary they are going to try to make it a temporary tax, rather than to continue it indefinitely.

Now in reply to a question this morning as to whether in the minds of the public tax reform does not really mean in the minds of the public tax reduction, and I think the committee member who was querying you folks, and you had a meeting of the minds, that tax reform would not mean tax reduction, so if that is the case in the public mind, tax reform they will not get, in the sense they will not get a tax reduction; that is, the average taxpayer.

Secretary KENNEDY. That is, in total. In some cases there would be a reduction, in other cases there would be increases.

Senator BYRD. Yes, but as a general looking at it from the point of view of the average citizen.

Secretary KENNEDY. It is not tax reduction.

Senator BYRD. And the general public, it will not bring about a tax reduction.

Secretary KENNEDY. No, it is not a tax reduction program. That is not called for now.

Senator BYRD. That is not the purpose of it.

Secretary KENNEDY. We can't afford tax reduction.

Senator BYRD. That is not the purpose of it.

Secretary KENNEDY. That is right.

Senator BYRD. The purpose of it is to ---

Secretary KENNEDY. Make it equitable.

Senator BYRD (continuing). Is to correct the inequities that might exist in the law. In correcting those inequities, you would increase the

taxes on some and decrease the taxes on others. As a practical matter, it is unlikely that the Government will get much net revenue.

Secretary KENNEDY. That is right.

Senator BYRD. Much additional revenue.

Secretary KENNEDY. That is precisely right.

Senator BYRD. Thank you, sir.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Mr. Mayo, this morning in answer to Senator Curtis' question I believe you said that the trust funds are inviolable.

Mr. MAYO. Yes, sir.

Senator MILLER. What do you mean by that?

Mr. MAYO. I mean simply that the receipts and expenditures of the trust fund and the investment provisions of the trust fund are not in any way affected, Senator Miller, by the decision to present a unified budget.

I mean therefore that the excess of receipts and expenditures in any given trust fund are properly invested according to law in U.S. Government securities, and nothing in the unified budget presentation affects that.

Senator MILLER. Properly invested in U.S. Government securities, but how are they going to be paid?

Mr. MAYO. They will be paid in the same way that all Government securities are paid when they come due.

Senator MILLER. And that will be out of the general fund of the Treasury, into which tax money is paid, is that correct?

Mr. MAYO. That is correct. They may be refunded from time to time just as other Government securities are refunded.

Senator MILLER. So that if the taxpayers want to know how much they are going to have to pay to finance the budget, they have to take into account not only the amount of money that the Federal Government is going to have to borrow from the general public for the publicly held debt, but also the amount of money that is obtained from the trust funds in the purchase of those securities as well; is that not so?

Mr. MAYO. That is part of the equation. That is why we look at all the receipts and expenditures of the trust fund, and you add them in for unified budget purposes.

Senator MILLER. The thing that troubles me about the unified budget is while I recognize there is some simplicity to it, it seems to me that the stockholders of the country, the taxpayers, are not given a clear picture of how much they are going to have to fork over in taxes to finance that budget, and the only way they can get that is to break it out into the old administrative budget.

Mr. MAYO. Well, our point in bringing the two together again is to talk on the receipt side, Senator Miller, in terms of not only personal income taxes, corporate income taxes, and excise taxes, but also employment taxes, for instance, and gas taxes for the highway fund. Those are all in the tax category. They have different effects, we know that.

The same on the outlay side. We have benefit for the aged in many of our programs that are financed out of Federal funds. We have the

old age and survivors insurance trust fund. We have highways constructed out of Federal funds. We have highways constructed out of the highway trust fund. This could be spread into other things.

Senator MILLER. I recognize the virtue. My only point is that I think there is a minus to this, and that is in not bringing home in stark, bold figures to the taxpayers, who are the stockholders of this country, how much in taxes they are going to have to pay, in order to meet any particular budget, and that is what I think would be a helpful thing, in boldfaced type.

Now, if this question has been asked, please forgive me. I will ask any member of the group. As I understand it, some of the larger banks are borrowing Euro dollars in order to meet some of their commitments; is that correct?

Secretary KENNEDY. That is correct, Senator.

Senator MILLER. And I understand further, Mr. Secretary, that they are having to pay a pretty good price for those Euro dollars.

Secretary KENNEDY. Yes. It varies at times and over a period of time, but it is now 11 or 12 percent.

Senator MILLER. I don't know whether you have the authority; if you do that is one thing, but if you don't, would it help any if Congress passed a law which would inhibit borrowing of Euro dollars in a period such as we are going through?

Secretary KENNEDY. I don't think that would be a wise move. I think that the use of Euro dollars serves a very useful purpose in this period. It provided an avenue for money to come in at a very heavy penalty rate, which helped to keep the credit crunch from breaking out, and carried us through the period.

Senator MILLER. But it also laid a foundation, as I understand it, for an increase in the prime interest rate.

Secretary KENNEDY. Yes; that combined with the commercial paper rate, which is more important in the equation, did just that. The Federal Reserve, as you know, has placed a Reserve requirement on the use of Euro dollars by member banks over the average amounts that they had outstanding in May of 10 percent. That will add further to the cost and availability of Euro dollars.

That will tend, of course, to put more pressure on local markets, because to the extent that the banks have Euro dollars at those rates and are lending them at 8½ percent, they are losing on that amount. They have got about $10 or $11 billion in total Euro dollars, so there is a very heavy penalty rate to take care of on the commitments.

If you removed those Euro dollars from the banking system, the banks would have to liquidate other assets to take care of it. That would be a very strong and very heavy hand on credit.

Senator MILLER. Then your point would be that if there was a prohibition against borrowing Euro dollars, that would only aggravate the domestic interest rate?

Secretary KENNEDY. It would aggravate it seriously.

Senator MILLER. There has been a lot of talk, and I am sure you have heard it, about controlling these interest rates, driving down the interest rates. I don't know whether you are supposed to take some action or wave a magic wand or whether Congress is supposed to legislate some kind of an interest ceiling.

As I understand it we have got about a 6½-percent annual rate of inflation going right now. Suppose that Congress passed a law saying 6½ percent was the maximum rate of interest that could be paid, and we have a 6½-percent rate of inflation. What did you tell me you paid for refinancing some of the Government debt the other day?

Secretary KENNEDY. About 7¼ or 7⅜.

Senator MILLER. You had to pay 7¼ or 7⅜. Suppose Congress passed this law, would you have been able to get that money, do you think?

Secretary KENNEDY. No. We would have had real problems.

Senator MILLER. In other words, an arbitrary ceiling which doesn't——

Secretary KENNEDY. It closes out markets.

Senator MILLER. Which doesn't take into account the rate of inflation just isn't going to work, is it?

Secretary KENNEDY. No, and it will affect the allocation of funds between various segments of the economy in a way that might have serious adverse consequences. We found out what ceilings do on interest rates. They can close out the complete market. We see that in housing. We see that in the 4¼-percent ceiling on the Government debt.

One reason for our interest rate escalation here is that most of our debt is becoming very short term. It is in part short term because we couldn't finance in the long-term market because of a statutory ceiling of 4¼ percent, which kept us out of the market, so those ceilings tend to drive markets into other channels.

Senator MILLER. Then would a proper response to those who advocate some kind of an artificial ceiling on interest rates, in an effort to drive them down, be to take care of the inflation first and then we won't have to worry about it?

Secretary KENNEDY. That is the response we are giving, and I think it is a very reasonable one.

Senator MILLER. This morning, Mr. Secretary, you were asked about a tolerable rate of inflation or something along that line. I believe you mentioned something about some low rate, but indicated that that low rate might reflect an improvement in quality which might really affect inflation.

After all, if it is an improved quality product, I don't think we can really call that inflation. I believe our Joint Economic Committee had the Chairman of the Council of Economic Advisers before us earlier this year, and he was asked what is the target as far as inflation is concerned. He said the target for this administration was zero inflation. Do you share that objective?

Secretary KENNEDY. That is a good target. I have done a lot of target shooting. I usually miss the center bull's eye a little.

I think the bad part of trying to have any target above zero is that it tends to get built in and starts to escalate, because they say if you can get along with 2 percent why not 3, if you can get along with 3, why not 4, and the first thing you know we are back in trouble again.

Senator MILLER. You see the importance of the question though——

Secretary KENNEDY. Yes.

Senator MILLER. To see whether or not this administration is going to go on record that the objectives set forth in the Employment Act

of 1946 of full employment and a stable dollar are impossible of achievement in a capitalistic economic system. It seems to me that if we get into an admission that we cannot achieve full employment and a stable dollar at the same time, then we have confessed to the failure of the capitalistic economic system.

I think that would be quite tragic, and I don't think that the Congress, when in a bipartisan effort they passed the 1946 act, intended to admit failure on either of those goals.

Secretary KENNEDY. That is right.

Senator MILLER. Now it was suggested this morning, I believe, that with a national defense budget of $80 billion, we just can't control inflation, and we can't have a stable dollar. I believe your response was that you thought we could.

Secretary KENNEDY. That is right.

Senator MILLER. But that is going to entail a reasonably balanced budget, is it not?

Secretary KENNEDY. It is going to encourage a surplus, other times we might have a slight deficit.

Senator MILLER. Mr. Mayo, do you have any figures as to how much of this fiscal 1970 budget is going to go into social welfare and antipoverty type of activities? Do you have any breakout on that?

Mr. MAYO. Yes, we have figures on that. The figure that comes to mind at the moment on just aid to the poor is $26.9 billion, which is an increase from $24.4 billion in the fiscal year just ended a week ago.

Senator MILLER. Then one could just as well ask the question whether with that estimated spending figure for aid to the poor and some of these other poverty measures we could do this without inflation, too.

Mr. MAYO. Yes.

Senator MILLER. Wouldn't that be an equally responsible question?

Mr. MAYO. You can ask it either way. You can ask it about State and local aid to Government, natural resource programs. This is a pie, and you can cut it up in various ways.

Senator MILLER. It would be rather unfortunate then for somebody to conclude that you can't spend $27 billion on aid to the poor in this country without having inflation.

Mr. MAYO. Yes.

Senator MILLER. And it would be quite consistent to say, oh, yes, we can, and we can do it without inflation, and it would be equally consistent to say, yes, we can have a $80 billion defense budget and do it without inflation, too, wouldn't it?

Secretary KENNEDY. If we pay for it and not borrow.

Senator MILLER. In other words, as I say, with a reasonably balanced budget.

Secretary KENNEDY. Right.

Senator MILLER. In other words, it is a matter of the willpower of the Congress, or more particularly those in control of the Congress, isn't it? Isn't that what it really comes down to?

Secretary KENNEDY. That is right.

Mr. MAYO. It requires an evaluation of national priorities, Senator Miller. It comes down simply to that, and the President in his responsibilities, and the Congress in their must make an evaluation for budget purposes as to how much is needed to insure a strong national

defense as well as how much is needed for Federal programs to do what we think is necessary in the cities and elsewhere.

Senator MILLER. That gets me into another question that was asked of you people this morning, and that is what has the administration been doing about inflation. Now it seems to me that there is a limit to what the executive branch can do.

No. 1, as Mr. Mayo, I think, has just pointed out, you have recommended to the Congress what you regard as a noninflationary budget. You can't legislate the taxes or the spending to meet that recommendation; can you?

Mr. MAYO. No.

Senator MILLER. That has to be done over at this end of the avenue?

Mr. MAYO. That is correct.

Senator MILLER. You have, I believe the Secretary stated this morning, secured the cooperation of the Federal Reserve on monetary policy. You can't tell them to do something but you can talk things over and persuade them that in a particular environment that certain policies should be followed, and to that extent you have done so.

Secretary KENNEDY. They are following, I think, the right policy at the present time.

Senator MILLER. And that is about all you can do; isn't it, Mr. Secretary? Isn't that about all you or the President of the United States could do about it?

Secretary KENNEDY. I think that is right. We can tell the public our program and can utilize our powers of persuasion to get our program implemented.

Senator MILLER. Yes; you can make speeches and you can make recommendations, but the ball is over here.

Secretary KENNEDY. Right.

Senator MILLER. And more particularly in the hands of those in control of Congress; is it not?

Secretary KENNEDY. Yes.

Senator MILLER. I just thought we ought to bring that out, so we would put that question in perspective. I have no further questions.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. What I would like to go into is just a little simple arithmetic. Do you know how much we will spend this year? Do you have an estimate? Can you tell me how much it is? What you want is a balanced budget; isn't that right?

Secretary KENNEDY. We want a surplus; yes.

Senator HARTKE. You want a surplus.

Secretary KENNEDY. Yes.

Senator HARTKE. How much of a surplus do you want?

Secretary KENNEDY. The figures show $6.3 billion.

Senator HARTKE. That is what you have asked for. Is that what you think you need? Do you think you need a surplus?

Secretary KENNEDY. Yes.

Senator HARTKE. Why?

Secretary KENNEDY. I think we need receipts in excess of expenditures in a period of strong inflationary pressure.

Senator HARTKE. Well, you could do that in a number of ways, could you not?

Secretary KENNEDY. Yes.

Senator HARTKE. You could cut expenditures.

Secretary KENNEDY. Yes.

Senator HARTKE. What if we cut expenditures by 5 percent, just across the board? That could be done.

Mr. MAYO. Does that include social security benefits, Senator?

Senator HARTKE. No. The social security fund, as has been explained to you, is nothing more than giving back to people, to poor people part of the money they have paid in. That is all you are really doing.

Mr. MAYO. I was just trying to clarify your 5 percent.

Senator HARTKE. In the trust fund all you are really doing is giving back to the people part of the money that they paid in, not even all of it; isn't that true?

Mr. MAYO. You would apply the 5 percent, then, just to——

Senator HARTKE. To the total expenditures outside the trust funds.

Mr. MAYO. Including interest on the public debt?

Senator HARTKE. Well, you can't very well default on interest. Let's go ahead, 5 percent across the board that you could cut in public expenditures. Interest is not an expenditure of Government. It is a cost of Government but not an expenditure.

Secretary KENNEDY. It isn't?

Senator HARTKE. It is a cost of Government. It is not an expense in regard to an obligational authority.

Mr. MAYO. How about veterans' pensions, Senator Hartke?

Senator HARTKE. Yes, cut across the board.

Mr. MAYO. Do you think the Congress would be willing to go along?

Senator HARTKE. I am asking you a question. I am just asking you a very simple question. How much would 5 percent across the board give you?

Mr. MAYO. Well, we have controllable expenditures, I believe, of something in the neighborhood of—what is it, Sam, $80 billion?

Mr. COHN. Yes.

Mr. MAYO. Five percent on $80 billion is $4 billion.

Senator HARTKE. Ten percent across the board even with your own figures would give you more than enough, is that right?

Mr. MAYO. That would give you $8 billion.

Senator HARTKE. That is more than the 10-percent surtax would give you.

Mr. MAYO. That is the way the arithmetic reads, $7.6 with the surtax—$8 billion is more than $7.6 billion. The next question is how do you do it?

Senator HARTKE. Well, there are a number of ways you could do it. I think you are having difficulty with the 10-percent surtax, why don't you just recommend—I am trying to give you a way out here, everyone else says no one gives you another answer, I am trying to give you a way out.

Mr. MAYO. Well, we have already cut the budget $4 billion to get it to $192.9 billion.

Senator HARTKE. Let's just stay with the figures first. I want to find out first exactly what you say you need. In other words, do you need the ABM, and how much is that going to cost?

Mr. MAYO. I believe the spending for ABM in the 1970 budget is in the neighborhood of $800 or $900 million.

Senator HARTKE. $800 or $900 million. That is roughly $1 billion, is that right? Now if you didn't do that you wouldn't need that money, right?

And if we vote that down in the Senate, we will save $1 billion, right?

Mr. MAYO. I think that is a correct statement.

Senator HARTKE. Now how far are we from a balanced budget?

Mr. MAYO. Part of the question would be, if you did not have ABM what else would you want in place of it?

Senator HARTKE. What I am coming back to is the simple fact that if you cut out the ABM, what if you cut back, now I am not advocating any of this, I am just saying this to you, what if you cut out the proposal by Secretary of HEW to increase the food stamp program? How much would that save you?

Mr. MAYO. In the fiscal year 1970 that would save approximately $300 million.

Senator HARTKE. All right. What if you cut out the retraining programs which have been proposed?

Mr. MAYO. Those are much smaller.

Senator HARTKE. Pardon me?

Mr. MAYO. I believe the figure on that is much smaller.

Senator HARTKE. How much?

Mr. MAYO. If we are talking about the same program, I have in mind the figure of only $30 or $40 million.

Senator HARTKE. These are all new programs, are they not?

Mr. MAYO. Yes.

Senator HARTKE. They are not programs basically which you say have a continuing obligation. In other words, there is no obligation to continue them either morally or legally.

Mr. MAYO. There is an obligation only to recognize a social or a defense need.

Senator HARTKE. Yes; which everyone can say about practically any program that comes along, depending upon his own subjective interpretation of what is socially and necessarily needed; isn't that right?

Mr. MAYO. Yes. It isn't just an individual's subjective judgment. It is a collection of them, of course, which produces a consensus in one way or another, whether it be in the administration or in the Congress.

Senator HARTKE. All right.

Now, then, if you have a decrease in your anticipated revenues, your budget deficit is going to be larger, we agree.

Mr. MAYO. Yes.

Senator HARTKE. What do you estimate that the 10-percent surtax is going to bring in for the 6-month period? That is not in the statement. It gives a combined figure of 10 percent and the 5 percent. What is the 10 percent going to bring in in the last half of 1969?

Mr. MAYO. $5.6 billion.

Senator HARTKE. $5.6, and would it be fair to say that it would bring in 11.1 in your own judgment if it can be continued for a full-year period? Is that a fair interpretation?

Mr. MAYO. I think it would be a little less than that because we are counting some spillover here. Ed, can you react to that?

Mr. COHEN. If we continued the 10-percent surtax for the entire year?

Senator HARTKE. Fiscal year.

Mr. COHEN. If we continued it until June 30, 1970, it would produce $9.5 billion in fiscal 1970, $1.9 billion more. There is a lag, Senator.

Senator HARTKE. What did it bring in last year?

Mr. COHEN. In fiscal——

Senator HARTKE. In fiscal 1969?

Mr. COHEN. In fiscal 1969 it produced $12.2 billion.

Senator HARTKE. Yes. Now you are saying that the same 10 percent will bring in less in 1970 by how much, by 1. what?

Mr. COHEN. Senator, the figures are in rough outline.

Senator HARTKE. I don't want them in rough outlines. I just want to do something that a Hoosier auditor could understand.

Now I am asking you pointblank, how much did it bring in, and you are right, 12.2 last year. What was the estimate, 11.6?

Mr. COHEN. I am sorry, I don't know the estimate.

Senator HARTKE. 11.6, I will give it to you; 11.6 last year was the estimate, and it brought in 12.2, which is a very good estimate you will have to admit; right?

Mr. COHEN. Yes.

Senator HARTKE. The inflation was a little bit more than anticipated, so it brought in a little bit more money. But what I am asking you is, why do you drop back to 9.; what is it?

Mr. COHEN. 9.5 billion.

Senator HARTKE. 9.5; you drop it by $1.7 billion, if you continue the surplus for the next year for the full year.

Mr. COHEN. I think that the reason may be corporate surcharge tax payments.

Senator HARTKE. To what?

Mr. COHEN. Corporate surcharge. The bill was passed in midyear, but the surcharge for corporations was effective as of January 1, 1968. As a result you had another 6 months of corporate surcharge.

Senator HARTKE. No, that is not the reason. I am talking of a yearly basis. That is just not fair. You are trying to give me 15 months.

Mr. COHEN. But, Senator, I believe there was an additional corporate payment required in July 1968, to make up for this, so that we did have more than 12 months' receipts in the 12-month fiscal year ended June 30, 1969.

Senator HARTKE. Let's take your own figures then and assume that you are right, $9.6 billion. It has never been brought out in these hearings, but it is a fact that the Government is a 50-percent partner in every tax collection of a corporate enterprise; isn't that correct?

Mr. COHEN. I am sorry.

Senator HARTKE. The Government is a 50-percent partner in every business operation in the country?

Mr. COHEN. Yes, but I did not know if I understood you correctly when you added "in every tax collection." It is roughly a 50-percent partner in all the net income of a corporate venture. That is correct.

Senator HARTKE. That is true. All right, now then, at a 6-percent interest rate, it was estimated that the surtax would bring in 11.1, is that right?

Mr. COHEN. I am sorry but I am not familiar with the estimate at that time. I had not been appointed at that time, Senator, so I am not familiar with the estimate going that far back.

Senator HARTKE. Can't you just take my figures for it?

Mr. COHEN. I would be delighted to.

Senator HARTKE. That they are right.

Mr. COHEN. Yes.

Senator HARTKE. But what happens when you add the rate? Your last 180-day Treasury bills went out at 7⅛, did they not, on the equivalent bond rate?

Secretary KENNEDY. 7⅜.

Senator HARTKE. 7⅜. That is equivalent to a 10-percent rate in the marketplace, is it not? Is that fair?

Secretary KENNEDY. Ed?

Mr. COHEN. Yes.

Senator HARTKE. Isn't that a fair interpretation? Let me just come on back. Your interest rates basically have gone up from 6 percent to 10 percent in a year. This is what has happened to you. That 4-percent interest in effect is a tax reduction, is it not, because it is a deduction from your cost of business, and when you are a 50-percent partner, that means that your total revenue is going to be reduced by that amount; isn't that right?

Mr. COHEN. Yes.

Senator HARTKE. All right.

Now, I am asking you where is that deduction? Where is that loss? Where is that projected loss? Let me just refer this to you before you answer that, just think about that:

"However, due to growth, revenue declined by 11.6." This is the amount of that increase.

Mr. COHEN. Senator, I am fairly confident that the reason for the estimates of this fiscal year being less than the estimates for the last fiscal year is that we did have more than 12 months last year. We had 18 months for corporations and 15 months——

Senator HARTKE. I am willing to concede that fact. I am not arguing with you on that. The point of it is that you have here a 50-percent partnership in every business concern in America, and Uncle Sam is that partner, and when those rates go from 6 to 10 percent, you in effect have reduced taxes by that amount, isn't that true?

Mr. COHEN. Are you speaking of the interest paid by one corporation or another?

Senator HARTKE. I am talking about all the corporations.

Mr. COHEN. No, then I would say "No."

Senator HARTKE. No?

Mr. COHEN. No, because if the interest is income to the lender, it is a deduction to the borrower, and from a Federal——

Senator HARTKE. But it depends on the net. It doesn't count on the top side.

Mr. COHEN. But the interest, additional interest paid by the borrower and deducted by him is income to the lender, and if they both are in a net income situation and both had the 25-percent rates, the tax revenue to the Government is——

Senator HARTKE. You know it doesn't work that way. You know as far as he is concerned that it costs him because of that 50-percent rate,

it goes out on both ends. The net result is instead of having—I don't know how much reduction it is, but I guarantee you that I can show you next year that your own revenue department will show you that the amount is a deduction because of the interest equivalent difference.

Mr. COHEN. If you are speaking about Government interest there would be a difference in the tax revenue, but interest in the private sector paid by one element of the private sector to another should produce no income tax revenue.

Senator HARTKE. I don't think you can show that, but I will be glad to let you show me how that works. Now let me come on back to something else.

Mr. COHEN. Yes, sir.

Senator HARTKE. Last year what was the stock market roughly in Dow Jones, 990, 980? No losses, right?

Mr. COHEN. No losses?

Senator HARTKE. No loss taking, was there?

Mr. COHEN. There would always be some. Net there were capital gains.

Senator HARTKE. Yes, but when the Dow Jones was 980, 970, there was very little loss taking, isn't that true?

Now it is about 880, and there is this real big amount of loss. How much have you taken into account that loss projection? I mean it is all over the board. Do you know how much that is?

Mr. COHEN. I don't know to what extent it has been realized, Senator. I am not familiar with the estimates or the effect in other years in which the market——

Senator HARTKE. Isn't a fair estimate around $2 billion?

Mr. COHEN. In revenue?

Senator HARTKE. In losses that have been taken this year, all income taxes deductible?

Mr. COHEN. Well, I would think that it would be more than that, but the losses——

Senator HARTKE. That is right. In other words that is a conservative estimate of losses. I am trying to find out—we are in this revenue picture—did you take this into consideration?

Mr. COHEN. Senator, let me point out, if I may, that a net capital loss is not deductible by a corporation as it is deductible by an individual only up to $1,000.

Now you still have in a period of a falling market net capital gains realized by some persons who have no losses, and you have no reduction effect from those who take losses but cannot offset them against ordinary income. Certainly in a period of a rising market your net capital gains tax wil be higher than in a period of a falling market, but they are not necessarily commensurate.

Senator HARTKE. But you have not taken this into consideration in the revenue picture, have you?

Mr. COHEN. I am confident that it has been taken into account by those who have estimated the total effect.

Senator HARTKE. Would you supply for the record whether it has or has not, and give me the amount that was taken into account?

Mr. COHEN. I would be happy to do so, Senator.

Senator HARTKE. All right. I would be surprised if there is any amount taken into account whatsoever.

Mr. COHEN. I have been handed a note which states that we have $1 billion less in our estimate of capital gains tax for 1969 compared to 1968.

Senator HARTKE. That is in collections.

Mr. COHEN. In the estimate.

Senator HARTKE. For fiscal 1970 or fiscal 1969?

Mr. COHEN. This was for calendar 1969, and I believe that most of this would be in fiscal 1970.

Senator HARTKE. In other words the 10 percent surtax though is not going to produce the same amount of revenue, due to these two factors, the increase in interest rate and the dropping of the stock market that it would have produced in the same period last year, is that true?

Mr. COHEN. I will not concede, Senator, that an interest rise would affect revenue. I think that in the private sector it would be largely a wash.

I would like to consider it further, but that would be my understanding. I adhere to my position that the principal reason for the estimated decrease is that in the fiscal year 1969 we had 15 months of individual surcharge receipts and 18 months of corporate surcharge receipts, and in our estimates for fiscal 1970 we have only 12 months.

Senator HARTKE. I think that your estimate is too high, if you want to know the truth. That is what I am saying. I think your estimate of revenue of 9.6 is going to be considerably higher.

Mr. COHEN. Of course that is only a factor in the estimate of the total revenue from the income tax.

Senator HARTKE. That is right, and so——

Mr. COHEN. If we are wrong in this we will be wrong——

Senator HARTKE. In the total revenue.

Mr. COHEN. In the total revenue, also.

Senator HARTKE. If you are wrong in the total revenue, that deficit could really be shocking.

Mr. COHEN. Yes.

Senator HARTKE. That is right.

Mr. COHEN. It could, and our estimate of corporate tax revenue, Senator, is down a little from the estimate for this past year. The increase is largely with respect to individual income taxes.

Senator HARTKE. Yes, I understand.

Mr. COHEN. And the increase in wages would tend to produce that.

Senator HARTKE. Yes, and if there is a slackening, a real cooling off of the economy, the corporate collection rate would be down still more.

Mr. COHEN. Yes, indeed.

Senator HARTKE. And no one has really taken into consideration or been able to give us that type of estimate, have they?

Mr. COHEN. We are estimating it in the best manner that we can.

Senator HARTKE. I know you are.

Mr. COHEN. And you must consider that other factors might affect it.

Senator HARTKE. If you get the slow down that Secretary Kennedy is talking about in the fourth quarter of 1969, and if that continues, in the third and fourth quarter of 1970 fiscal year, you could have a considerable drop in revenue, whch is equally effective to a budget deficit as much as increase in expenditures.

Mr. COHEN. Yes, it could.

Senator HARTKE. In that amount which Senator Williams has consistently pointed out during Democratic and Republican administrations, that there is a $2.7 billion loss in the Commodity Credit Corporation Fund which has never been included, isn't that true?

Mr. COHEN. I am sorry, I am not familiar with that.

Mr. MAYO. I am sorry, what was your question again, Senator?

Senator HARTKE. This is the Commodity Credit Corporation loss which has not ever been included in the budget under President Johnson's budget or President Nixon's budget, $2.7 billion, is that right, Senator Williams?

Mr. MAYO. Those losses are the net reconciliation of receipts and expenditures with reference to the capital impairment of CCC. The expenditures and the receipts themselves were reflected in the budget year by year as we went along, Senator. You are referring specifically I imagine to the $1 billion of capital impairment.

Senator HARTKE. I am talking about the $2.7 billion Commodity Credit Corporation loss.

Mr. MAYO. That is part of it. That has been reflected in the budget though. There is no omission of that from the budget.

Senator WILLIAMS. Will the Senator yield?

Senator HARTKE. Yes.

Senator WILLIAMS. It would be reflected in the unified budget. It was not reflected in the administrative budget at the time it was done. It was an expenditure but they are not receipts that were recognized, appropriated for or covered, and the Comptroller General was rather critical of that. Now reimbursing the Commodity Credit Corporation for that loss under this new unified system will not count at all because they have now gone back and charged those expenditures for the years in which they were made, is that not correct?

Mr. MAYO. It is my understanding that the expenditures took place when the cash flowed out in the first place and they were reflected in the budget over the years.

Senator WILLIAMS. I do not think so. I think that they were reflected in the cash budget.

Mr. MAYO. Yes.

Senator WILLIAMS. But we were not on a cash budget at that time. I think Mr. Cohn confirms that. I worked this out.

Mr. MAYO. All of the figures that we have been citing are consistent back over the years.

Senator WILLIAMS. They have been adjusted on this new proposal.

Mr. MAYO. I guess I would add that is another reason for the unified budget.

Senator HARTKE. President Nixon has referred to the surtax as a war tax, is that not true?

Secretary KENNEDY. That is correct.

Senator HARTKE. And in effect what he said is that we need this because of the war.

Secretary KENNEDY. Yes. He has indicated that we need it for the war effort and to adjust economic conditions, but he has emphasized the war.

Senator HARTKE. And is there not almost then an implied agreement that the war shall continue if we go ahead and put on the surtax?

Secretary KENNEDY. I would not reason that way; no. The reality is that we are at war. Vietnam has not ended. Efforts are being made to end it, efforts of the first order. The President is spending much of his personal time in this effort, but in these budget figures we are including a continuation of the Vietnam war. I think that is the only way we can project these figures.

Senator HARTKE. What is the estimated cost of the war in Vietnam for fiscal 1970?

Mr. MAYO. Approximately $25 billion, if I remember correctly.

Senator HARTKE. What was the cost last year?

Mr. MAYO. A bit larger than that.

Senator HARTKE. What?

Mr. MAYO. I believe the figure in the budget—we have a figure of $28.8 billion for military and $400 million for economic assistance in Southeast Asia, a total of $29.2 billion for fiscal 1969.

Senator HARTKE. Was that actual expenditures or the estimate?

Mr. MAYO. That is the estimate as of January.

Senator HARTKE. Yes; but that was $3 billion low, was it not?

Mr. MAYO. I am not aware of that—$3 billion low? No; the $3 billion I think you are referring to is already taken account of in that.

Senator HARTKE. In the $28.5 billion?

Mr. MAYO. Yes.

Senator HARTKE. What was the estimate for that year?

Mr. MAYO. I do not have that handy.

Senator HARTKE. What was the—pardon me?

Mr. MAYO. I am told it was about $2.7 billion less than this.

Senator HARTKE. Less. In other words, they underestimated by $3 billion roughly, and in 1966 what was the cost of the war in Vietnam?

Mr. MAYO. The actual figure is $5.8 billion for fiscal 1966. You are probably thinking of fiscal 1967, Senator, if I may anticipate you.

Senator HARTKE. Give me fiscal 1967, what is that?

Mr. MAYO. $20.1 billion.

Senator HARTKE. That was the year that they underestimated it only by 100 percent.

Mr. MAYO. Something like that.

Senator HARTKE. Yes.

Mr. MAYO. This is why we believe that fiscal prudence requires us to make an assumption that the Vietnam war will continue at its present level until proved otherwise.

Senator HARTKE. All right. But you do not make that assumption basically, because you have cut $1 billion out of the cost of the military budget, and how much of that is reduction in utilization of ammunition?

Mr. MAYO. If I remember the figures correctly, quite a significant amount is due to a reduction in ammunition.

Senator HARTKE. That is right. Has there actually been a reduction in the utilization of ammunition?

Mr. MAYO. That was my understanding at the time we were given the figures.

Senator HARTKE. How much? Secretary Laird testified that we had dropped more bombs and used more ammunition than any time in the history of the war.

Mr. MAYO. We are talking about fiscal 1970 which has not begun until a week ago.

Senator HARTKE. You are going to shoot less in 1970?

Mr. MAYO. That is implicit in the figure.

Senator HARTKE. There are three arguments in that.

Mr. MAYO. Maybe we are going to hit our targets better.

Senator HARTKE. What bothers me is that each step backward in estimated cost contains a hidden leap forward, it always appears to me.

Mr. MAYO. No.

Senator HARTKE. Because when I came here and the budget cost was estimated at $20 billion for fiscal 1967, I was accused by the Secretary at that time of not knowing what I was talking about. Of course, he came back a year later and had to admit that they did spend it. I am just asking you now on this $3-billion cut that you have projected, three items—lower consumption of ammunition in Vietnam, that is the main item; the second is the shift from the Sentinel to the Safeguard system, which is really a paper saving because in the long run the Safeguard system is estimated to cost more than $1 billion more than the Sentinel system; and third was a $326 million arrangement which occurred between March 27 and April 1 when Secretary Laird changed his mind about what was going to happen in regard to SRAM, which he said was a postponed procurement of the bomber missile that does not work. Are those not the three major items in the budget cuts?

Mr. MAYO. Yes; to be precise, the total cut in defense spending, this is outlays now for fiscal 1970, is $1.97 billion, of which Sentinel was $203 million; FB-111 was $64 million; the SRAM, $120 million; ammunition, $420 million.

Senator HARTKE. All right. Now then, in non-Vietnam military purposes——

Mr. MAYO. This includes non-Vietnam.

Senator HARTKE. I understand. I just want to get the totals. Is there more or less in the budget for 1970 for total for non-Vietnam purposes?

Mr. MAYO. The figure is larger in 1970. Again let me refer to my tables.

Senator HARTKE. By $3 billion, is that right? In other words, if we had spent the same amount of money for non-Vietnam military purposes as we did in 1969, we would have saved $3 billion.

Mr. MAYO. What we are saying here is defense military excluding Southeast Asia, $49 billion in 1969, $53 billion in 1970. That is an increase of $4 billion, and Vietnam, a decrease from $29 billion to $25 billion, a decrease of $4 billion, so the total is almost identical, 1969 and 1970. This is before our $1-billion cut.

Senator HARTKE. What it all comes down to, I mean it is a lot of confusion for most of us and for most Americans, and I think what they are worried about is how they get out of this inflationary spiral. Do you really think that the older people are able to continue to live as they did before, with about an equivalent of what is it, an 8-percent increase in the cost of living?

Mr. MAYO. Eight percent a year? No.

Senator HARTKE. Is that not what it has been the first 5 months of this year, equivalent?

Mr. MAYO. Six percent equivalent for the first 5 months or for the—yes, for the first 5 months.

Senator HARTKE. All right, for 6 percent then, do you think the old people ought to be given some consideration of this fact, those people on fixed payments, social security? In other words, that is a reduction for them in the standard of living.

Mr. MAYO. Yes, and that is one of the reasons why we believe it is very important that the surtax be extended.

Senator HARTKE. And the small businessman, is it not true, Secretary Kennedy, if we are really going to have a cutback on the loans which are available, that he is going to be the one who is going to suffer? You said before that the big man gets his money.

Secretary KENNEDY. Yes, the large corporations have avenues for credit. The smaller businesses have less.

Senator HARTKE. So really we can look forward to the time in which the old people have a reduced standard of living, in which a small businessman will have increased bankruptcies, where housing starts are already in sharp decline and are certainly not going to expand, and few new homes available. Those people involved in the homebuilding industry, if there is a reduction in the expansion of capital expenditures for corporations by removal of the 7-percent investment credit, they ultimately face—carpenters and bricklayers—face the problem of increased unemployment, and the industrial wage, which has really in purchasing power not increased since 1966, all of this adds up to a rather dismal picture, does it not?

Secretary KENNEDY. Yes; a very dismal picture. I am not so sure that it will work that way in the building industry, because one of the big pressures we have right now is wage increases in the construction area. That is one area that has been going too fast, and I do not see any serious problem of a slowdown. However, there is the possibility of a slowdown in the homebuilding industry. That is why the homebuilders are anxious to see the surtax extended.

Senator HARTKE. If the 7-percent investment credit, which incidentally the No. 1 economic adviser of President Nixon disputes as being anti-inflationary—in fact he says it is inflationary to repeal the 7-percent investment credit, and he also contends that the capital expenditure rate is down to probably at least 8 percent projection at this moment—is it not true that if there is a cutback in capital expenditure, that ultimately this man, no matter what his wage rate is, in the homebuilding industry or in the construction industry is just going to have a very difficult time finding a job?

Secretary KENNEDY. Not if it slows down and he works more normal hours. I do not think he will have any problem.

Senator HARTKE. By more normal hours, you mean he will not have any overtime?

Secretary KENNEDY. That is right.

Senator HARTKE. Even though he has built into his system of spending that overtime pay in anticipation?

Secretary KENNEDY. If you look at the rates they are receiving for common labor, $8 an hour or more, it cannot be too bad.

Senator HARTKE. Just one other item. Is it not the contention of those who have been advocating the slowdown in the economy that there is an overzealous demand for the areas that are in scarce supply? Is that not the theory?

Secretary KENNEDY. I think it is a demand-pull kind of inflation, yes.

Senator HARTKE. Now, is there really in the field of production good items any shortage of any item or overdemand for any item, and, if so, what areas?

Secretary KENNEDY. Dr. Walker, do you want to answer that?

Mr. WALKER. I think you have got to take the global figures, Senator, of the projects that were made earlier in the year under the SEC-Commerce survey, a 14-percent increase for the year shaded down slightly in the later survey.

Senator HARTKE. Now you are talking about investment.

Mr. WALKER. I thought that is what you were talking about.

Senator HARTKE. No, I am talking about overzealous demand, I am talking about production good items. I am not talking about capital expenditures.

Mr. WALKER. What do you mean by production good items?

Senator HARTKE. Automobiles, refrigerators, television sets.

Mr. WALKER. The demand for automobiles has been pretty strong. If you want to say that there are great shortages, I could not say that at the present time.

Senator HARTKE. Is there capacity for greater production of automobiles than are being supplied?

Mr. WALKER. I do not know the actual capacity.

Senator HARTKE. Is it not true that you have an industrial plant working at 82 percent capacity now?

Mr. WALKER. That is approximately correct.

Senator HARTKE. Let me just come back. Is it not true that in 1965, 4 years ago, we sold more automobiles than we did in any other year including this year even on the totals so far this year?

Mr. WALKER. I think that is probably correct.

Senator HARTKE. Is it not true you had a very strong quarter last year which is going to be very hard to keep even up automobile sales?

Mr. WALKER. The automobile industry has been doing very well, yes.

Senator HARTKE. Is it not true that the projections for sales are less for this year than last year?

Mr. WALKER. Yes.

Senator HARTKE. So they certainly can produce as much as they did last year and there certainly was not a shortage last year.

Mr. WALKER. I think that misses the mark. There is a great shortage of labor, so the 82 percent capacity figure is not a significant figure when you do not have labor available.

Senator HARTKE. You still have more than 3 percent of your population not employed.

Mr. WALKER. And many of those are teenagers and are discriminated against in the labor force. They do not have the skills, and they are moving around to other jobs. That is a very, very low level of unemployment. Your unemployment rate among married men is only about 1.6 percent.

Senator HARTKE. The point of it is you are telling me you have a shortage of skilled labor.

Mr. WALKER. Yes. I think everybody agrees.

Senator HARTKE. It has been agreed you are not going to create skills by putting people out of work. You are not going to create skills by cutting down overtime.

Mr. WALKER. You are going to create skills by having good job-training programs.

Senator HARTKE. Who is going to pay for those?

Mr. WALKER. The jobs program? It is shared by the Federal Government and the businessmen themselves.

Senator HARTKE. How many have they trained this year?

Mr. WALKER. I do not have the figures. They trained quite a few, but I wish that they could train many more.

Senator HARTKE. Less than 100,000.

Mr. WALKER. I do not have the figures, Senator.

Senator HARTKE. What I am saying to you quite honestly is that there is no shortage of production in any single line. I can get you any type of automobile at discount over list, any type of refrigerator, with or without an automatic ice tray. I can get you any type of washing machine, is that not right, any type television, 13-inch screen up to double vision with color, lights, everything you want. There is no shortage of these things.

Mr. WALKER. You are going to have a difficult time convincing my wife that the prices are not going up because we have an inflationary economy. That is the measure of inflation.

Senator HARTKE. I am not talking about that. The price has gone up in medical care. Are you going to reduce medical care?

Mr. WALKER. Food prices have gone up more in recent months than anything else.

Senator HARTKE. I do not think you can prove that.

Mr. WALKER. I think we can.

Senator HARTKE. You are going to have to back down on that one. The price of medical care has gone up much more, and the service industries have gone up faster.

Mr. WALKER. Food prices in the past 6 months———

Senator HARTKE. Not in the past 6 months, the last month. Give the last month.

Mr. WALKER. I did not mean the last month; no. In the last month—they went up eight-tenths of a point between March and April, which is a very big increase.

Senator HARTKE. I grant you that the price of groceries has gone up, but not as much as medical costs, not as much as services, generally speaking. Medical costs are up 60 percent. All I am saying to you—and if you will go back to your economics and among the games that people play is trying to devise an excuse for this type of an economy. For the life of me I cannot understand why we want a restrictive economy in the field of production of goods and a restrictive economy in the field of medical care.

Mr. WALKER. I think that the medical care factor is a very important factor in the rising cost of living. There is no question about that, but you are having general inflation across the board in the cost of living, if at a differential rate in the production goods area.

Senator HARTKE. I do not think that I can convince you anyway, so it does not make any difference, because you are committed to a policy of extending the 10-percent surtax, but I think if you want to just balance the budget, why do you not reduce it 2 percent and raise enough money to balance the budget?

Mr. WALKER. We need a surplus.

Senator HARTKE. Just one other thing. The proponents of this, just for the sake of putting it in the record— if you were not here, I will draw your attention to a book called "Hearings, Parts 1 and 2 of the President's Tax Proposal," in which they are all contained, about "how to meet the costs of Vietnam, to avoid excessively high interest rates and tight money, both of which have occurred since that time"—I am reading from the caption— "to protect our balance of payments"—and that is one I wanted to cover and I did not cover yet.

Our balance of payments are in the worst condition it has been since 1959; is that not true?

Mr. WALKER. The balance of payments?

Senator HARTKE. Right.

Mr. WALKER. The balance of payments overall had a slight surplus last year. Under the new measurements now available, it is a paradoxical situation. It is very strong on an official settlements basis but not a liquidity basis.

Secretary KENNEDY. I think it is the trade balance that you are talking about, Senator. That is the bad one.

Senator HARTKE. The trade balance is down to zero, from a surplus in 1964 down to zero now, and for the first time Japan is in a favorable trade balance relationship with us. The actual liquidity basis was even bad in the first quarter of 1969, a very sharp decrease.

Secretary KENNEDY. That is right.

Senator HARTKE. Very bad. So in other words it has failed on every count so far, but I guess we are going to have a continuance of failure.

Senator BYRD. May I ask for just three figures? Assuming the enactment of the surtax, what will be the total general fund receipts?

Mr. MAYO. The total?

Senator BYRD. General fund or Federal fund, either way you express it.

Mr. MAYO. The total Federal funds receipts including the enactment of the surtax would be $149.4 billion.

Senator BYRD. What will be the total receipts from the personal income tax, making the same assumption?

Mr. MAYO. I prefer to ask Ed Cohen that. I think he has the detail.

Mr. COHEN. I do not have the total figures. I have them only in the surcharge. The individual income tax figure estimated for the fiscal year 1970 is $91 billion.

Mr. MAYO. That is correct.

Mr. COHEN. In addition, $39 billion for the corporate income tax, for a total of $130 billion in income tax.

Senator BYRD. Total receipts, then, you estimate for fiscal 1970, assuming the continuation of the surtax, would be $91 billion from the individual income taxes?

Mr. COHEN. That is out of total budget receipts of $199.2 billion.

Senator BYRD. And that from the corporate income tax you estimated $39 billion.

Mr. COHEN. Yes; $39 billion.

Senator BYRD. And that is after credits and whatever else there might be.

Mr. COHEN. Yes; net receipts after refunds, including the surcharge.

Senator BYRD. Net after refunds but including the surtax.

Mr. COHEN. Yes.

Senator BYRD. That is the figure I wanted. Thank you very much.

Then would I be accurate in making this statement: You have in the budget—I will do a little arithmetic here for just a moment—you have in the budget a figure of $17.5 billion as the estimated interest charges, and then you estimate that you will take in from the personal or individual income tax $91 billion.

The point I am trying to suggest is this: It appears to me that 19 cents or 19 percent of the personal income tax would be required to pay the interest on the national debt for that one year, assuming that the entire interest were paid from that one fund. If that entire interest were not paid from that one fund but were paid from the total of your general fund receipts, then your interest charges would be roughly 11 cents on your general fund, total general fund receipts of $149 billion.

Mr. MAYO. Yes; that is roughly correct.

Senator BYRD. I just mention that as indicative of this tremendous interest charge that the Government is carrying.

Senator Williams?

Senator WILLIAMS. Mr. Secretary, just a couple of questions. Perhaps there is no significance in it, but I noticed in a recent Treasury report that our reserves of cash seem to be running higher, $500 million to $1 billion above what they were last year. Is that just accidental?

Secretary KENNEDY. I do not know that I can answer you, Senator. The receipts are higher because we are in a higher level of income. I do not know how many sales of securities are involved in that. We put out some Treasury bills recently, and it might have been involved in that.

Mr. WALKER. Receipts were a little higher than expected.

Secretary KENNEDY. Yes; very little though. Yes; they are a little higher.

Senator WILLIAMS. I am referring primarily to the daily cash balances.

Secretary KENNEDY. Yes.

Senator WILLIAMS. They are running on an average of close to $1 billion higher than they were a year ago.

Secretary KENNEDY. What happens in this period is a matter of expenditures as well as receipts, as you know, taking the net cash, and then the security sales are credited in there, and some tax and loan accounts. This recent tax bill offering did relate to tax and loan accounts.

Senator WILLIAMS. I understand that, but if as a result of increased receipts or less expenditures than are anticipated, I am wondering why we sold these recent bills, why we did not bring those balances down a little lower and save that much interest.

Secretary KENNEDY. We are running into a market situation in this last offering where a number of Government agencies were coming

in. We could not come in at the same time. We had to adjust our time period, and then, too, this money goes out very fast. We will have another financing within a month, so it is moving out very, very fast in this period.

We wanted also, in order to meet this very difficult market situation, to have as much tax loan credit as we could get because otherwise we pay more in the auction of the Treasury bills. The rate would have been higher on us, so it is a combination of factors. But we would only have had a week or two's adjustment in time anyway.

Senator WILLIAMS. You agree with me that to the extent that you are maintaining these balances a little larger than may be necessary——

Secretary KENNEDY. We want to keep the balance as small as we can, but given the volume of transactions we have, as you know, we need a balance around the $4 billion level.

Senator WILLIAMS. Yes. The reason that I mentioned that, I saw some hint the other day that this may be done on the basis of replenishing the reserves of the banking industry.

Secretary KENNEDY. It was not.

Senator WILLIAMS. It was not?

Secretary KENNEDY. There is no connection at all.

Mr. MAYO. Senator Williams, I have the figures here for June 30. A year ago the Treasury balance was $6.7 billion on June 30. This year it is $7.1 billion, which is about $400 million higher, which is not a significant amount really when you consider that this is a peak runup from the June 15 tax payments and July is a heavy deficit month.

Senator WILLIAMS. I know. I realize that, but there are comparable dates which run just a little in excess of $1 billion., too

Secretary KENNEDY. You can pick at such dates; yes.

Senator WILLIAMS. I notice the month of June has been fluctuating from say $400 million up to a little better than $1 billion, and I just wondered if there were any significance in that. Has there ever been any thought or consideration given that the Government should receive interest on this checking account?

Secretary KENNEDY. There have been a number of studies on that, as you know, Senator. I do not know when the last one was, 2 or 3 years ago, showing the costs involved in sales of securities and the other transactions, and at that time it was considered that on an average balance of $4 billion it was about the right amount to compensate for the work that was being done. We will take another look at that. I think that is worth while looking at.

Senator WILLIAMS. I remember that study, but as I recall the interest rates were around 4 to 4¼ percent.

Secretary KENNEDY. That is right. Of course, costs were much less then.

Senator WILLIAMS. That is correct.

Secretary KENNEDY. You have both sides of the equation.

Senator WILLIAMS. You do.

Secretary KENNEDY. So we will take a new look.

Senator WILLIAMS. A cash balance, a daily balance of $4 billion when interest rates were around 4 percent is considerably different

than when the prime rate is around 8.5 percent. I am just wondering if the money is deposited necessarily with those who have the expense of this refinancing, or is that a different group?

Secretary KENNEDY. It varies to some extent. Credit is given for securities that are sold, and the checks on tax collections that are made by corporations are credited in the banks where the corporations have their accounts. What they try to do is have the least fluctuation between the business side of the economy and the banking side. Some banks, of course, do more than others.

Senator WILLIAMS. Occasionally banks have entered into arrangements with private depositors, have they not, where they would pay them some lesser rate on an average balance in the checking accounts? That is customary, is it not, sometimes?

Secretary KENNEDY. On checking accounts, by regulation, the banks cannot pay interest. Money has to be in a time deposit before banks can pay interest on that money. To the extent that State funds are carrying interest, it has to be in the time category. It was interest payments on demand funds which started the troubles in the late twenties which led in turn to the Banking Act of 1933.

Senator WILLIAMS. The reason I raised that, I saw an item the other day inquiring whether this was just happening, and I notice there has been also a rather intriguing suggestion. Would it be possible for the Treasury to work out an arrangement where they could draw a reduced rate of interest on these cash balances and relate that to the fluctuation in the prime rate, which would put a premium on the banks to reduce the prime rate and hold it down. In other words, as the prime rate is raised 1 percent, interest on Government deposits would raise 1 percent, and if they dropped it 1, and give them a chance to vanish that out say when it reached 5.

Secretary KENNEDY. I think our bank balances of the Treasury should be operated as free balances and used to take care of our needs, because if you start to tie them up into time account categories, we will be frozen into the situation. If we want to attack high interest rates, let us attack them in a different way and not confuse the attack with tax and loan accounts.

Senator WILLIAMS. Has there been any recent study, there is this last study several years back to which you referred, as to the feasibility, advisability of the Government considering such a proposal?

Secretary KENNEDY. I know of none. We do have some time deposits in banks for specific purposes.

Senator WILLIAMS. What rate of interest?

Secretary KENNEDY. But it is merely to reimburse for certain activities that are not covered by our demand balance.

Senator WILLIAMS. What rate of interest do they draw under those circumstances?

Secretary KENNEDY. It would be very small, 2, 3, or 4 percent. I would have to look that up, Senator, but it would be a very low rate of interest. You see, the rate on savings that banks can pay is 4 percent by regulation.

Senator WILLIAMS. I just raise this point, because at a time when the Government is paying 7.5 percent, it becomes very important, as you recognize. I hope that some study will be made as to this, and if there are any suggestions that you have along that line——

Secretary KENNEDY. We can take a look at that, but we want to keep our balances free, because there are times when we really need them, when we have to transfer from one area to another, and then the lack of free balances could have impacts on the money markets that are very serious.

Senator WILLIAMS. At least we can be assured that there is no demand connection between the fact that these balances are running a little larger right at this particular time.

Secretary KENNEDY. There is not.

Senator BYRD. Senator Miller?

Senator MILLER. Mr. Secretary, you have been here a long time today. I am not going to detain you any further except for a couple of quick questions.

In your prepared remarks on page 4, you referred to the limitation on tax preferences recommendation by the administration. One thing that disappointed me was that you did not include tax-exempt municipal bonds in the limitation on tax preferences approach. I would like to find out why such bonds were omitted.

Mr. COHEN. Senator Miller, this was not included for several reasons. First, there is a question as to the legality of such a tax. Secondly and most significantly, because of the current problems in the municipal bond market, we did not think this would be an appropriate time to limit the market for the bonds. However, we did include tax-exempt interest in our allocation of deduction proposal presented to the House of Representatives on April 22. The proposal requires personal deductions by individuals to be allocated ratably between their taxable income and their tax-exempt income, and for that purpose tax-exempt interest is included.

The allocation principle has been sustained by the Supreme Court in the *Atlas Insurance Co.* case for insurance companies. But there is no similar precedent which supported the inclusion of tax-exempt income in our proposal for a limit on tax preferences.

Secretary KENNEDY. Senator, in addition, the question of what should be done with respect to tax-exempt income is being considered as a separate matter in the House Way and Means Committee, and I do not know how that will turn out because there are many problems involved.

Senator MILLER. Indeed there are, but with respect to the legality of this, it seemed to me that (a) a pretty good argument could be made fort he legality, and (b) if it should be determined it would be unconstitutional, a savings clause in the bill would certainly take care of it. It would not cause any problem. And as far as the market for tax-exempt municipals is concerned, whether that would be substantially interfered with because of the limited tax preference approach is very difficult to say I am sure, but I must tell you that there are a great many people among the general taxpayers who are quite unhappy when they read in the newspapers that somebody has invested all of their money in tax-exempt municipal bonds and have received a very fine economic income and pay no tax whatsoever to Uncle Sam.

It seemed to me that this might well be included without particularly hurting the municipal bond market. It might require some change in the portfolios on the part of some people.

Now, on page 9 of your statement, Mr. Secretary, you refer to this pollution control facility provision of the House-passed bill, and you suggest that the definition of a pollution control facility should be tightened so that the rapid amortization provisions will apply only to treatment facilities which are clearly identifiable as serving only antipollution purposes.

Suppose the taxpayer has an existing plant and has to put in a new boiler, and the boiler is going to cost $100,000, but if he will spend $150,000, he is going to be able to do a pretty good job on pollution control. Now there you have a situation where he can spend $100,000 or $150,000, and if he spends $150,000, with respect to the pollution control parts of that boiler, why should he not be allowed amortization?

Secretary KENNEDY. I think it is a matter of definition to be sure it relates to pollution control rather than other functions.

Senator MILLER. You see, that is my point, because your statement says "clearly identifiable as serving only antipollution purposes."

Secretary KENNEDY. The antipollution part of a given installation would be included in that statement, I should think.

Senator MILLER. Maybe I have made the question too simple. Suppose that you could have a boiler for $100,000 that is not going to do a job on pollution and you have another boiler for $150,000 and it may be rather difficult to pick out the various segments of that, but you do know this, there is $50,000 more being paid out for a boiler that is going to do a job on pollution. Would it not be reasonable and fair to permit a reasonable identifiable allocation for an overall facility like this?

Mr. COHEN. Yes. It might be possible, Senator, to allocate and allow amortization on the additional costs that are necessary for an antipollution, but part of this involves the question of whether you apply it to changes in existing structures or whether you are going to extend it also, as is done in the House bill, to new plants that are built.

Another question is whether you are going to allow the amortization for the cost of a smokestack which is a rather customary part of a plant facility, or whether you are going to allow it for sewer pipe, which is a major part of expenditure. It is rather difficult to know what devices are installed to prevent pollution.

On the other hand, if you are talking about a treatment facility, you do know that it is installed for the specific purpose of preventing pollution, and it is a problem of identification. If we could identify the additional cost that might be incurred to prevent pollution, it might be a simpler matter.

Senator MILLER. Mr. Secretary, suppose that there is a local municipal ordinance that states that a smoke stack must be 300-feet high, and the reason the local city fathers adopted that is because they want to minimize air pollution. But the owner of the plant concerned could certainly meet the needs of his plant with a smoke stack 100-feet high. Now there is a case where he has to build it 200 feet higher than he normally would for the sake of satisfying an air pollution requirement. I do not know that you would call that a treatment facility—that would stretch the definition of treatment facility somewhat, but it is an air pollution requirement that has been met. I wonder why that would not

satisfy the purposes and intent of the tax law if the facts that I have given you were able to be shown.

It seems to me if we are really going to encourage people to do something about pollution control, we ought to be fair across the board on it.

Now, I understand, the the Secretary brought this out in his statement about construction of new facilities, that due to technology such facilities may not cost any more than old facilities, and I understand that very well. That is why in my original question I used an existing plant for an example. But as long as you have made reference to the smoke stack, I think I might as well mention that, too, because I can see where if all I had to do is construct a 100-foot smoke stack to satisfy my boiler requirements, I might feel put upon if I had to construct one 300-feet high, and somebody down the road gets a tax amortization provision on some pollution control device and I cannot take the 200-foot cost of that smoke stack and amortize it.

Mr. COHEN. I think that if you had to replace an existing smoke stack with a new smoke stack for antipollution purposes, there is merit in your augument.

On the other hand, you do run into the boiler problem that you mentioned. A plant may have an existing boiler that may have to be replaced, and you have the question of whether the entire cost of the new boiler should be allowed for amortization or whether no amortization should be allowed to the extent that the money is being spent for a more expensive, more efficient boiler.

Senator MILLER. I do not have any trouble with that at all, because I would not allow that at all, if there was nothing more to it than that, but to the extent that the cost of that new boiler is increased to cover pollution control——

Secretary KENNEDY. Identifiable.

Senator MILLER. Then I suggest to you it would only be fair to allocate under evidence submitted by the taxpayer to permit that to be subject to amortization.

Mr. COHEN. If I can satisfy the problem of allocation, I think you can do that. This bill does not, nor did a suspension provision in 1966 provide for an allocation. It provides for extending the tax benefit to any item that is primarily installed for the purpose of combating pollution, and it an all or nothing test.

Senator MILLER. Would you have any objection to permiting an allocation in a reasonable situation such as I have described?

Mr. COHEN. If we can get, Senator, some means of determining this. Our problem is that revenue agents are not generally equipped to determine whether or the extent to which a particular addition has been installed to combat pollution and to what extent, on the other hand, it might have been used in the normal course of replacement of the facility.

I think that in the Korean war when we had 5-year amortization, we required certification by another agency of the portion of the plant which would be allocable to the emergency at the time.

Now, the procedures in the existing bill do not provide for certification by HEW or by the Interior Department of the extent to which the cost has been incurred to combat pollution, but only provides for certification that the installation is consistent with the program of

combating pollution. We would have to change the certification procedure.

Senator MILLER. I recognize the weakness in that last point. On the other hand, I would hope that we would not have to have every plant in the country have to run over to HEW to get a certificate, especially if they are trying to comply with a municipal ordinance, and I share your concern about throwing too big a load on revenue agents. This is something that I think we probably could work up in language that we could enlarge upon in regulations to make it quite clear that this is no grab bag, but as long as the intent of the Congress is to encourage people to install pollution control items, or to construct with pollution control in mind, even though it costs them more money, I believe we should come up in the end with this provision.

Mr. COHEN. Senator, I think we are conscious of the points that you make and are sympathetic to them. We feel, however, that this bill in imposing no limits in that regard has gone too far and should be tightened up.

Secretary KENNEDY. We have got to come up with some language, I think.

Senator MILLER. I share your concern about this Mr. Secretary. Thank you very much.

Thank you, Mr. Chairman.

Senator BYRD. I would like to ask one question, and then I will recognize the Senator from Arizona.

Is the Treasury Department satisfied with the legislation as passed by the House insofar as special exemptions, special rules or special consideration might be given to certain companies or groups of taxpayers in terminating the investment credit?

Secretary KENNEDY. Yes. The only question we have is with this pollution amortization schedule, and I think we have got to come up with some language to tie that in a little better.

Senator BYRD. But leaving the pollution amortization aside, is the Treasury satisfied with the rest of the proposal?

Secretary KENNEDY. The answer is yes.

Mr. COHEN. There are some language changes that we might prefer, but in essence we are satisfied.

Secretary KENNEDY. The changes would be minor clarifying changes in language; they would not be changes in substance.

Senator BYRD. In essence than it is what the House came up with you feel is a fair proposal.

Secretary KENNEDY. That is correct.

Senator BYRD. Before recognizing the Senator from Arizona, when the committee adjourns today it will adjourn to meet at 10 a.m. tomorrow.

The Senator from Arizona is recognized.

Senator FANNIN. Mr. Chairman, I regret that I did not have the opportunity to be here earlier this afternoon and I do not want to be repetitious, but in my State of Arizona we do have quite a mining industry producing better than 50 percent of all the copper produced in the country. We have an air pollution problem too. If we are going to rewrite this language, could you improve the incentive for the mines? Some of them are in nearby cities and we have an overburden

that is removed and cutting and landscaping to do. Would the credit apply to this problem? We have been able to get the mining companies to do extensive work in recent months on this problem and we want to give them this incentive.

Do you feel that they would qualify under the credit provision or do you think that they should qualify under some program that would be involved in this pollution requirement?

Mr. COHEN. Senator, I would be delighted to review this with you. I cannot tell from your description what the answers would be. We do have provisions in the amortization of pollution control facilities that would take into account items that relate to air pollution as well as water pollution. The provision on page 24 of the bill stated that—

Certified pollution control facilities means any new property that is depreciable which is used to abate or control atmospheric pollution or contamination.

As long as it is certified as being in conformity with the State program or requirements for abtement or control, and to the extent that equipment is used to control or abate atmospheric pollution or contamination, I would think it would qualify.

Senator FANNIN. That is what I was wondering. Of course on the smelters where you have the chimneys, I understand that those facilities qualify. This is quite a serious problem in one area of our State due to the presence of several large cities not too far from this particular area.

Secretary KENNEDY. I think we ought to look into that in detail to see whether it fits or whether it does not.

Senator FANNIN. Yes. I will not take the time today, but I will send the information to you so that we can bring this stipulation into the legislation, if it does fit.

Mr. COHEN. We will be happy to consider it, Senator.

Senator FANNIN. Thank you, sir.

Senator WILLIAMS. Mr. Secretary, just one question here and I will not delay.

I understood a moment ago from Senator Byrd's question you endorse the House action on the investment credit, and there are no exceptions?

Secretary KENNEDY. In essence. There may be some minor language changes, but, as I understand it, there will be no substantive changes.

Senator WILLIAMS. I am particularly referring to the three exceptions which I understand are in the bill on pages 15 and some on 17 and 18.

Secretary KENNEDY. Yes; they were put in for specific areas.

Senator WILLIAMS. Transactions, some of which run to 1973, then there was one on barges and oceangoing vessels and one on the pipelines. Do you endorse those three proposals?

Secretary KENNEDY. That is correct.

Mr. COHEN. We accepted them, Senator. We did not recommend them. We had recommended that the only credit allowed after the cutoff date would be installations made pursuant to binding contracts for the purchase of the equipment, but we accepted in committee the use, in general, of the same rules that had been provided in the 1966 suspension. We thought that these three additions would not materially differ from those that had been in the 1966 suspension.

Senator WILLIAMS. Do those fall under the exceptions of the 1966 rules?

Mr. COHEN. They do not fall precisely under the 1966 rules, but they fall under the general policy of the rules, we feel. The provisions with respect to the pipelines and with respect to the barges almost fit but did not specifically fit the 1966 rules. In the pipeline case, for example, the property was not described in the contract, but it was described in an application that had already been filed with the Federal Power Commission. It was not a contract to produce property, but a contract to transport property.

Similarly, with respect to the barges, they had been specifically designed—boats had been specifically designed to carry the barges, and we had provisions in the 1966 rules providing that where half—more than half of the cost of a total facility had been either expended on contracted for, the taxpayer would get the credit on the balance. We thought that the barges were such an integral part of the vessel itself for which it had been specifically designed that it ought to be treated as a part of the general rule for plant facilities and equipment. They are not precisely the same as the 1966 rules, but we thought they were within the general principles.

Senator WILLIAMS. You have commented on two of them. How about the third?

Mr. COHEN. The third one was more related to a provision in the 1966 law regarding the application of the investment credit to equipment purchased to fulfill an output contract. The credit applied to machinery purchased after the cutoff date if the output contract provided for the sale of substantially all the goods to be produced and the contract ran for a substantial portion of the useful life of the equipment purchased to perform the contract. The committee amendment liberalized these requirements somewhat in the case of certain new-design products.

Senator WILLIAMS. And you did not think of them at the time you sent the bill down. If you had known it, you would have included them in your bill?

Mr. COHEN. No. Our position was that we should make an exception only for property the purchase of which had been contracted for at the time. There is a delicate problem of judgment. You could even argue as to whether you should allow an exception for contracts that were binding at the time, but we agreed in committee to accept the 1966 rules, and we acquiesced three additional points.

Senator WILLIAMS. The point is when we start making exceptions I think you realize where you are going. What I wanted to get clear for the record, is that you are or that you are not endorsing these three proposals, and if you endorse them, standing by it. Let us make it clear. Do you recommend that they be deleted from the bill?

Secretary KENNEDY. I think we have agreed to acquiesce in keeping them in, because they are so similar to the earlier suspension of rules.

Senator WILLIAMS. How about if the committee finds some others that fall in a similar category? That is what we run into.

Secretary KENNEDY. Yes, I know. We do not want to open the door to all kinds of changes. There is a point beyond which you cannot go.

There were many others being considered, and they were turned down, but these were identifiable and they were, as Secretary Cohen indicated, so nearly alike in principle that we wanted the language to specifically cover them. Otherwise, there would have been confusion.

Senator WILLIAMS. You accept them and endorse them, but you would not have recommended them.

Secretary KENNEDY. We did not recommend them. In fact, we did not accept the 1966 rules to start with. However, we have acquiesced in their addition by the Ways and Means Committee.

Senator WILLIAMS. But you do not want to go back to the old line; is that correct?

Secretary KENNEDY. That is right.

Mr. COHEN. There were others, Senator, as Secretary Kennedy has said, which we opposed in committee and which were not adopted?

Senator WILLIAMS. The hearing is adjourned to 10 o'clock tomorrow morning.

(Whereupon, at 5 p.m., the committee was recessed, to reconvene Wednesday, July 9, 1969, at 10 a.m.)

PROPOSED EXTENSION OF THE SURCHARGE AND REPEAL OF THE INVESTMENT TAX CREDIT

WEDNESDAY, JULY 9, 1969

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

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

Present: Senators Long, Anderson, Gore, Talmadge, Williams, Bennett, Curtis, Miller, Jordan, and Fannin.

The CHAIRMAN. The hearing will come to order.

This morning we commence hearing the testimony of public witnesses testifying for various segments of industry and business. Our first witness if he is here today, will be Mr. William Graham Claytor, president of the Southern Railroad.

Mr. Claytor, I have received many communications from users of the railroads expressing their interest in this bill. While they are too numerous to include in the printed record, they will be placed in the official files of the committee.

You may proceed, sir. Do you have a prepared statement?

STATEMENT OF WILLIAM GRAHAM CLAYTOR, PRESIDENT, SOUTHERN RAILROAD

Mr. CLAYTOR. I do not, Mr. Chairman.

The CHAIRMAN. Then I hope you would more or less summarize your views on this matter. If you want to elaborate on them, we will accept an addendum for the record to go along with it.

Mr. CLAYTOR. Thank you very much. I did not have time to prepare my statement formally, and will just speak off the cuff as it were, but would appreciate the opportunity to submit something at a later time.[1]

My name is W. Graham Claytor, Jr. I am president of the Southern Railway system, with offices here in Washington, at 930 15th Street NW.

I want to thank the committee for this opportunity to appear and discuss some aspects of the proposed total repeal of the investment credit as contained in House bill H.R. 12290. I am not appearing as a spokesman for the railroad industry as such, but for my own railroad system and for our customers, largely in the Southeast. We serve 13 States including all the States of the Southeast plus southern Ohio, Indiana, and Illinois.

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[1] See p. 169.

First of all, I want to say clearly that I concur in the objectives of the bill, of the Congress, and of the administration to curb the inflationary spiral, and we do support extension of the 10-percent surtax as a means of doing this.

The railroad industry suffers from inflation probably more than almost any other industry because our pricing is restricted both by vigorous competition from other modes and by rate regulation.

For example, according to an ICC study, through 1967, rail rates decreased about 13 percent over those in 1958, 9 years before. In that period, consumer prices went up 15 percent, railroad construction costs went up over 4 percent, corporate profits generally went up from 1958 to 1968, 129 percent, railroad net income went down 1½ percent.

We are caught with increasing costs and we have, both because we felt this was in ours and the public interest, and because of the limitations under which we operate, have not increased our prices.

Under these circumstances, we believe that the investment credit as applied to railroad equipment is not only not inflationary, but is necessary to the railroad industry and to our shippers.

It has been one of the big factors over the last few years that has enabled us to hold the line on rate increases as well as we have, and still keep going, even though we have not kept going as well as we certainly would like to have.

Furthermore we have a unique problem in the railroad business in raising the capital that we must have for both freight cars and for our roadbed improvements. What we are asking for, therefore, is consideration of continuation of the investment credit in the limited area of railroad rolling stock as essential both to this industry and to the shippers that rely on this industry.

A subsidiary point I want to make is that as a matter of fairness the effective date of any repeal that is made should not cut off the credit for material ordered before the congressional action which was taken last month, especially as applied to the type of railroad equipment normally ordered not more than a year to 18 months in advance of delivery.

These are the two points that I want to discuss very briefly.

First of all, I want to suggest that the status of the railroad industry in our economy should be given some sympathetic consideration by Congress today. We are the only country in the world with a privately owned and operated railroad system. We think this is the best way.

We make enormous contributions to both Federal income and to State and local income in the taxes we pay. In other countries the railroad industry is supported by the taxypayers instead of supporting the taxpayers. We would like to keep it this way, but the road is rough, and we have got to have help from Congress if we are going to continue to go forward.

The railroad industry is highly capital intensive. That is to say we have to spend an enormous amount of capital every year just to stay even, and if we are going to keep up with the expanding economy we have got to spend even more.

In 1968 net capital investment was over $47,000 per employee, one of the highest in all American industry. The cost of an average new boxcar has more than doubled in the last 11 or 12 years, and we need more of them every year.

Because of the nature of our business, we have no ability, no means of raising capital for roadbed improvement. There just is not any way we can borrow money or raise equity to upgrade our railroad tracks, to expand our lines, to increase our speed and ability to carry. We have to do every bit of that out of retained earnings, that is to say we have to finance all of our work on roadbed out of what we are able to make as net profits.

Almost no other industry faces that problem to the extent we do.

In addition to that, we have to buy enormous amounts of equipment each year, and on that we have to pay a minimum of 20 percent cash downpayment. Most of us can finance the rest by equipment trust certificates in the market at, I must say, very high interest rates today, but the 20 percent down has to be paid again out of retained earnings.

Unless we have significant amounts of retained earnings, we will fall further and further behind and not be able to do the job.

Other industries and other segments even of the transportation industry do not have this problem to anything like the same degree. You see, neither the airlines nor the trucks nor the barges have maintenance-of-way capital problems. Their right-of-way is made available to them. True, they have to pay fees for it in some cases, taxes for it in some cases, but they do not have any capital expenditure problem on maintaining their right-of-way. We have to pay for it initially, we have to pay to keep it up, we have to pay to expand it, and then on top of that we pay taxes on it to all the local communities.

This is a real difference and a difference that is important financially.

In addition to this, as I have already pointed out, the rail industry from the standpoint of its profitability faces a difficult capital raising problem.

A First National City Bank study, which was put out recently, shows that return on net worth of common carrier trucks for the year 1968 was 19.1 percent; for air transport, 9.3 percent; ocean shipping, 9.3 percent. They did not include water carriers, but our estimate for class A water carriers for 1967, the latest date available, was 12.3 percent.

On the same basis, return on net worth for class 1 railroads was 3.3 percent. A return of 3.3 percent when interest rates are over 8½ percent on borrowed money. This is the capital raising problem that we face.

Under the ICC formula, which calls for return on investment in railroad property, a slightly different method of computation, the return in the railroad industry class 1 railroads in 1968 was only 2½ percent. My railroad I am glad to say is a good deal better than that.

We were of the order of 5½ percent in 1968, with the help of very substantial investment credit, but a 5½-percent return is wholly inadequate to move forward in this day and age. The railroad industry is in real difficulty from this standpoint.

The House committee report on this bill at page 11 gave as one of the many justifications for repeal of the investment credit that the economy is booming, and I would like to quote this:

> Expanding markets and high profit levels should provide sufficient investment incentive in the future, even without the investment credit.

Now with a return on investment of 2½ percent, I submit that this conclusion has no validity as applied to railroads. We are not wor-

ried about an incentive to invest. We are worried about an ability to make necessary investments to keep going forward even at the rate we now are let alone to expand with the future.

Now superimposed on this problem of raising capital generally is a problem presented not only to the railroads but to all the shippers that rely on the railroads—the freight car shortage. There is no need to take this committee's time extensively in discussing the details of this shortage. There is no disagreement I think that it has been more severe this year than at any time in recent history, and for the last few years it has always been seasonally overwhelmingly severe.

ICC affidavits submitted in a case attacking the Commission's effort to solve this problem at least to some extent with car service orders show that in the last week in March and the first week in April 1969 the freight car shortage was 18,000 to 19,000 cars compared to less than 5,000 for the corresponding period a year before.

When the grain season starts next fall, this is going to look like a car surplus. The shortage this fall I shudder to think about.

I know that the Interstate Commerce Commission, who is most deeply concerned with this, is also most well informed, and I commend to the members of this committee and its staff that a conference with the Interstate Commerce Commission on this problem might be most productive.

The ICC has issued literally dozens of car service orders in an effort to solve this problem, but these orders can do nothing but try to fairly ration the shortage. They do not solve the problem. They divide up the burden in a more equitable fashion.

Continuation of the investment credit on this badly needed railroad rolling stock will provide great aid in solving this problem, because the problem can only be solved by more cars (a), and by better utilization of the cars we have (b). Both (a) and (b) require the expenditure of capital, which the railroads can only get by increasing their net income after taxes, which is where the money comes from that goes to these things.

I would like to give an example on my own railroad. With the aid of the investment credit, which as I say has been the greatest single assistance to us in meeting our responsibilities in this area, Southern bought 271 locomotives and over 21,000 new and rebuilt freight cars in the 4-year period 1965 through 1968 at a total cost of some $239 million.

We had a credit last year of $12 million. That $12 million provided the downpayment on $60 million worth of freight cars, and we spent it all.

We projected a program to do the same for the rest of this year, and we have actually on orders for the rest of 1969 and 1970 another $165 million more locomotives and cars, because we feel that the only way we can lick this shortage is to get the cars that are required, and we are determined to do our part, but if the investment credit, which is the thing that is enabling us to finance this, goes we just won't be able to do it. It is not a matter of incentives, it is a matter of ability. The railroad industry just has not got the money, and this device as applied to the unique problem we have has done more than anything else to enable us to meet our responsibilities in this area.

We think really it is anti-inflationary, not inflationary, because as I pointed out before, we have been slow in increasing our prices compared to the rest of the economy. We on Southern, in fact we in the whole Southeast, have been leaders in saying we do not want freight rate increases unless we absolutely have to have them. They do drive some business away.

We have competition as well as regulation to cope with, and we have been the ones who have been slowest to increase our rates.

If the investment credit goes, I am confident that we will have no alternative, even though it is a disagreeable alternative, to going after substantial additional freight rate increases. Last year on our railroad 28 percent of our net income after taxes was represented by the investment credit. This is a tremendous slug. It was more than any other year because we had a substantial carryover, and we took all of it and put it into new capital equipment. But this is true to a greater or lesser extent of many railroads if not all of them in the industry. I really think continuation in this limited fashion for this limited purpose is not inflationary but anti-inflationary. It would certainly strengthen my hand in opposing additional rate increases.

Now the last item that I want to mention in conclusion is a word about the cutoff date. Most of us in the railroad business buy our locomotives and cars from about 6 months to 18 months in advance of delivery. This spring we on Southern were right in the middle of our purchase programs for delivery at the end of 1969 and for the year 1970 when the investment credit repeal was formally proposed.

We normally study the types of cars we need quite carefully, and then look at the situation with the car supply and place our orders as I say from 6 months to 18 months in advance, seldom more than that.

About one-third of our program had already been ordered and accepted prior to April 18. The other two-thirds we went ahead and placed on order thereafter. We placed it in April and May, all for delivery prior to the end of 1970. To go back to April 18 now and cut off all of these ordinary business orders that were conformed after that date, even though the orders are formerly delivery in ordinary course, delivery this year and in 1970, will work a severe hardship not only on us but on the rest of what I am afraid is an already badly battered industry.

Gentlemen, thank you very much. I will be glad to answer any questions that I can.

The CHAIRMAN. Senator Anderson?

Senator ANDERSON. What would you do now if you were here?

Mr. CLAYTOR. I would extend—I would continue permanently the investment credit for railroad rolling stock, not for the industry as such, but for railroad rolling stock. This will not only help the industry, but it will also be the best step that can be taken in enabling us to eliminate this terrible shortage which is going to continue, the shortage of freight cars and of the locomotives to haul them. The locomotives are equally important. This last year we on Southern had to "plug" as we call it one or two trains almost every day during the height of the car shortage. That means that a train was ready to leave the yard all made up, we did not have any locomotive to pull it,

because we were too short of locomotives. We had to leave the train sit there for maybe 12 hours until we could get locomotives available. This is why we redoubled our locomotive orders. "Plugging" freight trains in turn adversely affected the freight car supply because all those freight cars were sitting there not doing any work because there was nothing to pull them.

To me this is a justified extension, not an inflationary move, and will really do more for not just the railroads and their shippers, but for the good of the economy than anything else we can do, and goodness knows, as I said at the beginning, no one is more badly hurt by this inflation than we are. The inflation inflates everything except our net income.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. Mr. Claytor, I want to compliment you on your statement. You make a very impressive case. Of course, as you know, Southern serves Georgia.

Mr. CLAYTOR. Yes, sir.

Senator TALMADGE. I want to congratulate you on inaugurating the so-called Big John made available to bring in our growing poultry and livestock industry at reduced rates. I also want to compliment the Southern for coming in from time to time and advocating a reduction in freight rates rather than an increase as some other means of transportation have done.

You mentioned rolling stock. Did I understand you to say that there is a shortage of 17,000 boxcars in the country?

Mr. CLAYTOR. The shortage varies from week to week, Senator. It happens that the Interstate Commerce study, the data I had available, was for the last week in March and the first week in April, and there were 17,000 and 18,000, respectively, in each of those weeks that were short.

Now it is different every week. The significant thing about this is that normally in most years there is very little shortage in the spring of the year. This is the time when seasonally the cars are a little misplaced, but usually not short overall significantly. This year they are short overall at a time of year when this is not normal. The normal shortage, the normal shortage takes place when the grain comes in, when the grain harvest comes in in the fall.

Senator TALMADGE. I get reports from time to time in Georgia and other areas of the country about a shortage of boxcars. Is that through negligence of the railroad or because there are no boxcars available?

Mr. CLAYTOR. It is because there are not enough available, Senator. Now I will be the first one to say that we ought to use these cars more efficiently. We ought to move them faster. One problem that keeps them from moving faster was the one I mentioned, which as I say is our fault in a sense. We did not have engines to move them. We have to rectify that by getting more engines.

There are many other problems that need to be improved through utilization including I may say one of the most important, the present rules which permit cars to be held for a number of days by shippers without being unloaded. This means that a car—I think

our studies showed that the average boxcar on our line is permitted to be held for 12 days out of every month in the hands of a shipper without charge to the shipper. This is for the shipper's convenience. It is a historic thing. To cut that down increases the shipper's costs. The shippers are against it. We have tried from time to time to change these rules, and we are still trying. But boxcars are things that ought to be turned around quickly the way truck trailers are.

The trucking industry does not put up with that sort of thing. Those trucks get unloaded when they come in. Boxcars ought to be treated that way. That would greatly increase the supply. But the railroads are not without fault. We let them sit in the yards too long.

We need great management improvements on that. We need capital improvements. Southern has this year spent $10 million on a completely new computer system, which I am confident is going to increase our car utilization significantly.

The great thing is it takes money, capital money, and we have no means of raising money for things like this really except by increasing our earnings after taxes, because that is where the money has got to come from.

Senator TALMADGE. Did I understand you to say that the average return on the American railroad industry on invested capital is 2½ percent?

Mr. CLAYTOR. In 1968 the figure was slightly under 2½ percent.

Senator TALMADGE. Is that the lowest of any industry in the United States?

Mr. CLAYTOR. I would hate to say any industry. Perhaps harness-makers may be worse off, but it is low enough so that it is an extremely unattractive yield as you can see.

Senator TALMADGE. You are asking us to make the investment credit available for rolling stock?

Mr. CLAYTOR. Yes, sir.

Senator TALMADGE. You compete of course with airlines. You also compete with the trucking industry. You also compete with pipelines?

Mr. CLAYTOR. That is right.

Senator TALMADGE. Why should Congress give you an advantage over your other competitors?

Mr. CLAYTOR. I think the answer is primarily in the difference between the two industries, both in our ability to perform financially and in the kind of problem that we have. The main difference is that the railroads are the only one of these industries with the exception of pipelines which I will put aside for the moment, the real competitors are the trucks and the barges. Trucks and barges are our competition for moving freight, big competition.

Neither of them has any requirement of capital expenditure that amounts to anything for right-of-way. Their right-of-way is provided by the Government.

Senator TALMADGE. What you are saying is that the taxpayers build the roads that the truckers travel over?

Mr. CLAYTOR. That is right. Now I do not want to overstate this. I recognize that the trucks are required to pay a fee for using the highways in the form of a tax. There is some question about whether it is adequate or inadequate, but even if we assume that they pay an

adequate charge for using the highway, they are relieved of maintenance, they are relieved of the capital investment in those highways, which is the big thing. They do not have to put out $20 million to build a new section of the Interstate.

When we have to relocate one of our railroad lines, as we frequently do to get around a grade that is inadequate and to improve the service, we have got to put that $20 million in the ground ourselves, and then we pay taxes to the local county on it after we put it in.

This is the tremendous difference it seems to me between the two classes of competition, and it is reflected in the return on investment. Common carrier trucks get a nearly 20 percent return on investment, that was in 1968, barges around 12 percent, class A barges around 12 percent, railroads 2½ to 3 percent.

Senator TALMADGE. I believe you also mentioned something about the effective date of the cutoff?

Mr. CLAYTOR. Yes, sir.

Senator TALMADGE. How would that affect you and why should we change the Ways and Means Committee bill?

Mr. CLAYTOR. Well, I am hoping that the investment credit will be continued for railroad rolling stock, which would make the cutoff date less crucial to us, although it would still be important from the standpoint of other items in the investment credit that would not be continued.

It seems to me that the fair thing to do would be to make the cutoff date the date that either the House committee acted or this committee voted on June 25 to accept the general principles of the House committee, that then congressional action might draw the line.

Senator TALMADGE. What you object to is the retroactivity?

Mr. CLAYTOR. The retroactivity. Senator, back in, I am trying to remember my dates, but back in March, I think it was, we and everybody else, there are not any insiders in this business, everybody gets the word about the same time, got the word that the administration was considering repealing the investment credit.

It turned out to be, as most of these rumors do, turned out to be false at that time.

We got another rumor around the middle of April, and that turned out to be true. To say that because a word generally gets around that something is or is not about to be proposed then you go back retroactively and cut the date off at the time seems to me to be just unfair in the real world the way things work. This town is full of rumors, and in fact every one of the marketletters and the various newsletters that go out over the country carry these rumors to everybody, and most of them are wrong.

Senator TALMADGE. That is the next question I anticipated asking you. There is some rumor around town that there was a leak in one of the Federal agencies, maybe the Treasury or the White House on this message from the President on repeal of investment credit, indicating that it was coming up, and that many businesses immediately placed huge orders. In fact I have heard one rumor that stated they placed orders as high as $900 million in order to get in under the deadline.

Did you receive any such rumor?

Mr. CLAYTOR. Yes, indeed. I heard rumors, as I say, around the middle of that week that the administration was considering doing this, and it was the same rumor I had heard 3 weeks before that it was going to be done that weekend. It turned out to be wrong the first time. Now it turned out to be right the second time, but this is one of those things. As I say, we have rumors. I would hate to tabulate all the rumors that have been picked up since the first of January, about what is going to happen about 80 percent of which did not happen and 20 percent perhaps did.

Senator TALMADGE. Did you place any orders based on the rumors to get ahead of the deadline?

Mr. CLAYTOR. I certainly did, and so would anyone else, but not orders that would not have been placed anyway. What we have as I say, this time of year we are normally projecting our requirements which include really not so much what we need as what we think we can afford to buy in the way of freight cars over the next 18 months.

As of the early part of April, we had about one-third of our program actually on order. Actually when I heard the first rumor back in March or the first of April, I quickly asked the people who were doing the studying where were we on the projection of the types of cars we needed. We were about ready. I said let us get those orders in. Conceivably they might cut it off.

If we do not have the investment credit, we cannot afford to pay for them, so let us get the orders in.

I did the same thing when I heard the second rumor. I said now I know we have another batch of cars here that we are ordering for 1970, and I found out where they were and I expedited the filing of those orders.

They were orders that we were planning to file in May anyway, so I moved them up.

There were others that we were not in a position to place because we had not decided on the characteristics. These were locomotive orders, and these locomotive orders we worked on during the first 3 weeks in May, and we then filed them. We actually placed our locomotive orders for delivery at the end of 1969 and in 1970 sometime in May, 3 or 4 weeks after the announcement had actually come out, but these were orders again that would have been placed in any event along about this time.

Now if the investment credit does not apply to these, we may be in some difficulty, because as I say the problem is not what we need, it is what we can afford to buy, and I have placed those orders in the at least serious hope that I was going to be able to pay for them with investment credit money to the extent I could.

If the investment credit on these purchases is taken away from them, I am going to be badly pinched. You can say, well you took your own chances, it had already been announced when you put those locomotive orders in, and this is true, but it does seem to me that for this industry for this type of equipment that is so desperately needed, and for an industry that is so hard pressed, that it would be particularly unfair to go back and put a retroactive date like April 18 on all these orders.

Senator TALMADGE. Thank you, Mr. Claytor.

Thank you, Mr. Chairman.

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The CHAIRMAN. Senator Jordan?

Senator JORDAN. No questions.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Thank you, Mr. Chairman.

Mr. Claytor, what is the availability now of freight cars relative to demand? I happen to be from Arizona and I know that in California-Arizona at the present time we have a great shortage of cars for the shipment of vegetables and citrus. I am just wondering what situation exists as far as your railroad is concerned.

Mr. CLAYTOR. During June we had a shortage of box cars particularly almost every day. We varied on our railroad, I get a morning report as to the number of cars requested and the number of cars we can supply and the shortage. It has usually averaged around 50 to 60 cars every day. Since the first of July business has fallen off substantially.

It is a seasonal thing in part, the holiday and other things, and I have not had a reported box car shortage for about the last 5 days, the first time I think in 6 months. But the box car shortage, as I say, has continued through this spring in a way that I believe has never happened before for this time of year.

Senator FANNIN. We have had one of the most serious car shortages because we do have perishables and I assume that that is a problem that you have too—the hauling of perishables.

Mr. CLAYTOR. This is right, Senator. We serve the Florida perishable market, too, and it is a most severe problem. To a man who is trying to make money in a business in which this is a hard thing to do, it is most painful to have a president of a big company call up and say, "I ordered 40 boxcars for delivery on Monday and I got 15, and I have got my warehouse overflowing and I am now arranging to send all this stuff to Chicago by truck because you will not give me cars." I cannot afford to have business like that disappear, and yet that has happened over and over and over again. It is hard to take.

Senator FANNIN. When you are talking about going all the way across the country, you are talking about coming all the way down South, aren't you?

Mr. CLAYTOR. Practically all of the Southeast, south of Ohio and Potomac, east of the Mississippi. We only go into Florida as far as north Florida, but all the rest of the South, and, of course, we handle a lot of fruits and vegetables out of Florida, too.

Senator FANNIN. I understand. What is your leadtime on equipment purchases? What would be your normal leadtime?

Mr. CLAYTOR. Normally not less than—we have gotten cars on as short a leadtime as 3 months, but normally it is of the order of 6 months, between 6 months and 18 months. It depends greatly on the condition of the suppliers. We try to order over 6 months in advance, and usually a year in advance if we can.

We cannot always do that, and suddenly we find a certain type of car we need in a hurry; we shop around to find a carbuilder who has some capacity available, but, generally speaking, how much leadtime you have to have depends on the situation with the carbuilders.

Frequently, the carbuilders for special types of equipment have their carlines filled up for so many months, and you cannot get any from

them, but it is fair to say that we on our railroad have, on occasion, contracted for new and rebuilt cars as far in advance as 28 months, but the normal thing is 6 to 18 months, I would say.

Senator FANNIN. Do you purchase your cars outright or do you lease them?

Mr. CLAYTOR. We have in the past—it depends on, basically, what is the cheapest way to finance them under the particular circumstance. For our railroad, we have purchased everything for about the last 5 years. We leased a few cars back in the early 1960's because, under the situation which then existed, that seemed to be a cheaper way to finance it.

I must say that an important factor in this, of course, is the investment credit to us.

Senator FANNIN. Yes.

Mr. CLAYTOR. A railroad which does not have net income or enough net income to really take advantage of the investment credit still gets the advantage of it, and is able to buy more freight cars than it otherwise would by adopting the lease technique, so that the investment credit is equally valuable to a railroad, we will say, that pays no taxes, because it then does not buy its cars. It arranges for a leasing company to buy the cars, take the investment credit and pass the benefit of it along to the railroad at lower leasing terms, and this therefore enables the railroad to get the benefit of the investment credit whether or not it is in an income-tax-paying position.

Senator FANNIN. Thank you, very much.

Mr. CLAYTOR. Thank you, Senator.

The CHAIRMAN. Thank you, sir.

Mr. CLAYTOR. Thank you so much, sir.

(The following statement was subsequently received by the committee:)

STATEMENT OF W. GRAHAM CLAYTOR, JR., PRESIDENT, SOUTHERN RAILWAY SYSTEM

My name is W. Graham Claytor, Jr. I am President of the Southern Railway System, with offices in Washington, D.C.

I want to thank the committee for this opportunity to appear and discuss some aspects of the proposed total repeal of the investment credit as contained in House Bill H.R. 12290. I am not appearing as a spokesman for the railroad industry as such, but for my own railroad system and for our customers, largely in the Southeast. We serve 13 States including all the states of the Southeast plus Southern Ohio, Indiana and Illinois.

First of all, I want to say clearly that I concur in the objectives of the bill, of the Congress and of the Administration to curb the inflationary spiral, and we do support extension of the 10 per cent surtax as a means of doing this.

The railroad industry suffers from inflation probably more than almost any other industry because our pricing is restricted both by vigorous competition from other modes of transportation and by rate regulation.

For example, according to an Interstate Commerce study, railroad freight rates decreased 13 per cent during the period from 1958 through 1967 and consumer prices increased 15 per cent.[1] During the period from 1958 to 1968 corporate profits generally went up 129 per cent,[2] while railroad industry net income declined 1½ per cent.[3]

We are faced with increasing costs of labor and materials but we have not

[1] "Transport Economics," Interstate Commerce Commission, Bureau of Economics, June 1968.

[2] Department of Commerce, Survey of Current Business 1968.

[3] Association of American Railroads 1969 Yearbook of Railroad Facts. (P. 126.)

increased our prices because we felt this was in our interest and in the public interest, and because of the limitations under which we operate.

Under these circumstances we believe that the investment credit as applied to railroad equipment is not inflationary but, on the contrary is counter inflationary and is necessary to the railroad industry and to our shippers.

The investment credit has been one of the singularly significant factors over the last few years which has enabled us to hold the line on rate increases as well as we have and still maintain a steady level of growth.

Furthermore we have a unique problem in the railroad business in raising the necessary capital for the acquisition of freight cars and for improvements of our road bed. What we are seeking, therefore, is continuation of the investment credit in the limited area of railroad rolling stock as essential both to this industry and to the shippers that rely on this industry.

A subsidiary point I want to make is that as a matter of fairness the effective date of any repeal that is made should not cut off the credit for material ordered before the congressional action which was taken last month, especially as applied to the type of railroad equipment normally ordered not more than a year to 18 months in advance of delivery.

These are the two points that I want to discuss very briefly.

First of all I want to suggest that the status of the railroad industry in our economy should be given some sympathetic consideration by Congress today. We are the only country in the world with a privately owned and operated railroad system. We think this is the best way.

We make enormous contributions to both Federal revenues and to State and local revenues in the taxes we pay. In other countries the railroad industry is supported by the taxpayers instead of supporting the taxpayers. We would like to keep it this way, but it is difficult, and we have got to have help from Congress if we are going to continue to go forward.

The Railroad industry has a high requirement for capital investment. That is to say we have to spend an enormous amount of capital every year just to stay even, and if we are going to keep up with the expanding economy we have got to spend even more.

In 1968 net capital investment was over $47,000 per employee,[4] one of the highest in American industry. The cost of an average new boxcar has more than doubled in the last eleven or twelve years, and we need more of them every year.

Because of the nature of our business, we have a limited ability to raise capital for road bed improvement. There just is not any way we can borrow money or raise equity to upgrade our railroad tracks, to expand our lines, to increase our speed and ability to carry freight. We have to do every bit of that out of retained earnings, that is to say we have to finance all of our work on road bed out of what we are able to make as net profits. Almost no other industry faces that problem to the extent we do.

In addition to that, we have to buy substantial amounts of new equipment each year, and on that we have to pay a minimum of 20 per cent cash down payment. Most of us finance the balance of the purchase price by equipment trust certificates in the market at very high interest rates today, but the 20 per cent down has to be paid again out of retained earnings. Unless we have significant amounts of retained earnings, we will fall further behind and not be able to do the job.

Other industries and other segments of the transportation industry do not have this problem to anything like the same degree. You see, neither the airlines nor the truck nor the barges have the problem of providing capital for maintenance road way. Their right of way is made available to them. True, they have to pay fees for it in some cases, taxes for it in others, but they do not have any capital expenditure problem on maintaining a right of way. We must make the initial expenditure, we must pay to keep it up and we must pay to expand it. On top of that we pay taxes on our right of way to all the local communities in which we have property. This is a real difference and a difference that is important financially.

In addition to this, the rail industry from the standpoint of its profitability faces a difficult capital-raising problem.

A recent First National City Bank study shows that return on net worth of common carrier trucks for the year 1968 was 19.1 per cent, for air transport 9.3 per cent and for ocean shipping 9.3 per cent. On the same basis,

[4] Association of American Railroads 1969 Yearbook of Railroad Facts, p. 73.

return on net worth for class 1 railroads was 3.3 per cent, a return of 3.3 per cent when interest rates are over 8½ per cent on borrowed money.[5] This is the capital-raising problem that we face.

Under the ICC formula, which provides for a return on investment in railroad property, the return in the railroad industry for class 1 railroads in 1968 was only 2½ per cent.[6] The railroad industry is in real difficulty from this standpoint.

Southern Railway is earning a 5½ per cent return, but even this is wholly inadequate to move forward in this day and age. I wish to pont out that this is due in some measure to the beneficial effect of the investment credit.

The House Ways and Means Committee Report on this bill at page 11 gave as one of the many justifications for repeal of the investment credit that the economy is booming, and I would like to quote this:

"Expanding markets and high profit levels should provide sufficient investment incentive in the future, even without the investment credit."

With a return on investment of 2½ per cent, I submit that this conclusion has no validity when it is applied to the railroad industry. We are not worried about an incentive to invest. We are worried about an ability to make necessary investments to keep going forward even at the present rate let alone to expand with the future.

Superimposed on this problem of raising capital generally is a problem presented not only to the railroads but to all the shippers that rely on the railroads—the freight car shortage. It has been demonstrated to this committee that the freight car shortage has been more severe this year than at any time in recent history. For the last few years it has consistently been severe on a seasonable basis. In the last week in March and the first week in April 1969 the freight car shortage was 16,000 to 17,000[7] cars compared to less than 5,000 for the corresponding period a year before.

When the grain season starts next fall, this is going to create serious problems for grain dealers and shippers.

I know that the Interstate Commerce Commission, which is most deeply concerned with this, is also most well informed, and I recommend to the members of this committee and its staff that a conference with the Interstate Commerce Commission on this problem might be most productive.

The ICC has issued numerous car service orders in an effort to solve this problem, but these orders can do nothing but try to ration the available cars on a fair basis. They do not solve the problem. They divide up the burden in a more equitable fashion.

Continuation of the investment credit on this badly needed railroad rolling stock will provide a great aid in solving this problem, because the problem can only be solved by the acquisition of more cars and by better utilization of existing cars. Both objectives require the expenditure of capital, which the railroads can only get by increasing their net income after taxes.

I would like to give an example on my own railroad. With the aid of the investment credit, which has been the greatest single element of assistance to us in meeting our responsibilities in this area, Southern bought 271 locomotives and over 21,000 new and rebuilt freight cars in the four-year period 1965 through 1968 at a total cost of some $239 million. We had an investment credit last year of $12 million. That $12 million provided the down payment on $60 million worth of freight cars.

We projected a program to do the same for the rest of this year, and we have actually on order for the rest of '69 and '70 another $165 million more in locomotives and freight cars, because we feel that the only way we can solve the shortage is to get the cars that are required. We are determined to do our part, but if the investment credit is terminated, we will be unable to finance the purchases. The railroad industry does not have the capital to do this and the investment credit has done more than anything else to enable us to meet our responsibilities in this area.

The investment credit is anti-inflationary, not inflationary, when applied to the railroad industry. We have been slow to increase our prices compared to the rest of the economy. We on Southern, in fact, we in the whole southeast,

[5] First National City Bank Monthly Economic Letter, April 1969. (P. 41.)
[6] Association of American Railroads 1969 Yearbook of Railroad Facts. (P. 24.)
[7] Association of American Railroads Car Service Division Weekly Report.

have been leaders in saying we do not want freight rate increases unless they are absolutely necessary. Higher rates do drive some business away. We have competition as well as regulation to cope with, and the railroads have been the ones who have been slowest to increase freight rates.

If the investment credit is repealed, I am confident that we will have no other alternative, even though it is a disagreeable alternative, to going after substantial additional freight rate increases which would be an inflationary move. Last year on our railroad 28 per cent of our net income after taxes was represented by the investment credit. It was more than any other year because we had a substantial carryover, and we took all of it and put it into new capital equipment. Continuation of the investment credit in this limited fashion for this limited purpose is not inflationary but anti-inflationary. It would certainly strengthen our position in opposing freight rate increases.

Now the last item that I want to discuss is a word about the proposed effective date of the bill. Most of us in the railroad industry order our locomotives and freight cars about six months to eighteen months in advance of delivery. This spring Southern was in the middle of our purchasing programs set for deliveries to the end of 1969 and for the entire year 1970 when the investment credit repeal was formally proposed. We normally study the types of cars we need quite carefully, and then look at the situation regarding the car supply and place such orders six months to eighteen months in advance.

About one-third of our program had already been ordered and accepted prior to April 18. The other two-thirds we went ahead and placed on order thereafter. We placed them in April and May, all for delivery prior to the end of 1970. To go back to April 18 now and cut off all of these ordinary business orders that were confirmed after that date, even though the equipment is delivered in ordinary course later this year and through 1970, will work a severe hardship not only on Southern, but the entire railroad industry.

The CHAIRMAN. The next witness will be Mr. Paul D. Seghers, president of the Institute on U.S. Taxation of Foreign Income, Inc.

STATEMENT OF PAUL D. SEGHERS, PRESIDENT OF THE INSTITUTE ON U.S. TAXATION AND FOREIGN INCOME, INC.

Mr. SEGHERS. My name is Paul D. Seghers, and I appear today as president of the Institute on U.S. Taxation of Foreign Income, Inc., and we thank the committee for this opportunity to appear.

No matter how you slice it, a pound of baloney is still a pound of baloney. I am saying that because many excuses have been given for the thing that I am protesting, and when they get through, they do not solve the problem.

The stockholders of a corporation taxpayer which is required to pay, for example, 14 percent more U.S. income tax on its 1969 income than it would have paid on the same amount of 1967 income, cannot be made to believe that its U.S. tax burden is increased only 10 percent. And if other corporations are paying an increase of only 10 percent, those stockholders will resent paying an increase in the U.S. tax burden 40 percent higher than paid by some other corporations.

This is a typical example of U.S. corporations bringing home income from abroad. I repeat, no matter how you slice it, a pound of baloney is still a pound of baloney, and a lot of baloney was used to put this across, and it needs to be corrected.

This institute is not here to protest against the extension of the surcharge tax. All that it seeks is a correction of the tricky, inequitable method of computing that tax, which penalizes U.S. taxpayers that bring home taxable income from abroad.

This is no novel complaint—this injustice was pointed out by other organizations as well as by this institute early in 1967, and urged in its August 3, 1967, statement and appearance before the Ways and Means Committee, and in a number of subsequent statements and appearances before that committee and other congressional committees.

Twice before there has been a last minute rush act passage of a bill, without elimination of this discriminatory, inequitable, and unwise provision—it was just too late for any changes.

Must the same rush act be repeated?

What is our complaint, and what is it that we—along with others—ask?

As stated in our August 3, 1967, appearance before the Ways and Means Committee:

> Our recommendation: The 10-percent surtax should be exactly that—10 percent added to the amount of tax otherwise payable under existing law—neither more nor less.

Stated in other terms, the surcharge should be 10 percent of the net tax liability, computed after all allowable credits. This is essential in order for all taxpayers to bear a uniform and proportional increase in the amount of their U.S. income tax burden.

There are many other discriminatory tax burdens imposed on U.S. manufacturers selling their goods abroad. Let me repeat that—many other discriminatory tax burdens are imposed on U.S. manufacturers selling their goods abroad, which tend to aggravate the annual deficit in our balance of payments. At this time, however, we only ask this committee to eliminate this U.S. tax penalty on U.S. exports and on the bringing home of income from abroad.

The imposition of this penalty has helped to worsen our balance-of-payments deficit and to cut down our favorable balance of trade.

We ask this committee to take the statesmanlike position worthy of its traditions and to eliminate this discriminatory provision.

The 10-percent surcharge tax should be 10 percent of the amount of U.S. tax which would be payable in the absence of this surcharge. It should not be computed, as at present, by a method which has the effect of reducing by 10 percent the benefit of the foreign tax credit and the Western Hemisphere Trade Corp. deduction. Tax reform here would evidence a genuine intention of Congress to help, rather than to discourage, the export of U.S. products.

A dollar of export sales means more to the economy of our country and to our balance of payments than a few extra pennies of tax. Do not reduce the dollar inflow in the effort to squeeze out the extra pennies. Do not penalize exports. Do not discourage the small manufacturer who might otherwise enter the export field.

It would be a simple matter to amend the bill now before you, so as to eliminate the present discriminatory method of computing the 10-percent surcharge tax. With the permission of your chairman I will suggest the wording of such an amendment:

Proposed amendment of the 10-percent surcharge tax provisiosn of the Internal Revenue Code: (1) Strike out subsection (d) of section 51; (2) amend——

Senator GORE. Mr. Chairman, before the gentleman reads his technical amendment, he has a technical sentence here I would like to understand.

Would you explain just what you mean by the first sentence: "No matter how you slice it a pound of baloney is still a pound of baloney"?

Mr. SEGHERS. I say by way of explanation that to say that this does not penalize the bringing home of foreign income is a lot of baloney. If a U.S. taxpayer must pay more than a 10-percent increase in taxes, he is paying a discriminatory tax, and I do not care how long an explanation you give, you are still taking away more dollars of U.S. tax, more than 10 percent of what would be payable in the absence of this provision.

Now any other explanation to me is just baloney. If the tax bill goes up 14 percent it is not 10 percent. You can explain it as much as you want, it is still baloney.

Senator GORE. That does not explain this sentence though. What do you mean by this sentence?

Mr. SEGHERS. It does not explain the sentence?

Senator GORE. Is there some secret formula concealed in this sentence?

Mr. SEGHERS. There is nothing concealed in it. I am stating very frankly what I think of the explanations and excuses that have been used to justify this provision.

Senator GORE. I was anxious to find its meaning. It does not mean anything on the surface, and if there is no meaning concealed what does it mean?

Mr. SEGHERS. I regret that you do not understand it.

Senator GORE. You regret I do not understand it. Thank you; now I will attempt to understand your amendment.

Mr. SEGHERS. If I may proceed.

1. Strike out subsection (d) of section 51.

That subsection (d) would penalize Western Hemisphere trade corporations.

2. Amend subsection (b) of section 51 by striking out the portion thereof following the words "prior to aggregation" and adding the following: "and reduced by an amount equal to the sum of any credits which would be allowable under sections 33, 37, and 38 if no tax were imposed by this section for such taxable year."

Very simply stated that is equivalent to saying that the surcharge should be 10 percent of the net tax liability computed after all allowable credits.

The CHAIRMAN. Some of our staff do not agree with you, but I personally think you are right about it, Mr. Seghers.

If it is a 10-percent surcharge it ought to be a 10-percent surcharge. If you are paying 14 percent I think you have got a right to complain.

Mr. SEGHERS. Thank you very much, Senator. The reason that it did not get attention was, first of all, "we did not think we were going to pass it," and again, "we did not think we would act on it," and now, all of a sudden, there is a "rush act."

Now I say there is time to do it right.

In conclusion, we sincerely thank you once again, thank this committee for giving us this opportunity to present this recommendation, which we believe to be for the best interest of our country.

We hope we will be given a further opportunity, in connection with your subsequent consideration of other tax reform proposals to present further institute recommendations for the removal of unwise U.S. tax

burdens on U.S. business abroad. Increased exports and increased U.S. business abroad mean stronger ties between our country and other countries of the free world.

This is something for which I have been talking, fighting for as far as in my power lies, for a number of years. I believe firmly that whatever strengthens our overseas business strengthens our friendly ties.

Unlike government, business cannot take money from people against their will—buyers must value what they get more highly than the price they pay—otherwise they would not part with their money.

Now I am speaking of the manufacturing industry and its selling of goods abroad. They are not exploiting a foreign country when they sell their goods abroad. The local people, the inhabitants, are not required to buy one penny. If they do, they feel they are getting their money's worth and therefore there is no exploitation. On the contrary it makes more friendship. That friendship is resented, of course, by some people.

This statement has been made intentionally brief—it has only one purpose—to ask the Congress to correct an inequitable discrimination against those taxpayers bringing home income from abroad. If there is any point on which I have failed to make myself clear, or any point of disagreement, I hope that the members of this committee will comment or question me.

The CHAIRMAN. Senator Gore?

Senator GORE. I was a little late in arriving at this committee, Mr. Chairman, because I was meeting with a delegation representing a very important industry in my State, an industry that is very important throughout the country, too, and my constituents were greatly concerned with import competition. One of the principal items discussed was the preferential tax treatment of income earned abroad, and members of this delegation, composed of both owners and labor representatives in the industry, said that the preferential tax treatment given to income earned abroad operated as a subsidy for the export of American jobs. And yet, Mr. Chairman, this gentleman wants us to let income earned abroad be taxed at a still lesser rate than income earned at home.

The taxation of income and profits earned abroad is an item of tax reform which deserves and needs very probing examination. I do not wish to examine it in detail in colloquy with this gentleman because he might read that first sentence to me again.

Mr. SEGHERS. A tax benefit for U.S. manufacturers helps the United States. If we take away or impose a further burden on U.S. manufacturers, we are not imposing a comparable burden on Japanese and German manufacturers who are bringing in goods.

I know your position, Senator, in opposition to these higher foreign tax credits. That is a very important subject and I will debate it at any time, but I just boil it down to this. If you put a further burden on U.S. manufacturers exporting their goods, you are putting a further burden on their competitive position in foreign markets, where they must compete against the Japanese, German, Italian, and others goods. You will find that there is very little manufactured by American-owned concerns abroad and brought back to the United States as compared with goods manufactured by other foreign countries and imported into the United States.

Senator GORE. On the contrary, manufacturing abroad with U.S. capital results in greatly increased imports into the United States. As a matter of fact, to cite one example, not long ago there was a considerable period of time when not a single manual typewriter was being manufactured in the United States, though the United States is by all odds the greatest user of typewriters. I can give many examples which go to prove that preferential tax treatment of income earned abroad is not, as you say, a burden on the U.S. manufacturers, but operates instead as a subsidy for U.S. companies to move their manufacturing abroad, and this cannot continue. The result is that, in the past few years, our imports have greatly increased while our exports have had a very small increase.

I cite the example of small automobiles made abroad, of automobile parts made abroad, of assemblies accomplished abroad. There are many, many examples, and yet this gentleman—is this a part of the tax reform hearing? I think that it must be.

The CHAIRMAN. I was under the impression we are hearing the surtax and the investment tax credit and the man is talking about surtax. That at least is my impression.

Mr. SEGHERS. I say when we put 10 percent more tax, it should be limited to 10 percent. It should not be computed by a tricky means to reduce the foreign tax credit. I will admit to Senator Gore that this does have the effect of reducing the foreign tax credit.

Senator GORE. That is what I thought.

Mr. SEGHERS. I would be very glad to defend the foreign tax credit, but as the chairman has indicated, the Senator's question involves defending the basic provision whch is in the law. What I am saying is, don't use the backdoor approach, don't say that you are levying a 10-percent surcharge and use it as a means of cutting by 10 percent the foreign tax credit and thereby increasing the actual U.S. income tax by more than 10 percent.

Now, Senator, you will recognize that the foreign tax credit applies to bringing home income. It does not apply to manufacturing abroad. That is not the question. The question is one of bringing home income, and should income brought home from abroad bear a 10-percent higher tax than income earned here? I think that we should favor bringing home income from abroad to encourage the production and bringing home of income from abroad. It will help our balance-of-payments situation.

I agree with the Senator that our balance-of-payments and balance-of-trade position has deteriorated since 1962, and I was one of those who cried out the loudest to predict that the legislation, the unwise legislation then enacted, subpart F, would have just that effect. It would hurt our international balance of payments. It would hurt our balance of trade. It would hurt our exports. It would hurt our repatriation of income from abroad. It has done all those things. Now, do not make it worse.

Senator GORE. Mr. Chairman, could I take an example?

Let us take a simple example of a U.S. taxpayer who earns $1 million abroad. Let us say that this is taxed by the foreign country at 48 percent. You suggest that the foreign tax credit apply, which would be 48 percent, or $480,000, in such a way that he has zero tax.

You are suggesting that he be taxed by the surtax of 10 percent of zero?

Mr. SEGHERS. How much would you have collected from him in 1967 and all years before that, for the last 30 years?

Senator GORE. As a matter of fact, if that same taxpayer earned $1 million in the United States, he would be taxed 48 percent, or $480,000, plus the surtax of $48,000, which would be $528,000 total tax paid.

Now, as I understand you, you are suggesting that if he earns the $1 million abroad, that he only pay $480,000 total tax whereas if he earns it in the United States he pays $528,000. Is that correct?

Mr. SEGHERS. No matter how you slice it—I am only protesting penalizing him in comparison with another taxpayer, that he should not be required to pay a higher tax, more than 110 percent of the tax that you would have collected from him in 1967 and 1966 and 1965 or anywhere back to 1930.

In the second place, I am not talking about a "he," I am talking about a corporation which is doubly taxed anyway. It is first taxed as a corporation and then any profits that it has left after all the taxes and burdens that reaches any stockholder as a dividend is taxed again.

Now, I am simply saying this: If the tax system was fair prior to 1968, we should not try to correct it by a back-door method of computing the 10-percent surtax.

Senator GORE. Mr. Chairman, I may have been listening to the military who refer to the North Vietnamese collectively as "he," and I was referring to a corporation obviously as "he," and I will change that to "it." But the example stands. The gentleman says he does not want one taxpayer to be penalized as compared to another, but as a matter of fact that is exactly what he is proposing. He is proposing that we discriminate against the taxpayer who earns $1 million in the United States, and favor the taxpayer who earns $1 million abroad, so though he sets up an analogy to slicing baloney, he winds up giving us an uneven slice.

Mr. SEGHERS. I still say that any taxpayer that is required to pay more than 110 percent of the tax payable in prior years is being taxed more than 10 percent.

The CHAIRMAN. Let me just ask you this. Suppose you are competing with a British company, and you are manufacturing rubber boots in Holland, let us say. How much tax would Britain charge the British company on the money they make if they manufactured boots in Holland and send them over here?

Mr. SEGHERS. My understanding, and I won't say that I am up to the minute on this, my whole concentration now is on the U.S. tax, the final payoff on international business, but my understanding is that it is possible for a United Kingdom corporation to manufacture abroad and sell abroad and pay no United Kingdom tax.

The CHAIRMAN. My impression is that this is correct and that the law is the same with regard to the Germans, the Japanese, the Italians, everybody you are competing against over there.

Mr. SEGHERS. All of them have some means of that sort. I know that they have in Holland; I know they have in France. My understanding is that that is true with the United Kingdom. I start with computation of the foreign tax and go on from there.

The CHAIRMAN. As a practical matter I think if you will check it out you will find that this country gives its corporations that are doing business overseas the least favorable tax treatment of any major trading nation in the world.

Mr. SEGHERS. I certainly agree we do, Senator, and that is one of the things that has held down our exports. Before 1962 I was able to interest manufacturers in going abroad to sell their goods abroad through foreign sales subsidiaries. They thought they were getting away with something. That did not reduce their tax. They only postponed the time of paying the U.S. tax on income which had not been brought home, which had not been earned in the United States and had not yet been brought home.

The 1962 act was designed, subpart F was designed, to penalize the sale of U.S. goods abroad through foreign subsidiaries. Certainly there was an advantage in using a foreign subsidiary, but there was a tremendous advantage for the U.S. Government and the U.S. economy through selling those goods abroad.

Remember a dollar of sales is worth a lot more than the pennies of tax on the profit on that sale. Supposing the sale profit is 20 percent and the Government takes half. Well, that is 10 percent. But isn't it better to bring in the dollar of sales?

The CHAIRMAN. The point about it is that if we pile a 52 percent tax on top of a 50 percent tax or a 52 percent tax on top of a 75 percent tax, Americans simply could not do business over there. The result would be that instead of bringing money home, they would not bring anything home, and our balance of payments would be just a lot worse than it is. There would be a Japanese company or a German company or an Italian company trading over here instead of an American company.

Mr. SEGHERS. I certainly appreciate your comments, and it is the very statement that I made in the statement filed with the Ways and Means Committee. It is hard for me to build a complete defense here on the foreign tax credit when I am only saying do not discriminate against bringing home foreign income.

Senator GORE. Mr. Chairman, at the appropriate time I will introduce amendments in this field and be prepared to discuss them in detail. I would just like to make this brief comment at this time. Fortunately our country, unlike Germany, France, and others, has proceeded on a policy of equality of taxation of its citizens. There have been some unfortunate exceptions, one of which is preferential treatment of income earned abroad.

This must be eliminated, because it has operated as a subsidy to the movement of industry and jobs out of the United States. When there is an organization, established brand name, and distribution systems in the United States, and the product is then made abroad and imported into the United States, it musters the toughest possible import competition.

For instance, when an Underwood typewriter is in nearly every high school commercial class in the country, when there are sales agencies, when there is an established distribution system, a well-known and accepted brand name, and then that Underwood typewriter is manufactured by a company in Italy, it takes on the characteristics

of the toughest competition, and the movement of that factory abroad was subsidized by preferential treatment on the income earned abroad.

Now, the distinguished gentleman presently before the commttee may talk about taxing income earned abroad as he puts it to stimulate American exports. He has very adroitly avoided the comment upon the preferential tax treatment of income earned abroad on the manufacture of products abroad, yielding to the profit of American investors upon the imports of those products to the United States, again resulting in the profit to the investor but the loss of jobs and factory and income to the United States, and yet the gentleman submits an example here which would give preferential tax treatment even with respect to the 10-percent surtax on income earned abroad over income earned in industry in the United States.

I submit we cannot continue on this path. It is one of the reforms which must be dealt with, and at the appropriate time I will offer amendments to the bill for this purpose.

Mr. SEGHERS. I disagree with the use of the words "preferential treatment." That is a question of slicing the baloney. If you are going to pay 114 percent tax instead of 110 there is no preference, and in the second place I disagree with the facts just stated.

Third, I disagree with the conclusions.

I remember when the Underwood typewriter was a very popular typewriter. I hardly ever see or hear of one today. Everything I see and hear, and I have to buy typewriters—the girls want a prettier one, a newer one—they are Remingtons. They are not buying Underwoods. I think the Underwood has pretty much slipped out of sight.

I would request the opportunity to present a factual statement dealing with the extent of imports of goods manufactured abroad by U.S. companies. You are raising that point.

I would present facts in that regard. I do not know what they are until I have gotten them, but I will present facts which I can substantiate for the benefit of this committee. But I will say that most of the U.S. companies manufacturing abroad are doing it for two reasons. One, you penalize the export of U.S. goods with subpart F and you wanted it to be even more severe, Senator.

The second reason is that it is necessary to manufacture within the borders of many countries because it is just impossible to ship U.S. goods in there.

Senator BENNETT. Mr. Chairman, the witness is repeating himself. He has taken 30 minutes. We have got six other witnesses. None of the members on this side of the aisle have been allowed to question. I hope you will return to the 10-minute rule, and admonish the witness that we have limited time.

Mr. SEGHERS. I would welcome questions from that side of the committee, which should be on the side of business.

Senator ANDERSON. Are there additional questions?

Senator GORE. I have no objection to the witness submitting such facts as he wishes, though he says he does not know what the facts are. He wishes to gather them to support his point of view. That is a little unusual but I have no objection to it. I would say, in giving this example—I direct this to my colleague, Senator Bennett—that what the gentleman is suggesting is that a corporation that earns $1

million abroad be taxed only to the extent of 48 percent while the taxpayer earning a like amount in the United States be taxed at 52.8 percent, and this is inequitable.

Thank you, Mr. Chairman.

(The following was subsequently received by the committee:)

SUPPLEMENT TO STATEMENT OF THE INSTITUTE ON U.S. TAXATION OF BOND INCOME, INC.

The witness (Mr. Seghers) subsequently informed the committee that it would not be possible to submit the promised data before the report on these hearings went to press.

The U.S. Department of Commerce states that no comprehensive statistics of the type in question have been or are being compiled with respect to the entry of manufactured goods from abroad. Much information has been compiled on exports by U.S. manufacturers to affiliated companies abroad, but only limited data is available with respect to imports of goods manufactured abroad by U.S. controlled affiliates. Furthermore, any figures of this kind would be incomplete, inasmuch as a large portion of such imports (exclusive of petroleum and mineral imports) are of semifinished components entering into the manufacture of goods in the United States, such as the manufacture of semi-conductors (transistors) which alone make it possible for U.S. manufacturers to produce transistor radios in competition with Japanese manufacturers. See article "U.S. Exports to Foreign Affiliates of U.S. Firms, 'in May 1969' Survey of Current Business, U.S. Department of Commerce, Office of Business Economics—Part I."

The November 1966 issue of that publication includes a similar article entitled: "Sales of Foreign Affiliates of U.S. Firms in 1965." This article shows that such sales totaled $42.2 billion, a 13 percent increase over comparable figures for 1964. It also includes a significant tabulation (No. 4 on Page 9) of imports in selective industries which show that such imports amounted to 14 percent of comparable total U.S. imports of similar products. See also statement to stockholders included in the 1968 Caterpillar Tractor's annual report, included as Exhibit I of this institution's statement at the April 23, 1969, hearings of the Foreign Affairs Committee, Foreign Economic Policy Subcommittee on "Foreign Direct Investment Controls," a copy of which is submitted herewith and made a part hereof.[1] That report shows that the contribution of that corporation to the U.S. balance of payments constantly increasing from approximately $145 million in 1954 to approximately $580 million in 1968.

Senator ANDERSON. The next witness.

STATEMENT OF THOMAS J. RYAN, CHAIRMAN OF TAX COMMITTEE, NATIONAL CONSTRUCTORS ASSOCIATION; ACCOMPANIED BY GERALD S. OSTROWSKI

Mr. RYAN. For the record my name is Thomas J. Ryan and I am accompanied by Mr. Gerald Ostrowski, manager of public affairs for the National Constructors Association.

I would like to read into the record a statement of the National Constructors Association.

The National Constructors Association welcomes this opportunity to present its views in opposition to the precredit application of the 10 percent tax surcharge and proposed repeal of the 7 percent investment tax credit.

The association, known as NCA, is composed of 34 internationally known firms of engineers and constructors which design and erect large-scale industrial complexes within the United States and throughout the world, including oil refineries, chemical plants, steel mills, and

[1] See p. 477.

power generating plants. Attached to this statement is an informational folder describing the association and listing its members, officers, and major committees.

The NCA is opposed to an extension of the current application of the income tax surcharge to tax liability as determined before deduction of the presently allowable investment credit and foreign tax credit inasmuch as the ultimate effect of such application is discriminatory and inequitable to its member companies.

The NCA has reached this conclusion because the present application of the surcharge has the effect of imposing a rate of tax, higher than the present surcharge rate of 10 percent, on companies with extensive foreign operations that have allowable foreign tax credits and companies that engage in programs requiring expenditures for capital acquisitions which qualify for the investment credit.

Furthermore, application of the surcharge to income tax liability before the foreign tax credit results in the imposition of an additional tax burden on U.S. companies operating abroad. Such an additional tax burden has the undesirable effect of further aggravating the current annual deficit in our country's balance of payments.

In view of the foregoing, the National Construction Association is of the opinion that if the surcharge is to be extended beyond its current date of expiration, it should be modified so as to apply to the amount of income tax liability as determined after allowable tax credits rather than against precredit tax liability.

The NCA opposes the proposed repeal of the 7 percent investment credit because repeal of section 38 of the Internal Revenue Code will not successfully reduce the causes of existing inflationary trends but would instead adversely affect our national economy.

In a 1962 appearance before the Senate committee conducting hearings on the merits of amending the Internal Revenue Code to add section 38, the then Secretary of the Treasury, C. Douglas Dillon, testified:

> I urge this legislation because it will make a real addition to growth, consistent with the principles of a free economy; because it will provde 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.

He further added that:

> Early legislative action will resolve uncertainty or hesitancy and begin at once a strong and lasting incentive for modernizaton of the productive facilites of our national economy.

It should be noted that in the short period of time the investment credit has been in existence, one temporary suspension of this credit in the latter part of 1966 was also viewed as an inflationary restraint. This suspension resulted in reduced capital expenditures of such magnitude that the credit had to be restored approximately 9 months earlier than originally anticipated.

In order to improve the U.S. balance-of-payments position American industry must be competitive with foreign competitors. Industries in foreign countries such as United Kingdom, Belgium, and the Netherlands, currently realize investment stimulation by investment

credits and other export grants and allowances. A repeal of the investment credit would add to the already deteriorated competitive position of the U.S. in overseas markets by reducing U.S. export efforts, thus aggravating the balance-of-payments problem.

As many industries have already indicated, repeal of the credit will result in reduced capital outlays for modernization and replacement of machinery and equipment, eventually resulting in overall decreased productivity in industry and higher costs and reduced employment opportunities.

Although it is recognized that business requirements dictate new plant and equipment expenditures, the repeal of the investment credit would probably not influence management's decision as to whether or not such expenditures should be made. The overall lack of credit incentive will, however, indirectly inhibit future industry expansion and production with a consequential reduction in new plant construction.

Therefore, NCA rejects the theory that repeal of the investment credit would be beneficial to the national economy and is opposed to the proposed repeal of the credit.

Senator ANDERSON. Thank you.

Any questions?

Senator GORE. Yes, I have a question.

The gentleman mentioned the same point as the previous witness.

Mr. RYAN. I do.

Senator GORE. And I would like to take an example.

Mr. RYAN. My point on this, Senator Gore, is that I believe we should be allowed this in the field of foreign tax credit.

Senator GORE. What is that now?

Mr. RYAN. That we would be given this inflation of the surtax credit, or the surtax charge as——

Senator GORE. Inflation?

Mr. RYAN. It is inflated now because it is applied before the reduction of the foreign tax credit——

Senator GORE. Let us take an actual example. Let us take an example of a corporation that earns $1 million abroad.

Mr. RYAN. Correct.

Senator GORE. And let us say that the foreign tax is 47 percent.

Mr. RYAN. 47, yes, sir.

Senator GORE. And he is given credit for that.

Mr. RYAN. Agreed.

Senator GORE. Then you are advocating that the surtax apply only to the difference between 47 and 48 percent which in this case would be $10,000; 1 percent of $1 million.

Mr. RYAN. What I am advocating is take the same $1 million earned abroad and let us assume that it is 47 percent.

Senator GORE. Will you follow my example?

Mr. RYAN. Yes, sir.

Senator GORE. The result of what you advocate is that he would pay a tax to the U.S. Government, the surtax only on the difference between 47 and 48 percent, which would be a tax of $1,000.

Mr. RYAN. If the mathematics are correct, I would agree; yes, he would. May I provide the reason for that?

Senator GORE. I beg your pardon?

Mr. RYAN. May I give a reason for my indication on that?

Senator GORE. Why, sure.

Mr. RYAN. I feel that in our industry we operate overseas and are subject to foreign taxes and are also subject to U.S. income tax. Most of our operations are conducted through U.S. corporations.

Senator GORE. All right. Now, let us follow the example. I understand your reasons as you have stated them.

Mr. RYAN. All right. Now, when we prepare a proposal, a commercial proposal, we are faced with competition not only from U.S. competitors, but from worldwide competitors. Some of these competitors operate in this country.

Senator GORE. I understand that. I am trying to get to the point of discrimination between U.S. corporations, between a corporation which on the one hand earns $1 million abroad, and a corporation which on the other earns $1 million at home. Now in the instance I have given, according to your recommendation, this corporation that earns $1 million abroad would pay $1,000 in taxes to the United States.

Mr. RYAN. The corporation——

Senator GORE. The surtax.

Mr. RYAN. The U.S. corporation earning this income abroad would have an initial liability of $528,000. It then would have to qualify for foreign tax credit, if it meets all the conditions elsewhere for the foreign tax credit it could reduce that liability to the extent of the allowable foreign tax credit.

Senator GORE. I am doing that, in order to make it simple; if you don't mind, I would like to follow through.

Mr. RYAN. Yes, sir.

Senator GORE. I have given you an example of a company earning $1 million in a country that has a corporate tax of 47 percent.

Mr. RYAN. Yes, sir.

Senator GORE. While we have a 48 percent rate.

Mr. RYAN. Yes, sir.

Senator GORE. And you are advocating that the surtax apply only to the difference between the foreign tax and the U.S. tax.

Mr. RYAN. I am proposing or providing for your consideration that the surtax be applied to the tax, the U.S. tax payable after the allowance of the foreign tax credits.

Senator GORE. Which means your answer is yes.

Mr. RYAN. Pardon, sir?

Senator GORE. Which means your answer is yes to my question.

Mr. RYAN. Yes; and it appears, I would say it appears in that form.

Senator GORE. All right, then that would leave a $10,000 difference between the foreign tax credit and the U.S. tax to which the surtax would apply, the surtax being 10 percent.

Mr. RYAN. Yes.

Senator GORE. That would be a tax of $1,000 that the corporation earning $1 million abroad would pay the U.S. Government as a result of the surtax levied. Now, a U.S. corporation that earned $1 million in business in the United States would, on the other hand, pay a surtax of $48,000, so you are advocating really in this instance that the cor-

poration earning money at home pay 48 times as much surtax as the corporation earning abroad?

Mr. RYAN. As far as the surtax is concerned.

Senator GORE. Now, a more likely example is a corporation doing business in a country abroad that has a 48-percent corporate tax rate comparable to our own, which according to your advocacy and the gentleman preceding you would mean that they would pay no surtax to the United States at all, while a corporation earning $1 million in the United States would pay $48,000.

Now that, Mr. Chairman, is what is presented here in the language of equity. I say it is gross discrimination.

Mr. RYAN. In equity, though, if we are to maintain our position abroad, we must be able to compete and price our work at the same rate that our competitors are paying.

Senator GORE. Well, this is a different question. We do not propose in the United States to prevent anyone from making a profit abroad. We only propose to tax the income it earns from successful operations abroad. A tax on income does not prevent profitable operation, because there is no tax unless he earns a profit.

Mr. RYAN. I agree with you, Senator, and also I might add that many proposals, many contract awards hinge on as much as 1 percent of the total contract price.

Senator GORE. Mr. Chairman, I think this makes the point clear and I shall desist.

Senator ANDERSON. Senator Curtis.

Senator CURTIS. No questions.

Senator ANDERSON. Senator Miller?

Senator MILLER. With respect to your comments opposing the repeal of the investment tax credit, I am not sure I understand your position. Are you suggesting that if the investment tax credit is repealed, it should be repealed only with respect to domestic investment?

Mr. RYAN. No.

Senator MILLER. And that it be left on for foreign investment?

Mr. RYAN. On the contrary, we are in the construction industry. We are also in the engineering industry. On construction operation, if a U.S. corporation acquires plants and equipment for use overseas, we do not even get investment credit for the United States using the property outside of the United States. The problem I am referring to, Senator, is that when we put a job together, we buy large quantities of sophisticated, processed material from U.S. vendors. If we cannot get the price from the U.S. vendors, we must go elsewhere. We must buy from the Japanese, we must buy from Italians, we must buy from the Germans. We are operating most of the time on a cost-plus contract, and our costs are severely scrutinized by all our customers, and we must get the best price possible. We have to turn to German suppliers and other foreign suppliers. If U.S. suppliers cannot compete with these foreign suppliers, I feel that it will affect our balance of payments even further; it will aggravate even more our balance of payments.

Senator MILLER. I can understand some difference there, because we are concerned about estimates that there is an abnormal amount of expansion in this country to which the investment tax credit contributes, and if we are going to do something about inflation we have got to work on this as well as other angles, but that would not necessarily apply with respect to investment in foreign countries.

Suppose I have a client that wants to build a plant in France. That is going to entail hiring employees and doing some work over there, and purchasing equipment over there. That would not necessarily aggravate the inflationary condition in the United States. But if you are going to go across the board and just advocate repeal or retention of the investment tax credit completely without regard to overseas operation, then I think you are flying in the face of figures which we have received, which indicate that this is aggravating the inflationary condition of the country.

Now you might want to think about that as to whether or not that might be a partial solution to your problem.

The other thing is really when you get down to it, which leaves us further behind in competition, overseas competition, continued inflation and high interest rates on the one hand, or repeal of the investment tax credit on the other? I would respectfully submit to you that continued inflation and high interest rates leave us much further behind.

Mr. RYAN. I would agree with that. In some of our more recent proposals, customers have been asking us to quote not only U.S. engineering but foreign engineering. They recognize the vast difference in pricing, and this of course is a result of recent inflation.

We find that it is becoming almost impossible now to submit a successful proposal, strictly from all onshore U.S. working services. We must now turn to utilizing overseas engineering, overseas procurement, and other services intended for the construction industry. This has forced us now into the posture of either entering into joint ventures with other engineering operations overseas, whereas several years ago most of our engineering, all of our engineering in relation to any foreign job could be done in the United States.

Ninety percent of our procurement of our sophisticated materials could be done from U.S. suppliers. That has been reversed, and as I say, the difference in the successful award of a contract is now so close, 1 percent, one-half of 1 percent of the total estimated contract price, and these are not going to U.S. firms. They are going to foreign firms.

The Japanese are strong competitors, the Germans are strong competitors. As a matter of fact I daresay in the future you will see some of the construction that we have done in the United States being performed by these same people.

They will come in and do the work in the United States. They will put us completely out of business in the United States as well as overseas.

Senator MILLER. You see we are in a bad position here where we have

to make a choice between really the lesser of two evils, continued inflation on the one hand, or repeal of the investment tax credit on the other.

Mr. RYAN. I am speaking now from a personal point of view. We do not have the incentives in the form of taxation that other countries over our competitors, Japan, France, Germany all offer our competitors greater taxes, and we look at these tax incentives as an additional edge on us in our competition.

Senator MILLER. I appreciate your position. I think there is a lot of merit in it. But I would suggest to you that instead of trying to put your position on the basis of a retention of the inveatment tax credit, which we know is an aggravation of inflation in this country, that you come before the committee and put up a proposition of some kind with respect to preferential tax treatment, with respect to exports or overseas operations, which is going to get us away from trying to make an exception in this investment tax credit picture.

Mr. RYAN. Yes, sir.

Senator MILLER. I think you have a point, and I am sympathetic with it, and I say we have a choice of the lesser of two evils with respect to the proposition now before us.

I have no further questions, Mr. Chairman.

Senator ANDERSON. Senator Jordan?

Senator JORDAN. No questions.

Senator ANDERSON. Senator Fannin?

Senator FANNIN. Mr. Chairman.

Mr. Ryan, the previous witness talked about the balance of payments as well as the balance of exports being benefited. I can see the balance of payments benefit, but I do not think that you mentioned that this would assist the balance of exports. If we consider exports, the goods manufactured in the United States by American labor and then shipped abroad———

Mr. RYAN. Right.

Senator FANNIN (continuing). This would not be assisted, would it?

Mr. RYAN. Well, as I said, we buy—I might have to divert for a minute. A large portion of our operations overseas are covered by foreign credits, governmental credits similar to the Export-Import Bank of the United States. Where we are working on a customer's equity position we cannot control where the materials should be purchased, even though we would prefer to purchase from U.S. sources.

Senator FANNIN. At the same time the competitive matters enter into it.

Mr. RYAN. Definitely.

Senator FANNIN. Consequently you are changing the percentage purchased from the United States.

Mr. RYAN. We have been because of the constant changes in the methods of contracting we find that we are committed to a firm price, we must then reduce our cost if at all possible, first of all to even obtain the contract and, second, to make a profit on the contract.

We are in a very low profit position in relation to our gross bill, in this type of industry, so that a 1- or 2-percent variance of cost could result in the difference between profit and loss.

Senator FANNIN. If we were assisting you to compete in the world market and thereby obtaining additional income for the United States, that is one thing. If we are considering sales back to the United States that is an entirely different consideration because then we are talking about jobs being displaced. We are talking about many problems that accrue to us as a result of foreign manufacturing coming back into the United States which is almost, we could say, subsidized by our own funds.

Mr. RYAN. I can understand that, Senator, but as I say, when you talk of jobs, for example, there are on any particular job that we do hundreds of thousands of engineering hours that we supply from the United States in relation to a foreign job.

Senator FANNIN. I realize that, but then if we are shipping that product back to the United States that would still be the same.

Mr. RYAN. You are talking about our customers?

Senator FANNIN. Yes.

Mr. RYAN. In other words, that the product could be shipped back into the United States. I could not dispute that.

Senator FANNIN. I know circumstances, for instance, in the electronics industry, where we get component parts from foreign countries and that makes it possible for us to compete, then, in the world market in the finished good.

Mr. RYAN. Yes, sir.

Senator FANNIN. What I am worrying about is insisting on shipping back to the United States. I think that we have many barriers from the standpoint of regulations, tariffs, and all that in existence in foreign countries and that is, I think, one reason we have placed manufacturing establishments in some of these foreign countries. I realize the great benefits that accrue by way of balance of payments, but I also realize the detriments that come about from the standpoint of imports; that is, goods coming back into the United States.

Mr. RYAN. Yes, sir. That I cannot dispute. That is correct.

Senator FANNIN. Do you feel that what you are asking would assist you? I mean assist you in competing in the world market when we are not involved with the displacement of our American manufacturing.

Mr. RYAN. I would have to agree, Senator. I am not an economist. I am not versed with the balance-of-payments problem. I am just a tax manager, but from the volume of proposals that we have prepared and have lost to foreign competition, and it is only a matter of price, there is something that is definitely needed from Congress in this area to assist us to operate successfully abroad.

Incidentally, most of our business, 75 percent of our business is from foreign sources, and out of that 75 percent I would say 60 percent of that is done from the United States, and most of it is generated from personal service, technical supervision, and other.

We do procure and buy sophisticated merchandise from our cus-

tomers in the United States and on a worldwide basis, but we generally buy this at cost and only make a profit on the procurement fee which is personal service, and it is displacing U.S. jobs and we are seriously considering the possibility of completely decentralizing a U.S. operation and scattering it through areas all over the world.

This will result in the loss of jobs in the United States. It has to.

Senator FANNIN. Of course, that is exactly what we are concerned about. We realize, too, that there are so many restrictions placed upon our importing into these countries that we must have a quid pro quo. We certainly cannot continue giving these foreign countries all the advantages so far as their exporting into the United States and then not demand that they give us consideration for our exporting into their countries.

Mr. RYAN. Of course, our own Government has done that for years through AID and through Export-Import. They have provided the foreign customers with the wherewithal, first of all, to erect the facilities which in turn manufactures the product which in turn is sold right back in the United States, so that I think this is bound to happen, but I think we have to remain competitive with the foreign parts competing with the United States.

Senator FANNIN. Remaining competitive is one matter; but when we start talking about insisting on shipping back to the United States, I certainly cannot be in agreement. Of course, where only a minimal part, say 10 percent, of the product is contributed from the outside, then I think we have a different question. I do appreciate your comments.

Mr. RYAN. Thank you very much, Senator.

Senator ANDERSON. You appear here for the National Constructors Association. Have they specifically approved this statement of yours?

Mr. RYAN. Yes. It is their statement, sir. Thank you Mr. Chairman.

Senator ANDERSON. The next witness is Mr. J. R. Gulan.

STATEMENT OF J. R. GULAN, LEGISLATIVE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. GULAN. Thank you very much, Mr. Chairman.

We are convinced that the key to a sound nation and a meaningful approach to a solution of many of the social and economic problems facing us today lies with small independent business and professional enterprise throughout the country.

Our conviction, Mr. Chairman, is based—not on blue sky—but on hard facts—facts disclosed by more than 26 years of questioning independent business and professional people concerning more than 1,000 bills and issues that have been before succeeding Congress—and facts disclosed by over 8 years of increasingly intense economic surveys among our membership.

This year we will cover, in our survey, over 267,000 individual members in independent business and professional enterprises located in

all areas of the country—one out of every 19 small businesses in the country, active in all lines of enterprise and at all levels of each line.

We will receive responses from more than 100,000 of these enterprises. In other words, our recommendations are based on what actual operating independents tell us. To know a business or professional enterprise you have to ask a man who owns one.

Thus, let us consider the true picture. Despite the weight of laws, regulations, taxes, and edicts and whims of bureaucracy on many levels, there still miraculously exists: 5 million smaller, independent business and professional enterprises which account for, 73 percent of national retail sales, 73 percent of national wholesale sales, 82 percent of the construction activity, 80 percent of the service function, and 34 percent of the manufactured value added to the economy each year.

These are the cold statistics. Now let us look at the human involvement—people.

These smaller, independent business and professional enterprises provide 40 million jobs—more than half of our civilian labor force. Restated in another way, six out of every 10 American families depend on small business for livelihood. Thus, small business is everybody's business. Senator Winston Prouty puts it this way:

> Over the years the phenomenal growth of the economy in the United States has in large measure been the result of individual incentive. Our system of government has made it possible for small entrepreneurs, men with ability, initiative and a willingness to run risks, to found and expand their own business enterprises. This has meant jobs for an expanding population in our country and the highest standard of living in the world. Some of these once small businesses have grown into great corporations and on the whole, this has been good for the country. But if the time ever comes when the little man with initiative and competence is unable to make it on his own, then the whole fabric of our society will be drastically altered.

Mr. Chairman, the chief purpose of the legislation before us today is to curb the inflationary spiral now existing in the economy. During inflationary periods, the entire economy is subjected to pressures which often result in irreparable harm to sectors.

Business, of course, is always hard hit by increasing prices. Consumers, in turn, bear the brunt as the increased cost of doing business is passed on to the consuming public whenever and wherever possible.

Yet, within the entire business spectrum it is the small and independent businessman who is hit hardest. In a tight money situation, small business gets the least of lendable funds, and pays the greatest for it. In short supply situation, small business is first to be cut off by the supplier. Unfortunately, the converse of this story is not true.

When money is plentiful, small business still pays the highest rate. When supply begins to catch up with demand, it is still the larger accounts who get top priority.

Part of H.R. 12290 calls for outright repeal of the 7-percent investment tax credit. According to Treasury estimates, this would provide an additional annual revenue of $2.8 billion. It is assumed

that this move will greatly slow business expansion and provide a cooling off in the economy. Providing this assumption is correct, what precisely will be happening within the business community?

Some giants of industry may well slow down their expansion efforts in varying degrees, thereby helping somewhat to combat the inflationary forces. However, those same larger corporations who find it absolutely necessary to expand or modernize will continue doing so, financing the moves by borrowing money even at today's unprecedented high-interest rates.

Money is always available if one is capable of paying for it. Indicators drawn from our continuing field surveys suggest strongly that smaller business is already experiencing difficulties. The volume of sales seems to be slowing down on the one hand, while on the other hand, they are beset by the rising costs of goods and labor, taxes, and interest rates on what money they are able to borrow to finance their operations.

Although the 7 percent investment credit is biased toward big business, and particularly toward capital intensive manufacturing firms, small business has been able to derive substantial advantage from it.

Information received from our continuing economic surveys shows that the credit has truly proven helpful to smaller firms. Going back to 1965, 70,700 members responded to our questionnaire. Of this number, 30,709 or 43 percent stated that they had used the 7 percent credit. During 1966, based upon approximately 100,000 responses, 50 percent of them stated that they had utilized the credit.

Now, agreeing that in the long run control of inflation is vital to the economic health of small business—as it is to all business—and allowing—though not conceding—that repeal of the credit might be the best approach to the problem, we are still faced with one unalterable fact; namely, that the greatest revenue loss and the greatest capital investments are generated not by small business, but by the big business sector.

Mr. Chairman, if I may get away from my statement briefly to throw in a few facts on this, the latest figures we had available here reflect 1965. In that year the total number of corporations filing income tax returns amounted to 1.5 million, of which 51.8 percent had no tax liability, and therefore were unable to take any investment credits.

Of the additional half, 760,000 or 43.7 percent had tax liabilities of $25,000 or less from which investment credits could be taken. This group of corporations predominantly small benefited to the extent of only $183 million or 9.1 percent of the credit for that year.

Going up the ladder slightly, in medium-size corporations, some 62,000 of them, or 4.2 percent of all corporations filing returns, realized 3.3 million or 15.6 percent of the credit. Finally, 3,000 of the largest corporations were only 0.2 percent, realized $1.5 million in investment credit. This amounted in that year to more than 75 percent of the total credits taken.

I think it bears repeating, then, when we say that the greatest revenue loss and the greatest capital investments are generated not by small business, but by the big business sector.

Even during the first year of the credit's existence back in 1962, I believe smaller firms with assets of $500,000 or less accounted for approximately only 12 percent of the benefits realized by users of the credit. These figures have not changed appreciably during the intervening 6 years.

Importantly, we are talking about the really small businesses.

Without quibbling I would just run through this quickly by relating the size of our membership, which is somewhat in excess of 260,000 now.

Thirty-eight percent of our members employ three or four people, 30 percent employ between four and seven, 20 percent between 8 and 19, 8 percent between 20 and 49, and only 4 percent have 50 or more employees.

We feel, that another proof of the usefulness and effectiveness of the credit for small business is contained in the current report of the Small Business Advisory Council prepared for the Senate Select Committee on Small Business.

Mr. Chairman, I presented some copies of this to the clerk earlier. I think you have them. But a chart here shows that in all areas of business, the investment credit was by far the greatest, or proved to be the greatest, use for business. I will submit this for the record if I may, sir.

Proposal II on pages 13 and 16 and in particular, the chart on page 14 show this clearly.

The CHAIRMAN. Without objection, we will include in the record the excerpts mentioned.

(The material referred to follows:)

[Excerpt from the "Report of the Small Business Advisory Council," Dec. 16, 1968]

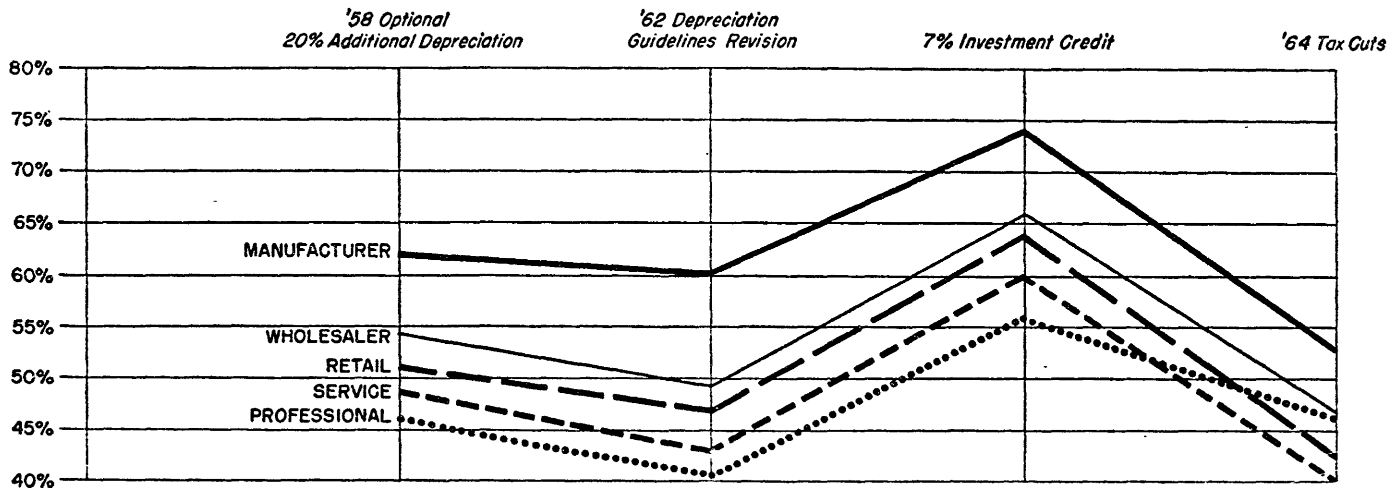
* * * * * * *

Proposal II. Investment credit in intangible property

The high cost of external financing, and the relative availability of personal savings and retained earnings, were highlighted by an opinion survey on Federal taxing policies taken recently by a national small business organization, the National Association of Independent Business, in 1965. The questions asked were: "Which of the following tax enactments have been of the greatest use to you in your expansion and/or modernization?" The responses, listed in order, were:

1. The 1958 law which enables independents to recover in the first year an extra 20 percent of the cost of new machinery or equipment, through deductions from taxable income;
2. The 1962 ruling which permits independents to speed up normal depreciation (for tax purposes) by an average 17 percent;
3. The 1962 law which permits independents to take a 7-percent credit against taxes on the cost of newly purchased machinery and equipment; and
4. The 1964 reductions in tax rates applying to corporations and unincorporated enterprises and professional people.

As the following trend chart indicates, the investment credit and the optional first year depreciation provision were of greatest use in the manufacturing sector; but allowance must be made for the date of the survey, which followed the enactment of the 1964 legislation closely enough that its full effects probably had not been felt.


RELATIVE USEFULNESS, VARIOUS SMALL BUSINESS-ORIENTED TAX ENACTMENTS
IN EXPANSIONS AND MODERNIZATIONS, 1965 SURVEY
'58 Optional
20% Additional Depreciation
'62 Depreciation
Guidelines Revision
7% Investment Credit
'64 Tax Cuts
80%
75%
70%
65%
60%
55%
50%
45%
40%
MANUFACTURER
WHOLESALER
RETAIL
SERVICE
PROFESSIONAL

First, it indicates that these types of enactments had been very helpful in encouraging and assisting in expansions which provide additional jobs. Second, it indicates a bias, however, toward capital-equipment oriented businesses, and away from areas of pressing interest to other types of enterprise, such as retail and service firms which have a heavy interest in inventories and receivables—and who, of all types of business, might be most expected to be prime sources of employment and training the unskilled.

This, in turn, brings into focus a tax proposal advanced more than 10 years ago—the "plowback allowance."

Senator John Sparkman, as chairman of the Senate Select Committee on Small Business, in a statement in 1960 described the plowback allowance as follows:

"Before leaving the subject of taxes and small business, I must mention one important objective that has not yet been achieved. American small business needs desperately a form of tax relief which will provide an incentive and make it possible to reinvest a portion of profits in the business.

"Our economy is making such a headway today it is not enough just to own a small concern. The concern must be a going concern, and it must be going in the same direction as the national economy. For a small company to rest on its oars, just drifting from day to day, is to risk being swamped by the waves of competition.

"There must be forward motion. For this compelling reason, I have introduced, and will continue to urge passage of my bill S. 59, which has carried over from the first session of the present Congress.

"The purpose of this measure is to help the owners of small companies to provide out of earnings money for expansion and modernization of their stores, plants, and equipment. This would be accomplished by the simple expedient of allowing a tax deduction of up to $30,000, or an amount equal to 20 percent of net income of the taxable year, for money plowed back into a business for additional investment in depreciable assets, inventory, and accounts receivable.[12]"

In a floor speech on January 6, 1961, Representative Frank Ikard of Texas, who had introduced a bill based on the plowback principle, stated that his proposal had the recommendation of the House Select Committee on Small Business, the Senate Select Committee on Small Business, as well as active support and sponsorship of many Members of Congress. In 1967, Representative James Corman introduced a similar measure.

The Committee on Ways and Means, after extensive hearings, recognized the desirability of this legislation in meeting one of the greatest problems of small business. In a committee report in 1958, the committee stated:

"Your committee is convinced that one of the greatest problems confronting small- and medium-sized business is the acquisition of sufficient capital to modernize and maintain a rate of expansion experienced by their larger competitors. In this regard your committee is aware of the fact that small- and medium-sized businesses must rely to a very large extent upon retained earnings for modernization and expansion. Thus, there is a need to allow such businesses to retain more earnings after taxes to provide the funds necessary for growth. To aid in achieving this end your committee has investigated thoroughly various proposals to postpone, or to reduce, taxes based upon reinvestment in inventory and depreciable property and would have liked to have included a provision along these lines in this bill.[13]

The House Ways and Means Committee concluded that budgetary considerations prohibited it from approving the measure at the time. Interestingly enough, however, during the same year it took a short step in the direction of the aim plowback proposal by recommending enactment of the 7-percent investment credit.

In truth, the investment credit may be identified as a "bloodbrother" of the plowback proposal, only coming as a credit after tax rather than a deduction from taxable income, and limited to depreciable assets.

A representative cross section of the Nation's entire small business community of the retail, wholesale, manufacturing, servicing, and professional occupational levels was polled on this measure, and three-fourths of them expressed an interest in enactment of such legislation.

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[12] Committee print, Senate Select Committee on Small Business, 86th Cong., second sess., Ten-Year Record of the Select Committee on Small Business—1950–60, Feb. 20, 1960.
[13] Rept. 2198, dated July 16, 1958.

The Council feels that if a fully graduated corporate income tax cannot be immediately achieved, a feasible alternative, for which an excellent precedent exists, should be seriously considered. That alternative is to extend the 7-percent investment credit principle to increases in investment in inventories and receivables. Since the 7-percent investment credit has worked so well in encouraging expansion and in helping to provide additional jobs in the area for which it was particularly intended, extension of its principles to inventories and receivables, critically important in the retailing and service trades, no doubt would do much to stimulate job-producing expansion and modernizations in these areas.

COUNCIL RECOMMENDATIONS

The legislative initiatives that we have described had the warm approval and strong support of the small business community. These efforts were instrumental in the proposal and adoption of the Revenue Acts of 1962 and 1964, which took the significant steps of liberalizing depreciation; offering the investment tax credit; and effecting an overall reduction in corporate rates, together with a reversal of normal and surtax rates. The statistics demonstrate that these measures have been of assistance to small firms in the ensuing years, and that wise policy in this area will have early and favorable consequences in profits, employment, business activity, and jobs.

The Council does not have the resources to appraise actual gradations which should apply, on the basis of the current surtax rate scales; nor the extent of reduction of Federal revenues, which would result from adoption of a more graduated tax scale or a "plowback" bill. We feel that the reduction would be very small, and would be offset by increased business and taxable revenues.

The Council believes that there should be further study of the impact of the tax system on small firms and upon the economy, as a basis for early governmental action.

The Council specifically recommends that a more highly graduated corporate tax be adopted along the lines of S. 4138, introduced by Senator Sparkman in 1956. Maximum improvement in retention of earnings should be at the lowest levels, with the break-even point at about $250,000 income level. As an alternative, reinvestment credit bill comparable to that most recently introduced by Representative Corman should receive serious consideration.[14]

Mr. GULAN. The federation strongly supported enactment of the credit in 1962 and vigorously opposed its suspension by the 89th Congress. Even at that time, the particular needs of small business in this area were recognized and the easing of the suspension to still permit a 7-percent credit on equipment purchases up to $20,000 proved of invaluable assistance to a great many smaller businesses.

Our surveys, once more broken down by employee size standards, show average investments in new equipment by firms employing—

0 to 3 employees	$2,765
4 to 7 employees	6,895
8 to 19 employees	14,998

In other words, 90 percent of all businesses invest considerably less than $20,000 per firm in new equipment annually.

Mr. Chairman, in view of these facts, we ask that you consider the position of small business and their particular need to moderize and expand. We fear that if some relief is not permitted, while in the long run we may be able to cure the disease of inflation the patient may die in the process.

We ask that provision be made whereby:

1. Continued use of investment credit be permitted to firms and individual businesses having net taxable incomes of $25,000 or less, or

[14] H.R. 4105, introduced by Congressman James Corman on Jan. 30, 1967, 90th Cong., first sess.

2. Permitting use of the credit to firms and industrial businesses doing a gross annual business volume of $500,000 or less, or

3. Permitting a credit to be taken on an across-the-board investment of $25,000 or $50,000.

Mr. Chairman, that concludes my formal statement.

One other point I would like to read into the record here. I have here the committee print of the Joint Economic Committee hearings on the Economic Report of the President, and this is only last April.

At that time the majority views in part stated:

The first priority in tax reform should be given to repeal of the 7-percent investment tax credit as a significant step toward reducing inflation. Small business should be protected either by retaining their right to the credit or by changes in the corporate tax rates.

At the same time, Mr. Chairman, the minority views expressed in this print, I believe, call for continuation of the credit in its entirety.

Since that time, of course, their views have changed somewhat.

The CHAIRMAN. Any questions?

Senator GORE. Yes. You are, in essence, proposing an exemption from the surtax for small business?

Mr. GULAN. Yes, Senator; we are.

Senator GORE. Is this a matter of principle or equity?

Mr. GULAN. A bit of both, but by far more equity, Senator Gore. I think you made a statement yesterday in the hearings that related to the high interest rate, the high prime rate. Now small business looked like it was well on its way to extinction and this is very true. We found that as the prime rate continues to go up as it has recently, that small business, if there is any money available at all after the prime users have used up their lines of credit, are forced to pay 10 or 11 percent now. When the prime rate was down to 7 percent, they were paying 9 or 10 in some sections of the country.

In a great many sectors, retail grocery, for instance, many of these people work on a 7- and 8-percent markup. They cannot afford to borrow money in excess of that, nor near that.

In other fields we have found that the small man, regardless of tax laws, manages to stay in business through additional services he performs in the community.

Senator GORE. And additional works.

Mr. GULAN. A lot more work, sir, and he cannot compete pricewise with the giant competitors. Again in the retail grocery, the small market, if you will, that we have in this area cannot compete pricewise with Safeway or Super Giant, but they stay in business even though each and every item is priced a few cents higher because in many cases they carry accounts, they are known locally in the neighborhoods. People are willing to pay a little more in many areas than they would pay at Super Giant so they are patronized, but in order to stay in business he finds that he has to modernize wherever possible. He has to get new showcases or showcases where his items are readily available, do everything possible to just try to stay in business.

Senator GORE. If I may interrupt——

Mr. GULAN. Surely, sir.

Senator GORE. I find myself in great sympathy with your point of view. What you are really saying, it seems to me, is that because of the

high interest rates, because of the difficulty that small business has in competing and existing, that it should be given a tax preference.

Mr. GULAN. Senator, I am, and I think a strong justification of this lies with the Treasury Department's own figures on increased revenue they expect to gain from doing away with the investment tax credit.

Senator GORE. Now I would like to advert to your reference to the discriminatory effect of high-interest rates on small business. To begin with, they pay the highest rates, do they not?

Mr. GULAN. Always, sir.

Senator GORE. Few of them get the prime rate.

Mr. GULAN. I do not know of anybody that gets the prime rate in a small business—unless he has a longstanding triple A credit rating or something of that nature which is not available.

Senator GORE. Whereas large business can go public and obtain equity capital at no interest rate, is that correct?

Mr. GULAN. Very often it is, Senator.

Senator GORE. And, therefore, the investor takes his chance on a dividend on his stock.

Mr. GULAN. Right.

Senator GORE. There is one other inequity in this high-interest rate structure. A man in the high-income bracket has a great advantage in that he can deduct his interest payments from his taxable income.

Mr. GULAN. Yes, sir.

Senator GORE. And if he has high income, thus subject to a high tax rate, this brings his effective interest rate down to a reasonable level?

Mr. GULAN. Yes, it does, because of the credit.

Senator GORE. So whereas a man who might be in the 60-percent bracket and pay interest on $100,000 borrowed might have an effective rate of 4½ percent, though he paid 9 percent at the bank. That is not exact.

Mr. GULAN. Well, it is very close and he could well do that.

Senator GORE. Now, on the other hand, Secretary Kennedy was before us yesterday asking that the surcharge be extended, but insisting that there was not anything he could do or would do or intended to do toward bringing interest rates down, and insisting that the Congress should not consider tax reforms as a part of this, and it was after he had belabored those two points for about an hour and a half that I expressed some doubt that I would support the surcharge without tax reform amendments and without some action on the part of the administration with respect to the unconscionably high-interest rate.

Mr. GULAN. I recall your statement on that.

Senator GORE. Did you find opposition or support for that point of view?

Mr. GULAN. From the Secretary you mean?

Senator GORE. Do you support my point of view or oppose it?

Mr. GULAN. I definitely would support your point of view and I believe our organization would, Senator. We think that reform is vital.

Senator GORE. I suppose the thing for me to do would be to say I support your point of view, but I cannot.

Mr. GULAN. Senator, we do need your support. We would like very much to have it.

Senator GORE. I think as a matter of principle, tax preference and tax credits are very dangerous things, and they create more inequities than they cure.

Thank you, Mr. Chairman.

Mr. GULAN. Thank you, Senator.

Senator BENNETT. No questions.

Senator MILLER. Mr. Gulan, I take it from this colloquy you have just had that you do not support Secretary Kennedy's and the President's position?

Mr. GULAN. Not in its entirety, Senator, no.

Senator MILLER. Where do you not support it?

Mr. GULAN. We do not support it on the proposal to repeal the investment credit across the board. We do think that there should be exceptions to this.

Senator MILLER. But do you support the President's and the Secretary of the Treasury's position that to do something about inflation we need to take prompt action on continuation of the surcharge, and hold Federal Government spending in check so that we will have a reasonably balanced budget?

Mr. GULAN. In general yes, we do, Senator.

Senator MILLER. In other words, you would support a prompt action on the part of the Congress to enact the continuation of the surcharge, and you would feel somewhat concerned about an undue delay in its passage?

Mr. GULAN. Senator, I think everyone is concerned about delay here, if this is the best approach to fight inflation, to depress the ever-increasing spiral here, by all means it should be done forthwith.

Senator MILLER. And if it might delay it for 2 or 3 or 4 months because tax reform measures were going to be piled on top of it rather than getting it out of the way and taking care of tax reform when the major tax reform measure comes over from the House, which we have been assured it will by August——

Mr. GULAN. Yes, sir.

Senator MILLER (continuing). Then you would prefer to have prompt action?

Mr. GULAN. Conditionally, yes, Senator. I think the type of approach we are asking for was handled during the suspension of the investment tax credit 2 years ago if you will recall. At that time the Ways and Means Committee did not see fit to include any exemptions, but this committee did it and did it very well and as I recall very promptly by inserting an amendment which would allow an across-the-board exemption of 7 percent on the first $20,000 of investment. As I recall that caused no undue delay and it had the support of the majority of the committee and the majority of the Senate.

Fortunately the Senate conferees held out on this point. We would like to see much the same thing happen here, sir.

Senator MILLER. You alluded to the Joint Economic Committee report a few moments ago.

Mr. GULAN. Yes.

Senator MILLER. I believe you said something about the minority views in there?

Mr. GULAN. Yes, Senator. I did not read the views. I will be gled to do so if you would like in part just as I did the majority views.

Senator MILLER. Do you have the page there?

Mr. GULAN. Yes, sir; page 102 I believe is what I was referring to.

Senator MILLER. What does it say?

Mr. GULAN. Minority views at that point stated:

We believe, however, that the very nature of the 7-percent investment tax credit makes it an inappropriate tool for short-run economic stabilization and oppose its suspension in 1969.

Senator MILLER. Do you find something else at the end of that sentence?

Mr. GULAN. Probably further on, Senator. Would you like me to read on?

Senator MILLER. Look at the end of that sentence; do you find a little number?

Mr. GULAN. A little footnote, by all means.

Senator MILLER. Would you mind reading that?

Mr. GULAN. By all means:

Senator Miller strongly disagrees, believing that the Congress should retain its constitutional power over the subject of taxes and tax rate. Senator Miller remains unconvinced that the investment tax credit is the fairest approach to plant modernization and, therefore, cannot agree that considerations of deeply serious inflation might not warrant suspension.

Senator MILLER. And is there a further footnote?

Mr. GULAN. There is a further one:

Senator Jordan believes that the circumstances which existed at the time of the investment tax credit provision was enacted do not now obtain and, therefore, abstains from the position expressed by the minority on this point.

Senator MILLER. I just wanted to have that put in perspective, Mr. Gulan. Let me say this. I am sympathetic toward small business as you know, and I do think you have a point on drawing a line perhaps beyond which the credit should not apply. I personally think that in the long run it would be much better to have a revision of the tax rate structure which you I know favor.

Mr. GULAN. Senator, we would agree wholeheartedly with that, and it would be our hope that this can happen, and should this come up, might I suggest that in the meantime we will let them take what little advantage they can with the credit, and at such time as the tax rate is restructured——

Senator MILLER. You see the difficulty is that if we are going to do a job on inflation, we need to do this to take this action on the surcharge promptly.

Mr. GULAN. Yes, sir.

Senator MILLER. And I can well see myself voting for repeal of the investment tax credit, but at the same time when the tax reform package comes over from the House, I would hope that it would contain something by way of revision of tax rates to accord with the needs of small business corporations at least.

Mr. GULAN. Right.

Senator MILLER. I have no further questions, Mr. Chairman, at this time.

Senator BENNETT. May I ask one question?

Mr. GULAN. Senator?

Senator BENNETT. You say you represent approximately how many small business firms?

Mr. GULAN. 267,000 small business, Senator.

Senator BENNETT. During 1966 you had 100,000 responses to your questionnaire about the tax credit, and 50 percent of those or approximately 50,000 said they had utilized the credit.

Mr. GULAN. Yes, sir.

Senator BENNETT. Do you think this is fair to the other 210,000 of your members who were not in a position to utilize the credit?

Mr. GULAN. Senator, that statement does not necessarily mean that they did not utilize the credit. The only thing we feel we can honestly speak on is those who did respond and inform us of this.

Senator BENNETT. Yes; but this is a tax advantage to the man who is in a position to make an investment.

Mr. GULAN. By all means, Senator.

Senator BENNETT. And the man who is not in a position to make an investment represented I would judge by at least two-thirds or four-fifths of your members in any given year?

Mr. GULAN. Probably.

Senator BENNETT. The others cannot take advantage of it, and don't you think we would be better off if we had a taxing program that treated all of your members alike, rather than giving some of them an advantage?

Mr. GULAN. Yes; that would be preferable, but we do not have that at the moment.

Senator BENNETT. The first step toward that is to eliminate the advantage?

Mr. GULAN. I am afraid that the cost might be excessive though, sir, in the process.

Senator BENNETT. All right

The CHAIRMAN. Thank you.

Mr. GULAN. Thank you, Senator.

The CHAIRMAN. The next witness will be Mr. Brice O'Brien, general counsel of the National Coal Association.

STATEMENT F BRICE O'BRIEN, GENERAL COUNSEL, NATIONAL COAL ASSOCIATION

Mr. O'BRIEN. Thank you, Mr. Chairman.

We are not here to oppose the bill. I am not here to ask for an exemption, but I am here to ask for a transitional role which I think is particularly applicable to coal and which I believe is necessary in the interests of equity.

Mr. Chairman, the National Coal Association, which represents the major producers and distributors of the Nation's commercial bituminous coal, respectfully requests this committee to adopt a transitional rule which will grant equity in a peculiar situation, as follows:

The bituminous coal industry has gone through a peculiar transformation in recent years. Throughout our history, we have been an industry with excess capacity, and coal mines normally were opened and equipped on the mere hope of finding a market for the coal.

Several years ago, however, the character of the industry changed—due primarily to the fears of the future which were generated by Government development of atomic competition for coal's major growth market, the electric power companies.

At the present time, it is very unusual for a coal mine to be opened in the hope of finding a market. Instead, a long-term contract for the output of a mine is negotiated and signed, and then it takes 2 or 3 years to obtain the equipment and get the mine into production.

In the negotiation of these long-term contracts, the coal operator calculates quite carefully his "cash flow" and his return after taxes, in order to determine whether it is worthwhile for him to invest his money to produce coal at the prices negotiated. Generally the price set forth in the contract will specify the general area of coal lands from which the coal is to be produced; it will also specify the minimum tonnage per year. And the contract will specify the price of the coal—subject to escalation for such things as labor costs and ad valorem taxes, but not subject to escalation for revisions in the Federal income tax laws.

As of April 18, 1969 (the proposed termination date of the investment tax credit), there were several coal companies which had entered into binding long-term contracts to open new coal mines and sell the coal to utilities at prices fixed in the contracts.

Those prices are not subject to escalation for loss of the investment credit, even though the coal operators negotiated those prices on the assumption that the equipment needed for the mine would be investment credit property. Those coal operators were, I believe, fully justified in making that assumption, because when they negotiated the contracts they had no way of knowing that Congress would repeal the credit. If they had been aware of the impending change, the coal prices negotiated would have been several cents per ton higher.

Those coal operators should not be penalized because of the accident of timing. Under the bill as passed by the House, those who were fortunate enough to have their equipment under order as of April 18 will not be penalized—they will receive the investment credit.

But the operators who signed binding contracts to open new mines and sell the coal, and had not yet ordered their equipment by April 18, will be penalized. We believe that equity demands that the credit be available in both cases, because the operator with the long-term contract to sell coal is contractually bound to go through with the deal. He cannot back out merely because the credit is repealed. He cannot adjust his selling price under the contract to compensate for loss of the credit.

In the 1966 suspension of the credit, Congress recognized the need for equity in this situation and granted relief from the suspension. Unfortunately, the repeal bill as passed by the House does not provide for similar relief. We are asking this committee to provide relief similar to that which was granted in the 1966 suspension, but we are suggesting somewhat different language which will cover our situation more explicitly than the 1966 language did.

Further, the language we are now suggesting will make it clear that the transition relief is available only where the selling price of the coal cannot be adjusted to compensate for loss of the credit upon which it was based in the first place.

At the risk of being repetitive, I want to point out the crucial difference between this situation in the coal industry and the more common situation where, for example, a company has decided to build a factory but has not yet ordered the equipment. The company build-

ing the factory will be free to adjust prices for the product to compensate for loss of the credit. The coal operators I am talking about cannot adjust the prices of the coal to compensate for loss of the credit, because they are bound by contracts to sell the coal at the prices specified in the contracts—and those contracts were entered into before the coal operators were put on notice that Congress might repeal the credit.

We are not asking for an "open end" relief provision. Under the terms of the bill as passed by the House, the credit phases out in all of these transitional situations, depending on the date the equipment is placed in service. Under the House bill, the 7 percent credit will be reduced by one-tenth of 1 percentage point for each month after December 1970 before the equipment is placed in service, and the credit will not be available at all for equipment placed in service after December 1974.

The language we ask you to add to the House bill is as follows:

> "(__) Where, pursuant to a binding contract in effect on April 18, 1969, (i) the taxpayer is required to construct, reconstruct, erect, or acquire property specified in the contract, or extractive property the general specifications of which are readily ascertainable from the location and characteristics of the mineral properties (specified in such contract) from which the product is to be produced, (ii) the property is to be used to produce one or more products under such contract, (iii) the other party to the contract is required to take substantially all of the products to be produced over a substantial portion of the expected useful life of the property, and (iv) the contract for sale of the product or products is a fixed-price contract (except for provisions for escalation under which the loss of the investment credit would not result in a price change), then such property shall be pretermination property. Clause (iii) of the preceding sentence shall not apply if a political subdivision of a State is the other party to the contract and is required by the contract to make substantial expenditures which benefit the taxpayer."

I thank you for the opportunity to be here, sir.

The CHAIRMAN. Let me ask you this. Frankly, I find some appeal to your statement here. I just want to ask this question in fairness. If we do this for the coal association would not the same logic apply to the man who paid for an oil lease and the lease is going to expire between now and next year? Would he not have the same right to say, "Look, I am going to build that well or I am going to lose that million dollars I paid for that lease." Some people who have leases that will expire will have to build the well or lose the lease.

Mr. O'BRIEN. Senator, I think there are many situations where taxpayers have made plans, very definite plans and have gone forward to a point where they probably should in equity be given the credit because they have probably made those plans based upon the availability of the credit, and I am by no means suggesting that there are not additional areas where relief should be granted. I have made our request quite restrictive feeling that we should request relief only in the circumstance where the taxpayer is already on April 18 under contract to go forward and also under contract not to raise his price due to loss of credit.

I have made it that restrictive, I know there are others who need relief, but I want to ask for the least that I can in order that we do get relief in his particular situation which I think we need.

The CHAIRMAN. I understand your position. What you are saying is that if you had a contract signed for the equipment, you would be entitled to credit under the House-passed bill?

Mr. O'BRIEN. Yes, sir.

The CHAIRMAN. And you are saying that you signed a contract where you are going to have to buy the equipment. You have no choice about it, you signed a contract to open a mine?

Mr. O'BRIEN. Yes, sir.

The CHAIRMAN. You are saying that if you are bound to a contract which forces you to buy the equipment, then you ought to have the same consideration as if you had signed a contract for the equipment. Is that what you are saying?

Mr. O'BRIEN. Exactly, sir; and I think probably there are many other situations with which I am not familiar where there is a need for similar equity and it might be granted but since I am not familiar with it I used this restrictive language.

The CHAIRMAN. I understand.

Senator Bennett?

Senator BENNETT. I have just one question, Mr. Chairman. How tight are your contracts? Let us assume a situation in which you are the coal company that entered into that contract had figured so closely that failure to get the 7-percent investment credit would make the contract unprofitable, and it notified the buyer that, "We are very sorry, under the circumstances we cannot get the machinery, so we cannot open the mine."

Mr. O'BRIEN. Senator, these contracts are tight. Now we have no previous experience as to loss of the credit. We have previous experience with other unexpected costs, and I am thinking particularly of the Mined Land Reclamation Laws. For example, Kentucky a couple of years ago imposed some very severe requirements that turned profitable contracts into a loss. Those coal companies who had these contracts with utilities had to go through with them and suffer a loss, unless they were lucky enough to have a particular escalation clause covering such an event. Most of them did not. In that situation I would like to give a little boost to TVA. Quite a few of the contracts were with TVA, and I understand that TVA did not stick them with the legal terms of the contract. They granted some relief to take care of the unexpected additional costs. but as a matter of legal right, these contracts are tight.

Senator BENNETT. Could the utility company, if you decided not to open the mine, go out and buy the coal somewhere else and charge it to you?

Mr. O'BRIEN. They would have a legal right to. I believe the measure of damages in such a situation would be the amount it cost them to buy the coal from someone else in excess of the amount that they would have had to pay you.

Senator BENNETT. They could charge that difference to you even though you never opened the mine and had no assets on which to pay?

Mr. O'BRIEN. That is correct, sir. They might have a worthless judgment against them.

Senator BENNETT. But they could have a judgment against you?

Mr. O'BRIEN. Yes, sir.

Senator BENNETT. They are that tight?

Mr. O'BRIEN. Yes, sir.

Senator BENNETT. That is the point I wanted to make.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Miller?

Senator MILLER. Mr. O'Brien, there is, I think, one difference between the situation facing us now and the situation back in 1966 at the time of the suspension. The difference is that now we are faced with a package in which as a tradeoff for the repeal of the investment tax credit there is a discontinuance of the surcharge, I am sorry, there is a continuance of the surcharge, but only for a short period of time. It goes on for 6 months at the present rate, and then down to 5 percent for the last 6 months of the current fiscal year, and then it is out. I take it there is nothing in these contracts to provide for a deescalation of the prices if the 10 percent goes out either, so I am wondering if we do not have a tradeoff situation here, where while the 7-percent investment tax credit might have been figured in calculating the price on the one hand, if that factor goes out and that disturbs the pricing, on the other hand there is the tradeoff of the discontinuance of the surcharge which I would think would be more profitable to you than retention of that 7-percent tax credit.

Mr. O'BRIEN. Senator, I think there is a little mixup. I am afraid we have an inequity in both situations. The surcharge in this bill now being considered by this committee is not going to cut off; it is not going to shorten the life of the surcharge. It is going to lengthen it. Without this bill the surcharge would be gone. So we are suffering on both ends of the deal. We are asking for relief on one.

Senator MILLER. Of course I think anybody who has been in the tax area for very long knows that so-called temporary taxes have a way of hanging around for a while, and especially if there is a problem with respect to inflation. That is the reason these excise taxes are on. The people from the utilities will tell you that those excise taxes are only going to be continued because of this bill, but that has been going on for a long, long time, so my point to you is that there is a tradeoff here which I would think would be more advantageous. Certainly if we have to do something about inflation and I have to have revenue, you are going to have a continuation of that 10 percent surcharge until something is done about inflation. Now if that 10 percent comes off, that is going to be helpful to you, and if the investment tax credit comes off, that is going to be harmful to you, but I suggest that there is a tradeoff here which in pricing out these items might be more advantageous to you than to not have a discontinuance of the surcharge.

Mr. O'BRIEN. I am not in a position to say how many of our people are as sophisticated about temporary taxes as the members of this committee are. I personally, if I had been negotiating a long-term contract, I would have negotiated it on the basis of the continuation of the surcharge permanently. I would do so even after Congress passes this bill. We have 10 percent through the rest of this year. I rather agree with the line of reasoning with which you are approaching this question of permanency. I doubt very much that it will continue to be only 5 percent next year for the first 6 months and then pass out of existence.

Senator MILLER. What you are really saying is that if you were in on the contract, you would have put a clause in there which appears in a good many contracts I might say, that this is subject to a revision to reflect changes in the Federal income tax laws?

Mr. O'BRIEN. Our people have tried to do that. They have been unable to get the utilities to agree to that procedure. It may be common in other industries. In ours it is not. The utilities simply will not go along with it. But my point there was that this bill as it actually stands, technically extends the surtax, not cuts it short, and in reality I suspect that there is no cutoff on the 10 percent. I think it is here forever.

Senator MILLER. To me if I were a stockholder, I would prefer to have the surcharge go off along with the repeal of the investment tax credit than to retain the investment tax credit and have the surcharge continue. I think it would be a better deal for the company, and that is the only point I wanted to make. I know we can get into some technical arguments about it.

Let me ask another question. You mentioned TVA. TVA is a Federal governmental Agency.

Mr. O'BRIEN. Yes.

Senator MILLER. If the Federal Government comes along, either because of action by TVA managers or action by the executive branch of the Government or action by the legislative branch of the Government, it still is the Federal Government. They come along and change the ground rules, so to speak. It seems to me that you might have a different situation there than you do in the case of a private utility because the Federal Government, the party to the contract, has by its own action undercut the guidelines or the understandings that existed in the contract. You said something about revisions being made by TVA. Do you know whether they are in position to make revisions in a situation like this?

Mr. O'BRIEN. I believe they have the authority where unexpected events occur to renegotiate. The only example I know of was when the State of Kentucky passed rather expensive reclamation laws, and made small-profit contracts into loss contracts, TVA, I think, wisely recognized they could not expect a continuous supply of coal because the companies would go broke over the years. These contracts run 15 to 20 years. TVA did sit down with some of those companies and say, "Look, we will increase the price to cover part of that additional cost."

I have little belief they would do so in this current situation, however.

Senator MILLER. In what?

Mr. O'BRIEN. In this investment credit situation. It is an entirely different picture.

Senator MILLER. You do not think they would have the authority to?

Mr. O'BRIEN. I do not believe they would be inclined to do so; no.

Senator MILLER. Don't you think they should be inclined to do so if the Federal Government has undercut the basis for negotiating of a price?

Mr. O'BRIEN. Some of the contracts I am talking about are with TVA, some with private utilities.

Senator MILLER. I am talking about those with TVA.

Mr. O'BRIEN. Where it is with TVA, I think clearly the taxpayer then can easily point to where this damage comes from. It comes from the Government. However, he is just as bad off where the contract is with the utilities. He is still being hurt just as badly but he cannot point quite so plainly as to who is to blame.

Senator MILLER. Except for the fact that the utility, being in the private sector, has had nothing whatsoever to do with changing the guidelines. Further if there is a benefit that accrues to the seller because of a discontinuance of a surcharge, the utility does not renegotiate the contract to cut down the price of the coal.

In other words, both parties in that situation, without having a clause covering Federal tax changes, take their chances, but in the TVA situation, that is a one-way street, because the Government does not take any chances there, and that I suggest to you is a difference relating to the TVA situation.

Mr. O'BRIEN. I agree that it is a much more culpable situation, but I do not want to point out to you that the coal company who has the contract with the utility is just as bad off and this is a matter of equity, as it is with TVA.

Senator MILLER. Thank you.

The CHAIRMAN. Thank you, Mr. O'Brien. Without objection, we will include in the record at this point, a letter I received from Mr. Stephen Dunn, president of the National Coal Association and a letter of Fred W. Peel, chairman of the American Mining Congress' Tax Committee.

(The letters referred to follow:)

NATIONAL COAL ASSOCIATION,
Washington, D.C., June 27, 1969.

Hon. RUSSELL B. LONG,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: Very shortly the Finance Committee will have before it the House bill to repeal the credit. We need your help to correct an inequity in the transition rules—an inequity which will do serious damage to several coal companies, through no fault of their own.

Prior to April 18, 1969, those companies entered into long-term contracts to open coal mines and sell coal at firm prices. In good faith, those prices were set with the expectation that the credit would be available for the machinery necessary to open the new coal mines.

We believe that equity calls for relief in this situation. We are not asking for "exemption" from the repeal—merely transitional relief for those caught by contract in this situation. The relief we ask, and the necessity therefor, are set forth on the enclosed one-page document.

Sincerely,

STEPHEN F. DUNN,
President.

Enclosure.

THE HOUSE BILL TO REPEAL THE INVESTMENT CREDIT SHOULD BE AMENDED TO GRANT RELIEF WHERE A COAL COMPANY ON APRIL 18 HAD A BINDING LONG-TERM CONTRACT TO OPEN A MINE BUT HAD NOT YET ORDERED THE MACHINERY—AND IS STUCK WITH THE CONTRACT PRICE FOR THE COAL

As of April 18, 1969 (the proposed termination date of the credit) there were several coal companies which had entered into binding long-term contracts to open new coal mines and sell the coal to utilities at a price fixed in the contracts (with prices subject to escalation for various factors such as wages, but *not* subject to escalation for loss of the investment credit). Those prices were negotiated on the assumption that the equipment for the mine would be investment credit property.

Those coal companies were justified in assuming, when they entered into those contracts, that the investment credit was going to be available for the equipment. If they had been aware of the impending change, the coal prices negotiated and set forth in the contracts would have been several cents per ton higher. Under the House bill these companies will be deprived of the credit for this machinery, and under their contracts they will be unable to change the price of coal to cover loss of the credit.

In the 1966 suspension of the credit Congress recognized the need for equity in this situation and granted relief from the suspension. Equity calls for similar relief now. Such relief would be granted if the following provision were added to the House bill:

"( ) Where, pursuant to a binding contract in effect on April 18, 1969, (i) the taxpayer is required to construct, reconstruct, erect, or acquire property specified in the contract, or extractive property the general specifications of which are readily ascertainable from the location and characteristics of the mineral properties (specified in such contract) from which the product is to be produced, (ii) the property is to be used to produce one or more products under such contract, (iii) the other party to the contract is required to take substantially all of the products to be produced over a substantial portion of the expected useful life of the property, a fixed-price contract (except for provisions for escalation under which the loss of the investment credit would not result in a price change), then such property shall be pre-termination property. Clause (iii) of the preceding sentence shall not apply if a political subdivision of a State is the other party to the contract and is required by the contract to make substantial expenditures which benefit the taxpayer."

AMERICAN MINING CONGRESS,
Washington, D.C., July 9, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate
Washington, D.C.

DEAR MR. CHAIRMAN: H.R. 12290, which would repeal the seven percent investment credit, will probably have its greatest impact on the mining industry, which has the highest ratio of investment in facilities and equipment per employee.

I can find no more concise statement of our basic views than those contained in our Declaration of Policy adopted at Salt Lake City, Utah on September 11, 1966 when suspension of the credit had been proposed:

"We urge that the investment credit not be repealed or suspended. Particularly as to the mining industry it has had, and continues to have, a valuable role in encouraging investment to increase productivity, which is a constructive way to combat inflation. When it was enacted in 1962, business was assured that it was not a temporary measure. It was justified in terms of the long-term need for increased productivity, which is an even more important objective today than it was when the credit was enacted. Retention of the 7 percent investment credit is one essential step toward providing feasible and economic financing of vitally needed expansion of mining facilities; the favorable effect of its cash flow helps prevent undue strains on the capital market."

We wish to remind the Committee that the investment credit was enacted as an integral part of a program of depreciation reform. For many years prior to the recommendation by President Kennedy that a tax credit be granted for new investment in plant and equipment, it was generally recognized that our depreciation allowances were inadequate. During 1962 Congress adopted the seven percent investment credit and the Administration promulgated new depreciation guidelines for the purpose of placing U.S. industry on a competitive basis with industries of other major industrialized nations of the free world that used their tax systems to encourage investment in machinery and equipment.

One of the main goals of this two-pronged attack on the obsolete character of our Nation's industrial machine was to make our industry competitive both at home and abroad and thus help correct our adverse balance of payments. For example, Mr. Stanley S. Surrey, Assistant Secretary of the Treasury for Tax Policy, told the Society of Business Professions, Inc. on March 12, 1962:

"The investment credit, coupled with realistic depreciable lives, will make the tax treatment of investment in the United States comparable with that offered

by our major competitors in Western Europe, Canada and Japan. The investment credit thus takes its place along with the variety of Western European devices—such as the incentive allowances afforded in addition to depreciation in the United Kingdom, Belgium and the Netherlands, or the first-year additional depreciation allowances permitted in the United Kingdom, France, Italy and the Netherlands."

If the investment credit is repealed, our country will again fall behind other industrialized nations in encouragement of modernization and expansion of capital equipment. We will be seriously handicapped in our competition with foreign producers both in our home market and in world markets, and our balance of payments inevitably will suffer.

The mining industry is basic to industrial production. We are faced with rising costs for air and water pollution, for land reclamation, and for mine safety. We believe that it would be unwise to put an additional burden on us by repealing the investment credit, and we strongly urge its retention as a permanent feature of our tax laws. If the Committee should approve the recommendation of the Administration to repeal the investment credit, however, we strongly urge that it be retained and increased for investment in air and water pollution abatement facilities since these facilities seldom, if ever, produce an economic return. An exception was made for air and water pollution facilities when the investment credit was suspended in 1966.

Finally, the Committee would be making a serious error if it were to assume that elimination of the investment credit this year would dampen the current rising trend in prices. Repealing the credit now would have little or no immediate effect. Instead, the impact would be postponed a year or more until current decisions to curtail or defer capital expenditures began to be felt. Turning the investment credit off and on is not an efficient tool of fiscal policy. The effects are felt in totally unexpected ways and at later times when fiscal policy considerations may have changed completely. In other words, repealing the credit now may cause or intensify a recession a year from now.

However, if the Committee should decide that the investment credit should be repealed, there is a situation particularly affecting the mining industry that deserves consideration. It involves the application of the effective date of the repeal to equipment purchased or constructed to meet binding commitments.

Binding commitments to buy equipment or to develop or construct an entire mining or mineral processing facility frequently arise as a result of contracts with so-called third parties—that is, contracts with persons other than a supplier. One example is prevalent in the coal industry. It involves the development of a mine or mines and related facilities pursuant to a binding contract with a coal user, frequently a utility, to develop the mine and supply a specified tonnage of coal from it for a term of years. Since the purpose of the binding contract exception is to avoid unfair surprise and hardship on taxpayers who were firmly committed to investment projects before the suspension of the credit, binding commitments of this nature should be recognized on the same basis as binding commitments to suppliers.

We also suggest that the 20 percent limitation on the carryover of unused investment credits to 1969 and later years is an unwarranted restriction. These unused credits were generated by investments made before repeal was suggested, and in fairness they should be allowed without the new 20 percent limitation. Some taxpayers may lose the use of part of their investment credit carryovers if their income fluctuates. Mining companies are vulnerable to this danger because of fluctuating metal and mineral prices and the expenses of developing new mines.

Since the investment credit was enacted as part of depreciation reform, it should not be repealed without compensatory corrections in the provisions for depreciation deductions. We suggest, as a start, the repeal of the reserve ratio test on the use of the guideline lives for depreciable assets.

We request that this letter be made a part of the printed record of the hearings on H.R. 12290.

Respectfully submitted,

FRED W. PEEL,
Chairman, AMC Tax Committee.

The CHAIRMAN. The next witness is Mr. Marvin L. McLain, of the American Farm Bureau Federation. Do you have a prepared statement?

STATEMENT OF MARVIN L. McLAIN, LEGISLATIVE DIRECTOR, AMERICAN FARM BUREAU FEDERATION; ACCOMPANIED BY WILLIAM C. ANDERSON, ASSISTANT LEGISLATIVE DIRECTOR

Mr. McLAIN. A very brief statement, Senator Long.

I have with me Mr. Anderson here, my assistant on tax matters if you have any questions.

On behalf of nearly 1,800,000 Farm Bureau member families in 49 States and Puerto Rico, we appreciate this opportunity to present Farm Bureau's views on the surtax extension bill recently passed by the House and now before this committee.

Last year Farm Bureau supported the Revenue and Expenditure Control Act of 1968. Believing that inflation was one of the most serious problems facing the country at that time, we supported the temporary surtax—tied to an effective expenditure ceiling.

The act had hardly been signed into law when the process of exempting various agencies from the expenditure ceiling began. These exemptions nearly nullified the intended purpose of the expenditure ceiling, greatly reducing the effectiveness of the act as an anti-inflationary tool.

At our most recent annual meeting, held in Kansas City last December, official voting delegates adopted the following resolution:

> We are experiencing an inflationary situation which demands a reduction in federal government spending to assure a balance of expenses and income.
>
> Deficit spending by the federal government and policies which expand the supply of money and credit faster than production clearly lead to inflation.
>
> The current fiscal situation calls for action to eliminate inflationary pressures. Congress sought to deal with this problem in 1968 through (1) action directing the administration to cut federal expenditures, and (2) passage of the 10 percent income surtax. Nevertheless, inflation has continued and is still our most serious economic problem.
>
> We therefore urge Congress to pursue inflation control with greater vigor in 1969. In achieving this, major emphasis should be on cutting federal expenditures, but, if necessary to obtain a balanced budget for fiscal 1970, we will support continuation of a surtax for an additional year.
>
> We urge the Executive Branch to make significant reductions in current expenditures and in future budget requests.
>
> At the same time, Congress should take steps to make changes in basic legislation enabling effective evaluation and control of government spending within annual appropriations.
>
> We commend those members of Congress who have worked to achieve sound fiscal goals and urge others to join them in this effort.

Those policies further state:

> The investment credit should be considered a permanent feature of our tax system.

This is the end of the quotation of our delegate body in Kansas City.

Earlier this year, Farm Bureau outlined and submitted to the appropriate committees of Congress specific recommendations for cutting expenditures during fiscal 1970 by at least $6.5 billion. While very little final action has been taken on appropriation bills for fiscal 1970, it does not at this time appear that significant reductions are going to be made in the January budget estimates.

Meeting here in Washington on June 11, the board of directors of the American Farm Bureau Federation issued the following statement, and this was at the time the tax bill was on the House side:

We are concerned about the prospects of continued inflation brought on by excessive government spending and continued budget deficits. Inflation hits farmers particularly hard as their expenses rise more rapidly than prices they receive.

Current discussion of the proposed surtax extension has centered on its use as an anti-inflationary measure. While we recognize the importance of a sound tax policy in the development of a balanced fiscal policy, we believe the current situation demands that more emphasis be placed on expenditure reductions. With such emphasis, expenditures could be reduced sufficiently to balance the budget, slow inflation, and permit early termination of the surtax.

Currently tied to the surtax extension is a proposal to repeal the 7 per cent investment credit. Farmers faced with the need to make heavy investments in new machinery and equipment as a means of increasing their efficiency have come to rely on this credit and believe it should be considered a permanent feature of our tax system.

In light of these facts, Farm Bureau opposes the so-called tax package now under consideration by the House Ways and Means Committee and calls upon both the Congress and the Administration to re-double efforts to bring about meaningful expenditure reductions. In this way, inflation control can be achieved to the benefit of all Americans.

We believe inflation can best be controlled by sharp reductions in Federal Government outlays. We, therefore, urge the Congress to make a real effort to balance the budget by requiring substantial reductions in Federal expenditures before giving any further consideration to an extension of the surtax and that the investment credit not be repealed.

We stand ready to assist in finding ways to make meaningful cuts in Federal spending to slow inflation and permit an early termination of the surtax.

The CHAIRMAN. Your position is that you would prefer that we reduce spending rather than continue this tax; that is your position?

Mr. McLAIN. That is right.

The CHAIRMAN. Maybe we can do a little of both. That is about where you stand.

Mr. McLAIN. Well, our interest is in reducing spending, Senator Long. There is not any question about it. That is the way our people feel.

Senator ANDERSON. The statement is very good.

The CHAIRMAN. Thank you very much. We will try to save some money if we can find a place to do it. Of course, as you know, we do not have much appropriations. We have the burden of raising the money. They have the satisfaction of spending it.

Mr. McLAIN. We understand that, Senator Long. We emphasize that point in our statement. We do appreciate it.

The CHAIRMAN. We have to raise money to pay for all this.

Thank you very much.

Now Mr. Angus McDonald, director of research, National Farmers Union.

We shall be glad to hear from you, sir.

You have a prepared statement, I believe.

Mr. McDONALD. Yes, sir.

STATEMENT OF ANGUS McDONALD, DIRECTOR OF RESEARCH, NATIONAL FARMERS UNION

Mr. McDONALD. Mr. Chairman and members of the committee, I have a very brief statement.

The CHAIRMAN. We will print the entire statement, Mr. McDonald, and if you can I would appreciate it if you would summarize it.

Mr. McDONALD. It is short. I understand farm losses you are not considering at this time.

The CHAIRMAN. Right.

Mr. McDONALD. I am appearing here in opposition to the 10-percent across-the-board surtax; in support of a tax credit exemption for farmers and small business up to an investment of $15,000; and in support of S. 500 which would eliminate tax abuses engaged in by certain individuals and corporations for the purpose of tax avoidance.

The National Farmers Union, like so many other groups and organizations, supported the surtax several years ago when we were assured that it would help balance the budget and check inflation. Today the fires of inflation are burning more brightly than ever and the efforts of this administration and the previous administration to check inflation have proved to be a dismal failure.

The House Ways and Means Committee, in its report of June 20, 1969, admits that the surcharge has not checked inflationary pressures, but lamely adds that "Conditions are changing and the surcharge, if continued in effect with other governmental policies, should reduce present inflationary pressures."

There is not a shred of evidence that the surtax and the misguided policies of the Federal Reserve Board have checked inflation. Only last week, according to the Wall Street Journal of July 7, 1969, "business loans outstanding at the 12 leading banks jumped $190 million * * *." This reliable publication adds, "that was in sharp contrast to a $16 million decline registered in the like 1968 week. In the latest 5 statement weeks," apparently they make these statements by the week, "such commercial and industrial loans have risen by almost $750 million."

Thus, we have evidence which cannot be challenged or disputed that the misguided policies of the Federal Reserve Board and the continuance of the surtax which was reauthorized by the House of Representatives only a few days ago, has not had the slightest effect.

Furthermore, this administration has turned a deaf ear to the pleas of farmers, small business, and the housing industry which are being strangled to death by exorbitant interest rates and has adopted a do-nothing policy.

President Nixon has not by word or deed admonished the New York banks for their wild excesses in raising the prime interest rate. The latest increase was 1 percent—7½ to 8½ percent.

The CHAIRMAN. Actually, Mr. McDonald, if I might interrupt you I do not know too much about it, but the press report I read indicated that some of the New York banks required a fellow to put 10 percent on deposit in the bank in order to get the loan and leave it there without interest. That makes it work out to being more than a 10-percent rate that they are charging.

Mr. McDONALD. You are quite correct, Mr. Chairman.

The CHAIRMAN. On good loans.

Mr. McDONALD. I have heard previous reports several weeks ago in the Wall Street Journal that the borrowers were required to leave 20 percent. I do not know if it is 20 or 10.

The CHAIRMAN. But now if they are required to put a large amount of money in the bank, whether it is 10 or 20, to put it in a bank at no interest, as a condition of having the loan, that is the way that those bankers can get more. Now, in a lot of States the laws traditionally define 10 percent as being usury, have they not?

Mr. McDONALD. Yes, sir.

The CHAIRMAN. So that in fact there are a lot of good people nowadays being required to pay usurious interest rates. In fact if not technically. As a practical matter when they are required to comply with that sort of a technique, it does go above 10 percent.

Mr. McDONALD. Yes, sir. We are not cheered by the testimony of the Secretary of the Treasury before the House Banking and Currency Committee when he said that he had done nothing whatsoever to turn the New York bankers from their policies which will, in our view, bring ruin to the entire Nation. When asked by the chairman why he had not done something to bring pressure on the New York banks, he plaintively replied, "Why should I?"

The CHAIRMAN. The Secretary of the Treasury told us much the same thing yesterday. He asked us the question, "What good would it do?" As a practical matter how would you know if you had not tried? Isn't that about the size of it, Mr. McDonald?

Mr. McDONALD. Yes, sir. It is not generally known, Mr. Chairman, but the Secretary of the Treasury does have authority to take the tax loan accounts out, it has authority under the Federal Reserve Board to act when the administration policies are inconsistent with the Federal Reserve Board. That is in the law. And yet he will not say a word.

The CHAIRMAN. We have some banks in Louisiana, I am happy to say, that have not charged 8½ percent; they just declined to go up that high. Maybe he ought to take that money out of some of those New York banks and put them in some of our Louisiana banks that are not charging 8½ percent.

Mr. McDONALD. I think it would be very good if he did.

The CHAIRMAN. I could support that.

Mr. McDONALD. We are aware that these matters do not lie primarily in the jurisdiction of this committee. However, all Members of Congress and every citizen are affected by excessive interest rates and must perforce be concerned and do whatever he can to alleviate or change policies which are leading us to disaster.

Farmers, on their part, continue to bear intolerable burdens. It was predicted some time ago by the Department of Agriculture that production costs will rise this year by more than $1 billion, thus more than wiping out any benefit farmers had hoped to gain by the slight increase in farm prices. Farmers are struggling under a gigantic burden of debt. The Department of Agriculture tells us that on January 1, 1969, farm debt amounted to more than $53 billion—an increase of $4.1 billion during 1968. Of this amount, $27.8 billion was farm mortgage debt and $25.3 billion was non-real-estate debt.

Interest charges in 1968, the Department estimates, amounted to $3 billion and will amount to more than $3.2 billion in 1969. This latter estimate was made before the recent skyrocketing of interest rates and no doubt is far below what the actual amount of interest rates will be for this year.

The National Farmers Union supports the President's proposal for elimination of the 7-percent tax investment credit, except that we want farmers and small business exempted up to a capital investment of $15,000. We call attention to Agricultural Finance Outlook, published by USDA, released on February 3, 1969.

According to this publication, "small-scale farmers were finding it more difficult to make loan payments and many marginal farmers will be faced with critical debt situations." According to one of the directors of the Farmers Home Administration, there is "an influx of applicants that formerly obtained credit from PCA's and banks."

The report goes on to say that many farmers previously delayed investments "in anticipation of lower interest charges." It is predicted, therefore, that farmers must necessarily make large purchases of farm machinery which despite high interest rates cannot be postponed any longer.

I emphasize the point that farmers are dependent in large part on machinery and vehicles. The U.S. Department of Agriculture reports that repairs and depreciation on farm machinery and vehicles amounts to 22 percent of total farm expenses. Farmers bought $2.4 billion worth of farm machinery in 1967. The inexorable march of technology forces farmers to make larger and larger purchases of capital equipment. In 1940 only 19 cents was invested in machinery and equipment per man-hour of labor input. In 1968 investment per man-hour was $3.62.

During the past 2 years the Farmers Union has given a great deal of attention to the fact that so-called tax farmers have gone into farming with the sole purpose of evading payment of their just share of taxes. I will not go into detail regarding the massive intrusion of wealthy individuals and corporations into farming.

I call attention to a table which is appended to this statement and which indicates that 86½ percent of those individuals with a net income of $1 million or more reported to the Internal Revenue Service a net loss on their farming investments.

During 1965, 119 of such individuals engaged in farming; 103 reported losses. Internal Revenue Service reports that of those individuals realizing incomes subject to taxes between $500,000 and $1 million, 202 engaged in farming; 170 of this group reported losses.

Since according to Internal Revenue Service statistics most individuals with modest outside incomes reported a profit on their farming operations, it seems obvious to us that either the wealthy are terribly inefficient or that they took advantage of loopholes in our tax laws. It appears that they entered the business of farming in order to lose money.

A simple example is given by the Treasury to illustrate this point. Assuming that the expenses of raising a herd of cattle are $200,000, it is obvious that the taxpayers in the top tax bracket will incur a tax saving of $140,000. On the sale of the herd, however, the entire sales price, including the $200,000 representing the recovery of these expenses, will be taxable only at the 25 percent capital gains rate. The capital gains tax on $200,000 is $50,000, or less than half the tax savings realized in the earlier years. Thus, the taxpayer in this situation would realize a $90,000 tax profit from a transaction which economically is merely a break even.

S. 500 would go far in eliminating abuses engaged in by wealthy individuals and corporations. It would limit the losses of a farm entrepreneur to $15,000 plus taxes, interest and losses resulting from natural disasters. It would not, as its opponents say, require that all farmers resort to the accrual method. Under this legislation taxpayers would still have the option of selecting the method they prefer.

However, if they did not restrict themselves to the restrictions under the $15,000 rules they would be required to report their inventory as do other businesses.

(The attachment to Mr. McDonald's prepared statement follows:)

The following statistics lead us to believe that wealthy individuals have been using farm investments to escape payment of taxes:

ALL 1965 INCOME TAX RETURNS OF INDIVIDUALS RELATING TO FARMING, BY ADJUSTED GROSS INCOME CLASSES

[Dollar amounts in thousands]

	Net profit		Net loss	
	Number of returns	Amount	Number of returns	Amount
Taxable returns, total	1,151,882	3,951,260	661,860	1,001,106
Under $1,000	6,546	4,338		
$1,000 under $2,000	65,519	69,113	16,603	13,739
$2,000 under $3,000	107,019	168,442	35,891	32,770
$3,000 under $4,000	139,737	259,685	64,020	63,354
$4,000 under $5,000	140,030	314,961	80,522	92,672
$5,000 under $6,000	132,512	345,937	83,450	84,166
$6,000 under $7,000	114,602	334,594	80,887	85,396
$7,000 under $8,000	96,434	293,086	68,302	64,550
$8,000 under $9,000	72,525	267,080	47,547	50,125
$9,000 under $10,000	57,875	242,904	39,555	50,706
$10,000 under $15,000	132,109	724,204	79,564	123,177
$15,000 under $20,000	42,160	347,490	23,843	60,292
$20,000 under $50,000	38,752	471,138	30,380	133,187
$50,000 under 100,000	4,974	82,700	7,424	76,852
$100,000 under $500,000	1,040	23,464	2,874	54,872
$500,000 under $1,000,000	32	518	170	6,625
$1,000,000 or more	16	1,606	103	7,630

Source: "Statistics of Income, 1965," individual income tax returns, U.S. Treasury Department, Internal Revenue Service.

ACTIVE CORPORATION INCOME TAX RETURNS, JULY 1965 TO JUNE 1966

Number of returns with and without net income	18,526
With net income	10,387
Without net income	8,139
Form 1120 S	4,862
Without net income (form 1120-S)	2,330

Source: Book of "Statistics of Income," U.S. Treasury Department, Internal Revene Service.

Mr. McDONALD. Mr. Chairman, I hope at some future time when the committee does consider S. 500 and other related legislation, I will have an opportunity to present our views on farm losses.

The CHAIRMAN. Fine. A good statement. Thank you very much, Mr. McDonald.

Mr. McDONALD. Thank you.

The CHAIRMAN. The committee will now stand in recess until 10 o'clock Friday on this hearing.

Tomorrow we expect to have a meeting of the Subcommittee on Veterans' Legislation, to consider veterans' bills.

(Whereupon, at 12:34 p.m. the committee recessed, to reconvene at 10 a.m., Friday, July 11, 1969.)

PROPOSED EXTENSION OF THE SURCHARGE AND REPEAL OF THE INVESTMENT TAX CREDIT

FRIDAY, JULY 11, 1969

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

The committee met, pursuant to recess, at 10:15 a.m., in Room 2221, New Senate Office Building, Senator Herman E. Talmadge, presiding.

Present: Senators Anderson, Talmadge, Byrd, Jr., Williams, Bennett, Curtis, Miller, Jordan, and Fannin.

Senator TALMADGE. The committee will please come to order. The committee is honored indeed to have with us this morning the Honorable Charles A. Vanik, a Member of Congress from the State of Ohio. Mr. Vanik, you may proceed as you see fit, sir.

STATEMENT OF HON. CHARLES A. VANIK, A U.S. REPRESENTATIVE IN CONGRESS FROM THE 22D CONGRESSIONAL DISTRICT OF THE STATE OF OHIO

Mr. VANIK. Thank you, Mr. Chairman.

First of all, I want to express my appreciation for the declared intention of your committee to fit meaningful revenue-raising tax reform into the surtax deliberations. Your action reflects the hopes of most of the 205 Members of the House who have declared that tax reform can be achieved within the practicable timetable of this session. The 91st Congress will overshadow most of its forebears—if it could indeed become known as the tax reform Congress.

In our House efforts for reform we were outmanuevered—but not defeated—if our best hopes are brought to fruition by your efforts.

In connection with the investment credit, I urge that your deliberations sanitize the repeal to insure that the exceptions are limited, explainable, and justified. In the Ways and Means Committee, I urged that the repeal date of the investment credit be set back to April 1, 1969, to coordinate the change in the law with the quarterly tax period. Congress has no obligation to extend the tax privilege of the investment credit to those who exploited the failure of Government to exercise more drastic efforts to slow down overindulgence in the expansion of our industrial plant.

When it was learned by our Ways and Means Committee on the day the surtax bill was reported out that one contractor boasted the execution of $900 million in contracts on the Sunday before the scheduled termination, we moved the tax termination date to Friday, midnight, April 18. In addition to the one group of $900 million in contracts,

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there is reason to believe that an additional $3 billion in contracts were executed on that Sunday, and perhaps $5 billion in contracts executed on Saturday April 19. Two extra days of investment credit repeal affected an estimated $9 billion in contracts for a potential Treasury gain of $630 million. Setting the investment credit repeal back to April 1, 1969, would reach a potential contract total of $35 billion for a Treasury saving of $2.45 billion. Should we provide a tax bonanza for the bad guys who flaunted the Government appeals for restraint and moderation? Should we penalize the responsible portions of our business sector which deferred expansion and borrowing to help cool down the inflationary spiral?

Second, I urge that within the framework of the repeal of the investment credit, language be inserted to eliminate the extension of the credit on items produced in foreign countries during the transition period.

I was shocked to discover that the investment credit would apply to items of foreign manufacture. It was my belief that the investment credit was designed to stimulate domestic industry. The extension of the credit to items of foreign manufacture—even during the period of transition—is indefensible and adds unwisely to the outflow of dollars. This provision extends a 7-percent incentive to items of foreign manufacture which is not reciprocated by any other country.

Almost simultaneous with the announcement of the repeal of the investment credit, the administration announced that depreciation guidelines would be modified and liberalized to substantially make up the loss of the investment credit tax advantage. It would be tragic if the administration would give away in increased depreciation whatever is gained by Treasury in the repeal of the investment credit. For this reason, I urge that your legislation provide at least a temporary mandate or moratorium against further liberalization of the depreciation schedule.

In our tax reform work in the House, we have agreed upon a substantial amount of reform items. We have brushed the kittens but the fat cats are still roaming the neighborhood. We have not increased taxable revenues. As a matter of fact, we have generated Treasury losses. However, in the last several days we have moved into critical areas of reform which could substantially increase revenues.

Our best hopes for revenue-raising reform rest in constructive changes in capital gains preferences, by extending the minumum holding period, decreasing the tax benefit, and eliminating the alternative tax.

The minimum holding period on capital gains was 2 years between 1922 through 1933. In 1934 it was reduced to one year and in 1938 was increased to 18 months. In 1942 the holding period was reduced to 6 months where it remains today.

The Revenue Act of 1932 provided for graduated taxation of capital gains. An asset held over 1 year and less than 2 years was taxable at 80 percent of gain. An asset held over 2 years and not over 5 years was taxable at 60 percent of gain. An asset held over 5 years and not over 10 years was taxable at 40 percent of gain, while an asset held over 10 years was taxable at 30 percent of gain.

The Revenue Act of 1938 provided for graduated taxation of capital gains as follows: An asset held more than 18 months but not more

than 24 months was taxable at 66¾ percent of gain while an asset held more than 24 months was taxable at 50 percent of gain.

Our present schedule of capital gains taxation was adopted in 1942 under war conditions when it was believed that a sudden reduction in capital gains taxation would result in an accelerated capital movement and increased tax yields. That decision provided a slight (2-year) short-term gain in capital gains taxation and a 25-year loss of potential capital gain revenue. The decision was no bargain for the Government.

I do not have a documented recommendation as to the details of a graduated schedule of capital gains taxation. It seems to me, however, that the minimum holding period for capital assets should be extended to 1 year—resulting in an annual Treasury gain of almost $0.5 billion. An increase in capital gains taxes based on the principles of the 1932 law would be more equitable and produce about $3¼ billion in annual revenues from capital gains and still preserve essential inducements for the investment of risk capital. Under the present law and the ease with which losses may be artificially created under the 31-day rule, too much of the risk in capital adventure is carried out by the U.S. Treasury.

Under present laws, Mr. Chairman, we suffer a $3 to $4 billion annual loss in tax revenues by permitting capital gains to escape taxation at death. This is totally irrational and against the public interest. This type of nontaxation encourages the prolonged holding and immobilization of assets. Rigor mortis sets in on the blocked capital long before it overcomes its owner. Philanthropy, family, and the Treasury will all benefit from a clean tax slate—with capital gains taxes paid.

Section 265 of the Internal Revenue Code, section 2, denies the interest deduction to financial institutions on indebtedness incurred to purchase or carry obligations on which interest income is tax exempt.

In fiscal 1965, approximately $15 billion in interest payments by individuals were deducted from the taxes due for a Treasury loss of $4 billion to $5 billion annually. For the same year, corporations utilized deduction totaling $26 billion for a Treasury loss of $9 billion. In view of the intensified borrowing in recent years, the annual Treasury loss in the interest deduction must total $6½ billion for individuals and $13 billion for corporations. High interest rates have served to multiply the interest deduction and the loss to Treasury in recent years.

There is unutilized power in the Congress to attack interest rates and to simultaneously increase tax yields. For example, a temporary suspension of the interest deduction on all debt contracted after a given date would eliminate the public subsidy for borrowing which results from the tax deductibility of interest paid. Such a provision suspending the tax deduction on all but housing debt contracted from this date could produce increased Treasury revenues. At the current rate of nonhousing debt increase, a suspension of the interest deduction would increase tax revenues by almost $4 billion and guarantee an almost instant reduction in interest rates to acceptable and tolerable levels.

This is strong medicine—but the patient is very sick with high-interest fever. It takes this kind of legislative remedy to preciptate a return to normalcy from the high-interest fever which threatens to destroy our economy. This is tax reform which attacks high interest.

I certainly hope that your committee will provide for a reduction of depletion allowances to levels which meet the criteria of justification.

The 27½ allowance was made arbitrarily and without any relevance to need. The depletion should be reduced to a percentage level that can be justified. The reform should endeavor to reach intangible drilling and deplorable bookkeeping procedures which avoid fair taxation.

In any event, there is no justification I can think of for extending the mineral depletion allowance extraterritorially to American investors in foreign countries. Some of these investors have multiple depletion allowances from the United States and from the host country. When depletion allowances for foreign extraction is combined with the benefits of the foreign tax credit—there is little left for the U.S. Treasury. In the meanwhile, billions of dollars of our foreign commitments in aid and military assistance are spent to protect these investors from other foreign invaders and from the people of the host country who are coming to resent our extraction of their mineral wealth.

The elimination of the foreign mineral depletion privileges, coupled with a sizable reduction in the privilege of domestic mineral and oil extraction, should raise $2 billion annually without adversely impairing the national security or the multiplicity of incentives for search and development.

Mr. Chairman, what is going on right now in the House Ways and Means Committee and the fervor with which your work has begun here, bears the hallmark of the great race for reform. Both of our committees are making reality from what was considered the impossible. The anguish of the taxpayer has gotten through to the Congress.

In this contest for achieving a higher degree of tax justice, there are 70 million winners. the overwhelming majority of American taxpayers who pay the full tax assessment through withholding—the taxpayers who have no haven, no tax shelter—no special line of defense from the tax collector.

We are engaged in one of the most vital tasks of the legislator. We know what needs doing, and we must do it. We have been preparing for this day for a long time. We must not fail the taxpayer who has patiently waited an even longer time.

Senator TALMADGE. Thank you very much, Congressman.

Any questions, Senator Anderson?

Senator Williams?

Senator Bennett?

Senator Curtis?

Senator CURTIS. Congressman Vanik, you spoke on the House floor on these matters, did you not?

Mr. VANIK. Oh, yes.

Senator CURTIS. And particularly you spoke in reference to the provision in the House bill involving the investment credit with reference to pipelines, that provision that takes care of situations where they had not gotten their authority yet to build them.

Mr. VANIK. Yes.

Senator CURTIS. As I understand it, in your speech you indicated that there were $612 million of proposed construction involved in applications before the Federal Power Commission.

Mr. VANIK. Yes, I did.

Senator CURTIS. And made an estimate that the amount amounted to about $42 million of investment credit.

Mr. VANIK. I do not recall that exact figure, but I do recall the $612 million.

Senator CURTIS. That is what it would about figure out.

Mr. VANIK. Yes.

Senator CURTIS. Now, did you take into account that these $612 million of applications, among other things, would include the cost of real estate, which is not eligible for the investment credit?

Mr. VANIK. What I based my statement on is a letter and attached appendix that I had received from Mr. Lee C. White, Chairman of the Federal Power Commission, dated June 30, 1969, and which I would like to make a part of this record.

Senator TALMADGE. Without objection, it will be inserted at this point.

(The letter with attachment referred to follows:)

FEDERAL POWER COMMISSION,
Washington, D.C., June 30, 1969.

Hon. CHARLES A. VANIK,
House of Representatives,
Washington, D.C.

DEAR CONGRESSMAN VANIK: Late in the day on June 27, 1969, your Mr. Talisman made a telephone request to Commission staff personnel requesting a company-by-company enumeration of applications for certificates of public convenience and necessity under the Natural Gas Act pending as of the close of business on April 18, 1969. Attached hereto is a listing of the requested information.

Sincerely,

LEE C. WHITE, *Chairman.*

Estimated cost of applications for certificates of convenience and necessity pending before Federal Power Commission at close of day on April 18, 1969

Name of company:	Total estimated cost
Alabama-Tennessee Natural Gas Co	$475,000
Arkansas Louisiana Gas Co	19,241,350
Chandeleur Pipeline Co	9,200,000
Cities Service Gas Co	36,810,730
Colorado Interstate Gas Co	4,914,448
Columbia Gulf Transmission Co	19,202,300
Columbia Offshore Pipeline Co	31,073,200
Consolidated Gas Supply Corp	35,274,946
East Tennessee Natural Gas Co	1,229,840
El Paso Natural Gas Co	29,529,930
Florida Gas Transmission Co	20,143,700
Great Lakes Gas Transmission Co	200,000
Kansas-Nebraska Natural Gas Co., Inc	8,649,000
Lone Star Gas Co	473,527
Manufacturers Light and Heat Co., The	6,121,041
Michigan Wisconsin Pipe Line Co	15,158,740
Mississippi River Transmission Corp	24,529,700
Natural Gas Pipeline Co. of America	796,865
Northern Natural Gas Co	18,111,485
Panhandle Eastern Pipe Line Co	11,774,300
Southern Natural Gas Co	2,588,590
South Texas Natural Gas Gathering Co	8,652,200
Tennessee Gas Pipe Line Co	33,643,769
Texas Eastern Transmission Corp	179,295,000
Texas Gas Transmission Corp	18,588,411
Transwestern Pipeline Co	13,834,000
Transcontinental Gas Pipe Line Corp	54,447,000
United Gas Pipe Line Co	6,057,700
United Natural Gas Co	1,797,202
Total	611,874,034

Mr. VANIK. As an appendix to that letter, Mr. White provided me with a table listing the estimated cost of applications for certificates of convenience and necessity pending before the Federal Power Commission at the close of the day on April 18, 1969, and this schedule lists 29 applications, with an aggregate estimated cost of $611,874,034. I do not have that broken down as to categories within applications.

Senator CURTIS. But that would imply there would be a sizable escape through the provision in the House bill which you oppose, is that right?

Mr. VANIK. Yes.

Senator CURTIS. But is it not true, however, that real estate, if it did make a part of that cost, is ineligible for the investment credit?

Mr. VANIK. If real estate is involved, that part of it that may be real estate would probably not be—will not be eligible as a matter of law for the investment credit, but most of this is not—it is construction costs, you know.

Senator CURTIS. That is one item that would cut your $611 million or $612 million down considerably.

Now, is it not also true that in that total there no doubt were sizable portions of it that represented equipment or other things purchased, that had already been purchased and delivered and are involved in the pending application, and they would be eligible for the investment credit under the ordinary rules?

Mr. VANIK. I do not know what portion of total contract authority would be ineligible for the investment credit. I would suspect that certainly that part of it that might be real estate would not be entitled to the credit, and some other items of purchase may not be entitled to the credit. I did not estimate the Treasury loss in that statement.

In my statement to the House, as I remember it, I quoted the fact that there were $611 million in contracts and this was no small item that was included in the House provision.

Senator CURTIS. Well, very respectfully, there are some of us who do not feel that your quoting of your $611 million or $612 million is quite as an informative yardstick for measuring the problem as it implies, first, because you have to exclude real estate; second, if there are some of these companies that have bought equipment in connection with these applications that have already been contracted for and delivered and they are eligible to the credit without the amendment.

Now, is it not also true that sometimes the FPC issues temporary certificates, and when they issue a temporary certificate it is still included in applications pendings?

Mr. VANIK. I do not know the extent to which temporary certificates are included in this list.

Senator CURTIS. I think you will find that is true, and I think you will further find that sometimes, perhaps not always, but sometimes, on the basis of a temporary certificate, they go ahead and install facilities or substantial portions of them. So if in this $611 million tabulation you have there are some temporary certificates that are included under the heading of pending cases, it is entirely possible under those temporary certificates purchases have been made that come clearly within the deadline without any special amendment providing for it. Is that not true?

Mr. VANIK. It is possible, and if it is true, then I think we ought to put it in the record. We ought to find out precisely how much of this is involved in real estate and how much of it is involved——

Senator CURTIS. You were the one who put it in the record.

Mr. VANIK. I put in the record what I have from the Federal Power Commission. I do not know the details of the contracts. That is not for me to——

Senator CURTIS. No, no; I think it is. You are a member of the committee, and you rose on the floor and you stated that $611 million was pending, and the implication was that somehow a majority of that committee had unwisely provided a loophole for an escape from the ordinary rules of taxation that was out of the ordinary.

Mr. VANIK. That is still my contention.

Senator CURTIS. But it is still not your contention that the total was $611 million.

Mr. VANIK. Whether it is $611 million or $610 million and 35 cents——

Senator CURTIS. But suppose it is $400 million.

Mr. VANIK. I do not think it is $400 million.

Senator CURTIS. Suppose it is $200 million.

Mr. VANIK. I think it is a very substantial amount, very close to $600 million, and that is my position, and I would not back off on it, and I think it is a very sizable concession, a very improper grant of privilege, that I would hope that this committee might correct.

Senator CURTIS. Well now, is it not also true that pipelines sometime make an application before the Federal Power Commission before they have done anything toward purchasing or installing the facilities to transport?

Mr. VANIK. That may be.

Senator CURTIS. And if so, that would further reduce your figure of $611 million.

Mr. VANIK. That may be to some extent.

Senator CURTIS. I think that is all, Mr. Chairman.

Senator TALMADGE. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Congressman, would it be your position that if there are negotiated prices in connection with a contract which is pending before the Federal Power Commission, those negotiated prices were premised upon the assumption that the investment tax credit would continue, and there is nothing in the contract itself which permits renegotiation based upon changes in the Federal income tax law, that the Federal Power Commission in approving the contract should also be permitted to take into account whether or not the prices arrived at in that contract might justifiably increase to reflect the change in ground rules by the repeal of the investment tax credit?

Mr. VANIK. Well, I would say that from my observation that whether or not it is a contract that meets the perquisities of the law is something for the Internal Revenue Service to pass on, and I do not think that I could substitute my judgment for the administrative agency that must determine whether a contract in fact has been executed which meets the perquisites of the law.

Senator MILLER. I do not think I made myself clear in my question.

As I understand it, the Federal Power Commission has the authority to set these rates or approve these rates or approve the prices set forth in contracts; that is part of their consideration.

Mr. VANIK. I understand, sir.

Senator MILLER. Let us say they have a request for approval of a contract, and the contract includes a price which had been negotiated between the two parties, the pipeline company and the purchaser. And this price had been arrived at by the parties some weeks ago, maybe some months ago, based upon the assumption that the present tax credit would continue.

Now, let us take, say Congress repeals the investment tax credit and the seller comes before the Federal Power Commission and says, "Look, we would like to have your approval to increase the price that was contained in this contract because the ground rules have been changed." Both parties recognize that the ground rules have been changed.

Would it be your position that the Power Commission would or should be able to revise the price upwards to take into account the change in the ground rules as a result of the repeal of the investment tax credit which had been assumed to be continued at the time of the negotiation? Now we are not talking about the Internal Revenue Service. We are talking about the FPC.

Mr. VANIK. Well, it would seem to me, Senator, that a contract could be drafted that would be valid and binding and irrevocable between the parties that could allow for price escalation, and if they failed to have that kind of contract, I do not think that we have any obligation in the Congress to do the work that the contracting parties should have more thoroughly done in the first place. I do not believe it is our responsibility. I look upon the investment credit as a privilege.

Senator MILLER. As a what?

Mr. VANIK. As a privilege. It is a preference, and as a privilege it can be withdrawn or modified. It can be extended. I think Congress has the full latitude to take away a privilege that it gives.

Senator MILLER. That really is not my question. My question is, Is it your position that the Federal Power Commission should be able to grant an application or grant a request to increase the price in the negotiated contract before they approve it?

Mr. VANIK. I am not competent to answer that question.

Senator MILLER. What do you think. I mean I am not asking you whether they can. I am asking you whether you think they should be permitted.

Mr. VANIK. I do not know. I really do not know.

Senator MILLER. Do you think they should be permitted to reduce the price if the buyer comes in and says, "Look, we have this contract, and there has been a change of the ground rules on the basis of which it was negotiated. Now we say the price is excessive, and now we ask the Federal Power Commission to reduce the rate."

Mr. VANIK. I must say to the Senator I am not that conversant with the activities and power of the Federal Power Commission to express a contributory opinion on that question. I have only dealt with the tax issue, and that is the only thing I have personally studied with as much intensity as I can.

Senator MILLER. May I say to you that I have not either. But my question is, What is your opinion on whether they should be allowed to do so because, you see, what we are talking about here is, as I understand it, a number of contracts which are awaiting approval of the FPC, and FPC has long had jurisdiction to work out rate increase approvals and rate decrease orders, and I am asking whether you think they should be allowed to have that authority when the ground rules have been changed with respect to a major change in the tax law such as the repeal of the investment tax credit. I do not know whether they have that authority or not, but I want to know whether you think they should have, and if they have it, whether they should exercise it.

Mr. VANIK. Well, Senator, I would say in response, I do not feel that I would want to make any contribution to the legislative history on that question because really I cannot answer that.

Senator MILLER. All right. No further questions, Mr. Chairman.

Senator TALMADGE. Thank you very much, Congressman. We appreciate your appearing before us.

Senator CURTIS. May I ask one more question?

Senator TALMADGE. Certainly, Senator Curtis.

Senator CURTIS. Is it your contention that the amount of money upon which the investment credit would be figured that would come within the purview of the Ways and Means Committee amendment that you disapproved is $611 million?

Mr. VANIK. Well, I would be inclined to agree with the Senator that it is something less than $611 million, but I would say that it probably is in excess of $600 million which gives my position in the House a lot of validity, and if I am off by that small percentage, I plead guilty to that error of omission.

Senator CURTIS. But you have not computed how much it is?

Mr. VANIK. Certainly not.

Senator CURTIS. How much is real estate?

Mr. VANIK. We would have to send that to——

Senator CURTIS. And you have not computed how much is already covered by investment credit that does not come under the transition?

Mr. VANIK. It would probably cost $150,000 to compute that. We would have to send it to Houston to find out.

Senator CURTIS. And you have not computed how much of it may be involved under temporary certificates where the facilities have already been completed.

Mr. VANIK. But I would make a statement, Senator, that it is in excess of $600 million.

Senator BENNETT. How can you do that if you have not computed it?

Mr. VANIK. Because I do not believe there is that much real estate or exempt business in here to reduce it below $600 million.

Now the committee, the Senate Committee, has a staff that can find out, and if your facilities can help find it out, I will be very happy to amend my statement to whatever the committee staff can determine is the correct amount. I certainly think we ought to have the precise amount in the record. But I do not think it is within my capacity as I do not have the staff capacity to analyze this. I do not have access to the records. They are secret. They are in the custody of the companies that are in the business.

Senator BENNETT. They are in the custody of the Federal Power Commission.

Mr. VANIK. And the Commission; yes.

Senator BENNETT. OK. That is public property, and I am surprised that you come over here and testify and then ask this committee to rectify an obvious mistake.

Mr. VANIK. I do not consider a percentage differential that may be as small as that a mistake. I consider that it gives pretty good validity to the statement I made. I do not think I have to, as a Member of Congress, nail down to the penny the exact Treasury loss on an item like this.

I am here to tell this committee that the principle is bad, and that the loophole is much bigger than was indicated during the earlier discussions before our committee. We were caught by great surprise when it was discovered that it would have this scope, and I am here to try to impress your committee with the fact that this is a much wider thing, a much more costly exemption that was ever reported before our committee in its deliberations.

Senator CURTIS. Let me ask you this: Did you ever submit a question to the Federal Power Commission asking them for the dollar amount that would come under this transition provision that was in the Ways and Means Committee bill? I think it was 6b.

Mr. VANIK. Yes. Well, this is the part of my exhibit because my letter of June 30 to the Commission sets out specifically what I requested, and I requested a company-by-company renumeration of applications for certificates of public convenience and necessity under the Natural Gas Act pending as of the close of business on April 18, 1969. That was the extent of my question, and the Commission answered my question.

Senator CURTIS. You never asked them for that part of those applications pending that would be covered by this particular subparagraph?

Mr. VANIK. Mr. Talisman of my staff called the Commission and made a telephone request, and his question, as he told me right now, was what was applicable under 6(b) of the bill, and this is the response we got.

Senator CURTIS. Well then, are we to understand that——

Mr. VANIK. In other words, we——

Senator CURTIS. Is it Mr. White's statement that the full $611 or $612 million does come under subparagraph 6(b)?

Mr. VANIK. We asked for the listing of the contracts that would be coming under section 6(b), the investment credit section.

Senator CURTIS. Your letter does not say that.

Mr. VANIK. I know that, but the conference, the telephone reqeust that we made, was to determine what would come under the provision, and this was the response we had. They said this was the best they could do. My request was made on June 27. This provision came into the bill in the very late hours of our deliberations.

I want you to know there was a very tight time factor within the days this provision was put in, and there was not really the time to get all of the detailed information that would be desirable, and my request was that we wanted to know which would have application under 6(b), and this is the list that was submitted.

Senator CURTIS. Well, Mr. Chairman, I will not take any more time on it.

Senator TALMADGE. Thank you very much, Congressman.

Mr. VANIK. Thank you very much.

Senator TALMADGE. We are honored to have as our next witness the Honorable Bob Eckhardt, Representative of the State of Texas.

We are happy to have you, Congressman.

STATEMENT OF HON. BOB ECKHARDT, A U.S. REPRESENTATIVE IN CONGRESS FROM THE EIGHTH CONGRESSIONAL DISTRICT OF THE STATE OF TEXAS

Mr. ECKHARDT. Thank you Mr. Chairman. I have a written statement which I would like to ask permission to be filed as stated, and I shall only deal largely with one part of the statement.

Senator TALMADGE. Without objection, it will be inserted in the record in full and you may summarize as you see fit.

(Mr. Eckhardt's prepared statement follows:)

PREPARED STATEMENT BY HON. BOB ECKHARDT, A U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

SUMMARY

A. Outline of Statement

I. Opposition to the surtax on general grounds:

(*a*) Review of past opposition: offsetting of the effects of the surtax by rising war expenditures—fear of more of the same.

(*b*) In full agreement with the Senate as to need for tax reform.

II. Opposition to the surtax respecting exemption:

(*a*) Explanation of the loophole in the House-passed bill that allows the gas pipeline industry an unnecessary and unjust exemption from the April 18 deadline for repeal of the 7% investment tax credit.

(*b*) Because the government allows this industry a guaranteed rate of profit, investment tax credit not warranted in the first place.

III. Need for responsible, effective alternatives:

(*a*) Extension of the withholding rates without an extension of the actual tax.

(*b*) Tax reform.

(*c*) Excess profits tax.

(*d*) Taxation of "excess interest".

B. Specific Recommendations

I. Continue the higher withholding rates. The economic restraining effects not lessened and the pressure for tax reform continues unabated. Should the economy turn downward, Congress could lower withholding rates to their normal level and permit refunds; otherwise, institute the surtax retroactively.

II. Reinstate an excess profits tax. This would shift the burden from the poor and middle income groups to those benefiting most from the conflict in Southeast Asia.

III. Institute "excess interest" tax analogous to excess profits tax. Revenues generated by this tax could be used to subsidize home mortgages and municipal bond markets.

STATEMENT

Mr. Chairman, members of the Committee, I appreciate this opportunity to come before you on perhaps the most pressing and urgent problems facing our Nation today. No one can argue with the fact that we are in the midst of of rampant inflation and that we are experiencing some of the tightest money conditions in United States' history. The appropriate question that we should be considering is not whether economic restraint is needed—no responsible legislator or competent economist could doubt that fact—but rather, what form this economic restraint should take.

I voted against the 10% surtax extension, just as I voted against its original adoption last year. I shall state briefly why I oppose this particular form of economic restraint, the defects that appear in the House-passed bill, and my recommendations for responsible and effective alternatives to the surtax.

I

I opposed the imposition of this tax in 1968 because I did not feel that it would succeed in halting inflation. This is not to say that I have no faith in what is popularly referred to as the "new" economics; on the contrary I believe very strongly in the efficacy of fiscal and monetary policy. But these policies can only succeed if they are not subjected to other government operations whose economic effects are in the direct opposite direction. I am referring, of course, to the expansionary and inflationary effects of the continued high spending on the war in Vietnam. This is how I made my case against the surtax last year and I see little reason to expect the situation to be any different this year. If our people are taxed—in the guise of fiscal constraint—when any meaningful disinflationary effects are negated by war expenditures, the effect is only to add the tax burden to the burdens of high interest and high prices.

Also, I wish to add my voice to the many urging that we not continue the surtax without adding meaningful tax reform. The surcharge is a tax on a tax, and, if one manages to avoid paying *any* taxes, he automatically escapes the surcharge. How can we, with a straight face, tell income earners and honest sharers of the tax burden that they must bear the burdens of fiscal restraint when many people with largely exempt incomes, capable of making many extravagant purchases, are not forced to curb their spending or fairly share the burden? I am heartened by the sentiment in the Senate for closing the many nefarious tax loopholes before final approval is given for extension of the surtax.

II

Now, I would like to point out to the members of the Committee a very serious inequity in the House bill that passed on June 30.

As you know, one very important provision of the bill was the repeal of the 7% investment tax credit. Let me first say that I am very much in favor of this action for it has been effectively demonstrated that the investment credit is the primary contributor to the inflationary expansion of investment demand.

The bill sets the repeal date as of April 18, 1969 but quite correctly makes provision for construction begun, and binding contracts in effect, on or before that date. The general rule is that pre-termination property, i.e., property eligible to receive the investment tax credit, includes "any property . . . (that) is constructed, reconstructed, erected, or acquired pursuant to a contract which was, on April 18, 1969, and at all times thereafter, binding on the taxpayer." If such facts do not prevail, action taken after April 18 does not accrue an investment credit.

But among the exceptions is this one:

> Where, in order to perform a binding contract . . . in effect on April 18, 1969, (i) the taxpayer is required to . . . acquire property specified in any order of a federal regulatory agency for which application was filed before April 19, 1969, (ii) the property is to be used to transport one or more products under such contract . . . and (iii) one or more parties to the contract . . . are required to take or to provide more than 50 % of the products to be transported over a substantial portion of the expected useful life of the property, then such property shall be pre-termination property.

This is the section (Section 4a) of the bill that I have a strong objection to.

The report accompanying H.R. 12290 explains this seemingly harmless exception to the general rule defining pre-termination property.

> An example of the type of case covered by this provision would be a situation where a company has entered into a binding contract to transport fuel through a pipeline for another party who will provide more than 50 percent of the fuel to be transported over a substantial portion of the estimated useful life of the pipeline. The provision would be applicable in this case, however, only if the company had filed prior to April 19, 1969, its application with the Federal regulatory agency for an order permitting it to construct the pipeline.

In sum, this provision is presented as one justly extending the deadline for those companies entering into contracts for which necessary Federal agency certification is not received by April 18. The major beneficiary of this exemption would be the gas pipeline industry. One of their chief supporters in the House, a Texas colleague, stated: ". . . they should not be denied the benefit of the credit because some Federal agency is sitting aside and refusing to act."

This is a dangerous, unnecessary and inequitable provision, and explanation of it on the floor of the House was misleading.

The implication on the floor debate was that a contract for purchase of capital goods which is binding as between seller and purchaser contingent only upon FPC approval constituted the exception that would qualify.

Thus, Mr. Bush, with whom the amendment originated in the committee, in answer to my question, said:

> * * * the contract spells out the equipment required and if these people have a bona fide contract, they should not be denied the benefit of the credit . . .

Mr. Boggs, who carried the bill on the floor, equated the provision to the ordinary contract for purchase of capital goods in the following language:

> * * * the contract has been entered into and qualifies as a binding contract. If you were to build a plant . . . and no equipment has been installed, but they simply entered into a contract, a binding contract, prior to April 19, that equipment is eligible for the full 7 percent * * *

I had previously been told by an Under Secretary of the Treasury that such was all that the amendment did. In candor, Mr. Boggs did at another point explan the amendment accurately. I do not attribute to anyone an intention to mislead, but the matter is technical and complex and needs clarification, both as to its provisions and its justification.

In fact, the contracts in question are not entracts to acquire property but are rather contracts *to supply gas*. These contracts are not binding without a certificate of approval from the Federal Power Commission, and it is in these certificates that the only requirement of designation of the capital goods to be acquired is made. In order for a gas pipeline company to obtain approval for an extension of service it must file an applocation with the Federal Power Commission within which it must include, among other things, an analysis of the equipment needed to fulfill the contract. This includes a detailed estimate of total capital cost of the proposed facilities for which application is made.

But, unlike the case of other pre-termination contracts, the contracts here are *not* binding without the certificate of approval; and hence the companies involved are not likely to be injured by the withdrawal of the investment tax credit. The FPC will allow a gas pipeline company to withdraw its application for an extension of service if the ocmpany can show just cause. Just cause might well include a reduction in the probability of the contract. Presumably a loss of the investment tax credit would indicate lower profits.

This is a means of escape from acontract which would not be as profitable as anticipated. But there is another even surer safeguard against an improvident contract (in anticipation of investment credit) which might actually result in a loss.

As a public utility, the gas pipeline industry has its rates regulated by the government, and these rates are set so as to give the company a reasonable rate of profit on its investment. If the rate of profit is set, the company cannot possibly be stuck with an unprofitable venture. True, it may not generate an investment credit, which is "cream" on top of profit, but it may be presumed that the utility would have expanded its market for the sake of profit alone. It did not act to its deteriment envisioning, improvidently, an investment credit.

Obviously there is, and was, plenty of inducement to improve and increase plant from gas pipelines *without* any investment tax credit. Even before the 7% investment tax credit provision was enacted, net gas utility plant for the entire Nation had grown from about $6 billion to about $8 billion from 1957 through 1961. After the enactment of the investment tax credit, through the next six years, net gas utility plant grew at about the same amount, from about $8 billion to about $10 billion. It is apparent from these figures that the investment tax credit was not needed to encourage investment in plant and it apparently did not affect such investment.

Actually, the gas pipeline industry has grown at a rate at least comparable to the other utilities which received only 3% investment tax credit. There is no

apparent reason why the pipelines were favored, but in the Revenue Act of 1964 Congress favored them again by eliminating any authority on the part of the Federal Power Commission to use the investment tax credit without the consent of the company involved in determining its cost of service. The tax savings from the investment tax credit could thus be used by the companies for reinvestment or dividends without regard to their rate of return.

From 1962 through 1967 the interstate natural gas pipeline companies generated $296,124,000 in investment tax credits. Of this amount, they utilized and retained $247,106,000. (*Statistics of Interstate Natural Gas Pipeline Companies, 1967*, Federal Power Commission, p. ix.)

Now the gas transmission companies are again asking for special treatment, as if they needed special relief. Are they weak? Are they an industry with a declining growth pattern? Quite on the contrary, the industry has grown by one third in the last five years. In 1962, natural gas utility sales were 100.81 billion therms and in 1967 they were 133.42 billion therms. (See 1968 "Gas Facts" of American Gas Association.)

It is just not possible to put an exact dollar value on this special provision in the surtax and investment credit bill as to how much it benefits gas pipelines. But it clearly would defer the cutoff date for withdrawing the investment tax credit. As I have pointed out, they never needed it or deserved it in the first place; and, at more than twice the figure granted other utilities, it was nothing but a windfall for the stockholders—not the consumers.

The windfall was at an average of about $50 million a year. Typically, in past years, the highest number of rate applications by the gas pipelines have been in the winter months. In the winter of 1967 and 1968 approximately as many permits were filed as during the entire remainder of the year. This was not exactly the situation in the FPC fiscal year 1968–69. In that year over 70% of the applications had been filed by January 1.

I am frank to say, I cannot tell the significance of the timing of the applications other than to say an adroit timing of applications well in advance of actual equipment purchases could keep the 7% investment credit going for a considerable time. If this extended time be 6 months, the special treatment in this law is worth $25 million in investment credits generated to the gas pipelines.

I served for a good number of years in a legislative body which was very sympathetic with gas pipeline companies, and I have had the experience of their long arm reaching right into a conference committee of the Texas Legislature to render a tax unconstitutional. I thought I had escaped this tampering when I came to Congress, but I underestimated their reach.

III

Because I do not believe the surtax to be a fair way to halt inflation, or even a feasible way if present spending patterns continue, and also because the bill contains several questionable clauses, I voted against it in the House on June 30. But it would be quite irresponsible to oppose the surtax and leave it at that. As I said at the opening of this statement, we are facing an inflationary spiral affecting prices, wages, and interest rates. Some viable alternative to the 10% surcharge must be suggested.

The Senate and House have voted to continue the withholding rates, as if the surtax were still in effect, as a temporary fiscal measure. This in itself is a logical and practical alternative to the President's fiscal package. It would preserve and continue the economic restraining effects of the surcharge while allowing time for further consideration of its need.

We should simply continue such withholding while we hammer out tax reform.

The benefits of following this course are several:

1. We would be able to avoid legislating on such an important matter under the pressure of a deadline.

2. Many economists are convinced that we will be in the throes of a dangerous economic slowdown in the first quarter of 1970. If the Congress took no action other than to extend the withholding rate, the economy would be rejuvenated by a great influx of spending money to the public at the time of its greatest needs, i.e., at tax refund time. If inflation is controlled or reversed, Congress would simply pass legislation lowering the withholding rate to its normal level.

3. The Congress, without engaging in a blind guess, would then be able to decide if the surtax was or was not needed. Congress is pretty good at "hind-

sight," and it could apply it then. If the inflation continued unabated the surtax could be enacted retroactively while none of the necessary economic effects would be lost in the interim. Retroactivity would not hurt the normal taxpayer because he would have paid his taxes by the previous withholding.

4. Tax reform minded Representatives would have the leverage that they have so long sought in this area. We would be able to put the heat on the President to push for tax reform without risking the dangers of too early relaxation of fiscal restraint.

5. Also, Congress would retain a real budget control. We could be satisfied that the cuts that are made by the administration forces are not made in the programs most vital to cities and to the poor. Likewise, that some reductions are made in areas of extravagance like some military boondoggles. With the surtax question impending *after* the budget cuts, Congress would have potent bargaining strength.

As another alternative, either independent of or in combination with the extension of the withholding rates, I would propose the institution of an excess profits tax. This worked successfully during the second World War and during the Korean War. It is unfair for most to suffer increased war-time burdens while others enjoy increased war-time profits. I fully concur with the efforts of Senator McGovern in this area.

One of the more serious manifestations of the inflation we are experiencing are the extremely high interest rates. I fully comprehend the meaning of the market and how unwise it is to tamper with the market mechanism. There can be no doubt that the high money rates are a manifestation of market pressures and cannot be condemned sweepingly as an explicit effort by the banking industry to raise its profits. I would not support legislating a ceiling on interest rates—I feel that that would only serve to disrupt what is an orderly, but very tight market.

What I would propose is that the Congress pass a tax on excess interest rates, as on excess profits. Such would drain off the excess income engendered by the tight money market, just as excess profits from the inflationary war stimulus is drained off by an excess profits tax.

I am not criticizing the banks for the recent increases in the prime interest rates. They are simply reacting to the huge loan pressure and the constricted supply of money. I am willing to accept the fact that the huge growth in bank earnings—largely due to the higher rates charged on loans—is incidental. But, just as I feel that it is unfair for corporations to earn extraordinary profits from the war, I feel that it is unfair for the banks to retain a fortuitous, incidental benefit from inflation. Unlike other industries, the costs of doing banking business during inflation does not rise as rapidly, or more rapidly, than revenues. As the price they charge for money goes up, so must their profits. Recent bank statements of earnings confirm this.

Note the following table showing net operating earnings of seven great New York banks in the second quarter of 1969 as compared to the second quarter of 1968. The increases are largely due to an advance in prime interest rate from 6–6½% in 1968 to 7–7½% in 1969, and, of course, accompanying increases in all interest rates. On June 9, 1969, the prime rate has further increased to 8½% which will undoubtedly be reflected in even greater earnings in the third quarter.

[Dollar amounts in millions]

Bank	Net earnings		Percentage increase in earnings
	1968 (6–6½ percent)[1]	1969 (7–7½ percent)[1]	
Manufacturing Hanover Corp	$17.5	$21.0	20.3
Charter New York	13.0	14.5	11.6
J. P. Morgan & Co	18.4	20.5	11.4
Chemical New York	32.8	36.5	11.2
Chase Manhattan	58.1	63.8	11.2
First National City	62.4	66.1	5.9
Bankers Trust	27.0	27.5	1.8

[1] Prime interest rate.

Source: New York Times, July 7 and 9, 1969.

If, as the banks say, they must raise their interest rates in order to ration their loanable funds, there would be no hindrance. An additional benefit could be gained by using the revenues generated by this excess interest tax to subsidize home mortgages and interest on municipal and state bonds.

Perhaps an example of how this tax would work would help to clarify my proposal. In order to allow for normal growth in the demand for money and to make sure that this tax would only be effective in times of very high interest rates, let us take as our base the 8% prime interest rate. Then any loan for more than $10,000 at a rate of over 8% would be subject to the tax.

Using this as the base for our interest tax, a possible levy could be 1.0% for every 0.1% increase in the rate of interest over 8%. Thus, a $10,000 loan at the current 8½% prime interest rate would bring in $850.00 per annum in interest which would be taxed $42.50 (5% of $850.00). The bank would earn $807.50, just a little more than it would have earned at the lower 8% rate. The following table demonstrates how this tax would work over a range of interest rates (assuming a loan of $10,000) :

Interest rate (percent)	Total interest payment	Rate of tax (percent)	Bank earnings	Tax
8	$800	0	$800.00	0
8½	850	5	807.50	$42.50
9	900	10	810.00	90.00
9½	950	15	807.50	142.50
10	1,000	20	800.00	200.00
10½	1,050	25	787.50	262.50

As you see, the interest earnings cease to grow after a certain point while government revenues from the tax rise rapidly. There would be no profit incentive for the banks to raise their rates although there would be nothing to prevent them from doing so if the pressures of the market made such raises expedient. Meanwhile, the revenues raised by the tax could be reserved for home mortgage subsidies and interest subsidies for states and municipalities on their bond issues.

We cannot in good conscience abandon the fight against inflation. This does not mean, however, that the Congress must passively accept whatever proposals the administration brings forth in the battle. I strongly believe that a combination of extended withholding rates, an excess profits tax, and an excess interest tax could most effectively curb inflation and high interest rates and, at the same time, pass the burden over from the least able to pay to the most able.

Mr. ECKHARDT. Mr. Chairman and members of the committee, I would not be so presumptuous as to reiterate the general arguments against the surtax extension to this committee after, of course, there has been so much said by persons who have had so much experience with it and have said it perhaps far better than I can.

I would though like to address myself to the point that has raised most of the questions of this committee and that is the exception with respect to natural gas pipelines.

In my experience in the Texas legislature for a good number of years before I came to Congress I noted a considerable reach of gas pipelines in that body, but I was rather surprised that its reach was as long as it does appear to be.

As the committee, of course, understands, the bill provides that there be three requirements for gas pipelines to come under the exception. First, there must be a contract to supply gas; and, second, there must be an application before the FPC, and then a certain amount of the gas must be transported by the company seeking to obtain the exemption over the facilities thus designated.

The point that I should like to make very clear here and, of course, I understand that the committee understands this, but I fear that per-

haps it has not been made clear enough to the public, that the contract involved here is a contract of supply of gas rather than a contract with an equipment supplier. I do not believe this was at all clear on the debate on the floor of the House. I think it is extremely important that it be made as clear as possible for the public's attention.

In that debate it was said by one of the chief supporters of the amendment, a Texas colleague, that they, the gas pipelines, "Should not be denied the benefit of the credit because some Federal agency is sitting aside and refusing to act."

The implication of the floor debate was that a contract for the purchase of capital goods was binding as between seller and purchaser, contingent only upon FPC approval constituting the exception to be qualified. Thus, Mr. Bush, with whom the amendment originated in the committee, in answer to my question said, "The contract spells out the equipment required and if these people have a bona fide contract, they should not be denied the benefit of the credit."

Well, in fact, the contract only spells out the obligation of the gas pipeline company to supply gas to the person or the municipality or the company to whom the supplier is to supply the gas.

The place where the equipment is described is in the application, not in the contract, and I believe that the discussion implied that the contract was, in fact, the contract to supply equipment, which, of course, it is not.

Mr. Boggs, who carried the bill on the floor, equated the provision to the ordinary contract for purchase of capital goods in the following language.

"* * * the contract has been entered into and qualifies as a binding contract. If you were to build a plant * * * and no equipment has been installed, but they have simply entered into a contract, a binding contract, prior to April 19, that equipment is eligible for the full 7 percent."

Now, I had previously been told by an Under Secretary of the Treasury that such was all that the amendment did. Now in candor Mr. Boggs did at another point explain the amendment accurately, and I do not attribute to anyone an intention to mislead. But the matter is technical and complex and needs clarification, both as to its provisions and as to its justification.

In fact, the contracts in question are not contracts to acquire property but are rather contracts to supply gas. These contracts are not binding without a certificate of approval from the Federal Power Commission, and it is in these certificates that the only requirement of designation of the capital goods to be acquired is made.

In order for a gas pipeline company to obtain approval for an extension of service it must file an application with the Federal Power Commission within which it must include, among other things, an analysis of the equipment needed to fulfill the contract. This includes a detailed estimate of total capital costs of the proposed facilities for which the application is made. But unlike the case of other pretermination contracts, contracts here are not binding without the certificate of approval, and hence the companies involved are not likely to be injured by the withdrawal of the investment tax credit. The FPC will allow gas pipeline companies to withdraw an application for an exten-

sion of service if the company can show just cause. Just cause might well include a reduction in the profitability of the contract. Presumably a loss of the investment tax credit would indicate lower profits.

This is a means of escape from the contract which would not be as profitable as anticipated. But there is another even surer safeguard that pipelines have with respect to the withdrawal of investment credit that ordinary businesses do not have, and this is based on their status as a public utility. As a public utility, of course, they are entitled to a reasonable profit, a reasonable rate of return on their investment. Therefore, they have been granted both the reasonable return on their investment, plus the overriding advantage of the investment credit of 7 percent.

In 1964 Congress provided that the question of the rate structure and the return on the investment should not be affected by the 7-percent investment credit. So, in effect, the 7-percent investment credit is cream on top of the profit.

Now, the main point I want to make is not so much the technical question of whether or not this equates a pipeline's position with that of an ordinary business, but I would like to simply make the point that pipelines do not need special treatment. They do not need the pretermination condition at all.

In the first place, it is impossible for me to see why Congress granted to the pipeline companies a 7-percent investment credit in the first place when to all other public utilities it only granted a 3-percent investment credit. In addition to this, we give pipelines a special treatment in an area in which they do not need special treatment, because they are protected by their status as a utility, and they are also protected by the fact that there are means by which they may withdraw their application.

Now, I am not so sure how much this means in dollars, as Mr. Vanik is. I respect his view on the thing, and I certainly respect his figures, and I know that he most carefully checked with the FPC with respect to those figures, but I believe it is very, very difficult to come out with a precise figure without very deep investigation of the details of the applications.

But I think this can be said, that over the period of 5 years the pipelines have received, in these 7-percent investment credit accruals and use they have received somewhere around $250 million. Now that means that they are getting an advantage from the investment credit at the rate of about $50 million per year.

Now, the applications are seasonal. They usually come at the beginning of the year or they come about the middle of the year. I do not know to what extent this special treatment would step up the time that the investment credit applies, but I know that it would set it up substantially—if it would set it up in effect as much as 6 months we might estimate that the amount in investment credit accrued, if this exemption is passed, would be at least $25 million or half the $50 million figure.

Now, I do not set this down as a positive figure. I do not know precisely how much it would be, but I know it would be a very substantial advantage to gas pipelines which I do not think we need to give them, in all fairness.

Now, I would like to point out here that as I understood investment credit, it had originally been established in order to encourage rebuilding of old plant, also to encourage and increase the GNP of the Nation, but I do not think it was necessary with respect to gas pipeines in the beginning, certainly not necessary at 7 percent, or more than twice the figure that was given, say, to electrical utilities.

I think this is clearly pointed out by the fact that natural gas utility sales were 100.81 billion therms in 1962. In 1967 they were 133.42 billion therms. This is from Gas Facts, 1968. This is an extremely fast growing business that does not need encouragement to continue to grow, because obviously the larger the plant and the larger the expenditure in capital investment, the larger the return.

Gas pipelines are entitled to make a reasonable return on investment. I do not know any reason in the world why they should have enjoyed a 7-percent investment credit for all this time in the first place, and then to give them special treatment with respect to closing out investment credit seems to me to be an extremely improvident thing for Congress to do.

Now, I have considerably more detail with respect to this growth that would show that the total amount of plant, of net plant, for the period immediately preceding investment credit had grown at about the same rate or even at a greater rate than it grew subsequent to investment credit. Of course, I have that in the statement in order to show that investment credit was not needed in the first place.

But what I am arguing here is that gas pipelines do not need special treatment and should not be given special treatment by this legislation.

Thank you.

Senator ANDERSON (presiding). Senator Bennett?

Senator Byrd?

Senator Curtis?

Senator CURTIS. It is your position that pipelines should not have been given investment credit in the law that was enacted 8 years ago?

Mr. ECKHARDT. Yes, sir.

Senator CURTIS. Were you opposed to the law in toto at that time?

Mr. ECKHARDT. Well, I was not in Congress at that time.

Senator CURTIS. I understand that, but in retrospect.

Mr. ECKHARDT. In retrospect——

Senator CURTIS. In retrospect do you think the enactment of the law was a mistake?

Mr. ECKHARDT. Not the law generally.

Senator CURTIS. Well, I do. I voted against it. I thought there would be a day of reckoning just like we have. But I believe that any argument that a particular industry should not have been included comes about 8 years too late.

Mr. ECKHARDT. Well, that may be true, Senator, but if the industry had little reason to be included, and if the industry is also in the best possible position to protect itself when investment credit is cut off, it seems to me the fact that it was not necessary to have included it is an argument that it should not receive special treatment in this legislation.

Senator CURTIS. No; I think when Congress enacts a law, that is the law, and American citizens and American business concerns can rely on it that they will all be treated alike under the law and all will be treated with equitable rules when the law is terminated.

Mr. ECKHARDT. Senator, I agree with that. I think they should be treated exactly the same.

Senator CURTIS. I cannot buy your reasoning that because you thought a particular industry should not have been included 8 years ago that that is a reason for doing something different about the phaseout of the law.

Mr. ECKHARDT. Well, Senator, may I explain my position on this? I do not urge that gas pipelines be treated differently but precisely and exactly the same as all other businesses and that is if they had a contract to purchase equipment on or before April 18, they should be permitted to apply the investment credit to those purchases under those existing contracts just like every other business.

Senator CURTIS. Of course, the Ways and Means Committee took into account the fact that before a contract could become an executed contract there had to be approval of a governing body, to wit, the Federal Power Commission; is that not correct?

Mr. ECKHARDT. I assume that that was their reasoning, sir.

Senator CURTIS. Yes. That is all.

Senator ANDERSON. Senator Miller?

Senator Fannin?

Senator FANNIN. Congressman Eckhardt, I am sorry I was not able to be here to hear your testimony. I have been glancing through it. I wonder if you took into consideration the demand we had, and have had over the past few years, for replacement of hazardous gaslines, especially pickup lines and high-pressure lines. We have tried to encourage the companies to replace these lines, and investment tax credit may be one means of giving encouragement. Have you taken that into consideration?

Mr. ECKHARDT. No, sir; I have not, Senator, and that may possibly be an argument in favor of the 7-percent figure instead of the 3-percent figure for other utilities.

However, I would hardly think that that would justify the difference between 3 and 7 percent considering the extremely high earning capacity of pipelines during the last number of years.

Senator FANNIN. I think if we take it overall, you would be correct. But in some instances we do have lines that have not been replaced and the reasoning is that there have been no earnings at all. We are still trying to replace them. We have a safety factor that is very much involved, and I was wondering if you had considered it.

Mr. ECKHARDT. It had not been considered by me, but I think, Senator it is a valid consideration.

Senator FANNIN. That is all.

Senator ANDERSON. Thank you very much.

Mr. ECKHARDT. Thank you, Senator.

Senator ANDERSON. The next witness will be Eugene Gulledge, president, National Association of Home Builders.

Will you introduce yourself and your associates?

STATEMENT OF EUGENE A. GULLEDGE, PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS; ACCOMPANIED BY NATHANIEL H. ROGG, EXECUTIVE VICE PRESIDENT; HERBERT S. COLTON, GENERAL COUNSEL; AND JOSEPH B. McGRATH, LEGISLATIVE COUNSEL

Mr. GULLEDGE. Thank you, Mr. Chairman.

My name is Eugene A. Gulledge, and I am a home builder from Greensboro, N.C. I am the president of the National Association of Home Builders, and I have with me at the table Mr. Joe McGrath, who is our legislative counsel; Mr. Herb Colton, our chief counsel; and Dr. Nathaniel Rogg, who is our executive vice president.

I also have with me our first vice president, Mr. Louis Barba of New Jersey and several other staff people in case they are needed for information.

I would like to proceed with the statement and be available for questions in case any members of the committee would like to ask them.

I am here today as the president of the National Association of Home Builders. We represent a membership of 51,000 affiliated members, and we have 47 local and State associations throughout the country.

We support the continuation of the income tax surcharge and termination of the investment credit as proposed in H.R. 12290 now pending before you. We urge prompt action on this measure and passage by the Senate at the earliest possible moment.

Our position on these proposals was adopted by our 600-man board of directors in a meeting on May 19, 1969. At that meeting we considered carefully and debated the issues inherent in this legislation prior to its enactment by the House of Representatives and, as an industry, we supported the favorable action in the House on this measure.

The reasons for our position, and why we urge quick action by this committee, stem from the serious and eroding impact of inflation upon the mortgage finance and housing sectors of our domestic economy. The fact is that homebuilding and homebuyers are facing an urgent crisis of extreme seriousness. Moreover, this is happening at a time when the housing needs of the Nation are escalating rapidly and when present levels of housing production and inventory are resulting in the worst housing shortage in the United States since World War II.

It is clear to us that the unavailability of long-term mortgage investment funds, together with the high price of short-term construction financing, when available, will result in a substantial drop in housing starts during this calendar year. The current unprecedented money situation, dramatically highlighted by the recent increases in the prime rate, has already affected new housing construction—but the drastic drop in starts is still to come. To provide the committee with more detailed information we have attached a summary of our findings on the current situation together with the most recent issues of our NAHB "Economic News Notes and Housing Starts" bulletin.

The first signs of a decline came in May, when the seasonally adjusted annual rate of new construction dropped from $91.9 to $91.6

billion. In the remaining months of this year, our best estimate is that the rate will drop as much as $10 to $12 billion. We estimate that total new construction for 1969, as a percentage of gross national product, will decline to its lowest point since World War II. We have attached charts to indicate that.

Further, unless there is a fast turnaround in the availability of money sometime soon, our economists estimate that the seasonally adjusted annual rate of housing starts will drop from the current level of 1.6 million units to a rate of 1 million units or lower by the end of this year and early next year. This, gentlemen, is a decline of nearly 40 percent from current levels.

Needless, to say, the hardest hit sales housing is in the low to medium income group. Multifamily housing markets are also affected. Builders are postponing or canceling plans for apartments because of their inability to obtain financing or because of the cost of financing or both. Even if financing were available, the cost of money is now so high that rents would be raised to levels which consumers generally would be unable to pay.

All this is happening, as mentioned earlier, at a time when the vacancy rate is at its lowest level since World War II. In some cities, for all practical purposes, there are no vacant units at all. We think the situation is urgent. This legislation should not be delayed.

The proposals in H.R. 12290 are fiscal restraints which we believe to be absolutely necessary in the fight against inflation. But if you delay very long in enactment of this legislation, or if it is defeated in some fashion, monetary policy will be forced to shoulder almost the entire burden of controlling inflation. We doubt that monetary policy can perform this task by itself without imposition of selective credit controls and possibly wage, price, and materials controls. Furthermore, we have already been experiencing tight monetary controls which, as we see it, have been relatively ineffective except once again to bring down upon residential construction the full weight of a new credit shortage.

We urge your committee to act quickly on H.R. 12290, and we support the earliest possible passage of this legislation in the Senate, because we are convinced that a very dangerous inflationary movement is underway in the economy. It is not likely to be stopped without clear and convincing evidence that the Congress and the administration mean business, in a hard, unequivocal fashion, in stopping what amounts to a runaway inflation. We think serious delay or procrastination in the enactment of H.R. 12290 will simply add stimulus to both the real inflation and the equally inflationary psychology now rampant as a major factor in business, financial, and investment decisions.

Industrial production is still expanding at a substantial rate. We do not believe that necessary plant and equipment investments will be quickly slowed by repeal of the investment credit, but certainly this repeal will remove whatever tax incentive may be involved in these

decisions. We are hopeful also that corporate restraints will be exercised in the national interest following clear demonstration by the Congress of leadership in the passage of H.R. 12290.

At present the private home-building industry is facing a fight for survival. The recent increase in the prime lending rate of private banks will be disastrous for our industry if the rate is not somehow rolled back by the force of public opinion and governmental action. We were asked to testify on this matter before the Committee on Banking and Currency in the House of Representatives at a hearing on June 23, 1969. Our views and recommendations were set forth in detail in a statement which we have appended to this testimony today, so that this Senate Committee on Finance may have a full record of the situation, as we see it at this time, while you are considering the pending bill.

We appreciate this opportunity to appear and to present our views on the pending legislation. We understand you may have further hearings on some tax reform proposals at which we may want to present our further views. At present, however, we wish to stress the vital importance to our industry of continuation of the surtax and elimination of the investment credit by prompt passage of H.R. 12290. Our interests in this, we believe, are entirely parallel with those of the Nation as a whole, since elimination of inflation must be accomplished if our economy is to remain viable. By the same token, this Nation, the administration, and this committee have a commitment to the American people to fulfill their housing needs and goals. H.R. 12290 will greatly help in both respects.

We thank you for the privilege of submitting this statement. We would like to have it and its appendages made a part of the record here.

(The attachments to Mr. Gulledge's statement follow:)

A Summary of the Current Situation in Mortgage Finance and Homebuilding

The unprecedented tight money situation has already affected overall new construction—but the drastic drop is still to come.

First signs of a decline came in May when the seasonally adjusted annual rate of new construction dropped from $91.9 to $91.6 billion. In the remaining months of this year, our best estimate is that the rate will drop as much as $10 to $12 billion. This decline very likely will show up when the data for June becomes available in about four weeks. The magnitude of this decline can well be seen from some scattered data collected from local building permit offices. This data for June indicates a very substantial drop—as much as 50%—in total value of building permits. Although monthly data is notoriously erractic and does not lend itself to an easy interpretation, a sudden and substantial drop in permit activity in many areas in one month is indicative of what is to come. For example, some of the cities showing declines (June 1968 to June 1969 comparisons): Roanoke, Virginia, down 48%; Eugene, Oregon, down 63%; Beaumont, Texas, down 44%; Gadsden, Alabama, down 10%; Knoxville, Tennessee, down 65%; Washington, D.C., down 82%, etc.

As a result, all new construction for 1969 as a percentage of Gross National Product will decline further to about 9.4%—the lowest since World War II.

This is in spite of the fact that the first four months of this year were substantially better than the first four months of last year. Private construction as a percentage of the Gross National Product likewise will drop to its lowest postwar level, 6.3%.

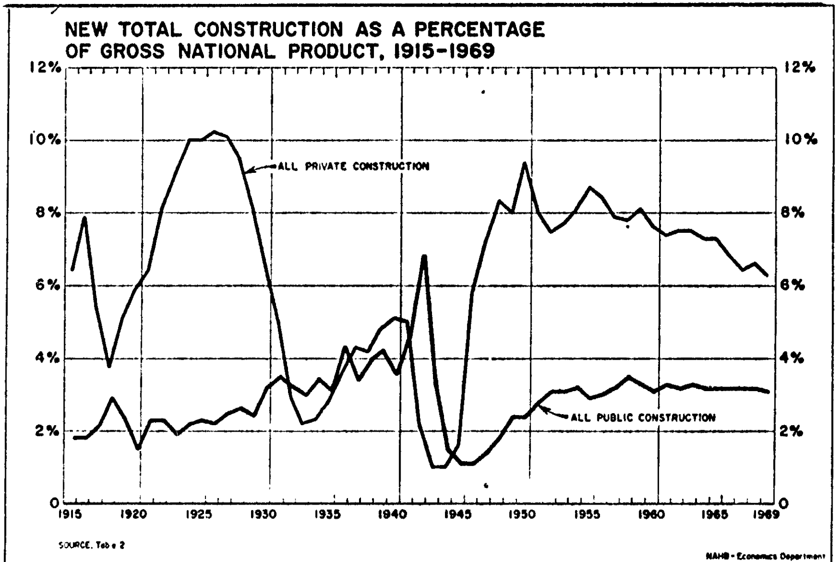
As background, we refer to two current publications prepared by our Economics Department (also attached)—"Housing Starts Bulletin" and the July issue of "Economic News Notes."

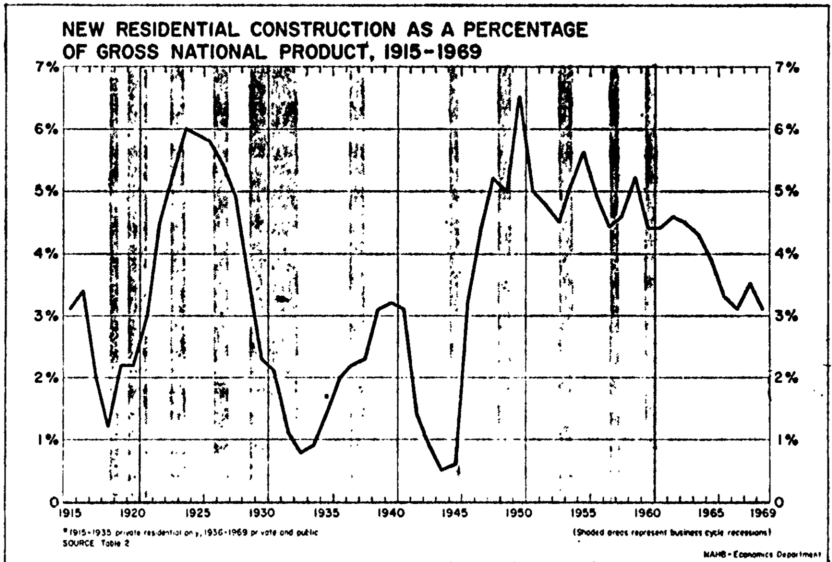
The "Starts Bulletin" shows a four month decline in housing starts as well as a decline of nearly 10% in the seasonally adjusted annual rate of building permits in May. The seasonally adjusted annual rate of housing starts by the end of this year and early next year is now estimated to drop to 1 million units or below.

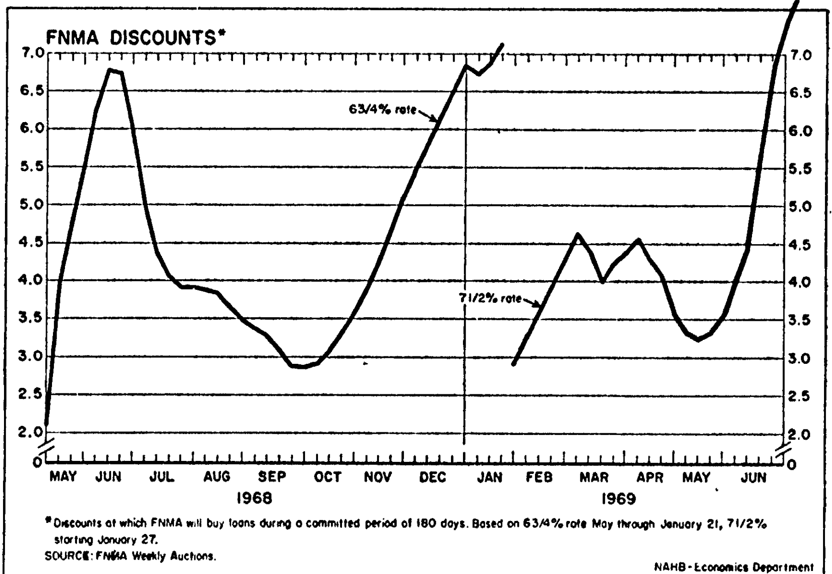
This would be a decline of nearly 40% from current levels. A current survey this week shows that a further drastic deterioration in builders' plans is about to take place. In some areas, builders are cutting back as much as 50% on their earlier expected construction. Commitments for loans are just impossible to obtain in most areas. If they are obtainable, the price is so high that for all practical purposes it is not feasible to build. Builders are working out their previous commitments, and after these are used, there appears to be no way to obtain new ones. Interest rates have now skyrocketed so that it is not unusual to find yields on construction financing running as high as 15% to 20%. Heavy discounts are being charged for the privilege of borrowing money. The FNMA discounts this week reached another record of 7.7 (see chart attached), making it impractical if not impossible for buyers to pay them.

The hardest hit sales housing is in the low to medium income group. The multifamily housing market is also affected. Builders are postponing or cancelling plans for multifamily units because of the inability to obtain financing and because of the cost of financing. Even if available, these costs would raise the rents to a level that consumers generally would be unable to pay.

All this is happening at the time when the vacancy rate is at the lowest since World War II. In some cities, for all practical purposes, there are no vacant units at all.







STATEMENT OF THE NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. Chairman and Members of the Committee:

My name is Nathaniel H. Rogg, and I am Executive Vice President of the National Association of Home Builders. Our Association represents a membership of over 51,000 builders and associates. We appreciate very much this opportunity to appear before you today to present our views on the recent increase in the prime rate to 8½%.

Gentlemen, the private home building industry is facing a fight for survival. We are told that if we wait two or three months things should get better. We are told that the Federal Reserve is giving some consideration to a program of voluntary credit restraint. We are told that the surtax extension and investment credit repeal will reduce inflation's flames to flickers.

In our opinion, we cannot wait longer. The prime lending rate of the private banks must be rolled back.

The Fed should immediately call on its member banks—as it did in the money crunch days of 1966—to slow their loans to business. The privilege of dealing at its discount window, and it is a privilege not a right, should be re-emphasized.

We also urge that—

The Fed maintain its current rate on time deposits under Regulation Q, in order to forestall any further outflow of savings from savings and loans and mutual savings banks

The FHA interest rate not be now raised until there is a clear demonstration of the absolute necessity to do so

FNMA continue and expand its present level of support for federally backed mortgages

The Fed be urged to purchase obligations of FNMA and the Federal Home Loan Bank Board in order to support, at a reasonable rate, this essential component of housing financing

Treasury and HUD take immediate steps to resolve their differences and make operational the authority for GNMA to guarantee mortgage-backed securities issued by FNMA and private mortgage holders

Adequate funding, at full authorized levels, be provided for the government-assisted housing programs, such as enacted in 1968

Full use be made of available GNMA special assistance funds, possibly in conjunction with FNMA purchase, at the going market price, of mortgages acquired by GNMA at par

These suggestions deal primarily with the immediate crisis. Beyond this, a much longer look and study should be undertaken. The history of recent economic activity indicates to us that much is wrong with the Nation's financial structure, its management, and its regulation.

Certainly the money crunch of 1966, as well as that of today, clearly indicates the present structure and the present regulatory system together are simply inadequate to meet the Nation's declared needs, particularly those of the housing sector.

The Nation's financial structure has evolved over many years. Its current form and regulatory system were established early in this century upon the heels of several monetary panics. It has been improved upon over the years and, certainly in the first two-thirds of this century, has made an enormous contribution to economic growth, though not in the housing field particullarly. However, the system, as presently constituted, is simply not geared to cope with recently emerging problems, and particularly those we will encounter in the last third of the century.

We therefore urge that a head-to-toe examination of the financial machinery and the regulatory system be begun immediately with a view toward making the system more responsive to the Nation's requirements. Unless this is done, we foresee continuing and intensified problems in satisfying our national aspirations.

But what the Nation needs now is a massive exercise in self-restraint, but this restraint should be more evenly applied, more equably shared. The home building industry and home buyers seem to be the only ones being restrained, in fact, strangled.

We are now building housing at a rate lower than five years ago. Yet this is a time when—in relation to housing needs and goals—we should be producing at least 50 per cent above our current level.

The severe effects, felt by the home building industry in recent years as a result of the significant increases in interest rates, serve to spotlight the precarious situation it finds itself in relation to the economy as a whole. The least fluctuation severely affects our industry. It may be of some interest to the Committee to examine the chart [1] attached to my statement which demonstrates the percentage of the gross national product that new residential construction has shared since 1915. This chart shows very vividly how our industry has not kept pace with the economy in recent years.

At the minimum, we believe that new residential construction should represent

[1] The chart referred to had been previously reproduced in this hearing at p. 288.

4.5% of the gross national product. At present it is only 3.5%. Except for the severe credit shortage period experienced in 1966, this is the lowest since the Second World War. A 4.5% level would assure greater stability in times such as we are now experiencing.

Spiraling inflation, fed by record-high interest rates, is pricing a large segment of our population out of the market. This latest hike must be rolled back. And, on behalf of our industry, I so wired the President on the day following the first press stories on the increase. (See copy attached.)

Unless immediate steps are taken to counteract these rising interest rates, the cost of mortgage money soon will be so high that even middle income purchasers will not be able to afford to buy homes, nor will middle income renters be able to afford to pay the rents made necessary by these high interest rates.

Already the hopes of low and moderate income families to obtain decent housing have been cruelly crippled. It has become increasingly harder to obtain short-term construction money or long-term mortgage money at any rate.

This increase means further loss of manpower to our industry, already seeking desperately to preserve its skilled workers. It means less use of materials. It means fewer jobs in related industries. It means loss of revenues to local communities.

This present situation is especially galling for our industry because we have consistently backed measures in the Congress and the Executive Branch to curb inflation. Home builders have supported—and still support—proposed anti-inflationary measures such as continuation of the surtax, removal of the investment credit, and reduced Federal expenditures. We have supported such measures, knowing full well they will have an impact on our industry. But knowing, too, they are necessary to contain inflation if the overall economy is to survive.

By contrast, we think the banks' recent prime rate increase disregards the lending industry's social and economic responsibilities to the Nation. The banks say this recent increase, and perhaps even further increases, are essential in the fight against inflation. This is illusory. The constant increases in lending rates have only fed an inflationary psychology. Borrowers, especially big corporate businesses, fearing further increases have continued in competition with each other to get at all available funds.

There is simply no evidence in recent experience to support the view that ever higher interest rates hold back inflationary fires of the kind we are now experiencing. They have not cut back the demand for business loans, they have not lowered prices, they have not freed more money for social purposes. Nor will they. Rationing credit, as is now being done by ever-increasing interest rates, results merely in excluding the weaker competitors for scarce credit and not the less meritorious borrowers. In short, it leaves no room for attention to using our credit resources for our Nation's needs.

Obviously, when it comes to competing for scarce funds, the home buying consumer is a much weaker competitor than are corporate giants, like General Motors. A statement in the June 20 issue of *Time Magazine* vividly illustrates what we are talking about:

"Big companies will be able to pay the new price of credit . . . mortgage rates immediately moved up to 9¼% in California and Colorado, and lenders in many cities raised the fees by which they increase their take from mortgage loans, without actually changing the interest rate. For the immediate future, the higher money rates will add to the upward pressure on prices. Companies figure interest charges as part of their cost of doing business, and the consumer must ultimately pay the bill."

An economic time bomb is ticking. High interest rates have so driven up yields on other obligations that commercial banks have suffered a net outflow of $600 million in savings during the first 5 months of this year as compared to a net inflow of $6.2 billion during the same period in 1968—a difference of nearly $7 billion.

Fortunately, and unlike the situation in 1966, the Federal Reserve Board has not increased maximum interest rates payable on time deposits; this has minimized a potentially significant and adverse effect on the savings inflow to savings and loans and mutual savings banks, thereby avoiding the disastrous results that occurred in the 1966 credit crunch. We welcome this and urge that it be continued, since such an action would only serve to unbalance the economy even more.

In urging a prime rate rollback, we believe that the full influence of the Congress, as well as of the Administration, must be brought to bear on the commercial banks. Such a rollback is necessary to stifle the call now being heard in some quarters for more direct Federal intervention in the allocation of economic resources. We, along with many others, abhor Federal controls. However, we also

recognize that for the first time we are engaged in a major military undertaking without some type of controls on the use of credit and on prices and wages. It could well be argued, of course, that general monetary restraints of the kind we are now experiencing are actually a form of selective credit controls imposed on small businesses and the housing industry.

Certainly, of extreme importance now is quick passage of the tax legislation reported by the Ways and Means Committee last week. The continuation of the surtax, the repeal of the 7% investment credit, and a continued effort to hold down unnecessary Federal spending are essential in the fight against inflation.

We are prepared to shoulder burdens in the fight against inflation in order to preserve a healthy national economy. Others should shoulder their share.

ATTACHMENT

Telegram to President Richard M. Nixon from Dr. Nathaniel H. Rogg, Executive Vice President of the National Association of Home Builders, dated June 10, 1969:

"Prime rate increase unwarranted, unnecessary, and in cynical disregard national interest and of public beset galloping inflation. Disheartening blow to our members supporting your anti-inflation program and who are vigorously attempting persuade Congress of need extending surtax and support of your fiscal program. Bank action will harm consumers, small businessmen, home buyers and renters, and millions of people employed in housing industry. It will enormously damage already difficult task of providing low income housing. We appeal to you to use your influence immediately to seek a rollback of prime rate and other necessary actions by lenders as their responsible part in anti-inflation fight."

[From the Economic News Notes, vol. XV, No. 6, June 16, 1969]

Annual rate in May down 3.0%.—The seasonally adjusted annual rate of housing starts in May decreased 3.0% to 1,509,000 units from the April rate of 1,556,000. The multi-family sector registered a decrease of 17.4%, from 768,000 units to 634,000 units, while single family starts increased 11.0% from 788,000 to 875,000 units at seasonally adjusted annual rates. Regionally, the South showed the only increase with a gain of 4.1%, from 582,000 to 606,000. The Northeast had the largest decline with a drop of 9.9% from 253,000 to 228,000. The West was down 8.8%, from 364,000 to 332,000 and the North Central was down 3.9%, from 357,000 to 343,000 units.

Actual starts for the first 5 months up 7.1%.—During the first five months of 1969 actual private housing starts were 7.1% higher than the same period of 1968, 637,000 units as compared with 594,600 units for 1968. Singles declined 5.2% from 364,700 to 345,700 units. Multi-family units are up 26.7% from 229,700 to 291,100 units.

Permits down 8.8%.—Permits in May were at an annual rate of 1,370,000, down 8.8% from the April rate of 1,502,000. Singles declined 3.3% from 659,000 to 637,000 units. Multifamily showed a decline of 13.0% from 761,000 to 651,000 units. Regionally, the South showed the only increase with a gain of 9.0% from 523,000 to 576,000 units. The North Central declined 23.4% from 342,000 to 262,000 units. The Northeast registered a decline of 19.3% from 249,000 to 201,000 units, while the West dropped 14.7% from 388,000 to 331,000 units.

In summary.—The increase in the prime rate by 1% just about killed the possibilities of a good housing year. An increase of such magnitude in mortgage rates means a decline as much as 10% in housing starts. The best projection at this time is for a continuation of the downward trend which began early this year. This decline will intensity early Fall and very likely will carry through well into 1970. It will be shared about equally in the mutifamily sector, until now showing considerable strength.

Although it is impossible to say what will happen next year, the current situation suggests trouble for residential construction.

ACTUAL STARTS, 5 MONTHS, 1968-69

	1968 (thousands of units)	1969 (thousands of units)	Percent change
Singles	364.7	345.7	−5.2
Multiples	229.7	291.1	26.7
Total	594.4	636.8	7.1

Source: Bureau of Census, NAHB Economics Department.

NEW HOUSING ACTIVITY

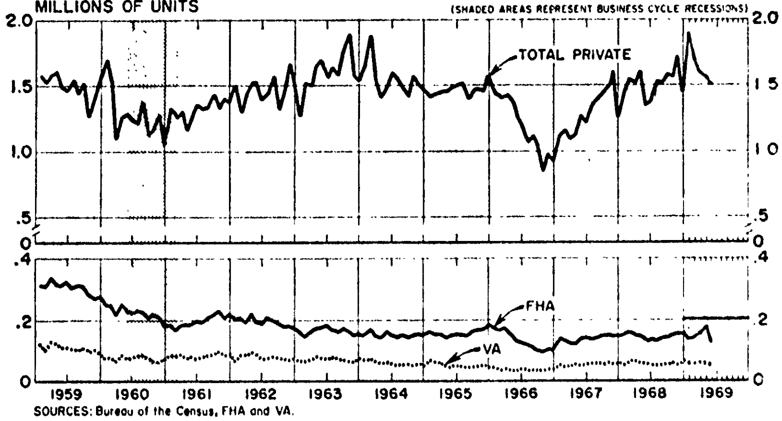
[In thousands of units]

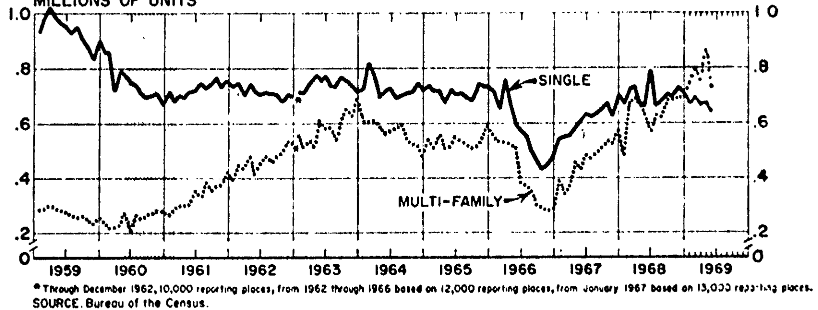
Years	Total private and public starts	Total	1 family	Multifamily	Total private starts	Starts Government programs: FHA[1]	Starts Government programs: VA	Building permits[2]	FHA applications[1]	VA appraisal requests
1960	1,296.0	1,252.1	994.8	257.4	1,251.1	260.9	74.6	998.0	242.4	142.9
1961	1,365.0	1,313.0	974.8	338.6	1,313.0	244.3	83.3	1,064.2	236.2	117.8
1962	1,492.4	1,462.8	991.6	471.4	1,462.8	260.8	77.8	1,186.6	287.4	171.2
1963	1,642.0	1,610.3	1,020.7	589.6	1,610.3	220.0	71.0	1,334.7	270.6	139.3
1964	1,561.6	1,529.3	971.5	557.8	1,529.3	204.6	59.2	1,285.8	249.8	113.6
1965	1,509.6	1,472.9	963.8	509.1	1,472.9	196.6	49.4	1,239.8	237.9	102.1
1966	1,196.2	1,165.0	778.5	386.5	1,165.0	158.4	36.8	971.9	197.0	99.2
1967	1,321.9	1,291.6	843.9	447.5	1,291.9	179.7	52.5	1,141.0	239.2	124.3
1968	1,547.6	1,507.5	899.4	609.9	1,507.5	227.1	56.1	1,330.3	245.5	131.7
	Actual starts				Seasonally adjusted annual rate					
1968:										
January	82.7	80.5	45.2	35.3	1,456.0	157.0	52.0	1,148.0	163.0	122.0
February	87.2	84.6	55.4	29.2	1,537.0	164.0	63.0	1,394.0	152.0	141.0
March	128.6	126.6	79.3	47.2	1,511.0	149.0	63.0	1,416.0	160.0	127.0
April	165.2	162.0	98.0	64.0	1,591.0	147.0	59.0	1,340.0	144.0	126.0
May	145.1	140.9	86.8	54.0	1,364.0	133.0	57.0	1,280.0	161.0	110.0
June	142.9	137.9	81.4	56.4	1,365.0	137.0	54.0	1,281.0	157.0	120.0
July	142.5	139.8	86.4	53.4	1,531.0	134.0	49.0	1,289.0	146.0	135.0
August	141.0	136.6	82.5	54.1	1,518.0	144.0	51.0	1,290.0	167.0	127.0
September	139.8	134.3	80.2	54.1	1,592.0	145.0	54.0	1,393.0	168.0	125.0
October	143.3	140.8	85.6	55.3	1,570.0	153.0	55.0	1,378.0	198.0	147.0
November	129.5	127.1	64.8	62.3	1,733.0	158.0	53.0	1,425.0	211.0	172.0
December	99.8	96.4	53.8	43.6	1,507.0	158.0	65.0	1,463.0	187.0	136.0
1969:										
January	105.8	101.5	51.3	50.2	1,878.0	137.0	59.0	1,403.0	189.0	148.0
February	94.8	90.1	47.9	42.1	1,686.0	138.0	52.0	1,477.0	180.0	132.0
March	135.8	131.9	71.9	59.9	1,584.0	157.0	53.0	1,421.0	174.0	136.0
April	159.1	158.3	84.3	74.0	1,556.0	166.0	48.0	1,502.0	179.0	124.0
May	157.4	155.2	90.3	64.9	1,509.0	134.0	47.0	1,370.0	182.0	122.0

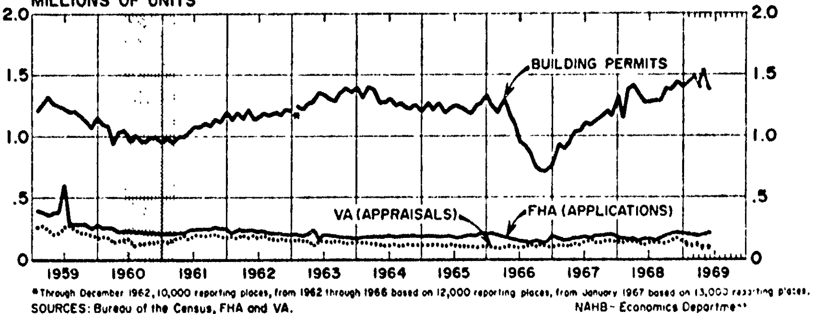
[1] FHA annual totals including all units; monthly rate includes 1-4 family.

[2] Based on 12,000 reporting places 1962-66 for permits, and 1962 to March 1968 for starts. Based on 13,000 reporting places from May 1967 for permits and from April 1968 for starts.

Sources: Department of Commerce, FHA, VA.







[From the Economic News Notes, vol. XV, No. 7, July 1969]

A FURTHER DETERIORATION IN MONEY MARKETS

Substantial deterioration in the money markets has occurred in the last four weeks. Outflow of funds from commercial banks intensified in June, when they lost an estimated $1.5 billion. The six months outflow, now put at $3.7 billion, is unmatched in the history of our banking system. Savings and loan associations, after holding their own for the first four months of this year, are substantially

down, and July may see an outflow of as much as $1 billion. Mutual savings banks in the first six months of 1969 have had an inflow of 20% less than the same period of 1968. Life insurance companies, the last holdout of stability for savings, shows a drastic decline as policy holders have begun to borrow heavily against their policies. Overall, the four types of lending institutions show a net inflow of savings for the period between January and June of this year down 66% from the comparable period in 1968.

The outflow of money at commercial banks has been largely in Certificates of Deposit. The CDs runoff since December 4, 1968, has reached $8.8 billion. This is substantially more than the runoff in the 1965-1966 period. (See chart and table.) This loss has resulted in renewed pressure from the banks on the Fed to raise the permissible interest rate given under Regulation Q, now set at a maximum of 6¼%. What this would do to the savings and loan industry, if the rate should be raised, was well illustrated during the 1966 money crunch. S & Ls lost over half of their savings deposits in that year—and stopped lending on mortgages.

The CDs outflow also suggests the possibility of a further increase in the prime rate or the inevitability of some sort of credit rationing. At present, the Federal Reserve Board has no restrictions on raising of rates. The only restriction set by law directs the Fed to consult with the Federal Home Loan Bank Board, and the Federal Insurance Corporation before any change is made in the interest rates payable on savings deposits. This is only a procedural matter and the Fed is not bound by recommendations of the other two institutions. (See box.)

The outflow of CDs was offset to some extent by the record rebuilding of liquidity by the banks through use of Euro-dollars. In June alone, U.S. banks brought in $4 billion from their foreign branches. To hold down the flow of Euro-dollars, the Fed has just proposed placing reserve requirements on certain Euro-dollar deposits which will make it more expensive for the banks to borrow money.

After the prime rate was raised in the early part of June from 7½% to 8½%, money rates started to increase sharply. The six months U.S. bill rate at auction in mid-June reached nearly 7%, the highest U.S. issue since the Civil War. Commercial paper rate now at close to 9% is the highest in 80 years. FHA mortgage yields at 8.06% are the highest on record. FNMA discounts likewise rose sharply. (See Chart.)

Substantial decline in starts expected

With high interest rates and the decline in the savings flow into lending institutions, the short-term outlook for mortgage financing is indeed bad. The outlook for housing starts has equally darkened. Not only will the single-family sector have to be revised downward, but it is becoming more certain that multi-family starts will have to be drastically scaled down from earlier expectations. This is already evident in preliminary tabulation of the current Journal of Homebuilding Metropolitan Housing Starts Forecast (to be published in August "Economic News Notes").

The projection at this time is for a continuation of the downward trend which began early this year. This decline will intensify in early fall and winter and will carry through into 1970. Unless some fast turnaround in the availability of money occurs the seasonally adjusted annual rate of housing starts by the end of this year and early next year will drop to 1 million units or below.

The tragic sequence of 1966 is now being repeated and will hit builders and consumers equally. Although some low income housing will be built under existing government programs, the bulk of middle income households will be drastically shut out of the new-housing market. This is happening at a time when over-all vacancy rates are substantially down with some areas having virtually no housing available for low or middle income families.

Flow of funds down substantially

Flow of funds into the four savings institutions for the first six months of 1969 was down 66.3% from the same period last year. Most of this decline is accounted for by *commercial banks* which lost $3.7 billion in the first six month. This is down from a net inflow of $6.9 billion in 1968 and it is the first time in history that banks have experienced an outflow for the first 6 months of any year. The commercial bank loss can be largely attributed to the decline in sale of large Certificates of Deposit. On June 18, large commercial banks issued $15.6 bililon in CDs. This is down 31.5% from the January 1, figure of $22.8 billion, and down 35.7% from the high of $24.4 billion reached on December 4, 1968. The June 18, level is comparable to the activity experienced in the second half of 1965. (See Chart and Table.)

If this trend continues, commercial banks will show outflows in future months. Considering that commercial banks accounted for approximately 22% of the mortgage loans made in 1968, this lack of funds available for loans will have drastic effects on the mortage market.

Life insurance companies, which at present are virtually out of the single-family market, are showing a decline in funds as well. A comparison of the first six months of 1969 with 1968 shows them down 8.9% from $5.1 billion to $4.6 billion. This decrease from the 1968 levels began in April and shows signs of continuing. This decrease is tied to the increase in policy loans which have been rising steadily. April, 1969 showed $11.9 billion in policy loans up 4.4% from the January level of $11.4 billion, and up 14.0% from the April 1968 level of $10.4 billion. This trend is expected to continue as long as interest rates remain at their present levels.

Large Certificates of Deposits Total Issued by Large Commercial Banks

[In millions of dollars]

1969	
January:	
1	22, 820
8	22, 374
15	21, 787
22	21, 345
29	21, 031
February:	
5	20, 603
12	20, 484
19	20, 126
26	19, 968
March:	
5	19, 592
12	19, 395
19	18, 809
26	18, 792
April:	
2	18, 626
9	18, 498
16	17, 999
23	17, 909
30	17, 622
May:	
7	17, 495
14	17, 408
21	17, 138
28	16, 973
June:	
4	16, 623
11	16, 275
18	[1] 15, 633

[1] Preliminary.

Source: Federal Reserve Board, "Federal Reserve Bulletin," table on "Assets and Liabilities of Large Commercial Banks."

These Certificates of Deposits include issues in denominations of $100,000 or more.

Savings and loan associations inflow is down 8.5% for the first six months of 1969 from the 1968 level of $3.7 billion. The inflow for June is expected to be about $1.4 billion, down 15% from the June, 1968 level. Indications are that S & Ls will experience a substantial outflow in July, possibly as much as $1 billion. This will be dramatically worse than the 1968 outflow of $588 million, and will lessen substantially funds available for mortgages.

Mutual savings banks, suppliers of 13% of mortgage funds in 1968, showed a decline of 20.4% from the 1968 inflow of $2.1 billion. The decline is not expected to be reversed in the near future.

Commercial banks profits at record high

During 1968, the dollar rise in net earnings of commercial banks from current operations was higher than in any previous year and the percentage increase was

close to the post World War II record set in 1959. The net earnings were $708 million, or 16.3% above 1967. This compares to the 16.9% record increase registered in 1959 over 1958.

Most of the rise in operating revenues is attributable to earnings on loans. These earnings increased at almost twice the 1967 rate. This rate reflected the faster growth in the volume of loans outstanding and the high rate of return on loans—the highest in the past 40 years.

FLOW OF FUNDS INTO SELECTED SAVINGS INSTITUTIONS

[In millions of dollars]

Month	Life insurance [1]	Savings and loans	Commercial banks	Mutual savings banks	Total
Total year:					
1968	[2] $10,650	$7,442	[2] $20,557	$4,193	$42,843
1967	$10,339	$10,678	$23,675	$5,116	$49,817
1966	$8,138	$3,615	$12,135	$2,589	$26,477
1965	$9,414	$8,513	$19,986	$3,594	$41,507
Percent change:					
1967-68	3.0	−30.4	−13.2	−18.0	−14.0
1966-68	30.9	105.9	69.4	62.0	61.8
1965-68	13.1	−12.6	2.9	16.7	3.2
1968:					
June	$876	$1,651	$644	$485	$3,656
July	$984	−$588	$2,956	$196	$3,548
August	$746	$389	$2,800	$244	$4,179
September	$912	$1,133	[2] $1,500	$530	$4,075
October	$949	$495	[2] $3,600	$169	$5,213
November	$1,191	$648	[2] $1,500	$251	$3,590
December	$803	$1,643	[2] $1,300	$693	$4,439
1969:					
January	$1,277	−$92	[2] −$1,600	$240	−$175
February	$952	$605	[2] $400	$339	$2,296
March	$903	$1,369	[2] $200	$672	$3,144
April	[2] $535	[2] −$516	[2] −$1,100	−$183	−$1,264
May	[3] $450	[2] $641	[2] −$100	[2] $313	$1,304
June	[3] $500	[3] $1,400	[3] −$1,500	[3] $300	$700
Total 6 months:					
1969	$4,617	$3,407	−$3,700	$1,681	$6,005
1968	$5,065	$3,722	$6,901	$2,111	$17,799
Percent change: 1968-69	−8.9	−8.5	(4)	−20.4	−66.3

[1] Assets net gain.
[2] Revised.
[3] Estimate.
[4] More than 100 percent decline.

Source: Federal Home Loan Bank Board, Federal Reserve Board, Life Insurance Institute, National Association of Mutual Savings Banks, estimates by NAHB.

Nonoperating transactions—net of profits and recoveries, losses and charge-offs, and changes in valuation reserves—accounted for a net reduction in earnings of $1.2 billion. This is nearly one-fourth of the net earnings from current operations. It is the largest dollar reduction in history, but as a percent of net earnings, it is smaller than in three other post-war years of high-level business activity.

COMMERCIAL BANK INCOME

[Dollar amounts in millions]

	1967	1968	Percent change
Revenue	$17,859	$20,819	16.6
Expenses	13,507	15,758	16.7
Net current earnings before income taxes	4,353	5,061	16.3
Net of profits and recoveries, losses and charge-offs, and changes in valuation reserves	737	1,202	63.1
Net income before related taxes	3,616	3,859	6.7
Taxes on net income	1,007	1,054	4.7
Net income	2,609	2,805	7.5
Cash dividends declared	1,248	1,385	11.0

Source: May 1969 Federal Reserve Bulletin.

Mortgage interest rates

The results of a special survey of the Builders Economic Council on mortgage interest rates revealed increases in interest rates and discounts on conventional mortgages and construction loans during the past year throughout the United States. This survey was conducted before the prime rate raise from 7.5% to 8.5%.

At the time the survey was conducted in early May, 62% of the BEC respondents said money was available for construction loans, 35% said it was difficult to obtain and 3% said it was not available. The availability of funds for permanent mortgages was not as good as for construction loans. Of the respondents, 54% said permanent mortgages were available, 42% said they were difficult to obtain and 4% said they were not available.

CONVENTIONAL MORTGAGE AND CONSTRUCTION LOAN RATES AND YIELDS (NATIONAL AVERAGES)

	Rate (percent)	Points
Conventional 25 year, 20 percent down:		
June 1, 1969	7.70	1.18
June 1, 1968	6.87	.77
Conventional 25 year, 25 percent down:		
June 1, 1969	7.64	.96
June 1, 1968	6.73	.63
Construction loan:		
June 1, 1969	7.83	1.14
June 1, 1968	6.97	.80

Source: Builders Economic Council, NAHB Economics.

CONVENTIONAL MORTGAGE, 25 YEARS, 25 PERCENT DOWN

[Rate in percent]

	June 1, 1969		June 1, 1968	
	Rate	Points	Rate	Points
New England	7.66	0.18	6.84	0.09
Middle Atlantic	7.88	1.00	6.81	.77
South Atlantic	7.46	1.16	6.74	.97
East North Central	7.45	1.09	6.26	.44
East South Central	7.80	1.10	6.54	.48
West North Central	7.68	.61	6.89	.52
West South Central	7.99	.93	7.09	.69
Mountain	7.88	1.00	6.81	.77
Pacific	8.00	1.30	6.98	.93

Source: Builders Economic Council, NAHB Economics Deparment.

Building materials

A survey of the building material manufacturers conducted in May showed that 42.4% of the respondents do not have production capacity to supply the materials required to meet the housing goals. The majority of these respondents said it would take at least three years to develop the required capacity. The industries which do not have capacity are producers of plumbing fixtures, asphalt roofing, insulation, vinyl siding, appliances, lumber, windows and doors.

The most critical problem in meet the housing goals according to the survey is manpower. The second most critical problem is the supply of raw materials.

Lumber and plywood

Lumber and plywood prices have now dropped to f.o.b. mill quotations lower than those of one year ago. (See table.) The average prices in June for Green Douglas fir Standard and better 2x4's was 17.9% below the June average in 1968. Green Douglas fir utility and better studs have shown a 24.7% drop from last year, and ⅜'' interior plywood averaged 20.5% below the June 1968 quotations.

As of June 27, lumber and plywood prices began to show signs of stabilizing after almost two years of chaotic fluctuations, both up and down. For the first time since the highs registered during the last week in February lumber and plywood prices remained constant or showed a modest increase. The main rea-

son for the leveling of lumber and plywood prices is not an increase in demand but a reduction of production.

The instability in lumber and plywood prices during the past two years and the optimism about 1969 were both beneficial and oppressive for the lumber industry. Last year during the rapid price escalation, the industry realized substantial gains in their profits. The tables turned this year. The industry began to produce with expectations of a good year for the construction industry. This did not come to fruition and the lumber industry was over supplying the market, thus causing a plummeting of prices. During the period of high expectations and high prices the lumber industry bid up the price of raw material. The stumpage valuation (price at which the Forest Service offers timber for auction) is based on the average price for the previous four quarters. Under this system the present stumpage price reflects the high prices of the last three quarters of 1968 and the first quarter of 1969. During this four quarter period the stumpage price increased 146.5%.

To counteract the present dilemma the lumber industry is requesting the recent offerings of timber be postponed and reappraised by Forest Service, basing the reappraisal on the current market prices. So far they have not had a favorable response from the Forest Service.

LUMBER PRICES, JUNE 1968 TO JUNE 1969

	June 1969	June 1968	Percent change
2 by 4 standard and better:			
Green Douglas-fir	78	95	−17.9
Kiln-dried Douglas-fir	95	105	−9.5
Kiln-dried hemlock	81	96	−15.6
Kiln-dried white fir	79	97	−18.6
Dry white spruce	107	118	−9.3
Green fir and larch	81	95	−14.7
Studs, utility and better:			
Green Douglas-fir	70	81	−24.7
Kiln-dried Douglas-fir	79	94	−3.6
Kiln-dried white fir	78	98	−16.0
Kiln-dried lodgepole pine	68	90	−20.4
Plywood:			
¼ in. AD interior	62	78	−5.8
⅜ in. interior	50	62	−20.5
½ in. CD interior	71	87	−19.4
¾ in. Concrete form	184	187	−1.6

Source: Random Lengths.

Senator ANDERSON. Thank you. There are some of the Senators who are anxious to have the bill passed who wish to ask questions.

Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

Mr. Gulledge, in your judgment, what is major cause for what you describe as "runaway inflation"?

Mr. GULLEDGE. Senator, I think it is the feeling which exists among a great many people in this country that it is going to cost more tomorrow, so buy it today. It is going to cost more to build a plant tomorrow, so build it now. It is going to cost more to buy a car, the house, the something else, so do it now, and the complete feeling that it is ging to cost more—the fact that prices will be higher later is causing people today to want to do a whole lot more than they should be doing and maybe a whole lot more than they would be doing. They feel rather than waiting they could get a better value for their dollar now. This is a psychology of feeling in the market that it is going to cost more later so do it now, and we think it is too much.

Senator BYRD. Do you think that a tremendous increase in Government spending during the past few years is a major cause?

Mr. GULLEDGE. I do not think the spending is, in and of itself, Sen-

ator. I think it is the failure to match our spending with our receipts. The fact that 2 years ago we went to over $25 billion in debt in our national budget placed undue pressure on the market. If we were paying our way as we go, then I think we would be a whole lot closer to a system of stability. But obviously if we spend $25 billion more than we have taken in, you have created a whole lot more pressure than the market can stand. This is what happened.

Senator BYRD. In other words, the $25 billion deficit is a major factor in the inflation we are experiencing today.

Mr. GULLEDGE. I think it is a major contributing factor; yes, sir.

Senator BYRD. Thank you.

Senator ANDERSON. Senator Bennett?

Senator BENNETT. No questions.

Senator CURTIS. No questions.

Senator MILLER. Mr. Gulledge, getting back to your response to Senator Byrd's question why we have this inflation, I believe what it amounted to is that you were talking about inflationary psychology.

Mr. GULLEDGE. Yes, sir.

Senator MILLER. Buy something today instead of tomorrow because it will cost more tomorrow. You could say build a home today instead of tomorrow because it will cost more to build a home tomorrow. So if that inflationary psycholgy would cause that reaction, why would you forecast a drop of 40 percent in homebuilding starts?

Mr. GULLEDGE. Simply because the houses are not going to get built, Senator. They are not going to get built because the builders cannot get the money to finance the construction and the purchaser cannot get loans to buy them at terms that he can afford.

Senator MILLER. At terms he can afford?

Mr. GULLEDGE. Yes.

Senator MILLER. You see, you are begging the question, "at terms he can afford." But if he thinks it is going to cost him more tomorrow, he is going to afford to do it today, that is what the inflationary psychology leads to.

Mr. GULLEDGE. I believe people have a limited income, unlike the Government, and, as a consequence, they do have to restrain themselves.

I have been around the country quite a bit, I have traveled over 65,000 miles domestically in the last 5 months, and I have talked with hundreds and hundreds of people, builders all over this country, about their problems. A man in Boston had a commitment to buy from a bank; he was going to buy a $40,000 home; and he had $11,000 cash to put down. When the prime rate changed, the bank called him up and said, "We can't go through with the deal." I submit to you that man cannot buy the home.

Senator MILLER. He cannot go through with the deal because of the interest rate.

Mr. GULLEDGE. At that particular time the interest rate was in excess of 8.5 percent.

Senator MILLER. Could he not go through with the deal if the interest rate was made 10.5 percent?

Mr. GULLEDGE. No, sir; because monthly payments take into consideration what interest rate is being charged, and there are formulas that relate income to monthly payments. When the monthly payments get too high in proportion to your income, you cannot consummate the purchase.

Senator MILLER. What you are really saying is that the inflationary psychology does not work if you are a homebuilder.

Mr. GULLEDGE. Yes, sir; it reaches the point of no return and the ability of the purchaser to buy a home or really a renter to rent an apartment ceases.

Senator MILLER. All right. I think I would be inclined to agree with you on that.

But I think it is well when we talk about inflationary psychology that we recognize there are certain points of no return such as in the homebuilding industry, and inflationary psychology does not necessarily mean build a home today instead of building one tomorrow.

Mr. GULLEDGE. That is correct.

Senator MILLER. Now, if there was a drop from 1.6 million units to 1 million units, that is a drop of 600,000 units, do you have any estimates of how many jobs that would mean would not be filled?

Mr. GULLEDGE. I would. Our industry is operating at a current level of around 3 million jobs, and some 600,000, a third—roughly, you are talking about 1 million jobs.

Senator MILLER. You are talking about a million members of the building trades crafts——

Mr. GULLEDGE. Yes, sir.

Senator MILLER (continuing). Who would not be working.

Mr. GULLEDGE. All up and down the line; yes, sir. We have some pretty clear statistics on that, Senator. We would be very happy to submit them to you.

Senator MILLER. May I suggest, Mr. Chairman, we might have them provide that for the record.

Senator ANDERSON. Without objection, that will be done.

(The material referred to follows:)

The loss of 100,000 houses means the loss of $1.2 billion in direct construction expenditures; the loss of 200,000 man-years of work, half of it onsite and half of it in materials production.

Specifically, the loss of 100,000 houses means the loss of a market for:

975 million board feet of lumber.
115 million board feet of finish wood flooring.
104 million square feet of softwood, plywood.
470 million bricks.
230 million pounds of cement.
1.9 million gallons of paint.
200,000 tons of steel.
156,000 water closets.
127,000 bath tubs.
73,000 warm air furnaces (with ducts).
11 million square feet of ceramic tile.
10 million square feet of linoleum floor covering.
20 million square feet of asphalt tile flooring.
1 million squares of asphalt roofing shingles.
140 million square feet of wall and ceiling insulation.
2.5 million convenience outlets.
1.1 million electric switches.
32,000 garbage disposal units.
55,000 kitchen exhaust fans.
7,000 air conditioners.
1 million kitchen cabinets.
1.4 million window frames.
Interior wall gypsum board for 48,000 houses and gypsum lath for another 40,000—close to a half billion square feet of gypsum board products in all.
1.2 million doors.
27,000 single-garage doors; 32,000 double-garage 1-door; 10,000 double-garage 2-doors.

A drop of 600,000 starts as referred to in the testimony would result in most cases in an increase of the above losses by six times and thus would have a substantial adverse impact on the economy.

Mr. GULLEDGE. Incidentally, this is what happened back in 1966 also, and we have had an exceedingly difficult time trying to gear the industry back up to its ability to produce the housing which the Nation needs.

Senator MILLER. What you are really saying is that if the Congress fails to take action, repealing the investment tax credit, and continuing the surcharge, this will promote a serious budget deficit, not as serious as the $25 billion of last year, granted, but a serious budget deficit, and this will promote inflation.

Mr. GULLEDGE. Yes, sir.

Senator MILLER. It will promote competition in the money market on the part of the Federal Government which will have to go out to cover that debt.

Mr. GULLEDGE. The same dollar.

Senator MILLER. And it will drive up interest rates even more.

Mr. GULLEDGE. Right.

Senator MILLER. It will discourage home building starts, and, really, in effect deprive people of jobs who would otherwise be working if the Congress got busy and did a job on balancing revenue and expenditures.

Mr. GULLEDGE. That is absolutely right, in our opinion.

Senator MILLER. Thank you very much.

Senator ANDERSON. Senator Fannin?

Senator FANNIN. Thank you, Mr. Chairman.

Mr. Gulledge, you point out inflation is cutting down housing starts, and I would also like to ask you how is increased productivity compared with increased labor costs? In other words, what has happened so far as labor costs are concerned?

Mr. GULLEDGE. One of the most serious problems the industry faces, Senator, is the problem of an exceedingly rapid rise in labor costs. Labor, and to some degree it responds to other things in the marketplace. When you have a shortage, the price builds up. In 1966 this industry had a devastating blow dealt to it in the credit crunch at that time. A large number of people who were in the construction industry left that industry simply because houses could not be built and they got jobs elsewhere. They did not come back into the industry. The shortage of labor in our industry has become therefore much more acute.

In dealing with the shortage from that source, and for other reasons, organized labor has succeeded in getting some phenomenal and what we think are pretty scandalous raises through the bargaining process simply because they were bargaining from the strength of shortage.

Senator FANNIN. I think that the estimate has been it has averaged about 17 percent each year for the past 3 years. If this continues, do you think——

Mr. GULLEDGE. Those in the recent settlements were much higher than that.

Senator FANNIN. Much higher?

Mr. GULLEDGE. Yes; there has been an increase in 2 years which is a normal pattern at the moment.

Senator FANNIN. If this continues possibly it will be priced out from the reach of most of our people.

Mr. GULLEDGE. They are pretty well that way now, Senator.

Senator FANNIN. Do you feel if this does continue it may be advisable to have wage and price controls?

Mr. GULLEDGE. If that is the only alternative, that is it.

Senator FANNIN. Fine, thank you.

Mr. GULLEDGE. If we cannot get appropriate action otherwise. As our statement says, we see no real alternative except that.

Senator FANNIN. But the construction industry has signed contracts that have exceeded even the highest so far as productivity is concerned.

Mr. GULLEDGE. Absolutely.

Senator FANNIN. Thank you.

Mr. GULLEDGE. Thank you, sir.

Senator ANDERSON. Thank you.

Our next witness is Mr. Thomas M. Goodfellow.

I see you have brought along a former member of our staff. We are glad you brought him along. We are glad to have you here.

Mr. MCDERMOTT. Thank you very much.

Mr. GOODFELLOW. Frank McDermott, our counsel.

Senator ANDERSON. He was a very good member of our staff.

Mr. MCDERMOTT. I appreciate your kind remarks. It was always an honor to serve this committee, and it is a privilege to be here to serve you again in deliberation on this question.

STATEMENT OF THOMAS M. GOODFELLOW, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS; ACCOMPANIED BY FRANK McDERMOTT, TAX COUNSEL [1]

Mr. GOODFELLOW. I am Tom Goodfellow, president of the Association of American Railroads. I appreciate this opportunity to present the association's views—and express its concern—on the effect repeal of the investment tax credit would have on the railroad industry.

With me is Frank McDermott, tax counsel of the association.

In the interest of time—and with your permission—I'd like to summarize my statement and submit the prepared testimony for inclusion in the record.

Senator ANDERSON. Without objection that will be done.

Mr. GOODFELLOW. The American railroads naturally are disappointed by the action of the House in failing to exempt this industry from the proposed repeal of the investment credit. We strongly and sincerely feel that the basis for repeal set forth in the House committee's report does not apply to the railroad industry.

We disagree that the use of the investment tax credit by American railroads has contributed to inflationary pressures. We are as concerned as anyone over these pressures and their effect on important national needs.

The justification for repeal given by the House committee, namely, that continuing expanding markets and high-profit levels should provide sufficient investment incentive in the future without the tax credit, just doesn't apply to our low-profit, low-earning industry. Ours is an industry which must engage in a highly competitive market, and it is anything but overinvested.

[1] Additional documents relative to this testimony appear at page 502.

In addition, by using April 18, 1969, as the effective date for repeal, the House bill imposes severe and unusual hardships on railroads as well as other taxpayers. Purchases were made—or binding contracts entered—that relied on present law. Moving the effective date back, to a time before Presidential announcement of the proposed repeal, constitutes a serious inequity.

We hope this committee will alleviate this situation, especially since no plausible reason has been given for the rollback of the date.

This suggestion is made without, of course, lessening in any way the urgency of our appeal for an exemption of the railroad industry.

There are, in fact, several other technical changes which we feel should be made in the House bill if it is enacted, and I've discussed these changes in my prepared statement.

The case for the railroads is quite clear. Our industry represents vital distribution arteries. The continuous, efficient flow of goods through these arteries depends on the availability of adequate numbers of modern locomotives and freight cars. In short, the national interest requires that the investment tax credit be retained for the railroads.

We have been struggling mightily to modernize our equipment and upgrade our service despite financial problems stemming from low earnings, scarcity of capital funds, and the high cost of borrowing. Repeal of the investment credit would discourage the purchase of the new cars and locomotives the railroads need to meet the Nation's growing transportation needs. Every consumer has a stake in this.

The investment credit has provided vital support for improvement programs—cash for railroads with taxable income and favorable lease terms for others.

We believe the case for exampting the railroads is based on economic reality.

In contrast to the situation of U.S. corporations as a whole, railroads have not in any year since 1962 generated enough cash through depreciation charges and retained income to cover their expenditures for new cars, locomotives, and other capital improvements.

There's been a widening gap between annual cash flow and capital outlays, amounting to nearly $3 billion in the period between 1963 and 1968. This has resulted in a $673 million decline in net working capital to a virtual alltime low, an increase in equipment debt to an alltme high of more than $4 billion, and a forced reduction in capital spending after 1966.

Railroads have not earned a rate of return on net investment (after depreciation) of as much as 4 percent since 1955. Quite recently—for the 12 months ended March 31—they earned only 2.4 percent. Also, our return on net worth last year was only 3.3 percent, compared with an average return of 10.5 percent for public utilities and 13.1 percent for manufacturing corporations. Without the investment tax credit, the railroads' earnings picture would be even worse.

Let's look in particular at the effect the credit has had on equipment.

Since its enactment, there has been substantial progress toward elimination of obsolescence from the railroad equipment fleet. During the 5 years between 1964 and 1968, new and rebuilt equipment included 447,000 freight cars and 6,100 locomotive units—almost double the

226,000 freight cars and 3,100 locomotive units installed in the previous years.

From yearend 1958 to yearend 1963, the freight car fleet declined by 217,000 cars. In the next 4 years to yearend 1967—despite continued large-scale retirements—the fleet increased by 8,000 cars.

The investment credit in the 1962–68 period provided $364 million for class I railroads alone—enough to cover a 20-percent downpayment on more than 120,000 freight cars or 7,000 locomotive units.

The credit also has enabled deficit railroads, with no taxable income, to acquire equipment under leasing arrangements from taxpaying lessors on more favorable terms that would otherwise have been possible.

Shutting off this vital financial assistance will seriously handicap our equipment programs. There can be no doubt of that.

And there's another important point to consider. In contrast to the premise upon which the House bill is based, the counterinflationary effect of capital improvements is especially pronounced in railroad transportation. Gross ton-miles per-man-hour—an overall indicator of railroad productivity—increased by 60 percent between 1958 and 1968, largely due to equipment modernization and other technological improvements. As a result, the railroads' average charge for carrying a ton of freight is now 8 percent below the 1958 average, despite a 56 percent increase in hourly labor costs. By way of contrast, the Consumer Price Index is more than 25 percent; about the 1958 level.

The American railroads should not be forced to curtail this significant contribution to the fight against inflationary cost pressures. But we will be required to do so if the investment tax credit is not retained for us.

While emphasizing the need and justification for an exemption, this question of the retroactive effect date contained in the House bill is an important one. It's not usual—and it's not fair—to deny the credit on property purchased or ordered under binding contract prior to congressional approval of the President's proposal.

Before the public announcement of the proposed repeal—which came at noon on April 21, 1969—the credit could be justifiably regarded as a permanent part of the Internal Revenue Code. In view of this, many railroads—and undoubtedly other taxpayers as well—made binding commitments and purchases prior to notice of the proposed repeal, relying on existing provisions of the law.

In order to remove this inequity, the effective date should be changed. We think this committee might well deem it appropriate to establish the effective date as the date of enactment of the bill or the date the committee orders it reported. Alternatively, the effective date could be the date this committee indicated approval of repeal—Wednesday, June 25.

This would be in line with the suspension period law as well as general legislative actions. It's essential, however, that the date be moved beyond the time of the President's message so that the undesirable and inequitable retroactivity of the House bill will be eliminated.

In conclusion, the American railroads urge that you give serious consideration to the special nature of our situation before following the action taken by the House—an action that would deprive this industry of significant help in its modernization efforts.

Rather, we hope this committee will follow the action it took during the suspension period and provide our industry with an exemption from repeal of the credit. The facts are largely the same—and the reasons are just as compelling—today as they were in 1966.

We are not alone in this recommendation. Before the House, we were joined in it by the Chairman of the Interstate Commerce Commission as well as many manufacturers and shippers dependent upon the American railroads for their vitality. They share our views and concern today, just as they did a month ago before the House.

In your consideration, we further urge that you bear in mind the fact that it has been this Government's policy to call upon the American railroads to modernize in response to the transportation challenges of today and tomorrow.

This is our goal and our determination. We feel it's inconsistent, on the one hand, to expect us to update our equipment fleet and, on the other hand, to deny us the necessary funds with which to accomplish this objective.

Because I believe the predictions about the future of this country, I see a great need for healthy railroads in the decades ahead. Economists predict a gross national product of nearly $2 trillion by 1980. That's doubling the present GNP in a decade.

There'll be 245 million people and 77 million households. There'll be an incredible demand for homes, automobiles, recreation equipment—for everything the mind can devise and the heart desire.

Zooming consumer needs—and the related unprecedented production—will combine to place unheard of demands and dependence on transportation.

Railroads are doing their best to prepare for the role they must play in our future. Their services will be vital. But the name of the game these days is modernization—and that takes money. Railroads can ill afford to have more money taken away from them.

Thanks for your interest and attention. And, if there are any questions—or if I can give you any further information—I'll be happy to do so.

(Mr. Goodfellow's prepared statement follows:)

STATEMENT OF THE ASSOCIATION OF AMERICAN RAILROADS SUBMITTED BY THOMAS M. GOODFELLOW, PRESIDENT

The American railroads appreciate this opportunity to present their views and concern regarding Section 4 of H.R. 12290, which would repeal the investment tax credit.

The national interest requires that the investment tax credit be retained for the railroad industry—especially for rolling stock and roadway expenditures.

Further, any exemption provision retaining the tax credit should extend to facilities either owned by railroads or, as in the case of many cars and locomotives, provided by others such as leasing companies and financial institutions through leases to railroads or by private car owners. No matter who owns or provides the equipment, if the investment credit remains available, it will help remedy existing problems.

The suggested repeal of the investment tax credit is particularly harmful to railroads—especially the direct effect on their passenger and freight cars, locomotives, and roadway facilities programs.

Investment credit termination weakens the railroads in their ability to meet expanding national needs.

Proposed repeal would increase the existing gap between the industry's annual cash flow and capital outlay and adversely affect equipment supplies and modernization programs—cutting efficiency and increasing costs.

Acceptance of suggested repeal does not further the national priorities but adds to, rather than diminishes, the inflationary pressure which the House proposal is designed to relieve.

Sound public policy calls for selective treatment to encourage urgently needed capital investments, particularly where there are clearly recognized bottlenecks which impair the nation's economic progress and security. This is the case the railroad industry makes, and thus deserves continued use of this important tax provision.

I. CAPITAL EXPENDITURES AND EQUIPMENT OUTLAYS

To repeal the investment tax credit at this time with respect to railroad capital expenditures would be in direct contradiction to the strongest urgings past and presents from Congress, government agencies and the nation's shippers that the railroads proceed with all possible dispatch to increase and improve their freight car supply and transportation capabilities.

RAILROAD EARNINGS GAP

In contrast to the situation of other industries, railroads have not in any year since 1962 generated enough cash through depreciation charges and retained income to cover their expenditures for new cars and locomotives and other capital investment. A widening gap between annual cash flow and capital outlays, amounting to nearly $3 billion in the period 1963–1968, has resulted in: (1) a $673 million decline in net working capital to a virtual all-time low, and (2) an increase in debt incurred to purchase capital equipment to an all-time high of more than $4 billion.

Railroads have earned a rate of return on net investment (after depreciation) of only 2.5 percent in 1967 and 1968 and, indeed, have not earned as much as 4 percent in any year since 1955. Their return on net worth (ratio of net income to shareowner's equity) last year was but 3.3 percent as compared with average returns of 10.5 percent for public utilities and 13.1 percent for manufacturing corporations. (See Exhibit A.)

Such unfavorable fiscal comparisons demonstrate that it is impossible for railroads to compete for capital funds on equal terms with other industries. Resort in these circumstances to the accumulation of more debt which burdens the borrower with higher fixed charges for funds is regressive. Railroad after railroad is having to curtail urgently needed equipment and other capital expenditure programs for want of access to the necessary funds. This predicament is currently of the utmost concern to the entire railroad industry.

EQUIPMENT PICTURE

It is noteworthy that just three years ago, in April 1966, during a similar heated-up economic period, the government, through the Office of Emergency Planning, appealed to business generally and to all agencies of government to reconsider their capital expenditure programs and, wherever feasible, to postpone such expenditures in the interest of preventing an overheated economy. Significantly, however, the Director of the Office of Emergency Planning was appraised of the then railroad equipment situation similar to today's situation. After conferring with the Interstate Commerce Commission and the Undersecretary of Commerce for Transportation, the Director specifically excepted the railroad industry from such request and acknowledge the need for full steam ahead on railroad equipment programs.

Of similar significance was the recognition given to the industry's equipment problems by this Committee in 1966. In its consideration of suspending the investment credit, this Committee was persuaded that the national interest required a limited exemption on behalf of the railroads. As the Committee pointed out:

> Withdrawal of the investment credit, even for a short period, would not be in the national interest. The slight effect such a withdrawal would have in lessening inflationary pressures in the capital goods industries would be

more than offset by the adverse effect which a continuation of the present shortage of railway cars would have. The latter could intensify a transportation bottleneck of serious proportions, particularly with regard to the transportation of grain.

The entire railroad industry urges that this Committee again take a particularly serious look at the railroad equipment situation before it takes the action contained in H.R. 12290 and proposed by the Administration.

The factors underlying the reduction in availability of freight cars are complex. Of prime importance is the fact that obsolete and unserviceable equipment must be retired. Equipment needs are not limited to numbers alone but also involve questions of quality and suitability for present-day operations. Another important factor is that the insistent demands of our shippers, for new specially designed equipment to serve them more efficiently and economically, have provided an impetus to modernize the freight car fleet and the investment credit has provided the means. Finally, the fact that we are currently retiring freight cars with an average original cost of $3,000, but are replacing them with units having an average cost of nearly $15,000, must be considered.

EQUIPMENT TRENDS

Following enactment of the investment tax credit there has been substantial progress toward elimination of obsolescence from the railroad equipment fleet. During the past five years (1964–1968, inclusive), new and rebuilt equipment placed in service included 447,000 freight cars and 6,100 locomotive units, almost double the 226,000 freight cars and 31,000 locomotive units installed in the previous five years (1959–1963, inclusive). Similarly, from 1957 through 1961, freight car acquisitions totaled 286,000 cars. This amount nearly doubled during the last five-year investment credit period.

Tax credits have enabled deficit railroads with no taxable income to acquire cars under leasing arrangements from tax-paying financial institutions and leasing companies on more favorable terms than would otherwise have been possible. Such assistance to railroads in financing needed improvement programs should not now be discontinued. Roads experiencing the most pressing financial circumstances would in this way be enabled to continue to carry a share of the load in advancing the industry's equipment programs.

For many of these distressed railroads, the Interstate Commerce Commission has formulated or is now considering plans for revitalization by inclusion in stronger railroad systems through mergers and reorganizations. In these determinations the investment tax credit has been regarded as a vital element in financing the rehabilitation of such roads. Repeal of the credit would distort the financial terms already set by the Commission for many of these reorganizations and would seriously impair the railroads' ability to provide more modern facilities and equipment and thus improve the transportation service of the weaker railroads.

Although Congress may determine, as a general proposition, that present circumstances require capital investments to be kept within safe speed limits, this restraint does not appropriately apply to railroad rolling stock and associated facilities. Continuing increases in such equipment and investment are urgently needed now.

Increasing the railroad equipment supply requires sustained and unabated efforts by all concerned. This sustained program would be stifled if the incentive of the investment tax credit, after having been guaranteed as part of the continuing tax structure, were to be taken away. The experience of the temporary repeal of investment credit in 1966–1967 is a dramatic example of the impact of such a move on railroad equipment replacement and improvement. Freight car orders in the fourth quarter of 1966, even including those placed prior to the October 10 effective day of the suspension, were lower than in any other 1966 quarter, although the fourth quarter in most years is the peak quarter for car orders. Then in the winter and early spring of 1967 car orders almost terminated, reaching a low of 1,726 cars in April. Orders for new locomotives also came to a virtual halt. As a consequence of the cutback in orders, the freight car builders and related suppliers discharged both skilled and unskilled workers and otherwise curtailed building activity. That experience, if repeated now, would have a very serious effect on the economy.

Despite encouraging progress, it will take time to cope with expanding requirements for railroad equipment and its financing. Since the nation's economy is growing and will continue to grow, it will not suffice merely to equate new equipment capacity with old units retired. Although of increased load capacity, the new units are also specialized and often lack the flexibility of much of the older car fleet.

The task of developing an adequate supply of railroad equipment in cars and locomotives and associated facilities for the nation's expanding requirements is far from finished. Despite financial problems stemming from low earnings, scarcity of capital funds and high cost of borrowing, ordering of freight cars spurted in the final quarter of 1968. Increasing freight car demands were a factor in the acceleration of orders, and car unavailability has continued through the winter and spring of 1969. It is unlikely that there is a member of either House who has not been apprised of the adverse effect on the economy of his district or state of the freight car shortage. In the face of such shortages, it is apparent that railroads are not overinvesting in rolling stock. Rather, their efforts are the minimum necessary to provide good transportation service. More encouragement should be given instead of forcing a reduction in the gains already made by repealing the investment credit. Repeal would immediately threaten a reversal of the long-sought but still slender net gain in car capacity.

II. EFFECT OF REPEAL ON NATIONAL PRIORITIES

The announced purpose of the Administration in proposing repeal of the credit is twofold: (1) The revenue released by repeal of the credit would be used to help fund the Administration's forthcoming programs, including revenue sharing with state and local governments and tax credits to encourage investment in poverty areas in hiring and training of the hard-core unemployed; and (2) elimination of the credit would relieve inflationary pressures by helping curtail the demand for business equipment. According to testimony by Administration officials before the Ways and Means Committee, monetary policy is recognized as the most important weapon in fighting inflation, and investment credit repeal was not mainly addressed to this purpose. The main reason for proposing investment credit repeal according to the testimony is to shift revenues to other projects. It was urged that social needs and economic condiions have changed since the early 1960's, and this change in circumstances was the primary reason for recommending removal of the investment credit.

The railroad industry is heartily in accord with the proposition that solutions must be found to the fiscal problems of state and local governments, the conditions found in poverty areas, the hard-core unemployment situation, and also relieving inflationary pressures. However, we no less firmly insist that withdrawal of the investment tax credit with respect to railroad equipment would not further these objectives, but in some cases would have precisely the opposite effect.

Railroads are major taxpayers insofar as state and local governments are concerned (and indeed in some states are bearing a disproportionate burden), railroads have made efforts to encourage location of industry in poverty areas, and have adopted programs designed to bring relief to the hard-core unemployed. The role of private industry in these areas should be recognized, and private efforts to cure these problems should be encouraged.

Inflationary pressures

Experience has demonstrated over and over again that pendulum swings in acquisition of railroad facilities, resulting in rolling stock needs such as we have now, are disruptive to the functioning of the whole economy. Stifled investment as a consequence of withdrawal of the investment tax credit would work serious injury by obstructing the smooth flow of the nation's production. Such obstruction to national productivity would quicken, rather than quell, inflationary tendencies.

A freight car shortage results in a breakdown in an important artery of distribution.

It is axiomatic that such a breakdown is itself an important inflationary pressure. The resultant surpluses in the producing geographical areas and shortages in the consuming areas result in price increases passed on to the ultimate con-

sumer. The use of distribution facilities alternative to cheaper rail transport likewise results in an added cost passed on to that consumer.

The counterinflationary effect of capital improvements is especially pronounced in railroad transportation. Gross ton-miles per man-hour, an overall indicator of railroad productivity, increased by 60 percent between 1958 and 1968, largely due to equipment modernization and other technological improvements. As a result, the railroads' average charge for carrying a ton of freight is now 8 percent below the 1958 average, despite a 56 percent increase in hourly labor costs. In contrast with the railroads' 8 percent reduction in average freight charges, the Consumer Price Index is now 25 percent above the 1958 level.

Railroads should not be forced to curtail this significant contribution to the fight against inflationary cost pressures.

Exemption of Railroads Consistent With Administration's Objectives

The Administration as previously noted indicates that it has priorities which must be met and the tax obtained by repeal of the investment tax credit will be available to meet these priorities. Acceptance of this premise is the prerogative of Congress. It is submitted that a first priority must be the assurance of a modern rail transportation system. Since the investment credit has been dramatically effective in promoting the necessary capital investment to achieve this goal, it is illogical to propose scrapping the credit and allegedly replacing it by an undefined, uncertain, totally untested and yet to be invented device. The unknown and unknowable efficacy and cost of such a device would be a poor substitute for a tested and effective program.

This apparent dilemma can be resolved in complete harmony with the national interest by exempting railroads from repeal of the investment tax credit. Whatever changes in social needs and economic conditions have prompted the Administration to seek repeal of this credit, it has been demonstrated that those changes have not been and are not now operative in the railroad industry. The incentive of the investment tax credit is no less essential to our industry now than it was when first enacted in 1962.

Notwithstanding a reluctance to open the door to exceptions from the recommended repeal, deliberately selective action is clearly consistent with the national interest where, as in the case of railroad facilities, recognized problems exist.

With respect to these urgently needed facilities the question presented is simply this: Does the Congress want to impair ongoing programs for improving and increasing the service capabilities of the nation's railroads and risk further impetus to the inflationary spiral? With respect to rolling stock, for example, two questions are presented:

1. Are additional freight cars and locomotives needed?
2. Should their acquisition be discouraged?

The answer to the first question is obviously in the affirmative. Thus, the answer to the second must be negative!

If the real purpose of the repeal is merely to obtain more dollars for certain priority programs—it should best be achieved without deterring the industry's effort to meet its transportation obligation. It is unquestionable that the railroads have benefited by the use of the investment credit—but in so doing have directly benefited the nation and more particularly our customers—and ultimately every consumer. Repeal of the credit can only be offset by railroads through increased rates with a resultant effect on prices.

III. RECOMMENDATIONS REGARDING ADVERSE IMPACT OF INVESTMENT CREDIT REPEAL PROVISIONS OF H.R. 12290

Effective Date

The bill as passed provides an effective date of midnight, April 18, for repeal of the investment credit. Apparently, the House Committee rolled the date back in order to put all taxpayers on the same footing. No reason appears in the Committee report for this move. The rollback is tenuous since on April 18 as well as on April 21 and to date the investment tax credit is available to taxpayers on property which they order and place into service.

The action taken by the Committee is arbitrary and has a retroactive effect, thereby undercuts a taxpayer's reliance on a presently operating provision of the law.

Further, no official announcement was made by the White House until the President's message calling for repeal was sent to Congress, which action took place on Monday noon, April 21. It is noteworthy that when the House previously considered the suspension bill, it rejected the Administration's request for an effective date earlier than the date the President's request for repeal took place, namely, September 8, 1966. Ultimately, Congress accepted the date the Finance Committee acted upon the bill, October 10, 1966.

The American railroads recommend that the effective date be the date of enactment of the bill; the date this Committee orders the bill reported; or, the date the Committee indicated its acceptance of the House action---Wednesday, June 25. This change of the effective date would be in line with the general legislative action where a law will deny a person certain benefits enjoyed prior to its enactment. Also, it will correspond with the previous action taken by Congress on the suspension law. It is noteworthy that the Ways and Means Committee gives no real justification for the effective date which it selected.

Limitation on Carryovers

The bill provides an annual limitation of 20 percent on the aggregate amount of carryover credits which a taxpayer has accumulated prior to 1969. The limitation will be applied for the years 1969 and thereafter. The rationale for the limitation according to the Ways and Means Committee is that "much of the revenue gain and economic restraint which could otherwise be expected in Fiscal Year 1970 arising from the repeal of the investment credit would be eliminated." The Committee report, however, fails to disclose why the 20 percent figure was chosen. It appears from newspaper accounts and other sources that the 20 percent rule arose out of a recommendation that the taxpayers be given a five-year period after repeal from 1969 to 1973 to write off all of their carryovers provided, of course, that they had sufficient tax liability against which to apply their carryover credits. This proposition, however, was rejected by the Committee; but the 20 percent figure is retained.

Further, this limitation is built on present limitations in the law, namely, that the carryovers can only be applied to 50 percent of the taxpayer's liability over $25,000 and carryovers can only be carried forward seven years from the year in which the credit was earned. Thus, railroads part of whose carryover credits arose in 1962 may lose part or all of these credits to the extent that they are unable to apply these 1962 carryover credits to their 1969 tax liability. Obviously having the amount of carryover which they can use reduced from 100 percent to 20 percent makes their chances of losing the use of their carryovers all the greater.

The Committee report emphasizes that credits generated through property placed in service qualifying under the liberalized binding contract rules may be carried back from the year in which they are earned and thus increase the aggregate amount of carryovers to which the 20 percent limitation is applied. In the case of many of the railroads this particular carryback feature of post-investment credit will not prove too helpful.

Inasmuch as the limitation on the use of carryovers was predicated on the need for revenue, it would appear that a 50 percent limitation on carryovers would be just as acceptable as the severe 20 percent. Furthermore, the investment credit provisions provide a parallel limitation of 50 percent with regard to the amount of tax liability available to be credited and should give support to the 50 percent limitation with respect to carryovers.

Affiliated Corporation Rule

The Committee's justification for treating contracts between members of an affiliated group as nonbinding is predicated on the assumption that the supposed facility for self-dealing among affiliated corporations would undermine the bona fide nature of an agreement. The Committee states: "Generally, although a contract between members of an affiliated group may be legally binding, it is not binding as a practical matter." This statement alone should not support departure from the suspension period transitional rules which recognized affiliated group contracts.

We recommend that contracts, including leases, between members of an affiliated group entered into on or before the effective date of repeal be recognized with regard to property acquired under the terms of such contracts or leases.

Phase Out of Credit

The bill would reduce the amount of credit available to property placed in service during the period 1971 to 1974 at a rate of 1/10 of 1 percent per month. The only apparent justification for the phase out would be to reduce the revenue impact that the availability of the full investment credit for such property would have. Regardless of this effect, when the property was originally ordered by the taxpayer either in 1969 or before it was on the basis that the full investment tax credit to which he was entitled would accrue to such property. It appears incongruous to allow a taxpayer who gets the property in service earlier under the terms of his contract rather than later to capitalize on this factor. Also, why should companies with short lead times with regard to their basic equipment be placed in a better position than companies whose cash flow or type of equipment require longer lead times under the provisions of their supplier or builder contracts? It would seem the most equitable rule would be the rule that the law presently establishes, namely, that property with a life of eight years or more would be entitled to a full 7 percent credit when placed in service by the taxpayer.

The proposed phase out of the investment credit should be eliminated and the full 7 percent (or applicable investment credit) be available to property placed in service after the effective date of repeal.

IV. NATIONAL DEFENSE REQUIREMENTS

Each of us is acutely aware of Viet Nam. We know the demands of a land war in Asia. No one at this time can say with assurance just how long it may take to bring that conflict to a satisfactory conclusion and peace.

What we do know is that for as long as it may continue, the railroads will be an essential arm of military logistics—as they always have been in wartime. The history of every conflict has been that the size and efficiency of the railroad industry has been a critical factor in ultimate victory. However, to discharge our responsibilities we must have equipment—and we have no standby equipment to meet unpredictable surges in military requirements.

While the military demands can best be assessed by the Department of Defense, this is certainly no time to take chances with military requirements by introducing a discouraging factor to the continued increases of railroad equipment, as withdrawal of the investment tax credit would do.

V. CONCLUSION

As detailed above, and as evidenced by the estimated results of our 1969 equipment acquisition programs, the railroad industry has come a long way—and is looking forward to the future. The remarkable strides we have made in the modernization of the freight car fleet, as well as the fact that we are now on the verge of a long overdue expansion, testifies to the resolve of our industry and to the effectiveness of the investment tax credit. I submit that this is no time to derail the industry.

Without the investment tax credit we would be substantially weakened in our power to accomplish the imperatively needed acquisition programs which are of such critical importance to our shippers, to the consuming public, and to the entire nation. Without the credit it is inevitable that equipment pinches and inflationary pressures will become more acute; that the consumer will be forced to pay added costs to acquire the produce and manufactured goods so vital to our economy; that we would be taking chances with the military requirements of the nation at a time of grave national emergency and an uncertain outlook; and that the future of the entire railroad equipment manufacturing industries would be severely threatened.

I can assure you, with respect to the railroad industry, a repeal of the investment credit could only increase rather than diminish the problems to which repeal is directed. As applied to the railroad industry particularly, repeal of the investment tax credit would put the "clout" in the wrong place and head our industry in precisely the wrong direction.

Should the Committee and its staff require any further data or assistance regarding an exemption as well as guidelines for orderly repeal provisions, I can assure you that I and the AAR staff stand ready to help in any manner.

EXHIBIT A

Railroad Financial Data

DECLINE IN NET WORKING CAPITAL AND INCREASE IN EQUIPMENT DEBT

(millions)

Year	Net working capital		Equipment obligations outstanding
	Excluding maturing debt	Including debt due in one year	
1963	$828	$376	$2 575
1964	731	277	2 814
1965	636	172	3 182
1966	477	Def. 52	3 869
1967	276	Def. 248	4 154
1968	155	Def. 457	4 201

CASH FLOW AND CAPITAL SPENDING

(millions)

Year	Cash flow (retained income and depreciation)	Capital expenditures	
		Amount	Excess over cash flow
1963	$950	$1 044	$94
1964	927	1 417	490
1965	1 058	1 631	573
1966	1 149	1 953	804
1967	817	1 522	705
1968	852	1 187	335

Note: Corporate cash flow exceeds capital spending in the U.S. generally.

RATE OF RETURN

Year	Return on railroad net investment	Return on net worth		
		Railroads	Public utilities	Manufacturing
1963	3.12%	3.7%	10.2%	11.5%
1964	3.16	3.9	10.7	12.7
1965	3.69	4.6	10.8	13.8
1966	3.90	5.1	10.9	14.1
1967	2.46	3.0	10.9	12.5
1968	2.44	3.3	10.5	13.1

Source: Interstate Commerce Commission and First National City Bank of New York.

Senator ANDERSON. Senator Bennett.

Senator BENNETT. No questions.

Senator ANDERSON. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Goodfellow, there is a report that a $900 million plant was contracted for shortly before April 21 and was subject to investment credit. Are you in a position to comment on that report?

Mr. GOODFELLOW. We have heard that same rumor, I guess it is more than a rumor. This plant was contracted for but we have been further advised that the amount of this contract that will come under the investment tax credit is only about $80 million.

Senator BYRD. Thank you. That is all, Mr. Chairman.

Senator ANDERSON. Senator Curtis.

INDUSTRY EXEMPTIONS FROM INVESTMENT CREDIT SUSPENSION

Senator CURTIS. Refresh my memory, if you will. When the investment credit was suspended a while back, what exemptions were made? I am not talking about special phaseout, but what industries were exempted from the suspension.

Mr. GOODFELLOW. I think Mr. McDermott could answer the question better than I could.

Mr. McDERMOTT. Senator Curtis, the Finance Committee reported the suspension bill with a special exemption for rolling stock given to the railroads specifically, for air and water pollution and for a few others, such as for small businessmen up to $25,000 of investment. On the Senate floor the bill was further amended with exemptions. These were passed by the Senate and included exemptions for truck trailers and cargo aircraft. In conference all of these industry exemptions, except that for small business, were dropped as a result of the conference committee action.

Senator CURTIS. The conference dropped the one on rolling stock?

Mr. McDERMOTT. Yes, sir.

Senator CURTIS. In other words cars?

Mr. McDERMOTT. Yes, sir. When the bill was reported from the Finance Committee the exemption provided specifically for railway rolling stock designed to carry freight or passengers other than a self-propelled car. In the Senate, the provision was limited to freight cars only, but then, expanded after a floor amendment was offered to include highway trailers and semitrailers. Then an amendment offered by Senator Javits for commuter service trains was adopted. The conference rejected among other exemptions the provisions for freight cars, highway trailers, and commuter service trains.

Senator CURTIS. I would like to ask you, Mr. Goodfellow, are the facts which caused the Finance Committee to exempt from the suspension rolling stock of the railroads, are they still present?

Mr. GOODFELLOW. We think they are just as present as they were in 1966.

Senator CURTIS. That is all, Mr. Chairman.

Senator BENNETT. Mr. Chairman, one comment: Isn't it true that the only exemption left in the bill when it was finally passed was a $20,000 exemption on a dollar basis?

Mr. GOODFELLOW. Yes.

Senator BENNETT. That is all.

Senator ANDERSON. Senator Miller.

Senator MILLER. Thank you, Mr. Chairman.

Mr. Goodfellow, on page 4 of your statement you say "Before the public announcement of the proposed repeal—which came at noon, April 21, 1969"—and you are talking about the public announcement in the President's press conference I presume?

Mr. GOODFELLOW. Yes; that is right, as well as his message to Congress.

Senator MILLER. The credit could be justifiably regarded as a permanent part of the Internal Revenue Code.

Yet on April 1, the Joint Economic Committee, consisting of both Members of the House and Senate, issued its report.

In the Joint Economic Committee, as you probably know, the Democrats and Republicans both write their respective views whereas in other committees you have Members of both parties joining in the majority and minority views. The Democratic majority views recommended repeal of the investment tax credit. If this had been Republican views it would be one thing, the Democrats are in control of the Congress and when the majority of the Democrats come out on April 1, and ask repeal of the investment tax credit I can tell you that it cannot be regarded as a permanent part of the Internal Revenue Code.

Mr. GOODFELLOW. Well, of course, there were minority views. Also Senator Proxmire expressed an opposite view to that of the majority report, nor was the Joint Economic report exactly in the same class as the President's press conference where he said he was sending the legislation to Congress and was putting an effective date on it of April 21. I appreciate there were a lot of rumors, I think Mr. Claytor said the other day there were a lot of rumors flying around Washington. It is not hard to find rumors. However, I do not think any official statement issued about the President sending a bill to Congress until he sent it up on April 21.

Senator MILLER. Well, of course, what the President recommends the Congress does not necessarily have to abide by.

Mr. GOODFELLOW. I agree.

Senator MILLER. Nor if the President does not recommend something it certainly does not tie the hands of Congress. The only thing is I do not think we should be so absolute on the certainty of the continuation of the investment tax credit. It has been the subject of considerable discussion, and in view of the Joint Economic Committee issuing that report, and granted there were some minority views, I think you would have to look at the membership and you would conclude that the majority of the Members from both Houses recommended that it be repealed and that is the only point I wanted to make. At best I think you might say that the certainty was not absolute in view of that. Now, let me ask you this: You testified that from 1962 to 1968, $364 million benefit was derived from the investment tax credit by class I railroads. Do you have any idea or do you have any way of providing committee with the picture from 1962 to 1968 of the operating cost increase in class I railroads.

Mr. GOODFELLOW. I cannot give that off the top of my head but we will be glad to furnish it for the staff.

Senator MILLER. You could get that for us?

Additionally you have indicated a considerable increase in the number of rolling stock units and locomotives purchased during that period of time, and I am wondering if you could get us the figure of unit costs, say, after 1961 as against the actual costs during that period of time. The point I want to bring out is that the inflation impact on the railroads, in the increase in their operating costs, and in the in-

crease of the purchase price of their rolling stock and in locomotives would substantially exceed the $364 million advantage from the investment tax credit.

If a conclusion from that could be drawn, my conclusion would be that the single most important thing the bill we are considering could contribute would be to put a stop to inflation and that would go beyond any investment tax credit by far.

Mr. GOODFELLOW. We certainly agree that we would like to see inflation stopped.

Senator MILLER. I am sure you would.

Mr. GOODFELLOW. We do not think that repeal of the investment tax credit in our case is the way to do it. It hurts us more than it helps us.

Senator MILLER. Now, but if you had a trade off, if you had a choice between stopping inflation and the increase in operating costs and increase in prices of the rolling stock and all that, on the one hand and the investment tax credit on the other, my guess is your stockholders would probably prefer to have that inflation package.

Mr. GOODFELLOW. We prefer the inflation, if it could be guaranteed like an exemption from the tax credit repeal will be guaranteed by your action if you give it to us.

Senator MILLER. Of course, nobody can guarantee it.

Mr. GOODFELLOW. No.

Senator MILLER. But——

Mr. GOODFELLOW. You can guarantee the exemption though.

Senator MILLER. We have to try to do a job on inflation and, as you know, the administration has testified that their target is to reduce inflation, and that means we need to come up with a reasonably balanced budget.

Mr. GOODFELLOW. Senator, if we were making 10 to 12 percent on our investment as some other companies are, I would feel we could sacrifice this investment tax credit. But with a 2.4 return on our investment we just cannot generate enough cash to do any modernization, so if you take this investment tax credit away from us we just are not going to have money to buy equipment which we sorely need.

Senator MILLER. Let me ask you a question on that one. I do not need to point out to you that if we start making exemptions in the repeal of the investment tax credit we could get into quite a chain reaction. People from the trucking industry and the airlines will be coming in and asking for the same thing and many others. But suppose that the investment tax credit is in fact repealed across the board, except maybe with respect to some transition rules. What is the depreciation life used generally on rolling stock?

Mr. GOODFELLOW. We use 14 years.

Senator MILLER. Fourteen years. And locomotives?

Mr. GOODFELLOW. The same period.

Senator MILLER. Well, suppose that Congress provided for a quick amortization of the costs, say, over a 5-year period? I give you that as an example because I remember back several years ago, long before I came here, we had an acute shortage of grain storage facilities and the Congress, in order to encourage people to build grain storage facilities, enacted a quick amortization provision with respect to it so

even though some of them might last 20 or 25 years they allowed them to be written off over a 5-year period. Will this be helpful to——

Mr. GOODFELLOW. We would like to discuss this with the staff. It is a little too complicated for me to say yes or no, but we would certainly like to discuss it with the staff as to whether this would be a good substitute.

Senator MILLER. I have no further questions.

Senator ANDERSON. Senator Fannin.

Senator FANNIN. Yes, Mr. Chairman, just one question.

Mr. Goodfellow, there has been a serious shortage of refrigeration cars, I know in my State of Arizona and also in California and many other States where they are marketing perishable commodities. I am wondering, because that shortage has come in the past few weeks or at least in the last couple of months, whether or not there has been a bulk ordering of these cars that will be affected by this investment tax credit.

Mr. GOODFELLOW. I would have to look that up to find out what has been ordered in that particular car type. I do not think we have that information with us today.

Senator FANNIN. I would like to know.

Mr. GOODFELLOW. We will be glad to furnish that information for you.

Senator FANNIN. All right.

Senator ANDERSON. Thank you.

(The following material was subsequently received by the committee:)

ASSOCIATION OF AMERICAN RAILROADS,
Washington, D.C., July 15, 1969.

DEAR SENATOR LONG: During the hearings on Friday morning, July 11, Senator Miller asked about trends in railroad operating costs since 1961 and particularly about trends in unit costs.

For the year 1968 the average rate of straight-time hourly pay of railroad employees was $3.47, an increase of 29 percent over the 1961 rate of $2.69. Including payroll taxes and other fringe benefits, labor costs per hour worked amounted to $4.87, up 38 per cent from 1961. Average wage rates in 1969 are about 6.3 percent higher than last year's.

Prices of materials and supplies have also increased, but less sharply. The rise between 1961 and 1968 was 7.5 percent, all of which occurred after 1965.

Despite the increase in wage rates and prices, railroads were able to reduce their unit costs year by year from 1961 to 1966. As shown by Table 1 attached, operating expenses, rents and taxes other than Federal income taxes declined from $5.95 per 1,000 gross ton-miles in 1961 to $5.58 in 1966. This decrease reflected gains in efficiency resulting from increased volume, from capital expendiures for modernization, and other cost cutting. The capital expenditures were stimulated and aided by the investment tax credits available after 1961. Railroads were able to reduce the average freight rate level during this period by 9 percent and still made annual gains in net earnings.

Since 1966 the rate of cost escalation has been too rapid to be offset by efficiency gains. Thus, as shown by Table 1, expenses per 1,000 gross ton-miles increased from $5.58 in 1966 to $6.06 in 1968. This increase of 48 cents per 1,000 gross ton-miles amounts to $800 million a year at the 1968 traffic level. It has resulted in depressed railroad earnings since 1966, as shown in my prepared statement, despite small freight rate increases in 1967 and 1968.

Senator Fannin asked me to submit for the record a statement of refrigerator car orders placed in recent months. That statement, attached as Table 2, shows 8,250 refrigerator cars ordered since January last year.

With best regards,

TOM GOODFELLOW,
President.

TABLE 1.—TRENDS IN UNIT COSTS, CLASS I RAILROADS, 1961-68

Year	Gross ton-miles, cars and contents (billions)	Operating expenses, taxes, and rents, except Federal income taxes	
		Total (millions)	Average per 1,000 gross ton-miles
	(1)	(4)	(3)
1961	1,413.0	$8,408.9	$5.95
1962	1,459.9	8,557.4	5.86
1963	1,499.7	8,589.8	5.73
1964	1,557.6	8,900.4	5.71
1965	1,608.7	9,082.7	5.65
1966	1,688.6	9,422.5	5.58
1967	1,645.3	9,622.2	5.85
1968	1,668.1	10,110.7	6.06

Source: Interstate Commerce Commission, "Transport Statistics in the United States" (and corresponding preliminary data for 1968).

TABLE 2.—NEW AND REBUILT REFRIGERATOR CARS ORDERED—CLASS I RAILROADS AND RAILROAD-CONTROLLED REFRIGERATOR CAR LINES, 1968 69

Year	Month	Number ordered
1968	January	550
	February	200
	March	230
	April	55
	May	505
	June	0
	July	0
	August	70
	September	700
	October	815
	November	450
	December	2,522
1969	January	228
	February	0
	March	900
	April	1,025
	May	0
Total, 17 months		8,250

Source: Car Service Division, AAR.

Senator ANDERSON. The next witness is Frank Barnett, chairman of the board, Union Pacific Railroad.

Mr. Barnett.

STATEMENT OF FRANK E. BARNETT, CHAIRMAN OF THE BOARD OF DIRECTORS, UNION PACIFIC RAILROAD CO.; ACCOMPANIED BY ROBERT J. CASEY AND JOHN A. CRAIG, TAX COUNSEL

Mr. BARNETT. Mr. Chairman, and members of the committee, my name is Frank E. Barnett. I am chairman of the board of directors of the Union Pacific Railroad Co. and have come here this morning to give you the experience of one railroad company which comprises about 5 percent of the industry.

I am accompanied by tax counsel to Union Pacific Robert J. Casey and John A. Craig, members of the firm Casey, Tyre, Craig & McCoy, of New York City.

Senator ANDERSON. Is your point of view somewhat different from the previous witness?

Mr. BARNETT. Sir?

Senator ANDERSON. Is your point of view different from the previous witness here?

Mr. BARNETT. It does not differ from the previous witness but it will give the experience of one individual company in this area which is a very pointed experience bearing on the question this committee has before it at the present time.

I have a written statement, Mr. Chairman, which I believe has been filed with the clerk and distributed to the committee, but I am not going to read any statement. I am going to come, hopefully, directly to the point which is before this committee this morning; namely, whether this credit should or should not be repealed.

Senator ANDERSON. Your statement will be placed in the record.

(Mr. Barnett's prepared statement follows:)

PREPARED STATEMENT OF FRANK E. BARNETT, UNION PACIFIC RAILROAD CO.

SUMMARY

I urge the Committee to exempt railroad property from the repeal of the investment tax credit. The credit has been largely responsible for the strides in the alleviation of the freight car shortage both directly for taxpaying railroads and indirectly, through freight car interchanges and lower-rate leases for financially distressed roads.

For the period 1962-1968 Union Pacific increased the number of its freight car units by 11.5% and increased the capacity of its fleet by 37%—this in spite of the retirement of some 26,000 obsolete and overage cars in that same period. These retirements were double the number retired in the 1955-1961 period.

The experience during the suspension should be closely studied to assess the impact of repeal on the important car building and supply industries with its work force of more than 500,000. Reduction in this work force as high as 75% was experienced by some companies in the suspension period.

Efficient and low cost distribution of goods would seem to be a critical anti-inflationary factor. The repeal of the credit will increase the effective tax rate. If the 1962 tax rate reduction increased Federal tax revenues, there is reason to fear an increase in tax rates might reduce revenues. At least it seems to call for a definitive study.

STATEMENT

Mr. Chairman and Members of the Committee:

My name is Frank E. Barnett. I am Chairman of the Board of Directors of Union Pacific Railroad Company and Union Pacific Corporation, with offices at 120 Broadway, New York City.

I am appearing here today on behalf of Union Pacific Railroad with respect to H.R. 12290, particularly that portion of the Bill which repeals the 7% investment tax credit. My statement on behalf of Union Pacific is, I believe, representative of the experience of the railroad industry with the investment tax credit.

Earlier, Thomas M. Goodfellow, President of the Association of American Railroads, presented a statement on behalf of the railroad industry. In part, my testimony will echo his comments but will refer to the specific experience of the Union Pacific during the period prior to the investment credit enactment and subsequent thereto.

In my appearance before this Committee in April of 1962 I urged, on behalf of the railroad industry, enactment of the investment credit. At that time I referred to the crisis which faced the railroad industry, particularly its basic need to generate capital for modernization of its facilities. In support of that proposition I pointed out the poor earnings position of the industry; its need to generate capital funds in order to maintain its existing plant and equipment; as well as its need to improve its freight car fleet by upgrading its quality with modern features suited to the demands of our shippers. At that time, when most industries regarded the credit with suspicion, we predicted that its enactment would help to produce the immediate additional capital necessary to meet the needs, not only of our industry but of the country as a whole.

With respect to Union Pacific, my testimony will clearly evidence that our prediction of 1962 was more than conservative. Union Pacific has experienced

an aggregate percentage unit increase during the seven-year period 1962–1968 of 11.5%, and an aggregate capacity percentage increase of 37%. I can state as a fact that Union Pacific's contribution to the national freight car fleet was in large measure made possible by the capital funds generated and made available to it by the investment credit. I further know as a fact that Union Pacific has met, and is currently meeting, the guideline reserve ratio test without benefit of any of the escape clauses, a fact which also is largely attributable to the investment credit. It is significant to note that the aforementioned percentage increases were accomplished *despite* the fact that some 26,000 units were retired during the 1962–68 period, which retirements were double the retirements accomplished during the 1955–61 period.

Thus, retirements of obsolete and over-aged equipment, and acquisition of new, modern equipment, which seemed impossible prior to the investment credit, have become a reality as a result of its enactment. Repeal of the credit, insofar as the railroad industry is concerned, will reverse this trend and we will return in all probability to pre-investment credit practices, not because we want to, but from economic necessity.

I need not impress upon this Committee the existing freight car shortage in the United States. The Congressional Record, merely for the 91st Congress through July of this year, memorializes the crisis which the industry is facing. Statements of members of both Houses of Congress, underscoring the need to expand the freight car fleet not only to meet our domestic demands but also to honor our foreign commitments, clearly evidence the fact that the railroad industry, despite the gains accruing from the investment credit, and the depreciation guidelines, still has a long way to go.

I urge that our progress not be halted and reversed. We are faced with a Janus-like approach by the Administration. On the one hand, the Interstate Commerce Commission, the Department of Transportation, and the Department of Defense have repeatedly urged the industry and called upon this Congress to aid in the acquisition of new equipment and modernization of plant facility, while on the other hand the Treasury Department proposes to deny us the very tools needed by seeking repeal of the investment credit which clearly has served the goals sought by the present and predecessor administrations.

I cannot predict the exact effect which repeal of the credit will have on the railroad industry as a whole. I do know, however, speaking for Union Pacific, that as a matter of economics our acquisition and plant modernization programs will have to be carefully reevaluated, and probably curtailed. The financing of our acquisitions, hampered by the drying up of available cash, as reflected, in ever-increasing interest rates, seem to dictate a cutback in continuing our contribution to the needs of the railroad industry. I must stress again that this is *not* a question of deliberate policy, but rather a question of economic necessity.

On October 6, 1966, Daniel P. Loomis testified before this Committee as a representative of our industry, with respect to the suspension of the investment credit proposed in H.R. 17607 of the 89th Congress. At that time the industry urged that suspension of the credit would: first, add substantially to the existing national freight car shortage; second, add to rather than decrease the inflationary spiral which the Administration, at that particular point in time, asserted the proposed legislation was designed to decrease; third, derogate from the needs of the Department of Defense during a time of national emergency; and fourth, critically depress within a few months after its enactment the car and locomotive building and supply industries which employ over 500,000 individuals. I am sure the members of this Committee can recall that history proved the accuracy of this presentation. Statements of members of both Houses of that Congress clearly recognized that the railroad industry, of all industries concerned, was the most critically affected by the suspension of the credit. The freight car shortage dramatically increased. The car and locomotive building industry was faced by the most critical period in its history. Car building plants were closed, and employment of thousands of individuals was terminated. In fact, the suspension of the credit was disastrous to the railroad car building and car supply industries.

Some companies reduced their work forces by as much as 75%. The least reduction in force was 25%. After the credit was restored very high costs were incurred in re-training personnel and in rebuilding the lines of supply to reopened plants. It is estimated that a drop in efficiency of as much as 30 to 35% was suffered during the start-up period. This inefficiency in production necessarily led to higher prices to customers, an obvious inflationary pressure.

In early 1967, the Administration reversed its position with respect to the investment credit suspension which the Congress had enacted and proposed im-

mediate reinstatement of the credit in order to stave off what was considered to be a recession. Members of both Houses of the Congress at that time quickly assented to the Administration's request and the credit was reinstated. It is highly significant to note the effect of such suspension, not only on the railroad industry but also on the related industries comprised of car builders and suppliers.

As we understand it, the Administration proposes to repeal the investment tax credit both because of its inflationary impact and because of its absorption of tax revenues. I must confess that so far as the railroad industry is concerned the logic of these predicates escapes me. As to the inflationary impact of the credit, it seems impossible that any incentive which led to an increase in efficiency and a reduction in cost of channels of distribution could do anything except combat inflationary pressures. We have experienced a dramatic increase in prices in a consumer area because of shortages based solely on lack of distribution facilities. As to the revenue impact of the investment credit, it seems to me that in this regard the investment tax credit does no more than reduce the effective Federal tax rate. I understand that the reduction in tax rates in 1962 in fact increased Federal revenues. Logically, I should think that an *increase* in the effective tax rate might very well have the effect of *reducing* Federal tax revenues. I have looked in vain for a study which would bear out this visceral reaction of mine. I would expect that the Treasury Department must have made such a study available to the Committee.

My concern is, of course, magnified by what may be a parochial view of the matter. Contrast for a moment the adverse competitive position of the railroads with the air, water and other land carriers. As I said in my statement before this Committee on April 6, 1962, the railroad industry is:

> "* * * required to construct and maintain our own rights of way in order to operate. While our competitors have available publicly financed and supported airports, highways, waterways and harbor facilities, the Class I railroads as of the end of 1960 had invested some 18.4 billion dollars of their own capital funds in road properties. This is indeed anomalous, especially if we consider that we have invested some 3.6 billion dollars in grading and tunnels alone no portion of which will be recovered until the property involved is at long last abandoned."

The situation which prevailed in 1962 exists today with slight dollar changes. The investment in grading and tunnels by Class I railroads as of 1966 was still approximately $3.6 billion. Union Pacific's current investment in these assets is some $143 million. Our grading and tunnel bores, which we have constructed and paid for ourselves, are frozen accounts. We are told by the Internal Revenue Service, as well as the Treasury Department, that these properties have no ascertainable useful life. And yet we are forced to sit idly by despite the fact that our competitors, directly or indirectly, are subsidized for the use of waterways, highways, and airway facilities.

On top of this, we are now faced by an immediate overall repeal of the investment credit which, in large measure, enabled us to compete effectively with these competing modes of transportation. In light of these facts, I do not believe that an exception from the repeal of the credit for the railroad industry necessarily carries with it an exception for all transportation industries. User charges paid by the water, land, and air carriers are deductible at current tax rates. We have no user charges, because we own and maintain our own properties at our own expense; which expense, unless related to a repair or maintenance program, cannot be recaptured until the day that we, and specifically Union Pacific, cease as a corporation.

Returning to Mr. Goodfellow's presentation, I would like to relate his broad industry statements to Union Pacific. Attached hereto as Exhibit A is a schedule reflecting freight car acquisitions and average capacity during the period 1960 through 1968, for the total car fleet in the United States and Union Pacific. Exhibit A establishes that while Union Pacific's experience, under the aegis of the investment credit, out-ranks that of the industry as a whole, nonetheless in the aggregate the experience of the industry is similar to that of Union Pacific. And this, I might add, is exactly what our industry has been called upon to accomplish by this Administration and at least four predecessor Administrations, not to mention members of this Committee and the Congress at large.

This exhibit, utilizing 1960 as a base index of 100%, dramatically underscores the effect of the investment credit within our industry. I might call particular attention to the significant drop in 1968 in acquisitions reflecting the credit's suspension period. The increase in capacity in 1968 is not inconsistent with the

dropping off of unit acquisitions inasmuch as our industry is constantly enlarging the individual unit capacity in order to meet the demands of our shippers. Repeal of the credit necessarily will be reflected in any subsequent acquisition programs and, as I have noted, will likely result in a sharp curtailment.

Exhibit B appended hereto reflects Union Pacific's freight car acquisition and ownership during the period commencing January 1, 1960 and terminating December 31, 1968, together with estimated 1969 acquisitions based on orders placed as of mid-June 1969. This exhibit is broken down into categories of equipment acquired; average cost per unit; total charged to investment account; number of units in service at year end after deduction of units retired; and average age at the close of each year. Estimated 1969 acquisitions have been excluded from items 4 through 7 since not all have as yet been placed in service. I might note, however, that in our statement to stockholders as of June 30, 1969 we estimated an aggregate investment in new equipment during the current year in the area of some $243 million. Retirements of equipment during this period totalled some 26,000 units, twice that of the retirements accomplished during the 1955–1961 period.

Even a casual scrutiny of this exhibit indicates the effective use to which Union Pacific has put the investment tax credit. There has been within our company a consistent increase in the number of freight cars owned as of the end of each of the years set forth. Even more significantly, the average capacity of our freight car fleet has been dramatically increased. This Committee should consider that while retirements were doubled, these represented obsolete, low-capacity cars which were replaced by cars having, in many instances, twice the capacity of the cars retired.

It should be further noted with respect to this exhibit that the average age of our freight car fleet, as of the end of each of the aforesaid years, steadily decreases. This indicates that Union Pacific, as a specific example of the railroad industry as a whole, is meeting the requirements placed upon it to keep pace with expanding national needs.

Financially distressed railroads are also materially benefitted by the credit. By the operation of the National freight car pool, cars purchased by the taxpaying roads under the spur of the credit are freely interchanged with our less fortunate brothers. In addition, these latter roads are able to secure the use of equipment at very favorable rates by leases from lessor-owners who use the investment credit—a significant plus in the critical equipment picture.

However, should the taxpaying roads, such as Union Pacific, be unable, due to adverse economic factors, to maintain a constant expansion of their car fleets, the effect will not be within one corporate entity but rather will reach across an entire Nation. If this be what this 91st Congress feels to be desirable, then so be it. As for myself, I cannot conceive that this is the goal sought by the Senate Finance Committee, the Commerce Committee, the Agricultural Committee, the Armed Services Committee and the Labor and Public Welfare Committee. Statements of members of these various Committees clearly indicate that the national welfare, both from an economic and political standpoint, can only be fostered through continued modernization and technological improvements of the railroad industry.

Union Pacific, utilizing the benefits flowing from the investment credit, has been able to employ the computer technology in electronic classification yards which permit a much more efficient utilization of our fleet. Also, computers enable us to determine at a moment's notice the location and status of each freight car on our system. Thus, the capital funds generated by the investment credit have served, and will continue to serve, if it be the wish of Congress, those industries which depend upon fast and efficient rail transportation in the distribution of their products.

I am compelled to conclude that unless the railroad industry is exempted from repeal of the investment credit with respect to its property, the gains reflected in the statistics appended hereto for the industry, and particularly for Union Pacific, will be sharply and drastically curtailed and even reversed. Will this serve the national policy enunciated by this Administration? Will the Department of Agriculture, the Department of Transportation, the Department of Defense attest that the national economy will be better served through reduction in railroad capacity as against an alleged and, so far as I know, unproved revenue-raising measure?

It cannot be gain said that the railroad industry, and particularly the Union Pacific, has served the National economy well. As a business man, entrusted with the duty of husbanding the assets of my principals—the shareholders of

Union Pacific—I must carefully evaluate the alternative channels of investment of the Company's resources. Without the credit, investment in railroad assets loses much of its allure.

In conclusion, I would like to thank this Committee for the courtesies which have been extended to me today.

EXHIBIT A

FREIGHT CARS—UNITS ACQUIRED AND AVERAGE CAPACITY 1960–68, FOR TOTAL FLEET IN THE UNITED STATES AND FOR UNION PACIFIC[1]

Year	U.S. car fleet [2]				Union Pacific [3]			
	Number of units acquired	Index 1960 equals 100 percent)	Average capacity (tons per car) close of year	Index 1960 equals 100 percent)	Number of units acquired	Index 1960 equals 100 percent	Average capacity (tons per car) close of year	Index 1960 equals 100 percent
1960	58,322	100.0	55.4	100.0	1,503	100.0	53.1	100.0
1961	34,241	58.7	55.7	100.5	659	43.8	53.2	100.2
1962	39,822	68.3	56.3	101.6	1,776	118.2	54.1	101.9
1963	48,255	82.7	56.8	102.5	2,733	181.8	55.1	103.8
1964	83,266	142.8	58.3	105.2	3,169	210.8	55.9	105.3
1965	89,653	153.7	59.7	107.8	4,283	285.0	57.0	107.3
1966	106,058	181.8	61.4	110.8	8,531	567.6	59.3	111.7
1967	100,181	171.8	63.4	114.4	7,910	526.3	61.1	115.1
1968	68,836	118.0	64.9	117.1	2,784	185.2	65.2	123.0

[1] Number of units owned:

	Jan. 1, 1960	Dec. 31, 1968
United States	1,980,531	1,802,787
Union Pacific	54,290	67,196

[2] Figures for United States include all railroads and car companies, such as Trailer Train, Pacific Fruit Express, etc. Data based on information furnished by Association of American Railroads.

[3] Average capacity per car for Union Pacific excludes cars leased to other companies.

EXHIBIT B

UNION PACIFIC RAILROAD CO. FREIGHT CAR ACQUISITIONS AND OWNERSHIP FOR YEARS 1960–68 AND UNITS ACQUIRED AND ON ORDER TO DATE IN 1969

	Box	Gondola and Hopper	Refrigerator mechanical	Flat	Stock	Tank	Other	Total
1 Number of units beginning of year 1960	29,110	16,908		2,746	3,488	1,238	800	54,290
2 Units acquired:[1]								
1960	550	653		300				1,503
1961	467	167		25				659
1962	751	940		85				1,776
1963	1,362	610	500	261				2,733
1964	1,304	475	500	490	300		100	3,169
1965	2,622	420	750	481			10	4,283
1966	4,824	1,927	1,000	755			25	8,531
1967	3,860	3,193	500	183			174	7,910
1968	2,031	350		302	100		1	2,784
1969 (acquired and on order)	4,417	2,695	1,100	741	300			9,253
3. Average cost per unit:								
1960	$13,067	$11,405		$14,511				$12,633
1961	11,059	13,042		15,903				11,745
1962	14,592	14,396		16,980				14,603
1963	17,002	13,519	$28,600	13,869				18,047
1964	15,120	14,476	28,791	18,096	$11,354		$20,838	17,465
1965	12,589	14,342	28,524	16,468			4,185	15,967
1966	13,903	15,029	28,307	17,277			21,129	16,166
1967	14,315	13,071	30,549	20,810			23,236	15,186
1968	12,980	16,273		22,626	11,165		1,482	14,371
1969 (estimate)	19,330	16,854	31,205	19,918	14,280			19,903

See footnote at end of table.

EXHIBIT B—Continued

	Box	Gondola and Hopper	Refrigerator mechanical	Flat	Stock	Tank	Other	Total
4. Total charge to investment account (including betterment costs), not available by type of equipment, total only:								
1960								18,874,003
1961								10,118,652
1962								26,908,493
1963								47,943,300
1964								57,873,068
1965								68,957,103
1966								140,834,529
1967								124,234,526
1968								37,813,843
5. Number of units end of year (after deducting units retired):								
1960	29,135	17,234		2,962	3,417	1,238	770	54,756
1961	29,233	17,143		2,972	3,296	1,237	740	54,621
1962	29,383	17,829		3,020	3,102	1,237	688	55,259
1963	29,305	18,266	500	3,005	2,751	1,237	639	55,703
1964	28,920	18,277	998	3,388	2,715	1,236	706	56,240
1965	28,881	18,415	1,744	3,675	2,564	1,234	681	57,194
1966	30,961	20,267	2,730	4,268	2,469	1,228	663	62,586
1967	31,747	23,382	3,212	4,378	2,414	1,224	829	67,186
1968	31,189	23,645	3,205	4,656	2,459	1,219	823	67,196
6. Average capacity (tons) per unit, end of year:								
1960	50.08	60.0		55.11	40.0	52.79	59.0	[2] 53.1
1961	50.06	60.0		53.58	40.0	52.78	59.2	[2] 53.2
1962	50.35	62.0		53.65	40.0	52.78	60.9	[2] 54.1
1963	51.00	63.0	66.5	54.86	40.0	52.78	61.6	[2] 55.1
1964	51.74	64.0	66.5	56.33	40.0	52.78	62.0	[2] 55.9
1965	53.0	65.0	65.0	59.0	40.0	52.80	62.0	[2] 57.0
1966	55.0	75.9	65.0	61.0	40.0	52.0	64.5	[2] 59.3
1967	51.0	71.8	65.0	62.0	40.0	52.0	79.0	[2] 61.1
1968	57.0	75.9	65.0	66.0	44.0	52.0	70.0	[2] 65.3
7. Average age (in years) at end of year (not available by type of unit):								
1960								15.80
1961								15.75
1962								15.92
1963								15.51
1964								15.28
1965								14.61
1966								13.19
1967								12.23
1968								12.14

[1] Includes units leased to others, as follows:

	Box	Gondola and hopper	Refrigerator mechanical	Flat	Stock	Tank	Other	Total
1960		76		200				276
1961		125		200				325
1962		100		200				300
1963		125	500	311				936
1964		115	998	372				1,485
1965		245	1,742	527				2,514
1966	647	320	2,719	596				4,282
1967	945	1,829	3,212	553			110	6,649
1968	939	1,855	3,205	507				6,506
1969 (acquired and on order)	939	1,855	4,299	507				7,600

[2] Excludes equipment leased to others.

Mr. BARNETT. The question is, "Why repeal the 7-percent credit? I am unable to understand whether this proposal has been brought before the Congress at this time as a counterinflationary measure or as a revenue measure. If it is a revenue measure then I think we should take a look at the amount of revenue which is involved.

The total railroad industry had a taxable income in 1968 of somewhat less than a billion dollars. It paid total income taxes of about $66 million in 1968.

Now, if you relieve the railroads entirely from their Federal income tax obligation you are decreasing Federal revenues by about $66 million. I do not think $66 million will go very far in the revenue picture.

Now, on the other hand, let's take inflation. Is that the question before us? Some people think that it is. If it is, then a careful look must be taken at any proposal which will cut down on the acquisition of new equipment by railroads.

Mr. Gulledge a few minutes ago mentioned the very sharp increase in the price of lumber in 1966. As a single illustration of inflation the Wall Street Journal on April 1, 1966, reported that a boxcar shortage was the prime reason for a very sharp rise in lumber prices. Between March 1 and April 6, 1966, the price of green Douglas 2 by 4's rose from $68 to $80 a thousand cubic feet. Specifically, the boxcar shortage was cited as the prime reason.

Are we really talking about inflation or an attempt to cure inflation? If we are seriously attempting to stop inflation, then let's take a look at the cost of transportation. About 20 percent of the cost that everything John Q. Public buys is devoted to the cost of transportation.

Also, alternative forms of transportation must be considered. The railroads carry freight at a cost of about 1.1 cents per ton-mile. The huge new jumbo jets are going to carry freight at a cost of about 3.5 cents per ton-mile. The trucks carry freight at a cost of somewhat over 6.5 cents per ton-mile.

Any move which cuts down on the acquisition of new rail equipment is obviously going to have the effect of increasing the cost of transportation. Thus, repeal of the credit is going to expand the cost of that 20 percent which John Q. pays, by driving freight to alternative and more expensive modes of transportation.

Mr. Goodfellow has just indicated that the industry, specifically class I railroads, have benefited by some $364 million by reason of the 7-percent credit. My company, the Union Pacific, has had the benefit of about $62½ million under the 7-percent credit since its inception in 1962. That is a downpayment on $300 million of equipment.

Prior to 1962, the Union Pacific was acquiring equipment at an average rate of about $40 million a year. Since the inception of the investment credit we are acquiring equipment at the rate of just over $100 million a year.

Exhibit A of my statement indicates the equipment purchases by my own company as compared with the industry over the period from 1960 through 1968. It shows that the industry capacity to carry freight, taking 1960 as an index of 100, has increased to about 118.

In our case the average capacity, that is, the tons per car, has increased since 1960 from an index of 100 to 123.

Senator Fannin asked about the acquisition of refrigerator cars.

The Union Pacific and the Southern Pacific jointly own the largest refrigerated fleet in the world. Our own acquisition of refrigerator cars are shown in exhibit B of my statement. I think this will give some information on the questions regarding the average cost of equipment. Item number 3 in exhibit B indicates the increasing costs of the various items of equipment. I think it may also be informative with respect to some of the questions which were raised this morning.

I would be glad to answer any questions that you gentlemen may have.

Senator ANDERSON. Senator Bennett.

Senator BENNETT. No questions.

Senator CURTIS. Mr. Barnett, in your opinion, will the continuation of the investment credit, so far as the railroad equipment is concerned, give us more cars than we can otherwise expect if it is terminated?

Mr. BARNETT. My answer to that question is a categorical yes, it certainly will. There is no question about it.

Senator CURTIS. For about 10 or 15 years, one of the very consistent problems placed before my office have been letters and telegrams and frantic telephone calls from shippers of grain throughout Nebraska for more cars. In some instances the grain has just been piled up on the ground out in the open, some of them who cannot fulfill a Government order that calls for turning of grain in at a given terminal market when called by the Government.

I wish you would elaborate just a little bit on how this might help that situation as contrasted if it is not done.

Mr. BARNETT. Yes, sir; and I would like to do that both on the positive side and on the negative side, if I may.

Let's take a look at the record of our company. In 1965 we spent $107 million on new equipment. In 1966, $188 million on new equipment. In 1967, $132 million on new equipment. Then comes the suspension of the credit, and this is the negative side. In 1968 our equipment expenditures were $61 million. We currently have on order $243 million of new rail equipment. Our rate of acquisition is far in excess of the record of the industry. We have a tremendous program before us. We need every bit of help we can get. We are going to continue to do our darnedest and in spite of everything we do, I am afraid that we are facing another grain car shortage now that the crops are coming ready for harvest in Kansas and in Nebraska.

Senator CURTIS. In general, what is the range of price of the cost of building a freight car? I am not talking about a specialty car, or a refrigerator car but one that hauls freight and can be used for grain?

Mr. BARNETT. Today, the average cost in 1969 of all of the cars that we have on order is $19,903. In 1960 the average cost of all of the cars on which we took delivery was $12,633.

Senator CURTIS. Now, you gave us some figures on your purchases by year——

Mr. BARNETT. Yes, sir.

Senator CURTIS (continuing). Of railroad equipment. Is a substantial portion of that cars?

Mr. BARNETT. The figures I gave, Senator, were all equipment cars.

Senator CURTIS. All cars?

Mr. BARNETT. No, sir; just equipment cars.

Senator CURTIS. So from those figures we can find a measuring stick or index so far as this law affecting supplies of cars, and it is not intermingled with the purchase of locomotives and others?

Mr. BARNETT. It is not intermingled, but you will not be able to find those figures. From 1955 through 1961, for freight cars alone my company spent $131,200,000, an average of $18,700,000 a year.

Then, the 7-percent credit came in, and in the years 1962 through 1968 my company put into service $504,600,000 of freight cars, or an average per annum of freight car acquisitions of $70,100,000; a 275% increase in our average freight car acquisition rate.

Senator ANDERSON. And that includes the fruit crops, didn't it?

Mr. BARNETT. Did you say the refrigerated car, Mr. Chairman?

Senator ANDERSON. Yes.

Mr. BARNETT. Yes, sir; it does.

Senator CURTIS. One more question: Is there any relation between the rebuilding or building of new railroad equipment and railroad safety?

Mr. BARNETT. Yes, sir. That is a question to which we are very sensitive at the moment.

On June 30, 1969 Secretary Volpe's task force on railroad safety rendered its report. The conclusion of that report is important and, if I may, Senator, I would like to supply a copy of that report for the record in this proceeding, if that is agreeable to you, Mr. Chairman.

Senator CURTIS. It will be.

(The report referred to follows:)

REPORT OF THE TASK FORCE ON RAILROAD SAFETY SUBMITTED TO THE SECRETARY OF TRANSPORTATION, JUNE 30, 1969, WASHINGTON, D.C.

DEPARTMENT OF TRANSPORTATION,
OFFICE OF THE ADMINISTRATOR,
FEDERAL RAILROAD ADMINISTRATION,
Washington, D.C., June 30, 1969.

Hon. JOHN A. VOLPE,
Secretary of Transportation,
Washington, D.C.

DEAR MR. SECRETARY: I am pleased to transmit the report and recommendations of the Task Force on Railroad Safety, which you established on April 18, 1969. As Chairman of the Task Force, I wish to commend to you the outstanding spirit of cooperation and dedication on the part of all the members which made this report possible.

Sincerely,

R. N. WHITMAN.

At the request of the Secretary of Transportation, we, the representatives of the railroad industry, railroad labor organizations and State regulatory commissions, met as a task force to examine railroad safety and to advise the Secretary. The Task Force began meeting May 1, 1969, and concludes with this report. There has been a free exchange of information and open discussion. Data supplied by the Federal Railroad Administration and its Bureau of Railroad Safety were used for purposes of analysis of problem areas. The agreed upon time limit did not permit additional outside research.

REVIEW OF THE PROBLEM

Railroad operations involve inherent dangers. Movement of large, heavy equipment at high speeds characterizes the industry. Daily, some two billion ton-miles of freight of all types move on the Nation's railroads. Hundreds of

railroad yards receive, classify and dispatch the 1.8 million freight car fleet on an around-the-clock, seven-day-a-week schedule. About 600,000 passengers daily commute to work and 200,000 travel intercity by rail; 630,000 railroad workers average 3.5 million man-hours of work per day.

It is logical to assume that operations of such magnitude will generate accidents. Thus, standards, procedures and rules are necessary to provide for safety. The bulk of existing railroad safety practices were developed over the years by the industry iteslf. For many years they met the safety requirements and produced the present safety record.

Grade crossings accidents rank as the major cause of fatalities in railroad operations. They account for 65% of the fatalities resulting from all types of railroad accidents, and rank second only to aviation mishaps in severity. Annually, about 4,000 accidents produce approximately 1,600 deaths which is also a matter of major public concern.

The yearly totals of crossing accidents, and accident casualties, in the 1920–1967 period, can be related very closely to the combined amount of rail and highway miles travelled and to the effects of major crossing safety improvement programs. The trend in both accidents and casualties up to 1958 was generally downward. The situation has been reversed since 1958, however, with a disturbing general trend upward in both categories. Only 20% of the total 225,000 grade crossings are protected with automatic devices.

Grade crossing safety receives attention from highway authorities as well as railroad organizations. Under existing law, Federal-aid highway funds may be used on grade crossings on the Federal-aid highway system. This includes interstate, primary and secondary roads which together account for slightly more than 20% of the total number of crossings. However, Federal funds may not be used to reduce hazards at railroad crossings of city streets and on many state supplementary highways and local roads which are not on the Federal-aid system and which represent the remaining 80% of the total. A certain number of safety improvements are being made currently by the carriers and state and local agencies on crossings not on the Federal-aid system. There is an imperative need for an expanded public program to cover these crossings in order to reduce immediately this extremely high fatality rate.

The most obvious trend in any recent examination of railroad safety is the large and steady increase in the number of train accidents. The 8,028 train accidents recorded in 1968, represents a significant increase, by any yardstick, over the 4,148 recorded in 1961. Derailments account for two-thirds of the total.

General causes of train accidents are almost evenly divided among human error, defects in or failure of equipment and defects in or improper maintenance of track and roadbed. Derailments are largely attributable to track and equipment problems while collisions are mostly caused by human error.

Employee safety in railroad operations is of continuing concern. In 1968, there were 146 employees killed and 17,993 injured. Employees involved in rail operations and track and roadbed maintenance are more exposed to the inherent hazards of the industry and, therefore, represent a major portion of the employee casualty figure. Contributing factors to the employee casualty rate include inadequate training programs, human errors, equipment defects, poor housekeeping, and non-compliance with safety and operating rules.

The need for transporting ever increasing quantities and varieties of hazardous materials—chemicals, gases, explosives and fuel—creates the possibility of serious accidents that have become a matter of major public concern. Thus, causal factors affecting train accidents—track, equipment, human factors and train-motor vehicle collisions—take on added significance when dangerous commodities are transported.

RAILROAD SAFETY REGULATIONS

Government involvement in railroad safety regulation came early. In 1893, Congress passed the first Safety Appliance Act. Then and in later years various Federal statutes granted varying degrees of Federal authority over locomotives, signaling systems, hours of service limitations on certain employees, airbrakes, couplers, hand brakes, grab irons, running boards, sill steps, and draft gears on rolling stock, and accident reporting. The Federal authority to regulate shipment of hazardous materials is applied largely to the packaging of these commodities, although some rules governing handling in transit have been adopted.

Federal statutes do not cover the trucks, wheels and axles of railroad cars nor their design, construction or maintenance. Bridges and tunnels are not subject to Federal regulations and no Federal authority governs track and roadbed. There is no general authority to promulgate standards for employee qualifications, physical requirements and training, nor to prescribe uniform railroad operating rules.

Almost all States have entered the field of rail safety regulation. However, there is no uniform pattern of involvement. Some are quite active in general rail safety matters, but most consideration is on grade crossing safety regulation. Certain States feel they are adequately equipped by statute or existing regulations to deal with any rail safety problem that may arise.

Rules and regulations issued under present Federal and State authority cover only the specific areas reached by the legislative acts. The limitation imposed on the regulatory process by specific, rather than general scope legislative authority, results in only minimal public agency involvement in some problem areas of safety.

PRIORITIES

Railroad safety is wide in scope and requires a more comprehensive national approach. Of first priority is treatment of total rail safety by relating all its various facets to definite goals. This demands a coordinated approach by industry, labor, State and Federal government.

To continue as the major transportation mode, railroads will require more innovation, advanced equipment and higher speed capabilities. Achievement of these advanced capabilities calls for parallel advancement in safe, dependable, operation. Therefore, major safety research is essential to guarantee that tomorrow's railroads will not only be more efficient but more safe.

Railroad operating personnel will continue to be the group most involved with rail safety, or the lack of it. New equipment and higher speeds will place great demands on employee skills and railroad operating practices. It is recognized that employee training is inadequate today, and could become more critical as new technology reshapes the industry. It seems imperative that formal, intensive training programs be given high priority along with human factors research. At the same time, railroad rules and practices must be kept responsive to change so that a high level of safety may be maintained.

The modern industrial economy is dependent upon hazardous materials that are shipped throughout the country. Consequently, the entire transportation network, particularly the railroads upon which a large share of chemicals, explosives, fuels and the like travel, must have the capacity to transport them safely. A top priority should be the complete evaluation of all factors related to the transportation of these commodities. Particularly, container standards for hazardous materials must take into account impact and stress requirements commensurate with today's longer, heavier and faster trains.

The motoring public is part of the safety problem at the grade crossing. Drivers must be educated to accept the meaning of warning devices and be required to heed them. Compliance must be enforced. Because this is a matter of public safety, public programs must be immediately initiated and properly funded to provide the motorist with positive, uniform and adequate information about the hazard at the crossing. More emphatically, firm and prompt consideration must be given to better use of existing funds and the making available of additional public funds to meet the increasing costs of crossing protection and grade separation, and to increase the number of grade crossings with automatic protection. There should be a long range, public commitment to eliminate this unnecessary and tragic loss of life.

Other improvements in railroad safety must necessarily involve substantial commitment of public and private resources. For Government, a major commitment should be toward research; for industry, upgrading and maintenance of plant should be foremost. Management and labor should cooperate to reduce human error. The economic restraints on the railroad industry make it essential that public policy be directed toward the development of financial incentives to support rail safety.

SUMMARY CONCLUSIONS

Recognizing that there have been longstanding differences among the three groups represented on the Task Force, the parties sought to emphasize areas of agreement rather than disagreement plus their mutuality of interest in railroad safety. The consensus view of the Task Force is as follows:

Railroad safety is a problem, national in scope, or concern to Federal and State Governments, as well as labor and management and which has been accented in recent years by the increase in the number of train accidents, particularly derailments.

Fatalities resulting from railroad accidents occur mostly at grade crossings. Trespassers rank second in the number of fatalities, and employees third.

Transportation of hazardous materials—chemicals, gases, explosives and guels—is an economic necessity. Involvement of these materials in train accidents creates a new dimension of public concern over railroad safety.

Reported causes of train accidents are almost evenly divided among defects in or failure of track and roadbed, defects in or failure of equipment, and human error.

Existing Federal and State rail safety regulations do not, in most instances, provide standards for track, roadbed, equipment, employee training and qualifications or rules governing safe railroad operations.

Accident reporting and investigation practices are inadequate. Available statistics do not relate sufficiently to determination of primary and contributory causes.

Research into factors affecting railroad safety is inadequate because it has been sporadic and not coordinated.

Present Federal, State and industry programs to reduce hazards at railway-highway grade crossings are extremely narrow and inadequately funded.

RECOMMENDATIONS

Regardless of the difference in the views of the parties, it is recognized that the safety experience of the American railroads during the past few years is at a point where some effective steps must be taken to bring the problem under control. It is also recognized that the public and Congress will demand definite assurance that safety will be improved. Solutions short of broad Federal regulation may not adequately meet the situation. Therefore, even though further regulation creates some problems for each of the parties, the Task Force agrees that legislation authorizing broad Federal regulatory powers should be enacted with certain safeguards. It is further recommended that a permanent advisory committee be established, by law, representing management, labor, and State regulatory commissions, to guide and assist in the development of safety standards and other related matters. The specific recommendations of this Task Force are:

1. That the Secretary of Transportation, through the Federal Railroad Administration, have authority to promulgate reasonable and necessary rules and regulations establishing safety standards in all areas of railroad safety, through such notice, hearing and review procedures as will protect the rights of all interested parties.

2. In order to strengthen the administration of Federal rail safety regulations, there should be established a National Railroad Safety Advisory Committee to advise, consult with, and make recommendations to the Secretary on matters relating to the activities and functions of the Department in the field of railroad safety. The Committee would be chaired by the Federal Railroad Administrator with the remaining members appointed by the Secretary to represent equally the State regulatory commissions, railroad management and labor. The Secretary would submit to the Committee proposed safety standards and amendments and afford it a reasonable opportunity to prepare a report on the technical feasibility, reasonableness, and practicability of each such proposal prior to adoption. The Committee may propose safety standards to the Secretary for his consideration.

3. Existing State rail safety statutes and regulations remain in force until and unless preempted by Federal regulation. Administration of the program should be through a Federal-State partnership, including state certification similar to the certification principles set forth in the Federal Natural Gas Pipeline Safety Act of 1968.

4. The Advisory Committee be directed to study the present delegation of authority to the Association of American Railroads' Bureau of Explosives in certain areas of the Transportation of Explosives and Other Dangerous Articles Act.

5. A research program be initiated by Government and industry into rail-

road safety technology, which should be funded immediately for an initial three year period, over and above existing research programs.

6. Formal employee training programs be expanded by railroad management, with the cooperation of labor and government, for the purpose of insuring compliance with safe operating practices and reducing the impact of human error in the accident experience.

7. An expanded, concerted program of grade crossing safety be undertaken utilizing established Federal and State agencies and advisory groups to set uniform procedures and standards. Early attention must be given to the development of improved crossing protection at lower cost plus greater emphasis placed on driver education and traffic enforcement. In addition to more extensive use of existing Federal funds now allocable to present highway safety programs, there must be new sources of funding to finance an expanded grade crossing program.

8. The Federal Railroad Administration should revise, in consultation with railroad management, labor, and state regulatory commissions, its rules for reporting accidents, The aim should be to make the data more current, more uniform and to identify causes more accurately.

9. The Secretary of Transportation in consultation with and assistance of the Task Force and appropriate Congressional committees should draft proposed legislation to implement these recommendations.

R. N. Whitman Chairman, Federal Railroad Administration; Charles J. Fain, Subchairman, Commissioner, Missouri Public Service Commission; Willis F. Ward, Chairman, Michigan Public Service Commission; John P. Vukasin, Jr., Commissioner, California Public Utilities Commission; George E. Leighty, Subchairman, Chairman, Railway Labor Executives' Association; Al H. Chesser, Vice President, National Legislative Representative, United Transportation Union: Donald S. Beattie, Executive Secretary, Railway Labor Executives' Association; William E. Skutt, Assistant Grand Chief Engineer, Brotherhood of Locomotive Engineers; Thomas M. Goodfellow, Subchairman, President, Association of American Railroads; William D. Lamprecht, Vice President, Systems Operations, Southern Pacific Co.; James R. Thorne, Vice President, Operating Department, Seaboard Coast Line Railroad: C. V. Cowan, Vice President, Operating Group, Baltimore & Ohio/Chesapeake & Ohio Railroad Co.

Mr. Barnett. The conclusion of that report was there are three primary reasons for rail accidents. One is human failure. The second reason is inadequate maintenance of right of way, and the third reason is antiquated equipment.

These conslusions and the underlying reasoning is borne out by the record on rail derailments.

In the first 6 months of 1968 the record shows that the Union Pacific had derailments of 1.99 per million locomotive miles. This statistic is important to bear in mind. The Southern Pacific had derailments of 2.5 per million locomotive miles. Both of these railroads are financially able and have been buying new equipment in tremendous quantities.

In that same 6-month period the Rock Island, for example, which has not been able to buy equipment, had 7.34 derailments per million locomotive miles, or almost four times the rate of the Union Pacific.

The Chicago and Northwestern had 11.56 derailments per million locomotive miles or a rate about six times that of the Union Pacific.

The Milwaukee had derailments of 6.32 per million locomotive miles or a rate almost three times that of the Union Pacific.

Senator Curtis. Now, these roads that you're reciting that had a high derailment rate were ones that had no program of replacing equipment or no substantial program?

Mr. Barnett. No substantial program would be the more accurate statement.

Senator Curtis. What is the situation with the Burlington?

Mr. Barnett. The Burlington had derailments in the same 6-month period of 3.61 per million locomotive miles. They are in much better shape in the derailment and accident category than either the Milwaukee, the Rock Island, or the Northwestern.

Senator Curtis. Have they been adding to their equipment or do you know?

Mr. Barnett. Yes, sir.

They have, at a very substantial rate.

Senator Curtis. I was impressed in your statement concerning the shortage of railroad equipment being a factor in increasing the cost of lumber. I believe a strong case can be made showing that the shortage of rail equipment is a substantial factor in reducing the price of grain, particularly in localities and at certain seasons. The inability to move it, to get it there because of the shortage of cars has been damaging to the farmers interests from the standpoint of the price that he can get because of his inability to deliver to the terminal markets or to storage.

Mr. Barnett. I dare say that is true, Senator Curtis. Of course, the lowering of the farmer's commodity price because of a car shortage, is something that we like even less than the farmer does, because when we cannot supply a car and run it down the track we are not collecting any revenue either.

Senator Curtis. That is all, Mr. Chairman.

Senator Anderson. Any further questions?

Thank you very much.

Mr. Barnett. Thank you, Mr. Chairman.

Senator Bennett. Mr. Chairman, before we hear the next witness I understand Mr. Ian F. McLaren, a member of the legislative assembly of Australia, who is a member of the public accounts committee of that parliament, is in the room with his wife. I think we would like to have Mr. McLaren stand with Mrs. McLaren and we would like to greet them. Are they still here?

(Applause.)

Senator Anderson. Mr. Biemiller.

Thank you, Mr. Biemiller, we are glad to have you as an old friend.

STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS; ACCOMPANIED BY NATHANIEL GOLDFINGER, DIRECTOR, DEPARTMENT OF RESEARCH, AFL-CIO

Mr. Biemiller. Thank you very much, Mr. Chairman.

For the record, my name is Andrew J. Biemiller, and I am director of the Department of Legislation o fthe American Federation of Labor and Congress of Industrial Organizations. I am accompanied by Mr. Nathaniel Goldfinger who is director of the department of research of the AFL-CIO.

We appear here today in complete opposition to the continuation of the surtax as it is contained in H.R. 12290. On May 14, 1969, the AFL-CIO executive council unanimously stated: "We in the AFL-CIO will not support any extension of the surtax, until it is combined with immediate, substantial and equitable reform of the Federal income tax structure." I am submitting a copy of the full statement which I request be included in the record.

Senator ANDERSON. Without objection that will be done.

(The statement referred to follows:)

PREPARED STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

SUMMARY

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"We in the AFL-CIO will not support any extension of the surtax, until it is combined with immediate, substantial and equitable reform of the federal income tax structure."

This is not a new position. On August 23, 1967, President Meany, testifying on the House side on the proposed surtax, said:

"We are fully in accord with the President's concept that a temporary war tax is needed. However, we are firmly opposed to the Administration's major recommendation of how to increase taxes."

Then—and now—we said federal revenues ought to be raised through measures that are fully keyed to ability to pay.

The surtax does not meet that test and the proposed extension does even more violence to that concept.

This bill would:

- raise taxes on millions who last year paid a 7½% surtax and now will pay 10%.
- continue the corporation surtax at the same level as last year despite record-breaking corporate profits.
- fail to close a single income-tax loophole and allow wealthy Americans who pay little or no tax to continue enjoying their loopholes and paying little or no surtax.

What is more, this unjust levy is being offered just at the time when the great majority of Americans have been led down a primrose path with promises of long overdue tax reform.

The effective surcharge rate on wage, salary and other ordinary income will be 10%. On capital-gain income it will not be more than 5%, and state and local bond interest income and the income sheltered through oil depletion, fast real estate depreciation write-offs, and other phantom cost write-offs will be taxed at a zero surcharge rate.

As long as these factors exist, asking those whose incomes are modest and whose tax shelters are nil to take the hardest bite of the deflationary bullet, in the name of fiscal responsibility, is economically shoddy and socially irresponsible.

We in the AFL-CIO will not support any extension of the surtax, until it is combined with immediate, substantial and equitable reform of the federal income tax structure.

STATEMENT

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Let me remind you of what we suggested in lieu of this surtax. We felt that the temporary surtax rate on corporations should be at least twice as great as on individuals. Low-income taxpayers should be exempt from any surtax and the temporary tax increase on other income groups should be based on ability to pay. We recommended the same rate as the surtax be applied to excluded income; those large sums that were not and still are not subject to taxation, such as interest on state and local bonds, the excluded half of capital gains and depletion allowances.

I come before you today, Mr. Chairman, on behalf of 13.5 million workers and their families who are again being told by the Administration and the House of Representatives that it is appropriate fiscal policy for them to increase their payments to the federal Treasury.

As a result of the 1968 Act, America's workers paid a 7.5% income-tax surcharge on their 1968 earnings. If H.R. 12290 should become law, they will pay a 10% surcharge rate on their 1969 wages and salaries.

We realize full well that federal revenues must be protected. Military commitments must be met, there is a critical need to fully fund domestic social programs, and, the stage must not be set for meat-axe budget cutting.

But the injustices in the nation's revenue-raising methods cannot again be ignored—or compounded through a tax increase based on a structure that is inequitable.

In short, Mr. Chairman, we do not question the need for some measure of fiscal restraint. We, however, must emphatically oppose the unjust method by which such restraint would be achieved through enactment of H.R. 12290.

This bill would:

—raise taxes on millions who last year paid a 7½% surtax and now will pay 10%.

—continue the corporation surtax at the same level as last year despite record-breaking corporate profits.

—fail to close a single income-tax loophole and allow wealthy Americans who pay little or no tax to continue enjoying their loopholes and paying little or no surtax.

The bill has some desirable features.

It appropriately recognizes that those whose incomes are so small that they cannot pay the grocer or the landlord should not be called upon to pay the federal tax collector. And that it makes little sense to continue a special provision of the Internal Revenue Code geared to encourage investments in plants and equipment at a time when such investments represent the only inflationary demand-pressure in our economy.

Yet, even these two basically desirable features have their weaknesses.

The special low-income allowance is a flat dollar figure geared to *today's* poverty threshold. Yet the allowance will not be effective until 1970. Hence it will be outdated even before it becomes effective.

The proposed elimination of the 7% investment tax credit contains unnecessary exceptions which, in combination with the transition rules, phase-outs and carryover privileges, will yield the Treasury only $1.35 billion in Fiscal Year 1970—less than half the $3–3.5 billion annual tax loss.

More critical and more basic is the simple fact that the surcharge as presently offered is an unjust levy. It is being offered just at the time when the great majority of Americans have been led down a primrose path with promises of long overdue tax reform.

A flat percentage tax on top of an existing tax, like the proposed surcharge, is a fair way to divide the burden of an increase in taxes—*but*, only if the original burden is justly levied. Since such a tax on a tax cannot be collected if no taxes are paid, the infamous nontaxpaying 21 persons with incomes of over $1 million

a year will not pay any surtax. Those who are rich enough to avoid their fair share of taxes through capital gains, oil depletion, accelerated depreciation, tax-exempt municipal bond interest and other tax-escape routes, will pay no surtax on such exempt income. Because of this, others pay more and the basic inequities are compounded.

The federal income-tax law operates on a triple standard in its treatment of various forms of income. Wages, salaries and so-called "ordinary income" are fully included in the tax base and are subject to the full, progressive rate scale. A second standard applies to income from capital gains, since only half of it enters the tax base and there is a 25% maximum limit on the tax rate. Still another standard applies to certain forms of income which are completely excluded from the tax base—and, of course, subject to a zero tax rate.

The surcharge is automatically subject to this same triple standard. The effective surcharge rate on wage, salary and other ordinary income will be 10%. On capital-gain income it's never more than 5%, and state and local bond interest income and the income sheltered through oil depletion, fast real-estate depreciation write-offs, and other phantom cost write-offs is taxed at a zero surcharge rate.

A married worker taking the standard deduction whose sole income in 1969 is $8,000 in wages will pay a $100 surcharge. But a married investor whose sole income in the year is an $8,000 profit from selling a stock or property at more than he paid for it will have to pay only a $13 surcharge. And, if this same $8,000 came from interest on municipal bond holdings, the surcharge would be zero.

If these forms of exempt income were all taxed at the full 10% rate, at least the surtax would be justly levied and the present inequities would not be compounded.

There are other dimensions of the inequity the surcharge bill would create. For, those in our society who can successfully and legally avoid the federal income-tax collector, are also those who are burdened least by the many other forces that have been tugging at the purse strings of most Americans.

Rising prices, the highest interest rates in 100 years, and phenomenal increases in regressive state and local sales and property taxes take their toll from those of low and moderate means. Since they must consume high proportions of their income and have little, if any, left to save and invest, they cannot avoid consumption-based taxes; they cannot hedge against inflation by investing in corporate stocks; and the interest rates they must pay for consumer loans and retail credit are a far cry from the "prime" rate charged the wealthy.

On April 24, 1969, the Bureau of Labor Statistics reported: "The purchasing power of the nation's rank-and-file workers was virtually unchanged in March," and "for the second straight month, real spendable earnings were below year-ago levels."

Yet, dividend payments to stockholders, in the first three months of 1969, were 10% greater than in the same quarter of last year, 29% above 1965 and almost double 1960 rates. *The New York Times* of May 11, 1969, reported that "the average remuneration of top executives is up 9%." "Most top bankers," according to *Business Week* magazine, "drew more than $200,000 in 1968." And of course tax gimmicks reduce the income-tax rate on portions of such compensation of many top business officials.

Inflation and high interest rates have also not eroded the buying power of corporations.

Corporate profits are swollen. In the first quarter of 1969 the yearly rate of after-tax profits was up a remarkable 98.5% above 1960, a much faster increase than other major forms of income. What is more, the only inflationary demand-pressure in the economy in the first half of 1969 was sharply rising business investment in new plants and machines. And a 12½% increase in such investment outlays is anticipated in 1969, despite soaring interest rates and the fact that industry was operating at only 84% of its existing productive capacity.

Corporations with huge after-tax cash flows—due in large part to depreciation write-offs—have little need to borrow. And, when they do, they pay the "prime" interest rate and deduct the interest as a cost of doing business.

Because of this, we feel that the surtax rate on corporations should be at least twice as high as on individuals. There is no justification for raising the tax on individuals while maintaining the same 10% rate on corporations.

As long as these factors exist, asking those whose incomes are modest and whose tax shelters are nil to take the hardest bite of the deflationary bullet, in the name of fiscal responsibility, is economically shoddy and socially irresponsible.

The four months of hearings and closed-door deliberations of the House Ways and Means Committee, the promises of the Administration, and the statements made by prominent members of the Senate, including yourself, Mr. Chairman, have led the vast majority of Americans who pay their full tax share to expect justice and equity.

So, to repeat, our position is simply stated:

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Statement by the AFL-CIO Executive Council on the Surtax

President Nixon, on April 19, 1969, asked the Congress to extend the so-called temporary surtax beyond its June 30 termination date. His proposal would raise the effective surtax rate on 1969 wages and salaries of individuals to 10 percent—up from last year's 7.5 percent rate.

He proposes, however, that the surtax rate on corporations, despite their unprecedented, after-tax profits, be the same as last year's rate. High-income individuals would, of course, continue to avoid their share of the surtax since so much of their income is tax exempt.

American workers pay their regular taxes and the surtax, payday after payday, through the payroll withholding program.

They are willing to pay their fair share.

But they are tired of having to pay the share of others whose incomes are greater and whose taxes are lower.

We welcome President Nixon's recommendation for repeal of the 7 percent tax credit for business investment, a special tax privilege, which is fueling the fires of the major source of inflationary demand in the economy. But this one proposal does not satisfy the long overdue and critically urgent need for tax justice.

Furthermore the April 22, 1969, tax reform proposals offered by the Administration, even if adopted immediately, would not succeed in moving the tax structure very far toward tax justice. The President's proposals fail to directly attack the major loopholes which unconscionably reduce the tax burdens on the wealthy, such as capital gains, depletion allowances and state and local bond interest. And, equally important, though the President's tax proposals would effectively remove from the tax rolls those whose incomes are below government poverty standards, no relief is recommended for those of moderate and middle incomes, who bear the brunt of the tax burden.

We in the AFL-CIO will not support any extension of the surtax, until it is combined with immediate, substantial and equitable reform of the federal income tax structure.

Full reform of the tax structure would provide revenue to eliminate the poor from the federal income tax rolls and provide much-needed tax relief to those with low- and moderate-incomes. And the urgently needed expansion of federal programs to meet America's urban crises would be fully funded.

The AFL-CIO's prescription for complete tax justice in America has been stated many times. In sum, achievement of tax justice depends upon taking the following steps:

Income from capital must be taxed the same as income from work. State and local bond interest must not be tax exempt. The provisions in the law which allow imaginary costs to be deducted from the taxable income of wealthy real estate operators, hobby farmers, and oil, gas and other mineral operations must be eliminated.

The Congress must close these and other loopholes and gimmicks which have rigged the federal tax structure against those whose income comes from the work they do.

There is no rational reason for lengthy delays. The time to bring the American standard of fair play into the tax structure is now.

The American people want tax justice and we will continue to fight for that goal.

Mr. BIEMILLER. This is not a new position, Mr. Chairman.

On August 23, 1967, President Meany, testifying on the House side on the proposed surtax, said:

> We are fully in accord with the President's concept that a temporary war tax is needed. However, we are firmly opposed to the Administration's major recommendations of how to increase taxes.

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So, to repeat, our position is simply stated:

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Thank you for our appearance this morning.

Senator BENNETT (presiding). Do you have any questions?

Senator MILLER. Yes; I have a few.

Senator BENNETT. I would hope we could keep it moving along because it is 20 after 12.

Senator MILLER. Good morning, Mr. Biemiller.

Mr. BIEMILLER. Good morning, Senator.

Senator MILLER. You testified that this present bill is "being offered just at the time when the great majority of Americans have been led down a primrose path with promises of long overdue tax reform"?

It seems to me, I have been hearing tax reform around here for a long time, not just right now.

Mr. BIEMILLER. I will agree that there has been talk for a long time. There have been promises made ever since I can remember. But the point I am making is that at the beginning of this year there was ample evidence that there was an attempt, a serious attempt, going to be made to have tax reform legislation passed. Speeches have been made by prominent members of both parties, and certainly there was an implicit promise by the last administration that in this Congress there would be every effort made to achieve tax reform. That is the reason for the statement. I can assure you that if you go into any local union meeting or I think, for that matter, any meeting of any kind of citizens today, one of the chief topics of conversations is the need for tax reform.

Senator MILLER. I am sure of that. I would suggest this to you through that in my 9 years around here, this is the first year that I can recall when the President of the United States has come out and made a clear commitment and also followed it up by testimony regarding many, many tax reform proposals. Also, the House Ways and Means Committee chairman has made a commitment to have a package of tax reform proposals, and as far as I know many of the members of this committee have made a commitment for a package of tax reform proposals. With that I wonder why you are trying to tack all of these tax reform proposals on this one particular bill instead of being content to let this bill go through and then let the Ways and Means Committee send over its package and do a job on tax reform which might take several weeks, as you well know?

With those understandings, why wouldn't the AFL-CIO support that and especially in the face of all kinds of dire warnings by economists that the longer this 10-percent surcharge is delayed and the longer the repeal of the investment tax credit is delayed the greater the inflationary cycle, and the greater the problem that even your own members have with inflation and high interest rates.

Mr. BIEMILLER. In the first place, Senator, we have just, I hope, made it clear that we do not consider the surtax a fair tax as long as there is not tax reform accompanying it. This is not a new position. We argued this in 1967 and 1968. We did not support the 1968 bill that was passed, and I think this is a point that has to be considered.

Secondly, we are firmly of the opinion, for whatever it is worth, that this Congress will wind up with just one tax bill, and I think this is the object that we are after.

Now, I will be delighted if the Ways and Means Committee reports a good bill by about the 5th or 6th of August, which is their alleged target date. I will be very happy if this committee proceeds, as I understand you are about to, starting on the 21st of July, with some rather thorough hearings on the whole question of tax reform, I would assume those hearings would certainly run right up to the August 13

recess, which the Congress is planning on taking, that would mean that hopefully you would have then in front of you from the House two bills, in addition to your own proposals and would be able to send back to the House a good solid bill which has been thoroughly considered.

Now, as for the dire warnings, I said in the first place we don't agree that this is a fair tax in the form it is in, but in the second place certainly none of us offered any opposition to the temporary extension of tax withholding and you are accomplishing exactly the same purpose of holding the money out of circulation if there is validity to that argument, as you are by reimposing the tax itself.

Senator MILLER. I am sure you are a practical person and wouldn't it be more practical granted, for the sake of argument, that the tax base has inequities in it, to have that continue for another 6 months of this year if as a trade off you are going to have substantial tax reform in the tax base commencing January 1 of next year, which is what I understand is what all of this is about?

It seems to me what we are really talking about is opposition to continuing the present tax base which has been there for a long time for another few months to give Congress a chance to do a job on that tax base through substantial tax reform?

Mr. BIEMILLER. Mr. Goldfinger.

Mr. GOLDFINGER. Well, Senator Miller as Mr. Biemiller explained, we are convinced that the existing surtax, this surtax now, is an unjust and inequitable tax and that a reform of the structure is needed.

Senator MILLER. I suggest to you that that is what this substantial tax reform package that the Ways and Means Committee is considering right now is all about although it probably wouldn't take effect until January 1 of this year, so, for the sake of your position, why not be content to let that go for another few months so that we can get a job done on trying to do something about the inflation?

Mr. GOLDFINGER. Well, we would like to see a fair and equitable surtax bill as such, and, furthermore, we have heard promises of tax reform for many years before.

Senator MILLER. Well, I do not think you have ever had quite the same ball game you have now with the President of the United States making a commitment, with the chairman of the Ways and Means Committee making the commitment, and with the Ways and Means Committee well along on tax reform. At least in the last 9 years I have never seen that situation and I guess I deduce from your statements that you just do not trust that situation.

Mr. GOLDFINGER. We agree with you that things are moving and that there are, there have been, statements by the leaders of both parties.

Senator MILLER. Yes; but you still think there is only going to be one bill?

Mr. GOLDFINGER. Yes.

Senator MILLER. Yes; all right.

Now, can I ask, are you opposed to the minimum tax approach? I am not talking about any particular minimum tax approach but are you opposed to it?

Mr. BIEMILLER. No; we did not testify at this time on other proposals because we understood the committee wanted to at this set of hearings consider only H.R. 12290. We certainly are not opposed to the minimum tax concept and we recommended it in the very com-

prehensive testimony we gave before the House Ways and Means Committee, and when the hearings start here we will be back with a very far-reaching program which will include a minimum tax.

Senator MILLER. Well, I deduced from your testimony here that since you wanted to tax municipal bonds and you appear to be opposed to capital gains that this might imply this is what you really wanted to have done by way of tax reform as distinguished from a minimum tax approach.

Mr. BIEMILLER. Oh, we want to close every loophole that we possibly can and then impose a minimum tax to pick up whatever loopholes are not closed. We have made no bones about that in our testimony. I will be happy to leave with you a summary of our attitude if you would like to have it.

Senator MILLER. I would like to have it, but I want to make clear what your position is. You know the minimum tax approach is designed to catch capital gains, catch certain depletion allowances, and catch tax exempted bonds, at least, and see to it that some taxes are paid on it.

Now, as I understand, you want to do away with tax-exempt municipal bond interest, capital gains and percentage depletion, and if you do there is no need for a minimum tax.

Mr. BIEMILLER. There are many other loopholes that still have to be caught, and furthermore suppose the various depletion allowances are only cut in half, that still leaves some more money to pick up on a minimum tax, if you want a concrete example.

Senator MILLER. I thought maybe you were advocating the repeal of all of those.

Mr. BIEMILLER. We are, but we say we also note that there still will be loopholes and we want the minimum tax to catch the loopholes that still exist.

Senator MILLER. Suppose that there is no repeal or no diminution of tax-exempt municipal bond interest and no repeal or diminution of capital gains or percentage depletion, but there is a minimum tax approach. Would you favor the minimum tax approach under those circumstances?

Mr. BIEMILLER. Under those circumstances we would be more than interested in having the strongest possible minimum tax that you can put into operation.

Senator MILLER. Let me ask you one last question: What has been the position of the AFL-CIO over the last 8 years with respect to a reasonably balanced Federal budget or I might say what has been your position in opposition to substantial budget deficits incurred by the Federal Government?

Mr. GOLDFINGER. We view the budget as an economic tool and we view the budget in terms of the national economy and national trends. We do not believe the budget should be or need be balanced or in surplus in every specific year, because in years of slow economic growth and high unemployment there is a need for an additional stimulus from the budget.

However, we were concerned, very much concerned, with the very large deficit of about $25 billion a couple of years ago as a result of the acceleration of Vietnam military expenditures, at a period of high employment and rapid economic growth. We stated so in statements

to the Congress at that time, and we supported the idea of some degree of fiscal restraint.

However, as Mr. Biemiller explained in the statement a few minutes ago, we did not agree with President Johnson and his administration on the ways of achieving such fiscal restraint.

Senator MILLER. I know you were concerned, as many were, but did you have a publicly issued position in opposition to any of these budget deficits any particular year?

Mr. GOLDFINGER. We discussed that at some length, Senator, in Mr. Meany's statement to the Ways and Means Committee of the House on August 23, 1967, yes, sir. We pointed to the problem created by the large deficit at that specific time.

Senator MILLER. Was that the first time in the last 8 years that was done?

Mr. GOLDFINGER. I believe that is true, sir, because that was the first time, in our opinion, that there was an economic problem arising from the budget situation.

Senator MILLER. All right. Thank you very much.

Senator BENNETT. Mr. Biemiller, I have both read your statement and listened to it. I am interested in the figures on the bottom of page 4 and the top of page 5 in which you list the very high incomes of people who are not members of your organization. Would you submit for the record a comparison between 1960 and 1968 of the wage rates in the building trades industry?

Mr. GOLDFINGER. Sir, that is easy to do. The Bureau of Labor Statistics publishes those, and we will submit them if you wish.

Senator BENNETT. Yes; I would like them submitted to be a part of our record because you have gone over on the other side and made some comparisons and I believe the record should contain your submissions of these rates.

Mr. GOLDFINGER. Surely.

Senator BENNETT. Fine. I have no other questions. Thank you very much.

Mr. GOLDFINGER. Thank you.

Mr. BIEMILLER. Thank you.

(The following was subsequently received by the committee:)

AMERICAN FEDERATION OF LABOR
AND CONGRESS OF INDUSTRIAL ORGANIZATIONS,
Washington, D.C., July 16, 1969.

Senator RUSSELL LONG,
Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR CHAIRMAN LONG: The following material is being sent to you, for the record of the Committee hearings on the surtax, in response to a question about the wages of construction workers, posed by Senator Bennett, during the hearing on Friday, July 11.

The Labor Department's figures show that improvements in the wages of construction workers—as well as the wages of other major groups of non-supervisory workers—have been relatively slow during the long economic expansion of the 1960s. They have lagged far behind the skyrocketing rise of profits and dividends, for example, which increased almost twice as fast between 1960 and the early months of 1969.

You will note from the following Labor Department figures that average hourly earnings in contract construction rose at a yearly rate of about 4.6% between 1960 and May 1969—not much faster than the 4.1% average annual rate of advance in the hourly earnings of the entire group of 46.4 million non-supervisory

employees in private non-farm industries. These rates of increase in wages hardly represent tremendous advances in a period of rapid economic growth, rising living costs and soaring increases in profits and dividends.

The buying power of the after-tax weekly earnings of the average worker in contract construction in May 1969 was only 23% greater than in 1960. A gain in buying power of approximately 2% a year, in almost eight and one-half years of skyrocketing profits and dividends, is hardly substantial. Moreover, this gain in buying power is partly due to the rise in the average number of hours worked per week from 36.7 hours in 1960 to 37.4 in 1968 and 38 in May 1969.

In that same period of time, the buying power of the average non-supervisory worker in non-farm industries increased much more slowly—10.5%, or not much over 1% per year in the 1960s, which included the long-expansion of the American economy. This very small gain was slower than the buying-power advance for workers in contract construction because of a decline in average weekly hours of work, as well as a somewhat smaller average yearly increase in hourly earnings.

The following column for the week of June 2, 1969, by Msgr. George Higgins, Director of the Division of Urban Life of the U.S. Catholic Conference, deals with labor costs in residential construction. Msgr. Higgins indicates that non-labor costs, such as interest rates and land costs, have been the major factors in the rising price of housing.

Msgr. Higgins shows that the on-site labor cost is only about 20% of the price of the private home or apartment unit, as revealed by studies for the Kaiser Committee. Moreover, as Msgr. Higgins indicates since debt retirement (principal and interest) is 42% of the monthly rent of an elevator apartment—in the neighborhood of 50% of the monthly payments on a private residence—the on-site labor cost accounts for only about 10% of the monthly rent or payments on a house, including interest payments on the labor cost portion of the original price.

Sincerely yours,

NAT GOLDFINGER,
Director, Department of Research.

EARNINGS OF PRODUCTION OR NONSUPERVISORY WORKERS IN PRIVATE NONFARM INDUSTRIES, CONSTRUCTION, MANUFACTURING, WHOLESALE AND RETAIL TRADE

PRIVATE NONFARM INDUSTRIES

	Average hourly earnings	Gross weekly earnings	After-tax average weekly earnings, worker with 3 dependents: Current dollars	After-tax average weekly earnings, worker with 3 dependents: Constant 1957–59 dollars
May:				
1960	$2.09	$80.67	$72.96	$70.77
1968	2.85	107.73	95.28	78.61
1969	3.02	113.55	99.19	78.23
CONTRACT CONSTRUCTION				
May:				
1960	$3.08	$113.04	$99.15	$96.17
1968	4.38	163.81	139.42	115.03
1969	4.68	177.84	149.80	118.14
MANUFACTURING				
May:				
1960	$2.26	$89.72	$80.11	$77.70
1968	3.01	122.51	106.75	88.08
1969	3.17	129.34	111.30	87.78
WHOLESALE AND RETAIL TRADE				
May:				
1960	$1.71	$70.77	$65.14	$63.18
1968	2.40	86.40	78.49	64.76
1969	2.54	89.66	80.76	63.69

Source: Bureau of Labor Statistics, U.S Department of Labor.

The Yardstick

CATHOLIC TESTS OF A SOCIAL ORDER

(By Msgr. George G. Higgins, Director, Division of Urban Life, U.S.C.C.)

Housing Secretary George Romney recently stirred up a bit of a rumpus with an all-out attack on the alleged selfishness and/or shortsightedness of the so-called craft unions in the building industry. Stomping in rather awkwardly where angels and even Cabinet members normally fear to tread, he bluntly told a convention of several thousand business agents and other craft representatives that their organizations were largely responsible for the critical shortage of housing in this country. He accused them of gouging the public by demanding exorbitant wage rates and by saddling the building industry with all sorts of restrictive practices. He also charged that some of them are guilty of racial discrimination in their recruiting and apprenticeship programs.

I was disappointed, but not surprised, to learn that the convention delegates repeatedly booed the Secretary. There must be a better way than that for grown men to show their disagreement with an invited speaker who happens at the same time to be a member of the President's Cabinet. They could have sat on their hands, for example, and given him the silent treatment. On the other hand, I am afraid that the Secretary got just about the kind of reception he was asking for. It would appear from the record that he was deliberately baiting his audience. If so, he shouldn't have been the least bit surprised that they more or less instinctively responded in kind.

Neither the convention delegates nor the Secretary won any points, then, in terms of etiquette and public relations. But that's of relatively minor importance. The more important question is whether or not the Secretary's all-out criticism of the building trades was warranted by the facts. The New York Times and a number of other papers have answered this question with a resounding "yes." In other words, they share the Secretary's opinion that the craft unions in the building industry are largely responsible for the current housing crisis.

My own reading of the available facts leads me to conclude that they and the Secretary are badly mistaken. The building trades are admittedly open to criticism on a number of counts, but to leave the impression that they are chiefly responsible for the high cost of housing is to oversimplify a very complicated problem—and, incidentally, to do them a grave injustice.

The so-called Kaiser Committee Report, "A Decent Home," which was issued on December 11, 1968, discloses, for example, that the on-site labor cost amounts to 19% of the development and construction cost of the conventional single-family house and 22% of the cost of the elevator apartment unit. It is hard to escape the conclusion, therefore, that a one-sided emphasis on the labor-cost issue (a la Secretary Romney and The New York Times, for example) seriously distorts the nature of the current housing problem, which is actually a series of problems, largely involving land costs and money costs rather than the cost of on-site labor.

Moreover an exaggerated emphasis on improved technology—aimed at reducing the cost of on-site labor—can only lead to utterly false promises of vast reductions in the price of homes. If technological improvements were to reduce the cost of on-site labor from 19% and 22% to 15% and 18% (a substantial achievement, if it were actually to be attained in the brief period of time anticipated by Secretary Romney) the impact on the price of a home and on monthly payments or rents would hardly be more than minimal.

The latter point is very clearly indicated on page 119 of the Kaiser Committee report. The committee points out, for example, that roughtly 50% of the monthly occupancy cost is involved in debt retirement—payments of interest and on principal. For a unit in an elevator apartment house, the debt retirement is 42% of the monthly rent, while the on-site labor cost amounts to 22% of the original development and construction costs. Therefore the Kaiser Committee concludes that the on-site labor cost for such an apartment amounts to 9.2% of the monthly rent. Allowing for a small increase to account for architect's fees and other miscellaneous costs, the committee estimates that "approximately 10% of monthly rents are attributable to the costs of on-site labor." It follows, then, that a 20% cut in building trades wages—or a 20% cut in the cost of on-site labor through a substantial technological breakthrough—would permit merely a 2% reduction in rents. This would mean a reduction from $100 a month, for example, to $98 a month.

In the light of these and other findings of the Kaiser Committee—which findings, to the best of my knowledge, have not been successfully challenged—I am forced to conclude that Secretary Romney's criticism of the building trades was grossly exaggerated. This being the case, his stock in the labor movement is currently—and quite understandably—very low.

Personally, I am rather sorry about that, for on the basis of firsthand experience over a period of many years I have developed a certain degree of respect for the Secretary's savvy in the field of labor-management relations. In any event, he could probably make a comeback if he were to start all over again and propose that the President convene a so-called White House conference on building costs—a conference made up of all of the parties involved in the building industry, including contractors, unions, bankers, realtors, architects, and the manufacturers of building materials.

I doubt that such a conference would be able to come up with a panacea for the housing crisis, but I strongly suspect that it would buttress the Kaiser Committee's conclusion that "the cost of housing is made up of many bits and pieces" and that "any progress toward cost reduction must proceed through a broadbased approach which would probe for potential savings in every cost element." In every cost element—not merely in on-site labor costs. The New York Times, please copy. (NC Features).

Senator BENNETT. Mr. Charles Derr, senior vice president of the Machinery & Allied Products Institute.

STATEMENT OF CHARLES I. DERR, SENIOR VICE PRESIDENT, MACHINERY & ALLIED PRODUCTS INSTITUTE; ACCOMPANIED BY WILLIAM J. HEALEY, STAFF COUNSEL; AND A. B. VAN DER VOORT, STAFF ECONOMIST

Mr. DERR. Mr. Chairman, my name is Charles Derr, senior vice president of the Machinery & Allied Products Institute, a national organization of capital goods and allied industrial products manufacturers. At the table with me are staff counsel of the institute William J. Healey on my left; and on my right A. B. van der Voort, staff economist.

With your permission, I would ask that my formal statement be filed for the record and I will simply highlight my comments if that is agreeable with the Chair.

Senator BENNETT. That will be done, and we appreciate your self-control.

(Mr. Derr's prepared statement follows:)

STATEMENT OF THE MACHINERY & ALLIED PRODUCTS INSTITUTE, PRESENTED BY CHARLES I. DERR, SENIOR VICE PRESIDENT

My name is Charles I Derr. I am Senior Vice President of the Machinery and Allied Products Institute, a national organization of capital goods and allied industrial product manufacturers. My associates are William J. Healey, Jr., Staff Counsel of the Institute and A. B. van der Voort, Staff Economist. We appreciate this opportunity to present our views on the proposed repeal of the investment credit as embodied in H.R. 12290.

Our statement considers briefly the Administration's case for repeal, the nature and history of the investment tax credit, its importance to our economy, reiterates our firm support of the credit's permanency, and—if Congress should ultimately decide to repeal the credit—makes certain recommendations respecting the rules governing transition.

THE ADMINISTRATION'S CASE FOR REPEAL

In his message to Congress of April 21, President Nixon recommended repeal of the investment tax credit with the assertion that "This subsidy to business investment no longer has priority over other pressing national needs." To similar

effect—with one thought added—was the statment of Secretary Kennedy to the House Ways and Means Committee on May 20:

"Although elimination of the credit would help curtail the demand for business equipment—and thus relieve inflationary pressures—that is not the only reason for suggesting its removal. This subsidy to business investment ranks below other pressing national need. . . .

"Stated simply, the case for removal of the investment credit rests primarily upon the fact that the social needs and economic conditions of the 1970s will be greatly different from those of a decade ago."

This underlying purpose of the repeal recommendation was, of course, reaffirmed in Secretary Kennedy's testimony before this Committee.

Thus, the Administration's case rests primarily upon a choice of program priorities but with the suggestion that repeal has the added virtue of tending to moderate our present inflation. This anti-inflationary them has also, of course, been expressed by the Joint Economic Committee, by individual members of the Congress, by political and economic commentators, and is strongly emphasized in the report of the House Ways and Means Committee on H.R. 12290. In connection with its recommendation, the Administration not only reversed repeated governmental assurances that the investment tax credit was a permanent part of the federal tax structure but, in a remarkably speedy turnabout, disavowed prior assurances of the credit's permanency by leading figures in the present Administration.

The recommendation for repeal has been adopted by the House and now the final decision rests with this Committee and the Senate. The decision embraces a number of very important questions quite apart from the redirection of government funds and the suggestion that repeal will tend to lessen inflation. There are involved here such issues as our international competitive position and the defense of the dollar, the moderation of domestic inflation and the wherewithal to undertake and carry forward such governmental programs as those which are now said to necessitate repeal.

Before engaging these issues, however, let us review briefly the purpose, the nature, and the history of the investment credit.

THE INVESTMENT CREDIT IN RETROSPECT

As initially enacted upon President Kennedy's recommendation, the investment tax credit was clearly envisioned as a long-term proposition. This consideration was underlined in a 1961 statement of the Council of Economic Advisers before the Joint Economic Committee:[1]

"Measures to stimulate business investment directly will contribute to our recovery from the present recession, but that is not their main purpose. All who have confidence in the American economy must look ahead to the day when the slack will be taken up and high levels of output and employment will again be the rule. The full benefit of our decision to supplement increases in consumer demand now with a higher rate of capital expansion and modernization will then be realized."

The message was and is clear. The investment credit is vital to economic health because it provides an incentive to continued growth of the nation's productive capacity and to the modernization and replacement of existing productive equipment.

The nature of the credit.—Because there appears to be much misunderstanding about the nature of the credit, its scope, the limitations on its utilization and the character of its beneficiaries, a word or two concerning its mechanics may be in order. First, the investment credit is claimable only on the installation and placement in service of qualifying equipment. Secondly, it is not unlimited in amount. It is restricted to 7 percent at the maximum—with lesser amounts for certain types of equipment—and must be earned by actual capital investments. Beyond the percentage limitations, there is a ceiling of $25,000 plus 50 percent of the taxpayers tax liability in excess of that amount which may be taken in any one year subject to a limited carryover privilege. It does not apply to buildings or their structural components, a point of some considerable significance since the Administration has used data on capital investment which includes both plant and equipment. Expendables are, of course, ruled out and where a period of utilization of qualifying equipment does not satisfy the statutory

[1] "The American Economy in 1961; Problems and Policies," March 6, 1961, p. 49.

scheme, the credit theretofore claimed may be recaptured. In short, the investment credit has substantial impact but it is by no means an unlimited device.

As for beneficiaries, the credit is available to virtually every industry in the United States including, of course, the farmer. Has it accomplished its intended goal?

Performance equals promise.—There is no need to argue here the question of whether the investment credit has fostered growth in capital equipment. In fact, it is this very point which is employed by those wishing to repeal the credit as a principal basis for their argument. President Nixon, Secretary Kennedy, and other Administration spokesmen have repeatedly referred to the fact that $400 billion has been invested in plant and equipment since the early 1960s. What is more centrally at issue though is not the amount but the "instability of investment" that the credit is alleged to bring about.[1] We offer in evidence on this point two recent research studies by the Institute.[2] For the sake of brevity, we cite only a few pertinent passages at this point:

"A quick glance at [monthly orders, shipments, and backlogs in dollars, orders as a percentage of shipments, and backlogs in months' shipments for the period (1950–1968) for business capital equipment] discloses two distinct and remarkably different periods. In the first, which extends to late 1958, orders swung in major cycles alternately far above and far below shipments, producing in consequence two major swings in the backlog. In the decade since 1958, the orders-shipments relation has been much closer, with no clearly defined backlog cycle. Over this period, there have been in fact only two sustained intervals when orders exceeded shipments by more than 5 percent, and none when they fell short by that ratio.

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"The comparatively orderly behavior of equipment demand over the past decade, and the generally excellent response of suppliers, represent a remarkable and gratifying achievement.

* * * * *

"It is an interesting fact that the production of business capital equipment was more regular and stable over the decade than that of consumers' durable equipment."

There is of course no intention of attributing this remarkable record to the investment credit alone. There are additional reasons for the relative stabilization of the orders-shipments ratio such as the f[illegible] regular flow of orders over the past decade. We have no desire to ove[illegible]ate the ca[illegible]. Our point is that the charge that "[s]ubsequent events have more tha[illegible] justified our fears that the credit would '. . . accentuate the instability of investment . . ." is clearly at odds with the facts.

INFLATION AND THE INVESTMENT CREDIT

Against the background of this much too brief look at the purpose, the application and the record of the investment credit, let us now return to the Administration's case. We turn first to the lesser of the two central arguments—the suggestion that repeal of the investment credit will have an anti-inflationary effect.

The estimated increase in capital expenditures.—The peg from which this argument was first suspended was a Commerce-SEC estimate in March that capital spending would rise by 14 percent in 1969. Already, a later Commerce-SEC report on capital spending in 1969, released in early June, has reduced the estimate to 12½ percent and further reductions are widely anticipated, in large measure because of a probable reduction in available funds. Even if we assume that the adjusted figure of 12½ percent were to prove correct, one must bear in mind that this figure is not adjusted for changes in the price level which are bound to occur so that in real terms the figure would be much closer to 8 percent than 12½ percent. Moreover, this projected rise is to be compared with *actual* increases of 4 percent in 1968 and 2 percent in 1967, or no rise at all in real terms. Finally, since the revised estimate represents a scaling down of an

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[1] See, for example, the 1969 *Joint Economic Report*, p. 20.

[2] "A Remarkable Decade for Business Capital Equipment," *Capital Goods Review* No. 77, March 1969, MAPI; and "Comparative Variability of Producers' and Consumers' Fixed Capital Formation in the Postwar Period," *Capital Goods Review* No. 72, December 1967, MAPI.

earlier estimate and is itself subject to the probability of further reduction over the course of the year, one needs to bear in mind that this is only a forecast, an estimate, not a fact. And just how good is the estimate?

As to the performance of the Commerce-SEC survey over a relatively long period of time, let us quote briefly from a recent Institute survey:[1]

"When forecasting errors are related to the amount of change in the actuals (from base to reference quarters), they are in most cases relatively large. This is a point of major importance, for the principal use of anticipations data is to forecast the *change* in actuals. . . .

"Over the entire period, the average error of both anticipations approximated 50 percent of the average change, and even in the second half, when the performance was better, it was 41 percent for one and 49 percent for the other. Even in the latter period, the deviations exceeded 40 percent in 40 percent of the cases for first anticipations, and in 57 percent for seconds.

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"These observations are not in disparagement of the Commerce-SEC anticipations series, which are extremely valuable notwithstanding their failure to gauge accurately the amount or degree of change in the actuals. This test of performance is a brutal one to impose on any series, and few can meet it with credit, particularly when the changes are as small, relatively, as the quarterly movements involved here. Our intent is simply to caution against excessive reliance on the series for this purpose."

To assume, then, that the estimate will be realized is to indulge in a dubious assumption. In any event, we face economic problems which will yield to complete solution only with a high level of capital investment.

The lesson of suspension.—It will be recalled that Congress temporarily suspended the investment credit in 1966–67 on President Johnson's assurance that: "A temporary suspension of the investment credit will relieve excessive pressures on our capital goods producers and on our financial markets." The scheme did not work although this episode had the negative virtue of demonstrating the investment tax credit's unsuitability for use as an economic control device. The Institute documented this truth in *Capitol Goods Review* No. 67, published in September 1966, and entitled "The Investment Credit as an Economic Control Device."

There is no reason to believe that repeal will prove any more effective than suspension in realizing short-term, anti-inflationary goals. The lag in the impact of either suspension or repeal is so great as to frustrate any such expectation. Worse yet, that impact may very well be felt at exactly the wrong point in the business cycle; in fact, it was just such timing that prompted reinstatement of the credit in 1967. If the Administration is correct in assuming that economic conditions will have so moderated as to permit reduction of the 10-percent surcharge to 5 percent on January 1, 1970, then the delayed impact of credit repeal could have substantially adverse effects at just the wrong time and could contribute to a more serious turndown or even to a recession six to twelve months hence.

The central cause of current inflationary pressures.—Recently, the Institute published a new economic study in pamphlet form entitled "The Inflation Dilemma." Its central conclusion is germane to this discussion of inflation. The author of this work, MAPI Research Director George Terborgh, summarizes the well-documented findings as follows:

"A final comment on our present predicament. If we are right that the principal inflationary dynamic of the past few years has been rising labor costs, if exhortation has failed to restrain them, and if direct controls are out, only one effective remedy remains: relaxing the labor market. So long as we continue to have a drum-tight labor market in the major wage-determining category—adult males—the chance of slowing down the advance of hourly compensation, and with it the advance of prices, is thin."

The relentless rise of labor costs is directly related to the need for continuation of the investment tax credit. Consider the steep uptrend in the index of labor cost per unit of output in manufacturing. From a low of 98.6 in July 1965 (1957–59=100), the index has increased to 113.4 in May of this year.

Suppose we examine some other pertinent statistics. Since 1963 compensation per man-hour in the private sector has risen by about one-third according to

[1] "Forecasting Performance of the Quarterly Commerce-SEC Capital Expenditure Anticipations Series," *Capital Goods Review* No. 73, March 1969.

data of the U.S. Bureau of Labor Statistics. During the same period, prices of producers' durable equipment rose by only 10 percent as revealed by the Department of Commerce's Office of Business Economics in the *Survey of Current Business* for July 1967 and May 1969. In our present tight labor market and with labor costs escalating alarmingly, the continuing improvement of our industrial capacity by the introduction of cost-cutting productive equipment would seem to be our only hope. Yet, faced with this crisis—and no other word adequatley describes our present economic situation—we are told by the Administration that we should discourage this absolutely essential process by repealing the investment credit.

Let us conclude our look at inflation and the investment credit by reference to this excerpt from a commentary by Mr. John O'Riley in "The Outlook" column on the front page of the May 12, 1969, *Wall Street Journal*:

". . . Over the long pull, no force on earth has done more to hold down the prices of things people buy than has capital spending.

"This money goes for factory machinery. And machinery, substituting for human hands, is the thing that gives maximum production at minimum cost. New and better machines come out every day. The new must replace the old. If they didn't, the soaring cost of human labor would push the prices on manufactured products into the sky. This is readily demonstrable. Factory wages in this decade have risen more than three times as fast as producer prices on finished consumer products."

Once again, the moral seems clear. If we are to hold the price line—if we are to fight inflation effectively—we must continually enlarge and upgrade our productive plant. The investment credit is a well-tested method of achieving that goal. But the investment credit is more than simply an anti-inflationary tool. By providing an incentive to continued growth of our national productive capacity and to the modernization and replacement of existing equipment, the investment credit helps to ensure that our economy can:

1. Provide the goods necessary to meet its domestic needs—civilian and defense—and, in so doing, *combat* inflation.
2. Provide the additional jobs and equipment required by an expanding labor force.[1]
3. Contribute to closing the gap between wage levels and productivity by increasing productivity.
4. Meet the competition for world markets and thus contribute to the solution of our balance-of-payments problem.

This summary recital of what the investment tax credit can do for the total economy provides an appropriate introduction to our commentary on the Administration's second—and principal—argument in support of repeal.

THE CONTINUING NEED FOR INCENTIVES TO CAPITAL INVESTMENT

The Administration's case for repeal consists mainly of a suggestion for a trade-off:

"The revenues released by repeal of the credit can be used—beginning in fiscal year 1971—to help fund the Administration's forthcoming programs, including revenue-sharing with state and local governments and tax credits to encourage investment in poverty areas and hiring and training of the hardcore unemployed."[2]

Without arguing the merits of these or any other Administration programs to be funded with "revenues released" by repeal of the investment tax credti, a most important question needs to be raised. In its zeal to embark upon new programs, has the Administration forgotten thta such programs depend upon the health, vigor, and growth capacity of our economy which produces all revenues? A central fallacy in the Administration's position, in our opinion, is to be found in the implied suggestion that this is a fair trade-off, an exchange of equals. We would sacrifice a tested, powerful—and, in our judgment, indispensable—economic generator for programs as yet untried.

Before the Senate accepts the bargain thus proffered, it seems to us that a long, hard look is in order. A bit more history may be helpful in such an examination.

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[1] See "Labor Force Growth and Capital Formation," *Capital Goods Review* No. 61, March 1965, MAPI.

[2] Statement of Secretary Kennedy before the House Ways and Means Committee, May 20, 1969.

Depreciation and the investment credit.—Both the Kennedy administration and the Congress viewed the investment credit as one part of a two-pronged effort to improve and modernize the productive plant of the United States in order to make it more competitive domestically and internationally. Extensive evidence was submitted to Congress to demonstrate that with both parts of this two-ply effort, the United Sates was then at or close to parity with our international competitors. To now remove one element of this coordinated program of capital recovery devices would obviously have seriously adverse effects on our competitive position.

Administration witnesses have responded to interrogation on this point by generalized references to alternatives to the investment credit now said to be under consideration. One infers that one or a combination of such alternatives may be offered to the Congress or effectuated administratively in the coming months or years. Liberalized depreciation has been suggested and Secretary Kennedy has indicated that a comprehensive survey of depreciation is now underway within the Treasury. Reference has also been made to a value-added tax that could be rebated to exporters.

The fact is, of course, that depreciation needs to be liberalized, regardless of the decision on the investment tax credit. An important first step would be the rescission of the complex and administratively burdensome reserve-ratio test as a limitation on taxpayer use of the so-called "guideline lives" for plant and equipment. We are pleased to know of the Treasury's present comprehensive study of depreciation, but we are concerned that such a study—like similar studies in the past—could take a very long time to complete and implement. Considering this possibility in the light of the need for continuing encouragement of plant and equipment modernization, we suggest that this committee include in its report on the measure now before it a mandate to the Treasury to formulate no later than the end of 1969 a program, including any necessary legislative recommendations, for depreciation liberalization to achieve this objective.

The experience of other countries.—We have been discussing capital recovery devices now working in tandem—the investment tax credit and liberalized depreciation—which are designed to encourage a continuing high level of capital investment. Fulfillment of this need is inescapable if the economy is to prosper and grow. The essentiality of the investment credit in maintaining a position at least approaching parity with other industrial nations becomes even more evident when we consider the experience of other countries.

The *Wall Street Journal* of Tuesday, May 13, carried a most interesting feature story on the economic policies of Finland since devaluation. Finnish policy has included a very strong program and inducement for industrial modernization needed to spur exports. The reporter responsible for this article even referred to union leaders in Finland who argued "rather startlingly" that relatively high unemployment is the price that must be paid temporarily for industrial modernization needed to spur exports. The German experience is also relevant. *United Business Service*, April 7, 1969, concludes: "The real secret of German success lies in its ability to maintain a high rate of fixed investment in new plant and equipment."

Consider this quotation from a pamphlet entitled "The Investment Credit" published by the Boston Consulting Group: "The world's fastest growing economy, Japan, is deferring approximately one third of its potential consumption in order to invest in increased capacity and lower cost production facilities. The current standard of living could be about half again as high if the Japanese were willing to forego growth. Yet, the deferred consumption is being converted through investment into a steadily *increasing* standard of living and national product—at a rate of 11% per year *in real terms*."

Contrast these stories with the postwar history of the British economy as recounted in the April 18, 1969 issue of the letter of Rinfret Boston Associates to their clients:

"In many ways what is now happening in the United States today has been going on in the U.K. for about twenty years. They have been suffering from inflation and have had a perpetually fully employed economy.

"Every time that the British would run up against a fully employed economy and generate inflation there would be a monetary crisis. Immediately everyone would start to look for the sector that could be cut back or prevented from increasing.

"Government would always take the position that they could not possibly cut back because of the social requirements of the people. Accordingly the

Government would also take the position that no one could cut back consumption under the unwritten law that consumers are voters. It therefore came to be that capital investment would be curtailed or held back in order to fight inflation.

"The answer to inflation therefore was to hold down on capital investment. It would clearly work—for awhile. But once the economy started to move forward it would soon come to pass that the economy would run out of capacity and the problem would start all over again.

"At the present moment optimism is rising in the U.K. (see International Economics "The Lion Roars" dated March 13, 1969). The optimism is based upon the fact that capital investment is rising while consumption and government are being restrained. The investments of today are the productive ability of tomorrow."

An ironic footnote to this account of the British experience appeared in the May 16 issue of the *Wall Street Journal.* A front-page article attributes to British workmen—long accused of low productivity and an "I'm alright, Jack" attitude—the claim that British productivity is low because of outmoded equipment rather than because of the workers' habits.

From all this, one may fairly conclude that contrary to the Administration's assertion that there should be a change in national goals with a reallocation of resources away from stimulation of capital investment, we need an uninterrupted national program of plant modernization and, where capacity requirements call for it, expansion. This would seem to be the only way the United States can keep pace with the rest of the world.

Our international competitiveness.—The extremely serious international competitive position of the United States cannot be overstated. The international balance-of-payments deficit in the March quarter hit a 19-year high for a three-month period according to government data. Export projections by the Department of Commerce ("U.S. Foreign Trade—A Five-Year Outlook With Recommendations For Action," a publication referred to previously) indicate that the overall growth of U.S. exports from now until 1973 will fall considerably short of our balance-of-payments requirements. The fortuitous and temporary circumstances which produced a modestly favorable balance of payments in 1968 may not be depended upon to produce such a result in the current year, and this is conceded by Secretary Stans in his National Press Club speech on March 5, in which he predicted a very substantial 1969 balance-of-payments deficit.

Periodically, the Institute prepares for the capital goods sector of the economy statistics on imports as a percentage of exports in major capital equipment categories. Every category of equipment has shown a frightening growth in imports as compared to exports. Totaling those categories of equipment for which we maintain statistical records, the import-export ratio for machinery has moved from 15.9 percent in 1961 to 42.7 percent in 1968. More detailed statistics are, of course, available to the Committee or its staff.

This problem will not go away; indeed, it may well grow worse. The moral would seem to be that all national policies which bear favorably on our international competitive position should be strengthened, not weakened. Yet the Administration recommends repeal of the investment credit which supports cash flow for capital investment and which in turn is absolutely critical to offsetting labor cost increases and to improving our international competitive position as well as our domestic productivity.

At least one department of government appears to agree with our conclusions as they affect our foreign trade. A U.S. Department of Commerce study entitled "U.S. Foreign Trade—A Five-Year Outlook With Recommendations For Action," which was prepared by the Bureau of International Commerce, advances this suggestion at page 76:

"An increase in the U.S. investment tax credit to stimulate industrial modernization and greater U.S. competitiveness should be considered.

"Increasing the investment tax credit from 7 to perhaps 14 percent either for trade-sensitive industries or for all industries would provide a powerful added incentive to modernize manufacturing plants and could significantly increase U.S. competitiveness in international trade both on the import and export sides.

"Such a step, however, would have to be carefully weighed against the loss of U.S. tax revenue and other economic considerations and might be put forward

when tax reduction becomes possible. If, however, the U.S. trade balance continues to worsen, the proposal should be given urgent consideration."

IS A TAX CREDIT BAD PER SE?

One fundamental question remains for consideration. Whatever the merits of the investment tax credit, should any tax credit of this type be a part of our tax structure? Important members of Congress appear to feel that the existence of the investment tax credit establishes an unfortunate precedent for other tax credits designed to meet such desirable social goals as the elimination of pollution, the support of education, the financing of industrial training, etc. This is a central and overriding issue and it requires comment. Regardless of the success that this or future Congresses may have in removing special preferences from the Internal Revenue Code, we have long since passed the stage in our nation's history when tax policy can be insulated and sealed off from the realization of well-rationalized and high priority national goals. The encouragement of a high level of capital investment is such a goal.

To briefly recapitulate arguments already made, the United States is committed legislatively to a full employment policy which invites progressively increasing wage rates, and to an international trade policy based on free trade and the minimization of U.S. nontariff barriers. Within the framework of these broad national policies, the Congress and the Executive Branch must continually reassess what must be done to offset increasing costs of production in order to make and keep us competitive both domestically and internationally. It is our conviction that continuance of the investment credit in order to support and encourage a high level of capital investment is essential to our national welfare. If we do not encourage such a pattern of investment, then we may well not be able to afford those programs—and other similar programs—for which the Administration would now sacrifice the investment tax credit.

We reiterate our basic position of complete opposition to repeal of the investment credit or diminution of the credit in any way. In the event, however, that Congress should decide on repeal, we believe that there are some structural matters that should be given very careful consideration, and accordingly, we have set out below certain specific recommendations for the Committee's consideration.

SPECIFIC RECOMMENDATIONS

Effective date of the proposed repeal.—President Nixon recommended that the investment credit be denied on all orders for capital equipment placed after midnight, April 20, 1969. The House, in approving H.R. 12290, accepted the Ways and Means Committee's recommendation that the repeal should apply to orders placed after midnight, April 18, two days earlier. And we recognize that this Committee has already indicated its tentative concurrence with the House position. We assume that the primary reason for moving the credit repeal back two days was to penalize those who were presumed to have correctly anticipated the Administration's proposal for repeal of the credit before that proposal was actually made public by the President on Monday, April 21. It seems to us, assuming there is to be a repeal of the investment credit, that this is not the best way to deal with the timing problem. It may be that certain purchasers, acting upon rumor or pure hunch, were able to place orders during the weekend of April 19–20. But it seems equally possible that some may have so acted even prior to the weekend. On the other hand—and of much greater importance—most companies, and particularly many smaller ones, may have had no inkling of the Administration's proposal to repeal the investment credit until President Nixon's announcement on Monday, April 21. All these companies had heard prior to that time was that the Administration had no intention of urging a credit repeal. This, you will recall, was the sentiment voiced by Secretary Kennedy, Under Secretary Walker, and Presidential Counsellor Burns, among others, prior to April 21.

The process of capital budgeting eventuating in actual capital investment in the form of an order which meets the test of a contractual commitment is frequently drawn out over a considerable period of time. Alternatives are considered even after the basic investment decision is made. Negotiations take place on individual equipment orders, especially where large projects are involved. The Administration's recommendation, therefore, undoubtedly caught a number of companies either in midpassage in the investment decision-making process or on the verge of placing an actual contractual commitment, all of the capital budget planning and investment analysis having preceded this final event. It seems dis-

criminatory under these circumstances to draw such a sharp line as midnight, April 20, or midnight, April 18, for that matter.

We urge that a later effective date for the investment credit repeal be adopted. For example, the Committee might adopt June 30, the date on which the House passed the bill, or June 20, the date on which the Ways and Means Committee reported the bill to the House.

A gradual approach to repeal.—If it is the decision of the Congress to repeal the investment credit outright, then, as suggested above, we recommend that the date of cutoff be set forward in the manner and for the reasons already suggested. Alternatively, and preferably, we think there is merit in the concept of progressively reducing over time the availability of the investment credit once a decision has been made to repeal it. This could be done through a gradual reduction in the rate of the credit over the next few years. For example, the full 7-percent credit might be made available with respect to orders through the full taxable year 1969, with a reduction to 5 percent during 1970, 3 percent during 1971, 1 percent during 1972, and complete repeal to take place at the end of that year. Such a phase-out would substantially ease the impact of the credit repeal on investment decisions made during the balance of the current year and within the next few years. Moreover, it would have the merit of leaving the investment credit in some form on the statute books for the next few years. On the basis of past experience, we venture to predict that within that period of time both the Treasury and the Congress will have reason to turn to the investment credit again as a desirable investment-incentive tool.

The "binding contract" approach.—If the investment credit is to be repealed—regardless of whether it is an outright repeal or a gradual one such as we urge—the question of credit eligibility is going to depend on the date an order is placed or construction is begun. Under the House bill, the credit would not be available with respect to property otherwise eligible for the credit, if the physical construction, reconstruction, or erection of the property is begun after April 18, 1969, or if the property is acquired by the taxpayer after that date. However, this cutoff does not apply to the extent that the property was constructed, reconstructed, erected, or acquired pursuant to a contract which was, on April 18, 1969, and at all times thereafter, binding on the taxpayer. The House Ways and Means Committee report makes it clear that, generally speaking, the rules of Code Section 48(h)(3) relating to the "binding contract" concept in connection with the investment credit suspension in October 1966, would apply in this case.

This, we think, is desirable so far as it goes. However, we have some rather serious reservations on whether the crucial issue of the cutoff date for the credit on otherwise eligible equipment ought to rest solely on a "binding contract" basis.

We concede that to some extent the explanation included by the Ways and Means Committee in its reports on the 1966 "suspension" legislation helps to relieve the "binding contract" concept of some of its harshness. Nevertheless, there are a number of problems and special circumstances involved in the sale of capital equipment—and which may in the individual case not satisfy the "binding contract" rule in a legal sense—to which we urge that consideration be given by the Committee. Some of these problems are taken care of by the special transition rules, such as those relating to "equipped buildings," "plant facilities," and "machinery and equipment." There are other problems, however, which do not fall within the scope of these rules.

The real solution, it seems to us, is to depart from the narrow concept of a "binding contract." The entitlement of the taxpayer to the investment credit on projects in work or then pending on the basis of established plans should be made to turn not upon the existence of "binding contracts" but rather, to the degree practicable, upon the fact of either a *firm commitment* for goods or services existing on the cutoff date or an *economic commitment* by the taxpayer existing on that same date from which he could not thereafter withdraw without substantial injury to his position. An administrative precedent for the use of such a standard exists in Section 722(b)(4) of the Revenue Act of 1942 (the World War II Excess Profits Tax law).

If the Committee decides to retain the "binding contract" concept, it should lay down clear guidelines so that taxpayers would not be confronted with narrow and legalistic administration of this very difficult language. We also urge that the Committee make clear its intent that regulations concerning the repeal are to be written, and the administration of such regulations is to be conducted, in the spirit of equity and reasonableness.

Phase-out rule for credit repeal.—Under the House bill, in cases where the investment credit is available because eligible property is acquired or constructed before April 19, 1969, or is covered by a "binding contract," or one of the special transition rules, it must be placed in service by the end of 1970 to be eligible for the full 7-percent credit. If the property is placed in service after that time, the credit would be reduced 1/10 of 1 percentage point for each full calendar month after November 1970, and before the time the property is placed in service. The investment credit would be wholly denied for property placed in service in 1975 or in later years.

We are opposed to these provisions. If the full investment credit is to be available for an investment because the order was placed before April 19, 1969, or a commitment was made before that date that is covered under one of the special transition rules, the full investment credit should be available, regardless of when the property covered by the investment is actually placed in service.

Special transition rules.—We are pleased to note that the House bill includes most of the special transition rules which were approved by Congress in connection with the investment credit suspension in October 1966 and the adoption of which was recommended in the Institute's letter of May 23 to the House Ways and Means Committee. These rules, incorporated in the House bills over Treasury objections, include the "equipped building," "plant facilities," and "machinery or equipment" rules in substantially the same form as they were adopted in connection with the credit suspension. We favor these provisions of the House bill. We think, as we have indicated above, that it would be preferable to make the credit available for firm commitments and economic commitments in existence before April 19, 1969, as well as for binding contracts placed before that date. However, in the absence of broadening the "binding contract" concept in this manner, we think that the special transition rules serve a useful purpose and should be approved by the Committee.

There is one significant change, however, that we urge in the transition rules. Section 4(a) of the House bill would add a new Section 49(b)(6) to the Code which would extend the credit in certain situations where a binding contract or lease is in effect on April 18, 1969, obligating a lessee or lessor to construct or acquire machinery or equipment. This provision recognizes the fact that the lessor of property in many situations may not be the person who will construct or supply that property.

This provision is apparently based on Section 48(h)(8) of the Code which applied to certain lease and contract obligations in connection with the credit suspension. However, there is one important difference. Under the House bill, unlike the 1966 suspension provision, there is no coverage for a binding contract entered into before April 19, 1969, under which a party agrees to buy substantially all of the output to be produced by the other party from a property to be built in the future, for a substantial portion of that property's estimated useful life. The 1966 provision would, for example, extend the credit where a party is obligated under the terms of a contract to build an oxygen plant specified in the contract for the purpose of supplying oxygen for use in a steel company's oxygen furnace.[1]

We think that this coverage should also be available in connection with a credit repeal. For that reason, we urge that the following language, based substantially on the existing text of Code Section 48(h)(8), be added to the proposed Code Section 49(b)(6) in Section 4(a) of the bill:

> Where, pursuant to a binding contract in effect on April 18, 1969, (i) the taxpayer is required to construct, reconstruct, erect, or acquire property specified in the contract, to be used to produce one or more products, and (ii) the other party is required to take substantially all of the products to be produced over a substantial portion of the expected useful life of the property, then such property shall be treated as property which is not suspension period property.

We have presented these suggestions for overcoming transitional problems incident to repeal on the assumption that Congress may well repeal the investment tax credit. Nevertheless, we conclude by reiterating our firm support for the credit's permanency and our opposition to its repeal on any basis.

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[1] Senate Report No. 1724, 89th Congress, 2d Session, October 3, 1969, p. 34.

Mr. DERR. Thank you, sir.

I invite the attention of the chairman and Senator Miller to the summary of our statement which appears on the face sheet. I would like to comment briefly on each of those points.

Point No. 1, the investment credit was conceived and enacted on the recommendation of President Kennedy as a permanent incentive to capital spending deemed necessary for the continuing growth and vigor of our economy.

I think there can be no question that the original proponents of this bill intended that it be permanent. Moreover that was reaffirmed by leading spokesmen of both the prior administrations and in fact by leading spokesmen of the present administration before the turnabout on April 21 when the administration recommended repeal.

The administration's case really consists of two points: One the necessity for reordering program priorities that can be redirected to other programs.

Secondly, and rather equivocally, the anti-inflation argument which, of course, has been strongly emphasized in the House Ways and Means Committee report.

Point No. 2, the investment credit has met its objectives and, because there is a substantial and continuing need for a high level of capital investment, it should not be preempted by other national goals.

There can be no question that credit has done the job for which it was designed and, in fact, those who now recommend its repeal would say it has worked too well.

As a matter of fact, the members of this committee will remember there was a two-pronged effort propounded by the Kennedy administration involving on the one hand, the investment credit and on the other hand liberalization of the depreciation in the form of guidelines intended to put the United States at or near parity with our international competitors. Now we proposed to remove one of the two horses from that team.

We believe very strongly that there is need for some alternative to the investment credit. We understand that the Treasury Department has now underway a comprehensive reexamination of depreciation but we believe this committee and the Congress ought to call upon the Treasury to present an alternative to replace the investment credit probably in the form of liberalized depreciation no later than the end of 1969.

Point No. 3, the repeal of the investment credit would have little or no effect on inflation in the short run, and its impact might in fact crest at precisely the wrong moment in the economic cycle. In the longer run, capital investment—which the investment credit encourages—is one of the most effective counterweights to continuing price inflation.

In the short run it certainly is true in the fight against inflation that the repeal of the credit would have little or no immediate effect because, as you gentlemen understand there is a lag in its effect. You cannot claim the credit until the capital goods are installed. As a matter of fact, as I said before, it might impact at just the wrong time. The administration has indicated that economic forces now at work will bring us to such a point that by the first of January we can reduce the

surtax to 5 percent. If that turnaround occurs, as this would seem to imply, then it might well be that 9 or 10 or 12 months out when the impact of the investment credit repeal is felt would be precisely the wrong time. We had a bad experience with it at the time of suspension which is documented in my full statement.

Over the long run, capital spending is anti-inflationary, as I believe you recognize, because it decreases costs by improving production methods, and enlarges the supply of goods by increasing capacity.

One of the real sources of inflation that was not mentioned prominently here this morning is rising labor costs. Since 1963, compensation per man-hour in the private sector of our economy has risen by about one-third according to statistics of the Bureau of Labor Statistics, and during this same period prices of producers durable equipment rose by only 10 percent or less than a third according to the U.S. Department of Commerce's Office of Business Economics.

Given this disparity the introduction of cost-cutting machinery would seem to us to be our only hope of controlling inflation.

Recently the Institute published a book entitled "The Inflationary Dilemma" which is an examination of the distasteful and inescapable trade-off between unemployment on the one hand, and inflation on the other.

Given our national commitment to a full employment policy, and the certainty, in my judgment, there will be no diminution of this dilemma, it will continue to stay with us, again it would seem to us that a high rate of capital investment such as is encouraged by the investment credit, is very necessary if we are to control inflation in the future.

Point No. 4, foreign experience suggests the necessity for a high level of capital spending as a prerequisite to economic growth and health. Repeal of the investment tax credit would remove an important incentive for installation of cost-cutting productive equipment and thus tend to further endanger an already precarious competitive position both at home and abroad.

Our discouraging trade balance grows worse. The Institute has for years maintained statistics on the ratio of imports to exports; that is, imports expressed as a percentage of exports. We find in the machinery categories with which we are concerned that the import-export ratio has risen from 15.9 percent in 1961 to 42.7 percent in 1969. The difficulty is that our exports have not kept pace with rising imports.

The Department of Commerce's export projections indicate that the growth of U.S. exports through 1973 will fall rather considerably short of what is required for our balance of payments.

If we are to maintain and hopefully to improve our international competitive position we must achieve and maintain the most efficient and productive industrial plant possible. This means continuous renewal and modernization which, in our judgment, requires continuance of the investment credit.

We do not believe you can simply say, as the administration does, that there have been $400 billion invested in capital equipment since the investment credit was adopted or as the House Ways and Means Committee said that the credit has outlived its usefulness. The fact is that modern technology is so dynamic, it is so relentless in its swift advance that we dare not rest on our oars and assume that the inter-

national competitive race is over. It never ends and the stakes are very high.

So we believe that the investments tax credit should be retained as a permanent feature of our tax program.

We have a number of technical suggestions to make with reference to the bill now before the committee. I renew my suggestion that we believe it should be continued, but in the interest of conserving the committee's time I will not take time to deal with those suggestions but rather throw myself open to any questions you may have.

Senator BENNETT. Any questions, Senator Miller?

Senator MILLER. Thank you.

Since 1964 our favorable trade balance has taken a very sharp downturn. As I recall it was about $7 billion in 1964. It is down to a deficit the last year.

Mr. DERR. Yes.

Senator MILLER. I believe you are in substantial agreement on that?

Mr. DERR. Substantially.

Senator MILLER. During that period of time we have the investment tax credit which enabled people to improve the efficiency of their plants and still with that the trade balance went down, so apparently that did not work.

Mr. DERR. I suppose the proper answer to that is, Senator, that without the investment credit it might be worse.

Senator MILLER. We do not know whether it would have been worse or not but we know a favorable trade balance of $7 billion has gone out the window in the past few years.

Mr. DERR. Unquestionably it did, and if I may lead you back to a point I made in my oral remarks, I suggested that probably the most significant factor in the inflationary push is labor costs, and Senator Bennett made reference just a few minutes ago to the rise in labor costs in certain elements of our economy.

Senator MILLER. What has been the foundation for the increase in labor costs, do you suppose generally?

Mr. DERR. Well, I think, probably—I am not an economist and perhaps I should not essay an answer but I will attempt to, Senator—I think the root problem is our national commitment to a full-employment policy. It becomes the burden of the U.S. Government by fiscal and monetary and other means to insure that we are as nearly as possible fully employed. This leads us back to the inflationary dilemma to which I referred a moment ago. The lower the unemployment, the higher the rate of inflation. It seems to be inevitable. It is well documented in this country.

Senator MILLER. Mr. Derr, I am sorry you say it seems to be inevitable because we have a national commitment for a stable dollar, too.

Mr. DERR. Precisely. They are in uneven and uneasy contradiction to each other, I am afraid.

Senator MILLER. We have had testimony from spokesmen of this administration that there is no reason why they both cannot be attained. I do not know why you say it is inevitable they cannot be attained. When Congress passed the Employment Act of 1946 they said both are there, and let's get going, and the Congress did not say it is inevitable that you cannot attain both of them at all.

Mr. DERR. Well——

Senator MILLER. The point I want to make is—I will grant you wage increases have had a lot to do with this—but why are they going up? Aren't they going up because of inflation? And you will find inflation, it may have dipped in other nations, but still comparing inflation rates between the United States and our overseas competitors, you will find that they may have a higher rate of inflation over there than we have had up until this year.

Mr. DERR. Until the past 2 years, I believe.

Senator MILLER. But even though going back to 1965, 1966, or 1967 when they had, most of them had, lower rates than we did because we had a high-wage base and they had a low one, and they could decrease their inflation and we slipped behind in competitive rates. So it seems to me the number one thing we have to zero in on is doing something about inflation.

Now, if that is so and if in order to do a job on that we have to do something about coming out with a reasonably balanced budget, and if by not repealing the investment tax credit we won't, what do you advocate that we do by way of taxation to fill the void?

Mr. DERR. First of all, so far as the surtax is concerned, although we are not here to testify on it, I certainly would have to support its continuation, Senator; there is no question about that.

Senator MILLER. Yes, but you see one reason why it goes down to 5 percent beginning next year is because the investment tax credit repeal is part of the package.

Mr. DERR. Well——

Senator MILLER. If we don't repeal the investment tax credit we are going to have a void there and what do you advocate?

Mr. DERR. I would advocate, Senator, a very, very rigid pruning of the budget. I think that attempts are already being made in that direction and Congress did a splendid job last year, but it seems to me still more could and should be done.

Senator MILLER. Let's say we prune the budget but we will need more revenue. Are you going to have a 12-percent surcharge?

Mr. DERR. I am sorry, sir.

Senator MILLER. I say we prune the budget but we still need more revenue in order to avoid a deficit. Are you going to have a 12-percent surcharge?

Mr. DERR. Well, I simply have to leave that question to people who have the figures at their fingertips.

Senator MILLER. You advocate filling the gap though to make sure we balance out on revenue and expenditures?

Mr. DERR. As nearly as possible. Unquestionably, one of the great causes of inflation is the continuous deficiteering of the Federal Government.

Senator MILLER. Thank you.

Senator BENNETT. Thank you very much, Mr. Derr.

Mr. DERR. Thank you.

Senator BENNETT. Mr. Peter Nevitt, senior vice president GATX-Armco-Boothe.

Mr. Nevitt, I find you and I are alone.

Mr. NEVITT. Yes, sir.

Senator BENNETT. You remember the old story of the man who took a load of hay to feed his cattle and then when only one cow showed up somebody said to him well, you don't dump the whole load, do you? Do you have a statement?

STATEMENT OF PETER K. NEVITT, SENIOR VICE PRESIDENT, GATX-ARMCO-BOOTHE, ACCOMPANIED BY LEONARD L. SILVERSTEIN, SPECIAL TAX COUNSEL

Mr. NEVITT. Yes, sir; I have a statement, and in the interest of time, the hour is late, I have submitted the statement and I will make my remarks rather brief and summarize the statement.

Senator BENNETT. Yes. It will be put in full in the record.

Mr. NEVITT. Thank you.

My name is Peter K. Nevitt. I appear before you today in my capacity as senior vice president of GATX Armco-Boothe, to testify with respect to certain provisions contained in H.R. 12290 relating to the proposed suspension of the investment credit. I am accompanied by Leonard L. Silverstein, special tax counsel.

GATX-Armco-Boothe is a partnership located in San Francisco, Calif., which is engaged in the purchase and lease of aircraft and other major transportation equipment to airlines and other users. GATX-Armco-Boothe arranges for the lease of such equipment as a method of financing the acquisition thereof in situations where the airline or other user is unable to obtain the necessary financing to make the acquisition directly.

There are two points that I wish to address to the attention of the committee. First, we urge that the committee retain the so-called binding contract rule and the other transitional rules, particularly the rule for certain leaseback transactions as proposed in section 49(b)(5) of the Internal Revenue Code as provided in section 4(a) of H.R. 12290 as passed by the House.

Further, we would like to especially draw to the attention of the committee that we urge the elimination of the proposed section 4(d) of H.R. 12240 to phase out the investment tax credit for property placed in service after December 31, 1970. We believe that the phaseout rule is discriminatory in nature as the airline industry and other industries where property requiring a long leadtime for manufacture is involved.

We believe that the phaseout rule is inequitable and inconsistent with the reasons underlying the desirability of adoption of the various transitional rules, including that covering the leaseback transactions proposed in section 49(b)(5).

Senator BENNETT. Do you suggest the elimination of that section rather than modification?

Mr. NEVITT. Yes, the elimination of the section, sir.

Senator BENNETT. That is fine. Thank you very much. Your full statement will be in the record of the hearings, and we appreciate your coming.

Mr. NEVITT. Thank you very much, sir.

(Mr. Nevitt's prepared statement follows:)

PREPARED STATEMENT OF PETER K. NEVITT, SENIOR VICE PRESIDENT GATX-ARMCO-BOOTHE

My name is Peter K. Nevitt. I appear before you today in my capacity as Senior Vice President of GATX-Armco-Boothe, to testify with respect to certain provisions contained in H.R. 12290 relating to the proposed suspension of the investment credit. I am accompanied by Leonard L. Silverstein, Special Tax Counsel.

GATX-Armco-Boothe is a partnership located in San Francisco, California, which is engaged in the purchase and lease of aircraft and other major transportation equipment to airlines and other users. GATX-Armco-Boothe arranges for the lease of such equipment as a method of financing the acquisition thereof in situations where the airline or other user is unable to obtain the necessary financing to make the acquisition directly.

The provisions of H.R. 12290 of specific interest to GATX-Armco-Boothe are the following:

1. *Transitional Rule for Certain Leaseback Transactions.*—(Proposed section 49(b)(5) of the Code as provided in section 4(a) of the Bill.)

I urge that this Committee retain the rule proposed as section 49(b)(5) of the Internal Revenue Code provided in section 4(a) of H.R. 12290 as passed by the House. Under this provision, where a person who is a party to a binding contract transfers rights in such contract (or in the property to which such contract relates) to another person but a party to such contract retains a right to use the property under a lease with such other person, then to the extent of the transferred rights such other person shall succeed to the position of the transferor with respect to such binding contract and such property. The application of such rule would permit GATX-Armco-Boothe as a lessor to claim the investment credit with respect to property leased after April 18, 1969, where the lessee was obligated to purchase such property under a contract for the construction of such property which was binding on the lessee on April 18, 1969, and at all times thereafter. This rule would apply only if a party to the contract retains the right to use the property under a lease for the term of at least one year.

The desirability of permitting the investment credit to be claimed by the lessor in the above lease-financing situation where a binding contract was in existence between the aircraft manufacturer and the airline before April 19, 1969, is based on two grounds. First, it is desirable on the grounds of equity. In this situation, the airline would, by reason of the existence of a binding contract on the effective date of the repeal, qualify for the investment credit if it were able to arrange financing for the purchase of the airplane directly. Since, upon the exercise of sound business judgment, the airline later determines that it is unable to secure the financing necessary to purchase the airplane but instead agrees to lease it in the manner described above in order to secure the long-term use thereof, the lesser should succeed to the position of the transferor airline with respect to the binding contract to acquire the airplane.

That such rule is justified is indicated clearly by its adoption as section 48(h)(7) upon the enactment of P.L. 89-800 which suspended the investment credit in 1966. The important factor, as indicated in the legislative history of the suspension, is that in such cases, "the person entering into the purchase contract [here the airline] initially is committed to purchase the article." It is clearly inequitable to preclude the user of such airplane, which is initially obligated to purchase the airplane from the manufacturer prior to the effective date of the repeal of the investment credit, to transfer less than its full rights in such contract to a lessor at any time prior to the date the airplane is placed in service or use.

The second reason for adoption of such rule is the adverse effect which the denial of the investment credit in such situation would have on the economy. The airlines may be required to cancel, at the cost of forfeiture of progress payments made with respect thereto, the contract for the purchase of such needed aircraft in view of the inability to arrange the necessary bank financing. Without the availability of the investment credit, the above-described lease financing would no longer be available to permit the airlines to acquire the aircraft. The acquisition of new aircraft is necessary in order for the airline industry to keep pace with technological development and meet the demands of its passengers. The denial of the investment credit in such situation would thus have an inflationary effect by causing an increase in the costs to passengers for utilizing obsolete airplanes as a method of commercial transportation.

2. *Rate of Credit Where Property is Placed in Service After 1970.*—(Proposed section 49(d) of the Code as provided in section 4(a) of the Bill.)

I urge that this Committee reject the proposed section 49(d) of the Code as provided in section 4(a) of the Bill as passed by the House to phase-out the investment credit otherwise available where the property is placed in service after 1970. Proposed section 49(d) as passed by the House provides that the investment credit otherwise available in the case of property placed in service after 1970 [generally because the property qualified under the binding contract or other transitional rules proposed in the Bill] is to be reduced by one-tenth of one percentage point for each full calendar month after November, 1970, and before the time when the property is placed in service. The Report of the House Ways and Means Committee provides, as an illustration of the application of this rule, that in the case of property placed in service in October, 1971, a 6 percent credit [rather than the full 7 percent] would be allowable since there are ten full calendar months between November, 1970, and October, 1971. No credit would be allowable under this provision for property placed in service after 1974.

It is submitted that enactment of the proposed phase-out of the investment credit would substantially negate the effect of adoption of the binding contract and all other transitional rules where property requiring a substantial period of time for manufacture or construction is involved.

As I previously indicated, adoption of the transitional rule to cover leaseback transactions is based both upon the ground of equity and upon the adverse effect which a denial of the investment credit in the situation involving the leaseback of aircraft to airlines would have on the economy. It is completely contrary to the reasons underlying such transitional rule to provide the lessor with the opportunity to claim the investment credit otherwise available to the airline on the one hand and then deny all or a substantial portion thereof to such lessor solely by reason of the fact that the property in question requires a long lead time for manufacture. If it is desirable, as a matter of equity, to permit the user of the airplane, which is initially obligated to purchase the airplane from the manufacturer prior to the effective date of the repeal of the investment credit, to transfer its full rights in such contract, including the investment credit with respect thereto, to a lessor at any time prior to the date the airplane is placed in service or use, then it is clearly inequitable to deny the credit in whole or part to the lessor solely by virtue of the fact that the manufacture of such aircraft cannot be completed and the property placed in service until after 1970. Indeed, the enactment of such provision would clearly be discriminatory against the airline and other industries in which the product in question requires a long lead time for manufacture.

The Report of the House Ways and Means Committee indicates that the reason for the proposed phase-out of the credit was to

"* * * reduce the inequity that arises between taxpayers because different lead-times for the needed equipment determined whether a firm had signed a binding contract before April 19, 1969. For example, even though two manufacturers planned to place machinery in service on the same date, one of them would have entered into a binding contract before April 19, 1969, simply because construction of the machinery required that an order be placed 2 years before use was planned as compared with 6 months for the other manufacturer * * *"[1]

It is submitted, however, that the above-described reasoning underlying the proposed phase-out in fact would result in *reverse* discrimination where the property by its nature requires a long lead time for the manufacture or construction thereof. In the leaseback situation under consideration, the airline placed an order with a manufacturer for the construction of an aircraft well before April 19, 1969, for reasons motivated solely by the projection of its business needs for such aircraft. The placing of such order was wholly unrelated to the availability of the investment credit to the airline but was instead based upon the necessity for such airline to keep pace with technological development and meet the demands of its passengers. It is clearly discriminatory to penalize the airline (and the lessor) solely because the airplane takes a long time to construct and the 1971 needs of the airline required that the order therefor be placed in early 1969. The enactment of such rule, intended to prevent discrimination against the user of a product requiring a short lead time for manufacture or construction, would in fact have quite the opposite effect of discriminating against a user of property which requires a long lead time for manufacture or construction.

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[1] H. Rept. 91-321, at p. 14.

I therefore urge that elimination of the proposed section 49(d) to phase-out the investment credit for property placed in service after December 31, 1970, which is discriminatory in nature as to the airline and other industries with property requiring long lead times for manufacture, as being inequitable and inconsistent with the reasons underlying the desirability of adoption of the various transitional rules, including that covering the leaseback transactions proposed in section 49(b)(5) which I have previously discussed.

I appreciate this opportunity to express my views to the Committee.

Senator BENNETT. Our last witness is Mr. Roscoe L. Egger, Jr., representing the U.S. Chamber of Commerce.

STATEMENT OF ROSCOE L. EGGER, JR., TAXATION COMMITTEE OF THE CHAMBER OF COMMERCE OF THE UNITED STATES; ACCOMPANIED BY ROBERT R. STATHAM, TAXATION AND FINANCE MANAGER OF THE NATIONAL CHAMBER, AND DR. CARL MADDEN, CHIEF ECONOMIST OF THE CHAMBER

Mr. EGGER. My name is Roscoe L. Egger, Jr. I am a member of the taxation committee of the Chamber of Commerce of the United States. I am also a partner in the accounting firm of Price Waterhouse & Co.

I am accompanied by Robert R. Statham, taxation and finance manager of the national chamber, and Dr. Carl Madden, chief economist of the chamber.

Mr. Chairman, the national chamber appreciates this opportunity to express its views on H.R. 12290, which would extend the income tax surcharge and repeal the investment tax credit.

In summary, the position of the national chamber is as follows:

(1) The chamber supports the continuation of the income tax surcharge at a 10-percent rate through the calendar year 1969 and 5 percent through June 1970, at which time the surcharge should be terminated.

(2) The chamber urges continued efforts to control inflationary pressures through the achievement of a substantial Federal budget surplus in fiscal year 1970. First emphasis should be placed on the further reduction of Federal expenditures to a level significantly below the present budgeted figure.

(3) The chamber supports the elimination of the investment tax credit, provided—

> (*a*) Fair transitional rules are adopted to assure equitable treatment for all taxpayers economically committed to expansion and modernization programs; and
>
> (*b*) There is a firm commitment now on the part of both the executive branch and the Congress to a tax structure, which through more liberal depreciation provisions and reduced taxes on business income, will insure the continued modernization of American industry, and enable us to compete more effectively in world markets.

It is the view of the national chamber that the income tax surcharge should be extended at a 10-percent rate through the calendar year 1969, and 5 percent through June 1970, at which time the surcharge should be terminated. In addition, the chamber strongly urges that additional efforts be made to control inflationary pressures by the achievement of a substantial Federal budget surplus in fiscal year

1970. Endeavors should be made to attain a further reduction in Federal expenditures to a level significantly below the present budgeted figure.

Everyone abhors high taxes and it is not easy to ask for an extension of this tax burden. However, the worst tax of all is inflation. Inflation may strip away 6 cents from every dollar earned and saved this year. Unless we bring under control the current surge of rampant inflation, the taxpayers of this country will surely lose far more through increased prices, higher interest rates, reduction in the value of savings, and the many other ill effects of inflation than is being extracted by the 10-percent surcharge. If we do not use the avenue of tighter fiscal controls by Government, we will have to rely on more monetary controls by the Federal Reserve. The latter course will result in tighter money, higher interest rates that restrict business activity, critical new problems for the construction industry, reduced employment, and many other economic and social difficulties.

The national chamber is in favor of coordinated and complementary economic policies which include the extension of the surcharge, vigorous efforts to control Federal spending, and appropriate monetary restraint. All of these courses are needed to combat inflation. At this crucial time both fiscal and monetary policies are restrictive to remove the steam from our overheated economy. It is imperative that these restrictive policies not be relaxed on either front—fiscal or monetary—until the powerful inflationary psychology built into the economy has been dissipated.

The real growth rate of the economy has slowed from an unsustainably high 6-plus percent in the second quarter of last year to 2.9 percent in the first quarter of this year. Moreover, some economic indicators are either growing more slowly or actually declining. These include industrial production, disposable income, retail sales, housing starts, and stock prices.

The current tight money policy is exerting more intense pressures on commercial banks than they felt in the "credit crunch" of 1966. Their net borrowed reserves from the Federal Reserve have climbed to a record $1.3 billion compared to the peak of about $600 million in 1966. Interest rates have risen to 60-year highs in many instances. The current month will be a critical one for savings institutions which may suffer a stepped-up outflow of funds as depositors seek higher interest rates.

Consumer prices have been rising at annual rates well above last year's 4.2-percent pace. Braking the price rise will be a slow process, due in part to accelerating wage demands. The collective bargaining schedule for the next 18 months is heavy. Contracts will come up for renewal covering almost 7 million workers in key industries—1 million in the second half of this year and 5.8 million in 1970. The 1970 schedule includes the teamsters, railroads, autos, rubber, farm machinery, aerospace, communications, garment workers, and meat packers. Recent agreements suggest the demands to come—maritime workers have won a 3-year contract providing for average annual increases of close to 11 percent; some cement workers will receive about a 12-percent increase annually over a 2-year period.

Progress is being made in the fight against inflation, as is indicated by the slowdown in real growth of the economy. But inflationary pres-

sures are still strong. It would be a tragic mistake for the Congress not to extend the surtax in view of these pressures—a mistake comparable to that of the Federal Reserve when it eased credit following passage of the surtax in mid-1968. Failure to extend the surtax would force the Federal Reserve to invoke an even tighter credit policy than is now in effect. This could force the construction industry and, ultimately, the whole economy into a sharp recession with its attendant rise in unemployment, especially among the poor.

The latest estimates indicate receipts for the current fiscal year will be $199.2 billion and that outlays will be $192.9 billion. The result will be a surplus of $6.3 billion. Much now depends on what action the Congress takes in this regard. It must be clearly understood that the surcharge is not a substitute for needed expenditure reduction. A rigid spending discipline is essential to the maintenance of public confidence in the integrity and responsibility of our fiscal system. For ths reason, the national chamber urges that primary emphasis be placed on the further reduction of Federal expenditures to a level significantly below the present budget figure.

We do not believe this request for additional spending reductions is unreasonable. If the situation is as serious as the administration and those in Congress contend, and we believe that it is, then meaningful reductions in spending should be made in conjunction with the extension of the surcharge.

The efforts of those in the executive and legislative branches of the Federal Government who have made it possible to anticipate a $6.3 billion surplus in the current fiscal year are commendable. The chamber urges continued efforts for the achievement of a substantial Federal surplus in fiscal year 1970. Early announcements of additional efforts to be taken in this regard would help reduce the inflationary psychology. Assurances there will be this additional spending restraint and resulting increase in the anticipated surplus would assist materially in meeting the current crisis.

What is being proposed in H.R. 12290 by way of tax burdens on business and American taxpayers generally results in a substantial sacrifice for many, even in an era of prosperity. The taxpayer who makes this sacrifice should have the assurance that efforts are being made by those in the Government sector of the economy to reduce spending, and that the revenues from that sacrifice are not being used for additional spending.

The national chamber has repeatedly urged meaningful depreciation reforms and reduced taxes on business income to insure the continued modernization of American industry, and to enable us to compete more effectively in world markets. The chamber will support the elimination of the investment tax credit if there is a firm commitment on the part of the executive branch and the Congress for more liberal depreciation and reduced taxes on business income, and if fair transitional rules are adopted. However, absent such a commitment, the national chamber cannot support the elimination of the credit.

The position taken here in consistent with the views expressed by the chamber since the credit was proposed in 1961. In testimony on the suspension before the House Ways and Means Committee in September 1966, the chamber detailed the history of its position on the credit:

When the credit was first proposed in 1961, it was a complicated, unworkable proposal which was presented as a substitute for the much-needed and long overdue depreciation reform that the chamber had been urging on the Treasury and the Congress for many years. It was also quite frankly proposed in the beginning as a counter-cyclical subsidy device that could be turned on and off to manipulate the economy. The chamber, thus, opposed it as originally presented.

The chamber wanted the equivalent in a permanent depreciation reform integrated into the existing depreciation structure, and not a subsidy, or a carrot on the stick unrelated to depreciation, that would be vulnerable to repeal or suspension at the first change in the economic climate.

As a result of the objections and criticism of the chamber and others, the Treasury came back in 1962 with a simplified credit which they assured us, over and over again, would be a permanent part of our tax structure, and not just a spigot to be turned off and on as a selective tax device of fiscal policy. * * *

The Goverment also made it plain in 1962 that the credit plus the depreciation guidelines would be the only depreciation reform we could expect or get, and we had better take that than nothing. They rejected our proposal to include the equivalent of the credit in the form of an initial allowance as an integral part of the depreciation structure. They also refused to adopt the permanent and more stable and dependable Canadian system.

Thus, left with what was in our opinion a Hobson's choice, we took the credit for better or for worse.

In 1962, industry and the national economy were desperate, as President Kennedy and everyone else recognized, for a realistic and adequate capital recovery tax structure. And so, as I say, we had no choice but to take the credit. We might have continued to press our objection in 1962 if we had known then what we know now, that the Treasury's assurances as to permanence were not to be relied on, and that in four short years the administration would forget its promises and be urging suspension, just as we feared.

If this committee and the Congress would enact into law the kind of permanent capital recovery tax system this Nation really needs, then we would be the first to say that this uncertain, undependable tax credit device should not only be suspended but be repealed.

It now appears that a main gear in the retooling of our industrial machinery may be removed without any sort of replacement readily available.

The United States cannot afford to fall farther behind our major trade competitors and still hope to recover from our precarious balance-of-payments position. We cannot afford to further handicap American business at a time when modernization and expansion of our production factors are so necessary to combat inflation. Until the time that the United States can close the gap between the systems of capital recovery used by our competitors and that which is allowed by our own tax system, there will be little chance for increasing exports and reducing imports.

With wages already outpacing productivity, there can be only one practical course of adjustment. Since wages cannot be lowered, production must be increased, and to do so requires that an adequate capital recovery system be permanently worked into our tax structure.

The investment credit was designed to close the obsolescence gap. Mr. Stanley S. Surrey acknowledged this a speech on March 12, 1962, in which the former Assistant Secretary of the Treasury said:

The investment credit, coupled with realistic depreciable lives will make the tax treatment of investment in the United States comparable with that offered by our major competitors in Western Europe, Canada, and Japan. The investment credit thus takes its place along with the variety of Western European devices such as the incentive allowances afforded in addition to depreciation in the United Kingdom, Belgium, and the Netherlands, or the first year additional depreciation allowances permitted in the United Kingdom, France, Italy, and the Netherlands.

The administration is aware of these problems. President Nixon has asked that there be a study of the value-added tax, which might serve as an incentive to capital and exports. With all the Common Market countries moving to a value-added tax, there will be increased pressures on our tax system to offer an incentive to capital. This form of taxation is rapidly becoming the major revenue producer throughout Europe. Since the type of value-added tax which is being adopted is the "consumption type," which means that the cost of capital expenditures are deducted in the year of purchase, a continuing surge of capital investment can be expected by business competitors in Europe.

The chamber urged such as study of the value-added tax as a means of correspondingly reducing the income tax and improving the Nation's international balance of payments.

The enactment of the credit was the reason given for not reducing corporate income tax rates in the same degree as individual rates in the Revenue Act of 1964. Thus, the credit was also a substitute for a fair reduction in tax rates for corporations as well as meaningful depreciation provisions.

The House Committee Report No. 749, September 13, 1963, page 27, stated:

> This tax cut for corporations, when fully effective, will amount to $2.2 billion a year. It should, of course, be viewed in connection with the reduction provided by Congress last year in the form of an investment credit and the reform provided last year in the depreciation guidelines. These taken, together, provide corporations with a tax reduction of approximately $4½ billion.

And this committee's Report No. 830, January 18, 1964, page 8, stated:

> This bill provides a balanced reduction between individuals and business firms. In this respect, the bill will reduce individual income taxes by $9.2 billion and will reduce corporate taxes by about $2.4 billion. These figures must be evaluated along with the effective tax reduction of 1962 through the investment credit and depreciation reform, the largest share of which went to corporations. Taking the 1962 and 1964 programs together, the share of the reduction going to individuals is about two-thirds and to corporations about one-third, which is approximately the present relative shares of individuals and corporations in income tax liabilities.

To eliminate the investment tax credit would result in a discriminatory tax increase for corporations, unless other appropriate adjustments were made in the tax structure.

We recognize the need for certification of water and air pollution control facilities for which a 5-year amortization deduction is sought under the provisions of H.R. 12290. However, we are concerned at this time over what we believe are some ambiguities in section 5 of the bill which, if not resolved, could lead to differences in certification requirements between State and Federal governmental agencies.

It would be possible by the application of the proposed dual certification process proposed in H.R. 12290 that a company could not qualify for Federal certification for the amortization deductions, even if its treatment of waste complies with State or interstate standards approved by the appropriate Federal agency. The proposed certification process would appear to conflict with the previously expressed congressional intent in both the Water Quality Act and Clean Air Act of allowing for State rather than Federal control and enforce-

ment. It was never intended that the Federal Government be permitted to set uniform treatment standards.

H.R. 12290 should be amended so as to provide for certification only by the State or regional regulatory agency concerned, except in instances where water and air quality standards have been promulgated by the Secretary of the Interior or the Secretary of Health, Education, and Welfare, pursuant to section 10(c)(2) of the Federal Water Pollution Control Act as amended, or section 108(c)(2) of the Clean Air Act of 1967, as the case may be, or where the State or interstate regulatory agency lacks authority to issue certification. In the latter two circumstances, the necessary certification would then be obtained from the appropriate Federal agency.

The chamber will submit to the committee a further statement in regard to its recommendations concerning the tax treatment of pollution control facilities.[1]

As a part of this testimony the national chamber submits a memorandum on the transitional rules it views necessary to assure equitable treatment of taxpayers in the event the credit is repealed. The memorandum follows and we request that it be made a permanent part of the record.

Mr. Chairman, this concludes our testimony. May I once again voice the appreciation of the national chamber for this opportunity to testify on these important matters.

(The memorandum referred to follows:)

MEMORANDUM ON APPROPRIATE TRANSITIONAL RULES IN THE EVENT OF REPEAL OF THE INVESTMENT TAX CREDIT

This paper considers what transitional provisions should be included in any repeal measure. In particular, consideration is given to the circumstances in which the credit should be allowed in respect of property acquired or begun to be constructed subsequent to the effective date of repeal, in the interest of fairness to taxpayers who undertook programs or made commitments in reliance upon the continued availability of the investment credit in the future.

SUSPENSION TRANSITIONAL PROVISIONS NOT ADEQUATE FOR REPEAL

We believe that to adopt a stringent repeal measure would be extremely unfair to taxpayers who have been advised time and again, by officials of this Administration and its two predecessors, that the credit was a permanent part of the tax structure so that its continuation could be relied upon in business and financial planning. The fact is that there is a need in these circumstances for far *more* effective transitional rules than those which Congress was able to work out under great time pressure in 1966.

Transitional considerations were given limited recognition in connection with the 1966 temporary suspension of the investment credit. That limited recognition took the following form:

First, there was a series of specific exceptions to the definition of "suspension period property", property acquired, ordered, or begun to be constructed after the suspension cut-off date, designed to protect the credit for those who could establish certain specific forms of pre-suspension-date commitment to acquire or construct machinery or equipment. These exceptions were for: (1) Property acquired pursuant to a contract which was legally binding on the taxpayer on and at all times after the suspension date; (2) Property constructed or acquired by a taxpayer pursuant to a lease or contract with a third party such as a shopping center tenant; (3) Property used in or incidental to a building or plant facility under construction or more than 50% under contract before the suspension date; and (4) Machinery and equipment constructed more than 50% from parts and components on hand or under binding contract before the suspension date.

[1] See p. 489.

Second, there was a specific exemption for air and water pollution control facilities, added to the suspension measure on the floor of the House.

Third, there was a $20,000 special exemption for any suspension period property.

Finally, there were provisions to ensure that the credit would not be lost as a consequence of post-suspension sale and leaseback financing and certain transfers within a related group.

There appear to have been several reasons for this limited transitional relief in the case of the 1966 suspension. A comparison of the circumstances surrounding the 1966 suspension with economic conditions today in the light of the experience gained from the 1966 law demonstrates that more adequate transitional measures should be adopted if the investment credit is repealed at this time.

First and foremost, the 1966 suspension measure was conceived as an effort to control a temporary credit crisis. To achieve this goal the Treasury Department felt that the suspension had to have maximum immediate effect. Hence, only the most basic and limited transitional rules were contained in the suspension measure as it was introduced. While these transitional rules were broadened somewhat as the measure proceded through Congress, it was generally recognized that they fell short by a wide margin of providing equitable treatment for business.

Second, and somewhat related to the first point, the 1966 suspension had a two-fold objective. It sought not merely to slow expansion by removing an incentive, but to shift order-taking forward to a later point in the business cycle. Thus, the suspension had a definite ending date and business was assured that the credit could be restored even before that time, just as soon as conditions would permit. On the other hand, orders placed during the suspension would cause the credit to be sacrificed even if the acquisition was after the period ended. With this type of counter-cyclical measure, fully adequate transitional rules could not be adopted.

Third, the suspension law was put through the Congress on an emergency basis under great time pressure. Congress was told that the measure would have little utility unless it was adopted almost overnight. With such a brief opportunity to review the measure, Congress could not fully take into account transitional problems.

Fourth, while the suspension was a serious blow to the business community, it was temporary, and fortunately proved to be even more brief than most had anticipated. Hence, the full seriousness of the transitional problems never fully emerged. Although it probably still is too early to appraise the audit experience of the 1966 suspension, it is probable that it will reveal only a small portion of the problems associated with an outright repeal of the credit. The issues simply are much smaller on both the government and private side.

Today, Congress faces a very different situation.

First, we are confronted with a proposal for outright repeal of the investment credit. The loss of this credit will be felt deeply, particularly in the capital-intensive industries such as steel, machine tools, and transportation. There is no question today of preserving the credit by deferring orders or deliveries for a few months to suit the business cycle. The credit will be lost, if repeal occurs, except for whatever temporary relief transitional rules may afford.

Second, it is recognized that repeal of the credit will not be effective as an anti-inflationary device. The suspension experience of 1966–1967 demonstrates that the credit is wholly unsuited to short-run manipulation of this character. Council of Economic Advisers Chairman McCraken emphasized in May in a speech before the Federal Statistics Users' Conference that the repeal proposal is not "business cycle oriented". Secretary Kennedy acknowledged as much in his May 20 testimony before the Ways and Means Committee in which he said: "Stated simply, the case for removal of the investment credit rests primarily upon the fact that the social needs and economic conditions of the 1970's will be greatly different from those of a decade ago."

The Administration's justification for repeal is that the revenue thereby saved or generated, beginning in 1970, will permit an earlier end to the income tax surcharge than otherwise would have been the case. Others have said that repeal is a political expedient to get surcharge-extension support of legislators who regard the credit as a business subsidy. In either event there is no compelling need in these circumstances for the kind of abrupt cut-off which was attempted in 1966 in the name of economic fine tuning.

Third, we have had the benefit of experience with what happens when the effort is made to legislate basically tough transitional rules, the experience of the 1966 legislation. Inevitably, special exceptions and rules creep in to take care of the most deserving or most persuasive hardship cases. These exceptions proliferate and become ever more complex. The result is a piece of legislation which few can appreciate or understand. Of course, this is preferable to a law which is harsh and unresponsive to equitable considerations. But it is far less satisfactory than a law with broad and fair guideposts.

SUGGESTED TRANSITIONAL RULES

1. Phase-Out Repeal

Congress should consider carefully the practicability and fairness of a gradual as opposed to a one-step repeal of the investment tax credit. For example, the credit might be reduced in stages from its present 7% level to zero over a period of several years.

The principal difficulty with a gradual repeal is the concern that it may lead to anticipatory orders in an effort to ensure maximum credit utilization. To lessen this risk the phase-out would have to be gradual and take place over a substantial period of time so that business factors other than slight future drops in the credit would become more important in order placing. Our suggestion would be that the phase-out occur over at least three years.

It is a fundamental principle of tax reform that where the elimination of a provision generally favorable to taxpayers will cause hardship because arrangements have been made or actions taken in reliance upon the provision, a reasonable phasing-out of the provision is appropriate, absent compelling considerations of public policy to the contrary. This principle is illustrated repeatedly in the current tax reform proposals of the Administration:

The proposed 50% Limit on Tax Preferences would be gradually put into force over a three-year period.

The required Allocation of Deductions between taxable and nontaxed income would be phased in over two years.

The proposed limitation on foundation control of business corporations incorporates a five-year transitional period.

The multiple corporation surtax exemption disallowance would also come in gradually over five years.

And there would be a three-year adjustment period for the taxation of public utility dividends paid out of accelerated depreciation reserves.

The fact that the Administration has chosen to associate the credit repeal with an extension of the tax surcharge does not alter the fact that repeal is a permanent change in the tax structure which amounts to "tax reform." As Secretary Kennedy's May 20 statement says, the removal of the credit is designed to shift economic resources "to meet pressing needs for housing, to aid state and local governments, and to improve the lot of the poor." This is the language of "reform." And repeal of the credit is a type of reform which will cause economic hardship to taxpayers who have relied upon its continued existence. Clearly, this is the type of measure which should qualify for phase-out treatment.

Such a gradual phase-out would be entirely justified in terms of fairness to business. Business has been assured on countless occasions over the years, from the days when the investment credit was first proposed, that this was intended to be a permanent part of the capital recovery tax structure of the Internal Revenue Code. Business plans have been laid on this foundation. Even a liberal commitment rule cannot fully do justice because of the great practical difficulty of producing documentation of the commitment in such a way as to satisfy an examining agent of the Internal Revenue Service. A graduated repeal will help to alleviate this practical problem.

Moreover, a gradual phase-out would afford time for Congress to consider and adopt appropriate changes in the depreciation provisions or other capital recovery elements of the Code to ensure long-run economic growth and greater efficiency before the loss of the credit has had too great a depressing effect. If and when such capital recovery provisions are adopted the credit could be phased out more rapidly, perhaps in a single step.

Gradual elimination of the credit over a period of time would not be inconsistent with present and future economic circumstances. As we have previously noted, even a one-step repeal of the credit now will have no material effect on government revenues or purchasing decisions for a considerable period of time—

until 1970. We know from the 1966 suspension experience that the credit cannot be manipulated successfully as a counter-cyclical economic control device. By the time repeal takes full effect it is probable that the state of the economy will be quite different from what it is today. Indeed, the credit repeal could operate to increase the risk of a serious business recession a year or more from today. Graduating the repeal will lessen this risk.

Finally, a graduated elimination of the credit would mitigate some of the more troublesome features of the proposed repeal. First, there is involved the extremely difficult problem of attempting to identify and define those deserving situations in which the taxpayer has made a sufficiently meaningful economic commitment to warrant exception. This seems particularly significant in the case of smaller business organizations whose plans tend to be somewhat less formalized than is the case with the larger companies. Second, there is the inevitable problem of the choice of the effective date. Where the question is qualifying or not qualifying for the full 7% credit, the effective date and the cut-off provisions become critical. To bar anticipatory orders the proposed measure has an effective date of April 18 which is two days before the date recommended by the Treasury.

One solution to these problems is, of course, to move forward the effective date from April 18 to the date the bill was introduced, reported out of committee or enacted. We feel, however, that graduated repeal would be less discriminatory and more consistent with sound tax legislation principles than any arbitrary cut-off feature.

2. Business Commitment Rule

The exceptions to the definition of "suspension period property" in the 1966 investment credit suspension legislation gave limited recognition to the fact that property placed in service after the suspension period commenced but as to the acquisition or construction of which the taxpayer had been committed prior to the suspension should not be disqualified for the credit. The binding contract, third-party lease or contract obligation, machinery completion, equipped building and plant facility exemptions to the definition of suspension period property all stemmed from the recognition of the principle that changes in the tax law should not affect prior commitments to any greater degree than necessary.

The bill contains provisions recognizing the principle that the repeal should have minimal effect on prior commitments and that such commitments should not be disturbed to any greater degree than is necessary. These exceptions which are patterned after the 1966 suspension rules are at least a logical starting point for the consideration of transitional rules associated with repeal of the credit. But at the outside they represent the minimum transitional relief which any repeal measures should contain. As indicated earlier, the need to give recognition to economic commitments made in reliance upon continued availability of the credit is much more acute in the case of repeal than in the case of suspension.

Practical and understandable commitment tests can and should be a part of any repeal measure. The credit should continue to be available for machinery and equipment placed in service after the effective date of repeal if the taxpayer can demonstrate, by appropriate records or consistent business practice, either:

(1) That the particular machinery or equipment (or like machinery or equipment) had been ordered for acquisition or scheduled for construction in the business sense prior to the effective date of repeal; or

(2) That the machinery or equipment constitutes part of a plan or program which, prior to the effective date of repeal, had been adopted or approved by the board of directors, executive committee, management or other officials of the taxpayer responsible for making decisions in respect of such plan or program.

The credit should also be available if the taxpayer can demonstrate that, prior to the effective date of repeal, it had made a significant financial commitment regarding the particular item to be acquired or constructed or to the program into which the machinery or equipment will be incorporated, even if this program has not been formally adopted or approved. A financial commitment would involve, for example, the borrowing of funds or raising of equity capital for an expansion program, the purchase of land on which facilities will be constructed, the entering into of contracts with third parties and the like.

Clearly the drafting of precise language to cover equitable commitment provisions such as these is not easily accomplished. It may be necessary for Congress to lay down fairly broad guidelines, leaving their practice implementation to

the Treasury. It would be tragic if fair transitional commitment rules were sacrificed on the basis of expediency.

In the absence of the type of broad economic commitment test we have recommended, the proposed specific commitment exemptions which are included in the bill should be modified so as to give greater recognition to difficulties of application and administration as well as the potential inequities.

The binding contract exemptions should be broadened to include orders placed with a manufacturer or distributor in accordance with the taxpayer's customary business practices, even if these do not constitute "binding contracts" in the strict legal sense. Post-repeal-date modifications of pre-repeal-date machinery or equipment orders, including the substitution of similar property acquired from the same or another supplier, should not defeat the credit. Similarly, a right to cancel the order should not cause the credit to be sacrificed if, in fact, the order is filled. These modifications of the "binding contract" exemption would permit business transactions to go forward without being artificially "frozen" by the fear of a lost tax credit. Finally, if a particular taxpayer can demonstrate that an order would have been placed before the repeal cut-off date but, for circumstances beyond the control of the taxpayer, such as a delay in some required government action, the order was delayed, the property ordered should qualify under the exemption.

This broader version of the binding contract exemption should be incorporated into the three "project exemptions" which were adopted in connection with the 1966 credit suspension, and should be included in any repeal measure—the equipped building, plant facility, and machinery and equipment construction rules—so that property in this order-exemption category will count toward the pre-repeal-date percentage requirements of the project exemptions. In addition, setting the project exemption percentages as high as 50%, as under the 1966 suspension law, would not afford adequate recognition to what constitutes a genuine commitment. A 20% test was used as a measure of commitment in connection with the repeal of the tax exemption privilege for industrial development bonds and we would recommend a percentage of that magnitude in connection with these credit repeal project exemptions.

3. Credit Utilization

The bill recognizes that the repeal should be aimed at curtailing future eligibility of property for the credit and that the utilization of the credit already earned should be generally preserved.

Certainly this is a fair transitional approach. However, the provisions in the bill dealing with this matter of utilization of carryovers will result in inequities in certain cases and requires reconsideration. Under the proposal, the general 50% of tax liability limitation is retained and, in addition, a special limitation is provided which would limit the allowable credit attributable to carryovers in any year beginning after 1968 to 20% of the aggregate amount of unused credits which would otherwise have been available as carryovers to each such year after 1968 or any prior year following 1968.

Under this arrangement a taxpayer could lose credit carryovers solely because of the 20% limitations when such carryovers could otherwise be utilized if there had been no change in existing law. There seems no justificaton for taking away the taxpayer's right to use the credits already earned.

This provision was inserted in the bill apparently to minimize the economic effect of accumulated carryovers in the first year following repeal. Moreover, there was the intention to avoid the possibility that a taxpayer could achieve a greater advantage from the carryover than would have been the case had there been no repeal.

A much more equitable approach to the use of the credit carryovers might be to limit the amount allowable in any one year following 1968 to a maximum of 20% of the total dollar amount available at the beginning of such year or any prior year subsequent to 1968, but without the limiting effect of the existing carryover period as is incorporated in the proposed version.

Admittedly this might permit credits to be utilized which might otherwise be lost, but it seems a small price to pay in light of the necessity to stretch out the economic consequences of the accumulated carryovers.

Although some argument can be made for the further limitation on the basis of the so-called "simulated" credit, the burden of record keeping, to say nothing of the problems of administering this further complexity, would greatly outweigh any need for precise symmetry.

The provisions of the bill should assure every taxpayer that his credits already earned will not be taken away. At the same time, the business community as a whole should not be saddled with administrative burdens disproportionate to the objective of protecting revenues.

SUMMARY

Appropriate transitional rules are essential to alleviate serious hardships and inequities which are threatened by any repeat of the 7% investment tax credit.

Congress should consider carefully the practicability and fairness of a gradual as opposed to a one-step repeal of the credit. For example, the credit might be reduced in stages from its present 7% level over a period of years. This would ease the problem presented by the use of an arbitrary cut-off date for the credit repeal.

Any credit repeal provision should contain a broad and understandable pre-repeal economic commitment exception which incorporates but extends beyond the limited, specific commitment exemptions of the 1966 credit suspension law. Machinery and equipment ordered for acquisition, scheduled for construction or within the scope of a plan or program adopted prior to the repeal cut-off date should qualify for the credit.

In the absence of a broad economic commitment exemption, all of the specific limited commitment exemptions of the 1966 suspension law should be adopted as part of any repeal. These include the binding contract, equipped building, plant facility, machinery and equipment completion, and third party contract exemptions. These exemptions should be modified to cover gaps in the 1966 provisions.

Any repeal measure should ensure that investment credits earned prior to repeal, including carryovers, and credits within the repeal laws exemptions can be fully utilized.

Senator BENNETT. Thank you very much.

This concludes the list of witnesses for the morning so that the committee will stand in recess until 10 o'clock Monday.

Thank you.

(Whereupon at 1:05 p.m., the hearing was recessed to reconvene, Monday, July 14, at 10 a.m.)

PROPOSED EXTENSION OF THE SURCHARGE AND REPEAL OF THE INVESTMENT TAX CREDIT

MONDAY, JULY 14, 1969

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

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

Present: Senators Long, Anderson, Williams, Bennett, Curtis, Miller, Jordan, and Fannin.

The CHAIRMAN. The hearing will come to order.

Continuing our hearing on the surtax bill, the first witness today will be the Honorable George McGovern.

Senator McGovern, I apologize for the scarcity of committee members at this moment, but I think you will find as you proceed with your statement that you will have more and more customers to hear you.

STATEMENT OF HON. GEORGE McGOVERN, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

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

Senator Long and members of the Finance Committee, I am happy to have this opportunity to explain my oppositon to the extension of the income tax surcharge and my support of an alternative fiscal measure—the excess war profits tax.

I think the essential considerations in coming to a decision on any tax proposal should be:

(1) What will be the overall effect of the tax on general levels of employment, output and prices;

(2) Where will the resources transferred as a consequence of the tax be used; and

(3) Is the proposal an equitable one in the light of all reasonable alternatives.

With these factors in mind, I think, the economic interests of America would be best served by enactment of a temporary tax on excessive war profits, which are the product of extraordinary wartime military spending. On May 27, I introduced a separate bill (S. 2277) with the cosponsorship of some 15 distinguished Senators to establish such a tax. Later this week I will formally resubmit the bill as an amendment to H.R. 12290, deleting entirely the language of section 2 and substituting the provisions of the Excess War Profits Tax Act.

Supporters of the income surcharge have urged that extension is necessary to prevent a runaway inflation in wholesale and consumer prices. I think we can apply a much more effective brake to the current inflation than the continued imposition of a regressive surtax, which extends and often aggravates the present inequities of our Federal tax system.

An emergency tax on excessive corporate profits would be a more appropriate and effective device for controlling the war-induced inflation we are now experiencing.

The way to eliminate this kind of inflation—short of ending the war—is to minimize the effects of the defense dollar on aggregate demand, by drawing off some $10 billion a year of the excessive profit yield in a special corporate tax. This would be the immediate impact of the excess war profits tax: a cooling off of the economy at its most overheated sector.

But there would be a secondary effect of great significance in the effort to halt inflation. To date, fiscal policy has proved inadequate to combat inflation, largely because military expenditures, the great bulk of Federal spending, have continued to grow. And with this growth has continued the expectation that military demand—and profit levels—will remain high.

Enactment of the Excess War Profits Tax would dampen the inflation psychology in the no-risk, guaranteed-profit defense industries. And action which restrains the expectation of high profits can have a profound effect in curbing inflation.

Enactment of the Excess Profits Tax is also recommended by reasons of fairness and equity.

It has been the consistent policy of this country to see that no one makes unrealistic profits from war—while thousands of our young men are dedicating an important portion of their lives at inconsequential pay.

This was the policy for World War I, for World War II, and again during the Korean war. On each occasion, Congress enacted an excess war profits tax, transferring a fair measure of the wartime increase in net corporate profits to the war effort.

We should be following this tradition today, when the increase in corporate profits is the most dramatic in our recent economic history.

From 1961 to 1964—the base period for computing excess profits under the amendment—the average yearly level of corporate profits before taxes was $57.8 billion; after taxes, the average retention was $32.5 billion.

For the post-Vietnam-escalation years, 1966–68, gross profits have soared to an average of $84 billion per year, and after taxes to an average of $50 billion, some $18 billion above the pre-1965 period.

This quantum jump in corporate profits represents an increase of $18.5 billion or 53 percent from the base period average.

The amendment I am proposing would impose on the taxable income of every corporation, a special levy equal to 37 percent of the excess profits taxable income: that part of the income which exceeds the deduction adjustment for tax years 1969 and 1970.

This deduction adjustment, computed according to the 1950 Tax Act formulas, approximates that amount of income which is not attributable to special wartime spending levels. The taxpayer may either de-

duct the average annual intake for the 4-year base period, 1961-64. Or he may deduct a normal return on invested capital, as calculated on the graduated scale of the 1950 act.

In any event, no corporation with excess profits under $25,000 per annum is liable for the extra tax under this bill.

Special relief for corporations experiencing abnormal growth during the emergency period is provided by section 1906(a)(3) which empowers the Secretary of the Treasury to make rules comparable to provisions of the 1950 act. These rules would prescribe certain special modifications for nondefense growth industries, for corporations which installed new product lines or new factories during the base period, and for corporations which experienced damaging fires, long-term labor strikes, or other severe abnormalities during the base period.

These special adjustments are designed to focus the excess profits tax as precisely as possible on the war-created increment of corporate income. It is a "surgical strike" taxation scheme; were are not interested in those profits which are a normal yield on capital and ingenuity.

We all pray that the stalemate in Paris will be broken, that the killing will end, and that American troops will be returned to our own shores. But for now, the war goes on and its costs continue at a very high level, which is the reason this tax matter is now before us.

I think it is time now to shift more of that cost to those industries that are deriving the greatest profits from the war.

Then moving on, Mr. Chairman, to the second proposal that I would like to call to the attention of the committee, it would modify the investment tax credit proposal along the lines suggested not only by myself but by the chairman of the Select Committee on Small Business, Senator Bible, and the ranking minority member of that committee, Senator Javits.

I would like to file with the committee a draft amendment which would retain the credit for investments below $25,000 as the chairman knows, that was a matter that was very seriously discussed in the other body, and as I understand it, it was almost adopted after considerable debate by the House committee.[1]

As you will recall, this proposal is quite similar to the approach employed in 1966 when the credit was suspended temporarily. At that time the Senate wrote in a $25,000 exemption and the conferees settled at $20,000. It is substantially the same proposal that I am making here today.

This amendment is offered in the belief that Congress has the ability to write tax laws with enough precision to insure that they will not work contrary to other national policies. I believe the case at hand is an extremely clear example of the need for such precision, for repeal of the investment tax credit without some provision for small businessmen and farmers would, in one large area, interfere quite seriously with the very motivation which underlies the administration's proposal. It would damage other important public purposes as well.

Administration spokesmen have left little doubt as to the reasons for repealing the credit. Secretary of the Treasury David Kennedy spelled them out before the House Ways and Means Committee on May 20, noting that:

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[1] See p. 329.

More than 3 years of inflation have distorted our economy, robbed the thrifty of part of their savings, and eliminated our favorable trade balance. A continuation of the inflationary boom ultimately is likely to lead to a sharp contraction in economic activity, accompanied by a painful level of unemployment. Inflation must be stopped—and it can only be stopped by continuing fiscal and monetary control.

I heartily agree with that objective, and I agree as well with the premise that the investment tax credit is an appropriate place to start. The credit was created in order to stimulate capital investment, and it has certainly been effective in achieving that purpose.

American business has spent some $400 billion in capital outlays since the early 1960's. But we no longer need that stimulation, particularly not for giant industry. On the contrary, the capital goods sector is the area where inflationary pressures seem to be most acute. The anti-inflationary effect of each dollar removed from this sector of the economy will, as noted by the Chairman of the Council of Economic Advisers, be greater than the effect of each dollar of surtax revenue.

Nevertheless, I am convinced that the broad brush approach, or total repeal of the investment tax credit is not desirable. Its effect will be to exacerbate the squeeze on a large number of those who have suffered most from rising costs and tight money. It will attack victim and villain alike with the same blow.

Senator Bible has recently described the "triple credit squeeze" facing small business. The disastrous rise in interest rates, particularly since December, creates the most crushing burden upon those least able to pay. The prime rate is, of course, reserved for the most reliable and largest borrowers, who also have methods of avoiding the squeeze in credit which are not available to smaller operations.

On top of this, we have noted that the administration reduced the fiscal year 1969 business loan program of the Small Business Administration by some 58 percent, further restricting their access to capital.

Addition of a third pressure, elimination of the investment tax credit, will force economic ruination in thousands of cases, all in the name of inflation control.

A similar situation exists in agriculture. Inflation has driven the necessities of efficient food and fiber output to the highest levels in modern times. Just this last week I had lunch with an implement dealer from my State, who told me that an ordinary combine of this kind that is in common use in the Dakotas today now sells for some $21,500, which is five times greater than the price of a comparable machine 15 years ago.

Production expenses rise by almost $1 billion in 1968 for farm families, and prices paid for implements, interest, taxes, and farm labor were 3-percent higher than in the previous year. Farm liabilities, excluding claims of the Commodity Credit Corporation, increased by some $4.1 billion in the 12 months preceding January of this year, and a large share of that debt was incurred to offset operating losses.

As is the case with business, these rising costs weigh most heavily upon smaller producers. Meanwhile the prices they receive have remained relatively constant. Farmers have no way to pass increased costs of operation on to the consumer.

At this time many operations are being sustained only because of the favorable market for livestock. When that cycle turns down, as

it always has in the past, we can be assured that the cost-price squeeze—with the intolerable interest rates, mounting production costs, and dismal price prospects—will continue to smother family farm agriculture.

If we eliminate the investment tax credit in the case of small farmers we will hasten that process, removing the economic viability of many existing farms and accelerating the migration from rural America to overcrowded cities.

We can easily afford to be somewhat selective, recognizing that if the 1960 need to stimulate plant and equipment investment no longer exists across the board, there are still areas where we should encourage or at least prevent any rise in the costs of such investments. Agriculture and small business are prime examples.

Over the past several decades our agricultural programs have spelled out a firm national preference for efficient family farm agriculture. We have been concerned about the rapid decline in farm numbers, the crowding of our cities as a consequence of that process, and by the prospect that our food and fiber supply will eventually be under the control of a few large producers.

At the same time, we have evolved a policy, declared in the Small Business Act of 1953, calling upon Government to "aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise * * *"

I believe these twin policies for agriculture and Small Business remain entirely valid, and that they supply ample reason for maintaining the investment tax credit up to $25,000. We should continue to reject the view that bigness is either naturally desirable or inevitable, and we should continue to embrace the concept that entrepreneurship should be widely dispersed and readily accessible.

The revenue cost of continuing the credit up to $25,000 I tried to determine by calling for assistance from the legislative reference service at the Library of Congress. They estimated that it would deprive us of about 9 percent of the $1½ billion that repeal of the investment tax credit is supposed to bring in, in other words somewhere around $150 million would be lost in revenues if we adopted this amendment I am proposing to exempt the first $25,000.

I urge the committee to act favorably on this amendment, in the interests of many thousands of small business and farm operations across the country.

Mr. Chairman, I would like to ask that the text of the amendment be included in the record.

The CHAIRMAN. All right.

(The proposed amendment referred to follows:)

[H.R. 12290, 91st Cong., first sess.]

AMENDMENTS intended to be proposed by Mr. McGovern

H.R. 12290, an Act to continue the income tax surcharge and the excise taxes on automobiles and communication services for temporary periods, to terminate the investment credit, to provide a low income allowance for individuals, and for other purposes, viz: Page 8, line 15, after "property" insert "and property to which subsection (e) applies".

Page 20, line 11, strike out the closing quotation marks and after line 11 insert the following:

"(e) Small Business Exemption.—

"(1) In general.—In the case of section 38 property (other than pre-termination property)—

"(A) the physical, construction, reconstruction, or erection of which is begun after April 18, 1969, or

"(B) which is acquired by the taxpayer after April 18, 1969,

and which is constructed, reconstructed, erected, or acquired for use in a trade or business, the taxpayer may select items to which this subsection applies to the extent that the qualified investment for the taxable year attributable to such items does not exceed the small business exemption limitation (as determined under paragraph (2)). In the case of any item so selected (to the extent of the qualified investment attributable to such item taken into account under the preceding sentence), subsections (a), (c), and (d) of this section, and section 46 (b) (5), shall not apply.

"(2) Small business exemption limitation.—For purposes of paragraph (1), a taxpayer's small business exemption limitation for any taxable year is $25,000, reduced by an amount equal to the amount by which the taxpayer's qualified investment for the taxable year (determined as if subsection (a) did not apply) exceeds $25,000.

"(3) Special rules.—

"(A) Married individuals.—In the case of a husband or wife who files a separate return, the amount specified in paragraph (2) shall be $12,500 in lieu of $25,000. This subparagraph shall not apply if the spouse of the taxpayer has no qualified investment for, and no unused credit carryback or carryover to, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

"(B) Affiliated groups.—In the case of an affiliated group, the $25,000 amount specified in paragraph (2) shall be reduced for each member of the group by apportioning $25,000 among the members of such group in such manner as the Secretary or his delegate shall be regulations prescribe. For purposes of the preceding sentence, the term 'affiliated group' has the meaning assigned to such term by section 1504 (a), except that—

"(i) the phrase 'more than 50 percent' shall be substituted for the phrase 'at least 80 percent' each place it appears in section 1504 (a). and

"(ii) all corporations shall be treated as includible corporations (without any exclusion under section 1504 (b)).

"(C) Partnerships.—In the case of a partnership, the $25,000 amount specified in paragraph (2) shall apply with respect to the partnership and with respect to each partner.

"(D) Other taxpayers.—Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by sections 46 (d), 48 (e), and 48 (f) shall be applied for purposes of this subsection."

The CHAIRMAN. It seems to me at one time I may have voted for both of your proposals.

Senator McGOVERN. I think that is right, Mr. Chairman.

The CHAIRMAN. They will certainly be considered when the committee gets to it.

Senator McGOVERN. I appreciate that.

The CHAIRMAN. Any questions?

Senator WILLIAMS. Senator, I understand that you are advocating supporting the repeal of the investment tax credit with the exception of an exemption for small business farmers. Is that correct?

Senator McGOVERN. Up to $25,000, that is correct.

Senator WILLIAMS. Do you think that the administration made a mistake last year when they reinstated the investment credit at that time? Do you now consider that a mistake?

Senator McGOVERN. I think it probably was, I will say to the Senator.

Senator WILLIAMS. That was one of the thoughts I had at the time, that this was not an anti-inflationary movement. In the past, I believe it was during the Korean war, we had an excess profits tax, and I sup-

ported it at that time. When the war in Vietnam broke out, I suggested then that we should take measures both to control our domestic spending and also to examine our tax policies. I notice that you are labeling your proposal as an excess war profits tax. Right at this moment, we are all hoping that we are going to end this war.

Senator McGOVERN. Yes.

Senator WILLIAMS. Isn't this a little late to propose an excess war profits measure, or have you given up hopes of ending the war?

Senator McGOVERN. I haven't given up hopes. I share the Senator's earnest desire that the war come to an early end. I have been advocating that for some time.

Senator WILLIAMS. I know you have.

Senator McGOVERN. I have also advocated this tax for some time. I tried to get the Senate to act on it last year. The chairman of this committee voted for it, as did the majority leader of the Senate and a number of other Senators, but I do not think any one of us can legally predict the length of this war.

What we do have before us is the urgent request of the administration to meet an emergency situation that is highly inflationary, and the war cost does not continue at least for the foreseeable future.

I do not know what that cost is, I guess somewhere between $25 to $30 billion a year, and it just seems to me that if we are going to act on that administration request to deal with the inflationary problem, that the President gave us some guidelines in his tax message, when he said that we ought to have the capacity to raise taxes to those that are not paying enough, and lower taxes to those that are paying too much. I think that enacting a surtax on everyone at this time or extending the surtax on everyone across the board, without reference to that principle, the President spelled out, does not come as close to meeting the situation as this excess profits tax does.

Senator WILLIAMS. Are you recommending the excess profits tax as a permanent fixture of the law?

Senator McGOVERN. No.

Senator WILLIAMS. Just for the duration of the war?

Senator McGOVERN. No, I would hope that it would be a very temporary proposal I will say to the Senator, along the same lines as the surtax. It is to meet an emergency situation, but I would hope we could very quickly repeal it, in the event the war comes to an end and spending tails off.

Senator WILLIAMS. Let me ask your opinion on one other matter. I realize we don't have it before us today, but it has been mentioned for some time. As to the depletion allowance, do you think that should be changed too? Do you think that it is due for a revision?

Senator McGOVERN. Yes, I do.

Senator BENNETT. No questions.

Senator CURTIS. In reference to the investment credit, you mentioned that certain machines cost around $21,000 at the present time.

Senator McGOVERN. Yes.

Senator CURTIS. The 7 percent investment credit would be a credit for someone who buys one of those on their tax bill of $1,470?

Senator McGOVERN. Yes.

Senator CURTIS. Now you are aware, are you not, that if that farmer sells that machine, even turns it in on a new one, before the end of 4 years, that the Treasury will recapture the $1,470?

Senator McGOVERN. I was not aware of that.

Senator CURTIS. Yes, they do, and he has to hold it for 8 years to the full benefit, between 4 and 8 it is on a graduated basis. Now if that goes on forever, what happens is that when they trade in for a new machine, they get a tax credit on the new machine, but they would lose it because they had not held the old machine for the full 8 years.

Senator McGOVERN. Does the Senator say that if they use the machine over a 4-year period they do get some permanent benefit from the tax writeoff?

Senator CURTIS. Unless you have a full 4 years, you have to repay the entire tax credit.

Senator McGOVERN. I see.

Senator CURTIS. And one of the reasons that I did not support the investment credit when it was first proposed was that the individual who had already purchased some equipment or was unable to purchase equipment got no tax credit. The operator who could buy a great deal of the heavy equipment got the most from the investment credit.

Now in reference to the surtax, are you aware that low-income people are exempt from the surtax?

Senator McGOVERN. Yes.

Senator CURTIS. I think you will find that a family of four would have to have an income of over $5,000, which, of course, is not much, before they would be subject to the surtax?

Senator McGOVERN. That is my understanding.

Senator CURTIS. But you are opposed to the extension of the surtax?

Senator McGOVERN. Yes. I would favor the formula we used in the Korean war and in World War II, which is essentially the proposal that I am making here today as an alternative.

Senator CURTIS. For your excess-profits tax would you apply it to all corporations?

Senator McGOVERN. Yes.

Senator CURTIS. Regardless of size?

Senator McGOVERN. Well, it exempts corporations—it does not become operative for a corporation that does not show more than a $25,000 gain in the excess-profits formula under the tax.

In other words, some $25,000 in what could be classified under this act as excess profits could be secured before the act would become operative.

Senator CURTIS. And what would be your base period?

Senator McGOVERN. The period from 1961 to 1965, which is the period prior to the real escalation of the war.

Senator CURTIS. But a corporation that had exceedingly high or just high earnings from 1961 to 1965 could continue that same rate of earning and pay no excess-profits tax, is that right?

Senator McGOVERN. That is correct.

Senator CURTIS. Now, suppose that a smaller corporation or any kind of corporation that did not do too well from 1961 to 1965, or was a new business; they would pay an excess-profits tax on the profit that they made over this base period, the base period plus $25,000, they would pay the excess-profits tax on the balance?

Senator McGOVERN. Senator, there is an alternative that is open to a taxpayer in that category, or open to anyone under this act. He could either deduct the average annual intake for the base period 1961 to 1964 to determine what tax he would pay, or he could deduct the normal return on invested capital, and that is calculated under a graduated scale that I took from the 1950 Excess Profits Act that the Congress enacted during the war, so it does provide for that kind of a contingency, and gives the taxpayer an alternative arrangement?

Senator CURTIS. Theoretically, it does. It has never worked out that way.

Senator McGOVERN. I think, if I could say to the Senator, that it could be administered. I recognize, I have been told this by a number of people who are familiar with the previous act which doubtless the Senator is, that there were some administrative difficulties with it; but I think the principle is a sound one, and that based on some of the experiences we have had with the act in the past, that those difficulties could be minimized.

I think there does have to be some leeway in the act to take care of situations of that kind, and we have provided for that contingency.

Senator CURTIS. I think you will find that an excess-profits tax will be very rough on concerns operating in an agricultural State, because of the base period primarily, the difficulty of switching to the alternative, or even using it. It means that the highest earners in the base period pay no tax. Would you apply this to individuals?

Senator McGOVERN. No; only to corporations.

Senator CURTIS. Only to corporations. You would not apply it to Senators?

Senator McGOVERN. That is correct; especially not Senators.

Senator CURTIS. I think there is something to be said, making it across the board. If we have inflation and we have a deficit, some segments of our economy are making a lot more money than they did between 1961 and 1965, I would suggest that for your consideration.

That is all, Mr. Chairman.

The CHAIRMAN. Senator Jordan had been here for a while, and if it is all right I will recognize him and come back to you, Senator Miller.

Senator JORDAN. Thank you, Mr. Chairman. I only have one or two questions, Senator. If I understand your position, you are opposed to the extension of the surtax at this time?

Senator McGOVERN. Yes. I prefer the substitute proposal, the excess-profits tax.

Senator JORDAN. And that is very similar to the one that was proposed during World War II?

Senator McGOVERN. Yes.

Senator JORDAN. The Korean war?

Senator McGOVERN. That is correct.

Senator JORDAN. At that time we had wage and price controls too, did we not?

Senator McGOVERN. That is correct.

Senator JORDAN. Are you suggesting that we have wage and price controls now?

Senator McGOVERN. No; I am not proposing that.

Senator JORDAN. Why not?

Senator McGOVERN. Well, I think that if the war were to continue over an extended period of time, I might come to the point where I would feel that was essential; but at the present time I think the committee can move along satisfactorily without it. I think the excess-profits tax will do a great deal to adjust some of the inquities in our present tax situation. I will keep an open mind on wage and price controls, but I am not advocating it at the present time.

Senator JORDAN. Thank you.

The CHAIRMAN. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

My colleague, when you advocate an excess-profits tax, I am reminded of the story that they told about the excess-profits tax that was enacted during World War II; a very complicated piece of legislation. When the Internal Revenue Service was given this to administer, they immediately checked through their files and managed to find 10 geniuses who were on board, sent them up to Harvard to take a 2-month course on the subject.

The story is, that after 2 weeks two of the 10 had dropped out; after a month two more had dropped out, after 6 weeks there was only one remaining and he took the exam and flunked.

I have had some occasions to work on this after the war. I think I can tell you it took me about a year to get a pretty good feel of it, and it is a horrible administrative and compliance problem that causes many people to shrink from going back and getting into this thing all over again.

I think everyone is opposed to excess profits generated out of the war. I don't think anybody in the United States would object to that as a general statement of policy. But I am wondering why you would not be content to let the Contract Renegotiation Board handle this problem. As you know, they are supposed to renegotiate contracts to eliminate excess profits.

Senator McGOVERN. Well, if that is their function I will say to the Senator they have not been carrying it out very well, because the excess profits continue. I described in my statement here an increase in profit levels for a number of different corporations over the last 4 years, Boeing Aircraft up 65 percent, and United Aircraft up 56 percent.

I do not quite understand why this renegotiation matter does not work better than it has, but I will cite the same evidence the Senator cited about the World War II act, to say it has not done the job. We did, in World War II with all the administrative difficulties, we did manage to raise $40 billion with the excess-profits tax which was a tremendously important part of our revenues but in maintaining the equities of that tax structure. For whatever reason the renegotiation approach has not worked very well at least during the Vietnam war.

Senator MILLER. I want to be fair about it. Of course, it would be very easy for me to point out who has been in control of that Contract Renegotiation Board. But, I want to be fair about it and point out we had testimony herein the Finance Committee about a month or so ago indicating that they were about 2 or 3 years behind in their cases, so you have got a backlog there, and I do not think you could make a fair evaluation of what the Contract Renegotiation Board has done

regarding excess profits until maybe 2 or 3 years from now, because it just takes a long time to handle these cases.

They have been somewhat shorthanded. They have got a horrible backlog there. It may be that Boeing ends up with 65 percent profit, but it may be that that will be chopped down by the time that renegotiation is reached. I assure you there will be a worse setup under the excess-profits tax, because I think that well into the 1950's there were excess-profits-tax cases kicking around, so I would just suggest to you that the Contract Renegotiation Board be given a fair chance to perform, as far as the Vietnam war case is concerned.

Senator McGOVERN. I am glad the Senator endorsed the principle, and I know he does, but I think it is fair to say that the formula that I am suggesting here did work successfully enough in the Second World War and in the Korean war so that it brought in substantial revenues.

I really do not understand why we have to wait for a period of 2 or 3 years to renegotiate these excessive profits. I think that the committee can draft language, perhaps greatly improve on the proposal that I made here, but could draft language that would be workable, and I think that if some flexibility were given to the Internal Revenue Service, that they could administer a proposal of this kind in such a way as to recapture a reasonable amount of what could be described as excessive profits, without great delay.

Now the Senator is an expert on tax matters. Would he not agree that administrative rules could be worked out to simplify this matter and recapture from industries that are making a high profit on war or during the war recapture a reasonable amount of that tax through the regular tax procedures, rather than waiting for 2 or 3 years to renegotiate these matters.

Senator MILLER. To the best of my knowledge, if the EPT was adopted it would not be made retroactive before the first of this year, and there you have an awful lot of years involved which are still going to have to be handled by the Contract Renegotiation Board.

I want to assure you that because of the complexities of administration and compliance, it is going to take a long, long while for EPT cases to be handled if this should go into effect. My only point, Senator, is that if the Congress does a job in staffing that Contract Renegotiation Board, I think we have the vehicle there to do the job.

You mentioned that you cannot understand why it should be 2 or 3 years behind. You talk to the people over there, they will tell you why. They will say "We just have not had the manpower to do the job," and I think because of cases necessitated by the Vietnam war, the Congress could well give them better and increased staff.

Senator McGOVERN. I would support that. I think we still need the excess-profits tax, but I would support an effort to strengthen the hand of the Renegotiation Board.

Senator MILLER. My point is that we already have a vehicle on the books, and if it does the job and is properly staffed by the Congress I would hope we would be able to avoid what I regard as one of the most complex, difficult pieces of legislation ever put on the books for compliance and for enforcement. It would take years to train the agents to do the job, and then you would have a backlog on audit returns. Some of these things would be open for years. But as I say,

there is not a soul in the United States that I know of who does not advocate doing away with excess profits generated out of a war or I would say excess profits as far as the Federal Government is concerned in war or peacetime.

Now on the investment tax credit you suggest you cut off the $25,000. I can understand the desirability of helping small businessmen and farmers out on something like this, but I believe we had testimony here just a couple of days ago from somebody representing the National Federation of Small Business, and the Senator from Nebraska pointed out or drew out the recognition that of all the membership that were represented, only about 25 percent at the most, or not that many—I guess it was the Senator from Utah—only about 25 percent of the membership had derived any benefits. With respect to the bulk of the small business people, you might say there was sort of a discrimination.

Now getting into the farmer area, I would say that most of the farmers in Iowa who would go up to $25,000 in their investments do not need any help. Those are the big ones. They are all right. They have got capital financing. They do not have any problems. But I am concerned about those operating on 160 or 240 acres, and I suggest to you that $10,000 would be more than ample for the great bulk of those people, $10,000 investment in 1 year.

Senator McGovern. I appreciate the fact the committee may want to adjust this figure. I am trying to establish a principle here though that we ought to be selective in applying the repeal of the investment tax credit. There is nothing magic about the figure of $25,000. As I said in my statement, the Senate approved that in 1966, and then when it went to conference it was set at $20,000, and there is room for compromise here. I do think that with a combine costing over $21,000 today though, that it is quite conceivable that even an ordinary commercial-type farmer would need this provision to expand his operation, or even to carry on his present operation.

I do not think it is an excessive figure.

Senator Miller. How many farmers in your State would have the capital and have the requirements to make that size of an investment in 1 year?

Senator McGovern. I think it would be a rather small percentage, but the $25,000 figure is the maximum, not the minimum figure.

Senator Miller. But——

Senator McGovern. You would cover a good many farmers on a scale below that figure. It would cover a sizable percentage of our commercial farms.

Senator Miller. You see, we have a bad public reaction among many farmers, and I am sure this happens in your State, when they pick up the newspapers and read that under the present feed grains and wheat programs there are some big operators receiving in excess of $20,000 a year of Government payments.

Now those are going to the so-called big operators, and those so-called big operators are the very ones that would be getting this maximum tax credit under your ceiling, whereas the bulk of the people are down in the area where I would guess if they put in $5,000 to $10,000

in equipment in 1 year that is doing pretty well, and that would not happen from year to year.

I think that we ought to take into account the area of need. I would suggest to you that the higher up you go the less area of need there is. That is why this concern over the amount of payments going to these big operators.

Senator McGOVERN. If we could get any percentage of this $25,000 figure exemption approved I would consider it a substantial victory.

As I say, I am not wedded to any one amount.

Senator MILLER. Thank you.

No further questions.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Senator McGovern, one of the principal reasons for approving the investment tax credit was to enable us to modernize our plants so that we could better compete with some of the foreign countries where there are lower wages and lower manufacturing costs. Do you feel that any incentives should be given in this regard, taking into consideration that we are exporting jobs each day?

Senator McGOVERN. Yes. Well, I am concerned about that I will say to the Senator. That is the reason I supported the investment tax credit proposal originally. But I do think we have an even more serious problem than that now, which is the inflationary problem in our own economy, and I do not know how we can deal with that any more directly than by at least temporarily setting aside this investment tax credit for our better established and larger businesses.

Senator FANNIN. If we have inflation as a result of supply and demand, or in other words, our production is not sufficient to take care of the demand, prices are consequently bid up. Are we not then defeating our own proposal by doing away with the investment tax credit? If we can increase the efficiency of a plant and increase productivity and better compete with other countries, and here we are as I say exporting jobs each day, are we really accomplishing the objective you are talking about by doing away with the investment tax credit?

Senator McGOVERN. I would say this, Senator. I think all of these proposals, the surtax, the excess profits tax that I have suggested, the repeal of the investment tax credit, they are all temporary patchwork devices that are not really going to in the long run do the job.

The only real way to have the resources available that we need to expand our plants and modernize our plants and do the things we need to do on the public side is to end the war. But given the present situation, I have made a judgment to support the repeal of the investment tax credit, because I did think that it might provide at least some temporary relief from the inflationary pressures that are causing so much difficulty.

Senator FANNIN. Secretary Kennedy when he was here a few days ago stated that he thought that we could give an incentive to manufacturing concerns better through some other means than through the investment tax credit. There are many different programs used in other countries of the world where they practically subsidize some of the industries so they can utilize their raw materials and better compete with other countries.

I am wondering if you have any thoughts as to what other program might be utilized rather than the investment tax credit to accomplish this objective, keeping in mind that we must have employment for our people, and that each time that we export a job, we are creating an additional problem.

Senator McGOVERN. I do not have any specific alternatives to propose now I would say to the Senator.

Senator FANNIN. Do you know that the Japanese and many other countries do have special incentive programs?

Senator McGOVERN. Yes.

Senator FANNIN. I am wondering if you had any thoughts as to what we might do other than the investment tax credit, that would not result in an inflationary trend.

Senator McGOVERN. I am not opposed to us trying to find some better way of doing it. I am concerned about the problem, but I am not prepared at the present time to suggest an alternative.

Senator FANNIN. One of the great problems of course is that inflation is brought about by higher wages and that they are not tied to productivity. I regret I was not here to hear your full testimony, but I understand that you stated that you are against wage and price controls. Do you feel we should call upon the industries and on the unions to voluntarily control wage and price increases?

Senator McGOVERN. Yes, I do.

Senator FANNIN. But that this should be done voluntarily?

Senator McGOVERN. As I said before the Senator came in, that if the war were to continue indefinitely, and this problem worsened, we may have to go to wage and price controls and rent controls as we did in previous wars.

I would not be prepared to recommend that at this time.

Senator FANNIN. Thank you, Senator.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator McGOVERN. Thank you, Mr. Chairman.

The CHAIRMAN. Members of the committee, before we call on our next witness, I would like to point out that we have eight witnesses to hear today, and they are all very interesting witnesses. Senator McGovern was a very appealing witness. By the time we got through interrogating Senator McGovern, we had used up an hour. That means that somebody will not be heard or will have to be postponed until later. I would hope that each member would try to limit himself in examining the witnesses to the things that he finds essential, so that we might hear the witness' views, without necessarily requiring that each witness know what we think about these various matters that they are testifying to.

Those of us on the committee can make our positions known to one another, and our views can be understood after we get into executive session. Of course if a member wants to testify in public session he can, but I am hopeful that we can hear as many of our witnesses as possible in the morning session while the press is here and there is better representation.

Now I will call Mr. Henry S. Reuss, the Representative from Wisconsin.

I am happy to welcome you here, Mr. Reuss. We are always pleased to know your views about this or other matters. Your views are usually very profound even when we do not agree with you.

Will you proceed, sir.

STATEMENT OF HON. HENRY S. REUSS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. REUSS. Thank you very much for your kindness, Mr. Chairman. I appreciate being here. I heard what the chairman just said about time. I would like to submit my statement in full and to summarize it briefly, hitting the high spots.

The CHAIRMAN. I see that you are somewhat familiar with the House 2-minute and 5-minute rule.

Mr. REUSS. I have just two points to make, Mr. Chairman. One is that I as well as the Chair believes that a meaningful tax reform ought to be arranged promptly. I am delighted to read that the chairman has asked his collegues in this body to submit their loophole plugging proposals I believe this Friday. I am delighted to know that many such will be submitted.

My own Senator, Senator Proxmire, told me just this morning that he has some meaningful proposals to make.

Then I want to say, secondly, a word about two or three unfortunate new loopholes which appear in the bill which we in the House sent over here the other day.

First on the linking of the surcharge and meaningful loophole plugging—while this is the position of a great number of Members of my body in the House—unfortunately the administration seems to be saying this; "Disaster impends if we do not immediately extend the surtax for a year, and if we will but do that now, meaningful tax reform proposals will be coming up presently."

I have a little difficulty with both those propositions. I think what the chairman has said about the way to handle it is just excellent, namely extend the withholding for a reasonable period, I think September 30 is the date mentioned. That will let businessmen and the Treasury know just what is happening. On the administration's inflationary argument, it will satisfy that by abstracting from the income stream this extra money, and as far as the investment tax credit goes, since the date there is April 18, 1969, a temporary extension while we grapple with loophole plugging is I think very possible and desirable.

On the second question of whether it really is good loophole plugging tactics to pass the surtax now and hope that the administration will come in, perhaps next November with a meaningful program, I have come to the regretful conclusion that so far the administration's commitment to loophole plugging seems slightly less than total in these critical areas, like mineral depletion allowance, tax exempt local bonds, capital gains at death, stock options, accelerated depreciation on speculative real estate, one looks in vain for any administration loophole-plugging proposals.

It is fashionable to say one man's loophole is another man's justified exemption, but the public knows what the loopholes are, and it hopes that the administration is not going to consider those as the legitimate exemptions.

Just take the oil depletion allowance. I come from a State which gets mineral benefits on clam shells, sand, gravel. I am quite ready to give those up. I would hope that representatives of the great petroleum producing States could take a similar view.

It is not easy, because back on November 1, Mr. Nixon, in a campaign speech in Texas, in fact in a series of them, promised that he would never tamper with that 27½-percent oil depletion allowance.

Or take tax-exempt bonds. Attorney General Mitchell was a leading tax counsel for most of his professional life for the issuers of these tax-exempt bonds. Since becoming Attorney General, he has said the taxing of income from such bonds would be unconstitutional.

I do not know what he is going to think about my colleagues on the Ways and Means Committee, who I am delighted to say propose to tax such income in an amendment they reported out just last week. But both Attorney General Mitchell and Vice President Agnew have been campaigning against doing anything with regard to tax-exempt municipal bonds.

In the capital gains area, Dr. Arthur Burns, President Nixon's chief economic counsel, not only does not want to close the capital gains at death loophole, but believes that capital gains should not be taxed at all. It is recorded that Dr. Burns' influence has kept any change in capital gains taxation out of the April administration tax package.

Moving on to stock options, it was before this very committee that Secretary of the Treasury Kennedy earlier this year negotiated successfully to take advantage of the stock option loophole with regard to his stock in the Continental Illinois Chicago Bank. He disposed of his stock before August and the bargained for tax benefit turned out to be unavailable.

Take the loophole allowing the accelerated depreciation on speculative real estate. There we find HUD Secretary George Romney arguing no changes should be made in this because he said it will do irreparable harm to low- and moderate-income housing, despite the fact that only 6 percent of the benefits of that accelerated depreciation provision go to those investing in low- and moderate-income housing.

In fact, the reason for the marriage of loophole plugging and the extension of the surcharge is that in my judgment loophole plugging cannot pass without Republican votes. The administration and its congressional leaders did a remarkable job in bringing out 154 Republican votes for extending the surcharge a week ago Monday, and I congratulate the President and his leaders on their persuasive skills. But we need similar persuasive skills exercised on tax reform, and once the opportunity to link it with the surcharge extension goes, I am very much afraid on this record that those persuasive skills just are not going to be exercised.

So I conclude by saying that the only way to keep up outside pressure is to say to the administration: No surtax without tax reform. No taxation without reformation.

Now a word on the investment credit repealer, which set up the general rule that the credit will be disallowed after April 9, 1969, unless the expenditures are made under a binding contract in effect on that date. That is a good general rule, but unfortunately three sec-

tions crept in unbeknownst to many of us, which cover only a few companies, and really destroy the principle of equality.

The first of those is designed to help some 13 pipeline companies save $14.2 million in taxes. It would enable those companies to take the investment credit on pipelines, which they have not yet bought, but for which approval was sought before the Federal Power Commission before April 19, in some cases just a day or two before.

Well, there are so many thousands of other legitimate businessmen who did not have a firm contract for whatever equipment it was, because they were waiting for commitments from the ICC, or the SEC, or the CAB, or the SBA, that I think it would be very unfair to write in any specific exemptions.

Similarly, another special interest exemption was made in the regular transition rules for three shipping companies with respect to barges to be carried on new types of seagoing cargo vessels, and a third special provision was made for the Lockheed Aircraft Co., which was given until 1972 to get the benefits of the credit.

I would hope that these little excrescences on what was otherwise a sensible repealer could be fixed up in this body, so that the benefits could be extended on an equal basis to all and not on the special interest basis which has unfortunately in the past so often vitiated and invalidated good tax legislation.

Thank you very much, Mr. Chairman. My point, I summarize, is that I hope you can fix up those additional three loopholes of the investment tax credit repealer, and above all I hope that our two bodies can enact a meaningful and revenue-raising plugging of the important loopholes. If we can, I am fully prepared to vote for such an extension of the surtax on the moderate income taxpayer as is necessary to pick up the interim revenues, so that we can do an adequate job of fighting inflation.

(The prepared statement of Mr. Reuss follows:)

STATEMENT OF HON. HENRY S. REUSS A U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

SUMMARY

I. The surcharge should be tied to tax reform.

A. Delay in passing the surcharge will not have serious consequences as long as withholding rates are extended.

B. Pressure on the Administration for tax reform must be kept up in order to offset anti-reform pressures from within the Administration.

II. The special transition rules in the investment tax credit repealer which allow a favored few companies to benefit from the credit after the April 18, 1969, cut-off date should be dropped.

STATEMENT

Mr. Chairman, I applaud your intention that any proposal to extend the income tax surcharge be considered simultaneously with recommendations on meaningful tax reform.

My testimony this morning makes two points:

(1) how very necessary such a marriage between the surcharge and tax reform is if we are ever to get tax reform; and (2) a warning about some new loopholes which, strangely enough, appear in the surcharge-investment tax credit repealer bill before you.

The position you have taken on the surcharge and tax reform is supported by a very large number of House members. Unfortunately, it seems not to have found favor with the Administration. The Administration's position is: "Disaster impends if the surcharge extension is delayed. If you will but pass the

surcharge now, tax reform in abundance will be forthcoming by the end of the summer."

I have my doubts about both of these Administration claims. I am not convinced that doom will be upon us if we merely continue to extend withholding rates without extending the surtax. Nor am I convinced that the Administration's professed ardor for meaningful tax reform will survive passage of the surtax.

If we extend the withholding rates each month to give Congress time to complete work on tax reform, there will be no great administrative burden on business men or on the Treasury. Taxes will continue to be withheld at the same rate as they have been in the past.

If we grant the Administration its argument that this tax revenue must be taken out of the economy in order to lessen inflationary pressures, extending the withholding rate will do this as well as an extension of the surcharge.

If we are concerned about the inflationary effect of delaying repeal of the 7 percent investment tax credit, we should recall that repeal, when passed, will be retroactive to April 18, 1969. Since businessmen know they can no longer count on the investment tax credit, a few months delay in enactment will not affect their investment plans.

As for the Administration's commitment to tax reform, there are signs that it is less than total. In such critical areas as the oil depletion allowance, tax-exempt state and local bonds, capital gains, stock options, accelerated depreciation on speculative real estate, and payment of estate taxes by the redemption of government bonds at par, one looks in vain for Administration loophole-plugging proposals. The reason, I suspect, is that there are strong anti-reform voices within the Administration blocking action in these areas.

Take the 27.5 percent oil depletion allowance. In a November 1, 1968, campaign speech in Lubbock, Texas, Mr. Nixon solemnly promised that he would never tamper with that sacrosanct loophole.

Or tax-exempt bonds. Attorney General John Mitchell was a leading tax counsel for the issuers of tax-exempt bonds for many years. Since becoming Attorney General, he has said that taxing income from such bonds would be unconstitutional, even though the great weight of legal authority is to the contrary. Vice President Spiro Agnew is another Nixon Administration figure who opposes taxing the interest from these bonds. Agnew, a former Governor and county executive, has reportedly been urging state and county officials to lobby against any proposals for tax reform in this area.

In the capital gains area, it has been reported that Dr. Arthur Burns, President Nixon's top economic advisor, does not believe that capital gains should be taxed at all. It was the influence of Dr. Burns, it is said, that kept any changes in capital gains taxation out of the April Nixon tax package.

Moving on to stock options, we find that Secretary of the Treasury Kennedy, earlier this year, negotiated successfully with the Senate to take advantage of the stock option loophole with regard to stock in his Chicago bank. Because he disposed of this stock before six months had passed, however, the bargained-for tax benefits turned out to be unavailable.

With regard to the loophole allowing accelerated depreciation on speculative real estate, we find Housing and Urban Development Secretary George Romney arguing that no changes can be made in this provision without doing irreparable harm to programs for low and middle income housing—despite the fact that only 6 percent of the tax benefits from this provision go to those investing in low and moderate income housing.

It should be clear from this that the Administration's commitment to "prompt and meaningful tax reform" would be strengthened by strong pressure from the outside. The only way to keep this outside pressure strong is to say to the Administration: No surtax without tax reform! No taxation without reformation!

Tax reform cannot pass without Republican votes. The amassing of 154 Republican votes for the tax surcharge in the House on June 30 demonstrates the wonders that can be worked when President Nixon and his Congressional leaders apply their persuasive skills.

Turning briefly to the investment tax credit repealer, the transition rules adopted by the House in connection with the repeal in at least three instances grant special privileges to individual companies which are very difficult to justify by any objective standard.

The transition rules generally allow the credit for expenditures after April 18, 1969, if the expenditures are made under a binding contract in effect on that

date. In addition, the credit is allowed for an entire facility in certain cases in which, prior to the cut-off date, there is an economic commitment evidenced by expenditures constituting more than half the cost of the facility.

But there are three sections, tightly drawn to cover only a few companies, which allow the credit in situations not covered by the general transition rules.

The first, designed to save thirteen gas pipeline companies some $14.2 million in taxes, would enable these companies to take the investment credit on pipeline which they have not yet bought but for which approval was sought from the Federal Power Commission before April 19 (Sec. 4(a) of the bill and Sec. 49(b)(6)(B) of the code). The theory is that the companies should not be penalized for delay by a Federal agency. But there are a great many other analogous situations in which a company must hold off entering into a binding contract while waiting for a Federal agency to act that are not covered by this provision. How about the thousands of legitimate businessmen who didn't have a firm contract because they were waiting for commitments from the Interstate Commerce Commission, Securities and Exchange Commission, Civil Aeronautics Board, or the Small Business Administration? The provision is very carefully drawn, however, so that only the thirteen pipeline companies can benefit. If there is so much merit in the pipeline companies' argument, why isn't similar largesse extended to everyone in the same position?

Another point—if it is the possible tardiness by a Federal agency which justifies this exemption from the general rule, why is it made available, as it is, to companies that sought Federal Power Commission approval only a day or two before the April 19 cut-off date? Surely these companies could not have expected action on their application within the space of a few days.

Finally, many economists have argued that the investment credit should never have been extended to utilities such as these pipeline companies in the first place, since they already recover all their investment costs plus a reasonable rate of return under the rates set for them by regulatory commissions.

The second special interest exception to the regular transition rules is designed to aid three shipping companies and would have them an estimated $3.5 million (sec. 4(a) of the bill and sec. 49(b)(9) of the code). The provision extends the investment credit to unordered and unbuilt barges which are to be carried on a new type of sea-going cargo vessel. The barges are made eligible for the credit if the ships which are to carry them are eligible, even if the barges have not been ordered before April 19. A general transition rule would make these barges eligible if they represented less than half the total cost of the ships plus the barges, but the special rule makes them eligible irrespective of this general provision. Again, the special exception is carefully drawn so that only the favored companies can benefit from it, leaving others in analogous situations to complain about the unfairness of the legislative process in Washington.

The third special provision is designed to aid the Lockheed Aircraft Corporation (sec. 4(a) of the bill and sec. 49(b)(10) of the code). The provision is tightly written to cover a contract Lockheed made last December with several companies for a new commercial plane. The planes will not all be delivered until 1973, and Lockheed has not yet bought all the tools needed to produce them. The provision would extend the credit not only to these tools, but to "all tangible personal property placed in service by [Lockheed] before January 1, 1972" which is required to carry out the contract, irrespective of the normal 50 percent rule. Once again we have a provision drafted in general terms which in fact applies to only one firm and which cynically excludes all others in similar situations.

My point, Mr. Chairman, is not that the Committee should seek out all others in similar circumstances so that the benefits unjustifiably extended to some are extended to all. Rather, I would urge the Committee to strike out these special interest provisions and leave these companies to be dealt with under the general rules that apply to everyone else. The Treasury Department has made a conscientious effort to draft transition rules that are as fair to everyone as possible. There will of course always be companies who are denied the credit under these rules who can plausibly claim to be entitled to it, but Congress is not well equipped to deal with these individual cases. The Congress should draw up rules which are generally applicable, leaving to the courts the task of applying them in individual cases. Once we get into the business of drafting special laws for special people, we simply compound the inequity of the laws we pass, while fostering cynicism and disillusionment among those who are excluded from the special benefits.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. No questions.

The CHAIRMAN. Senator Jordan?

Senator JORDAN. No questions.

The CHAIRMAN. Senator Miller?

Senator MILLER. I am always happy to see my colleague from the Joint Economic Committee. I do think that I ought to mention a couple of things that keep matters in perspective. I note that you refer to a speech during the last presidential campaign. I think that it is only fair to point out that in Business Week, I cannot think of the exact date, but it was during the presidential campaign, both Vice President Humphrey and candidate Nixon were asked about their views regarding the percentage depletion on oil and gas, and both of them, not just Mr. Nixon but Mr. Humphrey as well, indicated that they were opposed to tax changes. I want to put that in the record. My point is that both candidates made the point, both Vice President Humphrey and Dick Nixon, in stating their opposition to it, so there must be some pretty good reasons, and there are, as the Senator well knows.

This does not mean that this item is sacrosanct, but I just want to put that item in perspective.

Mr. REUSS. Could I comment on that, Senator?

Senator MILLER. Yes, you may.

Mr. REUSS. I weep for Senator Humphrey. I think both the gentlemen were wrong, and I have before me a release of the Republican National Committee dated "immediate release, November 1, 1968, statement of Richard M. Nixon, Lubbock, Tex.:

> Who can you trust? When we are in Texas I think it is right for me to bring up an issue of importance to Texas that indicates the great gulf of difference between Hubert Humphrey and Richard Nixon on the issues. On the question of the oil depletion allowance Senator Hubert Humphrey voted to reduce that allowance, and Vice President Hubert Humphrey said the allowance could stay as it is. As Senator, Richard Nixon supported the oil depletion allowance at its current level. I supported it as Vice President. I will maintain it. With Mr. Humphrey's waffling on this issue, Texans ought to ask themselves when they go to the polls on Tuesday who can you trust?

I think that gives the accurate historical record, and as the Senator from Iowa correctly reports, there did not seem to be an issue between the two presidential candidates as of last November 1. There was, however, an enormous issue between the people in this country who want fair taxation and those who for one reason or another have swallowed the unconscionable claim of the oil companies for their 27½ percent depletion allowance.

Senator MILLER. Of course, whether there was such an issue and how the votes went is something for the historians to write about. All I want to point out is that between candidate Humphrey and candidate Nixon they were on key on this point, and I just thought we ought to make the record clear on that. All the Republican campaign advertising down in Texas was designed to do was to show that candidate Humphrey talked out of both sides of his mouth, but be that as it may, the point is that they were both together as far as that is concerned.

Now with respect to tax-exempt bonds, I certainly have never had anything to do with representing municipalities or school boards, but I must tell my colleague from Wisconsin that I receive an awful lot of mail, phone calls, and many expressions of deepest concern from local school districts, school board members, teachers, members of the League of Municipalities stating that it would be disastrous if they were made noncompetive by having tax-exmpt local bonds made taxable.

I do not think that we ought to just concentrate on Attorney General John Mitchell. I believe much more can be done in concentrating on the school board members, teachers, and members of city councils from my State.

Finally the Congressman said that it was the influence of Dr. Burns. I do not know who said that but he says it was the influence of Dr. Burns that kept any changes in capital gains taxes out of the April Nixon tax package. To my recollection it was not kept out. It was very much put in, and it was included in the treatment of so-called limited tax preferences. So I think again we ought to make the record eminently clear on that point. I never talked to Dr. Burns. I do not know what Dr. Burns' views are on the subject, but be that as it may, we have the recommendations from the administration to have a taxation of what are called limitations on tax preferences, and capital gains as the Congressman knows are included in that package.

That is all I have, Congressman.

Mr. REUSS. I would say to the Senator from Iowa that no one would be happier than I if I have unwittingly misrepresented Dr. Burns, and if he were to come vigorously tomorrow to the aid of the cause for taxing capital gains at death and making other reforms. My authority was an article in the New York Times by Eileen Shanahan date July 6, 1969, where it said:

> One of the President's closet advisers, Dr. Arthur F. Burns, does not believe that capital gains should be taxed at all, not even at the current maximum rate of 25 percent for property owned at least 6 months. Dr. Burns had sufficient in fluence to keep changes in the taxation of capital gains completely out of the starter set of tax reforms that Mr. Nixon recommended to Congress in April.

If Miss Shanahan has spoken inaccurately of Dr. Burns, I am sure he will set the record straight, but that is my impression, too.

Senator MILLER. May I say with all due due deference to Miss Shanahan, I am much more impressed by what the President of the United States through the Secretary of the Treasury sent over to the House, and he sent over the recommendation for taxation of capital gains through the proposal of a limitation on tax preferences, so apparently Dr. Burns one way or the other did not have much impact on that, and that is the one that counts.

Mr. REUSS. I did not think, however, he said anything about the enormous capital-gains-at-death loophole which alone causes $2.5 billion a year to escape taxation.

Senator MILLER. The limited tax preferences would do a pretty good job, I suggest to my colleague.

Mr. REUSS. My impression is that it raises about $35 and a cigar over a year but I could be wrong.

Senator MILLER. I think the Congressman will find that the Joint Committee on Internal Revenue estimates a considerable amount of

revenue from the taxation and limited tax preference approach. My point to put it in perspective again, I personally could not care less what Dr. Arthur Burns has to say and whether he thinks capital gains should be taxed or not. What counts to me is what does the administration through Secretary Kennedy recommend, and when they recommend limited tax preference treatment, I suggest that we ought to recognize that. I just want to put it in perspective.

The CHAIRMAN. Thank you, very much.

Mr. REUSS. Thank you, Mr. Chairman.

The CHAIRMAN. The next witness is Mr. W. Gullander, president of the National Association of Manufacturers.

We are pleased to have you here today, Mr. Gullander.

STATEMENT OF W. P. GULLANDER, PRESIDENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. GULLANDER. Mr. Chairman and members of the Committee on Finance, my name is W. P. Gullander. I am president of the National Association of Manufacturers and on behalf of the association I express it appreciation for this opportunity to present its views on H.R. 12290.

At the risk of repeating myself but for the purpose of emphasis, I want to point out to this committee that the NAM is greatly concerned about the problems of inflation. As a result we strongly support extension of the surtax for a year together of course with adequate expenditure controls, and we commend the Congress for having established a ceiling for Federal spending for fiscal 1970.

Gentlemen, our credentials on this subject are pretty good. Two years ago I was the first public witness before the Ways and Means Committee to support the surtax, and therefore we are not newcomers to this business of recognizing that although we dislike taxes, that we dislike inflation more than we dislike taxes. So in hearing my testimony I hope you will do so with this clear understanding that we are in favor of the extension of the surtax.

The NAM is opposed to the enactment of H.R. 12290 in its present form which links extension of the income tax surcharge to repeal of the 7-percent investment credit. We feel strongly that this is inappropriate, inequitable, and economically unsound.

The business community has been asked to support the anti-inflationary objective of the surcharge extension and, in addition, accept the loss of the investment credit. The NAM will concede to no one greater concern over the problems of inflation today. Consistently, we have supported sound public policies to reduce inflationary trends. The NAM was among the first of business organizations to back the imposition of the income tax surcharge and I was the first of the public witnesses to testify in support of this unpopular course 2 years ago.

However, we cannot now endorse a bill which ties a short-term fiscal policy measure to a permanent and, in our opinion, unjustifiable additional tax burden on the business community.

Therefore, we urge this committee to reject this approach and to consider the surcharge extension on its own merits as a separate piece of legislation and to recommend retention of the 7-percent investment credit.

Before considering the issue of the investment credit, I would like to comment briefly on the fiscal policy decision to be made.

FISCAL POLICY OUTLOOK

The Revenue and Expenditure Control Act of 1968 was enacted in the shadow of the most massive Federal budget deficit since World War II and in the midst of accelerating inflation throughout the economy. At the time, many thought that the surcharge would serve as a quick brake on inflation. But even after making a generous allowance for the admitted lags between fiscal policy initiation and its impact, the income tax surcharge appears to have been a very imperfect anti-inflationary weapon.

Perhaps this should not be too surprising considering the extent to which higher taxes are elements of cost, which both business and labor seek to offset through higher prices or higher wage demands.

What the surcharge clearly has done and what in our opinion justified its imposition a year ago has been to set the stage for effective monetary policy restraint. The elimination of the huge Federal budget deficit over the past year has given the monetary authorities the opportunity to pursue the objective of orderly and restrained growth in the money supply, demanded by present economic conditions. It is unfortunate that there was a half year delay, after last year's fiscal legislation, in establishing such a monetary policy.

In fiscal 1970, if Congress approves the administration's spending plans generally as proposed but allows the surcharge to expire, there would be a budget deficit of at least $4 billion. The administration contends that this would be entirely inappropriate during such a period of inflation, and the NAM agrees with that conclusion.

The association does not believe, however, that the Nation is ready or willing to accept a permanently higher level of taxation as a means of supporting a permanently higher level of Government expenditures. The widespread unpopularity of the present 10 percent surcharge is convincing evidence of this.

Therefore, the ultimate solution must be sought, not in tax action, but in the control of spending, which both theory and experience indicate is the fiscal policy most effective against inflation. The NAM believes that, given sufficient determination, total outlays for the coming fiscal year could be reduced significantly below the proposed total of $192 billion. Such efforts may be painful, but the American people find the alternative of additional taxes even more painful.

However, the NAM would endorse extension of the surcharge for 1 year provided it were accompanied by a maximum effort at Government economy and not coupled with repeal of the investment credit.

LEGISLATIVE HISTORY OF THE INVESTMENT CREDIT

Throughout its brief history, there has been a tendency in some quarters to consider the 7-percent investment credit as a subsidy to business—in the sense that business was receiving a special privilege not available to others. Anticipation of this attitude was one of the reasons that business did not wholeheartedly endorse the credit in the first place. Many organizations, including the NAM, would have

preferred a lower corporate income tax rate to stimulate capital formation and long-term growth.

However, industry was assured that the credit was to be a permanent feature of our tax system to help counter inflation of equipment costs and to help equate our system with liberal tax practices overseas.

The Revenue Act of 1964—one of the most important single domestic economic measures of the last 20 years—reduced individual income tax rates by an average approximating 20 percent, about two-thirds of the reduction becoming effective in 1964 and the remainder in 1965.

Corporation rates, however, were not reduced 20 percent—they were reduced less than 8 percent, specifically from 52 percent to 50 percent for the year 1964 and 48 percent for 1965 and subsequent years.

The committee reports accompanying the Revenue Act of 1964 explained the disproportionate rate reductions as between individuals and corporations, pointing out that in 1962, corporations had been the principal "beneficiaries" of the investment tax credit enacted as part of the Revenue Act of 1962 and that depreciation reform, initiated in that year as an administrative measure, had also largely benefited corporations.

Your own Committee Report No. 830, January 18, 1964, page 8, stated:

> This bill provides a balanced reduction between individuals and business firms. In this respect, the bill is much the same as the bill that came from the House. When fully effective, the bill will reduce individual income taxes by $9.2 billion and will reduce corporate taxes by about $2.4 billion. These figures must be evaluated along with the effective tax reduction of 1962 through the investment credit and depreciation reform, the largest share of which went to corporations. Taking the 1962 and 1964 programs together, the share of the reduction going to individuals is about two-thirds and to corporations about one-third, which is approximately the present relative shares of individuals and corporations in income tax liabilities.

Thus the investment credit could hardly be considered an extra bonus to industry when it was clearly a part of a package designed to arrive at a fair distribution of tax reduction between individuals and corporations. Repeal of the credit, in its overall effect on corporate tax burdens, would be roughly equivalent to an additional 7-percent surcharge on corporate income taxes.

If someone proposed a permanent increase in corporate taxes in just that form, we doubt that the Congress would give it serious consideration. In addition, loss of the credit would be of serious consequence to farmers and other unincorporated enterprises.

ECONOMICS OF THE INVESTMENT CREDIT

Members of the Council of Economic Advisers publicly have stated that the investment credit repeal would not have a significant impact on aggregate demand or inflationary trends in the economy. Nevertheless, much of the consideration in Congress, as evidenced by the majority report of the Joint Economic Committee, has centered on the alleged inflationary effect of the investment credit.

We fully recognize that, in the circumstances of 1969, with the labor supply stretched to its tightest point in 18 years and the econ-

omy still reeling from the effects of past excesses of monetary and fiscal policies, any increases in spending, whether from the business, consumer, or government sectors, are to some extent "inflationary." We simply do not have the slack in our resources to take up additional demand pressures without some overheating.

Does this justify removing a part of the basic tax structure designed to make the economy more productive and competitive? We think not. Strictly from the point of view of controlling inflation, repeal of the credit would be self-defeating.

It cannot be overemphasized that new investment in capital equipment is necessary not only to expand capacity, but to modernize it, and, therefore, to ease pressures on costs and prices. In point of fact, the ultimate anti-inflationary weapon of the U.S. economy is its productivity, which must be maintained and enhanced to counter inflationary trends.

More efficient plant and equipment and a more productive economy are particularly crucial in view of the full or near-full employment conditions that we have had since the mid-1960's with all their implications for labor costs. Over even a short span of years, capital spending by business is a deflationary rather than inflationary force.

It is perhaps true that the special stimulus to inspire investment provided by the investment credit is not needed in the extraordinary boom conditions of the immediate present. But this boom will not last forever. Booms never do. In fact, the primary objective of the proposed extension of the surcharge is to bring this inflationary boom to a quick and orderly end.

We should be thinking of the kind of tax system that will be appropriate to the economic conditions that will prevail after the boom is over. The most optimistic assumption is that they will be similar to the conditions of the early 1960's when we had economic growth without any serious inflation.

It was in that period that the investment credit was adopted and played a highly constructive role in the economy. If you prefer a less optimistic assumption about future economic conditions, the investment credit might be needed even more.

In fiscal 1970, official estimates indicate that elimination of the credit would contribute only $1.35 billion to Federal revenues. When fully effective, it would add something over $3 billion a year to the tax liabilities of business enterprises, but that would not happen for several years. In other words, repeal of the investment credit would have only a limited impact on revenues when anti-inflationary action is needed most.

It would have its maximum impact several years later when it might be entirely inappropriate to the economic conditions which will then prevail. It could well turn out to be "fine tuning" in reverse.

Repeal of the credit also has been urged on the grounds that attention must be given to other "priorities." Yet all economic objectives depend on the real growth, productivity, and competitive strength of the economy. The rate of business fixed investment has been relatively high since 1962 and, concurrently, the performance of the economy in terms of real growth has been relatively good.

Most observers assign to the investment credit a significant, although not entirely measurable, role in this expansion. In short, the credit has

worked toward fulfilling one of its important objectives—to raise productivity.

An allied objective was to make the economy more competitive internationally, and we have seen progress toward this in some areas. However, because of a number of factors, including the acceleration of inflation over the last 2 years, our overall balance-of-trade position has deteriorated drastically. If ever there was a clear and present need for measures which improve our competitive stance abroad, it is right now. This must be a prime priority for economic policy. While the administration proposes to remove the 7-percent investment credit, foreign competitors will continue to utilize considerably more liberal investment incentives and, of course, enjoy considerably lower employment costs.

The 7-percent investment credit is essentially a partial offset to the adverse effect of the corporate income tax on capital formation. With the credit there would still be great need to assure more adequate capital supply in the 1970's. Without it, this need would be magnified.

Anyone who has even casual knowledge of interest rate trends today can appreciate the fact of the worsening capital shortage in this country and, indeed, worldwide. If the private sector is to continue to provide the means for economic advancement, not to mention the additional roles it has assumed or is being asked to assume in attacking various social problems, it must have the capital resources to do the job and a more favorable public policy toward these resources. Repeal of the investment credit would be a step backward.

Furthermore, in view of the foregoing, we are particularly disturbed that repeal of the investment credit has been proposed in legislation which has been repeatedly characterized as of an emergency nature, without opportunity for Congress to consider the vital issues involved with the same thoroughness that surrounded enactment of the credit in 1962.

AMORTIZATION OF POLLUTION CONTROL FACILITIES

H.R. 12290 provides an incentive for air and water pollution control efforts in the form of a 5-year amortization for "certified facilities." The NAM is entirely in sympathy with the objective of this provision and urges favorable consideration of this type of measure by the committee but, hopefully, in separate legislation in order that all aspects of this problem can be examined in depth and considered on their merits.

In conclusion, we urge the Committee on Finance to strike from H.R. 12290 all provisions other than those pertaining to the income tax surcharge and the excise rate extensions. These provisions can then be considered, if the committee so desires, in connection with the tax reform hearings which you have scheduled to begin next week. In this event, we would favor enactment of H.R. 12290.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. I will pass for the time being.

The CHAIRMAN. Senator Miller?

Senator MILLER. No questions.

The CHAIRMAN. Senator Jordan?

Senator JORDAN. No questions.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. You talk about the investment tax credit. Realizing the costs we have in competing with many of the countries of the world, do you have any suggestions as to what type of depreciation reform would be desirable or what incentive might be given to industry if the investment tax credit is removed?

Mr. GULLANDER. Mr. Senator, I think that is an issue which we would be prepared with a great deal of technical expertise to discuss with you at the time that is discussed as a separate piece of legislation.

Senator FANNIN. I think that would be best. I know when Secretary Kennedy was before us, he did make the statement that he thought that some other form of incentive would be better than the investment tax credit, and at that time he stated that his Department would be studying and making recommendations in that regard. I hope that you do cooperate with them in that instance.

Mr. GULLANDER. Senator, I would like to take advantage of your question to state that I think it is important that every member of this committee and the public, generally, recognize that depreciation reform, changes in depreciation policy, can be helpful to industry if they do not reduce the amount of depreciation we can take. It is all a question of timing. Do you take it early, do you take it late? There is an advantage to industry. It is preferable to have your tax deduction early because you in effect get refunds early but you do not get any reduction in taxes over the life that you depreciate. You merely get the interest back and, therefore, depreciation reform is not the same advantage as a tax credit or a lower tax rate. I think this has to be borne in mind.

You need a great deal of depreciation reform, because all you save is interest to counteract the loss of what is equivalent to the 7-percent tax rate.

Senator FANNIN. Thank you.

The CHAIRMAN. That is a very fine statement you have made.

Senator BENNETT. On page 5 of your statement, Mr. Gullander, you say in the middle of the middle paragraph: "Repeal of the credit would be roughly equivalent to an additional 7-percent surcharge on corporate income tax."

Mr. GULLANDER. Right.

Senator BENNETT. Of course there is no relationship between the method on which the investment credit is figured, and I just wanted to make clear that you just did not take 7 percent and add it in there, because that is the amount of the investment credit.

Mr. GULLANDER. No, we took the number of dollars involved, and of course I am talking here about society as a whole, not individual companies. You need much more than 7 percent for some companies and nothing for a company that has no assets that last more than 4 years, as brought out a little earlier. But as far as the effect on our society in generating capital to permit us to have more facilities and cut our costs, that is the effect, the same as the 7 percent.

Senator BENNETT. I just wanted to make the record clear you had not just taken the 7 percent.

Mr. GULLANDER. No, we have not.

Senator BENNETT. And added it on.

Mr. GULLANDER. It is a coincidence.

Senator BENNETT. In 1967, Mr. Chairman, the total corporate income plus the amount deducted for 7 percent credit was $31.2 billion, and the investment credit was $2.5 billion, so in 1967 it was slightly more than 8 percent rather than 7.

Mr. GULLANDER. But over the period of time it comes out to about 7 percent.

Senator BENNETT. Thank you.

The CHAIRMAN. Thank you.

The next witness is Mr. J. V. Ferguson of Air Products & Chemicals, Inc.

We are happy to have you, Mr. Ferguson, and we are happy to hear your views. Some of your views on tax matters go back 17 or 18 years.

STATEMENT OF JOSEPH V. FERGUSON, AIR PRODUCTS & CHEMICALS, INC., ACCOMPANIED BY LEON C. HOLT, JR., VICE PRESIDENT AND GENERAL COUNSEL

Mr. FERGUSON. I am Joseph V. Ferguson of the Air Products & Chemicals, Inc., producers of industrial gas. I want to address my remarks to the Louisiana operation.

It is not limited of course to air products but is limited to all corporations in similar situations.

As the chairman well knows we in Louisiana have experienced a tremendous industrial development between New Orleans and Baton Rouge, La., in the petrochemical field.

What concerns us here today is what we consider an inadvertent omission of determination of the investment credit provisions to the bill presently pending before this committee.

Air Products in Louisiana over the past 6 years has experienced a very large growth and expansion, in Louisiana primarily because of very favorable economic climate, including the presence of various raw materials which are necessary for its products.

Similar corporations located in other States have similar advantages to our corporate enterprise there would be equally affected by the termination of this investment credit.

I do not profess to be the expertise on taxation that many of the witnesses who appeared before the committee this morning are, but I would like to introduce to the committee Mr. Leon Holt, who is vice president and general counsel of Air Products & Chemicals, Inc., and who will address the committee in somewhat more detail as to the effect of the termination of this investment tax credit.

This is Leon Holt.

The CHAIRMAN. Let me see if I understand what you are saying. Are you saying that there was an inadvertent omission from the termination of the investment credit provisions?

Mr. FERGUSON. We consider that to be true, Senator. That is the problem here.

The CHAIRMAN. I do not think the committee is going to be inclined to vote any special advantage to any particular company, but I do think that it might be inclined to vote to treat all companies alike. If somebody has been discriminated against, we will try to act in general terms rather than to the specific advantage of any one taxpayer. I take it that this is what you are addressing yourself to?

Mr. HOLT. Yes, sir.

Senator and members of the committee, this is the general provision which was in the 1966 Suspension Act, and it was omitted from H.R. 12290, and we are requesting that this provision be restored.

As Mr. Ferguson said, it does affect our industry. I would expect that it affects several other industries as well.

Senator BENNETT. Mr. Chairman, may I interrupt? This is the same problem that was presented to us by a witness from the coal industry a little earlier.

Mr. HOLT. I have seen their statement. It is very similar to the situation which was presented for them. I might explain that one of the principal lines of business of Air Products & Chemicals is the onsite supply of industrial gas to major consumers such as steel companies and chemical companies. This onsite supply involves the construction of a major facility on, or adjacent to, the site of a customer, pursuant to a long-term contract, under which the customer agrees to buy its total requirements and it agrees to take or pay for a fixed amount of gas at fixed prices.

Prior to the cutoff date, or suggested cutoff date, April 18, Air Products had entered into 8 different contracts to build onsite facilities. These plants would involve the investment of approximately $12 million. Under H.R. 12290—and I should say that these contracts were entered into base on the assumption that the investment tax credit would be available—Under H.R. 12290, it appears that it will not be available except to the extent that construction has commenced or substantial orders have been placed. With these large facilities, there is a time interval for engineering of at least 6 months to put these facilities into being. It requires about 18 months, so a transitional provision of the nature that was in the 1966 act is very necessary to cover this type of situation.

We understand that it was omitted inadvertently. We would like to see it restored.

We have seen the statement that Senator Bennett mentioned of the coal industry. We think that their provision would cover our industry as well, and in fact in our prepared statement we have suggested some language for consideration that would cover we think both.

I should say that we were satisfied with the 1966 provision as it was written.

The CHAIRMAN. You refer to a "take or pay" contract. I think I understand what you are talking about, even though it is not too clear. Does that mean that you pay for the gas whether you get it or not, is that what it amounts to?

Mr. HOLT. Yes, sir. The essence is that the contracts provide for a fixed stream of revenues over the term of the useful life of the equipment, normally in our case it is 15 years.

Senator BENNETT. Mr. Chairman, that is another side. You furnish the gas even if you have it available or not, is that not right?

Mr. HOLT. That is frequently in such contracts.

Senator ANDERSON. You state that something was inadvertently left out by the House. What was is? Did Mr. Mills say it was inadvertent?

Mr. HOLT. No, sir; I do not think so.

Senator ANDERSON. Who said it was?

Mr. HOLT. By inadvertence I believe one of the earlier drafts contained this provision and it was broadened and the broadened provision was omitted, and it was felt that certain facets of this particular provision were covered by others included in the act. That is what I meant by it. It is clear that it was not that this provision would have to be included to cover this kind of situation.

The CHAIRMAN. Senator Miller.

Senator MILLER. With respect to the portion of that provision omitted which you have on page 1 of your statement, I note the last sentence says "Clause (ii) of the preceding sentence shall not apply if a political subdivision of a State is party to the contract and is required by the contract to make substantial expenditures which benefit the taxpayer."

May I say I think one of the most tormenting words from the standpoint of the Internal Revenue Service is the word "substantial." And after having been in practice myself and having walked with the other side on many occasions over that word, I have a rather abhorrent reaction to the use of such a word in legislation. What do you have in mind? What is substantial? Give us an example of what you are talking about.

Mr. HOLT. Well, I believe this provision also troubles us at times. It is hard too—I believe the Senate report in 1966 referred to substantial as being 80 percent.

Senator MILLER. Being what?

Mr. HOLT. 80 percent I believe was deemed substantial in the Senate report.

Senator MILLER. Give an example of an 80-percent expenditure which would benefit the taxpayer.

Mr. HOLT. I am sorry, Senator, I misunderstood your question. I thought you were referring to the use of the word "substantial" in the prior part.

Senator MILLER. You suggested that we add language which will be what I read, and I am asking you if you have that language to offer to us, what would you use as an example, a situation in which under a contract the political subdivision, let us say a city or municipality, is to make substantial expenditures which benefit the taxpayers?

Mr. HOLT. I would have trouble answering what is substantial under those circumstances. I must confess I do not know why this provision was inserted in the 1966 act. I do not understand the background, and it is not essential to our situation.

Senator MILLER. It may not be essential to your situation, but if you include all of it, it is going to provide for an exception to the situation.

Mr. HOLT. Yes, sir.

Senator MILLER. And I am trying to figure out what kind of an exception that would be.

Mr. HOLT. The only type that I could think of is where perhaps an industrial development corporation had contributed funds for the installation or the facility.

Senator MILLER. Contributed a site, for example?

Mr. HOLT. A site or something of that nature. But I must say it is speculation on my part. We would be happy to have that provision deleted. I do not know what it really adds.

Senator MILLER. Well, maybe you would be happy to have it deleted but I am sure that the reason it was put in there originanlly was so that a taxpayer would not get a double dip, so to speak.

Mr. HOLT. Yes.

Senator MILLER. A dip from the Federal Government and a dip from the local government, and so this would tend to reduce the coverage of what you are advocating. To this extent I suppose it is advantageous to the revenue, but I must say I have difficulty regarding the meaning of that word "substantial." I can see where a site acquired by a local corporation such as you mentioned might be deemed a substantial expenditure. I do not know where we draw the line. It is a pretty nebulous thing. If you have any suggestions——

Mr. HOLT. I do not have any immediate suggestions. One thought crosses my mind would be an amount which would exceed the investment credit, which would be available with respect to a facility. That would be one fair way of looking at it.

Senator MILLER. Thank you very much.

The CHAIRMAN. Thank you.

Mr. FERGUSON. Thank you very much.

The CHAIRMAN. Without objection, I will include in the record at this point a telegram I received from Mr. George S. Dillon, president of the Air Reduction Co., Inc., and a letter of Mr. Holt's dated July 8, 1969.

(The communications referred to and the prepared statements of Mr. Ferguson and Mr. Holt follow:)

STATEMENT OF JOSEPH V. FERGUSON, ATTORNEY, ON BEHALF OF AIR PRODUCTS AND CHEMICALS, INC.

Mr. Chairman and members of the Committee, I am Joseph V. Ferguson, an attorney in New Orleans, Louisiana. I appear before this Committee on behalf of Air Products and Chemicals, Inc. Air Products is concerned with what appears to be an inadvertent omission from the termination of investment credit transition provisions. If the omitted language is not restored, Air Products will not obtain investment credit on facilities which, prior to April 19, 1969, Air Products was under contract to construct and operate.

One of the major facilities involved will be located at Geismar, Louisiana, which will supply the Wyandotte Chemicals Corporation with its requirements for large quantities of industrial gases.

Air Products has expanded rapidly in Louisiana. It recognizes that Louisiana provides ideal condititons for chemical companies which are important customers for industrial gases produced by Air Products. Air Products recognizes that Louisiana has created and maintained a favorable tax climate which has and will continue to attract the chemical and other industries to Louisiana. It recognizes the importance of availability in Louisiana of raw materials, such as natural gas, required by chemical companies. Air Products also recognizes the importance to the chemical industry of the inexpensive water transportation available in Louisiana.

Air Products has contributed substantially to the economy of Louisiana through its investment in Louisiana based facilities which most chemical and other industries require in great quantity. The availability of industrial gas at known cost has been a substantial factor in attracting industry to Louisiana. The Geismar plant will be Air Products' fifth industrial gas facility in Louisiana. From a small investment prior to 1964, Air Products, on completion of the Geismar facility, will have invested approximately $40,000,000 in the State of Louisiana. On a book value basis, on completion of the Geismar plant, Air Products will have invested more in Louisiana than it has invested in any other state.

The industrial gas industry requires substantial capital investment. The availability of the tax credit is an important factor in establishing prices to cus-

tomers. The withdrawal of the credit on facilities that Air Products was required to construct under contracts in existence prior to April 19 will represent a substantial economic loss to the Company.

Mr. Leon C. Holt, Jr., Vice President and General Counsel of Air Products, will briefly outline for you the nature of the problem that Air Products faces on withdrawal of the credit.

STATEMENT OF AIR PRODUCTS AND CHEMICALS, INC., PRESENTED BY LEON C. HOLT, JR., VICE PRESIDENT AND GENERAL COUNSEL

SUMMARY

The investment credit termination provisions of H.R. 12290 omit a transition provision contained in the 1966 suspension period act related to binding contracts entered into before the effective date under which a taxpayer is required to construct or acquire a facility, and the other party to the contract is required to purchase substantially all of the products to be produced at the facility. This provision was intended to protect the taxpayer which had contracted to supply the output of a plant under long-term contracts at prices which were established under the assumption that the credit would be available on the facility to be constructed. It is requested that the Committee cause the omitted language to be restored to H.R. 12990. The language involved is contained in Section 48(h)(8) of the Internal Revenue Code and is quoted on the next page of this statement.

STATEMENT

The investment credit was suspended effective October 9, 1966, and was restored effective March 9, 1967. The transitional provisions of H.R. 12290, relating to termination of the investment credit, generally follow the language of the transitional provisions of the 1966 suspension period act, with some new provisions added. However, the fourth and fifth sentences of Section 48(h)(8) contained in the 1966 act are omitted from the corresponding provision of H.R. 12290. Section (48)(h)(8) is quoted below. The omitted language is italicized.

"Where, pursuant to a binding lease or contract to lease in effect on October 9, 1966, a lessor or lessee is obligated to construct, reconstruct, erect, or acquire property specified in such lease or contract, any property so constructed, reconstructed, erected, or acquired by the lessor or lessee which is section 38 property shall be treated as property which is not suspension period property. In the case of any project which includes property other than the property to be leased to such lessee, the preceding sentence shall be applied, in the case of the lessor, to such other property only if the binding leases and contracts with all lessees in effect on October 9, 1966, cover real property constituting 25 percent or more of the project (determined on the basis of rental value). For purposes of the preceding sentences of this paragraph, in the case of any project where one or more vendor-vendee relationships exist, such vendors and vendees shall be treated as lessors and lessees. *Where, pursuant to a binding contract in effect on October 9, 1966, (i) the taxpayer is required to construct, reconstruct, erect, or acquire property specified in the contract, to be used to produce one or more products, and (ii) the other party is required to take substantially all of the products to be produced over a substantial portion of the expected useful life of the property, then such property shall be treated as property which is not suspension period property. Clause (ii) of the preceding sentence shall not apply if a political subdivision of a State is the other party to the contract and is required by the contract to make substantial expenditures which benefit the taxpayer.*"

The portion of Section 48(h)(8), relating to lease obligations, which has been carried over from the 1966 act is contained in Subparagraph (A) of Section 49(b)(6). A Subparagraph (B) has been added which relates to property used to transport products. It is understood that an additional subparagraph to Section 49(b)(6) was contained in a Ways and Means Committee draft of the bill. This additional subparagraph carried over, in modified form, the language of the 1966 act quoted above. It is understood that the modified version would have had the effect of extending relief to situations which did not qualify under the 1966 provision. Apparently, the Ways and Means Committee did not desire to broaden the relief and voted to strike the subparagraph without realizing that it had removed a provision which had been contained in the 1966 act.

Prior to April 19, 1969, Air Products and Chemicals, Inc., had contracted with various users of industrial gas, such as steel and chemical companies, to supply substantially all of the output of certain facilities to be constructed and operated by Air Products. Because the contracts involve an agreement to supply product under which Air Products is required to build and operate facilities, rather than a contract to sell or lease the facilities, relief is not available under the pending bill, except to the extent that construction had commenced or substantial orders had been placed prior to April 19, 1969. We estimate that Air Products was contractually committed prior to April 19, 1969, on projects involving capital expenditures in excess of $10,000,000 which will not qualify for credit under the pending bill. The decision to enter into these contracts was made under the assumption that the credit would be available. The prices established in the contracts reflect the expectation of the availability of the investment credit. Provision is made for escalation of the price to reflect changes in major operating costs, such as power and labor. No provision is made, however, for an increase in price because of loss of the investment credit.

The firm contract to supply situation differs from the taxpayer which has decided to build a facility without advance commitment as to sales price of product to be produced. The taxpayer building the facility will be free to adjust prices for the product to compensate for loss of the credit. The taxpayer building a facility pursuant to a firm long-term price contract will not be able to adjust prices to compensate for loss of the credit.

In 1966, Congress placed the binding contract to supply situation in the same category as binding contracts to lease, under which the lessor was required to construct or erect the facility to be leased. Both cases were covered in the 1966 transition provisions in a paragraph entitled "Certain Lease and Contract Obligations."

The transition provisions of H.R. 12290, in proposed Section 49(b)(6)(A), carried over the provision relating to contracts to lease. We believe that, economically, the APCI contract to supply situation is equivalent to a contract to lease, under which the lessor contracts to construct property to be leased. We base this position on the following facts:

1. The APCI plant is constructed on or near the site of the customer's plant. The gas is delivered directly via a pipeline from the APCI plant to the customer's plant.
2. The contract to supply the customer is for a period of about fifteen years, which is approximately the life of the plant.
3. The APCI plant is designed to meet the customer's specifications as to purity, pressure of gas at delivery point, and quantity.
4. The customer agrees to pay APCI a guaranteed minimum rate which assures recovery of cost, plus profit.

It is requested that the Committee approve the restoration of the contract to supply language contained in the 1966 suspension period act.

It is understood that the Committee has been requested by other taxpayers to add a transitional provision which would have the effect of restoring the contract to supply provision in a broadened form. Should the Committee favor the broadening of the contract to supply provision, we feel that the language set forth in Attachment 1 would be more appropriate and easier to understand than that which has been proposed to the Committee by other taxpayers.

As a technical drafting matter, the provision relating to contracts to lease now contained in proposed Section 49(b)(6)(A) of H.R. 12290 and the Air Products long-term contract to supply situation are closely related to the "binding contract rule" contained in proposed Section 49(b)(1). Perhaps consideration should be given to broadening Section 49(b)(1) to cover binding contracts to lease and supply, as well as contracts to purchase. Attachment 2 contains language which we believe would accomplish a consolidation of these provisions without a great deal of complication. Consolidation in one paragraph of the clauses dealing with the various types of binding contracts should serve to simplify an already complicated provision.

In making these technical drafting suggestions, it should be emphasized that Air Products would be satisfied with the restoration of the 1966 language.

Economically, the Air Products long-term contract to Supply situation is no different than a contract to lease under which the lessor undertakes to erect the facility to be leased. The pending bill would grant the credit in a lease situation, but not the Air Products long-term contract situation. If Air Products' customers had contracted prior to April 19 to purchase the plants, rather than the produc-

tion of the plant for its useful life, the credit would clearly be available under the pending bill. Its availability would have been reflected in the sale price of the plant. Where the underlying economic substance is the same, the credit should be granted on an equal basis.

ATTACHMENT 1

49(b)(6)(C) Where pursuant to a binding contract in effect on April 18, 1969, (i) the taxpayer is required to construct, reconstruct, erect, or acquire property which is either identified in the contract, or which is identifiable from the terms of the contract relating to geographical location and product specifications, (ii) the property is to be used to produce one or more products under such contract, (iii) the other party to the contract is required to take substantially all of the products to be produced over a substantial portion of the expected usual life of the property, and (iv) the contract for sale of the product or products does not contain provisions permitting a price change as a result of the termination of the investment credit, then such property shall be pre-termination property. Clause (iii) of the preceding sentence shall not apply if a political subdivision of a state is the other party to the contract and is required, by the contract, to make substantial expenditures which benefit the taxpayer.

ATTACHMENT 2

49(b)(1) *Binding Contracts to Purchase or Supply*

Any property shall be treated as pre-termination property to the extent that such property is constructed, reconstructed, erected, or acquired pursuant to a contract with any party, including, without limiting the generality of the foregoing, a contractor, supplier, vendor, vendee, customer, or lessee which was, on April 18, 1969, and all times thereafter, binding on the taxpayer.

[Telegram]

AIR REDUCTION CO., INC.,
New York, N.Y., July 10, 1969.

Hon. RUSSELL B. LONG,
U.S. Senate, Washington, D.C.

The Nixon administration's bill continuing the 10-percent income tax surcharge and repealing the 7-percent investment tax credit—as recently passed by the Houes of Representatives—omitted an important feature. This is a provision providing relief for companies which have entered into binding contracts with customers prior to the repeal date of April 18, 1969, that require the construction or acquisition of machinery, equipment or buildings to be used in the production of products to be sold under the terms of those contracts.

Three years ago, when the investment tax credit was suspended, the legislation which suspended the credit provided, under Section 167(I)(1) of the Investment Credit and Accelerated Depreciation Act of 1966, Internal Revenue Code section 48(H)(8). That companies bound by contractual commitments were entitled to the investment credit on property constructed, reconstructed, erected, or acquired to fulfill their obligations.

H.R. 12290, which received a 210 to 205 approval in the House on June 30, does not contain a similar provision. Omission of this feature, we feel, will result in substantial economic losses for any companies unless this provision is restored.

The Senate, we submit, could acknowledge the need for equity in such situations by adding to section 4(b)(6)(b) of the House version of this act the following provision:

"Where, pursuant to a binding contract in effect on April 18, 1969, (1) the taxpayer is required to construct, reconstruct, erect, or acquire property specified in the contract, or extractive property, the general specifications of which are readily ascertainable from the location and characteristics of the mineral properties (specified in such contract) from which the product is to be produced, (2) the property is to be used to produce one or more products under such contract, (3) the other party to the contract is required to take substantially all of the products to be produced over a substantial portion of the expected useful life of the property, and (4) the contract for sale of the product or products is a fixed-price contract (except for provisions for escalation under which the

loss of the investment credit would not result in a price change), then such property shall be pretermination property. Clause (III) of the preceding sentence shall not apply if a political subdivision of a State is the other party to the contract and is required by the contract to make substantial expenditures which benefit the taxpayer."

Such a provision should be added to the bill now before the Senate, we believe, in the interests of consistency. If it was equitable in 1966, it is equally equitable now.

Your consideration of this matter and your support of this remedial suggestion will be deeply appreciated.

GEORGE S. DILLON, *President.*

AIR PRODUCTS AND CHEMICALS, INC.,
Allentown, Pa. July 8, 1969.

The HONORABLE RUSSELL B. LONG,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: From discussions with various congressmen and their staffs, we believe that the Ways and Means Committee inadvertently omitted language from the investment credit transition provisions of H.R. 12290 which had been contained in the 1966 suspension period transition provisions. The omission could have the effect of causing Air Products' new Geismar, Louisiana plant to not qualify for the investment credit even though Air Products was under contract prior to April 18 to construct, operate, and sell substantially all of the product to one customer, Wyandotte Chemicals Corporation. The binding contract rule, contained in H.R. 12290, applies to purchases of equipment versus a contract to construct and supply. As detailed in the attached, the contract, in effect, has the same economic effect as if APCI had contracted to lease the facility to Wyandotte, or to sell the facility to Wyandotte. Wyandotte would have qualified for the credit under the transition provisions of H.R. 12290.

As developed more fully in the attached, we believe that the Ways and Means Committee did not intend to omit the provision. Your support in restoration of the provision would be appreciated. Inasmuch as APCI has a similar problem with a larger plant being constructed in Burns Harbor, Indiana, we have also requested Senator Hartke's support of an amendment which would restore this provision.

Yours sincerely,

LEON C. HOLT, Jr.

H.R. 12290—EFFECT OF INVESTMENT CREDIT TRANSITION PROVISIONS ON INDUSTRIAL GAS INDUSTRY

Modern steel and many chemical plants require vast quantities of industrial gas, such as high purity oxygen and nitrogen. The most economical method of supply is through construction of a gas generating plant on or near the site of the customer. The gas is delivered via a short pipeline from the gas generation plant. The pattern in the industry is for the industrial gas company to construct, operate, and supply the output of the plant to the customer. In some situations, the plant is leased to the customer.

A binding contract, entered into before April 18, 1969, under which an industrial gas company is contractually obligated to build a plant and supply substantially all the output to a steel mill or a chemical company, will not qualify under the "binding contract" exception contained in the investment credit repeal transition rules of pending H.R. 12290 as passed by the House of Representatives. The 1966 transition rules contained a specific provision which would extend the credit to a plant constructed pursuant to such a contract to supply if the contract was in existence before the effective date. This provision was contained in the fourth and fifth sentences of Section 48(h)(8) as follows:

". . . Where, pursuant to a binding contract in effect on October 9, 1966, (i) the taxpayer is required to construct, reconstruct, erect, or acquire property specified in the contract, to be used to produce one or more products, and (ii) the other party is required to take substantially all of the products to be produced over a substantial portion of the expected useful life of the property, then such property shall be treated as property which is not suspension period property. Clause (ii) of the preceding sentence shall not apply if a political subdivision

of a state is the other party to the contract and is required, by the contract, to make substantial expenditures which benefit the taxpayer . . ."

To our knowledge, these two sentences are the only 1966 transition provision which was omitted in H.R. 12290.

In discussions with Congressman Herman T. Schneebeli and Mr. Lincoln Arnold of the Staff of the Joint Committee, we learned that Section 49(b) (6) of the preliminary Ways and Means Committee draft of H.R. 12290 contained three subparagraphs. Subparagraph (B) of the draft contained language similar to that quoted above.

In addition, we learned that new language was added to this Subparagraph which, it is understood, was designed to provide relief to the extractive industries, such as certain coal companies which had entered into long-term contracts to supply coal to utilities. It is understood that the motion to strike Subparagraph (B) of the draft bill was made and adopted in the context of a desire not to grant additional relief to the extractive industries over that which was available under the 1966 act. Mr. Arnold is under the impression that certain members of the Committee believed that the portion of the Subparagraph, carried over from the 1966 act, which is quoted above, was no longer necessary because of the addition of Paragraph (b) (10), relating to certain newly designed products. There is no question, at least in our minds, that this is not the case.

Prior to April 19, 1969, Air Products had contracted with various users of industrial gases, such as steel and chemical companies, to supply substantially all of the output of certain facilities to be constructed and operated by APCI. The contracts require APCI to construct the facility and require the customers to make fixed minimum monthly payments over the life of the contracts, which run typically for a minimum of fifteen years. Prices were established, in such contracts, under the assumption that the investment credit would be available. Under the bill, as presently drawn, the credit will not be available on facilities erected pursuant to these contracts. Economically, however, the situation is no different than if the customers had contracted to lease or buy the plants from Air Products prior to April 19, in which event the credit would be available.

We feel that the above-quoted provision was removed largely due to inadvertence and lack of understanding.

Air Products and Chemicals, Inc.'s Geismar Investment

Negotiations which commenced in November, 1967, resulted in a binding contract prior to April 18, 1969, between Wyandotte Chemicals Corporation and Air Products and Chemicals, Inc. under which Air Products and Chemicals, Inc. is to build a new 450 ton-per-day industrial gas generation plant. The plant will be erected on land owned by Wyandotte at the Geismar location.

Air Products and Chemicals, Inc.'s investment in the plant will be approximately $5,000,000. The plant will employ six to seven employees. In addition to the Geismar plant, Air Products and Chemicals, Inc. is under contract to construct a number of other gas generating plants which also have an uncertain status under the transition provisions of pending H.R. 12290. The principal plants involved will be located in Indiana, Illinois, Ohio, and California. Each of these plants, including the Geismar plant, is engineered to meet the specific requirements of customers in accordance with contractually established purity, pressure, etc., requirements. Under a typical contract:

1. APCI undertakes to supply the gas requirements of the customer for fifteen or more years, which approximates the useful life of the plant.
2. The customer is required to pay APCI a minimum amount, even though the plant is shut down, as a result of natural or other disaster or malfunctions.
3. The price of the industrial gas to the customer is subject to modification based on changes in power and water costs, but not for changes in APCI's income tax liability.

The economic effect of these arrangements is the same as if APCI had leased or sold the plant to the customer, in which event the credit would be available under the transition provisions. However, since the price of gas to these customers was set under the assumption that the investment credit would be available, APCI's after-tax margin will be reduced by 7 percent of the cost of the plant if the plant does not qualify. With respect to the Geismar plant, this is the equivalent of incurring unanticipated pre-tax expense of $700,000.

The CHAIRMAN. Our next witness will be Mr. Edwin A. Locke, Jr., president of the American Paper Institute.

STATEMENT OF EDWIN A. LOCKE, JR., PRESIDENT, AMERICAN PAPER INSTITUTE

Mr. LOCKE. Chairman Long and distinguished members of the Senate Finance Committee, I am Edwin A. Locke, Jr., president of the American Paper Institute. The institute represents the pulp, paper, and paperboard producers who comprise one of the Nation's 10 largest industries. We greatly appreciate the opportunity you have given us to testify on the proposal to repeal the investment credit. I will say at once that our industry, as a heavy user of capital assets, is without qualification against the proposal. All the evidence we have examined has convinced us that repeal would expose the economy to grave and unnecessary damage.

I should like to make it clear that we do not dispute the urgency of the fiscal and monetary problems confronting the administration. We recognize the need for tax legislation that will provide added revenue for the Government and restrain spending. If the proposed bill called for a brief suspension of the credit, instead of repeal, our industry would regard it as regrettable, rather than disastrous. But we are convinced that repeal would be an economic error of the first magnitude—that it would aggravate the long-term inflationary danger, do major harm to the Nation's competitive position in foreign trade, and weaken our economy dangerously.

In making this statement, I am fully aware of the arguments advanced in favor of repeal by the House Ways and Means Committee in its recent report (No. 91–321) on the tax bill now under consideration. I have read that report with close attention, especially the section headed "Repeal of the Investment Credit" (pp. 10–15), and I have found it a good deal less than convincing. Knowing the great abilities of the Ways and Means Committee and its staff, it seems to me that they must have strained to reach the conclusion that repeal is desirable, for that conclusion certainly does not emerge from the evidence presented.

For example, in the very first paragraph, (on p. 11) a key sentence reads as follows: "*The evidence of present heavy expenditures in the investment sector of the economy suggests that the removal of this special inducement to spending will be of special assistance to bringing inflation under control.*" The same thought appears elsewhere in the report. Now there is no doubt that removal of the credit would have a depressing effect on the economy. The real question is whether that depressing effect is going to be wanted when it comes. In arriving at a firm judgment on this point the matter of timing is crucial. The House report fails to mention that the full impact of the removal of the credit would not be felt until 1970 and 1971. By that time, there is good reason to believe that further depressing influences will be highly inadvisable. Extreme pressures of other kinds are currently being brought to bear to restrain inflation. According to a statement made on June 23 by Secretary of Commerce Stans—

> We expect inflation control to begin to show substantial results in 2 or 3 months.

In other words, the economy is almost sure to be considerably slowed down by the time the depressive effect of repeal of the credit begins to be felt. In that event the additional downward pressure on the economy resulting from a drying up of new investment will be dangerous. Just how dangerous is indicated by the speed at which plans for new investment are already being whittled away.

At the beginning of this year it was estimated by leading authorities that capital expenditures for new investment, measured in dollars, would be 14 percent higher than last year. Now at midyear it is obvious that nothing like that figure is going to be reached, that the reality will probably be 7 or 8 percent. It must further be considered that currently rising prices of equipment, machinery and construction distort the picture. In terms of constant dollars, the present expectation for an increase in capital expenditures this year is probably in the neighborhood of no more than 4 percent. This is a far cry from the 14 percent figures which sparked the agitation for repeal of the credit. An increase of only 4 percent in expenditures for plant and equipment is ominously low, relative to the requirements of our society.

This aspect of the problem is not mentioned in the House report. The report says (p. 11, par. 3), "*repeal of the credit is particularly desirable at this time.*" But the time referred to is obviously the time at which the report was prepared, the first half of this year. The situation is now changing sharply. If in 1970 the economy is already slowing down, the delayed impact of repeal could trigger an economic downturn of major proportions.

Surely the uncertain situation that we now face does not call for rigid policy, but for flexibility. Whatever useful effect the advocates of repeal may expect from removal of the credit, that same effect could be achieved merely by temporary suspension, say to the end of this year. Then, if it turned out that the effect of removal was negative, the administration would at least be able to count on quick restoration of the credit. But repeal, practically speaking, would be an irreversible commitment at a time when options should be kept open.

An even more misleading assumption of the House report is that capital expenditures by industry in recent years have been excessive. For example, the report (on p. 11, par. 1) speaks of "heavy expenditures" in the investment sector of the economy. It points out (in par. 2 on the same page) that since 1962 business has spent $400 billion on plant and equipment, implying that this is an ample or excessive figure. It states (on p. 12, par. 2) that at the end of April of this year, machine tool manufacturers had an order backlog of 9 months, with a distinct implication that this, too, is excessive. Such statements lose sight of the economic realities.

The fact is that in real noninflated terms, our private capital investment did not rise from 1966 to 1968, and the real rise in 1969 is going to be small![1] The fact is that the $400 billion expended by industry for capital investment in the past 7 years at rising prices has not purchased enough modern plant capacity to meet the requirements of the economy. The fact is that a 9 months backlog in machine tools is far from excessive, and a sharp shrinkage in the backlog would be cause for alarm. The facts are that what the economy is now suffering from is a deficiency of productivity, and that if the Government

[1] Pierre Rinfret, on Apr. 28, 1969.

discourages capital investment by removing the investment credit, it will be adding to that deficiency.

This country's productive capacity is so large compared to other nations' that the mind tends to resist the concept of a deficiency in our productivity. Yet all the evidence shows that the deficiency exists. Industry in this country as a whole is faced by a shortage of skilled manpower. Under such conditons wages are bound to rise and keep on rising much faster than productivity, thus worsening inflation. High interest rates on money and tighter credit may produce a temporary slowdown, but the fundamental inflationary pressure remains.

In order to overcome that situation, we need much more modern plant than we have. By speeding up the acquisition of more efficient equipment, industry could ease the skilled manpower shortage. If the productivity of labor rises, and producers find themselves with an excess of efficient capacity over demand, they would soon adjust prices in order to maintain their competitive position. In other words, the best long-range defense against inflation is more investment in increasingly efficient facilities.

There is every reason to believe that the stimulus of the investment credit is going to be needed even more in the years ahead than in the past. Without the credit, the deficiency in productivity and the skilled manpower shortage are likely to be permanent features of our economy. Indeed, if the Government wants to check inflation over the long term, it could hardly do better than to double the amount of the investment credit.

A particularly disturbing feature of the House report, it seems to me, is the assumption that industry does not need a tax incentive in order to expand and modernize its plant. This is what the report says (on p. 11, par. 2): "*Continuously expanding markets and high profit levels should provide sufficient investment incentive in the future even without the investment credit.*" That might be true in a relatively isolated society with a modest rate of population growth, an ample supply of skilled labor and a slow-moving technology. But it is not true of the United States of today, with a soaring population, a shortage of skilled manpower, a technology explosion, and a big stake in the world market. The experience of the country in the decade before the investment went into effect is highly significant. Without the incentive of the credit, new investment by industry lagged badly. The outlays of capital required to expand and modernize to the extent needed were so great that to undertake them without the credit was simply not financially feasible for most industries.

If the credit were to be repealed, and no comparable incentive provided in its place, industry might well slide back to the slow and wholly inadequate pace of the 1950's in plant expansion and modernization. Such a development would be catastrophic, and I do not use the word lightly. It would point directly to runaway inflation, even while our rate of real economic growth fell farther and farther behind that of other countries. It would mean that foreign competitors with technologically superior facilities would cut the ground from under us in foreign trade. It would mean a worsening of our position in the

balance of payments with further sapping of the Nation's monetary strength.

The plain fact is that we are up against intense foreign competition. often backed by government. Under such conditions, how is this country, with its high labor costs, going to retain an adequate share of the world market? Surely it is evident that our industries must be given strong incentives to replace outmoded facilities and production methods by the most modern equipment and techniques, and do it soon. The situation is becoming even more acute as a result of the last Kennedy round tariff agreement. Not unless we keep prices competitive and constantly improve product quality will be able to hold our own in foreign markets and maintain a healthy export-import balance.

To prevent ourselves from being swamped by foreign compeition. we will have to pour many billions of investment capital into new facilities, new processes, automation, computerization, and where necessary, relocation of plant to reduce transportation costs.

The investment credit was never more needed than it is right now to strengthen our competitive stance in foreign trade. It is an indispensable factor in our worldwide economic position. I think it is unmistakable that repeal of the credit would mean even more serious deterioration in our balance of trade and our influence abroad than we have already experienced.

I cannot leave the subject of the House report without referring to a sentence which, it seems to me, unintentionally destroys the entire argument for repeal. The report states (on p. 14, last paragraph) "*Even though an investment credit may have been useful in the past in inducing investment in periods when there was a large deficiency of investment, it is not clear that we will be faced with the same type of problem in the future.*" Surely we must ask ourselves whether it is wise to base a proposal of such importance on a premise that is "not clear" even to its advocates. Moreover, it is becoming abundantly clear that the deficiency in investment remains, and if the credit incentive is removed, that deficiency becomes more and more acute as our society grows and living standards rise.

Since the end of World War II this country has not made enough progress in the productivity of its plant to prevent inflation. If we are to overcome inflation and maintain our position in foreign trade we will need to avail ourselves of every means to expand capacity and introduce cost reducing facilities. To repeal the credit would be to exchange our best long-range prospects for a highly uncertain chance of temporary benefit.

Many people seem to have forgotten that the investment credit was established in 1962 because the administration and the Congress perceived an urgent need to stimulate the rate of capital expenditure for new plant and equipment. Since then the credit has grown into and become an integral part of the Nation's economic structure. It helps to generate and maintain a strong flow of capital to the economic areas where it is most needed. In one way or another, the constructive influence of the credit is felt in almost every aspect of industrial operation. It is intimately linked to financial policy, marketing policy, and production policy in thousands and thousands of enterprises, large and small. It cannot simply be yanked out like a tooth or clipped off like a long toenail. To remove it would be an act of major surgery per-

formed without a diagnosis. The House report itself indicates awareness of the immense complexity of the problems attending repeal. A long passage (p. 14) describes some of the involved measures required to phase out the credit. After reading it, one can have little doubt that the tremendous administrative burden imposed by repeal constitutes yet another good reason for leaving the credit alone.

The essential point in my view is that summary removal of the credit threatens to impair the health and growth potential of the economy for a long time to come. It would have an especially prejudicial effect on heavy industries which because of their fundamental character, must continuously invest new capital as the society expands. On such industries, including the paper industry, repeal of the credit would impose a penalty of the order of 8 percent on top of existing taxes. This additional burden would have a permanently crippling effect on many companies requiring expansion and modernization of plant.

The four main grounds on which we oppose repeal of the credit are, we believe, valid and significant. Repeal could well produce a major downturn in the economy. It would lock the Government into a rigid policy at a time when options should be kept open. It would cut away investment in modern industrial facilities that are urgently needed to bring costs under control and to check inflation. It would seriously injure our competitive position in world trade, with grave consequences for our balance-of-payments and monetary stability. For these reasons, the industry I represent respectfully requests this distinguished committee to reject the proposal for repeal of the credit.

With your permission, Mr. Chairman, I would like to file with you a recommendation on some of the more technical aspects of the bill before you.

Thank you.

The CHAIRMAN. I think it would be well to order printed at this point in the record the suggestions that you have made with regard to amendments that you think ought to be a part of this measure in the event that the commitee sees fit to recommend them.

(The suggestions referred to follow:)

MEMORANDUM ACCOMPANYING STATEMENT PRESENTED BY EDWIN A. LOCKE, JR., PRESIDENT OF THE AMERICAN PAPER INSTITUTE

RECOMMENDATIONS CONCERNING INVESTMENT CREDIT TRANSITION RULES CONTAINED IN H.R. 12290

The American Paper Institute strongly supports retention of the investment tax credit as a basic part of our tax law. However, if, contrary to our recommendation, there is repeal or suspension of the investment tax credit, industry will be faced with serious inequities unless very careful attention is given to the transition rules in H.R. 12290. Our review indicates that the transition provisions in H.R. 12290 do not provide for equity in all situations.

To correct these deficiencies we recommend the following:

1. The "phase-out" provision should be eliminated entirely, or at the very least modified by advancing the phase-out date from December 31, 1970 to December 31, 1971. If the "phase-out" provision is eliminated, it would enable companies to claim full credit for all property qualifying under the binding contract or other transition rules, regardless of when such property is placed in service. If the "phase-out" provision is modified by advancing the phase-out date from December 31, 1970 to December 31, 1971, it should be coupled with

an advance of the termination date to December 31, 1975, or December 31, 1976, thus allowing all property placed in service before this latter cutoff date to qualify for at least a partial credit.

2. In addition to the "binding contract" provision, there should be further tests which would qualify projects for the credit. Experience in our industry shows that major engineering and feasibility studies are completed well in advance of formal commitments. Under such circumstances a taxpayer should be able to show through "facts and circumstances" a "substantial commitment" prior to the effective date of repeal. Among the facts which could be used:

(*a*) Substantial sums have been expended for engineering and/or feasibility studies,

(*b*) Loan agreements have been negotiated,

(*c*) Official authorization by the Board of Directors has been granted,

(*d*) Construction started and project completed within a reasonable time.

Attached is an outline, developed with assistance from engineering and financial people in the industry, of the various steps taken in connection with a major capital project and the stages at which commitments develop. We believe it will be helpful in visualizing the problems and inequities involved for our industry under the transition provisions in H.R. 12290.

3. With respect to the equipped building rule, the plant facility rule, and the machinery and equipment rule, it is suggested that 25% rather than 50% of the "aggregate adjusted basis of all the property . . ." be considered sufficient to qualify for the credit. Certainly 25% of total cost represents a substantial commitment, especially when the commitment was made under the assumption that this project would qualify in full for the credit, without restrictions such as the "phase-out" or new "carry-over" limitations.

4. With respect to the amortization of pollution control facilities, it is suggested that taxpayers be permitted to elect a one to five year write-off instead of the proposed five year amortization period, to encourage companies to increase their pollution control expenditures and thus advance the date of their compliance with Federal pollution control standards.

Moreover, in the interests of both equity considerations and simplification of procedural rules, the "primary purpose" of investment in any facility should determine its eligibility for amortization deduction. If the primary purpose for constructing a facility is pollution control, the entire investment should qualify for rapid write-off regardless of any costs recovered through by-products derived from operation of the facility.

5. With respect to the certification of pollution control facilities required to establish eligibility for the sixty-month amortization deduction, it is suggested that there be *one* certifying authority rather than *two*, and that this authority be the state, interstate or Federal agency which has established Federally approved water or air quality standards applicable to the subject facility pursuant to the Federal Water Pollution Control Act or the Federal Clean Air Act; that the performance standard with the pollution control facility must meet in order to qualify for the amortization deduction shall be conformance with applicable water or air quality standards; and that the proposed grant of authority to the Secretaries of Interior and of Health, Education, and Welfare (Section 168(e)) to "promulgate minimum performance standards" for the purposes of Subsection (d) be deleted from the bill (H.R. 12290). The proposed system of dual certification, based in most cases on two different sets of performance standards—(1) those set by state or interstate agencies and approved by the appropriate Federal department under the applicable Federal Water Quality or Federal Clean Air Acts, and (2) those set by the appropriate Secretary (Interior or HEW) under the provisions of this bill (H.R. 12290)—will, if adopted, delay and add confusion and cost to the anti-pollution effort of industry and of the Federal and State Governments because the two sets of standards will either be the same and therefore redundant or different and therefore clearly in conflict. We recommend that this bill (H.R. 12290) require but one certification, issued by the state, interstate or Federal agency that establishes the water or air quality standards that apply to the facility involved in the application, and that the performance standard required of the pollution control facility be that it meets the water or air quality standards which apply to the facility.

6. The special limitation on the amount of unused credits which may be used as carryovers to the taxable year should be eliminated or modified, because the incidence of this provision falls most heavily on companies with a fluctuating profit pattern and high carryovers. These firms may lose much or at least a portion of the tax credit for which they have qualified under all other provisions.

7. The effective date of this bill should be advanced to the date when Congress enacts such legislation. Any earlier date would be inequitable in view of the many uncertainties surrounding provisions of this bill and their interpretation.

STEPS IN A TYPICAL MAJOR CAPITAL PROJECT IN THE PAPER INDUSTRY

1. Feasibility Studies

The first steps taken in any major capital project involve a number of feasibility studies. The first step in determining the feasibility of the program is a study of the need and the value of the program from the point of view of marketing. These studies include analysis of the competitive position of the company as to mill location, source of supply of raw materials, and similar consideration. A second step will involve engineering studies made to determine construction costs and mill profitability. These steps are conducted in some cases internally and in others by outside contractors and consultants. In the latter connection, it is likely that contract commitments will be undertaken at this stage for the performance of these services.

During the period before announcement, up to twelve months before announcement, substantial efforts must be made to make sales commitments for the products to be manufactured to justify the project. As a result of these efforts, long term contract commitments may be made with prospective customers. Up to 60 to 70% of the production may be committed in order to provide a firm economic base for the project. These contracts call for delivery of the product upon specific dates regardless of whether the project goes forward or is completed.

Prior to announcement, a whole range of other commitments may have been made depending upon the particular case involved. For example, options may have been entered into in connection with the acquisition of the plant site or land purchase agreements may have been executed. Also, a number of arrangements some involving commitments, will have been made with members of the local community chosen for the site. Licenses and zoning changes may be initiated.

2. Board Authorization and Public Announcement

Assuming the feasibility studies of the project are favorable, budgets will be developed and specific proposals will be submitted to and adopted by the Board of Directors. These proposals are in substantial detail, including long-range forecasts of sales and earnings and substantial supporting operating data listing the specific types of equipment and estimated costs. Naturally, the financial data included in the proposals are based on the allowance of investment credit, either as a direct reduction of the project cost, or in the project cash flow needed for financing the project.

Important practical commitments may flow from the public announcement of such a program. From the point of view of competition, once the announcement is made the intent of the company is known as to the type of product, the capacity and the mill location. At this point, more efforts will be made to commit that portion of the facility's production which has not yet been contracted for.

3. Financing

During the initial stages, one of the considerations will be the financing of the project. If outside financing is required, commitments will be made and loan agreements negotiated. It is possible in many cases that the loan agreement will be closed prior to the start of physical construction. Financing arrangements are based on the cash flow generated by the project. To the extent that the capital expenditures are internally financed, they also rely heavily on the cash flow generated by the project. Cash flow projections include the benefits which result from the investment credit as well as accelerated depreciation. If these benefits are removed and it is necessary to proceed with the program in any event, outside financing may then be necessary to make up the difference. If the need for outside financing as a result of the loss of these benefits becomes evident after the program is approved, larger costs may be involved, and the program penalized. For obvious competitive reasons, this penalty cannot be compensated for by an adjustment in prices.

4. Construction of Project

Construction may progress in many different forms. Depending on company practice and the type of project, work may be done completely on the basis of one contract, it may be done under multiple contracts executed at different times as they are needed, or work may be done internally.

Within three months following the announcement of the project, steps are normally taken to place equipment orders. In some cases, construction contracts are entered into and work begins on the preparation of the plant site.

A. *Machinery and Equipment.*—Immediately after orders are placed with large equipment manufacturers, they will enter into agreements with their suppliers and sub-contractors. Normally these will be based on contracts and other business arrangements with the suppliers. These will result in the accumulation of substantial commitments prior to the actual manufacture of the machine itself. Upon placement of the order, the manufacturing cycle begins and expenses in connection with engineering, purchasing and manufacturing will be incurred by the equipment manufacture. Depending upon the size of the equipment involved, the manufacturing cycle will be from 5 to 18 months. Because heavy equipment makes up the largest part of our capital expenditures, the longer cycle is more typical.

In general, installed equipment represents approximately 76% of total mill costs. (The remaining portion is made up of buildings, overhead, etc.) Approximately 43% of total mill costs represent the cost of equipment before installation. The remaining 33% represents installation costs of which labor is the major component. While most of the basic long-lead-time equipment of the mill will be on order at the very initial stages of a project, the installation costs, constituting about one-third of total costs, will be expended over the entire period of construction. The heaviest expenditures in this category occur in the first 6 months of the second year of the project. In many cases, expenditures relating to the installation costs will not be committed until the expenditures are made. It is with regard to these expenditures that informal and oral orders and other communications, which are of doubtful binding effect, number in the hundreds on major projects.

B. *Plant Construction.*—Coincidental with the manufacture of the equipment by the machine supplier, construction of buildings and equipment foundations is proceeding. Where construction on a whole mill is involved, this work may involve substantial long term contract commitments under which burdensome penalties would be incurred if the project were delayed.

As already indicated, multiple contracts may be used, and these are negotiated and concluded from time to time during the long construction period. Finally, the construction may be handled internally without any contract, the work being done and properties acquired as they are needed.

C. *Installation.*—The first deliveries of major machinery and equipment will begin approximately 12 to 15 months following the approval of the project. Delivery will normally be over a period of about 6 months. Completion of the project normally occurs 2 years from the date of approval. The suppliers may install the equipment. It may be installed by others under separate contract or it may be installed internally.

The CHAIRMAN. Thank you very much, Mr. Locke. I think you have made a very fine statement.

We will next hear from Mr. Albert Lannon, Washington representative of the International Longshoremen's & Warehousemen's Union.

STATEMENT OF ALBERT LANNON, WASHINGTON REPRESENTATIVE OF THE INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S UNION

Mr. LANNON. Good morning, Mr. Chairman. I am very appreciative of the opportunity to testify this morning. My name is Albert Lannon. I am the Washington representative for the International Longshoremen's & Warehousemen's Union. On behalf of our union's 65,000 members, I want to express our unreserved opposition to extension of the surtax. Our delegates from Alaska, Hawaii, Washington, Oregon, California. and British Columbia, at our April biennial convention, unanimously voted for an end to this tax on a tax which working

people have had added to an already staggering burden. We favor, in its place, immediate and meaningful tax reform.

We do not see the surtax extension merely as a lever for tax reform. Closing of millionaire and corporation tax loopholes—such as oil and mineral depletion allowances, capital gains, investment tax credits, et cetera—ought to raise even more revenue than the surtax, ending any justification for its continuance.

The argument that the surtax is needed to pay for the disastrous war in Vietnam could well be handled by enactment of S. 2277, the excess war profits tax. Working people are paying for the war with the blood of their sons; they ought not to bear the cost of bankrolling it also.

The surtax was supposed to halt inflation; it clearly has not, and there is nothing except verbiage to suggest that extending it would. Rolling back interest rates, which have reached unprecedented and intolerable levels, seems a more sensible way to aid the economy.

There is a "tax revolt" sweeping the country. Teabags to Congress, petitions, and pickets opposing the surtax are but one manifestation. Another, potentially critical manifestation of taxpayer rebellion is the defeat of school bond and other vital measures in towns and cities across the country. Unless working men and women obtain concrete tax relief—and ending the surtax would be a good start—communities face impairment and crippling of essential services.

The members of ILWU cover a wide range of jobs and earnings; from $2 an hour curtain makers to $20,000 a year skilled waterfront workers, from field workers on sugar and pineapple plantations to computer operators. They are all hurting and becoming increasingly vocal about it. They are tired of being bled to finance the apparently endless tragedy in Vietnam, of being bled to finance boondoggles like the ABM. Many hard-won wage increases have been virtually destroyed by the price-tax squeeze.

Our members, and working people generally, are, we are convinced, willing to pay their fair share towards the cost of running government and providing necessary services. But today they see a situation where those in the lower income brackets pay a higher proportion of their income in taxes of all kinds than do those in the upper income brackets. They see a Congress granting itself a 40-percent wage hike and then talking about wage controls. They see those who enjoy tax loopholes accepting the surtax with equanimity, for 10 percent of nothing is still nothing.

Tax reform, tax justice—call it what you will: the loopholes must be closed. Defeat of the surtax extension would be a far more powerfull "lever" for real tax reform than merely seeking to add a few reforms to the package. Defeat of the surtax extension would be a vital first step toward reducing the burden on overtaxed working people and heading off a revolt with potentially devastating consequences to our communities, our educational system and our economy.

Concrete tax relief for working people—short of overhauling the entire tax structure—ought to include, in addition to abolishing the surtax, an increase in personal exemptions from $600 to $1,200. It ought to include also a raise in the standard deduction to 15 percent, with a $2,000 maximum. Each of these three points would provide direct and immediate relief for the wage-earning taxpayer by lowering

the Government's take. As alternative sources of revenue, we offer a minimum loophole-closing program, adopted by our convention:

1. Repeal the capital gains provision.
2. Recover the taxes on capital gains which are lost at death.
3. Tighten the regulations on charitable deductions and crack down on the tax-free foundations.
4. Eliminate or reduce the oil and mineral depletion allowances.
5. Repeal the 7-percent investment tax credit.
6. Eliminate the tax break for a corporation's subsidiaries.

This is a minimum program; we also support higher corporate income taxes, tightening of the tax rules on stock options so that such earnings are taxed like wages and salaries, cracking down on "gentlemen farmers" who invest in farms on the side so as to enjoy the tax writeoffs for farm losses, taxing the earnings of churches and social clubs which engage in business ventures unrelated to their main purpose, ending tax advantages for conglomerate mergers. These are but a few of the loopholes which the Treasury Department estimates costs for Government—and the working taxpayer—some $50 billion each year.

The House of Representatives, by a five-vote margin gained through widely reported political pressures, passed the surtax extension. It is now up to this body to right that wrong. We urge you to reduce an onerous tax burden with tax relief, to end the surtax and pave the way for reforms in the tax system which will make it equitable and progressive in fact, as well as name.

Thank you.

(An attachment to Mr. Lannon's prepared statement follows:)

STATEMENT OF POLICY NO. 6, FEDERAL TAX REFORM

[18th Biennial Convention, Los Angeles, Calif., April 7–11, 1969]

The cost of running government is enormous. As Americans come to expect more in services and better schools, housing, medical care, and transportation among other things, the costs are going to keep on rising. Working people—are willing to pay their fair share, but they have been burdened with the heaviest share of the tax load while special interest groups enjoy a wide range of money-saving amendments to the tax laws.

Instead of a progressive tax structure—in which the tax load is supposed to be distributed according to ability to pay—those in the lower earnings brackets pay a higher proportion of their income in taxes than do those in the upper brackets. The average working person now puts in at least a day-and a-half out of each five-day work week just to pay his taxes.

A radical change to make our entire tax structure truly progressive is long overdue.

We recommend basic reforms which attack the most flagrant inequities in the system:

1. Abolish the surtax.
2. Increase the personal exemptions from $600 to $1,200.
3. Raise the standard deduction of 10 percent with a $1,000 maximum to 15 percent with a $2,000 maximum.

So-called tax loopholes cost the government from $50 to $53 billion a year. These billions are ultimately passed on to the taxpayers who do not benefit from the loopholes, meaning most of us. The special privileges and loopholes must be closed. A minimum program to do so follows:

1. Repeal the capital gains provision.
2. Recover the taxes on capital gains which are lost at death.
3. Tighten the regulations on charitable deductions and crack down on the tax-free foundations.
4. Eliminate the oil and mineral depletion allowances.
5. Repeal the 7 percent investment tax credit.
6. Eliminate the tax break for a corporation's subsidiaries.

The CHAIRMAN. Thank you.
Senator Anderson?
Senator ANDERSON. I want to compliment the witness on a good, clear statement. It is concise and straightforward. Thank you very much.
Mr. LANNON. Thank you.
The CHAIRMAN. Senator Bennett?
Senator BENNETT. I join in that compliment, but I have no questions.
The CHAIRMAN. The next witness is Mr. John R. Allen, vice president, eastern region, McDonnell Douglas Corp. I am told that McDonell Douglas is going to submit a statement and we will be glad to print their statement in the record at this point.
(The statement referred to follows:)

STATEMENT OF MCDONNELL DOUGLAS CORP., SUBMITTED BY K. C. ELIASBERG, TAX COUNSEL

McDonnell Douglas Corportaion offers the following amendments regarding the proposed elimination of the investment tax credit as contained in the provisions of H.R. 12990.

NEW DESIGN PRODUCTS

Section 4(a)(10) (Proposed Section 49(b)(10)(A) of the Internal Revenue Code) of H.R. 12990 represents Congress' awareness of, and response to, the problem of the taxpayer who has incurred substantial costs in furtherance of a production program involving a product of new design. It provides as follows:
"(10) Certain new-design products, where—
"(A) on April 18, 1969, the taxpayer had undertaken a project to produce a product of a new design pursuant to binding contracts in effect on such date which—
"(i) were fixed-price contracts (except for provisions for escalation in case of changes in rates of pay), and
"(ii) covered more than 60 percent of the entire production of such design to be delivered by the taxpayer before January 1, 1973, . . ."

The McDonnell Douglas Corporation applauds Congress' desire to respond to taxpayers in this position. Our company also is in general accord with the approach taken to provide such relief, *i.e.*, a specific provision for new design products. However, we believe that the measure in its present form, is needlessly narrow and would more equitably serve its intended purpose if slightly modified to incorporate the amendments discussed below.

McDonnell Douglas Corporation offers and urges the adoption of the following proposals, both of which are in complete harmony with the purpose behind the new design provision:

(1) *The 50 Percent Requirement.*—As presently drafted the only costs that would be covered are those incurred in a situation in which binding contracts in effect on April 18, 1969, cover "more than 60 percent of the entire production of such design to be delivered by the taxpayer before January 1, 1973." We respectfully request Congress to alter this percentage requirement to one of 50 percent. It is our view that this change in no way detracts from the purpose behind Section 4(b)(10), which is to partially protect the credit for a manufacturer who, on the proposed credit cut-off date, was firmly committed to the production of a "new design" product. Not to make such an adjustment would be to needlessly work a substantial hardship upon our company.

(2) *Price Escalation for Increased Costs of Materials.*—As Presently drawn, the Bill allows of price modification with respect to contractual changes attributable to increased labor costs. Again, we believe the Bill to be too narrowly drawn, and we respectfully request that it be amended to include increased costs attributable to material. Our contracts incorporate an escalation feature which embraces both labor and material, and we are aware of no reason to prefer one over the other. On the contrary, the escalation feature is controlled by various price indices and are not regulated by any volitional act of the taxpayer. Increased material costs are as much

the product of inflationary factors as are those attributable to labor. Accordingly, we urge the incorporation of a provision dealing with a price escalation feature attributable to an increase in the cost of materials.

The "new design" product exception to the repeal legislation is an effort to partially protect taxpayers who had become committed to a program to produce a new product in advance of the Administration's repeal proposals. It has built into it all the equity and certainty that is present in the binding contract situation: that is economic and legal commitments undertaken prior to any indication of the Administration's proposals to repeal the credit. Not to allow the credit in both situations would be inequitable.

McDonnell Douglas Corporation is firmly committed to the production of the DC–10, a 300 passenger jet aircraft which is exactly the type of product contemplated by the "new design" provision. Unfortunately, the provision as presently structured, does not cover our situation, and we offer the two amendments set forth above to assure such coverage.

Moreover, we wish to point out and to emphasize that unless these amendments are adopted, the "new design" provision operates to place us at a substantial competitive disadvantage with respect to a major competitor on this product, whose situation is presently described therein. As noted, there are no arguments that can be offered with regard to the present provision that are not equally compelling in the case of the amendments we now offer. On the contrary, we believe these amendments are in complete harmony with the reasons for the "new design" provision.

LEASE-BACK PROVISIONS

Section 4(a)(5) of the House Bill provides for the retention of the investment credit in a situation where the purchaser under a binding contract on April 18, 1969, subsequently assigns his interest in such contract to another party provided the original purchaser leases the property back from such other party for a term of at least one year. The language of the section goes on to provide, however, for a recapture of the credit by the lessor "at such time as the lessee [the purchaser under the binding contract] loses the right to use the property."

While the House apparently recognized and attempted to safeguard least financing as a proper method of obtaining various types of equipment such as aircraft, unfortunately, the quoted language may be so broad that it could very well vitiate the efficacy of the section and substantially limit the availability of lease financing for binding contract aircraft. This is because, unlike present law, the lessor of property would be required to recapture all or a portion of the credit in the event he repossesses the equipment pursuant to a bonafide financial default by the lessee under the lease within eight (8) years from the time the equipment is placed in service. In our view this is an untenable concept and we perceive no valid purpose in changing the status of current law.

At first blush it would seem arguable that the change in the law designed to place the lessor in the same position as the purchaser of equipment who has arranged for mortgage financing. In the latter situation, if the purchaser defaults during the period of the mortgage and the investment credit property is repossessed, the purchaser may lose all or a part of the credit. However, upon analysis, it becomes apparent that the purchase-mortgage situation is quite different than the lease financing case. In the first place, in the purchase-mortgage situation only one taxpayer, the purchaser, is concerned with the availability of the investment credit; the terms of his financing are not affected by its availability. As a result, the mortgagee's repossession because of the mortgagor's default affects only the mortgagor. Where however lease financing is used, the lessor retains the credit and passes on to the lessee the economic benefits thereof through a reduction in rental expense. Accordingly, any risk to the lessor of a later loss of the credit because of bonafide financial problems of the lessee will affect the lessor's willingness to pass on this economic benefit to the lessee.

In the second place, since the purchaser-mortgagor is the only taxpayer concerned with the investment credit's availability where he is simply a mortgagor, he need not concern himself with the problems of the loss of the credit until he defaults. In the lease financing case, however, the lessor must, at the time of the transaction, contemplate the possibility of recapture. In such case, while it is arguable the lessor may increase the rentals for the first four, six and eight years to take into account the risk of the lessee defaulting and then reduce the rent when the risk of repossession has expired, such device runs directly afoul of a major advantage in lease financing; namely, the savings in cash

flow to the lessee. The cash flow for an airline is especially significant at this time considering the quantum of financing which is presently required with the advent of the new generation of jumbo jets and when the interest charges on mortgage financing are the highest in our nation's history.

Additionally, we believe it would be most inequitable if Congress were to limit the availability of the investment credit where lease financing is required in a situation, where is often the case, an airline has contracted to purchase an aircraft at a time when the investment credit was thought to be an integral part of the Internal Revenue Code. Moreover, we note that when Congress suspended the credit in 1966, it elected not to penalize the user of equipment under a long-term lease and we see no reason to deviate from this philosophy which was calculated to minimize the economic injury to a taxpayer who had, prior to such suspension, firmly committed himself to the acquisition of equipment.

If Congress really intends (and we doubt that it does) to limit the long-term lease as a viable equipment financing device, it should say so in no uncertain terms. It should not, however, take such action by qualifying a section which purports to respect and encourage the financing of equipment by lease. Accordingly, we respectfully urge the Senate to amend the House Bill to eliminate the recapture of the investment credit where a lessor repossesses leased property pursuant to a bonofide financial default on the part of the lessee.

PHASE-OUT REDUCTION PROVISION

Proposed Section 49(d) provides for phase-out of the credit with respect to Section 38 property placed in service subsequent to December, 1970. Under the phase-out the seven percent (7%) credit will be reduced by $\frac{1}{10}$ of one percent (1%) for each month after December, 1970, before the equipment is placed in service, and the credit will not be available for equipment placed in service after December, 1974.

We believe that this provision, rather than eliminating an inequity, creates one, and we urge its elimination. To illustrate the inequity, we offer the following example. Two purchasers place orders for equipment on January 1, 1969 (a date on which the repeal of the credit would not have been contemplated by either); because of the different lead times involved in the production of each item, one is delivered in November, 1969, and the other is not delivered until June, 1971. The purchaser of the second item would be denied a portion of the credit.

This appears to involve no less an inequity than that involved in the situation described in that part of the Ways and Means Committee report addressed to the phase-out provision. On the contrary, it involves a greater inequity since it is one that Congress has specifically created with respect to taxpayers who contract for long lead time items. That is, the inequity which results from providing disparate treatment to taxpayers whose case falls on different sides of a revenue measure's effective date provision is one inherent in the taxing process. It reflects no desire to penalize specific taxpayers, although it may operate to do so. The inequity which results from, in effect, providing a different effective date for different taxpayers (based on the lead term periods which each requires to make delivery of his product) constitutes a specific congressional effort to discriminate between taxpayers, and, thus, is an even greater inequity.

The CHAIRMAN. That concludes this session for today. We will be back in session at 10 o'clock tomorrow morning.

(Whereupon, at 11:55 a.m. the committee was recessed, to reconvene at 10 a.m., Tuesday, July 15, 1969.)

PROPOSED EXTENSION OF THE SURCHARGE AND REPEAL OF THE INVESTMENT TAX CREDIT

TUESDAY, JULY 15, 1969

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

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

Present: Senators Long, Anderson, Gore, Talmadge, McCarthy, Williams, Bennett, Curtis, Miller, and Fannin.

The CHAIRMAN. The hearing will come to order.

Is the Honorable John Sparkman, the distinguished Senator from Alabama and chairman of the Banking and Currency Committee, here with us?

Senator TALMADGE. I understand, Mr. Chairman, he was detained and he had a statement he would submit for the record in lieu of his oral testimony.

The CHAIRMAN. That is fine. We certainly want to consider Senator Sparkman's suggestions.

(Senator Sparkman's statement with covering letter follows:)

U.S. SENATE,
SELECT COMMITTEE ON SMALL BUSINESS,
Washington, D.C. July 15, 1969.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee, U.S. Senate,
Washington, D.C.

DEAR RUSSELL: As you know, I made a proposal on July 14 for the continuance of the investment tax credit for small business firms, designated as Amendment No. 71.

Unfortunately, I must be absent during the time the Committee on Finance will take oral testimony on H.R. 12290. I very much appreciate the willingness of the Committee to set aside time for me to present my views in connection with this amendment. I would have welcomed the opportunity to appear. In lieu of an appearance, my statement is enclosed herewith for the Committee's consideration.

With best wishes,
Sincerely,

JOHN SPARKMAN.

Enclosure.

STATEMENT OF HON. JOHN SPARKMAN, A U.S. SENATOR FROM THE STATE OF ALABAMA

Mr. Chairman and Members of the Committee: I appreciate the opportunity to appear before you this morning as, for the third time in seven years, the

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Congress considers the merits of the investment tax credit generally, and its particular application to small business.

In 1961 and 1962 Congress considered and enacted the 7% credit. This was accompanied by administrative revision of the depreciation guidelines contained in Revenue Proclamation 62–21. The advent of these two measures brought the United States abreast of the tax structures of other industrialized countries, which were already combining both incentives together, with an eye to improving their balance of international payments.

In 1966 it was proposed that the tax credit be suspended for inflationary reasons. I am glad to say that the Finance Committee voted to continue the credit for small business at a level of $25,000 of investment, because of the special vulnerability of small firms to the tight money and credit conditions.[1] A similar amendment, at the $15,000 level, was attached in the House. As you recall, this was settled in conference at $20,000, which was the figure written into Public Law 89–800.

As far as I know, the considerations underlying these decisions have, if anything, become more forceful with the passage of time.

When this issue arose again at the beginning of this session, Senator Bible, as Chairman of the Select Committee on Small Business, took the initiative in putting the previous Senate position before the Committee on Ways and Means on May 20.[2] In an effort to further assist the House of Representatives, I placed in the Congressional Record the discussion of the serious balance of payments factors which I believe would justify the retention of the credit at the $150,000 level of investment. These remarks will be submitted as Exhibits for the convenience of the Committee.[3]

My best information is that the Ways and Means Committee did not come to a vote solely on the question of a "small business amendment." As I understand it, the Committee vote was taken on two combination proposals, both of which embraced not only a small business continuation at $15,000 for small firms, but substantial credits for other types of property as well.[4] It is thus no surprise that, when the Treasury Department came to cost-out the proposal actually before the Ways and Means Committee, their estimates of the revenue involved were sizable.

I would therefore think that we in the Senate could advance this matter by a clear test on the question of continuing the investment tax credit as limited to small business firms, and I believe the sentiment of such a measure is quite strong.

My reasons are the following:

First, the small businessman in 1969 faces what Senator Bible has been describing as a "triple credit squeeze." He is caught between the record interest rates in the private money markets, the 58½% cut-back in Congressionally approved SBA loan funds by the Budget Bureau, and the possible cut-off of the tax credit.

Secondly, the family farmer is in a parallel dilemma, as Senator McGovern has aptly informed the Committee in some detail.

Thirdly, there is increasing evidence that the capital investment and borrowing policies that may be contributing to inflation from the business side are concentrated among the largest corporations. Nearly three-fourths (i.e. 73.4%) of the total investment tax credit in 1965 was taken by the 2,647 biggest companies. More than half was absorbed by the largest 377 companies.

Similarly, in the loan field, about 1,000 loans a month, of $1 million or more each, generally account for more than one-half of the dollars loaned.

I would conclude from these statistics that small businesses are not the agents of inflation, but its victims. It seems unfair to me to penalize the overwhelming

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[1] See statement of Senator Sparkman, "Suspensions of Investment Credit and Accelerated Depreciation," hearings on H.R. 17607, Committee on Finance, 89th Congress, 2d Session, October 6, 1966, p. 314 et. seq. Also see Senate Report 1724 of 1966.

[2] Statement of Senator Alan Bible and Senator Jacob Javits, "President's Proposal to Repeal Investment Tax Credit and to Extend Tax Surcharge, etc.," 91st Cong., 1st Sess., May 20, 1969, p. 130a.

[3] 'The Investment Tax Credit—It's Relation to the Balance of Payments and Small Business," remarks on the Senate Floor: June 12, 1969, p. S6280.

[4] The "Statistics of Income, 1965," under the heading "Corporate Income Tax Returns," Table 13, page 146, reflect the following general distribution of the credit among types of activity (corporations only): Agriculture .05%; Mining 1.8%; Contract Construction 2.4%; Manufacturing 55.1%; Transportation, Communication, electric, gas, etc. 27.3%; wholesale trade 2.0%; Retail trade 5.0%; Finance, Insurance and Real Estate 3.2%; Services 2.7%.

majority of small firms for consequences preponderantly caused by the few firms of great size.

Fourth, as is well known, small business has special problems in raising capital. Newer firms traditionally have restricted access to bond markets, commercial paper, and equity financing, and now suffer diminished access to commercial lending institutions as well. They must therefore rely more than ever upon funds that are internally generated. It is estimated that the share of investment capital made up of "retained earnings" may be from two-thirds to as high as four-fifths of all business capital.[5]

Accordingly, tax policies affecting cash flows are of disproportionate importance to small firms. Such measures as the investment credit allow them to retain the capital they need from funds which they have already earned.

To summarize, I feel that the investment tax credit should be continued for small firms, basically because it was sound tax policy when it originated, continues to be so today, and will be increasingly important to small firms and the economy in the coming years.

My proposal is to permit $150,000 of qualified investment, with an additional allowance for "small business"[6] in connection with the purchase of certifiable air and water pollution equipment, crime prevention facilities, and modernization required by health and safety statutes under federal deadlines. Affiliated groups of corporations would be entitled to a single credit, and would be able to apportion it as prescribed by Treasury Department regulations.

The figure of $150,000 in investment, or $10,500 in credit, is chosen with reference to the average credit taken in the manufacturing segment of the economy. In 1965, this figure was $9310 per firm.

In 1962, Secretary of the Treasury Dillon advised this Committee that:

"Administrative modernization of depreciation [alone] simply cannot do the job . . . the combination of both [this] and a special incentive such as the investment credit . . . is needed if U.S. business firms are to be placed on a substantially equal footing with their foreign competitors."[7]

The wisdom of these words is evident in view of the steady deterioration of the U.S. trade surplus from $6.7 billion in 1964 to a trade deficit of $68.1 million in the first quarter of 1969.[8]

The future prospect is even more aggressive competition, not only in world export markets, but here at home as foreign-produced goods come into this country as imports. This situation, it seems to me, argues powerfully for a $150,000 figure, or one equally meaningful to U.S. businessmen trying to compete.
May 23, 1969, p. S5503.

It further seems to me that the bulk of the small business firms, in wholesaling, retailing, and service, have no foundation for immoderate expansion of their investments. Accordingly, the impact of such a measure would be on small firms across the spectrum of manufacturing. This is the heart of the economy and the place where the benefits of continuity of the credit for smaller and independent firms will do the most good. My estimate is that about 20% of the present corporate credit would be involved under my proposal, so that some 80% of the revenues would be restored to the Treasury, and 80% of any inflationary effects of the existing credit would be relieved. There is, in process, a formal request to the Joint Tax Committee to cost-out both my and Senator Bible's proposals.

The copy of my bill will be submitted to the Committee herewith. It will also be introduced on the floor and printed in order to be properly available to the Committee, as requested in the Chairman's notice of these hearings.

I would like to commend the efforts of all the Senators who have asked for a small business amendment before this committee and the House. I believe

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[5] Finance Committee Hearings, loc. cit. p. 314. Estimates are quoted from the testimony of the Machinery and Allied Products Institute at hearings of the Ways and Means Committee on H.R. 17607, Sept. 12–16, 1966, at p. 63.

[6] As defined pursuant to the Small Business Act of 1953 and the applicable regulations.

[7] Finance Committee Hearings, loc. cit., page 83.

[8] "The Serious Condition of the U.S. Balance of Payments," remarks on the Senate floor:

U.S. merchandise export account [1]

[Net, in billions of dollars]

Year:	
1964	+6.676
1965	+4.772
1966	+3.658
1967	+3.483
1968	+1.029

[1] Statistical Abstract of the United States, 1968.

there is merit in each of the proposals. This Committee is in a position to do a service. It can—in the exercise of its independent judgment—reconcile these various provisions into an appropriate committee amendment. It will then have taken the initiative in enacting a measure of fundamental significance not only to small companies, individual businessmen, and farmers across the country, but to economic justice in our economy, and to the U.S. balance of payments position.

The CHAIRMAN. Now we will call Mr. Don Magdanz, who is executive secretary of the National Livestock Feeders Association, and he is accompanied by Mr. G. L. Hadley, president of the association.

We are happy to have you here, Mr. Magdanz.

Mr. Magdanz, we are going to offer you an opportunity to testify about what is in this bill. I regret to say that we cannot offer you the opportunity to testify about what is not in this bill. I am sure you read the press nowadays and you are familiar with the fact that we are supposed to suggest other ways of taxing your livestock people which at the moment is not before our committee.

We shall be glad to hear from you, sir.

STATEMENT OF DON MAGDANZ, EXECUTIVE SECRETARY, NATIONAL LIVESTOCK FEEDERS ASSOCIATION; ACCOMPANIED BY G. L. HADLEY, PRESIDENT

Mr. MAGDANZ. Thank you, Mr. Chairman, members of the committee.

I can assure you that we will confine our remarks to provisions of the bill.

The CHAIRMAN. That is the best we can do for you. I just do not know what the suggestions will be to further tax your people. If you do not get a chance to testify on these other measures, we will be glad to receive a letter from you explaining what your attitude is about further suggestions.

Mr. MAGDANZ. As our statement will indicate, we are here entirely on the investment credit, which is a part of the bill.

The CHAIRMAN. If you could defend yourself against what is in this bill you will be doing pretty well, much less the other suggestions that someone is drafting for you, not that I am doing it or the members of this committee are doing it. You understand that.

Mr. MAGDANZ. We are of course not sure what the outcome will be, but we certainly will try to defend ourselves within the framework of what we have to say.

The CHAIRMAN. Go ahead.

Mr. MAGDANZ. For the record, as has already been indicated, I am Don F. Magdanz, executive secretary-treasurer of the National Livestock Feeders Association with headquarters in Omaha, Nebr. With me today is Mr. Gilbert L. Hadley, president of our association, an actual and prominent livestock feeder and farmer in the western part of Illinois. As president of the National Livestock Feeders Association, Mr. Hadley has also distinguished himself in numerous capacities over quite a number of years in local and State groups as well as the national organization.

It is his preference that I present our statement today. However, he will respond to any questions that members of the committee may direct to him.

Very briefly, the National Livestock Feeders Association is a trade organization of persons engaged in the business of finishing livestock—cattle, hogs, and lambs—for the slaughter market. Our membership is most prominent in the midwestern part of the United States, an area that still feeds about 62 percent of the cattle and raises about 75 percent of the hogs produced in this country.

It may be somewhat of a surprise that about one-fourth of our members also have beef cow herds along with their feeding and farming operations right in the vast grain producing area of the country.

As a group formed to determine policy of the membership as well as to perform certain services, we appear here today to object to one provision of H.R. 12290. Our comments are almost entirely confined to the section repealing the investment credit of 7 percent. We are not commenting about the extension of the income tax surcharge, excise taxes on automobiles and communication services, or the low income allowance for individuals.

We submit to the committee it would be a mistake to terminate the investment credit completely. We firmly believe the investment credit of 7 percent should be continued, but recommend its application be limited to purchases of depreciable property in the amount of $25,000 per year. Such a provision would be most meaningful to small business, to farmers, and to livestock operators.

While proceeding with arguments to substantiate our recommendation, we are presenting a few comparative figures relating to profits, numbers of farms, prices, and personal income.

It is evident that agricultural people, at least, have not shared equally in the economic and profit growth of the country. From 1960 to 1968 the annual rate of corporate profits after taxes rose 91 percent from $26.7 billion to $51 billion. Comparing the same period, the annual rate of net farm income, including corporations engaged in farming, rose 27 percent from $12.1 billion to $15.4 billion.[1]

It is true that during this 8-year period the number of farms declined from 3,962,000 in 1960 to just a little over 3 million in 1968—the 1967 figure was 3,146,000—meaning fewer farm operators were sharing the total farm income.[2] Net income per farm rose just 40 percent from $3,505 in 1960, to $5,035 in 1968.[3]

Over the same period of years, prices received for all farm products went up from the index figure of 99 in 1960 (index, 1957–59, 100) to 108 in 1968, an 8-percent increase. On the other hand, prices paid by farmers, including all items, interest, taxes, and wage rates, rose 20 percent from the index of 102 in 1960 to 121 in 1968.[3]

Nonagricultural personal income rose 72 percent from $385.2 billion in 1960 to $665.4 billion in 1968 while, as mentioned previously, farm income increased 27 percent.[4]

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[1] United States, prepared for the Joint Economic Committee by the Council of Economic Advisers, Economic Indicators, June 1969, pp. 6 and 7.

[2] U.S. Department of Agriculture, Farm Income Situation, FIS–211, July 1968, p. 46.

[3] United States, prepared for the Joint Economic Committee by the Council of Economic Advisers, Economic Indicators, June 1969, p. 28.

[4] Ibid., p. 4.

In our opinion, these comparative figures over a period of 8 years justify consideration of the advisability of continuing the investment credit up to a maximum amount, at least, of $25,000 per year. This amount would be ample to permit many farmers and livestock operators to slightly counteract their disadvantage in relation to other business and personal income. Furthermore, it would assist smaller farmers and operators to compete more favorably with large operations and corporations.

There appears to be ample precedence for the recommendation we make to the committee. When the investment credit was temporarily suspended in 1966, the Congress recognized, and I believe the provision originated in this committee, the need for a small business exemption and allowed the privilege, during the suspension, on purchases up to $20,000.

Furthermore, it is our opinion from observation there would be considerable favor among the Members of the Congress for the recommendation we make. Prior to the close vote in the House of Representatives on H.R. 12290 speakers debated all aspects of the bill, but many of them specifically and prominently objected to the termination of the investment credit. Some mentioned in their remarks the advisability of retaining the credit with a maximum limit. At the same time there was argument for reducing the percentage rate of the credit, or perhaps making its application more selective.[5]

When first initiated, we understand the investment credit was designed to bring growth into a stagnant economy. Now it is argued that the reverse is necessary and the investment credit should be terminated entirely. In fact, in its report accompanying H.R. 12290, the House Ways and Means Committee wrote:

> Although the investment credit was a stimulus to investment designed to increase our capital investment during the period of lagging demand during the early 1960s, sustained full employment has eliminated the need for this type of encouragement to investment. Businessmen, in response to the credit and other factors, have spent almost $400 billion on plant and equipment since 1962. Moreover, in the period since the enactment of the credit, the economy has been brought to full employment, the level of business investment has been raised, productive capacity has been expanded, and efficiency of production has reached very high levels. Continuously expanding markets and high profit levels should provide sufficient investment incentive in the future even without the investment credit.
>
> The repeal of the credit is particularly desirable at this time because the credit is contributing to a level of investment which is unsustainable and is exerting substantial inflationary pressure. In short, the credit has fulfilled its purpose of increasing investment during a period of slack demand and has "outlived its usefulness" as a longrun stimulant to investment.[6]

Mr. Chairman, we would not argue with the overall contention of the need to minimize inflationary pressures, nor do we take much issue with the premise that perhaps the investment credit has fulfilled its purpose as related to the overall economy. But we do dispute the arguments as they relate to agriculture alone.

The agricultural industry has not contributed to inflationary pressures, nor has it shared, as the record shows, in such price reactions which are part of inflation. Instead, agriculture has been a most

[5] U.S. Congressional Record, 91st Cong., first sess., vol. 115, No. 108, Monday, June 30, 1969, pp. H5377–H5475.

[6] U.S. Congress, House Committee on Ways and Means, Act Temporarily Continuing Surcharge and Excises, Repealing Investment Credit, etc., 91st Cong., first sess., 1969, H. Rept. 91–321 to accompany H.R. 12290, p. 11.

unfortunate victim of it. As far as agriculture is concerned, the sentence, "Continuously expanding markets and high profit levels should provide sufficient investment incentive in the future even without the investment credit," simply does not fit the circumstances in agriculture.[7]

It is our contention that the reasons for the investment credit in the first place still exist today as related to the agricultural economy. Among its purposes was to bring certain equalities into the tax code. We believe it is necessary to continue this purpose which can be accomplished by retention of the investment credit on maximum annual investments of $25,000.

For years, the Federal Government has addressed its attention toward bolstering the economy in rural areas and toward improving farm income. This remains a stated goal of the Government today. Yet the termination of the investment credit for small businessmen and farmers would work in exactly the opposite direction. In fact, the termination would amount to increasing the taxes of farmers and livestock operators, a group that needs tax consideration if any group does.

Repeal would also work certain hardships on rural communities and small towns. Much equipment that is subject to investment credit is bought by agricultural people in rural communities from small-town implement dealers. We submit that the absence of investment credit will discourage necessary purchase of equipment, the price of which is already way out of relationship with prices received for agricultural commodities. As a result thereof, implement dealers in small communities will be adversely affected, and this adversity can affect the economy in small towns involved.

It is reported that the revenue effect of repealing the investment credit will be an increase in U.S. Treasury receipts of $1.35 billion in fiscal 1970 with $930 million attributable to corporation income tax and $420 million to individual income tax.

In fiscal 1971, the repeal is expected to increase Treasury receipts by $2.6 billion with $2 billion coming from corporation income tax and $600 million from individuals.[8] The estimated total gain in revenue for fiscal 1970 from H.R. 12290 is $9.26 billion of which $7.64 billion would be from the extension of the tax surcharge.[9]

We are not able, Mr. Chairman, to make an accurate estimate of the reduction in revenue which might occur if the investment credit were continued on maximum annual purchases of $25,000. However, in 1967 gross farm capital expenditures for machinery, equipment, and motor vehicles for farm business use totaled $4.819 billion.[10] If the 7 percent investment credit were applied to all such purchases, which could not be the case, the tax saving in that year would have amounted to $337.33 million. A more reasonable figure, however, might well be $200 to $225 million on agricultural purchases only.

Even so, we submit it is safe to say the reduction in revenue would only be a fraction of the anticipated increase in Treasury receipts of $1.35 billion in fiscal 1970 and a much smaller percentage of the $2.6 billion expected in fiscal 1971. The reduction would be a very small

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[7] Ibid.
[8] Ibid., p. 15.
[9] Ibid., p. 3.
[10] U.S. Department of Agriculture, Economic Research Service, Farm Income Situation, FIS-211, July 1968, p. 60.

portion of the total gain in revenue expected from all provisions of H.R. 12290. In contrast, this amount of tax credit would be meaningful to agricultural people—farm and livestock operators—as well as small businessmen.

In order to continue their operations as efficiently as possible and try, at least, to produce additional profits, farmers and livestock operators need an increasing amount of new and larger equipment. Much of this machinery is in the nature of replacement of old, smaller, or less modern equipment. It has been increasingly difficult to purchase such machinery because of grossly inflated costs, and will be even more difficult to finance if the investment credit is terminated entirely.

Not only are farms increasing in size, but the labor force available for agricultural operators has been declining rapidly, thus making it necessary for newer and larger machines to take the place of farm labor. At the same time, nonagricultural employment has been increasing as the attractiveness of urban and manufacturing jobs has lured many people from farms and rural areas.

From 1960 to 1968 civilians employed in nonagricultural jobs went up 20 percent from 60,318,000 persons to 72,103,000. During the same 8-year period, the agricultural labor force declined 30 percent from 5,458,000 in 1960 to 3,817,000 in 1968. Hired farmworkers in 1960 totaled 1,885,000 persons. By 1967, this figure had dropped 33 percent to 1,253,000 persons. Early quarterly figures in 1968 indicate that for the year the figure had declined further to just a few over 1 million.[11]

With agricultural production at least stable in many instances, and higher in others, the necessity of further investment in agricultural machinery and equipment is correspondingly evident.

In conclusion, Mr. Chairman, we graciously submit these facts and arguments for the retention of the investment credit on annual purchases of eligible equipment up to $25,000. To withdraw the credit completely would work a hardship on farmers, livestock operators, and small businesses while contributing little if anything to halting inflation. At the same time, continuing the credit with a modest maximum limit will be meaningful to agricultural people and proprietors of small business firms.

The CHAIRMAN. Thank you.

Mr. MAGDANZ. We do appreciate the opportunity to appear and discuss our position with you.

The CHAIRMAN. Thank you, sir. As you know, we have a number of things in the statute books to help agriculture, and, of course, I want to put some other things on there to help agriculture. I don't think we are doing enough for agriculture, but this particular measure here is costing the Government about $3 billion a year in revenue, and it occurs to this Senator that we might find something we could do to help agriculture that would help it more than this investment tax credit.

Are you aware of some of those things we might be able to do that might help it more than the investment tax credit?

Mr. MAGDANZ. You mean in the particular tax area, Mr. Chairman?

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[11] U.S. Department of Commerce, Statistical Abstract of the United States, 89th edition, 1968, p. 215, and United States prepared for the Joint Economic Committee by the Council of Economic Advisers, Economic Indicators, June 1969, p. 10.

The CHAIRMAN. Well, no. I am just covering the all-out-doors.

Mr. MAGDANZ. You mean in the overall agricultural picture?

The CHAIRMAN. Yes, that is correct.

Mr. MAGDANZ. Well, of course, the price matter is the thing that has been plaguing agriculture for a long time, and even though we are proceeding with stable production, we are blessed with the ability to overproduce, and we sometimes do this.

We have the prospect, of course, of trying to raise farm income through higher prices which we hope can be brought about through some manner of means, and the Congress, the Senate, the House, and all the trade groups and everyone else have been working on this for years.

I think we would have to say we have not yet come up with a satisfactory answer and I am not prepared today to tell you what that might be.

Now you mentioned though the figure of loss of revenue to the Federal Government in the amount of $3 billion.

The CHAIRMAN. $3 billion.

Mr. MAGDANZ. Unless the investment credit is terminated. I did not have those figures. The most that we have is the total of $2,600 million in fiscal 1971, but this would be circumstances where the investment credit was terminated entirely. We are speaking of retaining it on the modest amount of $25,000 and I do not believe that as far as we were able to determine at least that this would reduce Federal revenue by any more than a fraction of the $3 billion.

The CHAIRMAN. You understand our problem though, that if we keep the investment tax credit for farmers, then small business comes in and makes an equally logical argument.

Mr. MAGDANZ. Yes.

The CHAIRMAN. Even though they might not be as badly distressed as the farmer. Many of them are in need of some help. And then various and sundry other groups come in and say the bill is not equitable. If you are going to do that for them and leave us out, we need some help to modernize and improve our situation.

So the fabric just begins to unweave and as each thread comes out of it the first thing you know it won't hold together. Now the thought is can we do it for you without being guilty of discriminating against a lot of other people by favoring you.

Mr. MAGDANZ. Mr. Chairman, we are asking merely for the retention of $25,000 for all business, not just farmers, and it would apply to small businessmen. It would apply to large business organizations, firms, and corporations. We are merely suggesting the $25,000 across the board.

The CHAIRMAN. How much would that cost us in terms of revenue? I will accept your figure of $2.6 billion. I was just rounding the figure to the nearest decimal point but I must admit that is a fairly good correction; $400 million is a substantial amount of money. How much revenue would it cost to exempt up to $25,000 of investment?

Mr. MAGDANZ. Our educated estimate of this for agriculture alone, as I indicated, was $200 million to $225 million. How much additional would arise out of other business I am hardly prepared to say.

The CHAIRMAN. Wouldn't you have a lot of this thing of corporations electing to rent a piece of equipment so that someone connected

with or friendly with the corporation could buy the piece of equipment and then lease it back to the corporation, whereby he gets the 7-percent investment credit and he perhaps is able thereby to lease it for a cheaper price than the corporation could buy the equipment itself?

Mr. MAGDANZ. This, of course, is a possibility; yes.

The CHAIRMAN. So you see you get into all that when you make that across the board. You have made a fine statement of your position. Thank you very much, sir.

Mr. MAGDANZ. Thank you.

Senator Williams?

Senator WILLIAMS. Just one question.

What would be your opinion instead of extending the investment credit, wouldn't the farmer and agriculture be better served if they just had a more rapid acceleration of depreciation itself, more lenient guidelines of depreciation?

Mr. MAGDANZ. This, of course, can be a helpful thing, Senator Williams. It would depend I think on how rapid the depreciation was. Of course the 7 percent amounts to a depreciation equivalent to 14 years, except that the depreciation is figured into the expense before the tax is figured, whereas the tax credit is an amount taken directly off the income tax.

Senator WILLIAMS. I realize that, but the investment credit is the equivalent of depreciating 114 percent of the cost is the equipment, whereas in the depreciation rates themselves you would only get 100 percent. But I wonder if a lot of your small farmers, if that is what you are talking about, and that is we are all placing emphasis on, wouldn't be better served if they had a depreciation schedule which they could understand without having to employ high-priced accountants to figure out your investment credit. Under the 8 years they have got to keep part of it to get their tax reduction under 4 or 5 years and many of the small ones do not like it, as you realize.

Mr. MAGDANZ. I think without doing some calculation, Senator, that the investment credit would be more meaningful to them than more rapid depreciation.

Senator WILLIAMS. I agree with that.

Mr. MAGDANZ. Yes.

Senator WILLIAMS. Because the investment credit is in effect the Government paying for 7 percent of the cost of the machines. We realize that. That is the reason we are talking about repeal.

Mr. MAGDANZ. However, I also would say this. Many of the agricultural people today, even smaller operators, are employing the services of certified public accountants in the preparation of their returns, and I do not believe we encounter any particular complication there. In fact, the change in depreciation might be more complicated than the investment credit. I merely offer that as a possibility, not as a statement of fact.

Senator WILLIAMS. Yes. Thank you.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. Mr. Chairman, I would like to have the record show that Mr. Magdanz is one of our prominent and well-informed citizens of Nebraska and we are delighted to have him before us. In this discussion here he has made a distinct contribution.

Mr. MAGDANZ. Thank you, sir.

Senator CURTIS. Is it your feeling that farm equipment really is an expense of operation, and that depreciation allowance, at least that which we have known in the past, has not been a complete compensation to the farmer for his expense of getting equipment?

Mr. MAGDANZ. I would agree with you entirely, Senator Curtis, and Mr. Hadley may want to comment a little bit on that. That is that we do not find farm machinery having a very long useful life, which means that after one owner was finished with it at the end of 4, 5, or 6 years, that it might have another 5 or 6 years for another farmer, and so forth. Much of our farm machinery actually wears out rather quickly.

Now, I do not mean to say that some of it won't last 8 or 10 years, but it wears out rather quickly, and I think that your observation is quite right, that it is more in the nature of an expense rather than in the nature of a——

Senator CURTIS. Of a capital improvement?

Mr. MAGDANZ. A capital investment, and yet is classified as a capital investment. May I ask Mr. Hadley if he would like to comment on that?

Mr. HADLEY. I think that is very possible that this might be the case. We do find that with the increased size of machinery that is now being employed in the farm operation, accompanied by the great increase in cost, a lot of these probably have many more useful hours in them.

Senator CURTIS. But you are faced with this proposition. A great many business concerns buying a machine, they are able to use it every workday of the year.

Mr. HADLEY. Yes.

Senator CURTIS. Because of the impossibility to hire farm labor, and because of the fact you never can turn progress backward, agriculture has to buy expensive machines. Individuals engaged in agriculture have to buy an expensive machine, and at best it is only used a very small part of the year; is that true?

Mr. MAGDANZ. This is absolutely correct. Normally tractors on a farm may be used quite a number of hours throughout the year, and we have certain harvesting machines now that are adaptable to small grain crops, soybeans, and even to corn harvesting, so that they can be used more days throughout the year, but let us take a corn planter——

Senator CURTIS. But even at that they are probably idle 300 days.

Mr. MAGDANZ. This is correct. They would be idle 300 days, but contrast this to a corn planter. Mr. Hadley, correct me if I do not give an exact figure, an accurate figure here, but a large, modern conr planter, with all the attachments today, may cost in the neighborhood of $6,000.

Mr. HADLEY. That is very possible.

Mr. MAGDANZ. And the farmer may use this to plant a given number of hundred acres of corn, and it may take him 4, 5, or 6 days, depending on how many hours it runs, and for the remaining 360 days, this $6,000 investment is put into the shed or the machine barn.

Senator CURTIS. And with the present level of farm prices, it has to be a sizable operation to break even; isn't that true?

Mr. MAGDANZ. This is very true.

Senator CURTIS. You cannot have a sizable operation without this expensive equipment, even though it may not be used more than 25 percent of the time, and in some instances less.

Mr. MAGDANZ. This is correct.

Senator CURTIS. I do not know what the committee will be able to do. I do not know what type of amendment would have the greatest consideration. In the event that this was provided, not for all purchases under $25,000 but in the event it was confined to agriculture, I would like to have an expression of our view on what would be a reasonable interpretation of agricultural usage. Farming is defined in the Internal Revenue Code. I understand, the staff tells me, that farm equipment is not defined. Let us take the case of an individual who operates a business in town. He also operates a farm. He buys a truck and uses it in both activities. If an amendment were to be advanced extending this limited investment credit to agriculture only, would you think that a rule that it be substantially used in agriculture, that it be used 75 percent of the time, which it is used in agriculture, would be a reasonable rule?

Mr. MAGDANZ. If I understand you——

Senator CURTIS. Because after all the tractors, the corn planters, and so on would have 100 percent use, and in order not to get into problems out on the fringe, where there would be a wide purchase of equipment that would be used for nonagricultural purposes?

Mr. MAGDANZ. Your question does not involve any problem with strictly farm machinery such as a tractor or combine.

Senator CURTIS. It is based on that assumption. I am not asking you to endorse an amendment that would limit this to agriculture alone. I say if the committee did limit it to agriculture equipment alone, would you feel that a machine for the days that it is used would have to be used 75 percent of the time in the business of farming to be a reasonable rule?

Mr. MAGDANZ. I would say yes, it would be reasonable, and I think it would be necessary for us to dwell on that a little bit more before we could give a positive statement that, yes, that would be the right percentage, but some such criteria could be established for the use of these machines that might be used partly in agriculture and partly in other business. I do not think there would be any question as to the application of investment credit against those agricultural pieces of equipment that were used entirely in agricultural production, even though this man might have another business in relation to agriculture. I do not believe that we could rule him out on that basis.

Senator CURTIS. No, I think agriculture stands as a rather unique position. I have made no survey. I know of no available statistics to show that a manufacturer buys a machine or a printer buys a printing press or some other business concern buys a piece of equipment, what portion of the year that stands idle. I do know a farmer has to have this expensive equipment, and he has to own it for the full year, even though the number of days that he needs it is very limited, but if he did not have it for those limited days, he would be out of business.

Mr. MAGDANZ. This is absolutely correct.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Senator Miller?

Senator MILLER. Good morning, Mr. Magdanz.

Mr. MAGDANZ. Good morning to you, Senator.

Senator MILLER. It is good to see you before the committee.

I have two questions.

Number one, I do not think we need to worry too much about the so-called large operator, because ordinarily the large operator has adequate capital. I do think we need to concern ourselves about the so-called medium-sized family farmer.

I would suggest to you that the income tax returns of the say 240-acre to 300-acre operator rarely show an investment in 1 year in equipment in excess of $10,000. I am wondering if $10,000 might not be more appropriate than $25,000, if we are really talking about the area of need. We have been having a lot of criticism, as you know, about the payments from the Government programs in excess of $20,000 or even in excess of $10,000. There was an amendment filed over here last week which would have limited the payments to $10,000. I think the philosophy behind that was to try to get in the area of the medium-size family farmer, who is an efficient man but nevertheless is not overly capitalized.

It seems to me that when we start going up over $10,000, we can be criticized for favoring the large operator as against the medium-size operator.

Now, before I came down here I made out a good many farm tax returns, and there were a few of them of what I would call large operators. They were pretty well capitalized, and sometimes their investment in farm equipment would exceed $10,000, but the great bulk of the farmers whose returns I saw and prepared certainly would not have come up even to $10,000 investment in 1 year. We are talking about an annual amount here. Do you have any comment on that?

Mr. MAGDANZ. Yes, you do make a point, Senator. I would say this to you. That we would not be very argumentative over a maximum limit of $20,000 instead of $25,000. I think perhaps that a figure of $10,000 in this day and age, because the small farmer is no longer as small as he used to be, and the middle-size farmer larger than he used to be, I think that a figure of $10,000 might be rather too low.

Senator MILLER. As I understand it, the average size farm in my State is about 240 acres, probably a little larger over in Nebraska. Of course there are some that are considerably larger than that, but you take a 240-acre or 300-acre farm, or even 320, I would suggest to you that it would be rather rare for that individual to plank down more than $10,000 in equipment in any one year.

Mr. HADLEY. Senator, might I say this. That if the $10,000 limit would apply, we certainly would want the privilege included to carry forward this credit to other years. An actual investment of $10,000 per year over a 9-year period would be considerable as you say I believe for the average farmer, so I think that we can be reasonably sure that this credit can be forward and backward, it might be given more favorable consideration.

Mr. MAGDANZ. Certainly this would be more helpful than the immediate repeal of the credit, Senator Miller. However, I would point out merely to exemplify what the situation is that today a $10,000 purchase may be represented by only one tractor.

Senator MILLER. I understand that. My point is though that the basic operation of the average farmer simply won't stand for more than that in 1 year. They may be putting in a tractor in one year and a cultivator or something else the next year, as a matter of being able to stand the capital requirements.

Mr. MAGDANZ. That is true.

Senator MILLER. And I must say that I try to think about the average size farmer more than I think about the big operator, because the big operator generally can get along pretty well.

Mr. MAGDANZ. This is usually the case. We made our presentation on the basis of $25,000, but we would certainly be delighted to leave the exact figure to the wisdom of the committee and the Congress.

Senator MILLER. Now the second question I have is this: I do not need to tell you how difficult it is to start making exceptions to repeal of the investment tax credit. You have got all kinds of activities. Suppose it is in effect repealed. Now the question is what can we do which will meet the needs of the agricultural industry.

You may recall that a good many years ago, long before I came down here, the Congress was faced with the problem of a lack of grain storage facilities, so the Congress in its wisdom set up the provisions in the tax law providing for quick amortization of grain storage over 5 years. Whether it lasted 15, 20, or 25 years, owners were allowed to write them off in 5 years.

Do you think something like this would be helpful? Let us say that the investment tax credit is going to be repealed. What can we do to replace it that would be helpful, and which would at least partially solve this problem? It seems to me that perhaps a reversion to the grain storage amortization approach might be one approach that we could use which would be helpful.

Mr. MAGDANZ. There is no question but what this would be helpful. However, an amortization program, more rapid amortization program or depreciation program would not be nearly as meaningful in our opinion as continuation of the investment credit at a reasonable level.

Senator MILLER. That is right, because take, for example, on a $6,000 item, 7 percent would be $420 less of a tax bill.

Mr. MAGDANZ. Yes.

Senator MILLER. Whereas if you allow that to be amortized off faster than ordinary, you would have a tax deduction which would give some benefit, not as much as a straight tax cut, but it would be a benefit.

Mr. MAGDANZ. Yes.

Senator MILLER. And it would be helpful.

Mr. MAGDANZ. This is correct, and we would agree. Now as far as other things that might be done for agriculture, we are into that problem right now, as you know perhaps better than we do, and various ideas are being proposed, and I am sure there will be hearings and consideration over in this body before too long. They are just starting today over in the House on what can we do with this agricultural program which everybody knows needs to have something done to it, but we are not sure just what it ought to be.

Senator MILLER. Then finally to me the No. 1 thing that we can do for farmers is to put a stop to inflation.

Mr. MAGDANZ. We agree completely.

Senator MILLER. The inroads of inflation, especially to the tenant farmer, have been far worse than any offsetting benefit of the 7-percent investment tax credit, far more. It seems to me the very thing we ought to do is to put a stop to inflation, and that is the best thing we can do for the farmer. And then from that point on let us see what we can do.

Mr. MAGDANZ. We agree wholeheartedly, and this is the reason, one of the reasons at least that we are not here before this committee suggesting that the surtax matter be repealed, taken off, or anything of the sort. We make the contention that we do for the investment credit because we feel that the retention of this in a modest amount will not materially affect efforts in curbing inflation.

Senator MILLER. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Mr. Magdanz, Mr. Hadley, first, our objective is to obtain lower food costs, fiber costs, and also give the farmer a return on his investment. He has been at the lower end of the totem pole, as far as getting consideration, over the years. We hear a great deal about the amount that is involved. As for the $25,000 or whatever the figure might be, in one State $25,000 may appear to be a tremendous figure, and in another State, for instance in my State of Arizona, where we have large ranches in the livestock industry, feeder operations, and many problems, $25,000 is not an appreciable amount, as you realize.

I do not think that size should be the criteria. What we are seeking is lower food costs, especially when we are talking about your particular industry. Arizona, of course, has a problem because we do have a serious labor shortage in many of our areas. We do not like to displace labor. What we would like to do is to be able to utilize labor perhaps on a higher scale where it would be more of a trained labor force, and to do away with our stoop labor, but we have some very serious problems as far as equipment cost is concerned.

Do you feel that you can just say it would be all right to go below $25,000 since when you go below the $25,000 you would be affecting a great number of people in my State, whereas in Iowa you may be affecting only a few.

Mr. MAGDANZ. You are correct, Senator, that there would be no way to equalize this thing between the States, between areas, other than to set a figure that was reasonably representative, because you do have many large operations in your State, they have them in California, where $25,000 would not nearly cover their annual investment in new equipment per year. But frankly we hardly know any other way to do it than to set it arbitrarily, rather than a percentage of operations or something of that sort, which could become terribly involved.

Senator FANNIN. I realize you are seeking something that would be fair and equitable to the greatest number possible, but one of our objectives has been to lower food costs and lower fiber costs, and we are not going to be able to compete with the other countries of the world unless we do. Certainly we cannot compete with synthetics unless we lower costs on some of the fibers that we produce. So I am saying that when we have a set figure here, such as the $25,000, we do curtail the opportunity, in many instances, to lower those costs.

Mr. MAGDANZ. You would not have this would you, among your larger operators, if they had the advantage of investment credit on

up to $25,000. This would at least be helpful to them. Their lower production costs as compared to a smaller operator could come about in part at least by their increased efficiency, and the fact that they might be able to use a machine that costs no more than one would cost a small farmer but uses it on many more acres and of course it would be more efficient for him.

Senator FANNIN. Of course this would be better than losing it all, I certainly grant you that, but we are trying to curb inflation to a certain extent, I will not say to a certain extent, it is our goal.

I look at it from the standpoint that if we have greater productivity, that alone will help curtail inflation. Certainly we know that as far as production of either the livestock or production of, for instance, vegetables in my State, or whatever it might be, if we can increase productivity we have a good chance of decreasing the increase in price.

Mr. MAGDANZ. If we can increase productivity without further costs, and put ourselves in a position where we are more efficient, whether it is farming, manufacturing, or anything else, products can be produced cheaper.

Senator FANNIN. And that is our goal as far as I know.

Senator McCARTHY (presiding). Thank you.

Does that finish your statement?

Mr. MAGDANZ. Yes, it does, Senator.

Senator McCARTHY. Thank you very much.

Mr. MAGDANZ. All right, sir; and thank you and the other members of the committee.

Senator McCARTHY. The next witness is the Reverend William T. Hogan, professor of economics, Fordham University.

STATEMENT OF REV. WILLIAM T. HOGAN, PROFESSOR OF ECONOMICS, FORDHAM UNIVERSITY

Father HOGAN. My name is William T. Hogan, S.J., professor of economics at Fordham University in New York City.

I appreciate the opportunity to appear before this committee to express my views on the 7-percent tax credit.

As an economist specializing in the economics of heavy industry in this country and abroad, I have been concerned since the middle 1950s with the subject of tax depreciation and the replacement of productive plant and equipment. As an early proponent of tax reform to assure a modern and competitive industrial sector in the United States I had an opportunity to be closely involved in the deliberations and proposals which led to the depreciation reform section of the Revenue Act of 1962.

On a number of occasions in the past, I have been accorded the privilege of addressing Congressional Committees on the depreciation aspects of the tax law, and I am here today to express my concern that the proposed repeal of the 7-percent investment tax credit will, if enacted, seriously affect the continued growth and development of the industrial segment of our economy.

In 1962, and indeed for several years before that time, many were interested in depreciation reform so that the tax treatment accorded capital investment would encourage our industries to replace and

modernize plant and equipment and thus remove the disadvantage that they faced in comparison with a number of industrialized nations which had more liberal depreciation practices.

A number of plans were proposed for depreciation reform. From these the administration selected the 7-percent investment tax credit coupled with a change in the guidelines whereby the length of time over which a capital asset would be written off was shortened. The combination of these two items represented depreciation reform.

The Secretary of the Treasury, Mr. Dillon in testifying before your committee stated at the time that—

A combination of both the forthcoming modernization of depreciation guidelines and a special incentive such as the investment credit contained in the bill before you is required if U.S. business firms are to be placed on substantially equal footing with the foreign competitors in this respect.

Thus the 7-percent investment credit, a vital part of depreciation reform, was not considered to be a device for stimulating the economy nor a tool for its management. In this respect, Secretary Dillion also stated the tax credit "must be a permanent part of our tax code," as opposed to "a temporary remedy for recession."

Since the establishment of the 7-percent investment tax credit in 1962, American industry has spent over $400 billion for plant and equipment. This is indeed an impressive total, and although the amount induced by the credit cannot be ascertained with precision, it is admitted by all to be substantial. The magnitude of investment indicates the effectiveness of the credit, but this aggregate figure, however large, should not lead us to believe that the problem has been solved.

Modernization is and must be a continuing process. No nation has a monopoly on technology, and the worldwide pressures for constant improvement to industrial processes are relentless. Thus it is impossible for any one nation, no matter how strong industrially, to cut back even temporarily its investment in plant and equipment if it wishes to remain in the competitive race. Thus, the investment record of the past 6 or 7 years cannot justify complacency at the present time.

The $400 billion expended since the introduction of the credit represents a nationwide figure covering many industries and many companies. However, its effectiveness must be considered on a company basis since the company is the producing unit that invests in facilities.

Many companies, although they have made substantial investments, have not yet balanced their facilities to derive the full benefit from modernized equipment. Two examples will illustrate the point:

First. A steel company, which is one of the marginal producers, recently invested $94 million in a continuous hot strip mill. This was a decided improvement over the replaced facility. However, in order to take advantage of the new mill much larger slabs had to be provided, and thus it was necessary for the company to consider the installation of a slab mill which would cost approximately $60 million.

Second. Another company installed a new basic oxygen plant for making steel; however, its blast furnace capacity is not modern nor adequate enough to provide the molten metal necessary to run the new oxygen process efficiently. Thus, although considerable investment has been made in both the hot strip mill and oxygen furnaces, further investment must be made in a slabbing mill and in blast furnaces

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if the full potential is to be realized. These are but two examples, yet they illustrate the need for balanced capital investment at the company level, and a great deal remains to be done in this respect.

The need for balanced facilities is one major reason why companies must continue to invest in plant and equipment. It cannot be deferred because of the ever increasing degree to which businessmen have found themselves living, working, producing and selling in an international economy.

They must compete against their counterparts in foreign countries where the latest industrial technology has been installed with generous Government assistance. American business has come to the realization that it is no longer possible to operate in a nationalistic vacuum and it is unrealistic for the Government to formulate its antiinflationary policy as if such a vacuum still exists.

Competition from abroad is severe in the automotive, steel, textile, and electronics industries, to mention a few. Business today can serve the best interests of this Nation by its ability to compete effectively in the world market and this should be recognized in the tax system and in our policies to control inflation.

It must be recognized that although our investment has increased we have spent far less proportionately on capital equipment than the other industrialized nations. A survey of the major industrialized countries indicates that between 1960 and 1968 they spent a greater percentage of their gross national product on plant and equipment than we did here in the United States.

Our average for the 8-year period was 16 percent while that of Japan was 33 percent and Western Germany's was 25 percent. This demonstrates beyond question that our competition is not slackening its efforts in the construction of new facilities.

During the past few years I have had a number of opportunities to inspect industrial installations in other countries. I was particularly impressed by developments in Japan where expansion and modernization are moving ahead at a feverish pace. This nation holds the undisputed leadership of the world in shipbuilding.

It is second only to the United States in the production of automobiles and ranks third in the production of iron and steel. Plans for expansion in both the auto and steel industry indicate that we can expect an even greater degree of competition than heretofore.

Japan's exports of automobiles in the United States rose from 70,000 units in 1967 to 170,000 units in 1968, and will most probably be in excess of 250,000 this year. In respect to steel, Japan's exports to the United States increased from 4,700,000 tons in 1967 to 7,500,000 tons in 1968. They will be somewhat less this year because of the voluntary quota. However, the Japanese steel industry will be producing in excess of 100 million tons of steel a year by 1971.

They will have at least four individual mills capable of producing 11 million tons of steel each. We in the United States will not have a single mill in this category by 1971. Further, their equipment represents the most modern technology.

In the face of such competition it would seem to be folly for industry in the United States to cut back its capital programs designed for modernization and low-cost operations.

In recommending the repeal of the 7-percent investment tax credit some concern has been expressed by the administration that the current rate of business capital expenditures will (1) increase inflationary pressures and (2) may lead to a problem of excess industrial capacity in the near future.

With respect to current inflation, repeal will not materially reduce capital expenditures this year. Most spending commitments were made before the April 18 deadline and, consequently, will be carried out. Curtailments will be minor in relation to the total.

In regard to excess industrial capacity, concern over its likelihood does not reflect very much confidence in the growth potential of the American economy. Rather, it smacks of what traditionally has been a shortcoming of many economic forecasts; namely, that they tend to underestimate our potential growth.

It would seem that a greater potential hazard for the future in terms of inflation would be to choke off investment and run the risk of inadequate industrial capacity which, in great part, will be either obsolete or out of balance, thus creating a situation of short supply, high-cost production, and higher prices. In short, to curtail productive investment now is one of the surest ways to guarantee inflation in the years ahead.

Capital investment is needed if we are to maintain the increase in productivity that has been a longstanding feature of the American economy. There has been some dispute about the rate of growth in productivity; the Council of Economic Advisers once placed it at 3.2 percent per year. Others have qeustioned this and claim a lower rate of gain, but whatever the rate is, it does not come automatically. It comes principally through the constant replacement and modernization of industrial plant and equipment.

If at all possible we must maintain an increase in productivity of between 2 and 3 percent a year. This is substantial considering the base on which it is calculated. However, it is necessary if we are to control inflation and assure our country of real economic growth.

Increased productivity stems in the main from investment in new technology and is the basis of an increase in real wealth for it means that we are operating our plant more efficiently and effectively. We are getting more output per unit of input and this is the greatest possible protection against inflation.

In addition to increasing productivity and controlling inflation, in the long run, capital investment will be required in the decade ahead to create additional jobs. Estimates have been given that an average of 1.4 million new jobs will be required annually during the 1970's; thus, 14 million new jobs must be created and equipped during the coming decade. This in itself is a gigantic task and will require a huge capital investment. Nevertheless, it must be undertaken if we are to maintain a high degree of employment in the future.

In view of the importance of capital investment to the American economy, it is unthinkable that the repeal of the tax credit would be considered by the administration much less proposed to the Congress without at least offering some alternative. Three such alternatives would be—

(1) The suspension of the investment credit for a limited period of time;

(2) The reduction of the rate of the investment credit to 4 or 5 percent; and

(3) The continuation of the credit as it now stands with amortization of the total amount over the life of the asset.

If the investment tax credit is repealed, something must be put in its place to avoid grave damage to growth in our capital structure. Increased productivity is at stake, the ability to provide jobs is at stake, the ability to compete with foreign manufacturers is at stake, as is the achievement of a higher standard of living.

Senator McCarthy. Father Hogan, you say that the suspension of the credit would have no effect on 1969, or very little effect. Yet you propose suspension of the credit for a limited period of time. How would you propose to have that apply, through half of 1970? As an alternative, I understand you are against our doing anything about it, but you offer an alternative, which seems to me a kind of contradiction of your general thesis. How would you recommend that we proceed, if we decide to suspend the credit for a limited period of time, since you said it would not have any effect in 1969? I assume you would want to have some effect in 1970.

Father Hogan. When I say it would not have an effect, I am talking about the major capital investment that is being made by large industry. It will have an effect in respect to what we call shelf items, items that can be bought that are already constructed, automobiles, certain office machinery, and so on. These could very well be postponed, so there will be some effect in regard to total investment, but as far as major industries are concerned, they have committed their 1969 capital expenditures.

My interest in this, Senator, is to maintain the investment credit on the books so that it can be reinstated and not completely lost. This is the point I want to make. It was suspended once before, but it was held in suspension so that it might be put back into operation at a future date.

I fear that if the investment credit is repealed completely, that its reinstatement will be a very difficult proposition, and therefore the suspension would be an alternative, not a particularly desirable one, but an alternative, because it still would be held on the books and could be reinstated at a time perhaps when it is needed in the economy, although I do not look on the investment credit as a tool for managing the economy. I look on it as part of depreciation reform, which indeed the administration signified it was back in 1962 when it was put into operation.

Senator McCarthy. Do you think 7 percent is too high? Is the reduction to 5 percent a compromise on your part? Do you feel 7 percent may be too high?

Father Hogan. No. Again, Senator, it is not a question of being too high. I feel that there is a definite mood to repeal the credit. I do not think the credit should be repealed. I am looking for some alternative, for some compromise so that the credit can be sustained at a lower rate and if necessary in the future can be moved back up to 7 percent or perhaps higher if necessary.

Senator McCarthy. From an administrative point of view and from a business management point of view would it be easier to adjust by a

change in the schedule of amortization than modification by repeal of the investment credit?

Father HOGAN. You mean something like rapid amortization that would allow you to write off plant?

Senator MCCARTHY. You suggest that the amortization schedule——

Father HOGAN. The amortization would be this, that the credit would be taken as the asset wears out.

Senator MCCARTHY. Instead of accelerated?

Father HOGAN. Yes.

Senator MCCARTHY. From an administrative point of view——

Father HOGAN. I think it would be easier, yes, to adjust to amortization rather than to an off-again on-again proposition.

Senator MCCARTHY. For management to adjust to the amortization change?

Father HOGAN. Yes, because, Senator, this way they would be certain that they had the 7 percent whereas otherwise they are not certain.

Senator MCCARTHY. You use the 16 percent of gross national product as the basis of comparison with investment in other countries. Is gross national product really an adequate base for comparing our investment rate with that of Japan or Europe, for example? Components of our GNP are quite different.

Father HOGAN. Yes, that is true, it is quite different, but it is one comparison that has been made and I think it is a valid comparison, because it indicates the proportion of the wealth of the economy that is going into capital investment.

Senator MCCARTHY. It is the only one we have. It is not really very good, is it? As a base it does not give you a solid basis for comparison?

Father HOGAN. It does not give you the full investment. It does not compare the dollars and cents investment, but it is a relative comparison, and in relation to the size of the West German economy and the Japanese economy with respect to ours I think it is an indication of activity.

Senator MCCARTHY. What would you propose we do by way of changes in tax law to try to control inflation? Where can we concentrate?

Father HOGAN. The point I am making here, Senator, is that I feel that——

Senator MCCARTHY. Repeal of the investment credit would not really be helpful to controlling inflation in your judgment.

Father HOGAN. That is right. I think we have two things to look at, Senator. We have the shortrun and the longer run, and certainly in the longer run I think that investment in plant and equipment, which would give us a modern plant and allow us to increase productivity or to keep our productivity pace going as it is would be a great safeguard against inflation, because if we fall behind in our productivity, if we fall behind in our plant capacity, we are going to come up against the situation where goods are relatively scarce, and this will put the inflationary pressure on I think rather severely, so I think that investment in modernized plant and equipment is one of the best ways in which we can safeguard against inflation in the long run.

Now you do have shortrun propositions too, and there can be other means taken to govern inflation in the shortrun, but I am interested here in the longer run. I do think that as a result of the $400 billion

that have been invested since the enactment of the credit, that we have greater productivity here in the United States industrial sector, and that our prices are certainly lower than they would be if we had not done this.

Senator McCARTHY. Is it your opinion that we ought to proceed by way of increasing taxes so as to reduce consumer demand?

Father HOGAN. I would think that if consumer demand can be held in check, it would be a more effective way of a shortrun approach to control inflation.

Senator McCARTHY. I think those are the only questions I have.

Senator WILLIAMS. No questions.

Senator BENNETT. No questions.

Senator McCARTHY. Senator Curtis?

Senator CURTIS. Mr. Chairman, I would like to inquire.

You made reference to the foreign industrial countries. Can you briefly tell us what provision in their tax law or otherwise they have to encourage new plant expansion?

Father HOGAN. In the first place, Senator, in the tax laws of many foreign countries during the past 10 to 15 years, they have revalued their plants and equipment in terms of current dollars. In other words, they have corrected for inflation in many countries, so that depreciation is taken on a current basis or a revalued basis, not the original cost basis.

Senator CURTIS. More a factor of replacement cost?

Father HOGAN. That is correct.

Senator CURTIS. Rather than existing?

Father HOGAN. That is correct, many of them have done this. In some countries, like the United Kingdom, they allow a company to write off 120 percent of the assets, value, giving them a sort of a bonus to write off against.

Senator CURTIS. The United Kingdom does that?

Father HOGAN. Yes, the United Kingdom. In other countries, such as Germany, they have allowed in one other respect something which I think we should give a great deal of consideration to in this country. They have allowed equipment that is used against air and water pollution to be written off quickly, 50 percent of its cost can be written off in the first year. This is a substantial incentive for the campaign against air and water pollution. I think this is something we well might consider in this country too.

In France another device has been used. The steel industry for one has been granted $600 million in loans at very low interest rates, about 3 or 4 percent, and this interest does not start until about 2 or 3 years after the loan has been granted. And when the $600 million runs out, there is to be an additional $900 million granted, so these are some of the things that are done in foreign countries.

Senator CURTIS. But on basing the depreciation allowance on current value you would have a situation something like this, a tractor costs $8,000. It is depreciated for 2 or 3 years. But its replacement value maybe is $14,000. They would take that new figure for the remainder of the years of depreciation. Is that somewhat the principle that is involved?

Father HOGAN. Senator, what I would suggest on this is a system whereby, by means of an index, you reevaluate your equipment every

year, so that if you are taking depreciation on $8,000 the year you buy it, and the next year let us say the tractor was worth $9,000, you take depreciation on $9,000 or whatever the figure would be, so that you move up to the depreciation cost of the replacement unit, which might be $14,000.

Senator CURTIS. But you would have to have an across-the-board increase figure, and not have it vary.

Father HOGAN. Oh, absolutely.

Senator CURTIS. As to different business and types of machines.

Father HOGAN. No question about this, Senator. Some index would have to be determined, and this would be applied across the board, so that we would know where we stand on these things.

Seantor CURTIS. Are there any foreign countries that have an investment credit anywhere near like that which was enacted in 1963?

Father HOGAN. Not as such to my knowledge, but they do achieve practically the same result by other incentives.

Senator CURTIS. There are some problems in connection with investment credit. Anything that is a credit against a tax decreases the revenue?

Father HOGAN. Yes.

Senator CURTIS. Because most officials get enthusiastic about their programs and want to finance it by tax credit.

Father HOGAN. That is right.

Senator CURTIS. Pretty soon there is no revenue left as they whittle away. Another problem with the investment credit back in 1962 was that investment credit really is quite a direct subsidy. The end result is just the same as if the taxpayer pays his full amount of taxes and got a check back from the Government for 7 percent of what he had spent on equipment, is that not right?

Father HOGAN. Senator, may I respond to your first point?

Senator CURTIS. Yes.

Father HOGAN. You say that investment credit is a loss of revenue. On a direct basis that would appear to be true, but if the investment credit stimulates investment in plant and equipment, and more money is spent for plant and equipment than would have been spent, then you have more revenue expended which can be taxed, because the income of the equipment builders is going to expand, and the employment in the equipment builders' plant will expand, and you will have a broader tax for individuals and corporations there.

Now you can look at the 7-percent credit as a subsidy. This is certainly one way of looking at it. But historically if we go back to the inception of it, it was decidedly placed on the books as depreciation reform and not as a stimulus to the economy.

Many of us worked for depreciation reform such as price level depreciation which we just discussed a moment ago, or some other means, but this was decided by the administration, it was to be a 7-percent credit plus a shortening of the guidelines, and this was depreciation reform as they stated it. So it was not considered at that time to be a subsidy, although certainly anyone is within his rights to consider it as such if he wishes.

Senator CURTIS. In the realm of small business, it does not have a universal application. A business that had made substantial plant

expansion just prior to 1962 did not get the benefit of it. Their competitor might have benefited. When it was suspended, you had some people on the inside and some people on the outside. Also some small businesses, due to a family situation or a limited market, substantial expansion, renewal of plant is not the wise thing and has not been the wise thing for many years. It does not give any tax relief to them.

It is tax relief that is denied to those segments of our economy that might need it the most.

Father HOGAN. Senator, I can agree with you heartily, but I do think that we need something to encourage investment in plant and equipment in this country to keep our plant and equipment modern and up to date, because I think this is the greatest guarantee we have against inflation, and the greatest potential we have for competing with foreign producers, so that we can devise almost anything, call it a 7-percent credit, call it depreciation reform, which I would prefer to the 7-percent credit, but it seems as though this will require a long study that is now presumably underway, and it may take some time before it comes to a conclusion.

But fundamentally we have to do something about providing jobs in the 1970's, 14 million of them, and it costs a lot of money in capital to provide jobs. We have to do something to keep increased productivity. We have to do something which will control inflation, and we have to do something to meet foreign competition.

In other words, I am looking for the end here and the means to it can be varied, but I am looking for some result that will achieve these things.

Senator CURTIS. Every time we update our depreciation allowance laws, we help out at that particular time. I think you would agree the code of 1954 when the declining balance was introduced for the first time as contrasted to the level rate then it was——

Father HOGAN. The straight line rate?

Senator CURTIS. Then it was a decided spur to the purchase of new equipment account.

Father HOGAN. Yes.

Senator CURTIS. And after one of these things is enacted, it is a spur to increased plant renewal and expansion and new equipment, and then after a period of time, it becomes the normal, and it takes something new to give it a new incentive, is that not right?

Father HOGAN. This is true, and the reason basically for it was the continued increase in inflation, which eroded the dollar necessary to replace plant and equipment just to stand still. The purchasing power, as far as construction is concerned, of your 1968 dollars is about 50 percent of your 1945 or 1946 dollar, so that with this continued inflation, and admittedly this is a difficult problem, you have to find ways and means of replacing, modernizing plant and equipment. I am firmly convinced that modernization of plant has helped in the fight against inflation. Granted we still have inflation, but I think it would have been much more rampant had we not had the more productive plant and equipment.

Senator CURTIS. It seems to me that one of the most potent causes of inflation is one that is never mentioned, never mentioned in public

beyond a whisper, and that is the wage level. You can have all the plant equipment in the world. If the wage level increase in greater than the increase in productivity, you are going to have inflation.

Father HOGAN. This is definitely true.

Senator CURTIS. Right now there are signs posted in the Safeway markets here in Washington that some 80 drivers of dairy trucks hauling dairy products draw in excess of $17,000 a year, and now they are tying up the markets and keeping about 1,100 people from going to work. It very definitely is the unspoken fact with reference to inflation but probably the most persistent and the most potent one of all.

Thank you.

Senator MCCARTHY. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Father Hogan, of the alternatives which you suggest on page 9, do I deduce that you would prefer the third one?

Father HOGAN. Yes.

Senator MILLER. Namely a continuation of the credit?

Father HOGAN. Yes, I would.

Senator MILLER. With amortization of the total amount over the life of the asset?

Father HOGAN. I believe, Senator Miller, this would insure the credit so that business could plan on the credit, even though it amortized the asset, that is the amount of it over the life of the asset.

Senator MILLER. That is one point on which I am not clear. What do you mean by amortization of the amount over the life of the asset? Let us take an example. A piece of equipment costs $100,000 and has a 10-year life, and gets a $7,000 investment tax credit. How would you handle this amortization?

Father HOGAN. $7,000 would be written off over the 10 years instead of taken immediately at the start.

Senator MILLER. So that for the 10 year period there would be $700 a year deduction?

Father HOGAN. That is right.

Senator BENNETT. It would be 107 percent of the value of the asset.

Father HOGAN. This is one way of doing it. Or you can work it out to be 100 percent. This is a matter of the mechanics of doing it.

Senator BENNETT. It is only 100 percent, you have no tax credit.

Father HOGAN. I am sorry, I beg your pardon.

Senator MILLER. I think I understand what your point is.

Father HOGAN. Yes.

Senator MILLER. Instead of letting the taxpayer charge off or write off the $7,000 against his tax bill in 1 year, he would have to write it off at the rate of $700 a year over the life of the asset for 10 years?

Father HOGAN. That is right.

Senator MILLER. If this credit is continued, as it is, writing it off in 1 year, in the example I gave you, you would have the taxpayers pay cost of that item of $93,000, because he would have $7,000 to take off his tax bill. Do you think it would be fair to allow him to amortize or depreciate only that remaining $93,000 off, or would you continue it as it is now, a so-called double dip?

In other words, he gets $7,000 off his tax bill. He has got a true cost of $93,000, but he turns around and takes depreciation or amortization on $100,000.

Father HOGAN. Senator Miller, as you recall, this was done at the beginning of the credit for about a year or so, by Senator Long's amendment which was made to the proposition and it could be restored. My problem is one of trying to keep something that will allow us to stimulate and encourage modernization of plant and equipment. The mechanics of this certainly are up to the wisdom of this committee and the wisdom of the Congress to work out, but some alternative I think must be there, if we are going to repeal the credit. This is precisely why I offer several alternatives. I favor one slightly above the others, but I would like to see something maintained.

Senator MILLER. May I say that I am surprised that you did not list a fourth alternative, and that is a reduction in the tax rates. You are looking for capital formation.

Father HOGAN. This is another possibility.

Senator MILLER. Then why not reduce the tax rates, and stop getting into the thicket of some complicated provision. I must tell you that some of the accountants and lawyers that work on the investment tax credit on the enforcement side for the Internal Revenue find it is pretty rough, especially when there is a sale of the equipment after 2 or 3 years. Why not just a reduction in the tax rates?

Father HOGAN. Senator, this is also a possibility, but basically I have always felt if we had what we like to call depreciation reform, if we are able to revalue assets and charge off the true cost of wear and tear on those assets, we would be much better off across the board, but we have this 7-percent credit as an institution now, and it has provided an incentive to modernization of plant and equipment. But as I have testified before committees previously the other type of depreciation reform I think is far preferable. I have always thought it far preferable, because that would be something permanent in the tax laws, whereas the 7-percent credit has in the past been used as a tool to manage the economy, and I might say not with tremendous success, and I certainly would prefer the other if we are going to have true depreciation reform but how long would that take in coming.

Senator MILLER. You are getting into so-called price level depreciation.

Father HOGAN. That is correct. Senator.

Senator MILLER. Failing that though you recognize the tax rate reduction would give you capital reform?

Father HOGAN. Yes, Senator; that is true.

Senator MILLER. I want to ask you a question about that price level depreciation. Here you suggest that an index would have to be prepared. I can see an awfully thick volume. It might make the Sears, Roebuck catalog look small, and when I multiply the problems all over the United States, the problems of enforcement on the part of the Internal Revenue Service, the problems of the people who have to work up that index, it alarms me.

I am wondering why it would not be feasible to just simply take the annual depreciation in the purchasing power of the dollar.

Father HOGAN. No problem at all, no problem whatever.

Senator MILLER. Instead of an index.

Father HOGAN. Any index which is a reputable index indicating the erosion of the dollar's value, because of inflation, would certainly be acceptable.

Senator MILLER. In other words, every year as of December 31 Treasury could put out the amount of depreciation in the purchasing power of the dollar.

Father HOGAN. Exactly.

Senator MILLER. And that could be applied to the depreciation base.

Father HOGAN. There are several indexes existing now, Senator, you know, the Consumer Price Index, the Wholesale Price Index, Engineering News Record Index which is a private one on construction costs. These are all there. I don't suggest that we develop a new index necessarily if we could agree on one of the existing ones. This would be splendid.

Senator MILLER. So that we could avoid a compendium of all kinds of prices on equipment?

Father HOGAN. Absolutely.

Senator MILLER. Now on this subject of capital formation, we have had testimony here a couple of days ago from representatives of the AFL-CIO claiming that there have been alltime record profits on the part of the corporations in this country. Now if they are correct in that, there seems to be an area for capital formation, if there are indeed alltime record profits. Do you have any comment on that?

Father HOGAN. Well, the question of alltime record profits I think bears examination as to particular companies. You can take aggregate figures and that is one thing, but I think you have to consider the profits of individual companies, which is another thing, not as easy to do of course as taking an aggregate figure, but we should consider the company and not the economy. The economy in a sense is an abstraction. The company is the one that lives or dies on the basis of its profit, and I think this bears investigation.

I will say this. That the installation, the continued installation of plant and equipment that is up to date is a necessity if we are going to maintain a profit level, if we are going to maintain a productivity level that will allow us to pay wage increases.

Senator MILLER. You see what they do, they come in here and they advocate an increase in the corporate tax rate. They do not advocate a decrease, and I don't recall if they said anything about capital formation and buying more equipment, but they just say corporations have an alltime record profit. We advocate putting on a 100-percent tax rate.

Father HOGAN. Senator, I can point to a number of corporations that are by no means at an alltime record profit, in fact have not reached their profit levels obtained in 1955 and 1957 and these companies are not basking in the light of alltime record profits by any means, and they are companies hard pressed in every labor negotiation to come up with a wage increase. This wage increase should not come through higher prices but through greater productivity. I pointed out in my statement that a lot of the facilities that have been put in are not yet rounded out and balanced, so companies have not obtained the full benefit of this cost reduction as yet. Unless they have it, there won't be the money forthcoming to increase wages.

Senator MILLER. Then are we getting into an area where there needs to be a changing of the tax rates according to percentage of profits or something, so that some company that is not doing too well, it may be operating efficiently but it has a different set of competitive factors, would have a decrease in its tax rates, and another company that is making alltime record profits, which the AFL-CIO representatives are referring to, is going to have an increase in tax rates?

Father HOGAN. Senator, this is a very complex subject and I am not prepared to discuss the question of differentiation in tax rates. I came to talk about one particular phase of this legislation—namely, the 7-percent credit which was an incentive to improving plant and equipment, to give more efficient plant and equipment, and this is all to the good for any company, no matter whether it is marginal or whether it is very profitable.

Senator MILLER. What I am suggesting to you is that when we start getting into alternatives, tax rates, we are talking about capital formation. Tax rates I think traditionally have been recognized as having an impact, a very deep impact on capital formation.

Father HOGAN. No question about it.

Senator MILLER. And then when we get into the tax rates, we get into this problem of what the testimony is that has come in here from the AFL-CIO people, what that shows, and it makes it very difficult for somebody like me to decide which way we are going to go.

Let me ask you this question. You referred to competition, especially in the steel industry from Japan. Would it not be true that the best thing we could possibly do—if Congress could waive a wand and do any one thing which would improve our competitive position vis-a-vis Japan—would be to put a stop to inflation. Hasn't the inflation factor been the single biggest factor in reducing our competitive position during the last few years?

Father HOGAN. Yes, no questions about it. Our increasing costs have put us in an inferior position competitively speaking.

Senator MILLER. Would you say the comparative wage rates have a great deal to do with this?

Father HOGAN. Senator, wage rates, dollars or cents per hour in themselves do not tell the story. The story is told by the amount of labor cost in an item, in a unit, the amount of labor cost in an automobile, the amount of labor cost in a ton of steel. This is the important thing rather than the actual dollars per hour, so that if we are twice as efficient as somebody and pay twice the wages they do, we are still all right. We are even with them. So it is our efficiency that counts here in the use of that labor, the number of man-hours that go into a unit. This is precisely what should be reduced, the number of man-hours in a unit, and this will be reduced by the installation of more effective and more efficient and more productive equipment.

Senator MILLER. But as I understand it when it comes to steel, Japan has about the latest technology available, and our problem is apparently not necessarily to go ahead in technology but to even keep pace with them.

Father HOGAN. Well, they have the latest technology in certain phases of the steel industry, Senator. In the initial phases, the blast furnace, they are the best in the world. They are the biggest and the best operators of blast furnaces. As far as oxygen general converters

are concerned they are second to none. But when you move into the rolling mill aspects of the steel industry, the United States is second to none in technology, and, of course, they use huge bulk cargo carriers to bring in tremendous tonnages of raw materials at cheap prices. Thus, they do have a cost advantage in their initial stages of steel production, so in some respects we have some catching up to do in our blast furnace segment and perhaps the oxygen steelmaking, but here we are certainly equal to them. Blast furnaces are an area where they are ahead and we will have to catch up in this respect, because there are dollars to be saved in this sector of the steel industry.

Senator MILLER. Let me ask you one last question. Former Under Secretary of the Treasury Joe Barr is quoted when he wrote about his trip to Japan as follows:

> Anyone who keeps his eyes open as he travels the western rim of the Pacific today will inevitably wonder how we can compete in the next generation. Watching the Chinese in Singapore and the Japanese in Tokyo working around the clock, you can understand why I was stunned by the investment credit announcement.

Have you visited Japan?

Father HOGAN. I have, yes; very recently.

Senator MILLER. Do you subscribe to Mr. Barr's concern?

Father HOGAN. Oh, yes; without question. As I mentioned in my statement, their steel mills are outstanding and they are constructing four of them at the present time, which will have an 11 million ton capacity each; their automobile industry now is second only to the United States. They have passed Great Britain and Western Germany in 2 successive years, and they are going to move far ahead, and they are going to export more and more automobiles. In fact the steelmakers are interested in exporting finished products rather than steel, because there is more labor involved in the finished product and there will be more profit involved. I can share this concern without question, having witnessed the Japanese industrial development firsthand within the last 2 years.

Senator MILLER. Thank you very much.

Senator FANNIN. Father Hogan, your statement is very clear and concise, and I certainly share your concern about the future, especially as to whether or not we are going forward with studies to meet the problems that will be with us. At the present time we have a good percentage of our plant capacity occupied with defense production. Do you feel that the removal of this 7-percent investment credit will affect our ability to continue the modernization that will make it possible for us to be in a better competitive position at the time that we do close off to a certain extent our defense production after Vietnam?

Father HOGAN. I do; yes, sir.

Senator FANNIN. Do you know of any studies that are going forward in this respect? I certainly am concerned because I feel we are exporting jobs daily. If we are not prepared when we have that downturn, and our plants are certainly not modernized from the standpoint of competing with many of the other plants throughout the world, we will have a shifting over of production, and with that shifting we probably will lose efficiency because many of the plants were not built for those particular functions. Is that a concern to you?

Father HOGAN. It is. Any conversion that takes place from one type of product to another in a company is a matter of cost, it is a matter of time, and it certainly is a matter of concern that this company should get into some other line or back into its original line as quickly as possible, so that jobs are not lost or jobs are not suspended.

Senator FANNIN. Don't you think that now we are being rather lackadaisical about some of our modernizing while we do have this plant capacity, we do have the employment, because of the defense demand. Consequently we are falling further and further behind,

Father HOGAN. I feel, Senator, that this figure of $400 billion which has been advanced and which is an accurate figure is much too comforting to some people. You take the figure $400 billion, it is almost astronomical and some say, "Fine, it looks like we have done the job."

I submit we have not done the job. We have not rounded out the modernization of plant and equipment as it is today, and in 2 or 3 years the plant and equipment that was put in in the 1950's will become somewhat obsolete, and as I said, no nation has a monopoly today on technology, and other nations are moving ahead and moving ahead rapidly and keeping as modern as they possibly can and I think it behooves us to do the same.

Senator FANNIN. Father Hogan, there are many questions I could ask you but time does not permit. We certainly appreciate your testimony here this morning. It is very sound and I just hope that these studies that we are talking about will go forward because I think we are facing emergencies if we do not.

Thank you.

Senator WILLIAMS. The next witness is Mr. Herbert B. Cohn.

The chairman had to leave to go over to the floor and he asked us to continue these hearings. I point out we have 11 witnesses on the agenda and we have just completed two. At this rate we will be here until about midnight and I wonder if the witnesses could condense their statements and maybe the witnesses could confine their statements to not exceeding 5 minutes, otherwise I do not think we can get through.

STATEMENT OF HERBERT B. COHN, ON BEHALF OF EDISON ELECTRIC INSTITUTE; ACCOMPANIED BY MAYNARD E. SMITH

Mr. COHN. My name is Herbert B. Cohn. I am executive vice president of the American Electric Power Services Corp., and chairman of the Edison Electric Institute's Committee on Cost of Money and Taxes.

Senator WILLIAMS. If you wish to summarize your statement we will put it in the record as though read.

Mr. COHN. I would appreciate that, sir.

Senator WILLIAMS. Yes; it may save a little time.

Mr. COHN. I am appearing here today on behalf of Edison Electric Institute, which is a national trade association of the investor-owned electric power companies. Its 181 member companies serve approximately 78 percent of all electric customers in the United States.

Our statement is directed to Section 4(a) of H.R. 12290, dealing with repeal of the investment credit, and to Section 5 of the bill, authorizing

60 month amortization of certified facilities for air or water pollution abatement or control.

I have with me Mr. Maynard E. Smith, a recognized authority on the abatement and control of air pollution. Mr. Smith has prepared the portion of our presentation dealing with the technical aspects of air pollution abatement, and will speak briefly on that point.

Specifically, we urge that this committee make the following changes in the bill:

1. With respect to the investment credit, we urge: (*a*) The deletion of the proposed new section 49(d) of the Internal Revenue Code, which—even where property is under a binding contract in effect on April 18, 1969—would progressively reduce the investment credit for such property if placed in service after December 31, 1970, and eliminate the credit entirely if placed in service after December 31, 1974 (*b*) The substitution of the concept of property "ordered" on or before April 18, 1969, as defining pre-termination property, in place of the "binding contract" concept which appears in section 49(b) (1). We suggest that this be accomplished by amending section 49(b) (1) to read as follows:

> (1) *Orders.*—Any property shall be treated as pretermination property to the extent that such property is constructed, reconstructed, erected, or acquired pursuant to an order placed by the taxpayer on or prior to April 18, 1969.

2. With respect to amortization of pollution control facilities, we urge that the committee clarify the definition of a "certified pollution control facility" in the new proposed section 168(d) (1) of the code so as to make it clear that such portion of a high stack at a generating station as is constructed solely for air pollution abatement may qualify for accelerated amortization. We suggest that this clarification can be achieved most simply by inserting in section 168(d) (1) the words "dispersing, diffusing," after the word "disposing."

I. THE INVESTMENT CREDIT

A. Section 49(d), providing for the so-called phaseout of the investment credit, should be deleted: The investment credit repeal provisions give general recognition to the inequity of disallowing the credit on property which was ordered, or whose construction was begun, in the reasonable expectation that the credit would apply when such property was placed in service. Section 49 (a), (b), and (c), provide that the credit will continue to be available for property under binding contract on April 18, 1969. The transition provisions in section 49 (a), (b), and (c), are generally similar to those included in the 1966 legislation suspending the tax credit. They recognize that prudent management orders substantial equipment and embarks on a substantial project only after an economic evaluation of the benefits and costs of such equipment or project and of possible alternatives. In such an evaluation the applicability of the tax credit may play a very substantial part; and its retroactive repeal may well have the effect of destroying the validity of the economic evaluation which was used as the basis for the judgment to go forward to order the equipment or begin the project.

The underlying reason for the transition provisions is that it would, therefore, be most unfair and inequitable to apply the repeal of the tax credit to property ordered prior to the cutoff date and in the rea-

sonable expectation and understanding that the tax credit would be applicable to such property.

But, after including such transition provisions in section 49 (a), (b), and (c), to eliminate such inequities, there was then inserted in the bill an additional and brandnew provision—unlike anything in the 1966 legislation—section 49(d), which, in many cases, will nullify the transition provisions and create the precise inequities the transition provisions were intended to eliminate.

Thus, section 49(d) provides that, in the case of property placed in service after December 31, 1970, the 7-percent credit figure will be reduced by one-tenth of 1 percent for each full calendar month between November 30, 1970, and the date on which the property is placed in service, and that there will be no credit whatever for property placed in service after December 31, 1974.

The House committee report makes it clear—page 2—that the credit is to be so reduced or eliminated even in the case of property which was under binding contract before April 19, 1969.

The House report states—page 14—that the committee—

> Decided to phase out the investment credit to reduce the inequity that arises between taxpayers because different lead times for the needed equipment determined whether a firm had signed a binding contract before April 19, 1969.

But, having in mind that equipment ordered before April 19, 1969, was ordered in reasonable reliance on the availability of the credit—which may have materially affected the economic basis for the judgment underlying the placing of the order—it becomes clear that the so-called phaseout in section 49(d) would create a most serious inequity, rather than remove one.

There is a long leadtime from the inception to the inservice date of complex equipment or of a large construction project, not because of choice but because of the complexity and scope of the construction, and because of the size and variety of the equipment which must be designed, ordered, manufactured, and installed at such a project.

A major project involves a very large number of different items of equipment. A long time elapses between placing under contract large and complex items of equipment and the time installation is completed. The whole project cannot be placed in service until all of the numerous items of equipment, large and small, have been installed, and tested, and all "bugs" have been eliminated.

Contributing factors to long leadtimes are delays associated with equipment of new and different design, and manufacturers' backlogs of orders.

Long leadtimes are common to the electric utility industry but they are by no means unique to it. Similar leadtimes exist in many other industries where complex equipment is involved. At the present time our industry has on order much equipment which cannot be in service within the next 18 months. Much of this is equipment ordered in 1966, 1967, and 1968.

In the last several years, for example, many orders have been placed for nuclear reactors for the production of electricity which are much larger and of much greater capacity than the earlier generation of experimental reactors. The time between the placing of the order and the date when these units will be ready for commercial operation is turning out to be considerably longer than was at first expected.

Many orders have also been placed for conventional units of much larger capacity than those installed a few years ago. The combination of size and the number of orders have taxed the capacity of the few manufacturers of such equipment.

Similarly, the industry is engaged in the construction of extensive transmission lines, with complicated related equipment, to transmit energy at unprecedentedly high voltages. Such projects take many years to plan and build.

Such generating and transmission facilities involve huge capital investment and the assumed applicability of the investment credit certainly played a substantial part, prior to April 19, in the underlying economic evaluations and in the judgments reached in placing orders for the necessary equipment.

Moreover, the passage of a long period of time from the beginning of planning and design until such a project is ready to be placed in service entails heavy carrying charges, such as engineering overheads, interest, and taxes. Frequently, in the case of large and expensive equipment, the manufacturer requires advance payments from time-to-time, commencing long before the equipment is delivered.

Senator BENNETT. Mr. Cohn, I thought you were going to summarize your statement. There are six or seven other witnesses behind you, and I had hoped that you could give us a summary rather than a word-by-word reading, after you were told that the statement would be in the record exactly as if it had been read, so now the record will show that the statement was presented twice. I do not think you are making any friends on the committee by ignoring our request.

Mr. COHN. Senator, I am sorry, sir, and I apologize. I will do my best. It is rather difficult on this short notice to try to pick out the paragraphs that might be of particular significance, but I will do my best, sir.

Senator BENNETT. Are the other witnesses also going to read their statements all the way through?

Mr. COHN. Sir, we have in the course of our presentation only one other gentleman. That is Mr. Smith. His statement is very brief and I am sure he will pay due regard to the request of the committee.

Senator BENNETT. I think you like all other witnesses were told you had 15 minutes. If you read all your statement, you will take pretty close to 25, and this in a sense also is a violation of the invitation under which you came.

Mr. COHN. Senator, I am sure that is correct. I may say that if the committee suggested that I had to be confined to 15 minutes I would have done so, but there is another witness on the agenda who has indicated to me that if it were necessary he would concede some of his 15 minutes to me. I will do my best to confine my remarks to the 15 minutes. The other witness is Mr. Poth.

Mr. POTH. I will be very happy to give 10 minutes or more of my time to Mr. Cohn.

Senator BENNETT. I do not think it is quite that way. I think it is assumed that each witness would summarize. The chairman asked you all a minute ago to do this. It is 5 minutes to 12. The Senate is in session. We should be over there. Maybe I am beating Mr. Cohn

over the head for the benefit of the other witnesses. But Mr. Cohn, this does not make many friends among the committee.

Mr. COHN. Senator, I will do my very best to pay due regard to the request of the committee, and I will now introduce Mr. Maynard Smith, a recognized expert in air pollution control techniques.

Mr. SMITH. I am appearing before you regarding the inclusion of tall stacks as certified pollution control facilities under section 5 of H.R. 12290.

I am a meteorologist, having received my educational background at Princeton University, New York University and the University of Chicago. I have spent 21 years engaged in research on atmospheric dispersion at Brookhaven National Laboratory, and I have also served as consultant to various governmental and private agencies on problems involving air pollution. I am, for example, on the Steering Committee for the large powerplant effluent study (LAPPES) project of the Department of Health, Education, and Welfare; I am chairman of the meteorological advisory committee for the New York City Department of Air Pollution Control; and I was chairman of the task group which prepared the "Recommended Guide for the Prediction of the Dispersion of Airborne Effluents for the American Society of Mechanical Engineers."

The historical reason for building a smokestack was to provide an enhanced natural draft for combustion, whether the stack served a fireplace or a large industrial plant. Recently, however, stack design has undergone a fundamental change, and virtually every major stack, both here and abroad, is now designed primarily as an air pollution abatement device. It would be far easier and cheaper to use a 50-foot vent pipe with induced-draft fans to accomplish combustion, but I assure you that there would be no more vehement objectors to such a design than the Federal and State air pollution officials, because they are fully cognizant of the necessity for good stack design.

Ideally, everyone would prefer that a major industrial facility produce no dust and no gaseous pollutants, and it is perfectly legitimate to stress the importance of reducing pollutant emissions at the source. A large modern combustion facility would, however, be an intolerable neighbor without a stack, even if current efforts to reduce dust and SO_2 emissions were completely successful. The other constituents of the stack gas, such as carbon dioxide, the oxides of nitrogen and heat would still have to be dispersed at a high elevation to maintain ground-level concentrations at reasonable levels.

There is no dispute that a well-designed stack reduces the concentrations of pollution over an area ranging up to 50 miles from the source, and this reduction may be a factor of several thousand over concentrations that would exist without the stack. Neither is there any question that, unlike most source controls, stacks reduce the concentrations of all pollutants simultaneously by approximately equal amounts. For some pollutants, it is true that stacks accomplish no reduction in the general atmospheric burden, but there is increasing evidence that stacks may in fact effectively reduce the total amounts of

certain reactive pollutants before they return to ground-level, simply by providing extended time for atmospheric conversion processes to operate.

Returning to my initial point—that stacks are built primarily as pollution abatement devices rather than combustion aids—it is important to observe that industries which use electricity as a heat source, and therefore have no combustion processes, still invest millions of dollars in tall stacks to reduce local air pollution. It seems abundantly clear to me that, until we reach the ideal state in which no pollutants are emitted, the tall stack is just as surely a pollution control facility as a dust collector or SO_2 removal process.

Attached to my statement is a more detailed description of how and why tall stacks do, in fact, abate and control air pollution.

(The attachment referred to follows:)

HOW AND WHY TALL STACKS ABATE AND CONTROL AIR POLLUTION

Tall stacks provide for better air quality in a number of different ways, all of which are fully in accord with accepted aerodynamic and meteorological principles.

1. The tall stack avoids aerodynamic downwash of the stack plume into the lee of the power plant structure. This prevents the occurrence of very high concentrations of various gases close to the plant.
2. Because the gas from a tall stack is released into a far less turbulent wind flow, its heat energy is conserved, and it rises considerably higher above the stack top than if it had been discharged from a stack closer to the ground.
3. Since the stack height and the thermal rise of the plume are greater, natural diffusion and mixing of the gas has longer to occur before the plume reaches ground-level. The result is significantly lower gas concentrations downwind of the stack.
4. A tall stack converts what would normally be the least favorable meteorological condition into the best one for controlling ground-level concentrations. During well developed temperature inversions, gases emitted from short stacks tend to be held close to the ground. In contrast, gases released from tall stacks are frequently discharged above the inversion layers, or have sufficient energy to pierce the few remaining layers above the stack top. In any event, they will experience no downward diffusion. Thus they will never contribute to the ground-level concentrations at times when such concentrations are most likely to be near maximum from low level sources such as motor vehicles.
5. While it is true that for some pollutants stacks accomplish no reduction in the total, overall atmospheric burden, there is increasing evidence that stacks may in fact effectively reduce the total amounts of certain reactive pollutants before they return to ground-level, simply by providing extended time for atmospheric conversion processes to operate. Where such processes are important, as is believed to be the case with SO_2, stacks can be said to accomplish actual reduction just as source controls do.
6. The tall stack exerts its beneficial diffusion action equally on all of the gases being discharged.
7. Finally, the stack is never bypassed or taken out of service when the unit is operating. It thus provides a high degree of in-service reliability.

Mr. SMITH. Thank you.

Senator WILLIAMS. Mr. Cohn?

Mr. COHN (continuing prepared statement). The various carrying charges more than offset the investment credit. But, in evaluating the economics of such projects, the presumed availability of the investment credit was one of the factors making the project feasible and leading to the decision to proceed.

Availability of the credit for property placed under contract before April 19, 1969, does not discriminate in favor of the purchaser where the leadtime is long. Such a leadtime is not of his choice. It is simply a fact of life from which he cannot escape.

It is also likely to be the fact that such a purchaser will have less equipment on order with short leadtimes and, in that context, it can be argued that section 49(d) creates still a further inequity by discriminating in favor of industries with short leadtimes.

Like everyone else, the purchaser with a long leadtime will not get the investment credit on property ordered after April 18, 1969. Like everyone else, he should get the credit on property ordered by that date.

The purchaser with a long leadtime made commitments in the reasonable expectation that the investment credit would partially offset his carrying costs. In these circumstances it would be highly inequitable to deny him part or all of the credit.

We urge that proposed section 49(d) be eliminated from the bill.

B. Property Ordered by April 18, 1969, Should Qualify for the Credit.—We believe that fairness and equity also require that, in defining pretermination property, the concept of placing an order prior to the cutoff date be substituted for the "binding contract" concept. In making this suggestion, the term "order" is intended in the same sense in which it was used in Public Law 89-900, which suspended the investment credit in 1966.

The House Committee Report (No. 2087) on the 1966 legislation states (page 30) that—

> Any directive, written or oral, to another person reasonably designed to effect the acquisition of property at a later date, constitutes an order.

A requirement that property, to be eligible for the credit, must be under binding contract by April 18, 1969, would deny the credit to many taxpayers who are in fact committed to proceeding with a project on which they embarked in the reasonable expectation that the credit would be earned.

A large project, such as, for example, an electric generating station, involves many steps in addition to the ordering of equipment. These include initial planning and engineering design work; the acquisition of land for the plant site, and land or land rights for related transmission; and, in many instances, obtaining the approval of one or more regulatory commissions.

In the meantime, many orders are placed for equipment, particularly the major items. While some of these orders may not technically meet the strictest test of a binding contract, the taxpayer has incurred large expenditures in reliance on the availability of the investment credit. He is, in fact, fully committed to the project provided all necessary regulatory approvals are obtained.

A binding contract requirement is also inequitable where the taxpayer has entered into a firm contract for one or more units of equipment, such as a boiler or turbine for the generation of electricity, of new design and larger capacity than units then in operation, and in the same contract places orders for additional units of the same equipment which may not be regarded as meeting the test of a binding contract until there is opportunity to test the first unit and it is found to be satisfactory.

The taxpayer expects to acquire the additional units and has evaluated such a contract, in the context of the availability of the tax credit, as a single package. Before acquiring the additional units, however, he desires thoroughly to test the first unit to insure that it will operate

satisfactorily. But it is clear that the economic evaluation of the order for all of the equipment was based on the reasonable expectation that the credit would be available.

Accordingly, in fairness and equity to taxpayers who have placed orders, and have, in fact, made a substantial economic commitment, in reasonable reliance on the availability of the investment credit, the word "order" should be substituted in section 49(b) (1) for the binding contract language. This will involve a number of conforming amendments, which are shown on the attached appendix A to this statement.

II. ACCELERATED AMORTIZATION OF POLLUTION CONTROL FACILITIES

A. The definition of "Certified Pollution Control Facility" should be clarified to make it clear that any portion of a high stack which is constructed solely to abate or control air pollution may qualify for accelerated amortization.—A pollution control facility is defined in section 168(d) (1) as property used to abate or control water or atmospheric pollution by "removing, altering, disposing, or storing" of pollutants.

Section 168(e) (2) excludes property which would be constructed or erected without regard to the need to abate or control pollution. The Ways and Means Committee Report states (page 37) that this exclusion applies to a smokestack installed for the effective operation of the plant rather than for pollution control purposes.

This indicates that the cost of that portion of a stack installed solely for pollution control purposes qualifies for accelerated amortization. We suggest that it would be desirable, however, to make this conclusion completely clear by adding the words "dispersing" and "diffusing" to the definition in section 168(d) (1).

Some form of a stack is necessary for the effective operation of a coal-fired generating station. But a stack for this purpose is a low stack, usually of metal and mounted on the roof of the boiler structure. The cost of such a stack is only a very small part of the cost of a free-standing concrete stack many hundreds of feet high.

That portion of the cost of a high stack in excess of the cost of a low roof-mounted stack is incurred for the sole purpose of abating and controlling air pollution, and should clearly qualify for accelerated amortization.

Section 168(f) already recognizes that ther may be certification of less than all of a facility, so that it is necessary only to make it clear beyond question that such portion of a high stack which is solely for the purpose of abating and controlling air pollution may be certified as a "pollution control facility."

In conclusion, for the reasons stated in our presentation, we urge:

(1) With respect to the investment tax credit:

(a) The deletion of the so-called phaseout provisions of section 49(d), and

(b) The substitution of the concept of property "ordered" on or prior to April 18, 1969, as defining pretermination property, in place of the "binding contract" concept.

(2) With respect to the accelerated amortization of pollution control facilities: Clarification of the fact that the portion of a high stack which is constructed solely to abate or control air pollution may qualify for accelerated amortization.

We very much appreciate the opportunity to appear before the committee.

(Mr. Cohn's attachment follows:)

APPENDIX A

CONFORMING AMENDMENTS TO SECTION 4 OF H.R. 12290, RELATED TO SUBSTITUTING "ORDER" FOR BINDING CONTRACT IN SECTION 49(b)(1)

[H.R. 12290 references]

Page	Line	Delete	Substitute
12	18, 19	a binding contract which was in effect on such date	an order which had been placed not later than such date
13	2	a binding contract	an order
13	3	contract	order
13	4	contract	order
13	5	contract	order
13	10	binding contract	order
13	14	contract	order
14	22, 23	a binding contract or contracts	an order or orders
15	4	contract or contracts	order or orders
15	12	a contract	an order
15	22	contract	order
16	2	a contract	an order
16	24	entered into a binding contract	placed an order
17	2	entered into a contract	placed an order
17	11, 12, 13	a contract between two members of an affiliated group shall not be treated as a binding contract as between such members	an order placed by one member of an affiliated group with another member of such group shall not be treated as an order

Senator MILLER. Mr. Chairman, will we have the opportunity to ask any questions?

I have a couple of brief questions.

Mr. Cohn, do I understand you to say in effect that an order placed is not a binding contract?

Mr. COHN. It may not be, Senator, under certain circumstances. Our understanding is that the consent of a binding contract means a contract which is under state law completely binding. The distinction I am making relates to an order which may be made which may be a firm commitment from the point of view of the purchaser which he may fully intend to carry out but which may have some kind of an out for him.

Senator MILLER. For him?

Mr. COHN. For the purchaser; yes, sir. For example, the kind of an order which would involve some highly sophisticated equipment of advanced design, of a boiler, let us say. The purchaser wants to be sure that the boiler will in fact work. The design does not pan out and he has to buy another. He needs to have some kind of an out, if the boiler does not pan out. This may not be a binding contract, but it would certainly be a firm commitment that the purchaser has made to buy a boiler.

Senator MILLER. I can see where it would be a firm commitment, but we are talking about a legal commitment. That seems to be the shade of difference you are talking about.

Mr. COHN. That is correct, sir.

Senator MILLER. Would that be subject to renegotiation on a price basis too, if it is that loose?

Mr. COHN. It might conceivably, although even here I think the legislative history suggests a binding contract might be subject to some adjustments in respect to prices.

Senator MILLER. You referred to economic evaluation and indicated that the economic evaluation in some of these programs would include or would have possibly included the continuation of the 7-percent investment tax credit?

Mr. COHN. That is right, sir.

Senator MILLER. Would it also have included possibly the continuation of the 10-percent surcharge?

Mr. COHN. I think perhaps not in quite the same respect. When a utility company, for example, which is the business that I think I know best, decides to put in a powerplant, there may be a choice of alternatives. There frequently is, the most obvious being these days between a nuclear and a conventional powerplant.

In making that determination, there will be economic evaluation, primarily of investment cost, and the tax credit has been considered to be associated with investment cost.

Now sure the tax rate into the future is a cost of operations, and may be taken into account also, but much less so than those costs which are associated with the investment.

Senator MILLER. Well actually the investment tax credit, all it is is a reduction of the overall tax bill?

Mr. COHN. Yes, sir.

Senator MILLER. And it seems to me what you are interested in is capital formation, and I would certainly think the Federal income tax rate would be a factor in this economic evaluation.

Mr. COHN. It would be a factor, that is right, sir; but what it comes down to is this. In looking at these alternatives, conventional plant as compared with a nuclear plant will have less capital cost, and therefore the investment credit associated with the nuclear plant will be greater.

Senator MILLER. My last question is on this amortization of pollution control facilities. Would it be feasible to take your language of adding disbursing and diffusing after the word disposing, and add a further phrase "as required by law"?

Mr. COHN. We would have no difficulty with that, Senator.

Senator MILLER. Because I would guess that local municipal ordinances or State law would require the construction of these high stacks in most cases. To the extent that local law requires you to build a higher stack, over and above what would be necessary for simply getting rid of the smoke from a boiler or a generating plant, then that would be the portion that would be amortized?

Mr. COHN. I had not understood your question, Senator Miller, until you elaborated on it. I think that I would not agree with that interpretation.

It does under the bill, any pollution facility does under the bill have to accord with the State program. There is a requirement for a State certification and a Federal certification which requires that a facility involved accord with the State program on the one hand and the Federal program on the other. I think that Mr. Smith may be able to add something on this. I am sure he can.

Senator MILLER. Let me just make this clear. The other day we had the Assistant Secretary of the Treasury, Mr. Cohen before us, and I was questioning him on this point, and he indicated that they would keep an open mind on this subject. But what I was trying to point out is that in a given situation having an engineering need to construct a stack only 100 feet high, but to meet the requirement of a local municipal ordinance you may have to construct it 300 feet high and to that extent you would have 200 feet of that stack which could fit within this idea of air pollution control, and would be susceptible to the evidence necessary to approve the deduction. That is what I am getting at. But if you just gratuitously, without any requirements at all, decide to construct a stack 500 feet tall or 400 feet, I would have some difficulty with that.

Mr. SMITH. Senator, the flaw in the reasoning in this is that there are a lot of pollutants that are not even under control at the present time, and moving out of the electric power industry, which is more generally affected because the regulations for SO_2, and dust and that sort of thing are defined.

Look at the aluminum industry for instance. In many instances stacks on the order of 3 to 500 feet are built in the aluminum industry without any regulation whatever necessary for this other than nuisance law if you like or damage.

Senator MILLER. Other than, but that nuisance clause would be a very important factor?

Mr. SMITH. OK., but you see what I am getting at. There are stacks being built that do not at present have anything directly to do with some air pollution legislation or municipal ordinances or something of that kind that exist, simply because they do not recognize that it is necessary to do this.

Senator MILLER. It seems to me that if you could show that you had constructed a stack 300 feet high instead of only 100 feet high, because of the local law relating to nuisances, that you would have a pretty good case, but I think we need to have some standard, and the standard would be as required by law.

Mr. COHN. Senator, I do not disagree with what I think is the underlying point which you are making. A company with which I am associated is building a stack at the present time which will cost close to $4.5 million. The kind of a stack that we would need for power purposes only would be $100,000. We are putting in another $3.5 million for no purpose other than to control and abate air pollution, and we think we can demonstrate this on almost any record at all. I think what you are suggesting is that we are not entitled to credit or we are not entitled to accelerated amortization for that portion of the stack that is necessary or is used to produce electric power. We agree with that.

Senator MILLER. Yes, but I am searching for a standard, and a requirement of law is a standard—an abatement of a nuisance, be it a local pollution control law—that might well be cranked into this thing, so that we make sure the Revenue Service on the enforcement side of the tax business will have something in evidence that you can furnish them to show that you could have got by from an engineering standpoint on a 100-foot stack, but you had to have a 300-foot stack, to avoid a conflict with the State or local law.

Mr. COHN. Senator, I agree that there ought to be a standard. I think the standard could be a very simple one, and that is to talk in terms of that portion of the stack which is constructed solely for the purpose of abating and controling air pollution.

Senator MILLER. But how are you going to prove that? You are going to have to get engineering figures out, you are going to end up with a possible conflict between your own engineers and the engineer revenue agents of Internal Revenue Service. Your engineers may say 50 feet is all that is necessary, their engineering people may say "We think 100." But if you have got something tied into this thing that relates to the local law, I think you have got a little better handle on it.

Mr. SMITH. Senator, I appreciate your concern. It is certainly a valid one because it is always a hard point to judge. But I suggest that you be extremely careful of this aspect of it, because in fact you may end up with a tax law that is ahead of the air pollution laws in a lot of the areas, and you may tie it to something that does not exist in many communities.

Senator MILLER. I have no further questions.

Senator WILLIAMS. Thank you.

The witness is excused.

Mr. COHN. Thank you, sir.

The CHAIRMAN. Before we call the next witness I wish to make a statement.

I thank the Senator from Delaware for chairing this meeting in my absence.

I had considered making this statement at the close of today's meeting, but the witnesses have been examined so long that I think I will just make it now and make it available to the press.

In the first instance I want to explain what the view of the Senator from Louisiana was with regard to the Policy Committee action. I now offer for the record the invitation by the majority leader to appear before the Policy Committee, and my statement before that committee which explains the view of the Senator from Louisiana with regard to the Policy Committee approach, and which I think started out in exactly the right fashion.

Here is what I said:

> I want to applaud the Democratic Policy Committee for taking the time from its important work to discuss the matter of tax reform, and I want to report on the role of the Committee on Finance in this area.

Then subsequently in my statement I said, "I think the statement does credit to our committee which has dealt in the area of tax relief," and I discussed the matter of timing, and explained that it usually takes about half as long for this committee to report a bill and to act on it as it does the House. The House has been working on reform since the first of the year. We expected their bill about August, if you want to be optimistic about it, and by that scheduling a tax reform bill of that dimension would require until December to act on, if we acted in less than half the time that the House acted.

It never occurred to this Senator that someone was going to insist that full and comprehensive tax reform be a part of this tax surcharge measure, which is regarded as being urgent, and I just submit the statement for the record.

At that particular time the Policy Committee invited me to put it in the record, which is a conversational courtesy that this Senator appreciates, and I will just make this available for the record. I will put it in the record and also for the committee.

(The material referred to follows:)

STATEMENT OF THE HONORABLE RUSSELL B. LONG, CHAIRMAN OF THE SENATE FINANCE COMMITTEE, BEFORE THE DEMOCRATIC POLICY COMMITTEE

I want to applaud the Democratic Policy Committee for taking time from its important work to discuss the matter of tax reform and I want to report on the role of the Committee on Finance in this area.

Before giving that report, however, let me state that—except in general terms—I do not know what will be in the tax reform bill now being drafted in the House Ways and Means Committee, Certainly, the rules governing the tax-exempt foundations are going to be tightened and I am optimistic that a minimum income tax will be enacted to do something about the fellow who is financially able to juggle his income and deductions in such a way as to avoid paying any Federal income tax—or perhaps only a token tax. That sort of exploitation of the tax law is a direct consequence of wealth. It creates an unfair preference in favor of the man who is fortunate enough to make his money from the ownership of property as contrasted to people who earn their living with their hands.

Thanks to hard work by people like Stanley Surrey a minimum tax, which I have long advocated, is close to enactment in this 91st Congress. It will do much to bolster taxpayer morale and confidence in our voluntary self-assessment tax system.

Now, in exploring the role of the Finance Committee in tax matters I want to point out that the Senate must operate under a consitutional infirmity which reserves to the House of Representatives the power to originate tax measures. We can't act in the tax area until we have received a bill from the House and then we can only amend the House bill.

Thus, if an idea develops in the Senate for a major tax change the chances are the House is going to get first crack at that suggestion and if it's a good one they are going to get credit for it. If it's a bad one the Senate is going to get the blame for not taking it out of the House bill.

The suspension of the investment tax credit in 1966 is a good example of the first point. I offered an amendment to suspend it in August. In September, the President submitted a recommendation to Congress that it be suspended. In October, the House passed a bill to do it, and was widely hailed for easing the pressures on the money markets and slowing inflation. But the fact remains that the impetus for that legislation came from the Senate.

Now, the Internal Revenue Code of 1954 and the Revenue Acts of 1962 and 1964 all represent great tax reform efforts.

But in talking about tax reform, we have to understand what we mean. To some people, tax reform is a process of simplification—getting the law to a state where common ordinary people and businessmen can read the statutes and determine how much tax they owe. Unfortunately, our tax law is too complicated, and we are always in need of this type of tax reform.

To other people, tax reform is a means of achieving equity between tax payers with similar income. Generally, what we mean here is that tax payers in similar lines of business or with similar types of income should pay similar amounts of tax. Equity can also mean bringing persons with different incomes into a better tax paying balance with each other—relating the tax schedules to ability to pay. To yet another group, tax reform means additional revenues to the Federal Government—revenues that can be put to work to better the lives of all our citizens. But, before anyone gets the impression that tax reform invariably means higher taxes, let me stress that some of the more significant reforms have actually brought tax reductions, not tax increases. The investment tax credit in 1962 is one. The dividend credit in 1954 is another. It was subsequently repealed and the repeal, too, was viewed as a tax reform. The tax reductions in the Revenue Act of 1964 totaling more than $13 billion was a major tax reform. And so was the repeal of most excise taxes in 1965.

Let me make this simple observation about tax reform. Nearly every provision of the tax law that is the target of today's tax reform was looked on as a tax reform itself when it was written into the law. The "reasonable allowance" for

depletion first granted in 1916 reformed the 1913 law which *prevented* a recovery of costs. "Discovery value" depletion was a reform when it came along in 1918. "Percentage depletion" in 1926 was a tax reform in the nature of simplification of discovery depletion. Now, tax reform of percentage depletion is being discussed by those who do not understand the minerals industry.

Now the significant point about this is that the first tax reform was in the name of equity. So was the 1918 reform. It recognized that what was being depleted was the mineral in the ground. The third tax reform--percentage depletion—involved tax simplification. The tax reform now being discussed is raised in the name of revenue.

Capital gains was a major reform when this liberal tax rule was first enacted in 1921. It recognized that some income accrues over a period longer than the taxable year, and it should not be taxed at the high graduated rates generally applicable to income earned in a single year. Since 1921 a great many features have been added to the capital gains provision broadening its scope and reducing the tax on a host of different types of income where some lower rate seemed appropriate. The income averaging rules constituted a tax reform when they came into law in but they were not very comprehensive. Congress reformed the averaging rules again in 1964 with an overall role which applies all sorts of situations, except where gambling gains are involved. Our efforts since 1964 have been to discourage further enlargement of the capital gain rule, and I might say we have been quite successful.

The dividend credit enacted the Internal Revenue Code of 1954 was looked on as a tax reform responding to the argument that corporation income was subject to double taxation. Its repeal in 1964 was a tax reform move also.

Accelerated depreciation dating from 1954 was a tax reform and the special rules for recapturing excess accelerated depreciation deductions at ordinary income rates—with respect to personal property in 1962 and with respect to real property in 1964—were also tax reforms. They stopped the conversion of ordinary income into tax-favored capital gains.

The investment tax credit was considered a major tax reform by President Kennedy in 1962 when it was enacted. It was the backbone of the Revenue Act of that year. Today, in a different climate and with a new set of priorities tax reform dictates that the investment credit be repealed. I might point out that once again the impetus for its repeal came from the Senate.

In another area it was tax reform motivations which prompted amendments to foster the development of private charitable foundations. Witness the unlimited charitable contribution deduction and the tax exemption for these institutions. Today, tax reform demands that foundations be severely restricted in their operations and that the unlimited charitable contribution deduction—a favorite device for avoiding Federal income tax—be repealed.

The system of private pension plans we have in this country developed under favorable tax amendments specifically designed to encourage employers to look after the retirement needs of their employees. Indeed social security itself rests on a tax base. Here tax reform has been adapted to mold and shape a socially desirable system of pension and retirement benefits, easing the financial burden on those whose working days are past. Today, the tax purist looks at the tax benefits associated with pension plans, concludes they are too generous and calls for reform.

These illustrations demonstrate, I believe, that tax reform is not a phenomenon of 1968 and 1969. It is a part of the never-ending process of legislating in the light of changing situations.

While a great deal of attention is presently focused on the closing of "loopholes" I can point to countless provisions of the tax law which prior Congresses put there to close the loopholes of their time. The personal holding company tax is one. The wash sale provision which prevents the creation of artificial losses in securities transactions in another. So are the provisions which deny capital gains treatment—or prevent the deduction of losses—in the case of sales between spouses *or* between a man and his controlled corporation. The tax on improperly accelerated surplus of corporations and the provision ignoring the corporate entity when tax gimmickry is involved are still others.

As a matter of fact one of the principal reasons the tax law is so complicated is because we have gone to great lengths to prevent loopholes in the new tax concessions Congress enacts. A look at the investment credit provisions with special recapture rules for early disposition of the property, reduced credits for short-lived property and for propety acquied by tax favoed organizations, and

denial of credits for property used outside the United States—all these restraints attest to our efforts to close loopholes before they really develop.

Examine the election in Subchapter S for small corporations to have their income taxed directly to their shareholders, thus avoiding the corporate income tax, and you will see the same pattern of concern.

As a matter of fact, we have done such a good job of closing possible loopholes in new legislation that few of the suggestions for tax reform are aimed at recent amendments. Most of them are directed at provisions which came into the law prior to the Internal Revenue Code of 1954. And many of them go back to the period before the depression.

These are the tough ones. As I have already observed most of them were looked on as desirable tax objectives when they came into the law. For many of them a strong case can be made that they are still desirable objectives. For instance the cash method accounting that farmers use dates from an Internal Revenue Ruling of 1916 designed to simplify tax reporting since most farmers could not understand accrued method accounting. Although we have fewer farmers now than we had then, and our farmers today are more sophisticated, simplicity of tax reporting is still a desirable objective. I'd like to offer every taxpayer a simplified method of reporting his income and paying his tax.

Unfortunately, the extension of capital gains treatment to livestock in 1951, combined with the favorable accounting rules of 1916, have created a very generous tax preference that has attracted non-farmers into the farm economy for tax reasons rather than good business reasons. At the present time there are at least four separate and different solutions before Congress to modify this situation in varying degrees and each one of them is heralded as a tax reform.

Now we'll take this farm loss issue and all the suggested solutions in the Finance Committee and we will study them and come to a decision as to what we think we should recommend to the Senate. We'll do the same thing with every other issue involved in tax reform. If we find loopholes in the law I am confident we will close them, and in the process we will probably also tighten up on a lot of tax concessions that are not loopholes.

At this point let me offer some comments on the question of timing of a tax reform bill and then I want to demonstrate why I believe the Finance Committee is becoming a more dynamic and significant force in the legislative process of enacting a tax bill.

It is a matter of fact that the Senate acts on major tax legislation in about one-half the time it takes for the House to prepare a bill and send it to us. And we are able to do this despite the fact that they act on tax bills under a closed rule which generally prohibits floor amendments and which usually limits debate to only four hours. Contrast that with the rule of unlimited debate under which we operate in the Senate and note that printed amendments to major tax bills now run over 100—and I mean the substantive amendments that Senators want to offer from the Floor. It becomes truly amazing that we are able to act as expeditiously as we do.

Let me relate the time span for consideration of the last three major income tax bills—the Internal Revenue Code of 1954 and the Revenue Acts of 1962 and 1964.

We received the Internal Revenue Code of 1954 nine and one-half months after the House Ways and Means Committee started to work on it. Five months later the Senate passed the bill and sent it to Conference.

Turning now to the Revenue Act of 1962, we find that the President submitted his recommendations to Congress in April of 1961. One year later, in April 1962, the bill passed the House and came before the Finance Committee. We began public hearings the same day we got the bill. The hearings lasted 29 days, covering 5,000 pages of testimony in 12 printed volumes. Despite this lengthy hearing and the consideration of more than 200 amendments the Senate passed the 1962 Act and sent it to conference in just four and one-half months—only slightly more than one-third of the time the bill was under consideration in the House.

The legislative history of the Revenue Act of 1964 reflects the same pattern. The House worked on it for 10 months before they sent it to the Senate in September of 1963. Thirty-two days of hearings were held on the bill in the Finance Committee. Nevertheless, only four months elapsed before the Senate passed the bill and sent it to conference.

Two significant facts emerge from this examination of the past. First, it takes longer than a single year to complete the legislative enactment of a major tax bill. Work on the 1954 Code began in June 1953; the law was enacted in August 1954.

The Revenue Act of 1962 was initiated in April, 1961, but enactment did not come until October, 1962. The Revenue Act of 1964 began with President Kennedy's message of January 24, 1963. It was completed in February, 1964 and I might say that the assassination of President Kennedy in the fall of 1963 probably spurred Congress to pass the bill several months sooner than would otherwise be the case. There was a lot of reluctance to cutting individual income taxes—and revenues—in the face of the budget deficits we were experiencing.

The second fact is that the Senate invariably acts more swiftly on major tax legislation than the House of Representatives.

Applying this history to the present situation we observe that the House Ways and Means Committee has already devoted four months to tax reform.

The most optimistic predictions are that they will send us a bill in August—three months away. Assuming they meet that schedule and that we begin hearings in the Finance Committee right after Labor Day (Congress will be in recess from August 13 until after Labor Day) it would probably be December before the Senate passes the bill. Even so it would be a tremendous accomplishment to pass a major tax bill in less than one year.

Now, as I have mentioned, the Committee on Finance and the Senate are becoming more innovative and effective in the tax legislative processes. For instance, when other approaches had failed, a tax amendment assured the legality of the merger of the two major professional football leagues and fostered the single player draft, thereby reducing a tremendous financial strain on that industry. The tax check-off amendment, by which a taxpayer could direct the use of $1 of his tax payment for presidential campaign purposes, is another illustration of Senate innovation in the tax area. Although the tax check-off was suspended a few months after it was enacted—and the suspension itself was Senate motivated—it has focused the attention of the nation on a problem we are going to have to deal with, probably before the next presidential election in 1972.

Indeed the 10 percent tax surcharge and the restraint on Federal spending in this fiscal year—which has made possible the first budget surplus in a good many years—was enacted as a Senate amendment. I would have preferred a change in the tax rates to the surcharge and my own amendment to provide an increase in the tax rates was at the desk when the surcharge amendment was agreed to. The many, many complaints we have had about the surcharge suggest to me that we would have done better from the standpoint of the public relations if we had taken the rate increase route.

In the Revenue Act of 1962 a Senate amendment (which I offered) assured enactment of the investment tax credit. It required that the depreciable basis for the property involved be decreased by the amount of the investment credit so that there would be no pyramiding of tax benefits. A Senate amendment calling for reporting to the tax collector of interest and dividents payments made to depositors and shareholders closed off a massive "leakage" in the tax system. This amendment was offered after it became clear that withholding of tax on this sort of income could not be passed.

The tie-breaking vote I cast in the Committee on the question of taxing foreign income of United States corporations and their subsidiaries probably saved those provisions. I cast that vote by telephone from Louisiana after the case for and against the amendment had been explained to me by Senators calling from the executive session of the Committee.

In the Revenue Act of 1964 a move in the Finance Committee to substitute an increase in the personal exemption for the rate reductions provided by the House bill was successfully resisted, guaranteeing that American taxpayers would realize their first tax reduction since the Korean War.

In another area, one of the important Senate amendments to the 1964 Act deleted a series of House provisions which would have substantially liberalized the capital gains treatment for property held longer than three years. This liberalization had been linked to a proposal to tax unrealized appreciation in value of property held at death, but in a last-minute maneuver the House Ways and Means Committee decided not to change the law with respect to property held at death. However, it left the provision lowering the capital gains tax in the bill.

We deleted those provisions in the Finance Committee and during the debates on the bill we demonstrated for the Senate how capital gains have permitted many high income individuals to pay inordinately low taxes. I have observed that in terms of sheer size capital gains is the "granddaddy" of all the tax preferences, and we just could not justify making capital gains still more rewarding and we made this attitude stick in conference.

More currently, the present move for tax reform really got its start as a Senate amendment which we prevailed upon the House to accept, calling on the President to submit recommendations for tax reform to Congress by December 31, 1968. Those recommendations, actually submitted by Treasury technicians in February of this year are now the backbone of the tax reform effort underway in the House Ways and Means Committee.

So in a large measure the present tax reform move owes its momentum to two significant developments, both of which occured in the Senate. First, the enactment of the surtax, which has created a great unrest among taxpayers across the land, causing a public demand for tax reform. Secondly, was the advance work on tax reform done by the Treasury Department in response to the Senate amendment calling for tax reform suggestions. When the call came much of the work was already done.

The CHAIRMAN. Since that time there developed some confusion about that matter, and I had prepared this statement for the close of this session, but I think I will make it now so the press can have it.

Before ending this phase of the hearing on the surtax bill the chairman would like to make his position on this bill clear if that is possible. To begin with, I am thoroughly confused about whatever it is that the Democratic Policy Committee wants this committee to do. I have been a Member of the Senate for more than 20 years and a member of the Committee on Finance for more than 16. During those years I have managed major revenue bills recommended by former Presidents John F. Kennedy and Lyndon B. Johnson. But unfortunately I had no such experience with the present policy of the Democratic Policy Committee because at that time the Democratic Policy Committee did not seek to provide guidance to the committees and committee chairmen about House revenue bills much less provide such guidance before the bills even reach the Senate.

The procedure is completely new to me and therefore I am groping for an answer just as the policy committee itself is groping for an answer to its own policy.

Before this bill came to the Senate the Democratic Policy Committee asked me to meet with that committee and discuss tax reform suggestions. The Democratic Policy Committee had one expert witness with them, a fair, distinguished and able man who is a former high Government official. I was invited back again 2 weeks later without prior knowledge of the subject to be discussed.

At that meeting the Democratic Policy Committee agreed to a resolution as follows, and I simply put it in the record in the release. The original text of this resolution used the words "full and comprehensive tax reform" instead of "meaningful" as was the published resolution. It is because I point out to the policy committee that it could take many months or even years to draft a full and comprehensive tax measure that the word "meaningful" was substituted for "full and comprehensive" in its resolution.

I explained to the policy committee that tax reform meant different things to different people.

It was my suggestion that the Committee on Finance should report whatever bill the committee could agree upon, and Senators could offer any amendments they chose when the bill reached the floor. It was my thought that the Senate would approve those amendments that a majority of Senators favored and voted down those amendments which a majority of the Senators did not favor. We have proceeded that way with revenue bills for the 20 years that I have served here. This is

an important measure that has been a major concern to the President of the United States and the Secretary of the Treasury. Both of them have expressed fear of the utter chaos that could descend upon this Nation if this bill, which is the only administration measure at this point seeking to maintain a stable, economic and fiscal condition in our land, fails to be enacted.

Their concern has been shared by public expression of every living ex-Secretary of the Treasury including such men as Joe Barr, Henry Fowler, Douglas Dillon, Bob Anderson, George Humphreys and John Snyder. All of these financial leaders have deplored the present situation which jeopardizes the ability of the Federal Government to pay its debts currently. They deplore the plight of the President and they deplore the plight of the Nation if this bill should fail.

It would be of the utmost concern to all of them and to the President if the present surtax should not be expeditiously extended. Therefore as chairman of this committee, I undertook to set a schedule which would bring this bill before the Senate prior to the expiration date set by law, July 31.

That is the basis upon which this committee is proceeding. Now it has been suggested that two bills should be reported by the Committee on Finance before the first bill is considered. That came as a surprise to me when it was first suggested as it surprised Senator Muskie, who is a member of the policy committee. His remarks on the floor yesterday as quoted correctly in the Record suggested that he thought the two-bill approach was contrary to the resolution of the Democratic Policy Committee.

Fortunately for us the task today is simple. We will conclude the hearing of the public witness testifying on the suspension of the investment tax credit. Our hope that we can hear Senators next week who desire to testify on the tax reform proposal that they plan to offer to this bill, and then I will seek to obtain for the benefit of the committee further guidance, after which the committee can then decide if it wishes to hear further testimony or commence voting.

As chairman of the committee, I regret that there has been a misunderstanding of how I intended to proceed with this bill. It was my intention to satisfy the view of the President, the Secretary of the Treasury, as well as the Democratic Policy Committee, by promptly reporting to the Senate a bill which would improve upon the House-passed measure and add some significant tax reform in addition to that which is already in the House bill.

I might say that I have often been advised by a President or Secretary of the Treasury or even by my majority leader that a bill was important or that it had something in it that should not be there, or that it lacked a feature which should be in it. That is nothing new to me.

If I had not accepted the guidance of the Democratic Policy Committee I would have known what to do with this bill. Major revenue measures are no novelty to the Committee on Finance. I do not presume to speak for the Democrats on this committee, nor do I presume to speak for the Republicans, except as they authorize me to speak for them. But in proceeding with the consideration of the surtax bill I am not unmindful of the major tax reform measure being readied for House action by the Committee on Ways and Means of

the House. That committee has dedicated itself to tax reform and the President and the Secretary of the Treasury have committed the administration to tax reform.

The Senate itself is gripped with tax reform fever, but the pressing business now is to maintain the fiscal integrity of the Federal Government and to give the President the tools that he needs to contain inflation.

As chairman of the Committee on Finance, it is my purpose to try to bring men of good will together so that the dual goals of fiscal policy and tax reform can be achieved in the best interests of the Nation. I thought that was also the purpose of the Democratic Policy Committee.

(The press release follows:)

[Committee on Finance press release, July 15, 1969]

CONSIDERATION OF THE SURTAX BY THE SENATE

Before ending this phase of hearings on the surtax bill, the Chairman would like to make his position on this bill clear, if that is possible. To begin with, I am thoroughly confused about whatever it is that the Democratic Policy Committee wants this Committee to do. I have been a member of the Senate for more than 20 years and a member of the Committee on Finance for more than 16. During those years I have managed major revenue bills recommended by former Presidents, John F. Kennedy and Lyndon B. Johnson.

But unfortunately, I had no such experience with the present policy of the Democratic Policy Committee, because at that time the Democratic Policy Committee did not seek to provide guidance to Committees and Committee Chairman about House revenue bills much less provide such guidance even before the bills reached the Senate. The procedure is completely new to me and therefore, I find myself groping for an answer just as the Policy Committee itself is groping for an answer to its own policy.

Before this bill came to the Senate, the Democratic Policy Committee requested me to meet with that Committee and discuss tax reform suggestions. The Democratic Policy Committee had one expert with them, a fair, distinguished and able man who is a former high government official. I was invited back again two weeks later without any prior knowledge of the subject to be discussed. At that meeting the Democratic Policy Committee agreed to a resolution as follows:

Whereas, the Senate Majority Policy Committee, having met and considered the matter of the extension of the income tax surcharge, hereby resolves:

That meaningful tax reform should be adopted as a means of achieving an equitable national income tax policy, and further resolves,

That any proposal to extend the income tax surcharge be considered simultaneously with recommendations on meaningful tax reform and further resolves,

That the present income tax withholding rates be continued after June 30, 1969 for a period of one quarter to permit full consideration and disposition of the reform and extension of the surtax.

The original text of this resolution used the words "full and comprehensive tax reform" instead of "meaningful" as was in the published resolution. It is because I pointed out to the Policy Committee that it could take many months or even years to draft a full and comprehensive tax reform measure that the word "meaningful" was substituted for "full and comprehensive" in its resolution.

I explained to the Policy Committee that tax reform meant different things to different people. It was my suggestion that the Committee on Finance should report whatever bill the Committee could agree upon, and Senators could offer any amendment they chose when the bill reached the floor.

It was my thought that the Senate would approve those amendments that a majority of the Senators favored and vote down those amendments which a majority of the Senate did not favor. We have proceeded that way with revenue bills for the twenty years that I have served here.

This important measure has been a major concern to the President of the United States and to the Secretary of the Treasury. Both of them have expressed fear of the utter chaos that could descend upon this nation, if this bill—

which is the only Administration measure at this point seeking to maintain a stable economic and fiscal condition in our land--should fail to be enacted.

Their concern has been shared by public expression of every living ex-Secretary of the Treasury, including such men as Joe Barr, Henry Fowler, Douglas Dillon, Bob Anderson, George Humphrey and John Snyder. All of these financial leaders have deplored the present situation which jeopardizes the ability of the Federal government to pay its debts currently. They deplore the plight of the President and they deplore the plight of the nation if this bill should fail. It would be of the utmost concern to all of them and to the President if the present surtax should not be expeditiously extended. Therefore, as Chairman of this Committee, I undertook to set a schedule which would bring this bill before the Senate prior to the expiration date set by law--July 31. That is the basis upon which this Committee is proceeding.

Now, it has been suggested that two bills should be reported by the Committee on Finance before the first bill is considered. That came as a surprise to me when it was first suggested, just as it surprised Senator Muskie who was a member of the Policy Committee. His remarks on the Floor yesterday suggested that he felt the two bills approach was contrary to the resolution of the Democratic Policy Committee.

Fortunately for us, the task today is simple--we will now conclude the hearing of the public witnesses testifying on the suspension of the investment tax credit I would hope that we can hear Senators next week who desire to testify on the tax reform proposals they plan to offer to this bill. Then I will seek to obtain for the Committee the benefit of further guidance, after which the Committee can then decide if it wishes to hear further testimony or commence voting.

As Chairman of this Committee I regret that there has been a misunderstanding of how I intend to proceed with this bill. It was my intention to satisfy the views of the President, Secretary of the Treasury as well as the Democratic Policy Committee by promptly reporting to the Senate a bill which would improve upon the House-passed measure and add some meaningful tax reform in addition to that which is already in the House bill.

I might say that I have often been advised by a President or a Secretary of the Treasury or even by my Majority Leader that a bill was important or that it had something in it that should not be there or that it lacked a feature which should be in it. That is nothing new to me. If I had not received the guidance of the Democratic Policy Committee I would have known what to do with this bill. Major revenue measures are no novelty to the Committee on Finance.

I do not presume to speak for the Democrats on this Committee nor do I presume to speak for the Republicans except as they authorize me to speak for them. But in proceeding with the consideration of the surtax bill I am not unmindful of the major tax reform measure being readied for House action by the Committee on Ways and Means. That Committee has dedicated itself to tax reform and the President and the Secretary of the Treasury has committed the Administration to tax reform. The Senate itself is gripped with tax reform fever.

But the pressing business now is to maintain the fiscal integrity of the Federal government and give the President the tools he says are needed to contain inflation.

As Chairman of the Committee on Finance it is my purpose to try and bring men of good will together so that the dual goals of fiscal policy and tax reform can be achieved in the best interest of the nation. I thought that was also the purpose of the resolution of the Democratic Policy Committee.

Senator WILLIAMS. Mr. Chairman, I agree with you that the pressing business is to maintain fiscal integrity of the Federal Government, and I think that in doing this it requires our Finance Committee, which has jurisdiction over these revenue-producing measures to act in a responsible manner. I respect the Democratic policy committee and the position it holds, but I most respectfully suggest that the Democratic policy committee heretofore has never taken the jurisdiction of the Finance Committee, and as a member of the committee, I think that we should set our own schedule.

I personally am very strongly in favor of a meaningful tax reform. I do think it is important to remove the uncertainty that is in

the financial community as to what this Congress will or will not do toward extending the surcharge, and if so at what rate, what we will or will not do in connection with repeal of the investment credit, and if we do repeal it the effective date and what exemptions if any would be contained in the bill. I think that these are major questions which should be answered in fairness to the financial community, to the country, and, in the interests of orderly procedure I would suggest that we should call the committee together in executive session Thursday, and that the committee itself decide if we want to proceed and report this bill out, and then can proceed, that we can hold hearings on the major tax reforms next week. I think that is a proper procedure. And if the Democratic policy committee wishes to testify, I certainly would be delighted to hear their testimony. I would even accept an invitation to go before them and enlighten them if they need some enlightenment, or if they really want to take over the jurisdiction of collection reform I would not raise objection if they want to hold hearings of their own. I would most respectfully suggest that we, having completed the hearings on this phase of our bill, this bill, have an executive session Thursday in order that we can proceed to whatever action the committee decides.

The CHAIRMAN. Senator Miller?

Senator MILLER. Mr. Chairman, may I say that I thoroughly endorse the observations and the priorities that the chairman has set forth in his statement. I am troubled, however, by what occurred yesterday. The Senator will remember, because he was on the floor at the time, that the junior Senator from Montana filed an amendment indicating that he wanted to be sure that this was going to be heard, and I pointed out that I had previously filed a bill which covered about the same subject.

I have some other ideas in mind too for tax reform.

I personally do not think that I ought to offer them to this tax surcharge continuation bill, because I think as the Senator from Delaware has said that fiscal policy should take priority. But in order to meet the chairman's requirements, I am wondering if I file a bill on a tax reform matter, if I could appear before the committee, or file a statement at least in support of that, so that if the time comes when the committee is taking up this surcharge bill, and it is decided to start tacking on some of these reform proposals, I will be protected in my position, with the understanding that I will do so only if it seems to be the wisdom of the committee to start making a Christmas tree bill out of this tax surcharge bill, and with the understanding further that I personally prefer to wait for the House package to come over, and put my amendment on at that time. Would that be agreeable with the chairman?

The CHAIRMAN. Yes, sir.

Senator WILLIAMS. If I may I would suggest that the Senator from Iowa withhold that at the moment, and after the meeting on Thursday I think we would then be in a better position, and he certainly would not lose his position.

Senator MILLER. As I understood it, the chairman wanted to have these amendments filed——

Senator WILLIAMS. By Friday. We would hold hearings on those next week.

The CHAIRMAN. May I say to the Senator that the bill is not going to be scheduled anyway, I do not see any particular point in asking you to have your amendment printed by Friday, Senator.

Senator MILLER. So we can wait for the executive committee meeting. And at that time I may file my proposals as an amendment to this bill, or maybe as a separate bill which could be called up as an amendment.

The CHAIRMAN. Senator, I would like to ask that committee—particularly if those on the Republican side of the aisle accord me the privilege if I think it is desirable of inviting the Democratic Policy Committee to meet with us—so that each group can converse with the other, because there has been some difficulty in communication here. I thought they meant one thing and some of them think they meant one thing and some think they meant something else, and I would think that it might be desirable, and if they want to, we would be happy to meet with them. If they want to instruct the committee what we should do I think it would be well if they instruct the full committee, because it might be necessary to get some Republican votes to report this bill. And then after we discuss the matter, and each has a chance to understand the other one, perhaps we can arrive at a judgment on procedure or on whether we want to proceed with the bill further at all, and perhaps get on with some other pressing matters. But if we are not going to act, and the bill will not be scheduled or considered until the House finishes action on a bill that is still over there, I think you will find that a lot of things in that bill that industry would like to be heard on, then I do not know why we must proceed with such haste and thinking that there is something of an emergency about the bill we have before us.

Senator WILLIAMS. Mr. Chairman, that is the reason I suggested yesterday that we run this in two packages, because recognizing that every Member of the Senate has his own views as to what constitutes reform, and it is going to entail some hearings, and I think that that could be done, in an orderly process, and those amendments relating to reform such as that can be put in a separate package. That is the reason that I was requesting that we have this executive session, and see if we cannot proceed. I have no objection to the Democratic Policy Committee sitting in if they want to advise. Frankly I might hear something and who knows, they may make some contribution.

The CHAIRMAN. We will then hear the remainder of our witnesses this afternoon, and I will schedule a meeting at 10 o'clock on Thursday to discuss procedure on this revenue bill.

We will meet here at 2:30.

(Whereupon, at 12:30 p.m. the committee recessed, to reconvene at 2:30 p.m. on the same day.)

AFTERNOON SESSION

Senator ANDERSON. Mr. Harry Poth.

STATEMENT OF HARRY A. POTH, JR., REPRESENTING THE ARIZONA PUBLIC SERVICE CO., PHOENIX, ARIZ.

Mr. POTH. Thank you, Mr. Chairman.

Mr. Chairman, I think I can be very brief and cut this down to about 3 or 4 minutes. I do not have a prepared statement as such, but I would

be happy to submit a rewrite or my manuscript to the committee if that would be helpful later on.

Senator ANDERSON. Thank you.

Mr. POTH. My name is Harry A. Poth, Jr. I am a partner in the law firm of Reid & Priest, 2 Rector Street, New York, N.Y.

I am here today on behalf of Arizona Public Service Co., Phoenix, Ariz.; Minnesota Power & Light Co., Duluth, Minn., and Tucson Gas & Electric Co., Tucson, Ariz., to concur in and support the statement made this morning by Mr. Herbert Cohn on behalf of the Edison Electrict Institute and its member companies.

We also wish to concur in the recommendations for modifications of the bill made by Mr. Cohn. Additionally, I would also like to take a few minutes of the committee's time to illustrate, by means of a simple, factual example, the inequitable effect of the proposed phaseout provisions of section 49(d) of the bill H.R. 12290 upon the electric utility industry.

To illustrate, Minnesota Power & Light Co. has on order the addition of a 350-megawatt unit to its Boswell steam electric generating station. This unit, estimated to cost $52 million, is scheduled to go into commercial operation in May 1973.

I have not had the time to ascertain whether all, and I emphasize all, the equipment for this unit was under binding contract, in the words of the bill, prior to April 19, 1969.

But I do know that one of the most important items, the 350-megawatt turbine, was committed as early as January 1967, underscoring the serious leadtime problem existing in the electric utility industry among others.

In fact, I understand that leadtime, and that is exclusive of the precommitment studies and planning, is now running 4–5 years on conventional thermal plants, and possibly as much as 6-7 years in the case of nuclear plants.

Under the present tax law, Minnesota Power & Light Co. would be entitled to an investment tax credit of 7 percent on three-sevenths of the tangible personal property included in this additional unit.

If one applies, however, the formula appearing at page 21 of the report of the House Ways and Means Committee dated June 20, 1969, the scaledown of one-tenth of 1 percentage point a month, under the phaseout provisions of section 49(d), beginning in January 1971, would reduce the tax credit to 4.1 percent, this again, of course is only on three-sevenths of the qualifying property, by May of 1973, when, as I have said, the facilities are first devoted to public service.

Arithmetically, this is a reduction of approximately 42 percent in the investment tax credit available to Minnesota, which, of course, would only be in the taxable year 1973.

If the possibility of such a differential had been known in late 1966, when the decision to build Boswell No. 3 was taken, a different conclusion might very well have been reached as to the construction of this particular unit at this time.

Thank you very much, Mr. Chairman. I think I have made my statement within the allotted time.

Senator ANDERSON. Thank you very much. You have done a fine job.

Mr. POTH. Thank you very much.

Senator ANDERSON. Thank you.

Mr. Randolph?

Will you proceed, sir.

STATEMENT OF JOHN M. RANDOLPH, CHAIRMAN OF THE BOARD, RANDOLPH COMPUTER CORP., IN BEHALF OF COMPUTER LESSORS ASSOCIATION, INC.

Mr. RANDOLPH. I am John M. Randolph. I am chairman of the board of directors and president of Randolph Computer Corp. I am appearing today before your distinguished committee on behalf of the Computer Lessors Association, Inc., in connection with section 4(b) of H.R. 12290, which places a new limitation on the amount of investment credit carryovers which a taxpayer may utilize in any taxable year after 1968.

The Computer Lessors Association, Inc. is a trade association comprised of nine of the largest independent computer leasing companies. The total cost of the computer equipment presently owned by the members of our association is approximately $1 billion.

The effect of the proposed limitation on the use of investment credit carryovers on the members of our association will be to deprive them of more than $3 million of investment credit on equipment already in use. Moreover, this proposed limitation will defer, for periods ranging from 1 to 4 years, the use by members of our association of at least an additional $10 million of investment credit on equipment already in use. The availability of these tax credits and the projections as to the timing of their use were central considerations in the decision to acquire equipment and in the determination of financing terms and rental schedules.

The forfeiture of more than $3 million of investment credit and the long-term deferral of the use of more than $10 million of investment credit is not necessary to accomplish the objectives of section 4(b) of the House bill.

The House committee report states that the purpose of this limitation on the use of investment credit carryovers is to produce a revenue gain and economic restraint in fiscal 1970. We have no argument with that whatsoever.

It would be possible to fulfill that purpose by applying the limitation in the House bill only to taxable years beginning before January 1, 1971. It is not necessary to continue this limitation to 1971 and thereafter.

In any event, there is no justification for, or purpose served by, applying the limitation in the House bill in a manner which allows for a forfeiture of the investment credit on equipment already in use.

Failure to amend the House bill to alleviate these unnecessary hardships will place into question the reliability of any business planning which is based upon the use of the carryover of tax benefits.

During the rapid expansion of the use by American business of computers and related equipment over the past several years, the traditional means of acquiring the use of computer equipment was to order it directly from the manufacturer under a contract of lease, which would later be converted into a purchase order.

Subsequently, the user would either lease the computer from the manufacturer or transfer the right to receive such property to a leas-

ing company, which would purchase the equipment from the manufacturer and lease it back to the user. In certain other instances, the user originally leased the computer from the manufacturer, and after the computer had been in use for some time, it was purchased by a leasing company which leased it back to the user.

The leases written by the leasing companies on new computer equipment have generally been for terms of between 1 and 5 years, with a 2-year basic term being the most common type of lease.

These leases often contain renewal options. Despite the activity of the independent leasing companies, the great bulk of computer equipment in use today is owned by the computer manufacturers and leased by them to the users.

During the past several years, computer equipment costing over $1 billion has been acquired by leasing companies and has been leased in the manner indicated above. Under existing law, the leasing companies are entitled to an investment credit with respect to a significant portion of this equipment. The availability of the investment credit and the continued application of the carryover limitations of existing law were crucial considerations in the decision to acquire the equipment. Rental schedules and financing arrangements in connection with this computer equipment were predicted upon the assumption that the investment credit would continue to be available and that limitations on the use of the credit as a carryover would remain unchanged.

If these rules are changed in midstream, as would be true if H.R. 12290 is enacted, it would be impossible for the leasing companies to increase rentals to compensate for the loss of the anticipated investment credit.

Many of the leasing companies have relied upon the carryover provisions of present law as the only mechanism by which they will be able to use their investment credit. The law now provides that the investment credit may be carried forward for 7 years and may be used during such period as a credit against up to 50 percent of the leasing companies' Federal income tax liabilities.

The leasing companies are, in general, only a few years old. Because the leases which they have written generally result in their suffering tax losses during the early years of the life of an item of equipment, a number of them have not generated taxable income to date. These companies are able to utilize the benefit of the investment credit only after their leases have reached the so-called "turn-around point" and begin to generate taxable income against which the credit can be applied.

Under present projections, substantially the full amount of investment credit carryover would be utilized within the 7-year carryover period provided by present law.

The provisions of the House bill unfairly deprive the computer leasing companies and I might add many other corporations of investment credit carryovers which they expected would be available. The House bill relating to carryovers of unused investment credits goes beyond what is necessary to achieve the desired revenue gain and economic restraint for the fiscal year 1970. Indeed, as applied to computer leasing the limitation on the use of carryovers represents needless "overkill."

The stated objectives of the carryover provision of the House bill will be fully achieved if the limitation now contained in section 4(b) of H.R. 12290 is amended to apply only to taxable years beginning prior to January 1, 1971. Under this suggestion, present law with
prior to January 1, 1971. Under this suggestion, present law with
and after January 1, 1971.

Mr. Chairman, I would like to thank you and the committee for this opportunity to express the views of the Computer Lessors Association, Inc. on H.R. 12290. Thank you.

Senator ANDERSON. Thank you very much.

Mr. John W. Scott, master of the National Grange.

STATEMENT OF JOHN W. SCOTT, MASTER OF THE NATIONAL GRANGE

Mr. SCOTT. Mr. Chairman and members of the committee: I am John W. Scott, master of the National Grange, with offices at 1616 H Street, NW., Washington, D.C.

The Grange is a farm and rural-urban community and family organization, with over 600,000 members, located in 7,000 communities in 40 of our 50 States. As such, we have a wide range of membership interest; therefore, our legislative activities are not limited to agriculture, but cover the complete gamut of governmental functions.

The importance of taxation and fiscal policy of the Federal Government to the National Grange is emphasized by the fact that at each annual session of the National Grange a committee considers resolutions from the 38 State Granges, pertaining to taxes and fiscal policy. This committee, in turn, reports its findings to the delegate body for action. The deliberations and debate by the delegates that follows formulates National Grange taxation and fiscal policy.

SURTAX

The National Grange saw the need for imposing a surtax as early as 1967 to slowdown the rapidly rising inflation that was eating away at the small economic gains we in agriculture had been able to make for the American farmer.

At the 101st Annual Session of the National Grange, held in Syracuse, N.Y., in November of 1967, the delegate body adopted the following statement:

> If the sum total of the lessons and teachings of the Grange were summarized into one word—that word would undoubtedly be *responsibility*. As this Committee has considered the various resolutions and testimonies presented to it, it has endeavored to exercise a high sense of purpose and responsibility. Fiscal responsibility, in this year 1967, is a subject requiring soul-searching decisions on difficult matters.
>
> Recognizing that the Taxation and Fiscal policy of the Federal Government has a direct and important impact on the economy of the nation and affects all citizens, it is essential that these policies be sound and in keeping with the obligations of the various units of government and the services rendered by the respective units of government. The tax structure should be so constituted as to fall as equally as possible on all individuals and all segments of the economy according to the income and resources of each.
>
> No individual or industry should enjoy unduly favorable or unreasonable advantages nor should any industry or individual be penalized by unfair tax levies or regulations. It is generally recognized that deficit financing at the federal level

is a prime cause of inflation and jeopardizes the ability of state and local governments to meet the needs of their areas in the future. We, therefore, reaffirm our position favoring a balanced federal budget at the earliest possible time.

We urge the Congress to review the budget with the purpose of reducing the budget deficit by eliminating or modifying programs not absolutely essential to the economy and immediate welfare of the nation. If budget reductions thus effected are not sufficient to relieve the inflationary pressures now threatening the welfare of the nation and its citizens, then we favor a surtax levy to decrease the pressures that would result in high interest rates, serious and damaging inflation and the necessity for wage and price controls. Unless this combination is implemented, or a surtax on revenue measure of greater proportions is levied, we face the certainty of high interest rates, serious and damaging inflation and the necessity of wage and price controls. The story of rising costs of interest does not stop with government; for if government pays more, this excessive interest cost extends to every citizen and every segment of the economy. The alternative of wage and price controls is not consistent with our free enterprise system and a growing and expanding economy.

Herschel D. Newsom, in his final address to the delegate body in November of 1968, before assuming his new duities with the U.S. Tariff Commission, charged the delegates with the following:

The historic position of the National Grange, calling for a tax policy predicated upon meeting the financial requirements of the federal government as those requirements are determined by the Congress—without adding significantly to the pressure of the federal government in the money markets of the United States—dictated our policy of asking two years ago for increased federal income taxes.

Failure to achieve this objective, until just a few months ago, resulted in the federal government going into the money markets and generated other factors that resulted in significant increases in the price and wage spiral—OUTSIDE OF AGRICULTURE. All of these factors, of course, gave to America a climbing consumer price index. But it gave to American agriculture the double problems of rising costs from non-agricultural prices and wage increases, but a rising interest rate structure on the necessary capital to finance our agricultural operation.

Let none escape recognition of the significance that farmers and rural Americans are seriously devoid of the ability which many other segments of our economy have of passing along the results of wage and price increases in their own operation. Farmers, almost alone in our American economy, are not capable of contributing to the consumer price index upward trend mentioned above. Nor was there any available mechanism by which we could pass along the increased costs in our operation from rising interest rates—which, in themselves, were generated by the imbalanced budget which forced the federal government to become a major competitor in the money markets of the country, thus running up interest rates on the very essential capital requirements of American agriculture to meet its deficit operation.

In fact, the tax increase came so late that many authorities in the field of taxation and fiscal policy had become apprehensive, lest a tax increase at such a late date might do a great deal more than just simply "bring the inflationary trends under control."

There is apparently increasingly widespread agreement that—until such time as we are able substantially to reduce our defense requirements and reduce the level of total expenditures of the federal government—the current level of taxation should be maintained; and that probably the only realistic prospect of maintaining fiscal responsibility under current overall budgetary requirements, is to extend the exising surtax now scheduled to expire next June 30th.

It is apparently rather well agreed that the surtax increase has scarcely been in effect long enough to make any clear determination of its real effect and value in terms of inflation control or increasing stability of the United States dollar. Let us, however, be clear and unequivocable that a major objective of a national taxation and fiscal policy must be a sort of fiscal responsibility that is predicated upon sound value of the dollar and a favorable trade balance that will, in large measure, offset our essential off-shore military or other expenditures. Major consideration in this connection must be given to holding any federal budgetary deficit to a minimum.

To fall short of this objective is to increase, rather than to diminish, our problems and responsibilities in other essential fields of Grange policy and objectives.

In reaction to the national master's remarks and to resolutions that were directed to the taxation and fiscal policy committee, the delegate body adopted the following resolutions at the 102d annual session, held in Peoria, Ill., in November 1968:

INCOME TAX EXEMPTION

RESOLVED, that as it becomes apparent that reductions in revenues received from Federal income taxes may be justified by reason of reductions in expenditures, the means employed in achieving such reductions should include: First, elimination of the recently enacted income tax surtax; and, second, a substantial increase in the personal exemption of individual taxpayers for themselves and their dependents.

BALANCED BUDGET

RESOLVED, that the National Grange (1) approves, as being an appropriate measure designed to balance the Federal budget, the recent action of the Congress levying a 10-percent income tax surtax, but at the same time requiring a cut in Federal expenditures: and (2) urges the Congress to take such other steps as may be feasible to retain the purchasing power of the dollar by eliminating deficit spending wherever possible.

The National Grange, in keeping with its long history of supporting fiscal responsibility, urges this committee, without further delay, to report to the Senate, legislation that will extend the 10-percent surtax until December 31, 1969, and then at 5 percent until June 30, 1970.

In recent weeks we have heard and observed in the press that an effort will be made to hold back on the surtax extension until major tax reforms are added to the tax measure. The National Grange, although strongly in favor of major tax reforms, cannot see the necessity of such action. We believe it to be the responsibility of Congress to make it known to the Nation and to the world financial interests that the United States is willing to take the necessary economic steps to curb the rapidly increasing inflationary trends that are galloping across our land.

It is our firm conviction that there is in the country enough support for major tax reforms that this Congress can pass such legislation before the August recess without further delay of the surtax extension. For if this administration and more importantly this Congress, is serious about more equity in our Internal Revenue Tax Code, you will not only have agriculture's support, but the support of Mr. and Mrs. Average Taxpayer, as they are insisting upon major tax reforms. They are tired of carrying a disproportionate share of the tax load. Therefore, they will demand such legislation and holding back the surtax extension is not necessary to obtain the stated goals on major tax reforms.

EXCISE TAX

The National Grange once again, in keeping with its history of fiscal responsibility, supports the continuation of the 7-percent excise tax on passenger cars and the 10-percent excise tax on communications services.

We appreciate the fact that these taxes were levied during wartime as emergency measures to help pay for the extra cost of national defense and were to be removed after the emergency had passed. Since

that time we have found ourselves in one emergency after another, either at home or abroad, which has continued the heavy demand upon the Federal Treasury and hence Congress has found it necessary to continue the excise taxes to meet our military and domestic obligations.

Each year the delegate body of the National Grange supports the continuation of the excise tax, asking that it be repealed when the budget is balanced and our national security is no longer in danger.

TAX REFORMS

We are committed to a comprehensive revision and reform in the income tax structure and agree with many members of this committee and other Members of Congress that this is the year the tax overhaul should and must take place.

The National Grange has been urging Congress since 1963 to undertake such a study and revision of the Federal tax structure, when the delegate body adopted the following resolution:

INCOME TAX REFORMS

The Grange is cognizant of inequities and defects in the present income tax structure, some of which tend to retard growth, invite recessions, adversely affect employment, and destroy incentives for full operation of the private enterprise system. The Grange, therefore, should urge the Congress to undertake a comprehensive revision and reform of the income tax structure.

SEVEN-PERCENT INVESTMENT CREDIT

The National Grange is strongly opposed to the outright repeal of the 7-percent investment credit for American agriculture.

Farmers should have a medal for what they have done in fighting the disease of inflation that wracks the country. Instead, we have to stay alert or we will be clobbered from the back side by the inflation "cures".

The whole idea of the 7-percent investment credit when it was spawned a few years back was to encourage businesses to keep their machinery up to date so that industry remains productive and can compete with imports.

Now tax reformers want to do away with investment credit. They say it's inflationary—raising demand and causing higher prices.

In our judgment, just the opposite can be argued. Since investment credit increases productivity and the supply of goods, it tends to lower consumer prices. This allows us to compete better with imports and strengthen our currency. In addition, and this is our primary interest in opposing accross-the-board repeal, small businesses and farmers need investment credit so that they can compete with big businesses, which have easier access to capital. These arguments all have merit, but we will not take the committees' time to develop them further at this time.

AGRICULTURAL IMPLICATIONS OF INFLATION

In recent years, inflation has increased farm costs more than it has expanded gross incomes. Inflation is being felt more keenly because production expenses are a higher proportion of gross income than ever before. Before the mid 1950's, production expenses typically repre-

sented 50 to 60 percent of gross farm income. Today, 70 percent or so is common. In addition, farm families are buying more of their family living items rather than producing for home consumption.

Farm wage rates have increased some 60 percent in the past decade and should continue to climb rapidly in the next few years. Increased Industrial wages and greater organizational activity by farm workers almost guarantees strong upward pressure on wages even if general inflation is slowed markedly.

Prices on family living items for farm families have increased about 20 percent in the past decade and prices on items used for farm production are up about 15 percent. However, trends are mixed for specific items. Prices on farm produced inputs such as feed and feeder livestock do not closely follow general price levels. Prices on many, but not all, nonfarm produced items do follow other prices closely. Prices of farm machinery increased about 30 percent, while prices of tractors, trucks and autos increased about 25 percent in the past decade. Of course it is often difficult to separate price increases from quality improvement on these items. Prices on farm supplies, building and fencing materials and motor supplies have increased only about 7 percent, while fertilizer and pesticide prices have been stable.

We submit to this committee that agriculture has been the No. 1 victim of inflation and has contributed the least to the causes.

The June 15, 1969, report from the Crop Reporting Board, USDA, contained the following regarding agricultural prices:

PRICES RECEIVED INDEX UP 2 POINTS, PARITY INDEX UP 1 POINT, ADJUSTED PARITY RATIO 82

The Index of Prices Received by Farmers advanced 2 points (3/4 percent) during the month ended in mid-June to 284 percent of its 1910–14 average, according to the Crop Reporting Board. Contributing most to the increase were higher cattle and hog prices. The most important price declines were for commercial vegetables, especially tomatoes and lettuce. The index was 24 points (9 percent) above June 1968.

The Index of Prices Paid by Farmers for Commodities and Services, Including Interest, Taxes and Farm Wage Rates advanced 1 point (1/4 percent) to 375. This was the sixth consecutive new high. The index was 20 points (6 percent) above a year earlier.

With prices of farm products and prices paid by farmers both higher, the Preliminary Adjusted Parity Ratio remained unchanged at 82, while the Parity Ratio advanced 1 point to 76.

In light of this we urge this committee to amend H.R. 12290 by continuing the 7-percent investment credit for the first $25,000 of yearly capital investment by farmers and all other businesses—such as was done in 1966 when investment credit was suspended for 6 months. The reasons, we believe, are plain enough to see.

Let's look at the real cause of inflation:

Increased Government debt, deficit financing, and goading the economy with Government spending push up the money supply.

As more money chases available goods, prices go up. This triggers economic forces that push prices even higher. For example, labor unions strike for higher wages, and usually get them. Wage escalation clauses automatically hoist wages as the cost of living rises. Businesses, beset with higher costs, raise their price—and get away with it, due to inflation fever.

Inflation fever is a general expectation that prices will go right on rising. People go out and borrow to buy more than usual. Businesses, thinking that prices will be higher later on, borrow now to expand before costs go up. Everyone runs faster just trying to stay even.

While this has been going on, farmers have been combating inflation. They have remained highly productive. They haven't raised their prices. And they haven't gone on a buying spree. Here's proof:

1. Since 1950, U.S. population has increased 32 percent—but total farm output is up 42 percent, easily outstripping population growth. Production per man-hour on farms is growing two to three times as fast as production per man-hour in business and industry—thus agriculture is leading the pack as an efficient, productive industry.

2. Farmers are putting more food on the market, which holds down food prices and consumer costs.

The average level of farm prices stood at the same figure in 1968 as in 1950, 18 years ago. Where else can you find that kind of price stability? Farmers got paid $2.79 more in 1968 than in 1950 for the market basket of farm food which cost the typical city wage earner family $1,118 last year. They paid $198.16 more than in 1950—partly because wage rates are 113 percent higher than in 1950, and it cost $195.37 more to get the market basket to the consumer.

If the rest of the economy had fought inflation and held prices as farmers did, the 1968 dollar would have been worth a full 1950 dollar instead of only 69 cents.

3. Farmers haven't gone on a wild buying spree to fuel the inflation fires. Farmers are spending about a third more for buildings, machinery, and equipment compared with 1950; industry has tripled outlays for new plant and equipment. Farmers increased their debt less in the wild inflation years of 1967–68 than in 1965–66.

Meantime, they have been victimized brutally by inflation. We are paying 37 percent higher prices than in 1950. When we can find help, we're paying twice as much for it as in 1950. Our real estate taxes are nearly three times higher than in 1950. Interest rates are sky high.

In short, instead of contributing to inflation, we have fought it, and we are bearing the brunt of it. Farmers—as well as many others—have already been taxed heavily by an inflation that has backed them into a corner and is shearing them like sheep.

We urge that, as a minimum, the 7-percent investment credit on $25,000 be retained.

We call upon this Congress to use its wisdom to help curb inflation by the immediate extension of the 10-percent surtax and other provisions of H.R. 12290, with the provision that the first $25,000 of capital investment be exempt from repeal of the 7-percent investment tax credit.

We appreciate the opportunity to appear before this distinguished committee charged with tremendous responsibility to our country, to make known the views of the National Grange. Thank you, Mr. Chairman, and members of the committee, for your consideration of our position.

Senator ANDERSON. Thank you very much.

Mr. John Huffaker.

STATEMENT OF JOHN HUFFAKER, CHAIRMAN OF THE COMMITTEE ON TRANSITION RULES UPON REPEAL OF INVESTMENT CREDIT OF THE PHILADELPHIA CHAMBER OF COMMERCE

Mr. HUFFAKER. Thank you. I am John B. Huffaker, a member of the Federal Tax Committee of the Greater Philadelphia Chamber of Commerce and chairman of its task force on the investment credit transition rules. I am appearing to express the committee's objection to the provision in the House bill that the credit not be available, or be reduced, unless the property is placed in service before the end of next year although the taxpayer had made a binding commitment prior to April 18, 1969. We feel that this limitation is particularly objectionable insofar as it applies to property of the type that a commitment of 2 years or more before it can be placed in service is normal.

The House bill has most of the same basic transition rules for the repeal of the investment credit as were enacted when the credit was suspended in 1966. To quote from Secretary Kennedy's statement to this committee on July 8:

> The transition rules * * * are generally the same rules adopted in 1966 in suspension of the investment credit * * *. The binding contract rule and these additional rules provide equitable treatment in the most deserving cases and they represent the most reasonable cut-off point.

We accept the Secretary's point that the 1966 rules are a reasonable cutoff point and that the House bill generally follows that line. We respectfully invite the committee's attention to a major departure in the House bill from the 1966 precedent and submit that the provision on which we are focusing is inconsistent with the basic policies reflected in the transition rules.

The general rule of the bill is that if the taxpayer has made a commitment to the expenditure prior to the cutoff date, he gets the credit. If he has not made an adequate commitment, he doesn't get the credit. This is the 1966 rule and it is the rule in the House bill. The Greater Philadelphia Chamber of Commerce Federal Tax Committee is of the opinion that transition rules which permit the credit whenever the taxpayer has made a binding commitment before the deadline date are necessary.

However, the House bill introduces the new concept—referred to as the "phaseout"—that although the binding commitment is timely, the credit is lost entirely if the property is not placed in service by 1974, and partially if placed in service after December 1970. We feel that the phaseout is unwise and unfair.

The desirability of this provision requires that we focus upon the criteria that should be used to judge equitable transition rules. The Federal tax committee of the chamber was split on the desirability of repeal, but it was unanimous that a taxpayer with an adequate commitment should get the credit. Now the bill makes the credit dependent on place-in-service date as well as the commitment date.

Why is there a credit when a binding commitment is made? Why is there acceptance of the general principle that the credit is available for property for which there was a commitment on April 18? It appears that Congress felt that a businessman should be able to make his plans with maximum reliance on the stability of the tax system. We know

that the greater the risk a businessman assumes, the greater the anticipated profit needed to justify the investment.

We know that many investments would not be made—or the price structure would be changed to give a more rapid return of investment—if the uncertainties are increased. Complete certainty is of course undesirable and impossible, but sound planning is fostered by relative stability and made more difficult by instability consistent with this principle. This committee reflected the desirability of a known law when it announced its position on the April 18 cutoff date before considering the rest of the bill.

As a second consideration, we also recognize that when the tax policy is intended to encourage (or discourage) a certain course of conduct through a special incentive and the taxpayer reacts as intended, the taxpayer must get the expected reward (or punishment) if future incentives are to be credible. Tax incentives give our economy a flexibility that would otherwise be absent.

Thus we see two sound reasons for the binding commitment rule. Now, let's see how the placed-in-service limitation stands up.

First, the taxpayers hit by the placed-in-service rule are apt to be hit hard—items such as industrial plants, ships, airplanes, and the like inherently have a long leadtime between commitment and delivery and they have a big price tag.

The typical management decision to undertake an acquisition of this sort compared projected cost and projected return. During 1968 and early 1969 the taxpayer thought he could count on the credit, so he could justify a project with lower profit margins than would otherwise have been possible. If it had been necessary to justify the project without the benefit of the investment credit, then we see that the taxpayer would need a greater potential profit to justify the investment. If he had not believed he could rely on the credit, then he might have projected higher prices to attain the same profit but he would have tended to disregard the incentive in making the decision to invest or not to invest. Sound management would dictate that the venture needs to work without an incentive whose availability is problematical so the incentive really doesn't act as an incentive at all. It's a windfall if luck holds out and not something to rely upon.

Thus we see that the placed-in-service rule will hit a most sensitive group of taxpayers—the ones with flexibility to invest or not and the ones most sensitive to incentives since they have the most sophisticated economic planning. An airline or shipping firm could probably use some of the existing equipment longer; new factories are frequently not a necessity of the moment. A taxpayer who acted in reliance on the credit and then retroactively lost it would be understandably skeptical about our tax structure in general and incentives in particular. Other taxpayers who were not caught would be impressed by the disaster of the unlucky ones and would be just as leery of incentives.

We recognize that there may be instances when the credit is not justified: for example, when a taxpayer has ordered several years needs of an item currently available. When the ordered goods are not to be placed in service within a normal time, indicating that taxpayer was trying to outguess Congress, the policy arguments for protecting the investment largely disappear. We do not think there was much

of this, but it is not necessary to give the credit to this type of taxpayer in order to protect the investments that are our concern.

In the light of this analysis we have alternative suggestions:

1. The simple solution is to remove the provision for gradual loss of the credit. The cases called to our attention are not so concerned with the 1974 deadline as with the graduated loss.

2. If the committee desires to retain the House rule except for those cases in which the placed-in-service rule is an obvious hardship, an exception could be made to the House bill for items for which a commitment of more than 1 year in advance of use is customary.

3. As another alternative, the House rule could be made applicable only when the order was for items that could be acquired by 1971 and the taxpayers' orders were clearly in excess of the reasonable needs of the business.

While our choice is the first because of its simplicity and we feel that the complexities may not be justified by the number of abuse cases, we believe that the reward of the credit can be denied to those who sought to acquire an unfair competitive advantage without punishing those who acted as Congress intended in the normal course of business. For the most part either our second or third suggestion should answer the policy argument in the House report that restrictions are necessary to prevent unfair competitive advantages while not being inconsistent with the basic policies supporting the adequate commitment rules.

Thank you.

Senator ANDERSON. Thank you.

Are there any questions?

Senator WILLIAMS. No questions. I just want to welcome you back to the committee. I remember you.

Mr. HUFFAKER. Thank you, Senator Williams. And incidentally some of the people with this problem are right in the Delaware Valley and in the State of Delaware.

Thank you, sir.

Senator ANDERSON. Mr. E. A. Trigg, president of the Alcan Aluminum Corp.

STATEMENT OF ERIC A. TRIGG, PRESIDENT OF THE ALCAN ALUMINUM CORP., CLEVELAND, OHIO

Mr. TRIGG. Mr. Chairman, Senator Williams, my name is Eric A. Trigg, president of the Alcan Aluminum Corp. Alcan Aluminum Corp. is a major fabricator of aluminum products in the United States with headquarters in Cleveland, Ohio. We operate 14 aluminum fabricating plants in nine States, our gross assets are in excess of $300 million, and we employ over 5,000 persons. Our company is a wholly owned subsidiary of Alcan Aluminum Limited of Montreal, Canada.

My remarks before this committee today are addressed to section 4(b) of H.R. 12290 which, in connection with the repeal of the investment tax credit, introduces a 20-percent limitation on the use of carryover credits. If enacted, this limitation could take from taxpayers some of the credits earned as a result of investments made within the terms of the existing legislation.

The House Ways and Means Committee, in addition to proposing the removal of the credit as an investment incentive, included additional steps designed to have the immediate effect of providing additional Federal revenues while reducing the amount of internal funds available to taxpayers for investment. The 20 percent restriction in the use of credit carryovers is included in recognition of the fact that there is an estimated $2 billion of carryovers heretofore accumulated by taxpayers, use of which in 1970 might tend to offset the immediate effect of the repeal of investment credits.

This dilemma may really put in question the desirability of relying on changes in investment credit legislation for short-term impact on the economy, but our immediate concern is not with such a far-reaching subject. Our concern is that action in pursuance of short-term objectives may result in depriving certain taxpayers of credits which accured to them as a result of actions taken in good faith under the prevailing laws of the land.

An example given on page 22 of the report of the House Committee on Ways and Means states simply that an amount carried over from 1962, which could no be used in 1969 as a result of the 20-percent limitation, would not be available for use as a carryover in a subsequent year because the 7-year carryover period would have expired.

Depriving a taxpayer, such as our company, of an investment credit in this fashion strikes us as being unfair and such a result does not appear to be intended, as can be demonstrated by reference to two major areas of the bill.

One is the apparent purpose of the 20-percent limitation itself, which is not to take away a portion of a credit accumulated by businessmen in reliance upon the commitment of previous Congresses, but rather to defer the current cash flow effects of the utilization of this backlog beyond fiscal year 1970.

Another is the inclusion of special provisions designed to prevent substantial injury where commitment had been made in reliance on the laws then in effect. Examples of such provisions are:

(1) The binding contract rule;
(2) The equipped building rule;
(3) The plant facility rule; and
(4) The machinery and equipment rule.

We agree with these sections of the proposed legislation and applaud the transitional relief granted. However, we feel that the 20-percent limitation rule is inconsistent with such an approach.

If it is the intent of Congress to provide additional revenue and economic restraint in 1970, we believe that additional time should be granted to taxpayers to absorb any credits which might otherwise be extinguished by the 20-percent limitation.

This could be accomplished by providing that any carryover lost to a taxpayer by the application of the 20-percent limitation could be taken in successive years, without regard to the year in which the credits would have expired under the present carryover rules, subject to the 50 percent of tax limitation.

Such action would be consistent with the action taken during the suspension period of the investment credit when 2 years were added to the carryover period.

In summary, we are seeking to have corrected an unfair, and, we surmise, an unintended, result.

Mr. Chairman, as you can see, this is a very brief statement on a particular section of H.R. 12290. We felt it necessary to present it to the committee not only because of its effect on our own company but also because of the possibility that its impact on others may have been overlooked.

Senator ANDERSON. Thank you.

The next witness is Mr. George W. James, vice president of economics and finance, Air Transport Association.

I understand you have several people along with you. Will you file the list of people for the record.

STATEMENT OF GEORGE W. JAMES, VICE PRESIDENT, ECONOMICS AND FINANCE, AIR TRANSPORT ASSOCIATION, ACCOMPANIED BY R. M. RAWLS, ASSISTANT VICE PRESIDENT; W. DALE HAY, VICE PRESIDENT, CORPORATE AFFAIRS, AND ASSISTANT SECRETARY, ALLEGHENY AIRLINES, INC.; THOMAS F. QUINN, VICE PRESIDENT, TAX ADMINISTRATION, AMERICAN AIRLINES, INC.; STEPHEN PICHLER, DIRECTOR OF TAXES, EASTERN AIR LINES, INC.; ROBERT G. FERGUSON, SENIOR VICE PRESIDENT-FINANCE, PAN AMERICAN WORLD AIRWAYS, INC.; HARLEY W. MEAD, ASSISTANT TO COMPTROLLER, TAX ADMINISTRATION, PAN AMERICAN WORLD AIRWAYS, INC.; MALCOLM T. HOPKINS, VICE PRESIDENT AND TREASURER, TRANS WORLD AIRLINES, INC.; AND JOHN A. TOCKSTON, DIRECTOR, TAX ADMINISTRATION, UNITED AIR LINES, INC.

Mr. JAMES. My name is George W. James, vice president of the Economics and Finance Air Transport Association, accompanied by Mr. Rawls, also representing the airline industry and the financial officers of seven of the carriers of our association.

The names of these financial officers have been given to your staff and I believe they have been distributed to you.

The Air Transport Association appreciates the opportunity to state the view of the airlines on H.R. 12290 and especially on the repeal of the investment tax credit.

Under the pending legislation, the scheduled air transport industry would lose approximately $100 million of investment tax credits already generated from binding contracts because of the operation of section 49(d) (p. 20, line 3-11 of the bill), which phases out the credit beginning in 1970. In addition, the industry also will lose untold millions from the special limitation on the use of carryover and carryback of the credit.

Both of these provisions constitute retroactive taxation in that they take credit away from taxpayers who had valid and binding contracts or existing credit under the law which was in effect when the orders were placed or the property delivered.

These unfortunate retroactive provisions strike a particularly serious blow at the airline industry at a time when airlines are in their

most severe financial straits in years. Airline expenses continue to increase faster than revenues, the earnings decline continues and the return on investment is less than half that deemed reasonable by the Civil Aeronautics Board.

The unfortunate ramifications of these provisions have not been fully explored.

THE PHASEOUT

Under the bill (proposed sec. 49(d) subpt. B, pt. IV, subch. A, ch. I), availability of the credit is diminished by one-tenth of 1 percent per month for section 38 property placed in service after December 31, 1970, even though such property was acquired pursuant to a binding contract in effect prior to April 18, 1969.

This provision is unfair and discriminatory against taxpayers whose purchases are predominantly long leadtime items. The airline industry is the outstanding example of this. The time between order and delivery of a transport aircraft, particularly the advanced, new technology planes, is from 3 to 5 years.

Airlines which placed orders a year or two ago for aircraft such as the Boeing 747, the DC-10, and the L-1011, did so in full expectation that they would be able to rely on the investment tax credit which the law provided. These carriers had a right to expect that they would not be stripped of the credit retroactively.

This is precisely the effect of the phaseout provision. The provision is inequitable on its face when one piece of transport equipment, such as a truck, bought off the shelf before April 18, 1969, receives full advantage of the credit, while another, such as a $20 million airplane ordered at the same time and not delivered for 4 years has the credit diminished simply by reason of the fact that it takes longer to build the airplane than the truck.

It must be emphasized that the aircraft and other equipment referred to were ordered as much as a year before the cutoff date requested by the President. Contracts binding on the airlines were entered into with aircraft manufacturers long before any consideration was given to the repeal of the investment tax credit.

THE SPECIAL LIMITATION

The second provision which is particularly damaging to the airline industry is the proposed new special limitation on the carryover of the credit (sec. 4 (b), p. 20, line 12 of the bill.)

This special limitation would magnify the problems of an industry which has a continuous requirement for vast amounts of capital investment while at the same time suffering from a low level of earnings.

The limitations on use of carryovers and carrybacks of investment credit (sec. 4(b) of H.R. 12290) is also retroactive and discriminatory legislation. It discriminates against those taxpayers who have not yet been able to make full use of investment credit which has accrued from purchases of equipment and reduces the amount of their investment credit carryovers and carrybacks, although purchases of equipment had been made in reliance on the existing investment credit carryover and carryback provisions.

THE AIRLINE SITUATION

One might ask the question: Why do airlines order aircraft? Airlines have ordered equipment both to provide additional service demanded by an increasing volume of passengers and cargo and to replace older equipment with safer and more modern aircraft. For a number of years air transportation has been growing at an average annual rate of about 15 percent for passengers and at about 20 percent for freight. This growth is expected to continue. In an industry as dynamic and technologically progressive as air transportation, reequipment is an economic imperative.

Next, one might ask the question: How do airlines finance their aircraft? The commercial airline industry has employed four major financing methods in acquiring aircraft and equipment in recent years—bank and insurance company senior term loans, convertible debentures, a small amount of common stock equity financing and investment credit leasing. Because of low earnings, leasing has become one of the most important methods of acquiring equipment.

Thus, the magnitude of aircraft leasing has increased dramatically over the last few years. Both large and small air carriers are presently leasing jet aircraft valued in excess of $1 billion from banks and other leasing institutions.

Such leasing arrangements have enlarged the total pool of capital available to these air carriers, thereby making it possible to acquire the equipment necessary to meet their public service obligations.

There is every indication that the debt-burdened and marginally profitable airlines will need to rely on leasing transactions to an even greater extent in the future.

How does the loss of the $100 million due to the phaseout in investment tax credits on binding contracts relate to the financial outlook of the airlines? The loss of this amount of credit would force the airlines to arrange "substitute" financing totaling $1.5 billion.

Thus the $100 million loss of investment tax credits eliminates a potential lease financing capability of $1.5 billion. Even if the required "substitute" financing could be arranged, and there is much doubt that it could be, it would have to be arranged in an extremely competitive money market, thus driving interest rates even higher, thereby defeating the administration's goal of reducing the inflationary pressures so evident in our economy today.

Since outright repeal of the credit will cause economic hardship to the airline industry and greatly diminish its ability to obtain the necessary capital to finance required capital programs, the carriers should not have imposed on them the further burden of withdrawal of credit by retroactive repeal.

We believe very strongly that equity requires that the two provisions referred to—the phaseout and the carryover limitation—be eliminated for the following reasons:

1. *Retroactivity.*—These two provisions are retroactive legislation of the worst sort and would result in penalizing taxpayers as well as hundreds of thousands of stockholders who relied in good faith on the investment credit when purchasing equipment before the cutoff date.

2. *No effect on retarding investment.*—Since a commitment has already been made for the new equipment, phaseout and limiting carry-

over provisions would not accomplish the desired retarding of investment. Conversely, eliminating the phaseout and the carryover limitation would not impair the purpose of the legislation.

3. *Inflationary.*—To the extent the airlines with binding contracts cannot lease, they must finance in other ways, thus exerting the very adverse pressures on capital markets and the economy which the present administration is attempting to avoid.

4. *Financing (both current and future) would be seriously impaired.*—Use of third party leases utilizing the investment credit has become the most expedient aircraft financing method. Loss of the credit through phaseout or loss of carryforward provisions eliminates or grossly hampers the ability to finance aircraft on binding orders which would otherwise qualify for the credit.

5. *Penalize long leadtime industries, of which the airlines are a major industry.*—These two provisions discriminate among taxpayers on the basis of the leadtime required in different industries for ordering equipment, a circumstance entirely beyond the control of the taxpayer.

6. *Discrimination.*—Even within a single highly competitive, regulated industry, there would be discrimination in favor of those companies who placed their equipment orders early in the pretermination period as comparer with those who ordered more recently.

7. *Delivery delays.*—Equipment, thought to be unaffected by phaseout, could be penalized if actual delivery date turn out to be later than scheduled delivery date—this too is beyond the control of the taxpayer.

8. *No special privilege.*—By eliminating these two provisions, the airlines will be in no better position than any other taxpayer; all that is requested is equity within the framework of the repeal legislation.

9. *Public interest.*—Air transportation provided by the aircraft now on order will better serve the public interest. The phaseout provision and the 20 percent carryover limitation jeopardize the financing and consequently, the purchase of this required equipment, thus adversely affecting the airlines' ability to meet their responsibilities to the traveling public.

Financing the needed massive improvements in airline service is going to be difficult at best. The investment tax credit has been vitally important in permitting the airlines to undertake the financing accomplished to date, and thus the credit has contributed to the maintenance of reasonable price levels as well as improved service, and increased efficiency. A great need still exists.

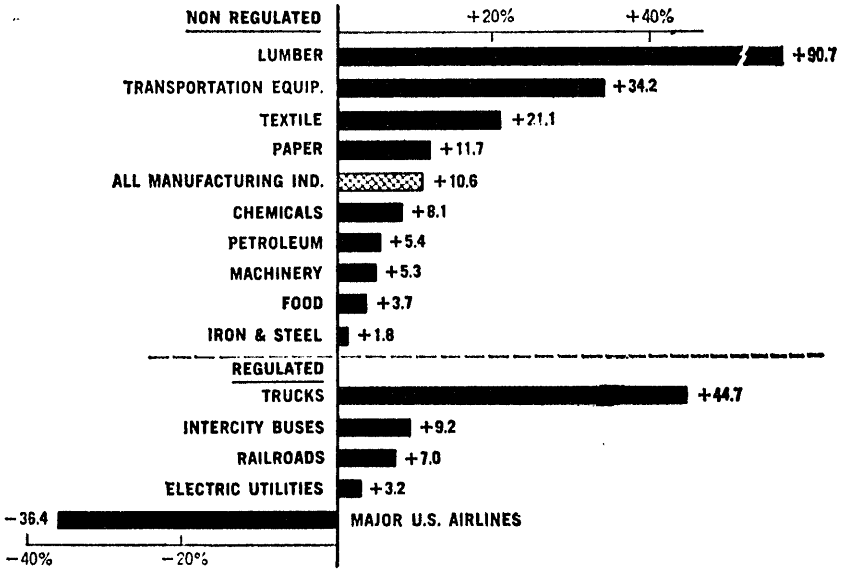
The increased taxes resulting from the elimination of the investment tax credit will cause a further financial drain on the carriers which can only result in the impairment of progress toward greater efficiency through modernization. Such efficiency is essential if continuing price increases are to be avoided.

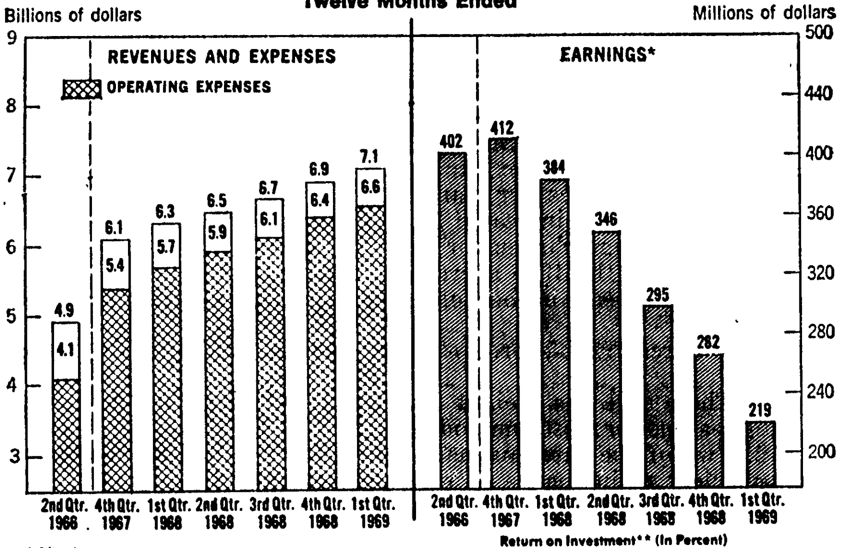
Retroactive repeal of the investment tax credit would be grossly unfair to business interests and thousands of stockholders because of widespread reliance on the credit in formulating investment decisions which were reached prior to the effective date of the repeal. It would be especially adverse to an industry whose prices are regulated.

The scheduled, certificated airlines of the United States, strongly urge the committee to strike these two provisions of H.R. 12290 and thus prevent the enactment of inequitable and harsh legislation.

That concludes our statement, Mr. Chairman.

(The attachment to Mr. James statement follows:)





Senator ANDERSON. Thank you very much.
The next witness is Mr. J. W. Henderson, chairman of the Railway Progress Institute.

STATEMENT OF J. WILLIAM HENDERSON, JR., PRESIDENT OF BUCKEYE INTERNATIONAL, CHAIRMAN OF THE RAILWAY PROGRESS INSTITUTE

Mr. HENDERSON. Mr. Chairman, members of the committee, I am J. William Henderson, Jr., president of Buckeye International of Columbus, Ohio, and chairman of the Railway Progress Institute, the national trade association of the railway supply industry, based in Washington.

With me today is Mr. Nils A. Lennartson, president of RPI.

We appreciate having the opportunity to appear here today on behalf of the railway supply industry to give our views on proposed repeal of the investment tax credit, section 4 of H.R. 12290.

I would like to explain that the Railway Progress Institute is made up of some 200 railway supply companies of all sizes, located throughout the United States. We provide the railroads with rolling stock, locomotives, components and other equipment and services of all kinds. My own company, Buckeye International, is a diversified corporation which manufactures steel castings for railroads, among other things.

All of us in the railway supply industry are gravely concerned with the tragic impact that repeal of the 7-percent investment tax credit would have on the railroads, on employment and production in our plants, and on the transportation system in this country.

As you have heard in previous testimony, the railroad industry regards the 7-percent investment tax credit as a key factor in the remarkable modernization progress which they have accomplished in recent years. New freight cars and locomotives purchased in the 5-year period—1964–68—were almost double those installed in the 1959–63 period. Many electronic classification yards and sophisticated computer systems have been installed.

The impact of the capital expenditures was marked:

1. Gross ton-miles per man-hour, an overall indicator of railroad productivity, increased by 60 percent in the last 10 years.
2. The average charge for carrying a ton of freight is now 8 percent below the 1958 average. Compare that reduction to the 25-percent increase in the Consumer Price Index during the same period.

Despite the remarkable progress, the point is, much remains to be done:

1. There still is a freight car shortage during the peak shipping seasons for most commodities.
2. Two of the three primary causes for railroad accidents are insufficient maintenance of way and antiquated equipment. The third is human failure.

Far greater amounts of capital are required if the industry is to make headway in these areas. For that reason, the exemption of the railroad industry, if the repeal of the 7-percent investment tax credit is enacted, is mandatory in our judgment.

Our experience, as suppliers, clearly indicates that the railroads would cut back in expenditures without such a financial inducement.

Look at what happened when the credit was suspended in October 1966.

The effect on railroad buying was immediate and catastrophic. To find out exactly how bad things were, RPI made a survey of our industry. We compared orders for the first quarters of 1967—after the loss of the credit—to orders for the first quarter of 1966—when the credit was in effect.

The survey showed an alarming drop in railroad purchases of capital equipment. There are the figures.

PERCENT DECREASE IN ORDERS, FROM FIRST QUARTER 1966, TO FIRST QUARTER 1967

Locomotives: Eighty-six percent down—475 units in 1966 to about 70 units in 1967.

Freight cars: Sixty-five percent down—about 26,000 to about 8,500.

Components: Sixty percent down.

We do not know of any other major industry which was hit nearly that hard by the loss of the investment credit.

We have not yet fully recovered from the disastrous effects of that suspension. Four manufacturers substantially went out of the freight car making business. Other companies were forced to close down production lines and lay off many thousands of workers, in plants all over the country. Many of these workers are highly skilled craftsmen who are eagerly sought after in other metal-working industries. They found good jobs outside our plants.

The loss of experienced labor, in itself, tends to create inflationary pressures. So if controlling inflation is the reason for repealing the 7 percent tax credit, we shouldn't do it. Let me explain:

1. Typically, we are unable to rehire people that are laid off—they seek new jobs which offer steady employment. The costs to rehire are high. In my own company's case, we have attempted to rebuild our hourly work force from 1,000 to 1,600—a net increase of 600. We have interviewed over 6,000, employed over 2,500 and yet today have less than the 600 we need. The hiring and turnover cost has to be passed on to the customer—an inflationary pressure.

2. Even when new-hires stay with us, inexperienced people are significantly less efficient, thus our unit costs rise. So the prices we charge tend to rise, more inflationary pressure on our customer.

3. We accelerate our capital spending for labor saving devices to offset the inefficiency, again more inflationary pressures on the economy in the short run.

4. In addition, tax revenues decline because of lower profits.

Therefore, we in the supply industry take strong exception to a repeal of the 7-percent investment tax credit without an exemption for the railroad industry.

We must remember that the railroads in this country are now fighting for their economic lives. They are caught in a vicious spiral of rising costs.

The volume of traffic, in billions of ton-miles, is going up. Operating revenues are going up. But operating costs, especially labor costs, are going up faster.

As a result, railroad earnings are squeezed razor thin. The rate of return on investment, after depreciation, for the industry as a whole in 1968 was only 2.44 percent. The year before it was 2.46 percent. Further, the net working capital of the industry has declined by about a half billion dollars, and the equipment debt of the carriers has increased by about $1½ billion in just the last 5 years.

The best hope for survival as privately owned companies is to cut costs and improve service to the Nation's shippers. To do that, the railroads must completely modernize their freight cars, locomotives, roadways, and all other facilities.

We stress that you can't "turn on and off" the railway supply industry. Every time a significant reduction in equipment purchases occurs, and we are predicting it will again if the 7-percent investment tax credit is repealed, it takes many months to rebuild the industry at a frightful cost. Delays and higher prices are inevitable. In some cases, productive capacity is permanently lost.

In view of the freight car shortages around the Nation, are we going to encourage further cutbacks in our freight car manufacturing capabilities?

If railroad safety would be aided by increased maintenance of way and newer rolling stock, are we going to discourage investment which could increase safety?

Little has been said of the long-term transportation needs of our Nation.

By the year 2,000 we'll have over 330 million people in the United States and a gross national product of at least half again as large as now.

Our superhighways are crowded, our airways and airports saturated.

The only mode of transportation whose carrying capacity can be readily expanded three or four times, is the railroads. It can be done by running more and better trains over existing right of way.

Billions of new capital will be needed to take advantage of the great opportunity which the railroads offer.

Can we afford to "shut off" railroad investment at this crucial time?

We certainly hope you will see the wisdom of an exemption from repeal for the railroad industry, and the long-range benefits that such a move will produce for all industries, shippers, and consumers.

The railroads are doing a good job now, and under most difficult circumstances. We are proud to be associated with them in serving America. They can do an even better job in the future, if they can obtain enough new capital.

Retention of the 7-percent investment tax credit would contribute a great deal to that goal. Therefore, we urge you to grant an exemption to the railroads, if the 7-percent tax credit is to repealed.

The railroads should be encouraged, not discouraged, to improve their equipment and plants.

In summary, gentlemen, we say this: Help the railroads now so they can serve the Nation better in the exciting years ahead.

We thank the committee for the privilege of appearing before you.

Senator ANDERSON. Thank you very much. The committee is now adjourned.

(Whereupon, at 3:10 p.m. the committee adjourned, to reconvene subject to the call of the Chair.)

(By direction of the chairman the following communications are made a part of the printed record:)

PREPARED STATEMENT OF HON. RALPH W. YARBOROUGH A U.S. SENATOR FROM THE STATE OF TEXAS

Senator Long, members of the Finance Committee: I appreciate this opportunity to testify with respect to my opposition to the extension of the income tax surcharge and my support of a viable alternative—the Excess War Profits Tax.

On May 27, Senator McGovern introduced a separate bill (S. 2277), with my cosponsorship, to establish an Excess War Profits Tax. Later this week he advises me that he will formally resubmit the bill as an amendment to H.R. 12290, deleting entirely the language of Section 2 (income tax surcharge) and substituting the provisions of the Excess War Profits Tax Act. I will be a cosponsor of this amendment.

I support S. 2277 and Senator McGovern's amendment to H.R. 12290 for the following cogent reasons:

(1) By substituting the Excess War Profits Tax for the income tax surcharge the government will suffer no loss in revenue, since the Excess War Profits Tax will yield at least as much (approximately $10 billion) as the income tax surcharge. The amendment which I cosponsor would impose on the taxable income of every corporation, a special levy equal to 37 percent of the excess profits taxable income: that part of income which exceeds the deduction adjustment for tax years 1969 and 1970.

This deduction adjustment, computed according to the 1950 Tax Act formulas, approximates that amount of income which is not attributable to special wartime spending levels. The taxpayer may either deduct the average annual intake for the 4-year base period, 1961–64, or he may deduct a normal return on invested capital, as calculated on the graduated scale of the 1950 act. In any event, no corporation with excess profits under $25,000 per annum is liable for the extra tax under this bill.

(2) The Excess War Profits Tax will have an even more salutary effect in stemming the tide of inflation than the income tax surcharge. We all know that the primary purpose of the income tax surcharge was to combat inflation. To date, the tax and our fiscal policy have failed to accomplish any substantial reduction in inflationary tendencies, largely because military expenditures, which constitute the great bulk of federal spending, have continued to grow. The income tax surcharge is regressive and serves to enhance the impact of the present inequities of our present federal tax system. As long as we are going to continue to spend so much money on the undeclared war in Southeast Asia the best way to effectively cool down the economy is to drain off some $10 billion a year of the excess profit yield produced by the war.

(3) The Excess War Profits Tax is the fairest and most equitable way of securing $10 billion additional revenue for the federal treasury. This tax is not designed to, and will not, draw upon those profits which are a normal yield on capital and ingenuity. For example, the amendment contains special relief for corporations experiencing abnormal growth during the emergency period. As provided by section 1906(a)(3), which empowers the Secretary of the Treasury to make rules comparable to provisions of the 1950 act. These rules would prescribe certain special modifications for nondefense growth industries, for corporations which installed new product lines or new factories during the base period, and for corporations which experienced damaging fires, long-term labor strikes, or other severe abnormalities during the base period.

The Excess War Profits Tax was the policy of our government for World I, for World War II, and again during the Korean War. Each year the war in Vietnam costs the United States over $30 billion—roughly one-sixth of all federal outlays.

I think it is time for American industry, which has enjoyed an unprecedented 33% rise in net after-taxes profits since the combat escalation of 1965, to assume more of the tax burden generated by the war.

Mr. Chairman, on Tuesday, May 27, 1969, I put into the *Congressional Record* the amount of money spent by the government each year on defense contracts from the year 1960 to 1969. This data, from the *U.S. News & World Report* of April 21, 1969, demonstrates clearly the impact of the war's escalation, as follows:

During 1960, $22.5 billion.
During 1961, $24.3 billion.
During 1962, $27.8 billion.
During 1963, $28.1 billion.
During 1964, $27.5 billion.
During 1965, $26.6 billion.
During 1966, $35.7 billion.
During 1967, $41.8 billion.
During 1968, $41.2 billion.
During 1969, $42.3 billion. (estimated).

I also put into the record on that date the amount of money paid by the federal government on prime military contracts, awarded to the 25 largest United States firms during the year ending June 30, 1968. This information was as follows:

General Dynamics Corporation, $2,239 million.
Lockheed Aircraft Corporation, $1,870 million.
General Electric Company, $1,489 million.
United Aircraft Corporation, $1,321 million.
McDonnell Douglas Corporation, $1,101 million.
American Telephone & Telegraph Company, $776 million.
Boeing Company, $762 million.
Ling-Temco-Vought, Inc., $758 million.
North American Rockwell Corporation, $669 million.
General Motors Corporation, $630 million.
Grumman Aircraft Engineering Corp., $629 million.
AVCO Corporation, $584 million.
Textron, Inc., $501 million.
Litton Industries, Inc., $466 million.
Raytheon Company, $452 million.
Sperry Rand Corporation, $447 million.
Martin Marietta Corporation, $393 million.
Kaiser Industries Corporation, $386 million.
Ford Motor Company, $381 million.
Honeywell, Inc., $352 million.
Olin Mathison Chemical Corporation, $329 million.
Northrup Corporation, $310 million.
Ryan Aeronautical Company, $293 million.
Hughes Aircraft Company, $286 million.
Standard Oil Company (New Jersey), $274 million.

These 25 companies got $17.7 billion, or more than 45 percent of the prime military contracts awarded to U.S. firms during the year ended June 30, 1968.

Mr. Chairman, I supported such an Excess War Profits Tax in the 90th Congress. Unfortunately, it failed. It is long overdue. It is the fairest and most honorable way for the American people to pay for the tragic war in Vietnam. It is fairer to put a reasonable portion of the burden upon those who have profited excessively from the war than to put the greatest portion of it on the wage-earner and the salaried worker.

Mr. Chairman, if we fail to adopt this amendment, as I said on the floor of the Senate on May 27, 1969, ". . . we value the profits of the war profiteer higher than the blood of the men fighting and dying in Vietnam."

U.S. SENATE,
Washington, D.C., July 17, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: I am pleased to submit, for consideration by your Committee, a statement on H.R. 12290 prepared for delivery on the Senate floor on

Friday, July 18. In this statement I urge immediate passage of the House-passed bill, as evidence for America and the world that our Government is determined to bring an orderly halt to our ruinous inflation. Immediate passage would bring new confidence in the dollar and dampen inflationary expectations; delay would accomplish just the opposite.

This immediate passage, I submit, should be contemporaneous with a concerted drive for meaningful and comprehensive tax reform. It is estimated that effective tax reform can ultimately produce more revenues than we have gained through the tax surcharge. We owe tax reform to the millions of patient American taxpayers who have been asked to shoulder the burdens of the inflation-generating policies of the past Administration and of the inequitable tax structure written into the Internal Revenue Code. The time for tax reform has come, and I note with much interest and satisfaction the concrete progress which has been made on this subject in your Committee. I pledge myself to support the work of your Committee in formulating meaningful tax reform proposals, and I have prepared a number of tax reform provisions for your consideration.

I believe tax reforms must come, and promptly, and in this spirit I have offered in my statement a sense of the Congress rider to H.R. 12290 which would commit the Congress to enact such reform as soon as possible, and in any event, before the end of this session. I hope that your Committee will give serious attention to this rider as a responsible course of action to dampen inflation and assure American taxpayers that their demand for tax reform will not go unanswered this year.

Sincerely,

JACOB K. JAVITS.

FROM THE OFFICE OF SENATOR JACOB K. JAVITS OF NEW YORK

For Immediate Release—Thursday, July 17, 1969

The following are remarks by Senator Javits prepared for delivery on the Senate floor regarding extension of the income tax surcharge and the passage of meaningful tax reform, Friday, July 18, 1969.

Mr. President: A decision, expressed as that of the Senate Democratic Policy Committee, was announced recently by our esteemed colleague, Senator Mansfield, that would have critical consequences for this nation, for the Administration's battle against inflation, for our international balance of payments position and even for international confidence in the dollar.

I refer to Senator Mansfield's statement that "it will not be possible to bring up the surtax extension prior to July 31." The distinguished majority leader further said that "there is no chance to consider and dispose of a tax bill containing extension of the surtax with the attendant amendments prior to July 31 or for that matter to August 13—the last day before the summer recess." His reason for this is the decision not to bring up the surtax extension until a tax reform measure is simultaneously reported out of the Finance Committee and put on the Senate calendar. This in turn probably means waiting for a tax reform bill to be forwarded to us from the House of Representatives. The consequences of this decision could put off the surtax extension (including such tax reforms as it contains) until the end of this session in December. The Chairman of the Finance Committee, Senator Long, this week has publicly stated "that to act *responsibly* on tax reform measures would require a wait until at least December or maybe until some time next year."

Mr. President, I regret this decision of the Democratic Policy Committee and feel that the indicated delay in the extension of the surtax will worsen the inflationary dangers threatening this nation. Any delay in the extension of the surtax will be seen—by those whose decisions cause inflationary price and interest rate increases—as major evidence that the Congress is not willing to continue to take the steps necessary to halt the inflationary peril. It will also further strain the faith of Americans in the ability of their national leaders in Washington to restrain the spiraling cost of living.

Tax reform is an urgent problem and the inequities of our tax system must be rectified—and in *this* legislative session. I am as committed to these reforms as any Senator and have shown it in my votes on bills and amendments and my introduction of bills over all the years I have been here. And it is my opinion that tax reform is an idea whose time has finally arrived and that it will be legislated in the very near future—it cannot be stopped now. But, if we delay the

urgently needed surtax extension, whom are we holding hostage? We would be holding hostage only ourselves and the nation! The opponents of tax reform will not be intimidated—but encouraged—if the surtax extension cannot be passed except with tax reform accompanying it. The reason is that those on the path of responsibility—including the Administration—know they must have the surtax extension for fear of suffering an even worse penalty than no major tax reform—to wit: more inflation. Those who wish to block tax reform have selfish individual interests and do not carry the same sense of responsibility. Hence, it is we, rather than they, who would be at a disadvantage if a protracted delay on tax reform can really hold up the surtax extension. In short, such a "tieing" strategy would have a reverse and self-defeating effect, exactly the contrary to the Democratic Policy Committee's view as to its effect.

According to Senator Mansfield, the Democratic Policy Committee based its view in part on the consideration that "the only impact" which surcharge extension has on inflation is the slowdown effected by removing an added 10 per cent of revenue from the private sector. In this regard, we are told that the Committee felt that temporary extension of the surcharge pending enactment of a combined surtax-tax reform package "has the same effect on the economy as immediate passage" of the surcharge.

The key to the situation as outlined by Senator Mansfield is found in his use of the words "the only impact" and "has the same effect." In other words, if the temporary extension of the surtax is equivalent in the eyes of the American people, the American investors and the international community to immediate passage of the surtax, and these people act accordingly, then the Democratic Policy Committee is right. But if this is not so, and people are left in doubt by the proposed timetable and even question whether the surtax will be examined at all, then it is wrong and bad policy. I believe the latter to be the case and therefore urge that the surtax be promptly extended based upon the House-passed bill.

As supporting proof I point out what has happened in the financial and stock markets, which are depressed and demoralized due to what they consider to be uncertainty as to our determination to halt the inflationary spiral—one major evidence of which is delay in extending the surtax. I point also to the harmful effects upon the economy of the delay of the Johnson Administration in recommending enactment of the surtax until almost a year after the economic indicators showed that the cost of the war in Vietnam made a tax increase critical to the health of the economy. Finally, I ask members themselves to ascertain the views of U.S. and world business and financial leaders and economic thinkers and I believe they will find the overwhelming sentiment favors immediate extension of the surtax as the principal step we must take now to sustain world confidence in our determination to restrain inflation and keep the dollar strong.

I realize fully the frustrations that many of the citizens of this nation are feeling. These frustrations are reflected in the Congress. The previous Administration, after following a guns and butter policy since 1965, then fed the expectation that passage of the surtax would cool the inflationary fires which are so rapidly consuming our incomes. Almost a year has passed since the passage of the surtax, but we still have seen little relief from rising inflationary pressures. I can understand that our burdened taxpayer may have the feeling of being deceived—a feeling that the extra tax he is paying is not having any effect on halting the price spiral affecting the cost of food, meat, gasoline, services and rent and mortgage interest, just to mention a few. I can understand the "tax revolt" particularly when the income of most Americans is being chipped away from both ends—for continued high taxation on one hand and by burgeoning price spiral on the other.

Inflation has forced the fixed income pensioner to lower his standard of living. It has forced young families in this most productive of nations to forego essential purchases. It has priced the single-family home—one of the vertibrae in the backbone of our democracy—out of the range of many families.

However, I would urge the consumer, who encompasses all of the American people, and this Congress, to give the surtax a fair deal. For, one cannot reverse overnight the problems resulting from the policies of the past. Failure to integrate this nation's fiscal policies with the restrictive monetary policies presently being followed by the Federal Reserve System will have most undesirable effects. Monetary policy alone cannot succeed in repressing the severe inflationary pressures facing the economy.

This inflation, which is the key problem facing our economy, must be curtailed. It is for this reason that the surtax must be extended now.

So let us get on with this urgent task. And, once this temporary measure has been extended—and I emphasize the surtax *is* a temporary measure—let us move on at once to tax reform. We all know now that the mood of this Congress will brook no slowdown on tax reform once it has committed itself to the taxpayer with the surtax extension—indeed, that is the very way to speed up tax reform.

Last year, at my own insistence, a tax-reform provision was included in the surtax bill when it passed the Congress and became law. It read as follows:

"Not later than December 31, 1968, the President shall submit to the Congress proposals for a comprehensive reform of the Internal Revenue Code of 1954."

Pursuant to that provision, the outgoing Johnson Administration made public in January, 1969, certain tax reform proposals, notwithstanding that in the first instance they were made under a seal of confidence to a few Congressional leaders. Subsequently, the Nixon Administration sent its own complete tax reform package up to the Hill. The Ways and Means Committee is actively considering tax reform and some of its proposals have been made public and the Finance Committee is about to start on this subject next Monday. The Democratic Policy Committee is committed to it. It seems clear that we will have tax reform, and soon, and to insure such action, I am proposing that there be added to the surtax extension bill now before us the following sense of Congress resolution:

"It is hereby declared to be the sense of the Congress that passage of this Act commits the Congress to consider and enact meaningful tax reform at its earliest practicable opportunity and in any event before the close of the first session of the 91st Congress."

I shall offer this resolution for inclusion in the surtax extension bill as an amendment before the Finance Committee and, if rejected there, then in the Senate so that it will help speed enactment of the surcharge and provide a concrete commitment to the millions of American taxpayers who look to their representatives in Congress to establish equity and justice in our tax structure and to safeguard the economy of the nation.

Statement of Hon. Alan Bible, a U.S. Senator from the State of Nevada, and Chairman, Senate Small Business Committee

Mr. Chairman and Members of the Committee, I am grateful for the opportunity to appear and present the case for retention of a partial investment tax credit limited to truly small business companies, partnerships, individual and farm enterprises.

On May 20, I submitted a statement to the Committee on Ways and Means in behalf of myself, as Chairman, and Senator Javits, as Ranking Member, of the Select Committee on Small Business. We advocated continuation of the tax credit up to $25,000 of investment with a cut-off of these benefits for corporations earning more than $1 million in income. With the Committee's permission, I would like to file that statement for the record, along with a draft amendment to H.R. 12290, which would effect this result, and go on to summarize what I believe to be the salient points in its favor.

Important in today's inflationary environment is the fact that small business accounts for a very minor share of the tax credit claimed and awarded. According to calculations based upon Internal Revenue Service figures set forth in Appendix I to my statement, the overwhelming majority of small firms[1] altogether accounted for only 3.7% of the tax credit in 1965, the latest year for which full data are available. In the smallest category, there are 486,000 corporations, and the average tax credit per return was $207 for an aggregate of $64.1 million. Extending the continuation upward to a level where the average credit approximates $25,000 in investment would, as nearly as we can determine, account for at most a bit over 9%.

In contrast, the 377 largest companies[2] alone accounted for more than one-half of the total credit—53.6%—with an average credit per firm of over $2.4 million, and an aggregate approaching $1 million in 1965.

From this evidence there is no question in my mind that preserving the investment tax credit for small firms would have little or no inflationary consequences.

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[1] Defined for this purpose as earning less than $25,000 and therefore not subject to the corporate surtax.

[2] Classified in Appendix I as earning over $1 million each.

This is corroborated by examination of the picture of commercial lending. According to the Federal Reserve, (See App. II) the percentage of bank loans absorbed by the largest loans—over $1 million—is 54.6%, a figure almost identical to the giant companies' share of the tax credit. Again, the small business activity as measured by loans under $100,000 accounted for 82% of the number of loans made, but only 12½% of the dollars. In this connection it was interesting to note the press reports of the recent bankers meeting here in Washington which suggested that it was as few as 50 or 60 of the largest corporations who were exerting the bulk of the inflationary pressures on the economy by their borrowing and investing policies.

I think this makes it clear that the great number of small firms across this country are *not* the moving force in this inflation, but its victims. To the extent that the investment tax credit is generating inflationary pressure, my proposal would relieve more than 90% of it.

On the other hand, the benefits of retaining a small business credit would be disproportionately large. It is well known that new and small firms are normally under-capitalized. A small, local, or family firm or any company with a new product and without a proven track record is simply not in a position to compete for credit with large national corporations.

In 1969 their financial problems are becoming acute as a result of the credit squeeze which has been front-page news all year. On one side are the escalating bank interest rates. With the prime rate at 8½% and including the requirement for compensating balances, the best corporate customers are paying an effective interest rate of 10.6%. Small firms are scaled up a point or higher.

On July 9 two witnesses testified before the Senate Banking Committee on the problems of obtaining funds to modernize meat-packing facilities before the deadline imposed by the Wholesome Meat Act can put them out of business in December. One mid-western firm expects to pay 12%. A substantial Atlanta firm had been unable to find financing at any rate, after trying for about a year. These are indications of how stringent conditions are in the private money market today.

If the small businessman should turn for help to the SBA—an agency created by the Congress to be the lender of last resort in periods such as this—he finds that the White House has cut the business loan program by 58½% below amounts approved by both Houses of Congress for fiscal year 1969. He finds this program virtually shut down, with applications accepted during less than ten days since the first of this year. Further details on these points, and the equally dismal outlook for next year's SBA lending levels, are contained in my remarks of June 25, which will be attached as Appendix III for the convenience of the Committee.[3] I understand that the Senator from South Dakota (Mr. McGovern) will review the parallel credit squeeze on farmers and ranchers.

With these two forces exerting pressure on the small business community, it would create a triple hardship to deprive small firms of the investment tax credit at this juncture.

On grounds of equity and fair play, it is puzzling to me that the Treasury Department is opposing the credit for small firms while at the same time expressing no opposition to the special privilege exemptions for one giant aircraft firm and one-half dozen pipelines companies. Press reports of these provisions are attached as Appendix IV.

Beyond these immediate and compelling factors are the longer term advantages which continuity of the investment tax credit would bring to small firms, the free enterprise system, and our entire economy.

A concise explanation was made by the Machinery and Allied Products Institute, contained in my formal statement:

"In view of the tightness of the domestic labor market and the pressures of international competition, we consider it essential to the continuing improvement of our industrial capacity that every means be used to facilitate the introduction of cost-cutting equipment. In recognition of this point, it is of interest that the Department of Commerce staff . . . recommended . . . (in mid-April, 1969) . . . 'that consideration be given to increasing the credit, to perhaps 14 percent, for 'trade-sensitive industries or for all industry.' " Although conceding that such a step "would have to be weighed against the loss of U.S. tax revenue" and other economic considerations, the report observes that 'increasing the credit

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[3] Appendix III. Senator Bible's speech on the Senate Floor (Congressional Record, p. S 7182, June 25, 1969) is made a part of the official files of the committee.

would provide a powerful added incentive to modernize manufacturing plants and could significantly increase U.S. competitiveness in international trade both on the import and export sides.'" [Emphasis supplied by the writer.]

The statistics gathered by McGraw-Hill on the upgrading of machine tools in this country, as explained further in the statement, demonstrate that our smaller plants have been the fastest to make use of the investment tax credit and are therefore best prepared to meet and set the terms of competition, both in our home markets and in international trade.

As the Committee knows, two-thirds of all business financing is from retained earnings. Because of this, any measure which the Government can take to improve internal cash flows for small firms is doubly important. In this light, the investment tax credit takes on a particular significance for small businesses, allowing them to retain the growth capital they vitally need from funds which they have already earned. Preserving the credit for small firms would assist the companies that need the help most and its effects would faster increase growth and competition in every industrial classification.

Mr. Chairman, the foregoing information has persuaded me and many of my small business-minded colleagues that the principle of continuing the investment tax credit for small business is a sound one. As to the level and conditions, I would feel quite flexible. I am pleased to join with Senator Sparkman, Senator McGovern, and all other Senators who have expressed an interest in this matter in recommending that the investment tax credit could be preserved for truly small businesses. By agreeing upon a common provision, the Congress could, at little cost, make it possible to assure great benefits for our economy, our system of free enterprise, and the U.S. position in international trade.

(Attachments to Senator Bible's statement follow:)

AMENDMENT INTENDED TO BE INTRODUCED BY SENATOR BIBLE

To continue the income tax surcharge and the excise taxes on automobiles and communication services for temporary periods, to terminate the investment credit, to provide a low income allowance for individuals, and for other purposes, viz: Page 8, line 15, after "property" insert "and property to which subsection (e) applies".

Page 20, line 11, strike out the closing quotation marks and after line 11 insert the following:

"(e) Small Business Exemption.—

"(1) In general.—In the case of section 38 property (other than pretermination property)—

"(A) the physical, construction, reconstruction, or erection of which is begun after April 18, 1969, or

"(B) which is acquired by the taxpayer after April 18, 1969,

and which is constructed, reconstructed, erected, or acquired for use in a trade or business, the taxpayer may select items to which this subsection applies to the extent that the qualified investment for the taxable year attributable to such items does not exceed the small business exemption limitation (as determined under paragraph (2)). In the case of any item so selected (to the extent of the qualified investment attributable to such item taken into account under the preceding sentence), subsections (a), (c), and (d) of this section, and section 46(b)(5), shall not apply.

"(2) Limitations.—For purposes of paragraph (1), a taxpayer's small business exemption limitation for any taxable year is $25,000, reduced by the sum of—

"(A) the amount of the taxpayer's qualified investment for the taxable year, determined before the application of this subsection, and

"(B) the amount by which the taxpayer's taxable income for the taxable year exceeds $975,000.

"(3) Special rules.—

"(A) Married individuals.—In the case of a husband or wife who files a separate return, the $25,000 amount specified in paragraph (2) shall be $12,500, and the $975,000 amount specified in such paragraph shall be $487,500. This subparagraph shall not apply if the spouse of the taxpayer has no qualified investment for, and no unused credit carryback or carryover to, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

"(B) Affiliated groups.—In the case of an affiliated group, the $25,000 amount and the $975,000 amount specified in paragraph (2) shall each be reduced for each member of the group by apportioning $25,000, and $975,000 among the members of such group in such manner as the Secretary or his delegate shall by regulations prescribe. For purposes of the preceding sentence, the term 'affiliated group' has the meaning assigned to such term by section 1504(a), except that—

"(i) the phrase 'more than 50 percent' shall be substituted for the phrase 'at least 80 percent' each place it appears in section 1504(a), and

"(ii) all corporations shall be treated as includible corporations (without any exclusion under section 1504(b)).

"(C) Partnerships.—In the case of a partnership, the $25,000 amount and the $975,000 amount specified in paragraph (2) shall each apply with respect to the partnership and with respect to each partner.

"(D) Other taxpayers.—Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by sections 46(d), 48(e), and 48(f) shall be applied for purposes of this subsection."

APPENDIX I

CORPORATIONS REPORTING INVESTMENT TAX CREDITS-NUMBER OF RETURNS, AND INVESTMENT TAX CREDITS, BY SIZE OF INCOME TAX (BEFORE CREDITS), 1965

	Investment tax credit				
Income tax classes (before credits)	Number of returns total	Total (Millions)	Average per return	Percent distribution of total ITC	Average net income (firms with investment tax credit)
Total	687,484	$1,716.3	$4,693	100.0	$188,323
Under $5,000	486,503	64.1	297	3.7	7,631
$5,000 to $10,000	85,844	47.7	847	2.8	26,198
$10,000 to $15,000	26,465	25.2	1,336	1.4	39,243
$15,000 to $20,000	16,389	20.4	1,655	1.2	50,706
$20,000 to $25,000	11,077	16.8	1,927	1.0	63,178
Subtotal	626,278	174.2	558	10.1	16,141
$25,000 to $50,000	25,506	48.1	2,268	2.8	90,095
$50,000 to $100,000	15,937	46.4	3,315	2.7	165,904
$100,000 to $250,000	10,907	67.1	6,709	3.9	354,215
$250,000 to $500,000	4,076	57.3	14,953	3.3	779,827
$500,000 to $1,000,000	2,133	62.1	30,561	3.6	1,575,197
$1,000,000 to $10,000,000	2,270	340.4	153,610	19.8	6,171,525
Over $10,000,000	377	920.4	2,480,862	53.6	97,542,857
Subtotal	61,206	1,542.1	1,189,200	9.9	1,189,517

Source: "Statistics of Income, Corporation Tax Returns, 1965" (table 12), Internal Revenue Service.

APPENDIX II

DISTRIBUTION OF BUSINESS LOANS, FEBRUARY 1969

	Size of loan					
	$1,000 to $9,000	$10,000 to $99,000	$100,000 to $499,000	$500,000 to $999,000	$1,000,000 and over	Total
Amount of loan (millions)	$49.3	$421.6	$793.3	$948.2	$2,118.2	$3,880.0
Percentage of dollars	1.27	10.86	20.44	12.83	[1] 54.58	
Number of loans	12,800	13,600	4,100	800	900	32,200
Percentage of number	39.75	42.23	12.73	2.48	[1] 2.79	

[1] Percentages may not add due to rounding.

Source: Federal Reserve Bulletin, June 1969 table A 31, "Bank Rates on Short Term Business Loans."

(The following communication was submitted to the committee by Hon. J. W. Fulbright, a U.S. Senator from the State of Arkansas:)

MEMORANDUM OF THE BERMEC CORPORATION, NEW YORK, N. Y., ON ADVERSE CONSEQUENCES OF PROPOSED TAX LEGISLATION AFFECTING FARMERS

The House Ways and Means Committee has recently issued tentative decisions with respect to proposed changes in the Federal income taxation of farm and ranch operations. If adopted, these proposals would adversely affect Bermec Corporation (a New York Stock Exchange listed company of which I am Chairman of the Board), inflict substantial losses on our many stockholders and endanger our very existence. Moreover, they would seriously harm the farming industry generally and cattle breeding in particular, causing substantial losses to present herd owners. Finally, they would deprive the farming industry of access to outside capital and would result in the withdrawal of millions of dollars now invested in farming.

While Bermec's farm operations are primarily in the area of quality cattle breeding, the devastating impact of these proposals would also hit every other branch of the farm industry. It should be noted at the outset that Bermec's farm income is substantially *all ordinary income* under present law, so my principal concern is *not* for Bermec's own taxes.

The production of quality breeding cattle requires, among other things, careful selection of breeding stock, accurate record keeping, the application of scientific methods and sophisticated programs of quality control, all of which are not economically feasible for the ordinary rancher. The quality breeding cattle industry has stepped in with large amounts of capital to provide these services.

The quality cattle breeding industry provides substantial economic benefits not only to the consumer who gets better meat at lower costs but also to ranchers who utilize the vastly improved cattle to improve their own herds and to produce more and better beef at less cost. For example, American beef cattle today provide three times as much beef per animal than the Texas Long Horn of only 70 years ago.

The quality cattle breeding industry could not have developed such improved cattle without massive infusions of investment capital, and the progress of the industry cannot continue unless adequate investment capital remains available. The use of scientific methods and professional management techniques and the ability to purchase the highest quality animals as herd sires require an amount of capital which is unavailable to the ordinary livestock operator.

As an indication of the magnitude of the capital investment required in the quality cattle breeding industry, consider Bermec's investments over the past few years:

1. Bermec paid over $40 million for Black Watch Farms.
2. The farm has invested well over $2 million in land, buildings and modern equipment and fixtures.
3. The farm has over 85,000 acres of ranch land, either owned or leased for purposes of maintaining the herds owned by us or herd owners.
4. The farm spends millions of dollars a year in wages and salaries and millions more for supplies such as feed, fertilizer, etc.
5. The farm spends substantial sums on its research facilities for the purpose of continuing to develop better animals, etc.

The quality cattle breeding industry must compete for investment capital with other industries which are seeking investment resources. There are substantial economic risks inherent in an investment in livestock, including rate of production, disease, accidents and infertility. But, the present tax proposals for farming, particularly EDA (Excess Deduction Account) have no counterpart in other industries and therefore their adoption would be grossly inequitable.

Any change in the tax laws which adversely affects potential investors in the quality cattle breeding industry without comparable effects on other industries competing for investment dollars would be manifestly unfair.

Thus, an investor in an oil venture can deduct his intangible drilling costs currently, but is not required to reduce his depletion allowance in subsequent years. Similarly, an investor in a Subchapter S corporation is not required to offset his corporation's capital gains with his share of corporate losses. Investors in oil, real estate and other industries would thus have an advantage over investors in farming.

Before adopting the current farm proposals. I believe the Congress should pause and consider both the economic effect such proposals would have on farming and the unfairness of singling out for adverse tax treatment one of many

31-701—69——30

competitors for risk capital. As an alternative, I would suggest that tax reform could be better accomplished by broadly based changes which would affect all industries equally.

If you desire, I or a representative of mine, would be pleased to meet with you or a member of your staff to discuss these matters in detail.

(The following communication was submitted to the committee by Hon. Hiram L. Fong, a U.S. Senator from the State of Hawaii:)

MAYTAG DOMESTIC AND COMMERCIAL APPLIANCES,
Honolulu, Hawaii, May 1, 1969.

Hon. HIRAM L. FONG,
U.S. Senator, Washington, D.C.

DEAR HIRAM: Pursuant to our past correspondence regarding the repeal of the Investment Tax Credit.

I should like to testify that, in my view, small business should be exempt from any repeal. I would hope that my opinions on this matter are worthy of your passing along to the proper committee. I can cite only as a repeal would adversely effect my activities.

We are presently engaged in an expansion of building a chain of self service laundries. Careful marketing research has proven a need for this community service type business. This is especially true in Hawaii. Here we serve not only locals but tourist who visit on a limited budget.

We build these laundry stores on speculation. That is we obtain a lease, improve the property, install the equipment and then sell the business as a package to an investor.

This investor is normally a highly qualified person who normally could not start his own business because of limited cash or other reasons. We are able to arrange financing for people of good character and of good, though limited, credit standing.

An average laundry is sold to the investor for about a low of $50 000 to a high of $80,000. His cash investment ranges from a low of $10,000 to a high of $25,000.

In the cost of an average laundry store there is about $30,000 in equipment and the balance is improvements, engineering fees and utility deposits.

These stores normally are in locations where we can obtain not less than a ten year lease. The equipment life runs from eight to ten years, when properly maintained.

The high gross monthly income to be expected is not over $3,500. The net after expenses, before taxes, is about $500 per month while his equipment note is being paid. This is normally over a three year period.

Thus you can readily see—his present Investment Tax Credit plus his depreciation schedule is urgently required. Without these benefits he would find better areas for investment.

Most of our investors are men employed in other occupations, pilots, attorneys, doctors, etc. They, therefore, usually employ part-time or even full time attendants and caretakers. A typical laundry will have two or three employees. Employees who are unskilled for high level employment. People who most likely are unemployable in other areas.

The tremendous growth of well designed, professionally engineered self service laundries is proof of their need in cities throughout the nation. The 7% Investment Tax Credit is greatly responsible for investors engaging in this industry. A slow down would stop production of hundreds of thousands of washers, dryers, air conditioners, dispensers, carpets, water heaters, etc. Building trades would be effected. Store space would not be rented and so on.

Please give every consideration to exempting small business from the Investors Tax Credit repeal.

Very sincerely yours,

LEE GRAY.

INTERSTATE COMMERCE COMMISSION,
Washington, D.C., July 11, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN LONG: This is in reply to your request for the views of the Interstate Commerce Commission with respect to the President's proposal to

extend the present income tax surcharge and to repeal the 7% investment tax credit. You specifically request our views as to the effect of this proposal on the domestic surface transportation carriers subject to the Commission's jurisdiction. These carriers include interstate railroads, motor carriers, water carriers, feight forwarders and oil pipeline companies.

The Commission fully recognizes and appreciates the seriousness of the problem of inflation and its effects on our Nation's economy which the President's proposal is designed to alleviate. In this context, it is our understanding that the Committee desires only an objective statement from us with respect to the effect that an extension of the tax surcharge and repeal of the 7% investment tax credit would have on the various segments of the surface transportation industry over which we administer some degree of regulation.

From the information available to us, it is apparent that enactment of these two measures will result in a material reduction in carrier income available for capital expenditures, particularly for the railroads. The representative associations of each mode subject to our jurisdiction undoubtedly will furnish the Committee with their own estimates of the effects of these two proposals as to their particularly industry along with appropriate supporting data. We, therefore, will not burden the record before your Committee with substantially the same information which we receive routinely from Commission-regulated carriers or carrier associations. If it would be of help to the Committee, we, of course, would be happy to review whatever information is given to you by the carriers or their associations and provide you with our comments on it.

As for exemptions from either of these two proposals for the surface transportation industry, we believe that, if the Committee feels that any exemptions are appropriate, consideration be given to exemptions only for those few types of railroad freight cars, such as boxcars, for which the supply does not meet demand.

We appreciate your giving us this opportunity to present our views on this matter.

Sincerely,

VIRGINIA MAE BROWN, *Chairman.*

THE DETROIT EDISON CO.,
Detroit, Mich., July 14, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: This statement is submitted to call your attention to the inequity that will result unless the "phaseout" rule of proposed new Code Subsection 49(d) contained in Section 4(a) of H.R. 12290 is not deleted.

Prior to the proposed investment credit repeal date of April 18, 1969 The Detroit Edison Company made irrevocable commitments for or started construction on new electric generating plant and equipment needed to serve our customers and to enable this Company to comply with air quality and other environmental laws of this State. Of necessity, orders must be placed and construction must begin on such plant and equipment some 5 years or more in advance of the service date.

The House of Representatives has recognized in H.R. 12290, as it did during the suspension period, that taxpayers should not be denied the credit where a substantial commitment had been made prior to a change in the law. For this reason the House of Representatives adopted a series of exception rules almost identical to the suspension period exception rules. If the House had stopped at this point I believe all would agree that the rules were fair and equitable. However, the House then added proposed Subsection 49(d), which proceeds to negate the equity so painstakingly preserved by the rules that preceded it.

The "phaseout" provisions of Subsection 49(d) would reduce the credit on eligible property gradually as plant is placed in service during years 1971–74 and entirely if placed in service after that date. There is neither logic nor fairness in switching the right to the credit from the commitment date to the completion date. The potential credit came into being when the taxpayer made his irrevocable commitment and it is the law and the credit provision in existence at that time which should control and not some later law enacted when the taxpayer could no longer change his business plans.

I submit that HR 12290 in its present form discriminates against our Company and those similarly situated. I therefore respectfully urge that proposed new Code Subsection 49(d) be deleted from the Bill.

Respectfully,

WALKER L. CISLER,
Chairman of the Board and Chief Executive Officer.

INSTITUTE OF SCRAP IRON & STEEL, INC.,
Washington, D.C., July 9, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

MY DEAR MR. LONG: The Institute of Scrap Iron & Steel, Inc., is the national trade association representing in excess of 1,350 shippers, brokers, and processors of iron and steel scrap and related commodities, and industry suppliers. Since we are actively investing in new equipment to help reduce the solid waste problems facing this nation, and since the investment credit is making possible much of this activity, we have a major interest in the proposal to repeal that provision.

Cordially,

WILLIAM S. STORY, CAE,
Executive Vice President.

STATEMENT OF THE AMERICAN HOTEL & MOTEL ASSOCIATION, SUBMITTED BY ALBERT L. MCDERMOTT

The American Hotel & Motel Association is a federation of hotel and motel associations located in the fifty states, the District of Columbia, Puerto Rico, and the Virgin Islands, having a membership in excess of 6,800 hotels and motels containing in excess of 750,000 rentable rooms. The Association maintains offices at 221 West 57th Street, New York, New York, and at 777—14th Street, N. W., Washington, D. C.

We would like to comment briefly on two sections of H.R. 12290 which propose to repeal the 7 percent investment tax credit and extend the 10 percent tax surcharge.

We have constantly favored sound fiscal policies and have always indicated a growing concern when existing tax law or tax policy threatens to undermine or seriously damage basic foundations which are required to assure a healthy rate of economic growth. We recognize that from time to time certain steps which might appear adverse to the business community must be taken by responsible legislators to bank the fires of inflation. We recognize that we are at a time in history when budget ceilings should be imposed and steps should be taken to slow the rapid rise of inflationary tendencies in the marketplace. We do not feel that the repeal of the 7 percent investment tax credit is the proper remedy to do this or to solve our economic ills.

The 7 percent investment tax credit has played but a small part when the whole picture is viewed in proper perspective in creating the financial problems which now face us. On the contrary, it has served to help small establishments refurbish their enterprises so that they may more properly and successfully compete with large giants who are prepared to build or expand regardless of such a tax inducement. Repeal of the credit in the tight money market would further restrict the efforts of small, old-time existing hotel properties to compete with those larger corporate enterprises who have a substantial amount of funds available for either new construction or expansion. In addition, the investment credit has expanded "job opportunities" to numerous trades whose workers construct and rebuild those items of equipment which are so necessary for the small businessman to purchase in order to update his business property. As a result, we would deeply regret from an overall national standpoint the repeal of the credit which, without a doubt, will contribute to additional unemployment among the members of our work force.

We naturally favor repeal of the 10 percent tax surcharge on corporations and individuals as soon as is practicable. We abhor penalty taxes of this kind. However, we recognize that it might be necessary, in view of financial and economic conditions, to extend this tax for a further interim period. We would recommend that it be reduced to no more than 5 percent for the fiscal year ending

June 30, 1970, both to corporations and individuals. This would place an overall 7.5 percent surcharge for both corporations and individuals on 1969 calendar year returns and it would be in keeping with the "penalty tax" imposed on 1968 returns. Depending on budgetary considerations, tax receipts, and the progress on tax reform legislation, the committee would be in a more favorable position to properly review the need for any further extension of this tax early in the next year.

While we abhor the penalty tax in the form of a tax surcharge, we equally dislike the repeal of tax laws which would tend to increase unemployment. For this reason, we would much prefer to see additional workers on private payrolls employed via provisions such as the 7 percent investment tax credit, who would as a result of such employment be able to contribute a proper share to tax receipts, even though such taxes may include a penalty tax in the form of a surcharge for a limited period of time.

[Telegram]

VISCOUNT CORP.,
Summit, N.J.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: If surcharge is extended without change, interest and depreciation deductions will be worth 10 percent more than without the surcharge. Such increase in tax benefits could contribute to further industrial plant expansion and thereby divert funds from housing and other pressing needs of the economy. Any such consequences would be at variance with surcharge's purpose of damping inflation.

Therefore I suggest that surcharge legislation be tailored to prevent such incentives to expansion by disallowing deductions for interest and depreciation under following circumstances:

(1) Deductions would be disallowed only for purposes of computing the surcharge. (2) Disallowances would apply only as to borrowings and investments made subsequent to an announcement of the proposed provision. (3) Disallowances would not apply to housing and small businesses.

MARTIN J. OPPENHEIMER, *President.*

STATEMENT OF THE TAX COUNCIL SUBMITTED BY JOHN R. GREENLEE, CHAIRMAN, TAX POLICY COMMITTEE

POLICY

1. We support extension of the income tax surcharge at ten percent through 1969, and five percent in the first six months of 1970.

2. With respect to repeal of the investment credit, we recommend that:

a. Repeal be delayed until it can be matched by comparable reduction in the top corporate rate below 48 percent, or if such a delay in repeal is unacceptable, then alternately

b. Comparable reduction in the top corporate rate be incorporated in H.R. 12290 to become effective at a subsequent date.

3. With respect to amortization of air and water pollution control facilities, we recommend that the provision in the bill for five-year amortization be liberalized to permit faster write-offs including deduction of the cost in the year of completion or acquisition at the option of the taxpayer.

4. We support the low-income allowance provided in the bill.

5. We urge that the Congress and the Administration become prepared to quickly inaugurate a program of regular, repetitive steps in reform and reduction of personal and corporate income tax rates when inflation has been contained. Such a program should:

a. Pre-empt a large part of the estimated annual revenue gain of $12 billion;

b. Make substantial cuts in personal tax rates in all brackets with the greatest cuts through the middle brackets to flatten the curve of graduation;

c. Contemplate a top rate of corporate tax below 40 percent; and

d. Provide for temporary arresting of scheduled reductions by Congress if and when the public interest requires.

DISCUSSION

1. The income tax surcharge

The reasons for enactment of the surcharge in the first instance are compelling as regards its extension. As stated by the Committee on Ways and Means in its report on H.R. 12290, ". . . failure to extend the surcharge in 1969 would be likely to nullify the effect on prices the 1968 surcharge otherwise would have had."

2. Repeal of investment credit

The investment credit was recommended to the Congress in 1961 as a tax solution to a non-tax problem, and this concept has remained to this time. Its inclusion in the tax law has tended to blur the distinction between tax solutions to non-tax and to tax problems, to the disadvantage of the latter. This is evidenced by the increasing attacks on such matters as tax treatment of pensions including social security benefits, of transfers of property, and of depletable resources, all of which are solutions to tax problems. It is hoped that repeal of the investment credit will improve the environment for objectivity with respect to the tax-problem provisions.

Despite its history, however, the investment credit should not be viewed as though it is a thing apart from the overall level of taxes on business. In the business community, there are two complementary views on the nature of the credit. The first is that it is in reality a part of the capital consumption allowance which otherwise would be (and apparently will be) seriously inadequate especially as regards international competition. The other view in industry is that the credit has the same value as an equivalent adjustment in tax rates and its affect on investment decisions is simply its rate conversion value.

Whichever view may be preferred, the credit is universally available to business for doing what business would do anyway within the limits of profit opportunities and available capital and hence in essence moderates the impairment by corporate taxation of both of these factors.

For business as a whole, repeal of the credit will be a tax increase of 7–8 percent. Even with termination of the surcharge next year, loss of the credit will mean a return to the level of corporate taxation existing before the top rate was reduced from 52 to 48% in the 1964 legislation. It should be kept in mind, moreover, that acceleration in payment swiped out any general benefit from the 1964 reductions.

Business investment financed from retained earnings is not inflationary, and hence the reduction in tax burdens by the investment credit is not an inflationary factor. Even as the credit is being repealed, it should be recognized that less inflation per dollar of economic growth would result from moderating taxes which limit capital formation. Excessive tax burdens make business investment more dependent on bank credit. When a growth-oriented economy is deprived by taxes of adequate capital, it inevitably will demand more of the credit system that can be delivered without inflation—and in part at least this is what is happening today. We would have less inflation if corporate taxes were lower instead of higher.

Because inflation may have subsided before the increase in tax burdens from repeal of the credit is fully weighted in corporate finances, the safer course would be to delay the repeal until it can be matched by comparable reduction in the top corporate rate below 48%. As a minimum safeguard against overkill as regards corporate investment, H.R. 12290 should provide for comparable reduction in the top corporate rate to become effective at a subsequent date.

3. Amortization of pollution control facilities

Because facilities for pollution abatement or control are non-productive and thus do not generate income from which the capital invested can be recovered, normal tax concepts of capital consumption allowances do not apply in this area. The five-year amortization of such facilities provided in H.R. 12290 would of course be most helpful, but it is an arbitrary and inherently restrictive approach to the problem. There is nothing in tax theory or practice which should inhibit a more flexible policy, down to deduction of the cost in the year of completion or acquisition at the option of the taxpayer.

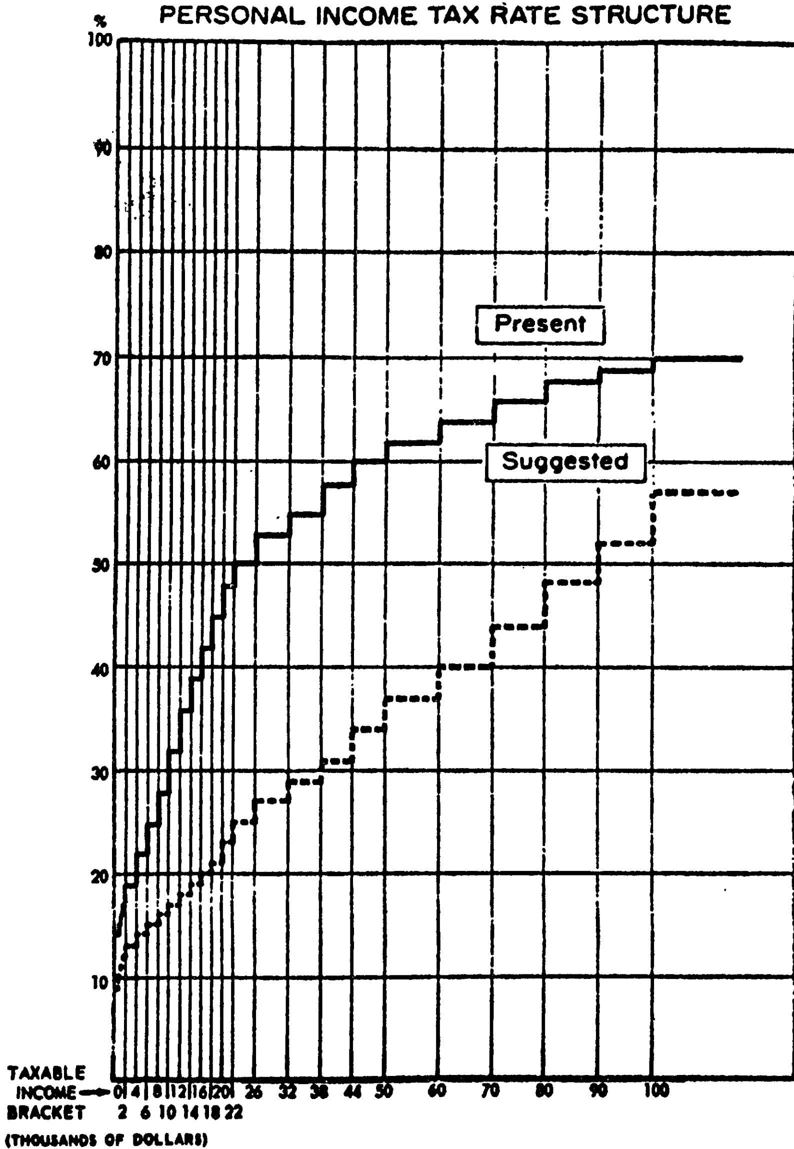
4. The low-income allowance

While we heretofore have given our support to an increase in the minimum standard deduction, we believe the low-income allowance improves on this original concept and we are happy to give it our endorsement and support.

5. Long-range tax rate reform and reduction

Looking back, the present inflation was allowed to come about because it was never fully anticipated in public policy. Looking ahead, the same thing could happen as regards deflation with the nagging problems of too little growth and too much unemployment.

Present and Suggested Rates
(disregarding temporary surcharge)



An encouraging aspect of the contemporary scene is the tendency of political leadership to think in terms of greater reliance on the self-motivating forces of the private economy, but it would be a mistake to believe that the operations of the government do not exert a major influence on these forces. Especially, the maintenance of stable tax rates when inflation has subsided and government costs are decreasing or have leveled out could quickly contribute to an escalating deflation. In lesser degree, there would be a deflationary effect even if government spending were increasing somewhat but at a slower rate than the annual growth of revenue now estimated in the range of $12 billion in a full economy.

In planning ahead, the government can maintain flexibility as regards that part of the estimated revenue growth which is earmarked for tax reduction, but will lose flexibility as regards the part earmarked for spending.

A program of scheduled tax reductions may readily provide for arresting or even temporarily reversing any given reduction, but spending programs do not lend themselves to this kind of procedure. If the Congress judges that the public interest so requires, revenue dollars earmarked for tax reduction may be quickly converted into spending dollars, but the reverse is not so. It is true that earmarking revenue growth dollars for tax reduction will create an obstacle to new spending commitments which has not existed in the past, but it would be a surmountable obstacle whenever the case for spending is clear and convincing.

If the thinking about greater reliance on the private economy is to be confirmed in policy, the place to start is with the overhang of excessive rates of tax on personal and corporate incomes. This is the course which would lead to more growth with less inflation, to ever better jobs as well as more jobs, and especially to the best opportunities for those Americans who to the present have been counted among the disadvantaged.

In its program, the Tax Council stresses the point that the sharply ascending scale of tax rates through the middle and into the higher brackets is both unfair and uneconomic. The scale is unfair because it heavily penalizes effort and contribution in contradiction of the principle of compensation that those who work harder and long and accomplish more should be rewarded. It is uneconomic because it drastically reduces the amount of new capital in the most dynamic hands.

The reform of personal tax rates suggested by the Council is illustrated in the attached chart.

6. Conclusion

While we agree that enactment of H.R. 12290 is of critical importance to removing inflation as a threat to the health of our economy, we believe it would be a mistake to assume that its enactment would alone assure transition to health, non-inflationary growth. Repeal of the credit could have an overkill effect unless the legislation provides an offset for its loss. The time to plan for rate reform and reduction to facilitate achievement of the desired state of growth over the years ahead is before deflation is a current threat.

STATEMENT OF THE DONOR-TRUSTEE, RAYMOND IRVING BISHOP, ARBIS COMMERCIAL HOUSE TRUST

Mr. Chairman and members of the Committee, I am grateful for this opportunity to testify with amendment on behalf of H.R. 12290 a bill which contains the anti-inflationary measures proposed by President Nixon, Chief Executive, United States of America.

As you undoubtedly recall, Mr. Chairman, the Secretary of Treasury, The Honorable David M. Kennedy, indicated the specifications H.R. 12290 as follows:

1. extend the surtax at 10% to December 31, 1969, and phasing out at 5% thereafter to June 30, 1970,
2. deferring for 1 year the reduction in the excise tax on automobile and telephone and teletypewriter exchange services for 1 year,
3. repeal the investment tax credit.

Also there was proposed as a tax reform measure by the President and incorporated into H.R. 12290 with minor changes the Low Income Allowance.

Mr. Chairman, I submit that the economic case for speedy action on these tax proposals appears to be overwhelming. And yet upon examination we see a healthy exuberance that in our listening watching, and following the course of our times we again can see our destiny and our leadership is still most valid.

As we listen, Mr. Chairman, we find that the present statement of the surcharge tax is just not the meat of the American people, for they remember to well "taxation without representation" led to a Boston tea party, and "give me liberty or give me death" of Patrick Henry when a tyrannical power tried to impose its will and tax without representation in finding for its necessity and formulation and collection. Today, to many Congressmen have had this rumbling drummed into their senses and are beginning to realize that there are errors in the formulation of the surcharge tax. One error lies in the fact that the surtax should have been in a monetary policy and not in a fiscal sense. In a fiscal sense the government takes the tax money from the people and pays for a necessity. While in the monetary policy sense the government shows the necessity of moral obligation to pursue the obtaining of certain goals above and beyond the present necessity of the government; but it realizes that moral swasion of good investment of a families or labourers, from a ditch-digger to a chairman of the board, hard earned money that has not been spent on the necessities, services, savings or entertainment.

Thus, then Mr. Chairman, when we accept this fact about the surcharge tax being improperly formulated, then we can begin watching what is going on around its immediate area. It was noted at the beginning that the labourers kept right on spending the same amount by almost completely cutting off the normal bank savings deposit. Good habits prevailed and back up went savings deposits upon having the attraction of banks paying higher interest rates on savings accounts. And then we saw higher bank loan rates to substantial corporations as well as in bank personal loans. But as we watched, Mr. Chairman, we again saw that the labourer demanded and received wage increases that nullified the amount of money taken away originally by the surtax. And so "galloping Gerty" continued to gallop, and "Sir-Tax" tried on his part to rein her in. But the formulation had been wrong, and little cognizance had been taken of history.

Perhaps, Mr. Chairman, as we follow the course of our times we find that moral swasion has developed from the pouting pigeons, cooks, clerks, debutants and diplomats, to the peaceful resistance of Gandhi, King, and Meany, and given final polish by the Hippies and Yippies. Also that our population increase will produce an overwhelming greater number of them much easier to listen, watch, and to follow. Certainly the government of the United States of America can find their ways most useful.

As you may recall, Mr. Chairman, on July 8th, 1969, The Honourable Mr. Kennedy, Secretary of Treasury, testified that he had no further ideas or tax bills on the surtax or on reform measures, nor that he had any powers of persuasion over the banks or the 50 key corporations that are tying up the money market by their demand to date.

Perhaps, Mr. Chairman, some of your committee members may recall the long term spent by Mr. Lyndon Johnson in these halls of legislature, and when as Vice-President, how his great knowledge of the legislature workings, and great art of the use of persuasion made him a truly great Vice-President. The force of law giving a head of agency certain powers is only a small part of leadership. And if our governments financial leaders were to follow the course of our times then their force of persuasion would be an awsome thing indeed. If David would telephone George, and as an ad hoc committee, call upon George and Walter—. I am sure that good government, as the voice of the people, can call upon the persuasive force of the body of the people to draw attention to the necessities of the times. Yes, the office of Secretary of Treasury does have and can modernize by immulation the awesome powers of persuasion; and by the silent marching people can show the laggard corporations that individuals free-wheeling such giants can be brought to task morally, just as well as a driver of an automobile for not watching or listening to the declaimations of the people when driving through a dense crowd.

I agree with those in labor and the Honourable Secretary of Treasury who believes the wait for meaningful tax reform has been "too long", but not in the legislative sense stated by them.

Possibly you are aware, Mr. Chairman, that the United States government has adopted as a ruling force the economic theory that Lord John Maynard Keynes propounded in 1935. As Dr. John Galbraith, stated it in the New York Times Book Review, 19, as follows.

Upon examination, Mr. Chairman, we find that Keynes assumed three things to be true, (1) the labour force was thoroughly trained, (2) the corporations would spend as much as possible in developing the economy; and (3) the state

would supplement the estimated amount by raising and receiving 100% of the face value of government loans from the lending agency or people.

As you undoubtedly know, Mr. Chairman, T.V.A., A.I.D., Appalachia, Marshall Plan, and a host of other government sponsored endeavors great and small are based on the Keynesian Theory. Yet we are still capable of l—f— of Adam Smith, but when such business and industry affects the whole economy then it is conducted by basic regulation to the good of but without regimentation of the whole.

And as you have undoubtedly recognized, Mr. Chairman, the H.R. 12290 investment credit proviso is also part of the Keynesian Theory of economic growth but the way it is constructed and is operated is bastardly to say the least. The investment credit is essentially good and necessary and it would be preposterous to permit it to die. It should be rewritten to follow the course and not in hinderance of our times by its inflationary tendencies. This can be aleviated by having its function within a given economic range, and its operation set on a sine curve assignment of investment credits so the present tendency does not reoccur. This then will permit the continued use of the Keynesian Theory without the regimentation of the business mass.

Mr. Chairman, a like critical judgment could be made of the surcharge tax to bring its function within a given economic range so that it would have a preventative effect on inflationary and deflationary trends through good operational practices. Under the circumstances as donor-trustee, Arbis Commercial House Trust, as the owner of the commercial method, I am not at liberty as a minority trust member to go into it at this moment. However, I should like to point out a commercial offer of the use of this commercial method was made to the British Government on September 1st, 1966, and the United States of America Government was notified as is required by business practice at that time. since a matter of reference by the British to the American, etcetera.

Undoubtedly, Mr. Chairman, you and your committee, realize that tax reform must employ a look at the whole. What, Why, Where, How, and When; and properly based upon a major policy acceptance in economics and finance through the Keynesian Theory. As it now stands in 1969 the Department of Treasury is in the top "Office" money poor and "think tank" poor. In the first instance to many areas of tax return have been removed from the books; and in the second instance The Honourable Secretary of Treasury does not have the learned assistance for conceptual examinations such as the Chief Justice of the United States Supreme Court has at his command in his Associate Justices. Probably the greatest Secretary of Treasury in modern times is The Honourable Douglas Dillon, who could have reached the heights of excellence of his fellow Scotchman, with nearly the same antecedents, the magnificent Alexander Hamilton; *provided*, he had not been bogged down by massive detail with finite asssitance in final analysis, thus leaving little time for considered policy leadership. Unamuno, the great Spanish philosopher, and one of the world's greatest in the early 20th century, was able to provide the able leadership to a small group of other writers and poets of his Country, and lifted their literature from 300 years of mediocrity by the use of "group therapy" five days a week for over 30 years. Their conversations provided the enrichment of the use and expression of language in brilliance, depth, and integrity, to bring forth the techniques of function and operation of their craft, completely satisfying to the mind, the life, the soul, and the spirit of their times.

As for the forgiveness of taxes from people with Low Income Allowance, I submit, Mr. Chariman, it is insulting to their face, and the beginning of a caste system not justifiable by the precepts as I have known them of my Country. Some other means of help or compassion can be had—But Not This!!!

(face: is the act of preserving the prestige or dignity)
(dignity: is the quality or state of being worthy and decent)
(prestige: standing or estimation in the eyes of the people)
(decent: is fitting, proper, honour, or appropriate)

Thank you, Mr. Chairman, and members of your Committee.

MEMORANDA SUBMITTED BY LIPMAN REDMAN OF MELROD, REDMAN & GARTLAN, JULY 15, 1969

I

This memorandum deals with the lease-back provisions of the proposed new Section 49(b)(5).

This section permits the retention of the credit where the party to the binding contract as of the required date transferred his rights to another party who retained the credit but who leased the property back to the original party. The retention of the credit requires that the original party's lease run for a term of at least one year, but it then provides that the credit is subject to the recapture rules "at such time as the lessee loses the right to use the property".

This language may well substantially destroy the availability of lease financing for such equipment as aircraft and presumably other property as well, particularly for lessees who are not prime credit risks and who are in particular need of lease financing. Unlike present law, the credit would be lost in the event of a lessor's repossession because of the lessee's default in a typical, bonafide situation, especially where that default consists of lessee's inability to pay the rent. Moreover, no valid reason exists for this change in prior law. To the extent any effort has been made to justify this change, it is said to be designed to put the lessor in the same position as the owner-operator of the aircraft who has arranged mortgage financing. In the latter instance, if the owner defaults during the period of the mortgage and the investment credit property is repossessed, the owner may lose all or part of the credit.

However, the owner-mortgage case is readily distinguishable from the case of lease financing and there is no reason to change present law which provides for different tax results. First, in the owner-mortgage case, only one taxpayer, the owner, is concerned with the availability of the investment credit; the terms of his financing are not affected by its availability. As a result, the mortgagee's repossession because of the mortgagor's default affects only the mortgagor. Where however lease financing is used, the lessor retains the credit and passes on to the lessee its equivalent through a reduction in rental expense. Accordingly any risk to the lessor of later loss of the credit because of bonafide financial problems of the lessee will affect the lessor's willingness to pass this economic benefit to the lessee.

Secondly, since the owner-mortgagee is the only taxpayer concerned with the investment credit's availability where he is simply a mortgagee, he need not concern himself with the problems of the loss of the credit until he defaults. In the lease financing case, however, the lessor must, at the time of the transaction, contemplate the possibility of recapture. At that point the lessor has several alternatives: first (as already indicated) increase the rent during the first four, six, and eight years to build in a factor for the recapture possibility, and then permit a sharp reduction during the balance of the lease term after that exposure has expired; second, pass the credit through to the lessee and eliminate the otherwise usual reduction in rent; or third, refuse to do the transaction in the first instance. Any of these choices may well effectively destroy the aircraft leasing business.

The major advantage of lease financing involves the savings in cash flow to the lessee. In the normal debt financing case, the owner pays up to 30% of the cost of the aircraft in pre-delivery payments and borrows and pays the balance at delivery. His mortgage will extend over periods varying from 6 to 12 years depending on the type of aircraft and will call for interest ranging from the prime rate up. In the normal lease, however, the lessee need pay no more than perhaps 5% of the aircraft's cost and frequently nothing at all other than the first quarter's rent in advance. Thus, at delivery the lessee receives a refund of the substantial deposit (up to 30% of cost) he previously made. Rent varies with the credit of the airline lessee and the aircraft; leases currently in effect for the Douglas DC–8 and the Boeing 707 type aircraft have interest rates which range generally between 4½% and 7%.

These are obviously cash differences of real significance and represent the important economic value contributed by the leasing companies. Particularly in the case of airlines who have been subjected to heavy cash demands for new equipment at a time when credit availability has sharply contracted, this difference is significant. This difference is even further aggravated by the fact that the proposed statutory change affects not only aircraft purchased currently (and perhaps in anticipation of the repeal) but also aircraft purchased several years ago when the investment credit was thought to be an integral part of the Code.

Furthermore with regard to the "solution" of the leasing company passing the credit to the lessee, that would have the effect of putting the leasing companies in the banking, not the leasing business. This is not their function.

There may be the feeling that this whole concept of lease financing has been abused, for two reasons. One is that it has been the source of considerable tax avoidance—'a legal gimmick'—by individuals who organize a series of limited partnerships. To the extent that that is true, it is not a valid consideration in the case of publicly held corporations engaged in the legitimate leasing business. Second, it may be felt that some of the major airlines have turned to leasing only because they have ample credit carryovers. Not only is this not so—and were it true, they would be seriously jeopardized by the 20% cut-back rule contained in the bill—but also the need to conserve cash has caused the turn to leasing, not any excess investment credit. The large costs of equipment for the new generation of jumbo jets—approximately $22 million for the 747, $18 million for the DC–10 and the L1011 with many airlines still buying the DC–8–63 aircraft at close to $12 million—has created a serious cash flow problem.

To the extent therefore that orders have been placed on or before the effective date of the repeal, it is not sound to decimate that important financing technique in this indirect and unrealistic manner.

To accomplish this, it is suggested that the following be added after line 20 on page 13 of the bill:

". . . unless the party to the contract retains the right to use the property under a lease for a term of years not less than the period which is to be used by the lessor in determining the amount of the credit, and lessee loses the right to use the property pursuant to lessor's repossession of the property in exercise of his rights under the lease."

(If this considered too broad, the following could be added: ". . . because of lessee's inability to pay the rent.")

The explanation in the Senate Finance Committee Report might read as follows:

"Our addition to the proposed new Section 49(b)(5) (line 20 on page 13) is designed to avoid an undesirable result of the House bill, namely, recapture of the credit in a bona fide situation of a long term lease which represents a substantial portion of the estimated useful life of the property, where lessee loses possession by virtue of a repossession by lessor because of lessee's default. Our addition is intended to make it clear that in that kind of a situation, present law continues without change, so that lessor has the same right to retake possession of the property and place it with another lessee or otherwise put it to use, without any effect on the continuation of the lessor's investment tax credit."

II

This memorandum deals with the proposed effective date of midnite, April 18, 1969.

When the Administration first submitted the proposed legislation to the Congress, the effective date for the proposed repeal of the investment tax credit was fixed at midnite, Sunday, April 20, 1969. This was in accordance with the normal rule which calls for the effectiveness of restrictive tax legislation to coincide with the public announcement of the proposal, as for example, the time of submission to the Congress. (There was in fact considerable speculation that the effective date was and should be midnite, April 21, the actual date of submission of the Administration's proposals, to avoid problems involving legitimate business transactions which might have occurred on the business day prior to the hour of submission. In fact, reading of the newspapers would probably establish that April 21 was frequently the date mentioned.) It was only after hearings had been completed by the House Ways and Means Committee that the Treasury Department recommended that the repeal be made retroactive to midnite Friday, April 18, 1969.

The newspapers have since carried a variety of stories to the effect that this retroactivity was designed to avoid later scandals involving certain few persons who had advance "secret" information that the Administration's proposals were to go to the Congress on Monday the 21st and that such persons "beat" the proposed legislation by placing large orders over the weekend of Friday, Saturday and Sunday, April 18, 19 and 20. (It is understood also that in fact Treasury's retroactive proposal was prompted by news that one particular company purchased $900 million worth of Section 38 property on Sunday, April 21, but that further examination disclosed that only $90 million worth of equipment would so qualify.)

In any event, it can be demonstrated without difficulty that the press had been giving considerable emphasis to the Administration's likely proposal to repeal the credit, and that during the entire week of April 14, there was considerable speculation in the press that repeal would be proposed shortly. The key disclosure came at the President's press conference at noon on Friday, April 18: in response to a specific question regarding speculation concerning the investment tax credit repeal, he stated that that subject would be covered in the Treasury's proposals which were to go forward to the Congress on Monday or Tuesday, April 21 or April 22.

In these circumstances, it is plain that no one was required to rely upon inside information. Rather any business man interested in the credit had only to read the newspapers during April to know that recommendation of the credit's repeal could be expected shortly, and he knew no later than Friday April 18 that it would be on Monday or Tuesday, April 21 or April 22, 1969. It is therefore indefensible to maintain that these taxpayers acted on the basis of inside information. There was no need for any.

The evidence which makes this perfectly clear probably also contains the real reason for the proposed date. That evidence involves the amount of orders for Section 38 property which were probably placed during the weekend in question. Obviously the larger that number, the clearer it is that the impeding April 21 repeal proposal was indeed widely known and anticipated. At the same time, however, and by the very same token, Treasury may be concerned about the number of dollars involved in the investment tax credit which would be preserved by these last minute orders. There are two answers to this: it has always been congressional and judicial policy to permit business affairs to be conducted in such a way as to avoid but not evade tax. There is nothing wrong or improper in responding to public information so as to save tax, any more than there is something wrong with accelerating or deferring income so as to have it fall in a "better" tax year, or with deferring sale of capital assets long enough to qualify for capital gains, etc. Absent any inside information problem, weekend business is no different. Second, retroactivity is not normally used to raise revenue. The bill is troublesome in this regard because of other retroactive features, namely the one tenth of one percent attrition rule in the proposed Section 49(d) and the 20% phase-out rule in the proposed Section 46(b)(5). Still another retroactive feature, for the unusual purpose of raising revenue, does not appear supportable.

Regardless of the effective date finally used, some clarification appears indicated in the discussion in the House Ways and Means Committee Report of what constitutes a binding contract. For example, references to the applicability of local law, along with the statement that an oral contract can suffice, do not account for such matters as local statutes of frauds which vary widely between states but which in essence frequently require some type of writing signed by the party to be bound thereby. Technically it can be contended that until that writing has been properly signed and delivered, the party is not bound. Clearly then, if the parties have agreed orally but do not execute and deliver the required writing until a later time, there may well be a serious question as to whether there was a binding contract as of April 18. The question can be illustrated by this actual example:

After consultation between the parties, buyer telegraphed the manufacturer an order for the purchase of four aircraft, setting out the key elements of the purchase, namely, delivery date, configuration (technical specifications, by reference to the same type aircraft already being operated by the buyer), provision for subsequent documentation to take the form of an amendment to the agreement covering the aircraft presently being operated by the buyer, and acknowledgement of buyer's making on that day a non-refundable deposit of $100,000 per aircraft. The payment was in fact made. On that same day, i.e. April 18, the manufacturer prepared and signed a letter addressed to the buyer confirming the key points of the telegram and adding the total price upon which the parties had agreed prior to the buyer's telegram but which had been omitted from that telegram. For the sake of good order, the seller's letter called for the signature of the buyer. This signature was affixed on Sunday, April 20, 1969.

Counsel has advised buyer that subject to the technicalities of the statute of frauds [Florida (the principal office of the buyer) or California (the principal office of the seller)], the buyer was bound by (1) the oral agreemnt with the manufacturer, as confirmed, by (2) his telegram and by (3) his non-refundable down payment, all on April 18, 1969, Counsel has also advised, however, that if

the buyer intends to finance the acquisition of these aircraft through the usual lease financing technique where the lessor retains the investment tax credit, counsel for the lessor might well raise the question involving these technicalities. In these circumstances, this buyer who relied upon information available to him in the public press and who purchased the four aircraft on the assumption that he was entitled to the investment tax credit, would indeed be exposed to severe sanctions.

The following suggestions are advanced for possible inclusion in the Senate Finance Committee Report:

"We agree with the discussion in the Ways and Means Committee Report regarding a binding agreement before the specified date. By way of clarification, however, the reference to local law is not intended to require full adherence to such technical requirements as a local statute of frauds. As long as the parties intended to be legally bound, had in fact reached agreement and can demonstrate that by some documentary evidence, the requirement is satisfied. In this connection it may be important to distinguish between the acts which constitute the making of the contract (for example, oral discussions, telegrams, down payment) and subsequent memoranda which only confirm the earlier arrangement.

"Also we would add a fourth example to the three set out in the last full paragraph on page 23 of the Ways and Means Committee Report, namely that a contract may be considered binding even though it requires subsequent documentation dealing with significant items, such as certain technical specifications as in the case of aircraft. Thus the requirement is satisfied if the buyer orders by telegram on April 18 and the manufacturer responds by letter dated and signed the same day, even though the buyer formally signs the manufacturer's letter on a later day (for example April 20) and even though the parties thereafter sign the usual more formal agreement containing additional provisions.

"In connection with the Ways and Means Committee Report reference to what constitutes a 'nominal' deposit on an option to purchase, it should be added that the custom of the trade may be significant. Where that custom indicates that the amount of cash required varies in part on the buyer's cash position at a particular time, (as for example where the manufacturer may accept a much smaller deposit from the same buyer at one time than at another), then a deposit of $100,000 against a total purchase price of even $12 million would be more than nominal."

STROOCK & STROOCK & LARVAN,
Washington, D.C., July 15, 1969.

Re Fuel Desulphurization, Inc: Proposed Amendment to H.R. 12290, 91st Cong., 1st Sess.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: The Secretary of the Interior, in order to implement the Air Quality Control Act of 1967, issued an amendment to Oil Import Regulation 1 (Revision 5) to add to Oil Import Regulation 1 a new Section 26, the purpose of which is to encourage the construction in District I, which includes the area from Maine to Virginia, of new facilities capable of producing sufficient quantities of low sulphur residual fuel oil to supply the East Coast market. The purpose of the amendment is to further the control of air pollution by providing facilities to remove sulphur at the primary source, to supply low sulphur residual oil for such consumers as power plants, industrial plants, public buildings, and other consumers of residual oil for heat and power.

The Secretary of the Interior deemed it necessary to provide such facilities to enable the consumers of residual fuel oil on the East Coast to meet federal, state, and local air pollution regulations which limit the amount of sulphur which may be contained in fuel oil.

Pursuant to Section 26 of Oil Import Regulation 1, the Secretary of the Interior also issued an import allocation to our clients, Fuel Desulphurization, Inc. to permit them to desulphurize up to 100,000 barrels per day per calendar year of imported residual fuel oil from Venezuela and other western hemisphere sources which naturally contain more sulphur than the Regulations referred to above permit. This allocation was issued on January 9, 1969, and has been affirmed by the new Administration. It is estimated that the desulphurization facilities of Fuel

Desulphurization, Inc., which are now in an advanced stage of design, may require a total investment in excess of $80 million.

Because of the exclusionary language in lines 13 through 22 on page 26 of H.R. 12290, there is now no provision in the Bill to permit the rapid amortization of fuel desulphurization facilities such as Fuel Desulphurization, Inc., and the other holders of import allocations under Section 26 are planning to construct. The desulphurization facilities of Fuel Desulphurization, Inc., will be constructed in the New York-New Jersey metropolitan area, which consumes more than 300,000 barrels of residual fuel oil per day. Under existing Regulations, all of this fuel oil must be low sulphur fuel.

There are presently under construction, or planned, fuel desulphurization facilities in Venezuela and in the Dutch West Indies but it is not anticipated that these facilities will be able to supply sufficient low sulphur fuel from western hemisphere sources of oil production to meet the full requirements of the East Coast area embraced within District I, which is over 1,000,000 barrels per day.

Accordingly, it is respectfully urged that H.R. 12290 be amended to include among the facilities granted rapid depreciation for pollution control new primary facilities designed and constructed to manufacture low sulphur fuel from fuel that contains more sulphur than the antipollution Regulations permit to be burned.

We suggest for this purpose the amendment which is annexed hereto.

Among the reasons why it is necessary to include fuel desulphurizing facilities within the class of pollution control facilities embraced within H.R. 12290 are the following:

1. It is desirable to advance the purposes of the Air Quality Control Act of 1967 by providing facilities constructed in the United States to abate air pollution at the source by removing from fuel produced in the western hemisphere the sulphur naturally contained in such fuel before it reaches the ultimate consumer, including coal as well as petroleum.

2. Facilities to remove sulphur from fuel prior to consumption are new and experimental. In fact, facilities for the desulphurization of fuel oil of the size required to treat large quantities of high sulphur fuel at a single plant have never been constructed in the United States.

3. Recognizing the experimental nature of large scale desulphurizing facilities to remove sulphur from residual fuel oil, other countries such as Venezuela, Japan, and Kuwait have granted rapid depreciation for such facilities as are now under construction in those countries.

4. The introduction of atomic power to replace fossil fuels in the United States is a factor which creates the possibility of rapid obsolescence of fuel desulphurizing facilities, apart from the obsolescence which naturally occurs with the introduction of processes which are experimental in nature.

5. The high capital cost of the large sized facilities required to produce low sulphur fuels in quantity to meet the anti-pollution Regulations involves a high risk factor for the investment required to build such facilities; therefore, a rapid return of the investment is required to compensate for this high risk.

6. The high cost of fuel desulphurization facilities which must of necessity be built on industrial shore-front land in areas such as the New York-New Jersey metropolitan area, includes the necessity of acquiring large parcels of high priced land with terminal facilities to handle large tankers. The disproportionately high cost of land in relation to the total investment, therefore, requires that the machinery and equipment of the facility be depreciated at an accelerated rate.

7. The size of the investment required to construct primary desulphurization facilities in the United States faces competition from naturally occurring low sulphur fuels produced in other parts of the world such as North and West Africa and, therefore, involves a high competitive risk which could not be undertaken by investors without the inducement of rapid depreciation, particularly in view of the very real possibility that additional deposits of naturally occurring low sulphur petroleum may be discovered either in those areas of present production or in other areas closer to the areas of consumption on the East Coast of the United States.

For the foregoing reasons, the proposed amendment to H.R. 12290 is respectfully urged.

Sincerely yours,

WALTER POZEN,
Resident Partner.

PROPOSED AMENDMENT TO H.R. 12290 TO INCLUDE PRIMARY AIR POLLUTION CONTROL FACILITIES IN THE CLASS OF FACILITIES GRANTED RAPID DEPRECIATION

I. On page 25 after line 2, insert a new paragraph (2)* of subsection (d), to read as follows:

"(2) PRIMARY AIR POLLUTION CONTROL FACILITY.—The term 'primary air pollution control facility' means a certified pollution control facility which is designed and operated to remove sulphur or other major atmospheric pollutants from combustible fuels before their delivery to the actual users of such fuels."

II. On page 26, line 14, delete the word "The" and insert the following instead "Except in the case of a primary air pollution control facility, the".

STROOCK & STROOCK & LAVAN,
Washington, D.C., July 16, 1969.

Re Fuel Desulphurization, Inc: Proposed amendment to H.R. 12290, 91st Congress, first session.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On Tuesday, July 15, Mr. Vail, Chief Counsel of the Committee, kindly gave Mr. Scoll of Fuel Desulphurization, Inc. and me the opportunity to explain more fully our concerns with § 5 of H.R. 12290 in its present form and the amendments of § 5 which we have proposed in a letter to you of that date.

At that meeting Mr. Vail asked whether fuel desulphurization facilities such as our client intends to erect are supplemental to or a substitute for the kind of "end of the line" pollution control facilities which the House sponsors of § 5 appear to have had in mind. In answer to that question, desulphurization facilities as such are necessary to remove sulphur from the fuel oil used by industrial consumers and power plants on the East Coast which must have low sulphur fuel oil to meet state and local regulations which are already in effect and are scheduled for more stringent implementation.

For example, the present allowable sulphur limit for heavy fuel oil in New York City is 1% by weight. However, it is contemplated that in the near future Subchapter A of Chapter IV of the Air Pollution Control Act of New York State will be amended to prohibit the construction, installation or modification within the New York City metropolitan area of any combustion installation that is designed for the use of fuel containing more than .2 lbs. of sulphur per million B.T.U. gross heat content (.33 lbs. of sulphur by weight). Furthermore, no fuel that contains more than .2 lbs. of sulphur per million B.T.U. gross heat content may, under contemplated restrictions, be purchased or used by stationary combustion installations in the New York City metropolitan area. The effective dates for these enactments have had to be postponed because heavy fuel oil meeting the .33% sulphur limit is presently not available to industrial and power plant consumers in the New York area.

While there are, of course, other air contaminants which can be controlled by so-called "end of the line" facilities, the fact remains that for the Eastern Seaboard, and particularly the New York area, sulfide contaminants are, by statute and regulation both in New York and New Jersey, already controlled by limiting the allowable amounts of sulphur in the fuel oil itself. The reason for such regulations is that there apparently is no other demonstrably effective method of controlling sulphur contained in gases which are released into the atmosphere from the burning of high sulphur oils. As you may know, Venezuelan and other Western Hemisphere high sulphur fuel oils have been the main source of energy and heat and power installations on the Eastern Seaboard.

In other parts of the country, such as the South and Middle West, high sulphur residual fuel oils are not the problem that they are on the Eastern Seaboard. Where sulfur limits in such fuel are or may be prescribed in these areas, the heat and energy requirements for industrial and electric power plants can be supplied by natural gas, which is cheaper in the South and Middle West than it is on the East Coast, because of the proximity to the sources of production. In fact, the consumption of residual fuel oil in the Middle West is negligible compared to that which is consumed on the Eastern Seaboard.

*Renumber the present paragraphs (2), (3), and (4) of subsection (d) as (3), (4), and (5), respectively.

As pointed out in our July 15 letter to you, processes for the desulphurization of residual fuel oil are relatively new, and the risk inherent in investing in such processes is so substantial that it cannot safely be accounted for by normal depreciation. It is of importance, therefore, that the accelerated depreciation provision of the House amendment be expanded to cover fuel oil desulphurization facilities, to encourage the construction of such facilities in areas where the use of high sulphur oils by stationary combustion plants is prohibited by State statutes and regulations.

Sincerely,

JAMES H. HELLER.

AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.,
July 16, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This statement with respect to the current consideration of the proposed repeal of the investment tax credit is submitted by the Aerospace Industries Association of America, Inc., on behalf of its 59 members, who are the principal manufacturers of aircraft, missiles and spacecraft, their propulsion, guidance systems and related components.

The investment tax credit was enacted to encourage American industry to acquire and maintain a modern, efficient productive capacity as the means of (1) protecting American employment against the in-roads of foreign goods and services, many of which benefit from the tax assistance in reducing prices, (2) providing better products and services at lower prices, and (3) improving the U.S. balance-of-payments by facilitating the production of goods and services for export. The credit has been a major factor in achieving those goals and providing a strong industrial base. Repeal of the credit will necessarily have adverse effects on each of these important national objectives.

The members of AIA are particularly aware of the need to maintain an up-to-date and efficient productive capacity. As principal suppliers of major defense and space systems, and as producers of the aircraft and ground-based equipment used by the domestic and foreign air transportation industry, they are in the forefront of a world wide technological advance. This carries with it continuing requirements both to utilize the most modern research and production facilities and to produce capital goods of the most advanced design for use by others. Because repeal of the investment tax credit will seriously inhibit the ability of these members to maintain necessary technological progress, they are compelled to oppose its repeal.

If repeal is intended to reduce inflationary pressures, it is respectfully submitted that such action may well have a contrary effect. Many of the companies are committed to long-range production programs and there is no way they can avoid acquiring the capital goods needed to discharge their obligation. Moreover, many of the industry's customers such as the airlines are committed to long-range programs to enlarge and improve existing fleets so as to maintain American leadership in the vital air transport system. Thus, repeal of the investment credit will not stop the acquisition of hundreds of millions of dollars worth of equipment. Repeal of the credit, however, will remove a source of cash which these companies have relied on to help finance these acquisitions and will force them to pay higher prices and borrow more heavily in an already tight money market, thereby adding to inflationary pressures.

These problems are intensified by the current Department of Defense policy which compels its suppliers to provide the facilities required to perform defense contracts in ever increasing amounts.

Therefore, the members of AIA respectfully urge that an action which would have such serious adverse impacts on the U.S. economy should not be taken hastily. As a minimum, the members urge that repeal of the investment tax credit not be considered as a matter separate and apart from the complete study and overhaul of the federal income tax laws presently underway in the Congress. The members of AIA believe it to be in the interest of developing sound legislation that this matter be considered by the Congress along with all other proposed changes in tax law so that the composite can be viewed in complete perspective.

Yours very truly,

V. J. ADDUCI.

31-701—69——31

REPUBLIC STEEL CORP.,
Cleveland, Ohio, July 16, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

MY DEAR MR. CHAIRMAN: We are pleased by the opportunity provided by your Committee for us to submit comments on the legislative proposal to repeal the 7% investment tax credit. The investment credit is a matter of vital concern to Republic Steel Corporation and its repeal will seriously affect Republic's capital program.

Although the investment credit has not been completely adequate to place Republic and other members of the domestic steel industry on an even footing with foreign competition, the credit, enacted in 1962 as a permanent incentive to U.S. industries, has significantly aided the steel industry in meeting the vast capital demands made upon it.

The competitive challenge posed by steel imports serves to underscore the importance to the steel industry of the 7% investment tax credit. Repeal of the credit would strike a heavy blow at capital intensive industries such as the steel industry which must continue to spend huge sums for new equipment to compete with foreign steelmakers. Moreover, repeal would seriously penalize Republic and the rest of the domestic steel industry for their efforts to equip this basic industry with the facilities required to serve the nation's economy and vital defense needs. Nevertheless, should the Congress determine that repeal of the tax credit is imperative, we believe some selective exemption should be given an industry in the position in which steel finds itself—namely, with the necessity to continue capital expenditures on a large scale to improve its competitive position against foreign steel producers. Failing that, we believe repeal of the credit should be accompanied by a liberalization of depreciation allowances for federal tax purposes, since, in effect, the original intent behind the passage of the tax credit was to augment depreciation allowances with a vehicle that would enable industries to carry out necessary long-term capital improvement programs.

Notwithstanding the possibility of alternative incentive measures, it is of prime importance that repeal of the investment tax credit be accomplished in an orderly and equitable manner so that industry will not be penalized for capital expenditures which have been committed or planned in the expectation that the incentive was permanent.

Therefore, we respectfully request your Committee to recommend that any repeal legislation provide exceptions substantially similar to the transition rules included in the legislation for the 1966 suspension of the investment credit. Among the exceptions from the proposed repeal of the investment credit should be the following:

1. Capital projects already committed either by binding contracts or by partial construction to such extent that they must be completed should continue to have the benefit of the 7% investment tax credit. The 1966 suspension legislation recognized numerous situations of economic commitment for which the investment credit continued to be applicable. If industry is to continue to respond to incentive measures of the Federal Government, in our judgment it is essential that similar exceptions must be a part of any repeal legislation. It should be borne in mind that we are considering here not a new tax but rather the withdrawal of a tax benefit on which the business community has in good faith relied in making economic commitments both short and long-term.

2. Entire projects for which engineering, site preparation or other similar activities have been commenced or funds have been appropriated should be recognized as binding commitments in respect of which investment credit would be available notwithstanding the fact that such projects have not reached the stage where they would qualify under the 50% tests contained in the 1966 transition rules.

3. Congress should give special consideration to the significance and importance of preserving the benefits of the investment credit with respect to air and water pollution control facilities, as was provided in the 1966 suspension legislation. Such facilities do not contribute to productivity nor does industry recapture any of its expenditure by way of return on investment. Therefore, since industry must continue to invest heavily in this important area of broad government and public interest, it should continue to be entitled to the investment tax credit incentive.

If the investment tax credit in its present form is repealed, in addition to the orderly and equitable transition referred to above we urge your Committee and Congress to consider alternative methods of providing incentive to the steel industry and other capital intensive industries to continue to invest in capital equipment, which investment we deem to be in the highest national interest. Among such possible alternatives would be (1) liberalized and broadened depreciation tax deductions as previously mentioned, and (2) the continuation of the investment tax credit but in such manner that the credit would be spread on a pro rata basis over a period of years.

In summary, Republic Steel Corporation believes that the anticipated benefits to be derived from repeal of the investment credit are of doubtful economic value when compared to the harmful effects of repeal upon the competitive position of U.S. industry, particularly the steel industry. However, if the investment tax credit is repealed, serious consideration must be given to incentive alternatives such as those outlined above, and to the adoption of transitional rules and legislation to temper the impact of repeal, with fairness and equity to the industrial community, which, in reliance on the continuing availability of the investment tax credit, has committed vast sums to capital programs.

The foregoing points are covered rather broadly and should you or your Committee be interested in additional analysis, information or proposals with respect to any of the preceding comments, Republic would greatly appreciate the opportunity to furnish such information to your staff.

I wish to express my appreciation for this opportunity to record Republic's views on this important subject.

Respectfully submitted.

T. F. PATTON,
Chairman and Chief Executive Officer.

[Telegram]

NEW YORK, N.Y., *July 14, 1969.*

SENATE FINANCE COMMITTEE,
Senate Office Building, Washington, D.C.:

Regarding hearing on H.R. 12290 we have examined draft statement of Herbert B. Cohn and endorsed his views. On behalf of New York State Electric and Gas Corp. and Rochester Gas and Electric Corp. we particularly request deletion of proposed section 49 (d) which (1) is completely inconsistant with the equitable purposes of the transition provisions of section 49, (2) disregard commitments prior to April 19th involving lead times up to seven years, which in many cases are legthened significantly by potential pollution problems, (3) fails to consider the essential fact that a power generating station and related transmission lines and substations costing well over a hundred million dollars over a period of years are placed in service on a specific day at the end of the construction and testing period, and (4) would directly materially and adversely affect our client and many utility companies similarly situated.

NAYLON, HUBER, MAGILL, LAWRENCE, AND FARRELL.
By BRADFORD S. MAGILL.

UNITED BROTHERHOOD OF CARPENTERS AND JOINERS OF AMERICA,
Washington, D.C., July 12, 1969.

Senator RUSSELL B. LONG,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: I am sure you are well aware of the fact that the AFL-CIO opposes extension of the surtax unless and until meaningful and comprehensive tax reforms are coupled therewith. This is the view of the overwhelming majority of the 800,000 members who make up the United Brotherhood of Carpenters and Joiners of America, if the flood of mail reaching my office can be used as a yardstick.

Our objection is not primarily against extension of the surtax, rather it is against extension without closing the numerous loopholes by which many wealthy individuals and corporations escape carrying a fair share of the tax load.

The carpenter who makes $7,000 a year and has $800 or $900 withheld from his pay will have no choice about coughing up another $80 or $90. On the other hand, without reform, the individual making $100,000 from sources amenable to

existing tax loopholes can get off scott free, since ten times nothing is still nothing.

Some members of Congress argue there is no time to work out meaningful reforms before extending the surtax. They point out that solemn pledges are being made to bring about tax reforms this year once the surtax has been extended. This reasoning we cannot buy. We were promised tax reform last year when the surtax originally was enacted. None has been forthcoming.

We do not question the sincerity of those who promise prompt and reasonable tax reform once the surtax hurdle is cleared, but we have no way of knowing what they consider reasonable nor what their power to deliver may be. Frankly, the only leverage we have for effective reform is blocking extension of the surtax until such time as comprehensive reform is made a part of the package. Anything less is buying a pig in a poke.

Therefore, we are unalterably opposed to any extension of the surtax without meaningful and comprehensive reform now.

Sincerely yours,

PETER E. TERZICK,
General Treasurer and Director of Legislation.

STATEMENT ON BEHALF OF THE AMERICAN DENTAL TRADE ASSOCIATION IN SUPPORT OF A LIMITED EXEMPTION FOR DENTAL EQUIPMENT FROM THE PROPOSED REPEAL OF THE INVESTMENT TAX CREDIT SUBMITTED BY EDMUND WELLINGTON, JR., EXECUTIVE VICE PRESIDENT

The American Dental Trade Association is a national association of the manufacturers and suppliers of dental equipment and supplies.

In this statement, the American Dental Trade Association shall discuss two major reasons to support its request that dentists purchasing dental equipment be allowed to claim the 7% investment credit on annual purchases of $15,000 or less.

These reasons are:

I. The demand for dental care is growing, while the ratio of dentists to the civilian population is remaining the same.

II. The increased demand for dental services from the limited number of dentists can be met only by the continuing purchase of new, advanced equipment, and the creation of "multiple operatories". The Investment Tax Credit has been most effective in encouraging this needed increase in patient care capacity.

The Association respectfully urges the Committee's attention to the discussion of the above points which follows, supporting the Association's request for a limited exemption.

I

Are the number of dentists keeping pace with the demand for dental care?

No. The demand for dental care is growing, while the ratio of dentists to the civilian population is remaining the same.

Because of the nature of dental health care, relatively few persons realize that in recent years, more and more dental services have been rendered by a relatively stable ratio of dentists to the civilian population.

The demand for dental care has increased because of a growing awareness of the value of good dental health. From 1958 to 1964, the number of dental patient visits per year rose by 14% while the population increased by only 9%.[1] This awareness can be further gauged by the number of private dental insurance plans, dental service corporations,[2] union-sponsored dental clinics now in operation, and the inclusion of certain dental services in Medicare.

Only a few statistics are required to demonstrate the seriousness of the shortage of dental services.

According to information from the Department of Health, Education and Welfare, submitted as Appendix "A" to this Statement, the population of the United States has increased by 61% since 1930 but the number of dentists has increased by only 29%.

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[1] Based on statistics from the Division of Dental Health, U.S. Public Health Service, Department of Health, Education, and Welfare.

[2] Dental health plans under which the contributions of the employer are used to reimburse employees for dental expenses incurred with cooperating dentists in private practice.

At present only 3,200 dentists are graduated each year from the nation's dental schools, and with the attrition among previous graduates through death or retirement, a net gain of some 1,100 dentists is realized each year.

II

What, then, is a viable solution?

The increased demand for dental services from the limited number of dentists can be met only by the continuing purchase of new, advanced equipment, and the creation of multiple operatories. The investment tax credit has been most effective in encouraging this needed increase in patient care capacity.

The ability of the dental profession in recent years to meet the increasing demand for dental health care has been through the profession's increased productivity, by using more advanced equipment and by employing the "multiple operatories".

An "operatory" is a patient treatment room containing a dental chair, a dental unit (which holds or carriers and drives the dental drill and other devices), and other professional equipment used by the dentist in treating the patient.

A study by the American Dental Association in 1962, submitted as Appendix "B" to this Statement, reveals that a dentist with *one* dental operatory can increase his workload in terms of patient visits by *over 40%* if he adds *one additional* operatory, and by *over 80%* if he adds *two* additional operatories. This substantial increase in capacity made possible by multiple operatories is confirmed by a 1964 survey by this Association, submitted as Appendix "C" to this Statement.

As an incentive to encourage the purchase of capital equipment which is so essential to the increased efficiency and capacity of the individual dentist, the Investment Tax Credit is even more effective for dentists than it is for corporate businesses.

The great majority of dentists practice alone and pay income taxes at individual rates. They do not have the financial resources of a partner to draw upon for equipment outlays, nor the corporate shelter for accumulating income for capital expenditures.

A dentist setting up a practice, must pay from $10,541.00 to $17,216.00[8] for the minimum equipment necessary for a single operatory. The same large expenditure is necessary for the dentist who wishes to benefit from the added capacity of a second, third or fourth operatory in order to gain the substantial efficiency of "multiple operatory" dentistry.

The cost can be quite large in relation to income, and without the credit sources and tax shelters generally available to corporate business, the relief afforded by the Investment Tax Credit is of substantial importance to the purchasing dentist.

CONCLUSION

For the above reasons, the American Dental Trade Association respectfully requests that dentists purchasing dental equipment be allowed to claim the 7% Investment Credit on purchases up to $15,000 annual.

This would be consistent with the disposition made in 1966 when an exemption of $15,000 was granted during the suspension of the Investment Tax Credit.

APPENDIX A.—U.S. CIVILIAN RESIDENTIAL POPULATION AND NUMBER OF ACTIVE, NON-FEDERAL DENTISTS, SELECTED YEARS

Year	U.S. civilian residential population	Active non-federal dentists
1930	122,783,000	71,055
1940	131,680,000	70,417
1950	150,790,000	75,313
1955	162,967,000	76,087
1960	178,153,000	82,630
1965	191,890,000	86,317
1968	198,571,000	92,013

Sources: Division of Dental Health, Public Health Service, U.S. Department of Health, Education, and Welfare; Bureau of the Census, U.S. Department of Commerce.

[8] 1969 Dental Students' Purchase Guide, American Dental Association.

APPENDIX B

MEAN NUMBER OF PATIENTS AND PATIENT-VISITS OF NONSALARIED DENTISTS IN 1961, ACCORDING TO NUMBER OF DENTAL CHAIRS

Number of chairs	Mean number of patients	Mean number of patient-visits
1	726	2,200
2	1,204	3,123
3	1,525	4,035
4	2,085	4,650
5 or more	(1)	(1)
All nonsalaried dentists	1,164	3,119

[1] To few replies for reliable statistics.

MEAN NUMBER OF PATIENTS AND PATIENT-VISITS OF NONSALARIED DENTISTS IN 1961, BY NUMBER OF DENTAL UNITS USED

Number of units	Mean number of patients	Mean number of patient-visits
1	767	2,276
2	1,221	3,159
3	1,588	4,121
4 or more	1,739	5,311
All nonsalaried dentists	1,164	3,119

Source: The 1962 survey of dental practice, American Dental Association Bureau of Economic Research and Statistics.

APPENDIX C

AVERAGE NUMBER OF COMPLETE DENTURES INSERTED DURING APRIL 1964, BY NUMBER OF CHAIRS IN OFFICE

Number of chairs	Upper	Lower
1	2.2	1.8
2	2.7	2.1
3	2.8	2.2
4	3.0	2.3
5 or more	6.9	5.9
All dentists	2.8	2.2

AVERAGE NUMBER OF RESTORATIONS PLACED, DURING WEEK OF APRIL 26 TO MAY 2, BY NUMBER OF CHAIRS IN OFFICE

Number of chairs	Amalgam restorations	Silicate restorations	Acrylic restorations
1	31.9	9.5	2.2
2	42.1	12.1	2.5
3	49.9	12.8	2.9
4	52.1	13.5	4.2
5 or more	56.6	13.4	4.3
All dentists	42.1	11.7	2.7

AVERAGE NUMBER OF GOLD INLAYS PLACED DURING APRIL 1964, BY NUMBER OF CHAIRS IN OFFICE

	Gold inlays
Number of chairs:	
1	1.9
2	3.0
3	4.5
4	6.0
5 or more	5.0
All dentists	3.2

Source: 1964 Survey of Dental Practice Requirement, American Dental Trade Association.

(The following was submitted for the record as an attachment to the supplemental statement of Mr. Paul D. Seghers, and is referred to on page 180 of this hearing.)

[From the 1968 Annual Report of Caterpillar Tractor Co.]

TO THE SHAREHOLDERS . . .

The business corporation engaged in international trade and investment has, of necessity, an important involvement in international moetary affairs. These, in recent times, have been cause and effect in their influence upon the actions of both government and business. And until such time as they become resolved into a state of somewhat greater stability, they are bound to create uncertainties and distortions which will, on the whole, operate to disturb and modify what would otherwise be a more normal pattern of trade and investment across international borders.

The major countries most involved in and, therefore, most affected by current world monetary disturbances are France, the United Kingdom and, to a lesser degree, the United States. The position of these countries and their currencies in international affairs is, however, such that any significant change produces repercussions throughout the whole financial world. And it is in France and the United Kingdom that Caterpillar has two of its most important manufacturing investments outside the United States.

The focal point of the current disturbance in the international monetary affairs of all three of the countries mentioned lies in or is reflected in the deficits in their balances of payments. These, however, are the effects of other causes, and the remedy must surely lie at the sources of the problem rather than in its consequences.

Nevertheless, there is a current danger that money—especially in international affairs—is being regarded more as an end than a means. The whole monetary system is an instrument for the achievement of purposes which have to do with the welfare of *people*—with the creation of "things" which contribute to that welfare and, therefore, with trade and investment which produce goods, employment and earnings.

* * * * * * *

For the ostensible purpose of improving their balance of payments, France, the United Kingdom and the United States have been taking actions designed to alter what would otherwise be the patterns of mutual-benefit trade and entrepreneurial investment. These, it is said, are to be "temporary"—with some recognition that they are fundamentally wr ng and should be adopted only as short-term expedients bridging the disrupted path to a better long term. But temporary expedients which do not produce quick cures have a way of being continued beyond the term of their hoped-for effectiveness and thereby of bringing about the consequences of their own innate deficiencies.

This could be dangerously true at this particular time. Until recent years, the United States had a substantial surplus in its balance of trade—an excess of exports over imports. This provided funds for nontrade disbursements abroad—as for military operations, mutual defense, foreign aid and other forms of federal government expenditure. Now, however, the prospects for expanding or even maintaining a surplus on trade account are declining because (1) U.S. wage rates and benefits, the principal basis for total costs, are rising faster than gains in productivity—thereby operating to increase prices, and (2) the need for imports is growing with the expanding requirements of the U.S. economy.

As to the first of these, it should be understood that while wage rates and benefits in other countries have also been rising—and sometimes in ratios even faster than in the United States—it is the *absolute* difference in wage levels which enters into unit costs, and this has not been shrinking. As a rough general rule, it may continue to be assumed that hourly labor rates in those industrialized countries which are most competitive are about 40% or less of those in the United States.

As to the need for imports, it should be appreciated that the United States is far from being self-sustaining. It imports more than a third of its metal requirements. Imports meet 90% of the need for bauxite and other aluminum ores. Ninety-seven percent of the manganese that is necessary for the production of virtually all steel is imported. U.S. industry would simply not be able to obtain

its basic ingredients at prices competitive to those in other countries if it did not have the ability and freedom to import. And much of such import needs will grow as the industrial economy expands further.

IN BRIEF—CONSOLIDATED

[All dollar amounts are expressed in millions except those given on a share basis]

	1968	1967
Sales	$1,707.1	$1,472.5
Profit	$121.6	$106.4
Profit percentage of sales	7.1	7.2
Profit per share of common stock	$2.14	$1.87
Cash dividends paid per share of common stock	$1.20	$1.20
Expenditures for land, buildings, machinery and equipment	$183.3	$219.9
Depreciation	$82.2	$64.0
U.S. and foreign income taxes	$90.5	$61.0
Average number of employees	59,848	56,635
Number of shareholders at end of year	48,126	48,910

Beyond mere need, there are, furthermore, those imported commodities or goods which have become staples in the life of a nation which has successfully achieved that state where it is able to buy what it desires—coffee, tea, sugar, tropical fruits, and a whole host of goods which have become a part of everyday American life. Their importation will inevitably grow with continuing population increase and with the expandng desire of free people to have what they want when they want it—whether it be goods or services or freedom of movement, including foreign travel.

If the foregoing opinion be true regarding imports, then it seems to follow that the counterbalancing need for more *exports* will be greater than ever. For nearly thirty-five years, the major countries of the free world have been moving forward on the basis of an increasing interchange of goods and services. This was facilitated very largely by the process of multilateral reciprocal reductions of tariffs negotiated from time to time under the terms of the International General Agreement on Tariffs and Trade (GATT). Now, when a continuance of that process is more than ever needed for the betterment of U.S. commerce, it is being jeopardized by the claims of certain domestic industries for the imposition of quotas which would restrict imports of competitive foreign products. Coming at this particular time, the adoption of any such protectionist device would surely operate to incite retaliation by customer countries also involved in the wealth-creating interdependence of international trade.

The retaliatory reprisals by other countries would be taken against products other than those involved in the U.S. quotas. Thus, for example, a limitation of imports of *steel* into the United States might well be expected to produce countermeasures which would restrict exports of *machinery* from the United States. This type of retaliation would most likely come from other steel-producing countries; and it is these countries which, in general, provide the best markets for machinery.

It also seems worth noting that, for the most part, machinery is made of steel and that machinery constitutes a major proportion of U.S. exports of manufactured goods.

* * * * * * *

Furthermore, if the United States is to be confronted with a narrowing balance on trade account, then it becomes more important than ever that attention be turned (in addition to export expansion) to means for improvement of the income to be derived from direct foreign investment. Every company engaged in international business seeks to better its own balance of payments, and, to the extent it succeeds, it also serves the appropriate national interest. But time is running against the long-term effectiveness of the short-term expedient adopted in the current U.S. foreign direct investment controls. Their continuance beyond the short duration of very limited necessity would be dangerous interference with and distortion of long-term private investment policy which in the years ahead may well become the source of the greatest net contribution to a favorable balance of payments. Among their unfavorable effects upon U.S. enterprise are (1) loss of the initial opportunity for foreign investment as the vacuum created by U.S. prohibition is filled by unrestrained foreign initiative, (2) greater later

difficulty in penetrating markets in which others will have become entrenched, and (3) deferment of the day when the repatriation of overseas earnings would contribute to a more favorable U.S. balance of payments.

Having undertaken most of its overseas investment before the controls were instituted, and also having ability to borrow outside the United States, Caterpillar has not yet been seriously affected by the present controls. As in the past, its contribution to the U.S. balance of payments rests very substantially upon exports of the American product. For 1968, this contribution reached a new record at $583 million—being the net excess of (a) inflow of dollars to the United States from exports, dividends, license fees, etc. over (b) outflow of dollars for imports, foreign investment, etc.

* * * * * * *

At this time the basic objective of U.S. government policy should be to improve the U.S. balance of payments by expanding international trade and investment, not by contracting them. Related policies on trade and investment should be integrated much more closely than they have been in the past, and these in turn should be coordinated more closely with fiscal and monetary action. The ultimate test should lie in social consequences.

The end purpose of the monetary system is not and should not be made money itself or the preservation of historical parities which can become outmoded in the changing times. Rather, it should be the preservation of real *values;* and these involve people and their needs or desires for employment, for goods and services which contribute to their welfare, and for a sense of security which at times seems to be more threatened than strengthened by efforts to overcome international monetary instability. It would, accordingly, seem timely to suggest an authoritative reconsideration of the modern workings of the international monetary system—reflecting contemplation of the possibility that appropriate readjustments of exchange rates might better serve the purposes of trade, investment, and the general public welfare.

In the meantime, it is our judgment that progressive business must continue to take such measures as may be considered necessary to protect and, if possible, to improve its competitive posture. This is particularly true for those companies which, like Caterpillar, seek to maximize their opportunities wherever markets are to be found or developed throughout the world. And it should be recognized also that solidly established business takes the long view—one which willingly sacrifices limited short-term advantage for greater long-term gain. This sometimes requires a capacity to make progress despite the political or financial expediencies of transitory governments. And it recognizes that the on-going internationalization of production is the natural concomitant of a purpose to be effectively competitive in world markets.

Caterpillar seeks no protection from competition in the United States or in any of the countries which host its subsidiaries and affiliates. It subscribes to the general objective of having all possible obstructions to the interchange of goods and services reduced to a minimum. Progress is being made toward this in trade through declining tariffs; but much needs to be done to eliminate the many types of devices, other than tariffs, which are employed by many countries to defeat, at least in part, the purpose and the spirit of the results achieved through tariff agreements. This should be made the primary objective of further negotiations under the GATT and should be accompanied by endeavors to have each exporting country grant to imports the same degree of freedom which it desires to have for its exports.

* * * * * * *

The matters referred to above are important in the general terms of a free world environment for trade and investment. And they are not without direct impact upon the policies of Caterpillar or the time and place of its actions. Nevertheless, they need not be regarded as insuperable hazards to the pursuit of successful business.

In the face of such problems and an unduly troubled world, Caterpillar has gone ahead with most of its plans—particularly as to product and properties. It has established a strategic deployment of its resources throughout the world, and it has created manufacturing capacity for a substantially higher volume of business than is being presently enjoyed.

This should eventually produce its reward when volume begins to increase faster than costs. In the meantime, certain costs—and particularly those that, like depreciation and interest, do not vary directly with volume—have to be

sustained in advance of the output for which they are being incurred. The fact that they now operate to depress reported current earnings should not, however, be allowed to obscure the underlying reason for their being: preparation for growth—not growth for the sake of size but for the development of expanded means through which it will be possible to earn additional profits.

Prepared Statement of Bethlehem Steel Corporation Submitted by Edmund F. Martin, Chairman and Chief Executive Officer

Dear Mr. Chairman, Bethlehem Steel Corporation welcomes this opportunity to present to the Committee on Finance this statement for the record setting forth our views on those provisions of H.R. 12290 which provide for the extension of the 10% income tax surcharge and certain excise tax rates, the repeal of the investment tax credit, and amortization of pollution control facilities.

SUMMARY OF STATEMENT

1. We oppose the repeal of the investment tax credit because we believe it is basically anti-inflationary and is as essential today as it was when enacted in 1962. The repeal of the credit will not reduce inflationary pressures either in the short range or the long range.
2. Elimination of the investment tax credit would not properly reflect the national priorities. The investment tax credit is serving the purposes for which it was enacted as a permanent part of our tax law; namely, to assist American industry in the modernization of its plants and equipment and in competing in domestic and foreign markets, and to improve our balance of payments.
3. Repeal of the credit will not tend to stabilize or reduce interest rates.
4. Experience shows the suspension of the investment tax credit in 1966 was a mistake and its repeal would be even a greater mistake.
5. The investment tax credit is particularly important to the steel industry which must compete against the steel industries of foreign countries that receive direct or indirect assistance from their governments in meeting their capital requirements. Repeal of the investment tax credit will decrease capital funds, and replacement funds can only be generated by an increase in steel prices, lower dividend payments, or additional borrowing.
6. Repeal of the credit would be uneven as between taxpayers and is inconsistent with President Nixon's announced objective of bringing equity to the Federal tax system.
7. Repeal of the credit may reduce rather than increase tax revenues.
8. Depreciation allowances should be liberalized but not as a substitute for the credit.
9. Broad equitable transition rules including an "economic commitment" test should be provided in H.R. 12290 if the Congress decides that there are absolutely no alternatives to the repeal of the investment tax credit.
10. The phaseout rules for the investment tax credit contained in H.R. 12290 are inequitable and should be eliminated. They will serve to "heat up" rather than "cool off" the economy because of demands for early delivery.
11. Air and water pollution control facilities should be exempt from any repeal of the investment tax credit. In addition, the provisions of H.R. 12290 providing for 5-year amortization of pollution control facilities should apply to any facility (whether depreciable or non-depreciable) where the "principal purpose" of the facility is to control pollution. Amortization should be in addition to and not in substitution for the credit.

TEXT OF STATEMENT

1. Investment credit is anti-inflationary

We recognize the urgent need to control inflation but do not believe repeal of the investment tax credit will do so. The full effect on inflationary forces of restrictive monetary policies, efforts to reduce governmental expenditures and the income tax surcharge which has been in effect can not as yet be determined. If further fiscal measures are essential at this time, we recommend additional reductions in governmental expenditures and, if it shall be demonstrated that expenditure reductions alone will not do the job, then a continuation of the income tax surcharge and the excise tax rates. Any extension of these taxes should be clearly recognized as temporary and limited in duration to the period of the Vietnam

conflict. We oppose the repeal of the investment tax credit because we believe that the credit is basically anti-inflationary and is as essential today as it was when originally enacted in 1962 as a permanent part of the tax structure.

Under Secretary of the Treasury Walker stated to the House Ways and Means Committee on April 23 that the repeal of the credit is consistent with the Administration's anti-inflationary program in reducing demands for business investment which, at that time, was projected to increase 14% this year over 1968. However, according to Commerce Department statistics released in June 1969, expenditures for business investment are expected to increase 12.5% over 1968. Whether or not the estimate truly reflects what the ultimate expenditures will be, repeal of the credit is not an effective way to deal with inflation. A sound anti-inflationary program should counter both short-range and long-range inflationary tendencies. In the short range, repeal of the credit will not reduce inflationary pressures because capital improvement programs now under way will have to be continued, whether or not the credit applies to all their components. In the long range, repeal of the credit will be inflationary because it will impair the ability of American industry to modernize its productive plant and equipment, to reduce costs and to improve its competitive position in world markets. It should be noted that estimated business expenditures for new plant and equipment, as a percentage of Gross National Product, are not excessive. According to June 1969, Commerce Department figures, such expenditures are estimated to be 8.0% of Gross National Product for 1969 as compared to 8.1% in 1966, 7.8% in 1967 and 7.4% in 1968. It should also be noted that the Commerce Department earlier this year estimated that expenditures for new plant and equipment as a percentage of Gross National Product would be 7.9% for the first quarter of 1969. The actual rate of expenditures was only 7.6% and there is general agreement that such expenditures will grow slowly, if at all, during the balance of the year.

2. Business investment as a national priority

President Nixon, in his message to Congress on April 21, 1969, stated that expanded business investment no longer has priority over other national needs such as Federal revenue sharing with State and local governments and tax credits to encourage investment in poverty areas and the hiring and training of hard-core unemployed. Certainly, those national needs should be carefully studied and considered by the Administration and the Congress, but eliminating the investment tax credit is an unwise method of providing funds for those purposes.

The investment tax credit was added to the tax law in 1962 as a permanent part of the tax system for the purposes of assisting American industry to improve its efficiency and reduce its costs by more modern productive facilities. It was not designed merely to stimulate private investment in a slack economy. The credit has been serving its original purpose. Its continuation is necessary if American industry is to compete more effectively with foreign goods in price and quality in domestic as well as foreign markets and its continuance is, therefore, essential to improving the balance of payments of the United States.

3. Repeal of credit will not reduce interest rates

Secretary of the Treasury Kennedy stated to the House Ways and Means Committee on May 20, 1969 that repeal of the investment tax credit would help to stabilize interest rates and Under Secretary of the Treasury Walker stated to that Committee on April 23, 1969 that repeal of the credit would tend to reduce interest rates. We submit, however, that repeal of the credit will not, in the short range, reduce or stabilize interest rates, demands for funds, or capital expenditures. In fact, it is more likely to have the opposite effect. In Bethlehem's case repeal of the credit will not result in any immediate curtailment in capital spending. Our typical capital improvement program has a long lead time (as much as several years) between initial authorization and ultimate completion. These programs now under way will have to be completed, even if it means that the loss of the investment tax credit must be counteracted by borrowing more funds. We believe our situation is typical of most heavy industry. Additional borrowing to complete such programs will increase, not lessen, pressures on available funds and interest rates.

4. Suspension a mistake—repeal a greater mistake

The investment tax credit was suspended by Congress in October 1966 for 15 months in order to "cool off" the economy. The suspension was actually in effect

for only 5 months. Whether or not the suspension achieved its announced purpose can never be ascertained with any degree of certainty. Suffice it to say that certain segments of the economy were quite adversely affected by the suspension and that Congress quickly restored the credit upon the recommendation of President Johnson. Most observers believe, as do we, that the suspension of the credit in 1966 by the Congress in an effort to control the overall economy was a mistake. We submit repeal would be even a greater mistake.

5. Importance of credit to steel industry

The investment tax credit is, of course, important to all industries, large and small, which must invest in plant and equipment. Its impact is greatest, however, on industries in which investment is high relative to revenues. Its contribution to the economy is greatest in those capital-intensive industries which are under heavy competitive pressures from foreign producers which receive direct or indirect assistance from their governments in meeting their capital requirements. Steel is an outstanding example of such an industry. If it is to continue to perform effectively its function in the economy, it must continue to make heavy investments in plant and equipment. Furthermore, it is competing against other steel industries which are favored by their governments.

Bethlehem Steel Corporation provides an excellent illustration of what the investment tax credit means to a steel producer. Bethlehem is in the midst of a long-range program of essential modernization of its productive facilities During the period 1962 through 1968 our capital expenditures were approximately $2.3 billion but did not increase significantly our steelmaking capacity. Our investment tax credit for this period of approximately $102 million represented 10.7% of our net income before dividend payments to shareholders and 25.4% of our net income after such dividend payments. For the next five years (1969–1973) capital expenditures are estimated at $1.9 billion and investment tax credits under existing law at $118 million. Repeal of the credit will certainly decrease our funds available for our needed modernization programs. Replacement funds can be generated only through higher prices for steel products, lower dividend payments to shareholders or additional borrowing.

6. Inequities resulting from the repeal

President Nixon has stated that the primary objective of his proposed tax program is to bring equity to the Federal tax system. We submit that there would not be equity as between those taxpayers who have just completed their capital improvement programs and those taxpayers who, relying on the permanency of the credit, were just about to embark on their capital improvement programs. Nor would there be equity between those industries where the effect of the repeal of the credit will be delayed and those industries where it will not, Furthermore, there would not be equity as between employees of those industries which would not be affected by the repeal of the credit and employees who lost their jobs because of the repeal of the credit.

Additionally, we submit that the repeal of the credit would be particularly inequitable to corporations relative to other taxpayers. The Congress, in the Revenue Act of 1964, specifically took into account the benefits of the investment tax credit when it voted to reduce the tax rates for corporations by less than 8% (from 52% to 48% over a two-year period) while voting tax reductions for individuals of approximately 23% for those in the low and high taxable income brackets and of approximately 15% for those individuals in the middle taxable income bracket. However, Congress considered that the total tax reductions for corporations were approximately the same as those for individuals, as was its intention, when the tax reductions granted to corporations in 1962 by the investment tax credit and depreciation reform were both taken into account. See, for example, the Senate Finance Committee Report accompanying the 1964 Act at page 8. Thus, repeal of the investment tax credit would distort the allocation of tax burdens between corporations and other taxpayers intended by the Congress in passing the 1964 Act.

7. Credit repeal may reduce tax revenues

According to the House Ways and Means Committee Report, accompanying H.R. 12290, page 15, it has been estimated that the revenue gain from the repeal of the investment tax credit will be $1.35 billion for the fiscal year ending June 30, 1970 and $2.6 billion annually for succeeding fiscal years. President Nixon stated on April 21, 1969 that the repeal of the investment tax credit

will begin to be significant during calendar year 1970 and that, accordingly, he was not renewing his recommendation to Congress of March 26, 1969 for continuance of the surcharge until June 30, 1970 at a 10% rate but instead was recommending that the investment tax credit repeal be accompanied by extension of the full surcharge only to January 1, 1970 with a reduction to 5% on that date. He further stated that the gradual increase in Federal revenues resulting from repeal of the credit and the growth of the economy will also facilitate a start during fiscal 1971 in funding revenue sharing with State and local governments and tax credits to encourage investment in poverty areas and hiring and training of the hard-core unemployed.

In our opinion, President Nixon expects more in the way of favorable revenue effects from the repeal of the credit than is justified. We doubt that repeal of the credit will make revenues available for other purposes. Certainly this will not be so if repeal, by curtailing future business investment, results in a decline in the growth of the economy. Tax revenues then would doubtless decrease rather than increase.

8. Liberalization of depreciation

It has been suggested that repeal of the investment tax credit can be offset by more liberal depreciation allowances. There should be further depreciation reform to liberalize depreciation allowances and to attain simplicity, certainty and flexibility in the depreciation area. But depreciation reform should not be a substitute for the credit. The long-range interests of American industry and the nation as a whole lie both in the continuation of the investment tax credit and in working to achieve further depreciation reform.

9. Need for "economic commitment" exception to any repeal

The legislative history of the investment tax credit clearly establishes that it should not be viewed as a contracyclical device and that the business community has been justified in making its capital investment plans on the basis that the credit will remain a permanent part of the tax law. If Congress votes repeal of the credit, then equitable transition rules are essential.

The provisions of H.R. 12290 provide limited exceptions to the repeal of the credit which are somewhat similar to those contained in the investment credit suspension Act of 1966 (Public Law 89–800). Some of those exceptions, such as the equipped building rule, the plant facility rule and the machinery and equipment rule have been provided in recognition of the various types of commitments which are made before physical construction has commenced or a binding contract made. Those exceptions, however, do not provide relief for all cases where the taxpayer is "economically committed" to proceed with the completion of a project. We urge the Congress to provide an "economic commitment" exception to the repeal of the investment credit as to property which the taxpayer is "economically committed" to acquire on the effective date of the repeal of the credit, the exception to apply even through construction of the property has not therefore begun or binding contracts covering the property made. That economic commitment may be evidenced by, for example, a commitment on the part of the taxpayer to borrow money for a planned facility, substantial expenditures for engineering or site clearance, or the necessity of completing a planned facility which is an integral part of another facility already under construction or subject to a binding construction contract. Congress could provide that the economic commitment exception would apply only where the property was acquired pursuant to a plan which was in effect on the date of the repeal of the credit.

10. Phaseout rules are inequitable and should be deleted

The exceptions to the repeal of the investment tax credit contained in H.R. 12290 are more restrictive than those contained in the investment credit suspension Act of 1966 because of the operation of the so-called investment credit "phaseout" rules. Under the "phaseout" rules, the credit applicable to property placed in service after December 31, 1970 is 7% less 1/10 of one percentage point for each month after December 1970 before the property is placed in service. Furthermore, the investment credit will not be available for any property placed in service after December 1974. This reduction of the credit applies even though the property qualifies for one of the exceptions to the repeal of the credit and is particularly inequitable where there is a long lead time between the date the contract was entered into, or the construction begins, and the date the property is placed in service. The "phaseout" rules will also be

inequitable to a taxpayer whose projects are unavoidably delayed because of strikes or inability to raise necessary funds. In addition, we believe the "phaseout" rules will cause demand pressures to build up for early delivery and completion of construction. These demands will serve to "heat up" rather than "cool off" the economy. These "phaseout" rules should be eliminated.

11. Air and water pollution control facilities

Another area of critical concern to Bethlehem is that of financing its programmed expenditures for air and water pollution control facilities. Pollution abatement is one of the nation's highest priority items. Thus, even if repeal of the investment tax credit for strictly business expenditures could be justified on the grounds that resources should be used for other purposes, it would continue to be appropriate for investment in pollution abatement facilities. During the past five years, Bethlehem has spent $104 million for air and water pollution control facilities, or about 6½% of its total steel plant investment in that period. In the next five years it is estimated that about 11% of Bethlehem's total steel plant investment will be for pollution control facilities, based on current air and water quality standards. Pollution control facilities do not increase earnings, improve competitive position, expand production or cut costs. They are costly to maintain and operate and require funds that otherwise would be available for investments in productive plant and equipment. For Congress to repeal the investment tax credit for air and water pollution control facilities would be particularly unfortunate for our company, and for the many other companies that are faced with heavy investments for such facilities. Such repeal would be incompatible with the action taken by Congress in 1966 in exempting investments in such facilities from the legislation suspending the investment tax credit. We urge Congress to continue the investment tax credit with respect to air and water pollution control facilities.

We approve of the action of the House in H.R. 12290 in recognizing the necessity of allowing taxpayers to recover their capital investments in pollution control facilities at a more rapid rate than under existing law. We do not, however, view the House provisions as a substitute for the investment credit for pollution control facilities and we believe these provisions are unnecessarily restrictive and complex. The provisions of the bill providing for amortization over a five-year period of certain pollution control facilities should be extended to include all facilities (whether consisting of depreciable or non-depreciable property) where the principal purpose thereof is to abate or control air or water pollution. This principal purpose test should be substituted for the two complex provisions now in the bill which would require a determination as to each pollution control property of "the extent it appears that (A) by reason of profits derived through the recovery of cost or otherwise in the operation of such property, its cost will be recovered over its actual useful life, or (B) such property would be constructed, reconstructed, erected or acquired without regard to the need to abate or control water or atmospheric pollution or contamination". That determination of the portion of the pollution control facility that would thereby not qualify for amortization will invite endless controversy between certifying auhorities and taxpayers.

CONCLUSIONS

We respectively oppose any repeal of the investment tax credit and urge that Congress address itself at its earliest convenience to further depreciation reform in the interests of the long-range growth of the economy. However, if the Congress decides to vote the repeal of the investment tax credit, then equitable transition rules as outlined herein should be provided. In any event, the investment tax credit should be retained for pollution control facilities and the provisions of the bill providing for five-year amortization of such facilities should be revised to permit amortization of any facility, whether depreciable or non-depreciable, where its principal purpose is to abate or control pollution.

CHAS. PFIZER & CO., INC.,
New York, N.Y., July 11, 1969.

Hon. RUSSELL B. LONG,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: Pfizer is engaged, directly and through wholly-owned subsidiary corporations, in the development, manufacture and sale of ethical and

proprietary drug products, fine chemicals, cosmetics, toiletries, animal feed supplements, metal oxides, limestone and other mineral products throughout the United States and various foreign countries in the free world.

The proposal for extension of the income tax surtax is presently before the Senate Finance Committee. As previously enacted the surtax is discriminatory in that it is levied against a corporation's "gross" tax liability rather than the net tax liability after allowable tax credits. The tax in this form discriminates against and penalizes those corporations receiving income from overseas, such as dividends from subsidiary corporations, inasmuch as it is levied prior to consideration of the foreign tax credit. The effect of imposing the surtax upon tax liabilities prior to the consideration of the foreign tax credit (and the investment tax credit as well) is to increase for many taxpayers their United States Taxes by more than 10% of that which would have been paid had the surtax not been adopted.

The present wording of the surtax sections makes it advisable for a corporation to avoid repatriation of funds from its foreign affiliates. Thus, at the same time that the Department of Commerce is attempting to increase the repatriation of funds for balance of payments purposes, the surtax tends to discourage such repatriation.

We urge that, if it becomes essential to extend the surtax, the present law be amended to provide that the maximum amount of surtax cannot exceed 10% of the tax which would have been paid had the surtax not been enacted.

Very truly yours,

M. P. LANDERS, *Treasurer.*

STATEMENT OF REEVES E. RITCHIE, PRESIDENT, ARKANSAS POWER & LIGHT CO.

I am president of the Arkansas Power & Light Company, an investor-owned Arkansas corporation serving over 370,000 electric customers located in 61 of the State's 75 counties.

My statement is directed to Section 4(a) of HR 12290, which repeals the investment tax credit and, more specifically, to the proposal contained therein to add the so-called phase-out provision, Section 49(d), to the Internal Revenue Code. This provision would progressively take away the benefits of the investment credit for industries which, by their very natures, have long lead times—*even where property was under a binding contract on or before April 18, 1969.*

First, I would like to point out that we have not opposed the elimination of the investment tax credit. We have not opposed it because we have relied upon the judgment of the Congress and of the Administration that its repeal was in the nation's best interest. Furthermore, we have relied upon the representations made by members of both the Congress and the Administration that there was every intention of honoring firm and binding contracts made in good faith prior to April 18, 1969.

I point out to this Committee that the inclusion of Section 49(d) in HR 12290 is not in keeping with what we had been led to believe would be the action of Congress. It severely penalizes industries who may have made major financial commitments long prior to April 18, 1969, and who, through no fault of their own, cannot possibly have the facility in service in less than three, four or five years from now.

My own Company is a case in point. I would like to present the case to you as an example, and it is by no means unique; there are many other industries which are similarly situated and which will be as seriously injured. The Arkansas Power & Light Company made a decision in 1967 to build an 800,000-kilowatt nuclear generating station in Arkansas. The decision was made after long and serious consideration of all possible economic and technical factors—including the effect of the three-percent (for utilities only) investment tax credit. In 1967, a Certificate of Convenience and Necessity was granted by the Arkansas Public Service Commission; and in that same year, binding contracts were entered into for the design, manufacture and delivery of the reactor, turbine-generator and other major components of the plant. In December of 1968, a Construction License was granted by the Atomic Energy Commission; and actual construction of the plant got underway.

The original schedule called for completion by late 1972. It now appears that some delay may be experienced in delivery of equipment, thus delaying the completion date. This long lead time does not come from choice, nor is it a controllable factor by us; rather it results from the complexity and scope of

the construction and from the size and variety of equipment which must be ordered, designed, manufactured and installed at such a project. In our case, you can readily see that mid-1973 would be 30 months past the beginning of the proposed phase-out period, December 31, 1970. Thirty months at the rate of one-tenth of one percent per month would equal three percent, which *all* of the investment tax credit allowed to utilities. Since the plant is expected to cost over $140 million, the effect of Section 49(d) would be to increase our cost by over $4.2 million.

I do not believe it was the intent of the House Ways and Means Committee in proposing Section 49(d) to penalize taxpayers who had acted in good faith and, in the usual and normal course of their businesses, to place orders and make binding contracts for essential industrial facilities well prior to the cut-off date of April 18, 1969. As a matter of fact the proposed Sections 49(a), 49(b) and 49(c) provide that the credit will continue to be available for property under binding contract on April 18, 1969. These transitional provision are similar to those included in the 1966 legislation suspending the tax credit.

But after including such transition provisions in Sections 49 (a), (b), and (c) to eliminate such inequities, there was then added in the bill the brand new provision, Section 49(d), which, in many cases, will completly nullify the transition provisions and create the precise inequities the transition provisions were intended to eliminate.

In my opinion, the House Ways and Means Committee's rationale for this phase-out procedure is based on a false premise. They have taken the position that companies which have long lead times have an undue advantage since they were able to order equipment before the cut-off date. This argument might have some validity if lead time were a controllable factor. I can assure you that in most cases with which I am familiar, it is not a controllable factor. It is far more a liability than an asset because of the very high costs of interest during construction and of inflation in the cost of materials and labor during the construction period.

I strongly urge this Committee to eliminate Section 49(d) from H.R. 12290 because it unduly and unfairly penalizes those segments of American industry which, by the nature of their businesses, have inherently long lead times between inception and completion of their industrial plant facilities.

STATEMENT SUBMITTED BY DR. MONROE M. BIRD, ASSISTANT PROFESSOR OF BUSINESS ADMINISTRATION AND CHAIRMAN OF MARKETING, VIRGINIA POLYTECHNIC INSTITUTE

THE INVESTMENT TAX CREDIT AND INFLATION

(By Dr. Monroe M. Bird)

Numerous arguments have been brought to the attention of this Committee as to why the 7 per cent investment tax credit should not be repealed. Some of the more widely stated and accepted reasons appear to be these:

(1) The investment tax credit was originally enacted as a part of depreciation reform, since existing depreciation was inadequate in light of inflation and in light of allowable depreciation abroad.

(2) The investment credit has always been intended as a permanent feature of the tax law, and businessmen have planned their capital expenditures accordingly.

(3) Retention of the investment credit is essential if our industries are to remain competitive with foreign industries and if we are to avoid further deterioration in our balance of payments.

(4) A high level of capital formation will be particularly vital during the 1970's, and continuation of the investment credit would contribute materially to such capital formation.

(5) The direct economic impact of the repeal might very well come at just the wrong time.

I agree with each of these reasons and urge you to give them careful consideration. However, this paper will not discuss the preceding reasons but will concentrate solely on still another reason—one which involves the economic relationship between the investment tax credit and inflation. By so doing, I hope to demonstrate the very real dangers involved if the investment tax credit should be repealed.

INFLATION: THE PROBLEM

Inflation—not deflation, recession, or stagnation—has been our nation's most persistent economic problem. The long run trend of price levels in the U.S. has been ever rising; hence, inflation is a long run problem. However, inflation is a very real short run problem as well. In fact, the long run price trend for the U.S. consists of a series of short run inflations joined by periods of relatively stable prices. Since inflation is both a long run and a short run problem, it seems logical that the economic weapons used to fight inflation should be carefully scrutinized for both their long run and short run possible effects on our nation.

SHORT-RUN ANALYSIS

The question before this committee is whether or not the 7 per cent investment tax credit should be repealed in an effort to help curb the present inflation. There is good reason to believe that such action might not be effective in fighting inflation, and that the repeal of the 7 per cent investment tax credit could actually cause an increase in the rate of inflation in the short run.

Assume first that our economy were at the full employment position (approximately 3 per cent unemployment) with less than perfect competition existing in the product market and the labor market. In such a situation (the present state of the U.S. economy), short-run, cost-push inflation would likely exist.[1] Under these conditions if the investment credit were removed, there would be an immediate lessening of profits and the prospects of future profits in the business sector. Although this would mean a decline in the volume of new projects undertaken, there would probably only be a very minor impact on the current level of spending because of the time lage of a year or sobetween authorization and completion of most projects. Also assume that our government spent the additional tax revenue for any purpose within our economy except to purchase productive capital goods. Temporary continuation of a high level of investment spending, coupled with an increase in consumption of goods and services, would actually compound the cost-push inflation with a demand-pull inflation.

In the above situation, an increase in the price level would tend to take place in the short run. It seems clear that as consumption increased while investment spending held at about its present level, only a short period of time would elapse before goods would become even more scarce. After a year or so, investment spending could be expected to be dampened. If this situation were allowed to exist, production of goods and productivity (output per unit of input) in the economy would fall, or at least the rate of increase in production and productivity would decrease. This situation could result only in a lower standard of living for our nation than otherwise would have been expected had the investment tax credit not been repealed. Therefore, under these conditions any reduction in investment due to a decrease in profits and profit expectations would diminish the expected rate of production and productivity of our nation, and could also stimulate inflation through the channel of demand-pull.

In a demand-pull situation, the repeal of the tax credit could actually aggravate inflation through increased scarcity. Therefore, repeal of the investment tax credit might not be the proper economic weapon to fight this short run problem.

LONG-RUN ANALYSIS

The first part of this paper pointed out that inflation is long run as well as short run in nature. Now consider the long run economic consequences of the repeal of the 7 per cent investment tax credit.

Assume our economy were at full employment and experiencing both cost-push and demand-pull inflation. If Congress removed the investment tax credit and thus reduced current and expected profits, investment in new projects could be expected to decrease. The decrease in investment would reduce the rate of capital formation as well as reduce the total income of the economy. Granted, the lessening of income might reduce the demand-pull portion of the inflation, given sufficient time for adjustments to take place; but a cutback in investment and capital formation would also reduce production in the long run. It could be argued that these effects of the removal of the investment tax credit would stem the tide of inflation. That would be true except for the lack of mobility of labor and the down-

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[1] J. M. Clark, "Economic Stability," *Problems of U.S. Economic Development* (New York: Committee for Economic Development, 1958), p. 49.

ward rigidity of the price of labor, coupled with imperfect product markets (caused by imperfect competition between sellers of goods). In short, the probable long run effect of a cut in the investment tax credit would not be a reduction in prices but would be unemployment and a total reduction in supply, the one factor that could offset excess demand.

If widespread unemployment occurred, the full Employment Act of 1946 would bind the government to reduce it through either monetary or fiscal action. If the government chose to reduce unemployment by increasing the money supply, and thereby reducing interest rates enough to again stimulate investment, there is some doubt whether interest rates could be reduced enough to offset the loss to business caused by the removal of the investment credit. Even if interest rates could be pushed low enough to again stimulate investment, this question arises: how long would this method take to stimulate investment and production?

In the long run the suspension of the tax credit resulting in the above chain of events would be harmful to the economy for three reasons. First, there would be unemployment in the interim between the removal of the tax credit and the reestablishment of investment resulting from an increase in the money supply. Second, because of the downward rigidity of wages and prices and the immobility of labor, there would not be a reduction in inflated prices. Third, there would be a loss of capital formation and production in the interim which, once lost, would take time to recover, if indeed such a loss could ever be recovered.

The long run effect of the repeal of the investment tax credit would be to reduce the rate of capital formation. This reduced rate of capital formation would lower the productive base for the U.S. far into the future. At best, all that a repeal could do would be to ease that part of inflation that was demand-pull in nature. But it will be recalled that in an earlier section it was shown that in the short run a repeal could actually cause an increase in inflation!

There is one logical long run solution that would curb domestic inflation without creating unemployment or necessitating direct controls. That solution is to achieve greater production through a higher rate of productivity per unit of input. The higher rate can be achieved only through increasing capital formation. Therefore, to achieve the long run objective of offsetting rising wages and preventing inflationary price rises, we need to encourage increased capital formation. Since reducing any incentive to invest could and probably would reduce capital formation, the repeal of the investment tax credit would be a step in the wrong direction.

ALTERNATIVE SOLUTIONS

If, however, in spite of all of the above reasons it is decided that the investment credit must be changed, then I would strongly urge that thorough consideration be given to the various alternatives to outright repeal. For example: Continue the investment credit but require that it be written off over five or more years, along the lines of the rapid amortization of emergency facilities. The enactment of this alternative would provide the government with increased tax revenue initially as compared with outright repeal, but would still provide business an incentive to invest in new productive capital equipment. Another example: Permit the taxpayer to recognize the decline in the value of the dollar, e.g., by recovering depreciation in excess of historical cost. A third example: Continue the investment credit but require that the credit be deducted from the depreciable base so that a taxpayer could only write off 93% of original cost in the form of depreciation. This approach has historical precedence in the form of the so-called "Long amendment." Still another example: Reduce the credit from 7% to 5% or 4%; this would tend to reduce capital spending but not by as much as would outright repeal.

Undoubtedly there are a number of other alternatives which would be preferable to outright repeal of the credit, and for the continuing good of our economy. I would sincerely hope that Congress adopts one of these alternatives to outright repeal of the investment credit. However, I continue to urge strongly that the present investment credit not be repealed or changed.

(The following was submitted as a supplement to the statement of the Chamber of Commerce of the United States which appears at page 313 of these hearings:)

CHAMBER OF COMMERCE OF THE UNITED STATES,
Washington, D.C., July 17, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: In oral testimony before the Committee on Finance on July 11, 1969, Mr. Roscoe L. Egger, representing the Chamber of Commerce of the United States, indicated that the Chamber would submit a supplemental written statement in regard to its recommendations concerning the tax treatment of pollution control facilities.

Section 5 of H.R. 12290 provides a five-year amortization for certified pollution control facilities. Inclusion of this section in the bill is consistent with previous Congressional action recognizing that benefits of pollution abatement are essentially public benefits. For example, when the Congress suspended the 7% investment tax credit in 1966, it specifically exempted pollution control facilities. The need for a pollution abatement program persists. Such a program merits continued Congressional encouragement. The Committee is urged to give favorable consideration to the concept of the amortization of pollution facilities as proposed in Section 5 of H.R. 12290.

The Chamber would support a more liberal tax policy in this regard. The text of a statement of position on the taxation of industrial pollution control and abatement facilities adopted by the National Chamber's Board of Directors in February 1968 is attached.

We wish to take this opportunity to reemphasize the need for attention to possible administrative difficulties in the dual certification process proposed in Section 5 of H.R. 12290 which could negate the significance of this Section.

As presently written, Section 5 would require both Federal and State certification of a facility prior to its being eligible for five-year amortization. Under this process, a company might not qualify for the amortization deduction even if its treatment of waste complied with State or interstate standards. Differences between Federal and State agencies in certification requirements for pollution abatement facilities during the 1966 suspension of the credit and the impossibility of satisfying both were a reason that industry did not utilize the tax credit for pollution abatement facilities available at that time.

The proposed dual certification process would also appear to be in conflict with the previously expressed Congressional intent of both the Water Quality Act and the Clean Air Act of allowing State rather than Federal control and enforcement.

H.R. 12290 should be amended so as to provide for certification only by the state or regional regulatory agency concerned in instances where a State or region has established quality standards in conformance with State and Federal laws. In instances where the State or regional agency has failed to set quality standards, or where such agencies lack jurisdiction, the necessary certification would be obtained from the appropriate Federal agency.

In summary, the National Chamber urges that favorable consideration be given to the amortization of pollution control facilities as is proposed in H.R. 12290. We recommend, however, that Section 5 of the bill be amended to provide for certification by the State or regional regulatory agency concerned.

It is requested that this letter and the attached statement be made a part of the hearings record with other written statements on H.R. 12290.

Cordially,

DON A. GOODALL,
General Manager, Legislaive Action.

STATEMENT OF POSITION ON THE TAXATION OF INDUSTRIAL POLLUTION CONTROL AND ABATEMENT INVESTMENTS

Adopted by the National Chamber's Board of Directors in February 1968

The Congress and State governments have determined, as a matter of public policy, that an accelerated pollution abatement and control program is to be carried out. Achieving these objectives will result in substantially increased costs to industry. This is causing many diseconomies and it therefore challenges the government, industry, and the public to find the solution which can be adopted

at the lowest total cost with least disturbance to the economy. It is the conclusions of the National Chamber that this can best be accomplished by:

1. Extending the existing investment tax credit applicable to pollution abatement facilities to include land and structures;
2. Amortizing pollution abatement facilities within 1–3 years at the option of the taxpayer, with land included but subject to a provision for the recapture of the land amortization in the event that this land is subsequently used for any purpose other than pollution control. This program of rapid amortization should not eliminate the investment tax credit.
3. Providing for certification for credits and amortization by the State, or regional regulatory agency concerned. This certification would identify that the facility is constructed to meet requirements imposed by that agency and that its purpose is primarily pollution control. In effect, any expenditure initiated by abatement needs should qualify for the investment tax credit (including land and structures) and accelerated amortization.

STATEMENT OF THE AMERICAN TRANSIT ASSOCIATION ON REPEAL OF THE INVESTMENT TAX CREDIT AS CONTAINED IN H.R. 12290, SUBMITTED BY ROBERT SLOAN, EXECUTIVE VICE PRESIDENT

The American Transit Association hereby respectfully urges of this Committee that H.R. 12290 be amended to provide that the seven percent investment tax credit continue to apply to local transit companies (as defined in section 172(j)(1) of the Internal Revenue Code).

By way of background, the A.T.A. is a voluntary trade association which represents urban transit systems, both public and private, which provide transportation for 85 percent of urban transit passengers in the United States.

The pending legislation which would repeal the seven percent investment tax credit is of grave concern to the members of the American Transit Association, ninety percent of whose members are privately-owned companies, which primarily serve medium and small cities and the suburbs.

These private transit companies have been hard pressed to maintain their operations in view of constantly rising costs coupled with the decline in number of passengers that occurs when fares are increased. The industry is in a most difficult position for while it faces ever increasing costs, it cannot meet these costs by fare box increases.

Congress has recognized the magnitude of the problem urban transit systems face by its enactment of the Urban Mass Transportation Act, which provides Federal grants for urban transit systems. The enormity of the problem and the crisis urban transit faces has led to the realization that the Federal government must do a great deal more. That is why there is ever-mounting support for an urban transit trust fund, similar in concept and design to the highway trust fund.

It is incongruous that at a time when there is a recognition that much larger Federal support must be given urban transit, that Congress would impose an added tax burden on the private transit companies of the Nation. Yet, that is just what Congress will be doing if it repeals the investment tax credit and fails to grant an exemption to the urban transit industry.

Failure to grant such an exemption will not serve the best interest of our country as it will only make it more difficult for private transit systems to continue to serve their communities.

The latest available figures for the year 1967 show that private urban transit companies operating revenues were $626 million, net income after taxes was only $22 million, investment in new equipment was $41 million, Federal taxes were $38 million, and state and local taxes were $28 million.

These figures demonstrate the need for a continuance of the investment tax credit if private transit systems are to have a chance to survive.

AMERICAN GAS ASSOCIATION, INC.,
New York, N.Y., July 8, 1969.

Re H.R. 12290, Repeal of Investment Credit.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.
(Attention of Tom Vail, Chief Counsel).

DEAR CHAIRMAN LONG: The American Gas Association (A.G.A.) is composed of 369 member companies and 5,600 individual members. The member companies

provide natural gas service to 40,000,000 customers in all 50 states and in virtually every major city and town in the country. On behalf of its member companies, A.G.A. desires to submit the following comments for your consideration regarding the proposed repeal of the investment credit:

1. Since the gas industry is closely regulated by the Federal Power Commission and the several state commissions and a number of its member companies "flow through" the benefits of investment credit to their customers through the media of reduced gas rates, and since many corporations in all industries have made investment decisions which are now irrevocable, A.G.A. feels that the effective date of the repeal of investment credit should be the date of the enactment of the legislation, rather than any retroactive date. This will enable all industry and the regulatory authorities to give consideration to the problems of possible customer price or rate modifications, as retroactive adjustment of rates or commodity prices is not possible.

2. The effect of the 20 percent limitation would be to retroactively deprive many taxpayers of part, if not all, of their earned investment credit not yet utilized. But for the limitation, these carryovers and carrybacks more than likely would be used within the carryover period. If a taxpayer has only four years of the carryover period left to him, under many situations the most he could use under the limitation is 80 percent. Even worse, if the particular carryover period expires in 1970 he could lose 80 percent of the carryover. Obviously, this would be a punitive result.

Throughout the Committee Report (No. 91–321) it is made abundantly clear that the repeal has two principal objectives: to continue the fight against inflation and to obtain a revenue gain in the year 1970. Permanently depriving taxpayers of a credit they are presently entitled to under the law is not necessary to realize the goals of repeal of investment credit. The carryovers involved result from capital expenditures already made and a permanent deprivation will not increase 1970 revenues.

It is submitted that the undesirable result of the 20 percent limitation can be avoided without nullifying the purposes of repeal. We strongly urge that the 7-year carryover limitation of Sec. 46(b)(1)(B) of the Code be eliminated as to any carryover governed by the application of the 20 percent limitation.

Respectfully submitted,

ROBERT E. BAKER,
Chairman, Subcommittee to Study Proposed Tax Legislation.

STATEMENT OF THE NATIONAL MACHINE TOOL BUILDERS ASSOCIATION, IN OPPOSITION TO THE PROPOSED REPEAL OF THE SEVEN PERCENT INVESTMENT CREDIT, SUBMITTED BY DONALD H. McIVER, PRESIDENT

The National Machine Tool Builders Association (NMTBA) is a trade association representing approximately 250 American machine tool manufacturing companies. These companies account for approximately 80% of U.S. machine tool production. We are submitting this statement to protest the proposed repeal of the 7% investment credit.

In the absence of a modern and realistic system of capital equipment write-off, the investment credit is of vital importance in encouraging American industry to keep pace with today's continuing technological revolution and to exploit, as other industrial nations of the world are doing, the innovative industrial techniques thereby made possible.

Accordingly, we urge that the Committee, at the very least, take no action towards repealing the credit without first satisfying both itself and the American business community that the deficencies in our tax system thus exposed will be promptly remedied by either the legislative or administrative adoption of appropriate reforms in current tax treatment of capital equipment depreciation.

We do not petition the Committee for special treatment for our industry or our products, except to the extent that Congress might otherwise be disposed to consider *ad hoc* exceptions to general legislation in this area. Should Congress ultimately determine to repeal the credit other than on an across-the-board basis, however, we believe no products or equipment have a stronger claim to selective retention of the credit than machine tools.

Machine tools are the master tools of industry and the foundation of a modern industrial economy. As the essential machines which cut and bend and form metal, they are indispensable to the production of virtually every type of metal product. Truly, the nation's industrial plant is only as modern as the machine tools that make it go, and accordingly, whatever arguments justify the credit in general apply with obviously unique force to machine tools.

As the Committee well knows, those arguments are many and persuasive, and this is so regardless of whether, in our present preoccupation with Vietnam and the ghettos, we open or close our ears to them.

1. *The need to which the 7% investment credit was addressed in 1962 is no less in 1969.*

In 1962 Congress enacted the 7% investment credit in response to the Administration's urgings and its own recognition that industrial obsolescence was contributing significantly to the cost of goods at home and was seriously threatening our continuing ability to compete with other industrial nations in the world marketplace. Our experience with the credit since 1962, including our experience during the 1966–67 suspension period, has more than confirmed the wisdom of Congress's original action. The credit has contributed importantly to industrial modernization in the last seven years, which in turn has improved our ability to compete in world markets and created new employment opportunities at home.

But industrial modernization, once reached or approached, is not a permanent condition. The technological revolution continues apace, and other industrial nations, with their far more liberal systems of capital recovery allowances (which provide more cash flow for research and development and at the same time permit continuing plant modernization) are keeping up.

As a nation whose vulnerability in world markets is being constantly demonstrated anew, we must also keep up. We will not, however, if Congress should now decide that what in 1962 it gaveth, in 1969 it will taketh away—at least unless it provides or paves the way for compensatory reforms relating to the tax treatment of investment in necessary productive facilities.

The United States, even with the investment credit, has a far more antiquated and less generous system of capital recovery allowances than other leading industrial nations. This was true in 1962, and it is still true. It is a major contributing factor to our excess labor costs and our overall high costs of production, problems which are likewise as troublesome today as they were seven years ago.

Because the problems generated by relative industrial obsolescence (including high consumer prices at home and unfavorable trade balances abroad) are as serious in 1969 as in 1962, we believe that repeal of the credit, absent appropriate legislative or administrative substitutes, could seriously and perhaps irreparably damage the nation, just as failure to take the steps Congress did in 1962 would have exposed us to such dangers then.

2. *The asserted reasons for elimination of the credit are not persuasive.*

What is especially distressing about the current proposal to end the investment credit is that the arguments advanced in support of repeal are neither consistent nor convincing. One is left with the conviction that if the credit is killed, it will have died the victim of a political trade having little or no relevance to the economic issues involved.

Originally critics of the credit argued that it was inflationary, and of course that rationale underlay the unfortunate experiment with suspension in 1966. The alleged inflationary effect of the credit is also argued by the House Ways and Means Committee in its report accompanying H.R. 12290. But that argument is shortsighted. For while the credit may have limited, short-term warming effects on the economy, it is in the long run essentially anti-inflationary, because it makes possible lower production costs through expansion and modernization. Moreover, the long, divers and unpredictable lead times that characterize the purchase of various types of capital equipment, both at the planning and production ends, make the investment credit a peculiarly inappropriate economic fine-tuning device. This is true whether the proposed adjustment be in the form of enactment, suspension, restoration or, as here, outright repeal of the credit.

Nor can repeal of the credit be justified as a revenue measure, which is the argument on which the Administration apparently places primary reliance. We do not minimize the overall needs of the Treasury nor dismiss the budgetary significance of $3 billion, which is the Treasury's approximate estimate of the potential annual tax revenues involved. But there are other ways to collect such sums—one (but only one) of which would be to postpone the proposed downward adjustment of the present surtax.

In any event, in view of the revenue-collecting and revenue-saving alternatives available, we believe that immediate revenue needs should not lead the Government to forsake its policy of granting to industry reasonable capital recovery allowances as a means of preventing industrial obsolescence and thereby advancing such obviously related national goals as improving our balance of trade, maintaining a stable dollar and discouraging continuing expatriation of our vital and indigenous industrial base.

3. *If the credit is repealed, depreciation reform must follow.*

We have suggested reasons why it is imperative that industry in this country be accorded by its Government tax treatment comparable to that which obtains in other leading industrial nations. We live in one world, and we compete in one world. If we are to compete successfully, we must not add to our handicaps through our tax system by penalizing replacement of capital, where other nations encourage it. We must, in short, adopt permanent and realistic rules for the write-off of capital equipment.

Should Congress yield to the pressure for repeal of the credit, it is vital that it should promptly address itself, through its tax-writing committees, to overall depreciation reform.

Specifically, it should, in the interest of making realistic depreciation practically available, give prompt attention to elimination of the "reserve ratio" test, to authorizing larger initial allowances and to enactment of direct statutory authority for the use by taxpayers of depreciable lives realistically reflecting obsolescene.

4. *If the credit is repealed, liberal transition rules should be adopted.*

If the Committee decides to recommend repeal of the investment credit, either to pave the way for a basic overhaul and modernization of our depreciation system or otherwise, we would urge that any such legislation provide for liberal transitional rules. When the investment credit was originally enacted, American business was assured that it would be a permanent aspect of our capital recovery system. This assurance was also made in connection with 1966–67 suspension.

In these circumstances it is not surprising that many taxpayers have made important business planning decisions on the assumption that the credit would apply to the expansion or replacement programs contemplated. Fundamental fairness would require that possible repealing legislation not deny the credit to investments made in pursuance of such programs.

For example, we would urge that the narrow "binding contract" test be rejected in favor of a test that would grant the credit in the case of any invesment that could be shown to be "firm" in a practical business sense, if not in a strict legal sense, or which was made pursuant to any expansion or modernization program to which the taxpayer had made financial commitments prior to the effective date of repeal.

5. *Should Congress repeal the credit on a selective basis, there could be no jurisdiction for failing to retain the credit with respect to machine tools.*

We do not file this statement to plead our own special cause, for we believe the issues involved are national issues, requiring solution by the Committee with reference to its overall views of national policy. But we would be remiss in our responsibility to the Committee, as well as to ourselves, if we did not emphasize the special importance of machine tools to our national industrial plant.

As we have already suggested, machine tools are the master tools of industry—a metalworking industrial facility is only as modern as the machine tools within it. So if the purpose of the investment credit be to encourage investment in modern industrial facilities, and as to that there cannot be debate, no investment could be more consistent with that legislative purpose than investment in modern machine tools.

Accordingly, we urge, not alone in our interest, but in the interest of accomplishing the central purposes which the credit was designed to achieve, that any selective retention of the credit include retention with respect to machine tools.

STATEMENT OF WILLIAM VERITY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ARMCO STEEL CORP., MIDDLETON, OHIO, ON THE INVESTMENT TAX CREDIT

My name is William Verity. I am president and chief executive officer of Armco Steel Corporation. We are one of the nation's leading producers of carbon, specialty and stainless steels. We are also engaged in specialized manufacturing opera

tions and the production of materials such as titanium, stainless steel pipe and tubing, plastic sewer pipe and pre-engineered steel buildings, as well as in heavy equipment leasing and financial services.

The 45,000 men and women who comprise our organization are employed in forty-five plants in the United States and thirty-nine fabricating establishments in twenty-two foreign countries. The latter product for foreign markets.

We submit this statement for the record because we believe that repeal of the Investment Tax Credit would be a serious error—overly strong medicine, for a short-term malady. It could badly undermine the corporate and economic health of this nation. Its side effect could sap the competitive strength of American industry in world markets. Its direct effect could be more, rather than less, inflation.

We agree wholeheartedly that inflation is one of the most serious problems facing the United States today. From any point of view, however, it is most difficult for us to see how the investment tax credit contributes to that inflation or how its repeal will lessen the inflationary pressures.

The United States economy is plagued with labor shortages, as is clearly evident in accelerating wage demands. Conservatively, hourly wages will rise 10% in 1969. To whatever degree the investment tax credit encourages industry to modernize its facilities so as to use labor more efficiently, it is reducing inflationary pressures from that source.

The classic answer to rising prices for goods and services has been to increase the supply sufficiently to bring prices down. Repeal of the Investment Tax Credit will decrease the ability of industry to add to the supply. Restricting the growth of capacity practically assures continued inflation.

Moreover, the United States was lagging badly in the worldwide struggle for markets through capital expansion even before repeal of the Investment Tax Credit was proposed. With no "real" growth in 1967 and 1968 and perhaps 6% (after inflation) in 1969, the United States is averaging about a 2% annual improvement in its industrial capacity. Other industrial countries are expanding four to six times faster. It will require considerably more than minor adjustment of depreciation schedules to prevent large deficits in the United States merchandise trade balance in the next few years.

During the past decade, which has been a modernization period for the steel industry, our position in world markets has been declining. In 1957 foreign producers sold one million tons of steel products in this country. Last year they sold 18 million tons here—they took 16.7 per-cent of the U.S. market for steel products.

In terms of the effect on the Nation's balance of payments, our foreign trade in steel has moved from a surplus of $41 million in 1961 to a deficit of $1.5 billion last year. This trend hardly supports the conclusion that incentives for modernization of the domestic steel industry are no longer necessary.

The large, modern, deep water steel plants that have been built since World War II have changed the nature of world steel trade.

Low labor costs, low cost transportation of raw materials and finished products, and modern steel production facilities have made it possible for foreign producers to sell high quality steel products in our home markets at prices below our production costs. Many industrialized nations offer their steel producers far more incentive than our 7% Investment Tax Credit to encourage them to invest in new, modern steel producing facilities. This is the climate in which we must compete today.

Our ability to generate funds to build the best, most modern steel-making equipment is the very least we can do to meet this competitive challenge from overseas producers. It certainly is not in the National interest for our Government to put our industry at any further competitive disadvantage by depriving it of tax assistance that it now has on capital investment.

Repeal of the tax credit can have little impact on overall capital spending until late 1970. Based upon the 1966 experience when the credit was temporarily suspended, it is quite likely that by late 1970 a slowdown in capital investment would be exactly the wrong kind of economic remedy. By its very nature, the 7% Investment Tax Credit must be a long-range incentive to business investment. To expect it to have a significant short-range impact on investment decisions is not realistic.

Armco's participation in the U.S. steel industry's modernization has been substantial. Shortly after the investment tax credit was enacted in 1962, our management translated our plans for the last half of this decade into specific

modernization programs, including air and water pollution abatement facilities. We planned the facilities we knew we would need to serve our customers and the best interests of the public in the late 1960's and 1970's. We identified the technological improvements we would need to match and exceed foreign modernization programs and reverse the trend in steel imports.

We accepted at face value official statements that the investment tax credit and accelerated depreciation were to be permanent parts of our tax structure. The Honorable Douglas Dillon, then Secretary of the Treasury, made a very strong statement on this subject at the time the investment tax credit was enacted. He said:

"I consider our program of depreciation reform—including the investment credit—a central part of our economic policy . . . It is my conviction that depreciation reform, including both the administrative revision of depreciation guidelines and the investment credit, is not only the best way to bring about a higher investment level, but is absolutely necessary if we are to grow at a more rapid rate and maintain a widespread international confidence in our currency."

Assistant Secretary of the Treasury Stanley S. Surrey made a similar comment which stated the intentions of the Government in unmistakable terms. In a speech before the Society of Business Advisory Professions, Inc. on March 12, 1962, he said:

"I gather that some might say that the credit is, of course, effective, but why use it now when there is still slack in the economy? The fact that the investment credit was suggested at a time when we were in a recession period and the fact that it is being adopted in a period of recovery does not mean that it is to be regarded a counter-cyclical tool. Rather, it is intended to be a permanent part of our basic tax law."

Our financial planning was based on such responsible assurances that the tax credit was to be a permanent part of the tax structure.

After more than a year of planning—planning that included travel throughout the world to study the newest post-war steel mills in Germany, Japan, and other countries—we established a coordinated capital improvements program. It called originally for an investment of more than $600 million during the six-year period from 1964 through 1969. The program has since grown into an investment of more than $800 million that will not be completed until late 1970. This program is the first phase of an expected long period of continued and substantial investment in new and improved plant and equipment. New projects will be planned, engineered, and put into place just as rapidly as the economics of our business permit.

This modernization program is not one which was started solely because of the investment tax credit. Neither can it be stopped if the tax credit is repealed, because modernization is vital to our success as a company in the most competitive time in our history. The tax credit is, however, a vital tool which helps our company invest in much-needed modern equipment at a rate which otherwise would not be possible.

From a very short-term point of view, repeal of the investment tax credit will add to rather than relieve inflationary pressures. Where capital programs must continue regardless of the tax credit and where market conditions are favorable, prices will have to be raised to offset tax credit losses.

The investment tax credit is also an extremely important factor in our ongoing and very costly efforts to provide the best available air and water pollution control facilities. Pollution abatement equipment not only has a high initial cost but also a very high operation cost that goes on and on for the life of the equipment. This equipment does not add to production—it only adds to the cost of operation.

Proposed solutions to today's pressures and problems seem to converge on a set of national policies to curb inflation by concentrating almost exclusively on the business sector. Roughly proportioned, the economy is split up two-thirds consumers, one-sixth Government and one-sixth business. Despite their disparate sizes, each sector must function in harmony with the others in the system or the entire system operates like a badly tuned engine that sputters and balks at the most critical time.

We believe that any attempt to curb inflation which has permeated all sectors of the economy by concentrating restraint on just one . . . the business community . . . entails a dangerously high degree of risk.

I would respectfully suggest that it would be far better for the Congress to consider the investment tax credit in the overall context of reform that would

give this Nation an improved and realistic depreciation tax structure. It is urgently important to the continuing industrial health and progress that we stop once and for all the ill-advised practice of changing the rules whenever a variation is detected in our national economy.

STATEMENT OF THE NATIONAL MILK PRODUCERS FEDERATION, SUBMITTED BY PATRICK B. HEALY, SECRETARY

The National Milk Producers Federation is a national commodity organization. It represents dairy farmers and the dairy cooperative associations which they own and operate. Through these associations, farmers act together to process and market for themselves, on a cost basis, the milk produced on their farms.

The investment credit is available to dairy farmers, and it is important to them at the present time.

Very substantial changes are taking place in dairy farming and in the dairy industry.

The change from the use of milk cans to refrigerated bulk milk holding tanks on the farm is almost complete. Milk now flows through improved pipe-line milking equipment directly to refrigerated farm tanks where it is immediately cooled. Bulk tank trucks keep it cooled during transportation, and high quality sanitary equipment processes it in the dairy plants.

This is resulting in milk supplies which are greatly improved in quality, sanitation, and keeping ability. We are justly proud of the steady and substantial progress being made in this direction by the Nation's dairy farmers.

Coupled with the changes above mentioned, there is a strong trend at the present time toward fewer, larger, and more efficient dairy farms.

Because of the changes taking place, and which will continue to take place for several years, there is a pressing need for new equipment.

Total milk production is decreasing, production costs are high, prices have been too low, and there is a deep-seated feeling of dissatisfaction among dairy farmers with their economic lot.

The tax incentive provided by the investment credit is needed by dairy farmers to help them make the necessary adjustments required by the period of change taking place and also to prevent an increase in taxes which would further aggravate the cost-price squeeze in which they find themselves.

Figures published by the U.S. Department of Agriculture indicate hourly returns to dairy farmers for their labor ranging from 91 cents to $1.08 per hour.

Dairy processing plants operated by dairy farmers through their cooperative associations do not have net income, since all savings made through the operation of these plants must be returned to the farmers in the form of increased returns on their produce. The investment credit does not benefit the plants.

The retention of the investment credit for dairy farmers can be justified on the grounds that (1) they need the tax incentive to help them buy equipment to meet the needs of modernized and enlarged farms; (2) the production of high quality milk with modernized equipment benefits the Nation as a whole; (3) the cost-price squeeze of dairy farmers should not be further aggravated by increased taxes, and (4) declining milk production must be stabilized soon if adequate supplies of this important and essential food are to be assured.

In view of the foregoing, we urge retention of the investment credit for dairy farmers.

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA,
Houston, Tex., July 15, 1969.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

(Attention of Tom Vail, Chief Counsel).

DEAR MR. CHAIRMAN: The Independent Natural Gas Association of America (INGAA) is a non-profit trade organization composed of virtually all of the interstate natural gas pipeline companies in the United States, as well as producers and distributors of natural gas. This letter sets forth the position of INGAA with reference to the proposed repeal of the investment tax credit. It is respectfully requested that the letter be included as a part of the record of the hearings of the Finance Committee on the subject matter.

INGAA opposes the repeal of the investment tax credit for the following reasons:

1. *Natural gas pipeline service is essential to the Nation.*—Natural gas provides one-third of the energy requirements of this Nation for residential, commercial and industrial use, to approximately 38,369,000 customers. Demand for natural gas has increased at an average rate of 6.3% a year. Present projections indicate continued increases in demand. The continued health growth of the Nation depends upon uninterrupted natural gas service.

2. *Present and future demands require constant expansion of facilities.*—The present and future demands for natural gas require constant expansion of pipeline facilities. The projected demands for this low-cost, clean fuel indicate that expenditures for new facilities will increase in the future if the urgent public needs are to be met. The industry, however, is characterized by a high debt structure and in this day of high interest costs, the needed capital is extremely costly to obtain. Retention of the investment tax credit is highly important, if not absolutely essential, for the natural gas pipeline industry to have available sufficient capital to meet the present demands and increased demands of the future Repeal of the investment tax credit would deprive the industry of a vital source of capital upon which it has depended for its future programming to provide an indispensable fuel supply to meet market demands.

3. *Repeal of investment tax credit would loose inflationary forces.*—The loss of capital available through the investment tax credit, would force the gas pipe line industry into the already inflated money markets. The acquisition of needed funds through borrowing at the presently high interest rates would further increase the imbedded debt cost of the industry and require additional rate increases which would fall on the gas customers. The additional requirements of the gas pipe lines for such additional borrowing in the competitive money market would also tend to create increases in interest rates which would affect the entire economy, and increase rather than lessen inflationary trends.

There is no danger that the interstate pipe lines will contribute to inflation by construction of uneconomic or unnecessary facilities. The Natural Gas Act prohibits the construction of interstate gas pipe line facilities unless and until the Federal Power Commission has determined that they are required by the present or future public convenience and necessity. In fact, further expansion of the gas pipe lines would tend to arrest inflationary forces by making available on a wider range, lower cost fuel with which to meet energy requirements and to combat air pollution problems in the metropolitan and industrial areas.

4. *Surtax reduction will not offset repeal of investment tax credit.*—The argument that a reduction in the present ten percent surtax would partially offset the repeal of the investment tax credit is fallacious. Natural gas pipe lines are regulated by the Federal Power Commission. That Commission requires the pipe lines to pass on to its customers in the form of reduced rates, any reduction in the surtax. Hence, the regulated companies do not receive the same benefit from a reduction in the surtax as is available to non-regulated companies. It also follows that any funds generated by the reduction in the surtax are not available to the regulated companies (gas pipe lines) for expansion purposes. Funds generated by the investment tax credit are, by virtue of the law itself, available for investment purposes in accordance with the purposes and reasons for the investment tax credit.

In the Event Repeal of Investment Tax Credit Cannot be Avoided

It is the position of INGAA that in the event the Congress should repeal the investment tax credit despite the foregoing arguments, a transitional procedure be adopted to preserve the basic right of the taxpayer and to lessen the shock of the economic impact.

1. *Effective date of repeal.*—Repeal should be on a gradual scale, preferably over a three-year period, if a violent economic shock is to be avoided.

It is the position of INGAA that in the event gradual repeal cannot be accomplished, the effective date of repeal should be the date of enactment of the legislation: that any other date would, in a legal sense be retroactive and in violation of the Constitution, and in an economic sense, highly punitive.

However, should the Committee choose a date prior to the date of enactment it would seem only fair that the end of the Federal fiscal year to wit: June 30, 1969, would be appropriate.

2. *Qualified property.*—It is the position of INGAA that should the investment tax credit be repealed, provision be made to include as eligible and qualified property—any property which would be a part of a pipe line project which the Federal Power Commission has found or finds to be required by the present or future public convenience and necessity pursuant to certifcate applications filed with the Commission on or before the effective date of the repeal. Such applications and commitments have been made upon an economic basis, assuming the availability of the investment tax credit. Hence, it would appear that fairness requires a continuation of the investment tax credit for pipe line projects covered by pending applications which are found to be in the public interest by the Federal Power Commission. In no event should repeal destroy the eligibility of property included under an existing application whether fully contracted or not.

A repeal without at least the same transitional rules as were enacted at the time credit was suspended (Section 48(h) 1954 IRC) would be punitive.

AVAILABILITY TO THE TAXPAYER OF UNUSED INVESTMENT TAX CREDIT CARRYOVERS

It is the position of the INGAA that fairness requires provision for the taxpayer to be able to utilize unused investment tax credit carryovers. Although these credits were accumulated in good faith, the Treasury Department's proposal threatens to eliminate large portions thereof through offset against "simulated" computations, commonly referred to as "phantom" credits. To follow the suggestion of the Treasury in this regard would be to penalize those taxpayers who responded to the incentive objective during the very period in which national policy was deemed by Congress to require construction or acquisition of new plant and equipment.

INGAA respectfully submits that all accumulated investment tax credits should be available to the taxpayer. If necessary, the seven-year cut-off period provided under the present law should be extended.

IN CONCLUSION

INGAA respectfully submits the foregoing views and is fully prepared to substantiate the conclusions stated, should your Committee desire further advice thereon.

Sincerely yours,

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA,
WALTER E. ROGERS, *President.*

AMERICAN IRON AND STEEL INSTITUTE,
New York, N.Y., July 16, 1969.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The domestic steel company members of the American Iron and Steel Institute are concerned with the provision of H.R. 12290 currently being considered by the Committee on Finance, which provides for the repeal of the investment tax credit. We recognize the urgent need to control inflation but do not believe that repeal of the investment tax credit is the solution. We oppose the repeal of the credit because it is absolutely essential to the steel industry, which must continue to make very heavy capital expenditures to meet both domestic and foreign competition.

We believe the credit is basically anti-inflationary and as essential today as it was when enacted in 1962. The best long-term anti-inflationary climate exists where there are ample, adequate and modern productive facilities turning out an abundance of products at a rapid rate and at a low cost to meet demand. Capital spending for more efficient productive facilities is a powerful force for stabilizing prices. The investment credit encourages the operation of this anti-inflationary force. The effect of repeal would therefore be inflationary rather than deflationary.

Moreover, the enactment of the investment credit in 1962 was a part of the overall depreciation reform at that time. This reform was intended to enable American industry to better maintain and modernize its productive plant and

equipment, thereby helping to alleviate its competitive disadvantage with producers of other nations. That objective is more important than ever at this time in view of our nation's current balance of payments and related balance of trade problem of which the deficit balance in steel trade is a significant element, as evidenced by a drop from a $41 million surplus position in 1961 to a deficit over $1.5 billion in 1968. Furthermore, the investment credit was intended to be a permanent part of our basic tax law, and was not intended as a counter-cyclical tool. Official statements were made by Treasury Secretary Dillon and Assistant Secretary of Treasury Surrey at the time of the enactment of the investment credit in 1962 which clearly established these purposes. (Pertinent extracts from those statements are attached hereto.)

If, however, the Committee considers suspension or repeal of the investment credit necessary, we urge that you give most serious consideration to suspension rather than repeal. Reinstatement of the credit, if it were suspended rather than repealed, would be far simpler than the passage of entirely new legislation when concern over immediate measures to curb inflation is less acute than it is now. Additionally, air and water pollution control facilities should be exempt from any proposed repeal of the investment credit, and the provisions of H. R. 12290 providing for five-year amortization of such facilities should be revised to permit amortization of any facilities, whether depreciable or non-depreciable when its principal purpose is to abate or control pollution.

The steel industry is one of those most adversely affected by competition from foreign producers which enjoy more liberal depreciation and other special government benefits. Such foreign producers have increased their participation in the United States domestic steel market from 3.2 million tons or 4.7% in 1961, to 18 million tons or 16.7% in 1968. Depreciation allowances of American industry should be liberalized to strengthen their ability to compete more effectively, but not as a substitute for the loss of the credit.

Sincerely,

GEORGE A. STINSON, *Chairman.*

Attachments.

MAY 2, 1969.

EXTRACT—STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE TREASURY, BEFORE THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, JANUARY 18, 1962

. . . As you know, the first step of this reform was completed last fall with the announcement of new depreciation guidelines for a major part of the textile industry.

. . . This administrative revision of depreciation—if complemented by the investment credit now before the Congress—will place American industry on a substantially equal footing with its foreign competitors.

DEPRECIATION ABROAD

. . . In today's highly competitive world we find widespread use of initial allowances and incentive allowances supplementing depreciation charges. Thus for the major industrialized nations of the free world—Belgium, Canada, France, West Germany, Italy, Japan, the Netherlands, Sweden, and the United Kingdom—we have assembled reliable information with respect not only to depreciation practices, but also regarding initial and incentive allowances.

. . . Moreover, in addition to ordinary depreciation, Belgium, the Netherlands, the United Kingdom, and under certain conditions, Sweden, permit the deduction from income of incentive allowances. Initial allowances, which add very appreciably to the deduction that may be taken in the year of acquisition of a depreciable asset, are permitted in Canada, Italy, Japan, the Netherlands, Sweden, and the United Kingdom.

The impact of ordinary depreciation plus initial and incentive allowances on the amounts that may be deducted in the year in which a new asset is acquired is shown in the second column of the table. Here it may be seen that the percentage of the cost of an asset that may be deducted in the first year ranges from 20 percent in West Germany to 43.4 to Japan, compared with as low as 10.5 percent in the United States.

. . . Columns 3 and 4 of Table 1 show the percentage of the cost of the asset that may be deducted during the first two and first five years of its life. Here, again, it may be seen that the deductions permitted in each of the nine industrialized foreign countries comprise a far higher proportion of the cost of industrial machinery and equipment than is permitted under current law and practices in the United States.

. . . This picture changes dramatically, however, when the proposed investment credit enters. In terms of its effect on current liability, the 8 percent investment tax credit is equivalent to an incentive allowance of approximately 16 percent for corporations subject to the 52 percent corporate income tax rate and about 27 percent for corporations subject only to the normal tax rate of 30 percent. . . . In combination with a somewhat shorter life of 15 years, we find that the first year's equivalent deductions in the United States would be equal to 29.3 percent of the cost of new depreciable assets. This proportion is higher than that which obtains in Belgium, France, West Germany, Italy and the Netherlands. First-year deductions or their equivalents would remain substantially higher than those permitted in the United States only in Japan and the United Kingdom.

. . . The data presented in the bottom portion of Table 1 demonstrate clearly that, especially within the first two years of the life of an asset, even a revision to provide realistic tax lives will not, by itself, place the United States in a position comparable to that of its most immediate foreign competitors. The achievement of this objective, rather, requires both the investment tax credit and the faster write-offs that would be permitted under depreciation policies, which, in broader recognition of the increasing importance of obsolescence in the postwar world, would permit American firms to assume shorter tax lives for depreciable property.

Reviewing this summary and analysis, three important conclusions emerge: (1) Shorter tax lives alone will not do the job of bringing American industry abreast of its foreign competitors with respect to tax allowances for investment. (2) The investment credit will make a major contribution toward achieving that goal. (3) The combination of the credit and the forthcoming revision of depreciation guidelines will place the United States on substantially equal footing with other major industrial nations. These conclusions underscore the necessity for the Treasury's two-pronged program of revised, realistic depreciation and the investment credit.

SUMMARY AND CONCLUSION

I consider our program of depreciation reform—including the investment credit—a central part of our economic policy. Our two most important long-range economic problems today are to stimulate growth in the domestic economy and to eliminate the deficit in our balance of payment.

. . . It is my conviction that depreciation reform including both the administrative reevision of depreciation guidelines and the investment credit, is not only the best way to bring about a higher investment level, but is absolutely necessary if we are to grow at a more rapid rate and maintain widespread international confidence in our currency."

MAY 2, 1969.

EXTRACT—REMARKS BY STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY, BEFORE THE SOCIETY OF BUSINESS ADVISORY PROFESSIONS, INC., NEW YORK UNIVERSITY CLUB, NEW YORK CITY, MONDAY, MARCH 12, 1962

TAX POLICY AND ECONOMIC GROWTH

. . . The Treasury will complete its administrative revision of guidelines this spring. Why not stop depreciation reform there? The answer lies in an interesting table submitted by Secretary Dillon to the Joint Committee on Internal Revenue Taxation—a table which has three comparisons. It first gives for the Western European countries, and Canada and Japan, the percentage of the cost of industrial equipment which can be recovered over the first five years of the investment. It then shows the percentage for the United States, starting with the Bulletin F weighted average of 19 years for depreciable lives and going down through lives of 15 years on to 10 years. At no one of these levels would depreciation charges in the United States be comparable to those allowed abroad. In short realistic lives alone will not achieve for the United States the

tax treatment structures which is characteristic of European tax systems. The reason lies in the simple fact that the Europeans have built into their depreciation for investment a variety of incentive features which go beyond realistic depreciation. If we are to achieve comparable tax treatment for productive equipment—a comparability that will be very meaningful in a world of increased international competition and freer trade—and if we are to move on under our tax system to the modernizing and deepening of our own capital equipment, we must provide an over-all treatment that includes some allowance or incentive in addition to realistic depreciation.

The Administration and the House Ways and Means Committee propose to do this through an investment credit.

. . . *Comparability with Western Europe.*—The investment credit, coupled with realistic depreciable lives, will make the tax treatment of investment in the United States comparable with that offered by our major competitors in Western Europe, Canada and Japan. The investment credit thus takes its place along with the variety of Western European devices—such as the incentive allowances afforded in addition to depreciation in the United Kingdom, Belgium and the Netherlands, or the first-year additional depreciation allowances permitted in the United Kingdom, France, Italy and the Netherlands.

. . . I gather that some might say that the credit is, of course, effective, but why use it now when there is still slack in the economy? The fact that the investment credit was suggested at a time when we were in a recession period and the fact that it is being adopted in a period of recovery does not mean that it is to be regarded as a counter-cyclical tool. Rather, it is intended to be a permanent part of our basic tax law.

. . . In brief, the credit is far more powerful as a stimulus or incentive than most of the depreciation deduction incentives that have been suggested.

. . . *Revenue cost.*—When we look at the comparable revenue costs of various devices, we find that the incentive effectiveness of the credit is obtained at far smaller revenue cost to the Government than incentive depreciation deduction devices.

. . . This set of comparisons indicates that the investment credit out-performs on all counts commonly advocated incentive depreciation devices. Of course, there are some things neither vastly speeded-up depreciation nor the credit will do. It seldom has been realized, however, that criticisms aimed at the investment credit equally apply to the other suggested incentives. Thus, it is said that since the credit covers only acquisitions in this year or hereafter, it does not apply to the taxpayer who undertook an investment program a year or so ago. But the suggested depreciation deduction incentives also apply only to future acquisitions, as did the 1954 Code accelerated depreciation methods. It is also said that the investment credit will not immediately increase investments. Time is required for management decisions and planning, so that the year 1962 will not reflect the full effect of the credit. Again, this is equally true of any depreciation incentive. In short, these and similar observations apply to any incentive to investment, and are not peculiar to the investment credit.

STATEMENT OF THE BOEING CO. SUBMITTED BY J. O. MITCHELL, PUBLIC AFFAIRS MANAGER

Senator RUSSELL B. LONG,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

(Copies to selected Senators).

As a part of the record in connection with the hearings on H.R. 12290, the following is submitted to bring to your attention certain considerations as they relate to the Boeing Co. and the air transportation industry.

The Boeing Co. has supported an extension of the surtax as proposed by the administration. It is believed such an extension is a necessary step at this time to further the overall program to improve national economic conditions.

The proposal for the outright and permanent repeal of the 7-percent investment tax credit will have the effect of not only creating a permanent increase of the taxes borne by business but in addition, during the time of the extension of the surtax, will create a double tax burden beyond that which had been forecasted:

First, the "temporary" surtax would be extended beyond the original proposed period.

Secondly, during the same period of surtax extension, the 7-percent investment investment tax credit which was promised as a permanent part of the tax structure would be lost.

In connection with specific problems related to the repeal of the investment tax credit, we believe the suggested repeal date for the investment tax credit of midnight of April 18, 1969, places an unfair penalty on certain types of businesses that must operate from long-range plans, often involving a span covering a number of years. A more reasonable date would be related to the actual enactment of leigslation. This would give some opportunity for businesses to make a reasonable adjustment to such a far-reaching change.

At a minimum ,the effective date should not be established before midnight of April 21, 1969 ,the date of the presidential announcement. The suggested date of April 18 establishes an unprecedented retroactivity for a major change in tax legislation which is grossly unfair.

Two other features of the proposed legislaiton repealing the investment tax credit should be eliminated:

1. The one-tenth of 1 percentage point per month phaseout provision, starting January 1971.
2. The 20-percent carryover limitation on the investment tax credit.

The reasons we find these proposals objectionable are:

They will have a retroactive effect, penalizing taxpayers who relied on good faith on the availability of the credit when purchasing the equipment before the cutoff date.

The proposals are unfair to customers of a long leadtime industry, or a particular customer in a highy competitive industry who just hapened, for any of a number of reasons, to have placed a timely order for a later delivery.

The prospect of the credit phaseout will make it difficult to secure financing through third-party leases, which in turn will put additional pressures on capital markets to meet the established obligations. This is the very type of pressure the legislation is designed to avoid.

It should be pointed out elimination of these two features of the proposed legislation will not lessen the intended effect of retarding investments since the new equipment involved has already been ordered.

Your consideration and support of these proposals to insure that any tax legislation on these issues is fair and reflects proper consideration to problems of the transportation industry is earnestly requested.

Respectfully.

BOEING CO.
T. A. WILSON, *President*.

THE CHESAPEAKE AND OHIO RAILWAY CO.,
Cleveland, Ohio.

Mr. FRANCIS O. MCDERMOTT,
Tax Counsel, Association of American Railroads,
Washington, D.C.

DEAR FRANK: In accordance with your telephone conversation with Mr. R. S. Garnett on July 15, 1969, we are enclosing a draft of Bill and supporting statement to amend H.R. 12290, Section 168, by providing a special rule relating to termination of amortization of emergency facilities.

Very truly yours,

JOHN W. TISSUE.

SPECIAL RULE RELATING TO TERMINATION OF DEDUCTIONS FOR AMORTIZATION OF EMERGENCY FACILITIES

This amendment to H.R. 12290 is designed to preserve emergency facilities amortization deductions for taxpayers who were still engaged on December 31, 1968, in amortizing existing facilities or portions thereof previously certified to be necessary in the interest of national defense.

It will allow taxpayers that were "mid-stream" in recovering the adjusted basis (usually cost) of such facilities to complete a pre-planned financial program of capital expenditures associated and coordinated with national defense. It will not permit anything other than an opportunity for taxpayers to complete the 60-month write-off anticipated in the planning, construction, and financing of such facilities, with respect to which certificates were obtained and elections were made.

In the event a taxpayer desires at any time prior to the expiration of the 60-month period to discontinue taking the amortization deductions, the provision in the present law whereby a termination is absolute, is retained.

This provision merely eliminates the hardship imposed under H.R. 12290 which completely terminates the emergency facilities amortization deduction without making any provision for taxpayers that have completed all of the necessary statutory and regulatory prerequisites and are engaged in taking the deduction in reliance upon present law.

SPECIAL RULE RELATING TO TERMINATION OF DEDUCTIONS FOR AMORTIZATION OF EMERGENCY FACILITIES UNDER PRIOR LAW

If a taxpayer elected under Sec. 168(b) of C. 736, Public Law 591 (August 16, 1954), as amended, to take the emergency facilities amortization deduction allowed in subsection (a) of such law based on a period of 60 months, and the taxpayer on the effective date of this section has not completed amortization of such facilities, the taxpayer shall be allowed such further amortization deductions with respect thereto as are necessary to complete the elected period, except that nothing herein shall prohibit the taxpayer from discontinuing the amortization deduction as provided in Sec. 168(c) of C. 736, Public Law 591 (August 16, 1954), as amended.

THE CHESAPEAKE AND OHIO RAILWAY CO.,
THE BALTIMORE AND OHIO RAILROAD CO.,
Cleveland, Ohio, July 8, 1969.

FRANCIS O. MCDERMOTT, Esq.
Tax Counsel, Association of American Railroads,
American Railroads Building, Washington, D.C.

DEAR FRANK: This letter provides remaining amounts of basis and other background information with respect to emergency facilities of The Chesapeake and Ohio Railway Company subject to amortization deductions under Section 168 of the Internal Revenue Code of 1954.

Certificate No. TA–NC–26641 was issued for the construction of a Centralized Traffic Control facility from Limeville, Kentucky, to Parsons, Ohio. C&O elected to begin claiming amortization deductions on August 1, 1967, with respect to $375,000.00 (estimated) expended upon such facility, based on project completions during July, 1967. The estimated amount of $280,000.00 remained unamortized as of December 31, 1968, and the statutory deduction period with respect thereto will expire on July 1, 1972.

Certificate No. TA–NC–28861 was issued for improvements to a viaduct facility in Richmond, Virginia. C&O elected to begin claiming amortization deductions on January 1, 1965, with respect to $62,000.00 expended upon such facility, based upon project completions during 1964. The amount of $12,400.00 remained unamortized as of December 31, 1968, and the statutory deduction period with respect thereto will expire on December 1, 1969.

We feel that House Bill 12290, which provides in effect that deductions with respect to the amortization of emergency facilities will no longer be available after December 31, 1968, should be amended to provide that although amortization deductions for such facilities may not be commenced after December 31, 1968, a taxpayer who has previously elected to amortize certified facilities, and, who is in fact entitled to claim deductions with respect thereto under present law for a 60-month period for facilities completed before such date, will be entitled to continue to do so until (1) the expiration of the statutory 60-month period elected by him, or, (2) earlier termination by such taxpayer of his election to take such deductions.

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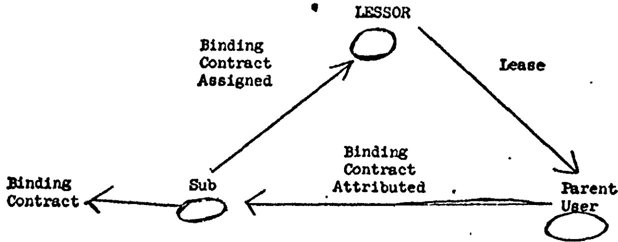
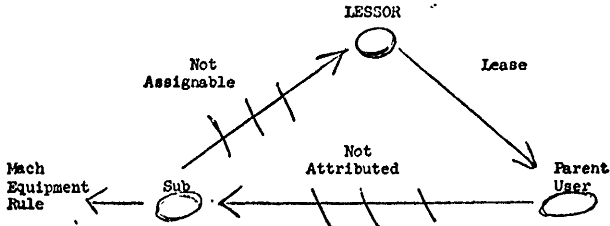


CREDIT IS ALLOWED TO LESSOR AND PASSED ON TO PARENT-USER



CREDIT IS NOT ALLOWED TO LESSOR OR TO PARENT-USER

We did not complete any certified projects during 1968 (with intent to elect amortization to commence January 1, 1969), nor did we have any such projects to progress on December 31, 1968. Thus, while we do not have those factual circumstances, they are mentioned since statutory language drafted in accordance with the foregoing probably would not resolve problems incident to such facts if they are presented by any other taxpayer.

Very truly yours,

ROBERT S. GARNETT.

STATEMENT OF REASONS FOR ALLOWING INVESTMENT CREDIT ON LEASEBACK TRANSACTIONS INVOLVING PROPERTY QUALIFIED UNDER MACHINERY AND EQUIPMENT RULE

The Chesapeake and Ohio Railway Company (C&O) acquires a large part of its freight car requirements by having the cars built by its wholly owned manufacturing subsidiary, Chessie Corporation.

Also, in recent years, C&O has begun to finance a susbtantial part of its freight car requirements through sale and leaseback. That is, a car which C&O has ordered from Chessie or from an outside builder will actually be purchased by a third party and leased to C&O.

In planning its freight car acquisitions for 1969, C&O ordered Chessie, among other things, to build a certain 1,500 cars at a cost somewhat above $16 million. Chessie ordered and acquired all of the necessary parts and components early in 1969, but did not begin construction until after April 18. Meanwhile, C&O was looking for a lessor to buy and lease back the cars, but did not enter into a binding lease until after April 18.

If either Chessie or C&O had had a binding contract for these cars in early 1969, it could have assigned the contract to a lessor and the lessor would have been entitled to investment credit for them; see proposed section 49(b)(5). This is true even if no construction and no lease had occurred before April 18.

Under the actual facts, Chessie and C&O were just as committed to the acquisition of the cars as if they had had a binding contract, because all of the neces-

sary parts and components had been acquired before April 18. The proposed legislation recognizes that acquisition of parts qualifies a taxpayer for the credit just as much as a binding contract; compare paragraph (4) of proposed section 49(b) with paragraph (1). Yet the benefit of a binding contract can be assigned to a lessor under paragraph (5), while the benefit of acquisition of parts cannot.

It is proposed to cure this unfounded discrimination by amending paragraph (5), relating to certain lease-back transactions. The amendments would make it possible to assign the benefit of acquisition of parts under paragraph (4) in addition to the benefit of a binding contract under paragraph (1) as the bill now provides, where a party to the assignment retains a right to use the property under lease. Also, a corporation affiliated with the assignor would be treated as being the same taxpayer as the assignor for purposes of this rule, in line with the rationale of the affiliated company rules of proposed section 49(b)(8). A technical amendment of paragraph (8) is also required in order to define the term "affiliated group" for purposes of the lease-back rule.

"(5) CERTAIN LEASE-BACK TRANSACTIONS, ETC.—Where a person who is a party to a binding contract described in paragraph (1), or who holds property which is pre-termination property by reason of the rules of paragraph (4), transfers rights in such contract or property (or in the property to which such contract relates) to another person but a party to such contract or transfer retains a right to use the property under a lease with such other person, then to the extent of the transferred rights such other person shall, for purposes of paragraphs (1) and (4), succeed to the position of the transferor with respect to such binding contract and such property. A corporation which is a member of the same affiliated group as the transferor, and which simultaneously with the transfer acquires a right to use the property under a lease with the transferee, shall be treated for purposes of this paragraph as the transferor and as a party to the transfer. In any case in which the lessor does not make an election under section 48(d)—

"(A) the preceding sentences shall apply only if a party to the contract or transfer retains the right to use the property under a lease for a term of at least 1 year; and

"(B) if such use is retained, the lessor shall be deemed for the purposes of section 47 as having made a disposition of the property at such time as the lessee loses the right to use the property.

For purposes of subparagraph (B), if the lessee transfers the lease in a transfer described in paragraph (7), the lessee shall be considered as having the right to use of the property so long as the transferee has such use.

* * * * * * *

SECTION 49(b)(8)

property on the date on which such other member entered into a contract for the construction, reconstruction, erection, or acquisition of such property, and

"(C) such corporation shall be treated as having commenced the construction, reconstruction, or erection of such property on the date on which such other member commenced such construction, reconstruction, or erection.

For purposes of this subsection and subsection (c), a contract between two members of an affiliated group shall not be treated as a binding contract as between such members. For purposes of this section, the term 'affiliated group' has the meaning assigned to it by section 1504(a), except that all corporations shall be treated as includible corporations (without any exclusion under section 1504(b)).

STATEMENT OF WALTER R. McDONALD, CHAIRMAN, COMMITTEE ON RAILROADS, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Mr. Chairman and Members of the Committee: My name is Walter R. McDonald. I am the Chairman of the Committee on Railroads of the National Association of Regulatory Utility Commissioners (NARUC). I am also a Commissioner of the Georgia Public Service Commission which office I have held since January 1, 1923.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within its membership are the governmental bodies of the fifty States engaged in the regulation of carriers and public utilities. Our chief objective is to serve the public interest through the improvement of government regulation.

We very much appreciate this opportunity to express our views on H.R. 12290, a bill, which among other things, proposes the repeal of the investment tax credit.

We of State regulation have long been vigorously engaged in an effort to strengthen and improve our national rail transportation system so that it may better serve the American people. Historically, the States were the first to develop public utility type regulation to protect the public interest in such fields as railroad transportation, grain storage and others. It was not until 1887 that the Congress created the first Federal regulatory agency—the Interstate Commerce Commission.

We believe that the national interest demands that the investment tax credit be retained for the railroad industry.

The solution of the Nation's growing transportation crisis is largely dependent upon improved rail passenger service, elimination of chronic freight car shortages, and improvement of roadway facilities. Obviously, any shortage of transportation, by disrupting flows of production, would be inherently inflationary and would weaken the national defense.

The railroad industry is of course characterized by large annual requirements for reinvestment in both rolling stock and fixed plant. However, the railroad industry falls far short of generating internally enough funds to finance required capital improvement programs because of extremely low earnings.

Accordingly, the investment tax credit provides vital support for improvement programs—cash for railroads with taxable income, and favorable lease terms for others.

The adverse effect of removing the stimulation of the investment tax credit from the railroad industry is illustrated by the industry's experience with the temporary suspension of the credit in 1966–67. During this period orders for freight cars drastically fell off and, just prior to the end of the suspension, orders for new cars were minuscule.

The Nation simply cannot afford a worsening of the serious freight car shortage which has long weakened our economy. Nor can the Nation tolerate any further deterioration in the character of its passenger train service.

In view of these considerations, we strongly urge the members of the Committee to exert every effort to preserve the investment tax credit for the railroad industry so that it may better serve the American people.

Attached is a copy of the resolution of the Executive Committee of the Association supporting this statement. The resolution was adopted on July 17, 1969.

Resolution Urging the Continuation of the Investment Tax Credit re Railroad Rolling Stock and Roadway Facilities

Whereas there is now pending before the Congress of the United States H.R. 12290 ,a bill to repeal the present seven percent investment tax credit; and

Whereas the National Association of Regulatory Utility Commissioners has been concerned with the regulation of railroads since being founded in 1889; and

Whereas the Association is vitally interested in the improvement and modernization of rail transportation and railroad facilities; and

Whereas the Association has for many years directed substantial energies toward finding means to reduce and eliminate chronic freight car shortages and toward the improvement of railroad passenger train, freight car and roadway facilities; and

Whereas the Executive Committee of the Association is of the opinion that elimination of chronic freight car shortages and improvement of passenger train and roadway facilities is in the national interest and, in fact, should be regarded as a national priority; and

Whereas the financial condition of the railroad industry is not as propitious as comparable industries and therefore capital investments are more difficult to make; and

Whereas the ability of the railroads to eliminate freight car shortages and improve passenger train and roadway facilities will be greatly curtailed if investment in same is not exempted from the proposed repeal of the seven percent investment tax credit law: Now, therefore, be it

Resolved, That the Executive Committee of the National Association of Regulatory Utility Commissioners hereby urges the Congress of the United States to amend H.R. 12290, or any similar bills, proposing the repeal of the investment tax credit, so as to continue the application of such tax credit to investments made in railroad rolling stock and roadway facilities; and be it further

Resolved, That representatives of this Association are hereby authorized and directed to take such measures as are necessary to advise the Congress of the position of the Association on such legislation; and be it further

Resolved, That copies of this resolution be furnished by the General Counsel of the Association to the members of the Committee on Finance of the Senate and of the Committee on Ways and Means of the House of Representatives of the United States Congress.

AMERICAN TRUCKING ASSOCIATIONS, INC.,
Washington, D.C., July 18, 1969

Subject: Repeal of Investment Credit—H.R. 12290.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee, New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The 7% investment credit provision now in our tax law has been of material benefit to the nation's regulated trucking industry. It has helped in preserving a reasonable rate structure and maintaining the necessary equipment for a safe and adequate public transportation system on which the commerce of the country and its economy depend.

We hope that if any changes are to be made in H.R. 12290 in the way of preserving this credit, consideration will be given to its continuation for the transportation industry. We believe that would be in the public interest.

However, any such action should not be limited to any single mode of transportation but should apply to all of the carriers. Otherwise, in the highly competitive transportation area someone could be hurt.

Respectfully submitted.

JAMES F. PINKNEY.

LAW OFFICES, EDWARD L. MERRIGAN,
Washington, D.C., July 18, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: We are writing to you on behalf of Central Gulf Steamship Corporation an unsubsidized carrier of the American Merchant Marine, to urge that your Committee correct the gross inequity which inadvertently developed as a result of a last minute amendment added to H.R. 12290, the Surtax and Investment Credit Suspension Bill, whereby an exception to the repeal of the investment credit was made in favor of *subsidized U.S. flag carriers only.*

The particular section to which we refer is in Section 4b) of the bill under the heading 'Barges for Ocean Going Vessels." Under the House bill, investments in barges to be carried on ocean-going vessels (LASH-type vessels), are exempt from the investment credit repeal if they are to be constructed pursuant to a contract with the Maritime Administration of the Department of Commerce, and if they are specified in the same contract pursuant to which the so-called "mother vessels" are being constructed with U.S. subsidy contributions.

Inasmuch as these provisions require the existence of a contract with the Maritime Administration, they cover only those American carriers who are subsidized by the Maritime Administration and they completely exclude unsubsidized carriers, such as Central Gulf. Moreover, the said provisions unfairly make it necessary for barges to be covered by the same subsidy contract pursuant to which the mother vessels are constructed with subsidy payments by the Government, and thus they exclude the case where an unsubsidized carrier, like Central Gulf, has contracted for the separate construction of its barges in an American shipyard—in this case, the Equitable-Higgins Shipyard in New Orleans, Louisiana.

Accordingly, we urge your Committee not to report the pending bill until this gross inequity is corrected by modifying language.

In order for you completely to understand the thrust of this request, please permit me to set forth hereinbelow the facts surrounding Central Gulf's barge construction contracts, which clearly should be covered under the exception from the investment credit repeal granted by the House as aforesaid.

On December 15, 1967, Central Gulf Steamship Corporation of New Orleans, an unsubsidized U.S. flag carrier, entered into a contract to build a LASH-type vessel to carry barges in foreign commerce between the Gulf Coast and Europe. In that contract, Central Gulf reserved an option for the construction of a second LASH-type vessel, and that option was exercised on February 19, 1969. Both of these shipbuilding contracts were assigned by Central Gulf to another closely

related company which thereupon entered into contracts with Central Gulf in February, 1969, whereby the two vessels were chartered to Central Gulf for a period of 10 years. The cost of construction of the two "mother vessels" will be appproximately $20,000,000.

On January 8, 1968, shortly after Central Gulf entered into the aforesaid contract for construction of the "mother vessels", Central Gulf entered into a second, *separate* contract with Equitable-Higgins Shipyard Company of New Orleans, Louisiana, whereby Central Gulf ordered a total of 383 barges to be constructed in the New Orleans shipyard for use on the "mother vessels" when the latter are finally constructed and ready for operation, the first "mother vessel" to be ready and available in late 1969. Under the terms of this barge contract, 233 barges were ordered for immediate production and Central Gulf reserved an option for later construction of the remaining 150 - Central Gulf's purpose being to determine first whether the shipyard in New Orleans would satisfactorily construct and deliver on time the first 233 before it became irrevocably liable for the construction of the remaining 150 barges.

On December 31, 1968, when it became clear that Equitable-Higgins was satisfactorily proceeding with construction of the initial barges, Central Gulf exercised its option in writing for construction of the balance of 150 barges required to operate the two mother vessels mentioned above.

On February 24, 1969, almost two months after the last mentioned option had been exercised, Central Gulf wrote to the Equitable-Higgins Shipyard reminding the shipyard that it had not yet received the additional supplementary contract required to confirm the terms and conditions on which the last 150 barges would be delivered to Central Gulf. For various reasons, the negotiations with reference to these last mentioned terms and conditions continued between Central Gulf and Equitable-Higgins during the period from February, 1969, through early April, 1969.

At one point during the negotiations, it appeared the parties might not be able to get together on these terms and conditions and Central Gulf actually withdrew from further negotiations. However, this withdrawal was temporary only, with the result that on May 26, 1969 Central Gulf and Equitable-Higgins entered into a formal agreement whereby the parties reconfirmed their earlier contractual commitments and Equitable-Higgins proceeded with the construction of the balance of the 150 barges required by Central Gulf to operate the two mother vessels referred to hereinabove.

As mentioned above, the cost of construction of the two mother vessels is $20,000,000. The 233 barges constructed under the first installment of the January 8, 1968 contract between Central Gulf and Equitable-Higgins will cost $6,200,000. The balance of 150 barges, which, of course, are the subject of Central Gulf's concern, insofar as the suspension of the investment credit is involved, will be $4,500,000.

Please permit me to reiterate that these 150 barges, like the 233 mentioned above, are absolutely and vitally required to operate the two mother vessels hereinabove referred to. In other words, without the barges, the mother vessels ordered almost two years ago will be useless to Central Gulf.

The provisions of the House bill are totally objectionable to Central Gulf because they are limited to subsidized vessels only, and they are made totally contingent on the barges being specified in one and the same contract for construction of the mother vessels. In this case, Central Gulf contracted for the mother vessels under one contract and contracted for the barges under a second, separate contract--the reason being that the mother vessels were constructed by one shipyard, while the barges were constructed by a second shipyard.

Patently, if the Congress is to grant an exception from the investment credit repeal to any segment of the American Merchant Marine, it should positively include those carriers who are otherwise unsubsidized by the United States Government. The unsubsidized carrier, who has to finance its entire vessel construction with its own funds, certainly must be treated on at least an equal footing as those carriers of the merchant marine who construct their vessels with a 55% construction differential subsidy payment of all costs by the United States Government. Please understand that we do not oppose relief which has been granted to these other American carriers—we simply submit that such relief must be made available on equal terms to unsubsidized carriers such as Central Gulf.

If you or you staff require additional information for the correction of this gross inequity, please feel free to call upon me, and with kindest regards, I am,

Sincerely,

EDWARD L. MERRIGAN.

[TELEGRAM]

TRANSPORTATION ASSOCIATION OF AMERICA,
Washington, D.C., July 17, 1969.

Senator RUSSELL LONG, *Chairman, Senate Committee on Finance, New Senate Office Building, Washington, D.C.:*

The Transportation Association of America with broad membership comprised of transportation shippers and other users, investors, and for-hire airlines. Freight forwarders, highway carriers, oil pipelines, railroads and water carriers urges continuation of investment tax credit for publicly regulated transportation modes.

Tax credit incentive has enabled carriers to finance extensive technological advances which have expanded public services while holding down rates and fares, thereby restraining inflation.

Industry is commited to long-range program to enlarge and improve existing equipment with lead times far beyond immediate impact of inflation. Credit repeal will force more intensive competition with other more profitable business for capital funds to finance fleet expansion. This will increase capital cost. Regulated transportation lacks freedom to adjust rate and fare levels. It has become low-profit, low-earnings industry and needs tax credit to keep pace with vast public need for expanded service.

TAA also asserts that justification for credit repeal generally supporting House action does not apply to transportation industry. We urge Senate Finance Committee approval of credit extension for all modes of publicly regulated transportation. We request that this TAA recommendation be made a part of the official committee records.

HAROLD F. HAMMOND, *President*

[TELEGRAM]

NEW YORK, N.Y., *June 18, 1969.*

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
New Senate Office Building, Washington, D.C.

Wall Street Journal June 18 indicates that unused investment credits be allowable only to the extent of 20 percent in years 1969 through 1973. This represents unfair deprivation to members of our Association of the unlimited carryover in each of 7 years provided by present law. Urgently request reconsideration of this limitation and suggest that unlimited utilization in each year beginning in 1969 be retained. Purchases of equipment acquired under present law were based upon estimates which assumed use of full investment credit including carryover utilization. Retroactive repeal of carryover provisions unfairly removes benefits reasonably assumed to exist when commitments for equipment were made.

COMPUTER LESSORS ASSOCIATION INC.

STATEMENT BY ROBERT C. TYSON, CHAIRMAN, FINANCE COMMITTEE, UNITED STATES STEEL CORP.

We are pleased to have this opportunity to present this statement to the Committee on Finance in connection with its consideration of the proposed repeal of the investment tax credit. We have previously presented a number of reasons for opposing repeal to the House Ways and Means Committee. In the following statement, these reasons are summarized and amplified in light of more recent developments.

A. PERMANENCY

Initially, it should be pointed out that businesses have made their capital expenditure decisions on the basis that the credit would remain permanent. The testimony of Administration witnesses during the hearings held on the investment credit in 1962 and again in 1966 clearly indicates this intended permanency of the credit. As late as April of this year, former Treasury Secretary Fowler stated that the credit "was designed, adopted and has proven effective as a permanent structural feature of our tax system . . ."

B. DEPRECIATION REFORM

The reason underlying the intended permanency of the credit is that it has always been considered part of depreciation reform. Throughout the decade following the end of the Korean War, there was much discussion and concern about the fact that depreciation does not recover dollars having purchasing power equivalent to those originally expended many years ago for plant and equipment. Because of this, there was an inequitable tax burden on those companies and their owners who are more heavily invested in long-lived plant and equipment. The investment credit was designed to eliminate part of this inequity.

In adidtion, it was generally recognized that lagging capital formation and rising facility obsolescence were largely attributable to lagging depreciation allowances—lagging in relation to inflation of facility costs and in relation to liberal depreciation policies abroad. It was also generally recognized that industrial plant replacement would continue to decline unless capital monies otherwise destined for expansion were used instead for replacement purposes. Thus, the credit has helped to prevent a lag in capital expenditures for replacement and modernization. It has also materially aided capital formation.

As the then Secretary of the Treasury Douglas Dillon stated before the Joint Committee on Internal Revenue Taxation on January 18, 1962: "I consider our program of depreciation reform—including the investment credit—a central part of our economic policy." The need for the investment credit as an integral part of depreciation is just as great today as it was in 1962.

Repeal of the investment credit would be tantamount to a reduction in depreciation charges and tend to defeat the purposes of depreciation reform. Depreciation is the real seed corn which permits industry to keep existing plant intact and modern. It is sometimes overlooked that any extension of the surtax would be a tax on corporations, just as it would be a tax on individuals. Any cutback in the investment credit or its elimination would, in effect, be an additional tax on those taxpayers presently qualifying for the investment credit. This is an inequity by itself but one which would involve a further inequity in the tax system because, as previously indicated, in an inflationary period those companies which are more heavily invested in long-lived equipment would pay relatively more tax than would those having lesser capital investment requirements. This was one of the inequities that the credit was designed to eliminate. Thus, the credit was not and is not a subsidy.

C. INTERNATIONAL COMPETITIVENESS

Another compelling reason for adoption of the investment credit in 1962 was to help improve the international competitiveness of American industries. Despite President Nixon's claim that new plant and equipment since the early 1960's has brought the Army economy to new levels of productivity and efficiency, a recently completed survey by McGraw-Hill, Inc. indicates that the United States today has the highest percentage of over-age, obsolescent production facilities of any leading industrial nation. This is reflective of the facts that the U.S. continues to have the lowest ratio of capital investment to Gross National Product of any of the major industrial nations, and that many of our foreign competitors continue to have tax policies and incentives for capital investment that are more beneficial than our own. The ratio of investment to GNP was fully documented in the *Statistical Yearbook for the United Nations* (1967), and the foreign tax policies were fully summarized in *Business International* (February 7, 1969 issue).

These factors, coupled with the deterioration in our trade balance, strongly suggest that the need to improve our international competitiveness is equally as great today—if not greater—than it was in 1962. Improved productivity is our nation's best means of meeting foreign competition, and improved productivity stems largely from more capital spending. Thus, repeal of the investment credit would weaken this nation's competitive strength, which in turn would further aggravate our problems relating to balance of payments.

D. INFLATION

Despite the importance of capital spending in improving productivity, it has recently been challenged by some as "excessive" and hence an inflationary stimulus to demand. Although we share the concern about reducing inflation, we believe an examination of the following facts will show that the current level of capital

spending is not "excessive" and, further, that the investment credit is not inflationary.

As to the level of capital spending, even if it were to raise by the 12½% cited in a June 1969 survey by the Department of Commerce, it would still only bring the spending percentage of GNP back to about 8 percent—the same level as in 1966 when our economy became fully employed. In addition, the percentage gain in such spending since 1966 would be slightly less than the projected gain in GNP and the projected gain in personal consumption expenditures; it would lag far behind the percentage increase in government purchases of goods and services. Furthermore, it should be noted that a 12½ percent gain in plant and equipment spending this year would only involve additional outlays of about $8 billion, while a projected 7 percent gain in personal consumption expenditures would involve additional outlays of $36 billion. So the big inflationary pressure is being registered not by the businessman but by the consumer and the government.

As to the relationship between the proposed repeal of the investment credit and inflation, any such repeal would do little if anything to curtail capital spending in the short run because businesses will in all probability complete projects which are now underway. If it is assumed that the Federal Government would spend the resulting additional tax revenue for other than capital goods, in the short run this would tend to stimulate demand-pull inflation since our economy is already at full employment; this stimulation would be on top of the cost-push inflation induced by labor settlements and continuing union demands far in excess of gains in output per man-hour which our economy has been experiencing. In terms of the long run, history clearly demonstrates that nothing has done more to hold down prices of things which people buy than has the improved productivity and additional potential output resulting from capital spending.

E. CAPITAL FORMATION

This long-term necessity of a high level of capital spending was recognized by President Nixon's statement of April 21: ". . . . a vigorous pace of capital formation will certainly continue to be needed . . ." Just as experience with the investment credit has been to the national good during the last seven years, so too can the credit help to insure future capital formation vital to achieving the goals of improving industrial productivity, maintaining economic growth, combatting inflation, employing an expanding labor force, meeting intensified international competition strengthening our national security, and waging the war against poverty. There is every reason to believe that achievement of these goals will become even more imperative during the 1970's than was the case during the 1960's and that continuation of the investment credit could play a key role in this effort.

F. TIMING

In addition to the long-run impact which repeal of the credit would have on capital formation, there are also shorter-run implications since, as the Treasury Department has pointed out in their estimates of revenue, it will be a full year—if not longer—before much of the direct impact of this repeal can be felt. But this impact might very well come at a time when it will compound already weak or weakening economic conditions and thus lead to a substantial "overkill" of the boom.

G. ALTERNATIVES

If, in spite of all of these reasons for retaining the investment credit it is believed that something must be done, it seems to us that any of the three alternatives mentioned by Father Hogan to this Committee on July 15, 1969, would more effectively accomplish the indicated objectives of the proposed repeal legislation while at the same time avoid in part the disruptive and damaging effects which repeal would have. These three alternatives to outright repeal were stated as follows: (1) The suspension of the credit for a limited period of time. (2) The reduction of the rate of the investment credit to 4 or 5%. (This alternative could conceivably take several forms—for example, an immediate reduction in rate, a gradual reduction over a period of time, or a reinstatement of the former so-called "Long amendment" which required a reduction of the depreciable base by the amount of credit allowed.) (3) The continuation of the credit as it now stands with amortization of the total amount over the life of the asset. A variation of Father Hogan's third alternative would be a further depreciation

allowance of 14%, to be spread over the life of the facility; this variation, providing for depreciation in excess of historical cost, would be a partial recognition of the fact that present depreciation laws in an inflationary era do not permit the recovery of dollars having purchasing power equivalent to those originally expended. A small step in the direction of these alternatives was taken by the House of Representatives in its bill, which permits amortization of expenditures for air and water pollution equipment over five years.

It seems to us that, short of full retention of the credit, each of these three alternatives would be far preferable to outright repeal on several grounds:

—During the fiscal year beginning July 1, 1969, the Federal Government would realize more tax revenue if the credit were amortized over a period of years instead of deducted currently for facilities completed during the year but qualifying for the credit under existing law, would realize the same revenue if the credit were suspended instead of repealed, and would receive less revenue if the investment credit rate were reduced rather than eliminated. In the long run, however, tax revenues would be favorably affected because the additional investment flowing from continuation of the investment credit (but in some modified form) would tend to result in more production and employment and hence more tax revenue.

—Any of the three alternatives would run less risk of "overkill" and recession. Further, if the investment credit were maintained as part of the law, but in some modified form, the present credit could in all probability be reinstated more easily and more quickly than if the credit were repealed outright at this time.

—Economic growth would be less retarded because in the long run such growth is related to the rate of business investment in plant and equipment.

—Productivity and efficiency gains would be less inhibited, since modern tools and technology go hand in hand with rising productivity and high efficiency.

—Employment and job creation would be less threatened because there would be a greater incentive to invest in job-creating tools of production, as well as a greater financial ability to so invest.

—This nation's international competitiveness and balance of payments would be less adversely affected because American businesses could continue to recover their investment in plant and equipment at a rate which would more closely approach those permitted by many foreign nations who are our very powerful competitors.

—National defense capabilities would be less jeopardized, since any reduced incentive to invest not only has a stagnating effect on our peacetime economy but would also limit our ability to produce goods of all types needed during a national emergency and in preparation for such an emergency.

—Finally, improving our nation's standard of living and meeting our social priorities would be less difficult, since more production and taxable income would result from the additional investment associable to each of the three alternatives.

II. EQUIVALENT DEPRECIATION

If, despite all of these reasons for retaining the investment credit—even if only in modified form—it is decided to repeal it, then we would strongly urge that additional equivalent depreciation reform be simultaneously substituted for it. If such meaningful reform is not effected simultaneously, there is a grave danger that it will be forgotten about—and the whole nation would be the loser if this happened.

Toward this end, the Treasury Department has recently initiated a study of more liberalized depreciation which would, in part at least, offset the repeal of the investment credit. Until the results of this study become available, it would appear prudent to defer action on the investment credit which, as previously pointed out, was and is considered an integral part of depreciation reform.

In lieu of the investment credit, various types of equivalent depreciation reform have been proposed recently. These include the previously mentioned additional depreciation allowance of 14 percent; elimination of the reserve ratio test, and thus making the guideline lives a matter of right; shorter write-off periods; triple declining balance depreciation; and additional first-year depreciation. Although any of these would be a step in the right direction, all of them still fall short of fully dealing with the fundamental facility replacement problem arising from past inflation—let alone currently accelerating inflation—since except for the first of these proposals total depreciation over the lives of facilities would still be limited to original cost. Realistic depreciation recognizing changes in purchasing power in our inflationary age has yet to come.

In summary, we strongly urge continuation of the investment credit in its present form. If this is not possible, then we would urge either its continuation in modified form or meaningful depreciation reform.

(The following communication was submitted to the committee by Hon. John Sherman Cooper, a U.S. Senator from the State of Kentucky:)

RYDER TRUCK RENTAL INC.,
Louisville, Ky., June 3, 1969.

HON. JOHN SHERMAN COOPER,
The U.S. Senate, Washington, D.C.

DEAR SIR: As you know, the Administration has proposed that the Investment Tax Credit be repealed as of April 21, 1969. In this connection, we wish to bring to your attention and ask your consideration of a proposal for the modification of the "credit recapture" provisions of Section 47 of the Internal Revenue Code and a revision of the effective date in the event the Investment Credit is repealed.

Owners of commercial trucks and tractor-trailers set up the Investment Tax Credit on the basis of the normal depreciable lives of the equipment. Frequently, however, we replace existing equipment earlier than its normal depreciable life because of obsolescence, failing components, collision damage or other casualty. As the law now stands, if we do take such equipment out of service before its credit life, all or a part of the Investment Tax Credit is payable as additional taxes in the year the equipment is removed from service; but the investment credit on the replacement equipment to some extent offsets the credit lost due to early retirement.

We propose that if the Investment Tax Credit law is repealed, that the recapture provisions which would otherwise apply to the early retirement of equipment be made inoperative where the equipment is removed before its normal depreciable life because of collision or other casualty, failing components, obsolescence or similar reasons, and the equipment taken out of service is replaced by equipment of like kind. We believe such suggested modification of Section 47 in the event of repeal of the Investment Tax Credit would be fair to all industry and would relieve one of the harsher consequences of the repeal.

As regards the Administration's proposed repeal date of April 21, 1969, we request your consideration to advance such effective date to May 1, 1969. A repeal date which coincides with a month end date we believe would facilitate the transition and avoid the type of problems that were experienced by industry and the Treasury Department when the Investment Tax Credit was suspended in 1966 on a mid-month date.

Sincerely,

RYDER TRUCK RENTAL, INC.,
JAMES M. SMITH,
District Manager.

MID-WEST ADVISORY BOARD,
Chicago, Ill., July 15, 1969.

Hon. RUSSELL B. LONG,
Chairman, U.S. Senate Committee on Finance,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: The contemplated repeal of the 7 per cent investment tax credit is a subject of vital interest to the many shippers and receivers of the Mid-West Advisory Board.

We vigorously oppose its appeal.

The Mid-West Advisory Board is one of a National group of Shipper Advisory Boards, whose primary objective is to ensure an adequate supply of rail cars and motive power for our shipping requirements. To that end we have a cooperative effort for improved efficiency in the use of the present equipment.

The repeal of this tax credit is designed to curb industrial expansion, and inflation. As proven in the past, the absence of the tax credit abruptly curtailed the purchase of railway rolling stock.

The demand for transporation services is a deprived demand, based on the present need of industries for railway cars to transport their products to consumers. To artificially restrict the supply of railway cars would impose severe operating difficulties on industry, superimpose inefficiency in physical distribution of their products, and force the use of higher cost modes of transportation.

The purchase (replenishment) of railroad cars cannot be considered an industrial expansion, and we believe this item should be given the incentive of the 7 per cent investment tax credit. Car supply daily becomes more critical, with retirements exceeding replacements, and the National car shortage is the subject of an investigation by the Senate Surface Transportation Subcommittee.

The Senate Commerce Committee also has taken a strong position toward the Interstate Commerce Commission for not taking action to solve this chronic car shortage. Note that the Interstate Commerce Commission has drastically increased penalty demurrage for industries guilty of excessive car detention.

May we also add to the record that the maintenance of a strong railway system is a vital part of National Defense.

The Senate has knowledge of the car shortage through its investigations, and we respectfully suggest combining that knowledge with your consideration of the 7 per cent investment tax credit.

The Mid-West Advisory Board respectfully submits this appeal---Retain the investment tax credit insofar as it applies to transportation equipment, particularly freight cars.

Very truly yours,

HAROLD S. DALZELL, *Chairman Legislative Committee.*

GRAIN & FEED DEALERS NATIONAL ASSOCIATION,
Washington, D.C., July 15, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: The Grain and Feed Dealers National Association has 1500 direct members which range in size from the smallest country elevators to the largest grain, feed and processing complexes. In addition, we have 56 state and regional associations as affiliate members. Those associations have memberships in excess of 15,000 business firms.

The Grain and Feed Dealers National Association endorsed the original concept of investment tax credit and testified for its enactment, opposed its suspension and supported its reinstatement.

Our members are acutely concerned with the problems brought on by the inflationary forces which are probably our most serious domestic problem. The causes are many fold and the solution lies in not one proposal but the interaction of many factors of which your committee has the duty of resolving. One of these factors is the increased costs of goods and services without a corresponding increase of productivity. We have always believed that the investment tax credit which encourages modernization of facilities and in turn increases productivity has an anti-inflationary effect. The repeal of this advantage can have an inflationary effect and we would hope that your committee would

analyze this carefully before you recommend the repeal of the investment tax credit.

If in the wisdom of your committee its repeal is required to halt inflation which all of our members desire, it is recommended that several exemptions be considered. These exemptions and the reasons therefor are as follows:

1. *Transportation equipment.*—A modern, efficient transportation system is essential to the continued growth of our economy by improved efficiencies and lower distribution costs. We are currently enduring one of the most serious shortages of freight cars. To encourage additional transportation equipment to ease this shortage and facilitate trade is in the public interest and should be encouraged.

2. *Water and air pollution control equipment.*—Environmental pollution is a most serious domestic problem facing our Nation. Legislation at all levels of government place requirements on the business community to reduce the emissions of pollutants. Few, if any, industries are exempt from the financial implications of the varied laws and ordinances and the costs involved in pollution control does not add to the productivity or efficiency of the plant involved. In order to encourage the installation of ths control equipment some financial relief is desirable.

3. *Small business.*—The small businessman is hard pressed in an inflationary economy to make investments which would take advantage of technological advances to increase his efficiency and productivity which in itself is anti-inflationary. The retention of the investment tax credit could well be the factor which would encourage such modernization.

Finally, Mr. Chairman, if it is decided that the investment tax credit should be repealed and further if no exceptions are to be permitted, equity dictates that there be some provisions enacted which would phase out the tax credit. Those firms which had started improvements, expansion or modernization or had committed themselves to same should have some relief from an arbitrary and drastic selection of an effective date.

In summary we recommend the following alternatives in order of preference:

1. Retain the investment tax credit.
2. Retain the credit for: (*a*) Transportataion equipment; (*b*) water and air pollution control equipment; (*c*) Small businessmen.
3. Phase out the tax credit over a period of time.

I hope your committee will consider these recommendations. It is requested that this letter be made a part of the hearing record.

Sincerely yours,

ALVIN E. OLIVER, *Executive Vice President.*

STATE OF NORTH DAKOTA,
EXECUTIVE OFFICE.
Bismarck, July 16, 1969.

Hon. RUSSELL B. LONG,
Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: The farming industry has had to face up to commodity and livestock prices which have changed very little in the last 25 years. In many cases, what change did take place saw livestock and commodity prices lower instead of rise. The farming industry has been able to hold on, even while losing hundreds of thousands of farm families from the land, by becoming more efficient and increasing its productivity year by year.

President Kennedy's administration proposed the income tax credit for capital investments as a spur to the nation's economy. There is no question that it did spur the nation's economy. But even more important to the farming industry, it was a device by which farmers could continue to buy equipment that would make them more efficient and would increase their productivity, at a time when failure to be able to do so meant failure in farming.

The public has benefited greatly by the tax credit for equipment purchase because it has enabled food and fiber production to continue, year after year in this country, at depressed prices which favor the consumer.

We, as a nation, find ourselves facing the ravages of inflation and high interest rates, which came about because our economic system did not respond rapidly enough to ward them off.

I know of no industry which is hit harder by inflation and high interest rates than farming. Perhaps this would not be so serious if the unique characteristics of farming would permit farmers to pass off the higher cost of money and the inflated costs of operating farms in higher prices to consumers. Farmers cannot pass off higher costs to consumers as can many other industries.

I, therefore, appeal to you that when the tax credit investment is repealed in order to help dampen down our runaway inflation, the Congress make note of the unique conditions of the farming industry and continue the investment tax credit at a reasonable level for normal-sized farm operating units.

I fear that the heavy burden of inflation and high interest rates being forced upon farming at the present time will not only adversely affect the economy of North Dakota and other farm states, but will drastically and adversely alter social patterns of rural living as well.

Sincerely yours,

WILLIAM L. GUY, *Governor.*

STATEMENT OF THE AMERICAN INSTITUTE OF MERCHANT SHIPPING BY JAMES J. REYNOLDS, PRESIDENT

The American Institute of Merchant Shipping greatly appreciates this opportunity to present its views and abiding concern regarding the pending recommendation of President Nixon to repeal the 7% investment tax credit.

In his message to the Congress on April 21, 1969, the President indicated that in the "early 60's, America's productive capacity needed prompt modernization to enable it to compete with industry abroad. Accordingly, Government gave high priority to providing tax incentives for this modernization.

"Since that time, American business has invested close to $400 billion in new plant and equipment, bringing the American economy to new levels of productivity and efficiency. While a vigorous pace of capital formation will certainly continue to be needed, national priorities now require that we give attention to the need for general tax relief."

While we of course cannot disagree with most of the President's premises, we would like to point out to the Committee the crucial factor that the ocean-going marine industry differs from other American industries in the greater degree to which it is *continually operating* in *direct* competition on the oceans of the world with the foreign flag fleets which operate at one-fourth the labor costs of U.S. flag operators and which can procure its capital equipment at half the cost. One of the key factors in making it increasingly more difficult for a U.S. shipowner to operate at a profit has been the tremendous cost increases in the areas of labor, repairs and insurance. Even taking into account operating subsidy paid to the owner and construction subsidy paid to the shipyards in behalf of the subsidized operators which number approximately one-third of American-flag operations, it is readily apparent that repeal of the investment credit would have a repressive effect on the ability of the U.S. Merchant fleet to compete with the already flourishing foreign-flag fleets of the world. The foreigners not only have lower labor and capital costs but they also are the beneficiaries of governmental aid and incentives which are not being repealed. For example, ships built anywhere in the world by British owners for UK registry are eligible for an investment grant at the rate of 20 percent of costs incurred; in Norway the government provides that all industries with an annual income (after depreciation) of $2,794 may deposit 20 percent thereof in a tax deferred fund. The money would be blocked for 4 years and after that it must be spent for investment in depreciable property, in which case that property would have to be written down by 85 percent of the amount taken from the account, leaving 15 percent tax free.

From the standpoint of the present status of the U.S. merchant marine, the timing of the proposed repeal of the investment tax credit is extremely poor. I say this because the American-flag fleet is undergoing vast technological changes both through the container revolution and innovative new vessels. American ship operators are investing in the LASH (Lighter Aboard Ship) and Sea Barge Ships which cost aproximately $23 million and $33 million, respectively. These huge vessels are a whole new concept in ocean transportation and it has been estimated that three Sea Barges will provide the capacity of 15 existing freighters. As to containers, a full containership capable of carrying 1,000 loaded container costs approximately $20 million and by 1977 an estimated 104 containerships will engage in the U.S. foreign commerce. By 1970, approximately 165,000 containers should be in use and the investment in containers

alone by that date will be in excess of $300 million. The point is, that although the Government tax incentive for modernization may have served its purpose, as suggested by the President, for American industry, this is certainly not the case with respect to deep ocean shipping. This particular industry is just now in the throes of the most extensive and far-reaching modernization in its history. To withdraw the benefits of the investment tax credit from our industry at this crucial time would undoubtedly blunt two of the most significant developments in the history of the U.S. merchant marine and have an adverse impact on an already disadvantaged industry operating on a small profit margin.

In this connection, it is noted that the profits of most U.S. flag shipping operators are among the lowest in U.S. industry and thus the tax credit is relatively more important to this industry than to others. While data on industry-wide earnings are not available, (many steamship companies are privately held and do not release Profit and Loss Statements), the Institute does have data on the 14 liner companies holding operating subsidy contracts with the government. These 14 companies have a stockholder investment of about $990 million but in 4 of the past 10 years their combined earnings after taxes have been less than $30 million. Their return on investment during the past decade has averaged 4.7 percent a year after taxes.

One of the reasons given by the Treasury Department for its recommendation to repeal the investment tax credit, was that its continuance would contribute to inflation. We believe that repeal would increase transportation costs and would effect inflationary rather than counter-inflationary pressures which in turn would lead to a scarcity of transportation facilities necessary to the commerce and the military strength of the nation. In this connection, it is noted, Mr. Chairman, that in the early 60's officials of the Defense Department pushed the theory on Capitol Hill and everywhere else, that future military transport would be by air and not by water. The realities of Vietnam have proved them incorrect. Approximately 98 percent of the materiel and 67 percent of the personnel have gone to Vietnam in ocean-going vessels. The national reserve fleet of old World War II ships is at the end of its useful life and over 80 percent of our commercial fleet will soon be 25 years old. In sobering contrast, over 80 percent of the Russian merchant fleet is under 10 years old and it has moved from 21st place to fifth in the world's merchant fleets in less than 20 years. In addition, they are outbuilding us at the rate of 10 ships to 1 per year.

It is fairly obvious, I think, that our merchant fleet is in a critical state and that it needs immediate help. As is well known, the appropriate committees of Congress have worked on and the Administration is working on a program to revitalize the American-flag fleet. I submit that the repeal of the investment tax credit at this time would be inimical to these efforts and to the U.S. merchant marine.

With respect to the 14 subsidized lines mentioned above, since 1962 these companies have invested about $600 million in new ship construction in U.S. yards. The 7% tax credit on this investment was worth about $42 million to these lines. This cogent factor considered together with these companies' small profit margin, make it evident that the investment tax credit is a most important factor in their decision as to the economic feasibility of proceeding with new ship construction. In addition, the 7 percent tax credit is just as great an inducement for the non-subsidized lines to enter into new ship construction since their profit margin has also generally been low. Since 1962, when the investment credit went into effect, private owners have ordered ocean-going vessels costing approximately $1,900,000,000 from U.S. shipyards. About $600 million of this total was paid to the shipyards by the government as construction subsidies. Thus, the 7 percent tax credit has meant about $84,000,000 to our industry in the past seven years. Without this tax credit benefit many of the new ship construction orders would almost certainly have not materialized in this risky low-profit business.

In closing, I would like to just briefly discuss several more pertinent arguments which contra-indicate the repeal of the tax credit with respect to our industry. A recent study by Harbridge House, "The Balance of Payments and the U.S. Merchant Marine disclosed that the dwindling and inadequate existing fleet contributed about $914 million to our balance-of-payments account in 1966 and a total of $7.3 billion during the 10 years between 1957 and 1966.

Moreover, I would like to comment on the many recent reports that the Government was considering amendments to the tax laws and other devices to encourage U.S. exports. The export of services contributes just as much to our favorable balance of payments as the export of goods. It would, thus, seem

only logical to continue the tax credit as a means of increasing the export of U.S.-flag shipping services.

On the basis of the reasons set out above, the American Institute of Merchant Shipping requests that the Committee retain the 7 percent investment tax credit. In the event that the Committee in its wisdom should decide that it is in the national interest to repeal the investment tax credit, we earnestly request that the Committee consider an exempion so that the investment tax credit may be retained for the vital but moribund maritime indusry.

This concludes my statement, Mr. Chairman, and I would like to thank you for this opportunity afforded us to present our position on this critical matter.

MANUFACTURING CHEMISTS ASSOCIATION,
Washington, D.C., July 15, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On July 2, 1969, you announced that the Senate Committee on Finance would begin hearings on July 8, 1969, on H.R. 12290, a bill to extend the income tax surcharge and to repeal the 7 percent investment tax credit. Your announcement stated that the Committee would be pleased to receive written reports from interested persons regarding provisions contained in the House passed bill. In addition, in your announcement of July 12, concerning Senate consideration of the surtax, you stated that "the Senate Finance Committee should correct such inequities as witnesses before the Committee and members of the Committee staff have uncovered to assure tax uniformity and fairness in the repeal of the tax credit".

The Manufacturing Chemists Association wishes to present for your Committee's consideration its views on the provisions of H.R. 12290 which would repeal the investment tax credit. The Manufacturing Chemists Association is a non-profit trade association of 172 United States company members representing more than 90 percent of the production capacity of basic industrial chemicals in this country.

When the investment tax credit was adopted in 1962, it was specifically designed to (1) renew and expand U.S. domestic productive facilities and capacity and (2) provide relief to industry in replacing obsolete manufacturing facilities which entailed a cost substantially in excess of depreciation reserves. It was anticipated that the foregoing would result in a new, efficient industrial base in the U.S. which would enable industry to compete effectively in world markets in addition to meeting successfully foreign competition in U.S. markets. In turn this was expected to contribute to the solution of the nation's balance of payments difficulties. The investment tax credit is accomplishing these objectives and should be retained.

The investment credit was adopted as a permanent structural feature of our tax system. In testifying before your Committee in 1962, Secretary of the Treasury Dillon pointed out that capital allowances in the United States at that time were not comparable to those permitted by the governments of our foreign competitors. He emphasized that a combination of both modernization of depreciation guidelines and a special incentive such as the investment credit would be required if United States firms were to be placed on a substantially equal footing with their foreign competitors in this respect. We believe that Secretary Dillon's comments are just as valid today as in 1962. The elimination of this credit, which has contributed so much to the economic gains of our country during the past years, would be damaging to American industries and workers who are feeling increasingly the effects of foreign competition at home and abroad.

Furthermore, we believe that the repeal of the investment credit would hurt rather than help the anti-inflation effort. Capital investment is not only essential to holding down prices; it is indispensable to the maintenance of our living standard. Continuing gains in productivity and constant modernization of our factories are vital to the economic strength of America. The most effective way to halt inflation is to increase the supply of available goods and services over and above demand, to modernize and automate, and thus cut the unit costs of production with lower selling prices ensuing as a natural result of competition.

The House Ways and Means Committee report on H.R. 12290 state that "the credit has fulfilled its purpose of increasing investment during a period of slack demand and has 'outlived its usefulness' as a longrun stimulant to investment". We take issue with this comment insofar as it applies to the chemical industry.

The wholesale price index of the chemical industry has dropped 0.2 percent in the last year, thus putting additional pressure on chemical manufacturers for further modernization of plants in order to cut the unit cost of production. The chemical industry is presently operating at about 90 percent of plant capacity, which represents very close to normal plant utilization. Thus, in view of the predicted increase in demand for chemical products, there is a need for new plant capacity in the chemical industry.

The investment credit is needed now more than ever to enable American industry to compete in the international market place. Foreign producers have historically had the competitive advantage of cheap labor which we managed to counterbalance through more efficient machines and equipment. But foreign producers now have modern machines also, as well as low-wage labor, and their governments grant tax credits to encourage the most up-to-date, efficient production facilities. Removal of the investment credit would, we believe, seriously weaken the competitive position of American industry with unfortunate consequences to our balance of trade and payments.

Without presuming to modify our strong opposition to the repeal of the investment tax credit, we wish to offer the following comments with regard to certain provisions of H.R. 12290.

One of the very disturbing factors in H.R. 12290 is the establishment of the cut-off date at midnight, April 18, 1969. Inasmuch as industry had been led to believe that it could make plans for modernization of equipment and expansion in reliance on the availability of the credit, the fixing of the April 18 date is unduly severe. If the investment tax credit is to be repealed, industry should be given sufficient notice to preserve the credit on all projects planned in reliance on its availability.

We recommend, therefore, that your Committee change the effective date to the date on which the Committee reports out the bill. This extension of the effective date is consistent with your action in the case of the suspension of the credit in 1966.

Section 4(a) of the bill contains a number of transition rules that are generally the same as the rules provided by Congress in 1966 in connection with the suspension of the investment credit. These transition rules would mitigate in some measure the adverse effects of repeal of the tax credit on taxpayers who have become committed to projects relying on assurances from the Executive and Legislative Brnches of Government that the investment credit was to be a permanent part of the tax structure. Accordingly, we commend for your favorable consideration those provisions of section 4(a) which would provide for a binding contract rule, an equipped building rule, a plant facility rule and a machinery and equipment rule. As you will recall, the chemical industry is vitally interested in the plant facility rule, which your committee was responsible for including in the legislation which suspended the investment credit in 1966.

We believe, however, that the relief provisions contained in H.R. 12290 do not go far enough in providing equitable relief to industry in the many cases where projects were committed to implementation prior to the effective date of repeal in reliance on the availability of the credit.

Investments in new plant and machinery in a complex economy such as ours are not made on the spur of the moment. A company must commit itself to a given program well in advance of its execution so that its plans can unfold in an orderly fashion: for example, a site must be selected, engineering and design work done, specifications drawn, financing arranged, materials ordered (often many months in advance of the availability date), contractors selected, product sales negotiated, etc. At the time of this commitment the company looks at its potential market, its estimated producing costs and the other pertinent factors to determine whether or not the project can be expected to yield a sufficient return, after taxes, to justify the expenditure.

The business community has been making such commitments relying on the current state of the law and on flat statements by government leaders in the Legislative and Executive Branches that the investment tax credit was to be a permanent part of the tax structure. In all fairness they should not have this tax provision taken away without adequate notice. The taxpayer should not be put into the position of having to choose between either a loss from abandoning a project he is already committed to, or a loss from going forward with a project which is no longer expected to yield the return required by the investment.

In order to alleviate this economic hardship we urge that one additional transition rule be added to those presently provided in H.R. 12290. This pro-

vision may be classified as the "Economic Commitment Rule" and it would continue the credit for all projects and acquisition of components in connection therewith where the taxpayer can establish that it was committed to the project prior to the effective date of repeal. This rule would cover definite and specifically described projects which had been reduced to writing and which could be evidenced by a preponderance of facts and circumstances in existence on the cut-off date, among which might be the following:

(*a*) Approval by taxpayer's Board of Directors or other internal management group having approval authority under established written procedures and policies of the taxpayer.

(*b*) Engineering and design specifications.

(*c*) Financing program and arrangements connected therewith.

(*d*) Feasibility studies concerning such matters as market research, plant location, transportation, labor and raw material considerations, arrangements with suppliers and customers.

(*e*) Research and development effort and related expenditures directly connected with the project.

(*f*) Expenditures made or incurred in connection with the project which are more than nominal in amount.

(*g*) Licenses and zoning board actions which had been initiated.

(*h*) The ordering of more than an insubstantial part of the materials and services required.

(*i*) The acquisition or leasing of land which is required in connection with the project.

The proposed new section 49(d) of the Internal Revenue Code set forth in section 4(a) of H.R. 12290 provides for phasing out the investment credit for property otherwise qualifying for the credit under the transition rules which is placed in service after December 31, 1970. If the investment credit is deemed to be of no further use to the economy, we recommend that it be phased out in this manner for all section 38 property. Under such a phase-out provision all qualifying taxpayers would continue to be entitled to the full 7 percent credit through 1970. Thereafter, the credit would be reduced by one-tenth of 1 percent each month through 1974. After 1974 no further investment credit would be allowed. If such a phase-out provision were adopted the law would be greatly simplified as no other transition or relief provisions would be necessary.

In closing, Mr. Chairman, permit me to reiterate the Association's strong opposition to any legislative action which would remove the investment tax credit. We firmly believe that this credit is needed as much today as at any time since its adoption seven years ago, both to ease inflationary pressures and to improve our competitive position vis-a-vis foreign manufacturers.

Sincerely,

G. H. DECKER.

DUKE POWER COMPANY,
LEGAL DEPARTMENT,
Charlotte, N.C., July 16, 1969.

Re H.R. 12290
Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: Duke Power Company is an electric utility serving more than 900,000 customers in North and South Carolina. Our Company presently has under construction facilities at an estimated cost of $320,000,000 which, at the time we became committed to construction, we anticipated would be eligible for the investment tax credit. Consequently, the method and the timing which the Congress chooses in repealing the investment tax credit is of considerable importance to our Company and our customers.

We fully endorse the statement regarding H.R. 12290 presented to the Senate Finance Committee on July 15, 1969, by Mr. Herbert B. Cohn, who appeared on behalf of Edison Electric Institute. He made certain recommendations with respect to (A) the phaseout rule, (B) the binding contract rule and (C) the amortization of smokestacks as pollution control facilities. We concur in each of these recommendations.

We hope that your Committee will accept what we consider to be the very persuasive testimony of Mr. Cohn and Mr. Maynard E. Smith that high smokestacks are in fact effective pollution control facilities and, therefore, should be

treated as such under the accelerated amortization tax provisions. We hope also that your Committee will consider revising the manner in which the investment tax credit is repealed in H.R. 12290, and in this connection, we are enclosing a memorandum stating our views upon the phaseout rule and the binding contract rule. We ask that this letter and the enclosed memorandum be included in the printed record.

Respectfully yours,

JOHN D. HICKS,
Secretary and Assistant General Council.

Enclosure.

SUGGESTED SENATE AMENDMENTS TO H.R. 12290

A BILL TO CONTINUE THE SURCHARGE AND OTHER TAXES AND TO TERMINATE THE INVESTMENT CREDIT

H.R. 12290 would repeal the investment tax credit in a retroactive manner, resulting in substantial inequities against taxpayers who have made financial commitments relying upon the present law. In order to cure these inequities in the Bill, two amendments are suggested and discussed below.

Phaseout rule

On page 29, lines 3 through 11, of H.R. 12290 the following provision is found:

> "(d) RATE OF CREDIT WHERE PROPERTY IS PLACED IN SERVICE AFTER 1970.—In the case of property placed in service after December 31, 1970, section 38 and this subpart shall be applied by reducing the 7 percent figure of section 46(a)(1) by one-tenth of 1 percent for each full calendar month between November 30, 1970, and the date on which the property is placed in service, except that in the case of property placed in service after December 31, 1970, 0 percent shall be substituted for 7 percent."

This provision should be deleted from the Bill.

On page 14 of the House Committee Report (No. 91–321) which accompanied H.R. 12290 it is stated that the purpose of this provision is "to phaseout the investment credit to reduce the inequity that arises between taxpayers because different leadtimes for the needed equipment determined whether a firm had signed a binding contract before April 19, 1969". The provision does not purport to have been included to produce revenue, but rather to reduce an "inequity" which it was assumed would exist between taxpayers faced with different "leadtimes". It is submitted that the assumption of "inequity" is entirely erroneous and that the insertion of the above provision, instead of *curing* an inequity, would actually *create* an inequity which does not now exist.

On page 14 of the House Committee Report it is stated:

> "For example, even though two manufacturers planned to place machinery in service on the same date, one of them would have entered into a binding contract before April 19, 1969, simply because construction of the machinery required that an order be placed 2 years before use was planned as compared with 6 months for the other manufacturer. In order to reduce this inequity between businesses, and to assure that eligibility for the investment credit would not last indefinitey, a phaseout rule was adopted.

The conclusion that an inequity would result unless a phaseout rule were adopted is based upon an illogical and incorrect approach which measures the effects on the two taxpayers *at the date the machines are placed in service*. The date of placing equipment in service should not be the reference point as to whether a tax credit should ultimately be allowed. On page 13 of the House Committee Report, the quite correct observation is made:

> "Investment plans are made on the basis of the availability of the investment credit and various commitments are then made on this basis."

And, regardless of leadtime, or when machines may be placed in service, the potential credit is generated and comes into being when construction is first started or committed. It is at this earlier date that the matter must be viewed in determining whether any "inequity" exists. As to this, it is submitted that neither taxpayer in the above-quoted example from the Committee Report can be said to have been treated inequitably. Each knew the status of the law at the time he contracted for his construction and therefore, could gauge his construction program with full knowledge of the ensuing tax consequences.

It is a fallacy in reasoning to suggest that the "long leadtime" taxpayer should be singled out and penalized by retroactive adverse tax treatment merely because repeal of investment credit eligibility as of April 18, 1969, precludes a "short leadtime" taxpayer from *generating* investment credits after that date. The basic repeal provision has the identical effect on a "long leadtime" taxpayer who, in the same manner and to the same extent, is also precluded from *generating* investment credits after April 18, 1969. All taxpayers would be treated alike under the basic repeal provision. The adoption of any phaseout rule, comparatively speaking, would adversely affect only "long leadtime" taxpayers and would be grossly inequitable and discriminatory to such taxpayers.

For these reasons, it is strongly urged that the proposed phaseout rule be deleted from the Bill.

Binding contract rule

On page 8, lines 18 through 23, of H.R. 12290 the following provision is found:

"(1) BINDING CONTRACTS.—Any property shall be treated as pretermination property to the extent that such property is constructed, reconstructed, erected, or acquired pursuant to a contract which was, on April 18, 1969, and at all times thereafter, binding on the taxpayer."

We urge that this provision be revised to read as follows:

"(v) *ORDERS.*—Any property shall be treated as pretermination property to the extent that such property is constructed, reconstructed, erected, or acquired pursuant to an order placed prior to April 19, 1969."

Use of the word "order" instead of the term "binding contract" has precedent in Public Law 89–800, which suspended the investment credit in 1966. The 1966 House Committee Report (No. 2087) stated that "any directive, written or oral, to another person reasonably designed to effect the acquisition of property at a later date, constitutes an order".

The reason for the above-suggested revision is that taxpayers make irrevocable commitments to construct, reconstruct, erect or acquire property without entering into "binding contracts" as defined on pages 23 through 25 in the House Committee Report (No. 91–321) which accompanied H.R. 12290. The House Committee Report indicates that in a number of circumstances, legally effective contracts are not "binding contracts". The result is that many taxpayers who are fully committed to the construction of property and who have made commitments in contemplation of availability of the investment credit would be deprived of that credit.

A specific example of this is the case of Duke Power Company's $269 million Belews Creek Generating Plant, the construction of which began after April 18, 1969. Some steps taken by Duke Power by April 18 were as follows:

(1) Initial engineering design work was completed.

(2) Approximately $4,500,000 worth of land for the plant site was purchased or brought under option.

(3) Turbo-generators with an approximate cost of $45,000,000 and boilers with an approximate cost of $40,000,000 were ordered in December, 1968.

(4) The required application to the State utilities commission for a certificate of convenience and necessity was prepared.

In substantial accordance with a time schedule set up in January and February of 1969, plans for the plant were announced to public officials on April 25, the application for a certificate of convenience and necessity was filed May 1, the plant was announced to the public on May 3 and preliminary work on borings commenced on May 5.

The orders issued in December, 1968, resulted in legally effective contracts but not in "binding contracts" as defined in the House Committee Report. This is because the orders could have been canceled after April 18 without payment of damages, since manufacture had not started and damages from cancellation would be based on manufacturing costs incurred.

The foregoing details are set forth to establish the fact that on April 18, 1969, Duke Power was definitely committed to the project. The commitment predated President Nixon's recommendation that the investment credit be terminated. It was made at a time when the taxpayer relied on the fact that the credit would be available with respect to the facility.

It is urged that the word "order" be substituted for the term "binding contract" wherever it appears in H.R. 12290 in order to prevent an unfair result to taxpayers who were fully committed to construction prior to April 19, 1969. Especially does this seem a valid suggestion in light of the fact that the same provision was made in Public Law 89–800 which suspended the investment tax credit in 1966.

JOHN D. HICKS,
Secretary and Assistant General Counsel.

PUGET SOUND POWER & LIGHT CO.
Bellevue, Wash., July 16, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

Since passage of H. R. 12290 by the House of Representatives on June 30, 1969, representatives of the Edison Electric Institute have made a careful study of the Bill and the related Report (No. 91-321) of the Committee on Ways and Means of the House of Representatives. This study has revealed the need for corrective action by the Senate in regard to certain aspects of the Bill pertaining to particular provisions associated with the repeal of the investment credit.

The specific provisions involved, and the E.E.I. recommendations concerning them, we understand were presented orally to the Committee on June 15, 1969 by Mr. H. B. Cohn of American Electric Power Service Corporation.

One area of H.R. 12290 with which we are especially concerned is the 20% limitation on use of investment credit carryovers and carrybacks and our recommendations concerning this matter are set forth herein for your information and further study.

We strongly urge your careful and serious consideration of this matter as it is of major importance in the common objective of fair and equitable treatment of all taxpayers who will be affected, either directly or indirectly, by the repeal of the investment credit. In making this presentation to you, and through you to the other members of the Senate Finance Committee and to the members of the Senate as a whole, we do so not only on behalf of Puget Sound Power & Light Company but also in view of the impact of this legislation on our 330,000 customers.

Provision in section 4(b) of H.R. 12290 adding new paragraph (5) to code section 46(b)

Section 4(b) of H. R. 12290 provides as follows:

"Limitations on use of carryovers and carrybacks.

"Section 46(b) (relating to carryback and carryover of unused credits) is amended by adding at the end thereof the following new paragraph:

> "(5) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1968, AND ENDING AFTER APRIL 18, 1969. The amount which may be added under this subsection for any taxable year beginning after December 31, 1968, and ending after April 18, 1969, shall not exceed 20 percent of the higher of—
>
> "(A) the aggregate of the investment credit carrybacks and investment credit carryovers to the taxable year, or
>
> "(B) the highest amount computed under subparagraph (A) for any preceding taxable year which began after December 31, 1968, and ended after April 18, 1969."

We believe that the drastic cut-back of ensuing years' allowances of investment credit carryover (as provided for in proposed new paragraph (5) to be added to Code Section 46(b), should be accompanied by suitable statutory amendments which would preclude the ultimate disallowance of credit carryovers which, due solely to the restrictive effect of the insertion of the "20% limitation" provision, could not be utilized by the end of the 7-year carryover period referred to in Code Section 46(b)(1)(B).

The effect of the above "20% limitation" provision would be to retroactively deprive many taxpayers of part, if not all, of their earned investment credit not yet utilized. But for the limitation, these carryovers and carrybacks more than likely would be used within the carryover period. If a taxpayer has only four years of the carryover period left to him, under many situations the most he could use under the limitation would be 80%. Even worse, if the particular carryover period expires in 1970 he could lose 80% of the carryover. Obviously, this would be a punitive result.

Throughout the House Committee Report (No. 91-321) it is made abundantly clear that the repeal has two principal objectives: to continue the fight against inflation and to obtain a revenue gain in the year 1970. Permanently depriving taxpayers of credits they are presently entitled to under the law is not neces-

sary to realize the goals of repeal of investment credit. The carryovers involved result from capital expenditures already made and the limitation on their use is not properly related to an increase in 1970 revenues.

It is submitted that the undesirable result of the 20% limitation can be avoided without nullifying the purposes of repeal. We strongly urge that the 7-year carryover limitation of Section 46(b)(1)(B) of the Code be eliminated as to any carryover governed by the application of the 20% limitation. This could be accomplished by the following statutory changes:

Amend Code Section 46(b)(1)(B) to read as follows:

"except as provided in paragraph (5), an investment credit carryover to each of the 7 taxable years following the unused credit ear",

Amend proposed new Code Section 46(b)(5) by substituting a comma for the period at the end of paragraph (B), and inserting the following wording after the language presently appearing in subparagraphs (A) and (B):

"provided that the carryover period referred to in paragraph (1)(B) shall not be limited to 7 years in the case of carryovers, the allowable amount of which, for any taxable year, is restricted under this paragraph (5)."

Very truly yours,

PUGET SOUND POWER & LIGHT CO.,
By J. H. KING, *Treasurer.*

CHANDLER LEASING CORP.,
Waltham, Mass., July 16, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: I write on behalf of the Association of Equipment Lessors, Inc., a trade association whose members are engaged in the business of leasing personal property and equipment to commercial and industrial users, to request that a specific provision of H.R. 12290, dealing with the investment credit, be eliminated from the bill.

The specific provision to which we refer is proposed Section 49(b)(5)(B) of the Internal Revenue Code, which is contained in Section 4(a) of the bill. Proposed Section 49(b)(5) of the Code would provide (at page 13) that when a person who is a party to a "binding contract," as that term is described in Section 4(a) of the bill and proposed Section 49(b)(1) of the Code, transfers his rights in the contract (or the property covered by the contract) to another person and a party to the contract retains a right to use the property under a lease, the property is to be eligible for the investment credit, and, to the extent of the transferred rights, the other person is to succeed to the position of the transferor with respect to the binding contract and the property. The section also would provide that, if the lessor does not make an election under Section 48(d) and permit the lessee to claim the investment credit, the lease must be for a term of at least one year in order for the investment credit to be available to the lessor. These provisions, which are comparable to existing Section 48(h) (7) of the Code, are fully supported by the members of our Association.

However, the bill then provides in proposed Subsection 49(b)(5)(B) that, in a case where the lessor does *not* make a Section 48(d) election, the lessor shall be deemed, for purposes of Section 47 of the Code, to have made a disposition of the property at any time that the lessee loses the right to use the property. This Subsection (B) thus would create a special rule which would cause a recapture of the investment credit previously allowed to the *lessor* where the *lessee* loses the right to use the property.

This special recapture rule of Subsection (B) should, we submit, be eliminated from H.R. 12290 in the event that your Committee decides to report legislation terminating the investment credit. It is contrary to the present provisions of the Code relating to recapture where Section 38 property is disposed of before the end of the estimated useful life used in computing the amount of the qualified investment in the property. Under Section 47 of the Code and Regulations § 1.47-2(b), a lessor who did not make a Section 48(d) election is not deemed to have made a disposition of the property at such time as the lessee "loses his right" to use the property. Moreover, as indicated above, the Investment Credit and Accelerated Depreciation Suspension Act of 1966 also contained a "lease-back"

provision (Section 48(h) (7) of the Code) comparable to proposed Section 49(b) (5), but Section 48(h) (7) did not require a recapture of the investment credit taken by the lessor where the lessee lost the right to use the property prior to the end of the estimated useful life of the leased property.

Subsection (B) would apply only where the lessor does not make an election under Section 48(d). This frequently has occurred in situations where the lessee is a small business concern which could not obtain financing to purchase property or equipment necessary for the conduct of its business and the maintenance of its competitive position, and which could not use the investment credit if the lessor had made a Section 48(d) election. In such cases, the lessee nevertheless often received the benefit of the investment credit because the lessor, in effect, passd it on to the lessee in the form of reduced periodic rental payments. Leasing thereby served the vital economic function of assisting such small business concerns to acquire the use of needed property, and at a cost comparable to that paid by their larger competitors. Leasing helped to ensure that the credit would benefit the small business enterprises which most needed it.

Subsection (B), however, either could penalize lessors who attempted so to assist small businesses, or would, in effect, completely deprive, during this tight-money period, such companies of the benefit of the credit available to their competitors. Under Subsection (B), if a lessor claimed the credit and then passed it on to the lessee in the form of reduced rentals, the credit would be recaptured from the lessor if the lessee lost the right to use the property because of a default in making rental payments or the lessee's need to terminate the lease and return the property to the lessor because of a change in circumstances. The dangers of repossession and early termination are present in transactions with such small business concerns. The result would be that the lessor would be unfairly penalized because he did not receive any benefit from claiming the credit, and he would suffer a loss on the lease because he had already passed the credit on in the form of reduced rental payments. For example, if the lessor and the lessee entered into a six-year lease and the lessor claimed the investment credit and reduced the rentals otherwise due under the lease, and if the lessee thereafter defaulted under the lease after the first three years, the entire credit would be recaptured from the lessor, even though the lessor would continue to use the leased property in his business by leasing it to another lessee, and even though the lessor had passed the credit on to the lessee by reducing rentals for three years.

For this reason, lessors would probably be extremely reluctant in the circumstances to enter into lease-back arrangements with such small business concerns. Accordingly, even though a small business concern had a "binding contract" in effect on April 18, 1969, it may not be able to receive any benefit from the availability of the credit. For, as previously noted, it may not be able to purchase the property because it cannot obtain adequate financing, and it may not be able to use the credit if the lessor were to make a Section 48(d) election. On the other hand, larger companies which are in competition with such small business concerns may not be affected by Subsection (B). They may have the options of purchasing the property, or leasing it and having the lessor make a Section 48(d) election, or, because their financial position is more secure, of leasing it and having the lessor claim the credit and pass it on in the form of reduced rentals. In any event, they will receive the financial assistance of the investment credit.

The opportunity of making this statement for your consideration and for the record is very much appreciated.

Very truly yours,

E. R. HERMAN, *President.*

CF&I STEEL CORP.,
Denver, Colo., July 16, 1969.

Re Investment Tax Credit

Hon. RUSSELL B. LONG,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: I am advised that the Senate Finance Committee currently has before it a proposal to repeal the 7% investment tax credit. It is my belief that the repeal of this credit would be very harmful not only to CF&I Steel Corporation, of which I am President, but to the steel industry in general. I would respectfully urge the following points for your consideration:

1. *Foreign competition.*—In order for the domestic steel industry to compete with the increasing imports of foreign steel, we must constantly modernize and update our plants and facilities. We here at CF&I are now in the process of replacing our bar mill built in 1902 and we have made plans for numerous other replacements and improvements involving many millions of dollars. We must do this to compete with foreign steel produced in plants constructed after World War II, in many cases with United States financial assistance. Retention of the investment credit is necessary to enable us to update our plants so as to compete effectively with the relatively newer foreign facilities.

2. *Unit cost reduction.*—The investment credit incentive is necessary in the steel industry to encourage the construction and installation of new and more efficient plants and machinery to reduce unit costs. As wages and other expenses of doing business increase, the industry must expend huge amounts of capital in order to continue to produce steel at a price competitive with imported steel. These expenditures are not inflationary in their final effect, since they ultimately result in lower unit costs to the consumer.

3. *Regional producer.*—CF&I is a regional producer and not one of the largest in the industry. This company has just embarked on a massive capital improvement program that will keep us competitive in the industry. Projected over a period of 10 years, it is estimated that the loss of the investment tax credit, even after allowing for the simultaneous repeal of the temporary 10% surcharge, will cost CF&I millions of dollars. This would be a serious blow to our efforts to remain a strong regional producer. However, CF&I must go ahead with a major part of its program to which it is now committed.

4. *Offset rising wages.*—CF&I must find ways to offset ever increasing wages in order to remain competitive not only with foreign steel and larger domestic steel producers, but also with competing products such as cement and lumber. The investment tax credit creates the necessary incentive for a company such as ours to search for better and more efficient ways to make our product.

5. *Investment credit not intended to be temporary.*—It is our understanding that, when the investment tax credit was adopted in 1962, it was intended to be a permanent part of our tax structure and not a temporary expedient to meet some particular problem. It has been with this assumption in mind that we and other companies have planned plant modernization programs. As I have suggested earlier in this letter, the investment tax credit is not inflationary in effect. Further more, it is significant that when the credit was removed in 1966, the effect was so undesirable that it was quickly reinstated.

6. *Air and water pollution control facilities.*—As I am sure you know, the steel industry is presently engaged in a costly program of air and water pollution control. This program for CF&I and most other companies involves the installation of very expensive facilities which have primarily a social purpose and do not produce any return on investment. We are glad to undertake this program in the public interest, but it does seem that not only should the investment tax credit be retained, but it should be increased with respect to air and water pollution control facilities.

We urge most strongly the retention of the investment tax credit, which is so vital to our domestic steel industry.

Sincerely yours,

F. A. FIELDER.

NATIONAL PLANT FOOD INSTITUTE,
Washington, D.C., July 8, 1969.

HON. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: As your Senate Committee takes up the extension of the Surtax and the repeal of the 7% Investment Credit Provision, we, as a matter of record, want to urge your Committee to give careful consideration to the credit repeal.

Our association is the representative of the fertilizer industry. Of the 38 million tons of fertilizer used in this country last year, nearly 29 million tons moved by rail. Except for barge transportation, we are captive traffic. Like all industry, the critical freight car shortage penalized us severely this year. We are particularly vulnerable because of peak short season demand.

What the House forgot was the harmful effect on the shipper, not on just the railroads. We know they are earning less than 3% on investment, and to deprive

them of these additional funds means a severe cutback in their ability to provide us with the equipment when needed.

A little research shows that the last time the Investment Credit was cut, the railroads virtually stopped buying cars; however, when it was restored, orders went up 61%.

All of us favor reasonable freight rates—but we can't have both cars and low rates unless the Investment Credit Provision is continued. While I know of the reluctance of "opening the door" to any one group, the fact remains that the entire nation is heavily dependent on the common carrier system, and the shipper is going to be damaged—not the carrier.

On behalf of our members, I respectfully request your favorable consideration in leaving the 7% Investment Credit as is, in so far as it applies to the purchase of trucks, railroad cars and locomotives.

We would appreciate your making this letter a part of your Committee's official proceedings.

Sincerely yours,

EDWIN M. WHEELER, *President.*

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
New York, N.Y., July 17, 1969.

Re H.R. 12290

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SIR: This letter sets forth the views of Consolidated Edison Company of New York, Inc. on certain portions of H.R. 12290, namely—

(1) the investment credit phaseout provision (Code section 49(d));
(2) the "performance standards" to be promulgated in connection with certification of pollution control facilities (Code section 168(e)(1)).

Investment credit phaseout

The bill would add to the investment credit sub-part of the Internal Revenue Code a new provision, section 49(d), which would reduce the basic 7% investment credit by one-tenth of 1% for each full calendar month between November 30, 1970 and the date the property is placed in service, except that no credit will be allowed for property placed in service after December 31, 1974.

It is submitted that this last minute limiting change comes too late, that the rules which have been relied upon should not be changed, that changing horses in midstream is unfair. One cut-off date (April 18, 1969) is necessary to establish termination; a second cut-off date is onerous.

The Ways and Means Committee Report justifies the phaseout as reducing the inequity between taxpayers with different lead times, reasoning that it is the need to have equipment in service at a given date which should govern and not the date the order is placed or construction is begun. This is inconsistent with the original purpose of the investment tax credit provisions which was to stimulate orders for capital facilities.

The phaseout ignores the fact that plans were made, construction begun and binding contracts entered into prior to the cutoff date in good faith and in reliance on availability of the credit for projects initiated under the existing rules and procedures. As the Committee Report stated (p. 13) in discussing the relative merits of suspension versus termination: "Investment plans are made on the basis of the availability of the investment credit and various commitments are then made on this basis."

The Committee also explains the phaseout as assuring that eligibility for the credit will not last indefinitely. It would not last indefinitely of course—the April 18, 1969 cut-off date insures that.

The inequity of denying or reducing credit at this late date because the equipment or facility requires a relatively lengthy construction time is apparent and requires no further comment.

Pollution Control Facilities

The bill would add to the Internal Revenue Code a new provision, section 168, which would allow certain capital expenditures for certified pollution control facilities to be amortized over a 60-month period instead of over useful life.

The provision defines a "certified pollution control facility" so as to require two certificates:

(1) The State authority certifies that the facility is in conformity with the State program or requirements, and

(2) The Federal authority certifies that the facility meets certain federal minimum performance standards.

The apparent requirement that national performance standards be established is contrary to the procedures previously established in both the Federal Water Pollution Control Act and the Clean Air Act. Under both control laws, an individual state proposes pollution control standards. If these are approved by the federal agency, the state's standards become legally applicable in that state and are enforceable by the state agency, and not by the federal agency. If a state fails to submit standards which receive federal approval, then the federal government establishes the legally applicable standards. Accordingly, there are either state or federal standards applicable to a specific state, but never both.

The new section 168 should require a state certificate where state standaras are applicable or a federal certificate where the federal standards apply.

The requirement of a federal compliance certificate where state stndards are legally applicable imposes new pollution control requirements. At the very least, this can result in wasteful duplication of pollution control review because both federal and state agencies will have to make determinations. The outcome could be conflicts between federal and state agencies.

Further, where favorable tax treatment under section 168 is desired, the requirement of federal certification could make the state requirement a nullity because it would create pressures to conform the state requirements to the federal, to the neglect of local needs.

A requirement in section 168 that federal minimum performance standards be established would overturn a decision of the Congress made when the Clean Air Act and the Federal Water Pollution Control Act were adopted: Both of those statutes rejected the requirement of national standards. The situation has not changed: Pollution control is too complex and contains too many variables to tolerate a national standard. A suitable minimum for one part of the country is completely unacceptable for another. Congress has decided that water pollution control standards must be established separately for each waterway, and that air pollution control standards must be established separately for each air region. This decision, reached only after extensive investigation and consideration, should not be inadvertently reversed by an Internal Revenue Code requirement that federal minimum performance standards be established.

It is respectfully submitted:

1. Any tax incentive for pollution control should incorporate certification procedures consistent with existing pollution and air control statutes:

2. Additional air and water pollution control requirements, as deemed necessary, should be by way of amendment to the existing pollution control legislation, not by amendment of the Internal Revenue Code;

3. The Congressional determination that national minimum performance standards are unworkable and undesirable should not lightly be reversed; and

4. The requirement of dual standards and dual certification would make qualification for the tax incentive needlessly complex and difficult and should be deleted.

Respectfully submitted.

John V. Cleary.

American Airlines,
New York, N.Y., July 16, 1969.

Hon. Russell B. Long,
U.S. Senator from Louisiana,
Washington, D.C.

Dear Senator Long: This is to comment, in specific terms, on the retroactive effects of the transition rules of the investment tax credit repeal legislation (H.R. 12290) presently being considered by the Finance Committee.

For reasons set forth in detail in the attached statement, we strongly urge that the transition rules of the investment tax credit repeal provision be modified by omitting the 0.1% per month reduction in credit and the 20% limitation on use of credit carryovers. The proposed rules are retroactive and, therefore, unjustified, as applied to contracts binding on April 18, 1969.

Adoption of the proposed transition rules would constitute an unfortunate precedent wholly at variance with Finance Committee policy which has been to avoid retroactive tax legislation.

The limitations on use of credit embodied in existing law will amply provide an orderly and equitable transition to repeal status.

Respectfully submitted.

T. F. QUINN, Jr.,
Vice President, Taxes and Insurance.

STATEMENT CONCERNING RETROACTIVE EFFECTS OF INVESTMENT TAX CREDIT REPEAL

At the outset, it is noted that we are not requesting an exemption from the legislation. While we do not agree that the investment tax credit should be repealed, we accept the fact that, in all probability, it will be repealed.

Two aspects of the transition rules of the repeal legislation are particularly troublesome. First, the 0.1% per month reduction in the investment tax credit commencing 1/7/71 and second, the 20% limitation on the use of carryover credits. Both of these rules are retroactive because they erect barriers to the use of credits attributable to contracts binding on April 18, 1969 (the effective date of the legislation).

The transition rules are avowedly designed to introduce equity into the repeal provision and to retard the stimulus afforded by the investment tax credit to capital investments. It is respectfully submitted that, in fact, the transaction rules create inequities and, with respect to property delivered pursuant to contracts binding on April 18, 1969, will in no way retard capital investment.

Specifically, H.R. 12290 provides for the 0.1% per month reduction in the 7% investment tax credit during the period 1/1/71 through 12/31/74. Thus, the credit for property placed in service in January, 1971 will be 6.9%, in February, 1971, the credit will be 6.8%, etc., down to 2.2% in December, 1974. Equipment which is subject to long lead time, such as the new large capacity jets (the Boeing 747, the Douglas DC-10, and the Lockheed L-1011), will be subject to a progressive reduction in tax credits depending on the date of delivery.

American Airlines has contracted for the delivery of approximately $500 million of Boeing 747's and Douglas DC-10's in 1971 and 1972. Three facts should be noted: 1) this equipment was subject to binding contract prior to April 18, 1969, 2) it is not possible to accelerate delivery, and 3) it is not possible or desirable to cancel the contracts. This equipment was ordered in reliance upon existing law, that is, on the reasonable expectation that the full investment tax credit would be available. To change the rules at this time with respect to these contracts clearly constitutes retroactive legislation. The impact of this retroactive change on American Airlines is approximately $7 million, an amount equivalent to the investment tax credit on $100 million of aircraft.

The adverse effects could be aggravated by delays in deliveries which are completely beyond the control of the airlines, such as strikes at the manufacturer's facilities or Federal Aviation Administration certification problems.

In recognition of the importance of investment tax credit leasing, H.R. 12290 properly preserves the feature of existing law which permits transfer of the credit to lessors of equipment, such as banks. The benefits of the investment tax credit are shared with the airlines in the form of a lower interest equivalent cost than would be available through other forms of financing. While it is economically most desirable to retain the investment tax credit, airlines, because of depressed earnings and a consequent inability to otherwise use the credit, have made extensive use of the investment tax credit lease. Such leases have been the principal source of outside financing for large carriers in recent years. The 0.1% per month reduction in the credit will seriously impair the usefulness of the investment tax credit lease at a time when, because of the airlines' massive capital requirements, every source of financing must be available. Moreover, as previously noted, commitments to purchase the equipment were made on the reasonable expectation that full investment tax credit would be available.

Another transition rule which may have serious retroactive effects is the 20% limitation on the use of carryover credits. This rule generally limits to 20% the amount of carryover credit that may be used in any taxable year after 1968. The 20% rule is superimposed on the normal 7-year limitation on the use of carryovers. While at present, American does not expect to lose credits by reason of the 20% rule, any substantial reduction in forecast earnings for the years

1969 and later could produce losses of credit. The loss would result from the fact that the 20% limitation defers the use of credit and the 7-year limitation causes credits to expire. We understand that several airlines expect substantial adverse effects from the 20% rule.

It is submitted that the principles on which the above-described transition rules are based are fundamentally unsound in disturbing the tax consequences of binding contracts. For this reason, the rules should be omitted from the Senate version of H.R. 12290. The only way to d^ equity in repealing the investment tax credit is allow existing rules to function with respect to contracts binding on April 18, 1969. The limitations of existing law obviously applied when the contracts were signed and such limitations will amply provide an orderly and equitable transition to repeal status.

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