THE REVENUE ACT OF 1971

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-SECOND CONGRESS

FIRST SESSION

ON

H.R. 10947

AN ACT TO PROVIDE A JOB DEVELOPMENT INVESTMENT CREDIT, TO REDUCE INDIVIDUAL INCOME TAXES, TO REDUCE CERTAIN EXCISE TAXES, AND FOR OTHER PURPOSES

OCTOBER 7, 12, 13, 14, 15, AND 18, 1971

Part 1 of 2 Parts
Oral Testimony
October 7, 12, and 13, 1971

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THE REVENUE ACT OF 1971

THURSDAY, OCTOBER 7, 1971

U.S. Senate,
Committee on Finance,
Washington, D.C.

The committee met, pursuant to recess, at 10 o'clock a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (Chairman) presiding.

Present: Senators Long (presiding), Anderson, Talmadge, Hartke, Fulbright, Ribicoff, Harris, Byrd, Jr. of Va., Nelson, Bennett, Curtis, Jordan, Fannin, Hansen and Griffin.

The Chairman. Today the Committee on Finance begins an analysis of the President's program for economic recovery. The heart of the economic plan, as embodied in H.R. 10947, is the restoration of the investment tax credit, a benefit to business associated with purchases of new plants and equipment.

As we proceed through these hearings and on into executive sessions to mark up the bill, it would be well for us to consider how this legislation will fit into the so-called phase II program of economic controls.

I hope we can learn the extent to which wages and prices will continue to be controlled after November 15, when the current freeze ends. Only if we have a clear picture of phase II can we be sure that the goals sought by this bill will not be thwarted by administrative actions beyond the control of Congress.

H.R. 10947 has been heralded as a measure providing tax cuts of more than $15 billion over the next 3 years. Of this, individuals are reported to receive "a substantial share."

My own analysis shows a rather different situation. In large measure, the personal income tax reductions under this bill are illusory—illusory in the sense that they involve nothing more substantial than a speed up of the tax cuts already enacted by Congress. The increase in the low-income allowance, which was not recommended by the President, is the lone exception. It provides new tax cuts in 1973 of $1.1 billion for our poorest taxpayers.

The business community on the other hand would receive permanent new income tax reductions by the bill, totaling $6.5 billion in 1973.

As I see it, the bill is that simple—$7.6 billion of new tax cuts, only one-seventh of which go to individuals. In my judgment, that can hardly be characterized as a "substantial share." It certainly cannot be characterized as a fair share.

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I should think the Senate would want to redress such an imbalance in the bill and provide a tax cut for every taxpaying American in this country. Economic recovery, however it is achieved, is going to require the cooperation of all Americans, and this bill should be a bill for all Americans. In its present form, the bill appears to be too much of a "trickle down" operation, with too little of it ever getting down.

We can make it a better bill and still be fiscally responsible in the Senate, if we scale down the business tax benefits contained in the depreciation speed-ups and the investment tax credit.

The revenue thus saved could be used to provide across-the-board personal tax cuts, possible by increasing the personal exemption or by reducing tax rates.

Such a restructuring of the bill, in my opinion, would make it more responsive to what I perceive to be the mood of the Senate.

The principal feature of this bill is the restoration of the 7 percent investment tax credit. I recall, for the record, that Congress has twice terminated this business tax credit for its role in overheating a prosperous economy and contributing to money crises and high interest rates.

No doubt its restoration now will encourage business investments in new labor-saving machines and equipment. History attests to that. But we should be cautious lest restoration of this business tax subsidy start another round of undesirable interest rate hikes.

Interest rates remain free of the President's wage-price freeze. For the life of me, I cannot understand why bankers should be so favored when everyone else is asked to make a sacrifice in the name of economic recovery.

At this point, I think Congress and the American people are entitled to some assurance that the tax-credit is not going to drive up interest rates and prevent hard-working Americans from finding the credit they need to buy houses, automobiles, and other costly items.

In the last analysis, it is axiomatic that if people can't buy, business can't sell—and economic recovery, which we all want so badly, will continue to elude us.

I would hope the Secretary would help us to find a way to provide this assurance.

If prices are to be stabilized then the public is entitled to more than a freeze on interest rates. There should be a major rollback.

We will include in the record at this point the committee's press release announcing these hearings and a copy of the bill as it passed the House and was referred to the Committee on Finance.

(The material referred to follows. Hearing continues on p. 5.)

PRESS RELEASE

FOR IMMEDIATE RELEASE
Monday, October 4, 1971

COMMITTEE ON FINANCE
UNITED STATES SENATE
2227 New Senate Office Bldg.

REVENUE ACT OF 1971 HEARINGS
COMMITTEE ON FINANCE

The House of Representatives is expected to pass the Revenue Act of 1971 tomorrow. This bill deals with the legislative proposals of the President's recent economic message.

The principal features of this measure involve the reinstitution of the investment tax credit, the repeal of the Federal excise tax on automobiles, the acceleration of certain individual income tax reductions, and the enlargement of the low income allowance.

In keeping with previous announcements that the Committee would expedite action on this legislation when it reaches the Senate, the Honorable Russell B. Long, (D., La.), Chairman of the Committee on Finance, announced today that on Thursday, October 7, 1971, the Committee would begin public hearings on H. R. 10947, the Revenue Act of 1971. The hearing will begin at 10:00 a.m., on Thursday, October 7, in Room 2221, New Senate Office Building.

Administration Witness. -- The Chairman stated that the lead-off witness would be the Honorable John B. Connally, Secretary of the Treasury, who would testify on Thursday, October 7.

Public Witnesses. -- The Chairman stated that public witnesses testifying on the proposed Revenue Act of 1971 would be scheduled beginning on Tuesday, October 12. Following the conclusion of the public hearings, the Committee will begin closed door mark-up sessions on the bill.

Senator Long noted that because of the broad interest in the legislative proposals of the President's recent economic message, and the need to expedite action on the bill, it will be necessary that oral presentations not exceed ten minutes.

Requests to Testify. -- Senator Long advised that witnesses desiring to testify during this hearing must make their request to testify to Tom Vail, Chief Counsel, Committee on Finance, 2227 New Senate Office Building, Washington, D. C., not later than Friday, October 8, 1971. Witnesses will be notified as soon as possible after this cutoff date as to when they are scheduled to appear. Once the witness has been advised of his date of appearance, it will not be possible for this date to be changed. If for some reason the witness is unable to appear on the date scheduled, he may file a written statement for the record of the hearing in lieu of a personal appearance.

Consolidated Testimony . -- The Chairman also stated that the Committee urges all witnesses who have a common position or with the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Committee. This procedure will enable the Committee to receive a wider expression of views on the total bill than it might otherwise obtain. The Chairman praised witnesses who in the past have combined their statements in order to conserve the time of the Committee. And he urged very strongly that all witnesses exert a maximum effort, taking into account the limited advance notice, to consolidate and coordinate their statements.

Legislative Reorganization Act . -- In this respect, the Chairman observed that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress --

> "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

The statute also directs the staff of each Committee to prepare digests of all testimony for the use of Committee members.

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

(1) All statements must be filed with the Committee at least one day in advance of the day on which the witness is to appear. If a witness is scheduled to testify on a Monday or a Tuesday, he must file his written statement with the Committee by the Friday preceding his appearance.

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

(3) The written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be submitted to the Committee.

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

Witnesses who fail to comply with these rules will forfeit their privilege to testify.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman. Just this one thing. Since the President is going to announce phase II of the program tonight, I imagine the Secretary has a very busy day ahead of him so I appreciate the fact that you will give him the advantage of the time that might have been used to read your prepared statement and I will not make any further comment at this time.

The CHAIRMAN. Then if there is no further comment I recognize the Secretary of the Treasury.

STATEMENT OF HON. JOHN B. CONNALLY, SECRETARY OF THE TREASURY, ACCOMPANIED BY JOHN PETTY, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS; AND JOHN S. NOLAN, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY

Secretary CONNALLY. Mr. Chairman, and distinguished members of the committee: I am very grateful for the opportunity to appear here this morning, and I want to apologize at the outset for the length of my statement. It is frankly much longer than I would like to make but I feel in fairness to the many issues involved that this length is required.

I will try to get through it as quickly as I possibly can but before I do I would like to introduce again to the committee the two gentlemen accompanying me. On my right is Mr. John Petty, Assistant Secretary of the Treasury for International Affairs, and on my left, Mr. John Nolan, Deputy Assistant Secretary for Tax Policy.

If I may now proceed with reading my statement: I appear before you today to urge the earliest possible enactment of H.R. 10947 (the Revenue Act of 1971). These tax proposals are an integral part of the comprehensive economic program announced by President Nixon on August 15.

The success of the new economic policy is gratifying, and I expect this success to continue. Domestically, confidence is rising, inflationary expectations are diminishing, and the outlook for strong growth in employment progress in our efforts to improve our foreign trade and financial position. Steps are being made to create a viable and effective international monetary system.

Briefly stated, Mr. Chairman, H.R. 10947 would:

Establish a 7-percent job development credit;

Reduce individual income taxes for 1971 and the years thereafter;

Repeal the 7-percent excise tax on passenger automobiles, and the 10-percent tax on small trucks;

Permit deferral of taxes for export income of Domestic International Sales Corp. (DISC's);

Provide for creation of a new depreciation system containing elements of the asset depreciation range (ADR) system adopted by the Treasury Department in June, 1971, except the special first year convention (which resulted in a major part of the revenue loss); and

Make a number of structural improvements in the tax law, including some which are clarifications of existing law.

Mr. Chairman, with two exceptions the administration is prepared to accept H.R. 10947 as passed by the House. First, we object to the action of the House in applying the DISC proposal on an incremental basis.

We earnestly believe that all qualified export income should be eligible for the deferral. I shall discuss our reasons for this view later.

We also object to the rejection by the House of the President's request for a two-stage investment credit. In order to stimulate equipment purchasing and employment in the months ahead, President Nixon asked for a credit of 10 percent until August 15, 1972, and 5 percent thereafter. In authorizing a flat 7-percent credit, the House has eliminated some portion of the short-run stimulative effects of the President's program. Businessmen faced with the opportunity to obtain a 10-percent credit rather than a lower amount for increasing their level of activity in the short run would take advantage of it. Employment would be increased much more quickly.

Mr. Chairman, an objective analysis of the comments made in the House Ways and Means public hearings and the discussions in the executive sessions must conclude that this Nation needs a job development credit at a permanent rate of at least 7 percent in the years ahead.

Experience with earlier investment credits demonstrates that the domestic benefits will be great. Such a credit will provide jobs and income for workers and will foster the greater productivity that promotes price stability and rising living standards for all Americans.

However, the really clinching argument for a long-run credit of at least 7 percent, coupled with the depreciation changes approved by the House, stems from the well-recognized need for the United States to enhance its competitive position in world trade. All of us are familiar with the remarkable progress made by Japan and the industrial nations of Western Europe—with, I might add, considerable help from us—in rebuilding their war-torn economies.

But what is not generally recognized is that many of these nations tailor their tax systems to encourage capital investment. After the war, these countries had to encourage savings and investment in their economies. Their economic survival was at stake. Our own country has never previously been so challenged. As a result, our tax system is to a considerable extent biased in the opposite direction.

For example, other industrial nations are relying increasingly on the value-added tax as a major source of revenue. As generally applied abroad, purchases of new capital equipment are exempt from the tax. To the extent these countries rely on the value-added tax instead of income taxes, the effect is the same as if the cost of capital equipment were allowed to be deducted in full in the year purchased, rather than being depreciated over a period of years as we require under our income tax system. Further, a value-added tax affects only spending, in contrast with an income tax, which hits the saver just as hard as the spender.

There are several ways in which tax structures in industrial nations can be analyzed to estimate their impact on new productive investment. The most informative analysis is the comparison of capital costs of manufacturing machinery and equipment, from country to country, when adjustment is made for income tax provisions.

These tax provisions include the level of the corporate tax, depreciation allowances, and investment allowances and credits. Stated simply, we must ask how the total tax systems affect the cost of acquiring and using new manufacturing equipment in the various countries.

In this respect, the American tax system compared poorly with those of our major competitors. In table I the cost of acquiring and using machinery and equipment in the United States in 1970 is equated to an index of one full dollar. As illustrated, businesses abroad enjoy tax provisions that lower their costs to:

79 cents in the United Kingdom;
81 cents in Japan;
82 cents in Italy; and
83 cents in Western Germany.

Will the 7 percent Job Development Credit and the new depreciation system put U.S. business on an equal footing with its competitors abroad?

The answer is no. Even taken together they will lower cost only to 87 cents in the United States. It would take a long-term credit of at least 10 percent—plus the depreciation changes—to bring us into their range of capital costs.

Clearly, Mr. Chairman, if our producers are to be able in the years ahead to compete more effectively in an increasingly competitive world protecting the American working man's job and income, we must enact an effective Job Development Credit and retain the features of the depreciation system approved by the House.

Indeed, the case for both the short-run stimulation of a two-stage credit and the benefit to our competitive capacity of a permanent 7 percent credit is so strong that we urge the committee to adopt an amendment that would effectively serve both goals—the establishment of a 10 percent Job Development Credit until August 15, 1972, falling to only 7 percent thereafter.

(A table follows:)

Table I.—Comparative capital costs of manufacturing machinery and equipment as influenced by income tax policies: Corporation income tax rates, depreciation allowances, and investment allowances and credits; major industrial countries, 1971

[United States, 1970=100]

Country:	Comparative cost of capital
United Kingdom	79.1
Japan	81.1
Italy	81.9
West Germany	82.8
Sweden	83.0
Belgium	84.7
France	89.7
The Netherlands	94.1
Canada	97.2
United States (1970)	100.0
United States with ADR	95.6
plus 5 percent investment credit[1]	88.9
plus 7 percent investment credit[1]	86.2
plus 10 percent investment credit[1]	82.1
United States with ADR, less modified 1st-year convention	96.6
plus 5 percent investment credit	89.8
plus 7 percent investment credit	87.1
plus 10 percent investment credit	83.0
United States without ADR	
but with 5 percent investment credit	93.2
but with 7 percent investment credit	90.5
but with 10 percent investment credit	86.4

Office of the Secretary of the Treasury: Office of Tax Analysis.

[1] Effective credit assumed to be unaffected by income limitation for purposes of international comparisons.

Secretary CONNALLY. Mr. Chairman, H.R. 10947 has been criticized as favoring business over individuals. In this respect, I think any fair-minded person would agree that neither the House bill nor the resident's proposals on which it is based should be judged alone. All of the recent and prospective changes in the income tax laws should be considered. As you know, the Tax Reform Act of 1969 granted a massive tax cut for individuals, spread over a 4-year period, while it sharply raised taxes on corporations. In fairness, therefore, any judgment about the relative tax impact between corporations and individuals should cover the 5-year period beginning in 1969. It should also include the impact of the new depreciation system as well as the other provisions in the House bill.

When this tally is made, as set forth in table II, you will find that tax payments in this 5-year period by individuals (mainly in the low- and middle-income brackets) will have been reduced by $36.4 billion. Tax payments of corporations in the same period will have actually increased by $3.2 billion.

(Table II referred to follows:)

TABLE II.—ESTIMATED EFFECT OF 1969 TAX REFORM ACT, ADR AND WAYS AND MEANS COMMITTEE ACTION ON CALENDAR YEAR LIABILITIES DIVIDED BETWEEN INDIVIDUALS AND CORPORATIONS

[In billions of dollars]

	Individual								Corporations								
	1969 act		Committee action						1969 act		Committee action						
Calendar year	Reform and relief	Termination of investment credit	ADR	Eliminate ADR ¾ year convention	Income tax reduction	Excise tax relief [1]	New investment credit	Total	Reform and relief	Termination of investment credit	ADR	Eliminate ADR ¾ year convention	New investment credit	DISC	Excise tax relief [1]	Total	Total individuals and corporation
1969		+0.4						+0.4		+0.5						+0.5	+0.9
1970	−1.4	+.6						−.8	+1.0	+1.9						+2.9	+2.1
1971	−5.2	+.6	−0.6	+0.4	+1.4	−0.8	−0.3	−7.3	+1.1	+2.5	−2.2	+1.7	−1.2		−0.1	+1.8	−5.5
1972	−8.1	+.6	−.7	−.3	−3.2	−2.3	−.7	+14.1	+1.2	+2.7	−2.7	+1.4	−2.9	−0.1	−.3	−.7	−14.8
1973	−10.8	+.6	−0.8	+.3	−1.1	−2.0	−.8	−14.6	+1.3	+2.9	−2.2	+1.2	−3.1	−.2	−.2	−1.4	−16.0
Total	−25.5	+2.8	−2.1	+1.1	−5.7	−5.1	−1.8	−36.4	+4.6	+10.5	−8.1	+4.2	−7.2	−.3	−.6	+3.2	−33.2

[1] Split as per committee report.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Secretary CONNALLY. These figures indicate that rather than providing a "bonanza for business", we have if anything gone too far in cutting individual income taxes at the cost of productivity, growth and international competitiveness.

But the fact is, Mr. Chairman, that constructive discussion of tax policies in this country has been hampered for years by the old dogma which pits individuals against business. A corporation is not an entity that stands separate and apart from individuals. A corporation is simply a type of arrangement that every free nation has found exceedingly useful in serving the ends of any economic system—the creation of jobs and a rising standard of living.

Moreover, the task of "allocating" income tax cuts or increases to individuals versus corporations is greatly complicated by the fact that, by and large, an income tax levied on an individual cannot be passed on; he must bear the brunt of it.

However, taxes borne by corporations inevitably affect individuals. If a tax cut is passed on in the form of lower prices, consumers benefit. If passed on in the form of dividends, stockholders benefit. And if reinvested in new and better equipment, jobs will increase in the industries that supply the equipment, future pressure on prices will be reduced, as productivity rises, and our trade position should improve as a result of increased competitiveness in world markets.

However, my purpose today is not to explain the fundamental aspects of our free enterprise system, but rather to illustrate the need for a little realism in dealing with tax policy.

Before turning to the specific provisions of H.R. 10947, I should like to emphasize the need for maintaining the fiscal balance in President Nixon's New Economic Policy. Although a small deficit in the full employment budget may be unavoidable in the fiscal year ending June 30, 1972, we shall run grave risks if we unduly enlarge that deficit.

It is, therefore, gratifying to note that H.R. 10947, together with the administration's planned outlay reductions, will actually reduce the full employment deficit for fiscal year 1972. I would hope that your committee and the Senate as a whole would guard carefully against increasing that deficit. This means that additional tax relief to individuals which is already huge in the 5 years since 1969 could not be granted unless offset with appropriate revenue increases from other sources. With the pressing need for cutting business taxes to stimulate investment, I know of no source from which such revenues could be drawn.

Let me now turn to the specific provisions of H.R. 10947, beginning with the job development credit.

A. JOB DEVELOPMENT CREDIT

The President recommended enactment of a job development credit, similar in many respects to the old investment credit, except that it would initially be at the rate of 10 percent and would later drop to 5 percent as the permanent rate. The two-level credit was designed to achieve an immediate response in order to reduce unemployment and improve productivity quickly.

The reward of a higher credit for immediate purchases of capital goods, and the prospect of a much lower credit if capital spending plans were not accelerated, would have had the effect of inducing a quick response.

After public hearings, the House Ways and Means Committee concluded that there were serious difficulties in a two-level credit. The committee expressed concern over the transitional problems in dropping from one level to another, the inequities to producers of some long leadtime equipment, and the danger of accelerating too much of the normal capital spending that would occur in 1973 and 1974 into 1971 and 1972. This led the House to adopt a flat 7-percent credit.

Nevertheless, we remain convinced that a two-stage credit is preferable. As noted earlier, however, the case for a 7-percent figure on a continuing basis is very strong. Consequently we urge the committee to adopt a 10-percent credit for property acquired in the period August 16, 1971, through August 15, 1972, or property ordered by August 15, 1972, and acquired by February 15, 1973. The credit should be at the permanent rate of 7 percent thereafter.

The other major difference of the job development credit from the old investment credit is the exclusion of foreign-produced property from the benefits of the credit for as long as the temporary import surcharge remains in effect. The House improved upon our original recommendation by giving the President authority to allow the credit during this period for any article or class of articles if he determines that the disallowance of the credit is not in the public interest.

This will permit the credit to be allowed, for example, in cases where there are no U.S. producers of the equipment, or where there is only one U.S. producer and allowance of the credit for that producer's equipment and no others would tend to create a monopoly. We recommend that the provision excluding foreign-produced property during the period of the temporary import surcharge, subject to this Presidential authority, be adopted by the Senate.

We also accept other actions by the House in revising the application of the credit——

in increasing the credit for property of regulated public utilities from 3 to 4 percent;

in allowing the credit in part (one-third) for property with a life of 3 or 4 years, in greater part (two-thirds) 5 or 6 years, and in full for property with a life of 7 years or more, rather than the longer lives required under the 1962 credit;

in extending the credit to livestock so that farmers will benefit to a greater extent;

in limiting the credit for used property by offsetting against the new $65,000 limit the cost of new property acquired by the taxpayer so as to limit this allowance to small business for whom it was intended; and

in making other structural improvements in the credit.

We strongly endorse the action of the House in approving a new depreciation system which incorporates the major administrative advantages and simplifications of the ADR System adopted by the Treasury Department in June 1971. The House bill provides that the Treasury Department has authority to permit depreciation lives to be taken from a range which varies up to 20 percent from the anticipated industrywide levels for the particular classes of assets. The House bill rejects the so-called three-quarter-year convention, which was an element of the ADR System resulting in a major revenue loss ($2.1 billion of a total revenue effect of the ADR System of $2.8 billion in 1971 and somewhat lesser amounts in subsequent years.) This special first-year convention was designed, within the limits of the administrative authority of the Treasury Department, to provide more uniform benefits to long- and short-lived equipment. In general, the shortening of lives benefits long-life equipment more than short-life equipment, and the three-quarter-year convention served to restore much of the balance.

The authority to prescribe a range of lives which varies up to 20 percent from anticipated industrywide levels is essential, in conjunction with the Job Development Credit, as I have previously shown, to provide allowances in any way comparable to those granted by other major industrialized countries. We must provide comparable allowances if we expect our companies to continue producing in the United States for foreign markets rather than building factories abroad. The 20-percent variance is also essential to make all the major administrative reforms in the new depreciation system work effectively; to do equity between competing taxpayers, some of whom could establish their individual right to shorter lives within this range in any event; and to recognize the substantial degree of obsolescence which has occurred since 1962—when the industrywide guideline lives were adopted—as a result of technological change, increasingly severe environmental control requirements, increase competition from new highly efficient foreign plants, and other factors.

As was recognized by Congress in 1962 in enacting the investment credit in conjunction with a shortening of depreciation lives by administrative action at that time, the two provisions work hand in hand to encourage modernization of plant and equipment. The combination of the Job Development Credit and the new depreciation system in the limited form adopted by the House will be a highly effective incentive for investment in new productive facilities, enabling us to expand our productive capacity and our output of goods and services. The benefits will be shared by workers, consumers and investors. Thus:

Workers will benefit because the number of jobs will thereby be increased, reducing unemployment. Permanent benefits from increased productivity as a result of giving workers the most modern machinery and equipment available will provide the basis for wage increases which are not eroded by higher prices.

Consumers will benefit because greater efficiency and productivity will help stabilize prices, and greater output will encourage development of new products and services. U.S. industry will become more competitive with foreign producers, with obvious resulting benefits to consumers.

Investors will benefit because the changes will help restore a reasonable level of corporate profits, providing adequate incentive to sustain investment for a continuing high level of economic activity and future growth in the United States.

This growth is essential if we are to achieve the goals we seek as a nation today. We seek a higher standard of living—higher wages without higher prices. We seek as a society to deal more effectively with poverty, inadequate health and educational facilities, undesirable living and working conditions in our congested cities, the deteriorating quality of our environment, and other pressing human problems. To achieve these objectives, we must increase productivity and thereby growth in our real output. The resulting increase in national wealth will provide revenues for wage increases, an adequate return on investment, and increased taxes in the long run to enable government to provide for the needs of all our citizens.

B. TAX REDUCTIONS FOR INDIVIDUALS

The House bill follows the President's recommendation to accelerate the individual income tax reductions scheduled for January 1, 1973, to January 1, 1972. As a result, the personal exemption will be increased to $750 and the standard deduction will be increased to 15 percent with a $2,000 maximum effective that date, resulting in additional tax relief for individuals in 1972 of $2.2 billion.

The House bill grants much greater tax relief for individuals by also increasing the personal exemption for 1971 from $650 to $700 effective July 1, 1971, resulting in additional relief of $900 million; by eliminating the "phase-out" of the low income allowance for 1971, thus providing an additional $400 million in benefits in 1971 to low and middle income taxpayers; and by increasing the low income allowance for 1972 and subsequent years from $1,000 to $1,300, resulting in tax reductions of $1.0 billion per year. The latter change will insure that no person or family with an income at or below 1972 poverty levels will be required to pay any tax or file a return; it will also provide substantial tax relief for persons and families with incomes above the poverty levels.

These changes would be implemented in part by changes in withholding taxes to take effect November 15, 1971, underscoring the great importance of early action on this bill by the Senate. The withholding tax changes on November 15, 1971, and on January 1, 1973, will also resolve in large part the problem of underwithholding which have occurred as a result of the increase in the low-income allowance in the 1969 act, and which would be accentuated by the increases in that allowance in the House bill.

The additional tax relief for individuals without important revenue loss in the bill was made possible by the reduction in the benefits of the liberalized depreciation system by the House. We consider these changes to be reasonable. The combination of these changes and the benefits accruing to individuals from repeal of the automobile and small truck excise taxes will mean reductions in taxes of individuals of $2.1 billion in 1971, $5.9 billion in 1972, and $3.6 billion in 1973. If the reductions already scheduled for 1972 and 1973 under the Tax Reform Act of 1969 are also taken into account, the additional tax reduction for individuals from preexisting 1971 levels will be $8.6 billion per year.

The resulting increase in consumer purchasing power at the rate of $8.6 billion per year beginning January 1, 1971, will provide a powerful stimulus to business activity. It will operate hand-in-hand with the job development credit and the depreciation changes to increase the number of jobs, the level of output of goods and services, and hence the level of Government revenues in the future. They will thereby help finance a better society for all our people.

C. REPEAL OF THE AUTOMOBILE EXCISE TAX

The House adopted the President's recommendation for repeal of the 7-percent automobile excise tax effective August 16, 1971, and also repealed the 10 percent excise tax on small trucks, effective September 23, 1971. These trucks, primarily pickup trucks, are extensively used for pleasure and recreational purposes or are used by farmers and small businessmen and to a very large extent they are sold in direct competition with private automobiles. While the truck tax goes to the highway trust fund, the truck tax on these small trucks generates more tax than is appropriate in light of their cost responsibility for the highway system. We endorse this additional action in the House bill.

The repeal will result in refunds to persons who purchased cars or small trucks on or after these effective dates and prior to this bill becoming law. Purchasers after the date of actual repeal will pay reduced prices for their automobiles or small trucks. The average reduction per automobile buyer is $200 per car, and the four major U.S. automobile manufacturers have given assurance that the entire benefit of the repeal will be passed on to the consumers. The distribution of automobile purchases is roughly a constant proportion of income, so this reduction amounts to a fairly uniform benefit among all income groups. While a higher proportion of used cars are purchased by lower-income groups, the repeal of the tax on new automobiles will result in a reduction in the price of used cars, so the lower-income groups will obtain proportional benefits.

Lower prices will mean a substantial increase in the demand for automobiles and small trucks. When coupled with the temporary import surcharge and the denial of the job development credit during this same temporary period for foreign-produced items, there will be an even larger growth in the sales of domestic cars and small trucks.

D. DISC

Our fourth recommendation was for adoption of our prior proposal for tax deferral for export income of Domestic International Sales Corporations (DISC) if such income is used in export-related activities. Our original DISC proposal was favorably reported by the House Ways and Means Committee and adopted by the House in 1970. We recommend adoption of that same proposal now except that it should be fully effective on January 1, 1972, rather than being "phased in" gradually over several years as the 1970 House bill provided.

In the current bill, the House has substantially crippled the effectiveness of the DISC proposal in serving its main objective of keeping jobs in the United States by applying the DISC proposal largely only to increased or incremental export sales. We strongly urge the Senate at this time to restore DISC to the form in which we recommended it so that it will be fully effective in encouraging our companies to produce in the United States for export sale in foreign markets, rather than to move their factories abroad to take advantage of more favorable tax treatment for manufacturing abroad.

Under existing law U.S. companies may obtain deferral of U.S. tax by manufacturing abroad through foreign subsidiaries for sale in foreign markets. The DISC proposal would provide the same tax treatment for income up to 50 percent of profits attributable to the manufacture and sale of goods for export if the manufacturing occurs in the United States. The other 50 percent of the profits would be deemed to be the manufacturing portion of the total profits attributable to the manufacturing activity in the United States rather than the portion attributable to sale outside the United States, and such 50 percent would be taxable currently by the United States.

The income from export sales which receives the deferral treatment must be used either to increase the export sales activities of the DISC or it may be lent to a U.S. producer, usually the parent company, to finance increases in inventories, machinery, and equipment and other fixed assets, or research and development expenditures. The amount of such loans could not exceed the portion of the total expenditures for these purposes which the borrower's export sales bear to its total sales. Thus, the deferral of tax on DISC income is available only so long as the income is, in effect, used for export-related activities. When the amounts are paid as dividends to the DISC shareholders, or when the DISC ceases to qualify as such for any reason, the income is fully taxed as ordinary income to the U.S. shareholders.

The DISC proposal is obviously designed to induce companies to continue manufacturing in the United States for sale abroad, thus keeping jobs at home, rather than exporting their manufacturing activities and know-how to foreign countries.

This purpose will be largely frustrated by the incremental concept. More than one-third of our top 100 exporters showed a declining or level export trend for the period 1964–67, and it is fair to assume that this downward trend has worsened since 1967 as foreign competition has grown stronger. These companies will have no incentive to continue manufacturing in the United States for foreign markets. In the case of other companies, the incremental DISC concept at best provides only partial deferral treatment, so the effectiveness of the DISC in keeping jobs at home will be greatly reduced.

The original form of the DISC, as adopted by the House of Representatives in 1970, would be extremely effective in inducing U.S. companies to continue manufacturing in this country. Detailed presentations of the effect of the full DISC concept on their planning submitted by Union Carbide, Hewlett-Packard, and other companies made this clear.

Furthermore, the "incremental" limitation misconceives the importance the DISC would play in helping to resolve our balance of payments difficulties. A DISC on an incremental basis will not provide an incentive to help arrest the decline in export sales of so many of our companies. From a balance-of-payments standpoint, it is as important to maintain a dollar of existing export sales against loss as it is to increase export sales by $1.

The incremental approach gives rise to very serious inequities. It penalizes those corporations who made substantial efforts to maintain or boost their exports in the base period years, while favoring those who did not do so, thus creating disparities between companies directly competing with one another, some of which will get the benefits of tax deferral and some of which will not. Unless very complex adjustments are made, the approach takes no account of unusual business conditions which may have resulted in either abnormally high or low exports during the base period. Moreover, it favors new entities, who have borne no risks in developing new markets abroad, and discriminates against the exporters who have heretofore made the greatest effort. In a very real sense it betrays those businesses which acted responsibly by participating in the Commerce Department's voluntary export expansion programs. These companies are prejudiced in direct proportion to the extent they *increased* their export sales in the 1968–70 period at the Government's request.

Finally, the incremental concept poses extraordinary technical problems. This complexity greatly reduces the utility of the concept to smaller businesses.

The House Ways and Means Committee in 1961 considered in detail the possibility of adopting the investment credit on an incremental basis in an effort to respond to similar allegations of windfall benefits for investments in capital goods that would have been made anyway even without the credit. That committee finally abandoned the idea as inherently inequitable and unworkable. The Senate should reject the incremental DISC concept as equally unworkable, inequitable, and damaging to the basic purpose of DISC to retain jobs in the United States.

In addition to serving the interests of labor by creating more jobs in the United States, the DISC proposal serves the interests of business and consumers as well. The interests of business are served because our present tax laws and those of other countries tend to favor overseas productions; many U.S. businessmen would prefer to continue producing in the United States for foreign markets if the tax treatment for U.S. production could be equalized. The interests of consumers are served because a higher level of exports is needed to support continued expansion in imports.

The DISC proposal, when fully effective, even without the incremental concept, would result in a revenue deferral of only approximately $600 million annually before allowing for the effect of increased revenues from the feedback benefits to the economy. This amount might be only $300 million in the first full year of its operation while exporters arrange to take full advantage of its provisions. We estimate that without the incremental limitation, it will result in an increase in annual export sales of $1.5 billion or more, which will mean more gross national product—more tax base in the United States and more tax revenues.

Mr. Chairman, thank you very much.

The CHAIRMAN. Thank you, Mr. Secretary.

In order to accord all members an opportunity to ask those questions that come to them first and participate in this morning's session, the Chair will impose a 10-minute rule, if there is no objection to it, on all Senators, on the first round of interrogation. On this occasion I believe it would be appropriate to let the junior members begin the interrogation. I will first call on the Senator from Wisconsin, Mr. Nelson.

Senator NELSON. Thank you, Mr. Chairman.

Mr. Secretary, I would like to pursue the question of the DISC a little more. Last Friday I read some excerpts, you may recall, from a strong criticism made of DISC by Prof. Stanley Surrey. At that time your response was:

I think much of the difference of philosophy between Mr. Surrey and Mr. Cohen and Mr. Nolan and I would certainly include myself on the side of Mr. Cohen and Mr. Nolan.

On September 30, several days ago, the Wall Street Journal wrote a strong editorial criticism of DISC and they came out on the philosophical side of Stanley Surrey.

They state:

Professor Surrey's objections are persuasive and can be augmented. The use of special tax incentives to further public policy is a doubtful technique in principle to begin with. It soon gets the entire tax structure out of kilter creating loopholes for some taxpayers and transferring to others the burdens that had been lifted from the fortunate. The result is a sense of unfairness and ill will among taxpayers which is the first step toward wide scale efforts at evasion.

I would like to ask you about that part of your statement, Mr. Secretary, in which you say:

The income from export sales which receives the deferral treatment must be used either to increase the export sales activities of the DISC or it may be lent to the U.S. producer, usually the parent company, to finance increases in inventories, machinery and equipment and the other fixed assets or research and development expenditures.

On that point, Professor Surrey states:

The Treasury stresses that the profits of a DISC, freed from taxes, will be used to promote export activities. But the tax experts who study the technical details know that these tax-free funds can be used for activities that have nothing to do with exports. Thus the funds can be used by large manufacturing companies, who are presently exporters, for purely domestic activities where the favored companies are able to compete with tax-free DISC money against companies not so favored.

They can be used even to build manufacturing plants abroad and thus reduce the export trade of the United States. The DISC money is simply made available to the companies and the Treasury will ask no questions on how it is used.

Would you like to comment on that, Mr. Secretary?

Secretary CONNALLY. Senator, if you will permit it, I would prefer that Mr. Nolan comment on it for a number of reasons.

First, because I think he is, perhaps more knowledgeable about it and, secondly, I did allude to him the other day in placing myself on his side in regard to the philosophical differences we have with Mr. Surrey, I think he might actually provide a better answer to you than I could.

Mr. NOLAN. Senator, the thrust of Professor Surrey's comments is that if we are to have the DISC proposal we should have a rule which traces the use of the tax benefits that are available to the DISC into some particular form of investment.

We have been generally unsuccessful, however, over a long period of years in applying rules which try to trace dollars to specific kinds of investments. What we have tried to do in the DISC proposal therefore is to set up a carefully limited system so that the DISC tax benefits can only be effectively used for certain purposes which we think basically confine them to export-related functions without actually tracing dollars.

In the first place, the moneys retained by the DISC can only be used by it in one of two ways; first, by the DISC to increase its own export activities because if it accumulates dollars itself for other purposes then it loses its qualification as a DISC.

The second way is to use moneys to make loans to domestic producers of export property. If the money is loaned back under the producer loan rules for example, to a DISC's parent company those loans will qualify only if the parent increases its investment in the year in which the loan is made in fixed assets, R. & D. expenses, or inventories and we have limited the extent to which these parent company loans can be made to that proportion of the parent company's investment in those categories of assets which its export sales bear to its total sales—in other words, that portion of the producer's total assets which may reasonably be deemed to be related to its export productions.

Now, it is true that we do not attempt to trace the dollars into particular export-related investments, we have, however, imposed the limitation which I just described.

Any U.S. manufacturer has funds coming in to it from a variety of sources—from its current income, from its borrowings, from all sorts of sources—and it is simply not practical to say that this dollar went into this particular investment or that one went into another.

The important thing is to limit the extent to which the DISC profits can be used by the parent company, and we have limited the loans to producers to the proportion of the total investment in these kinds of manufacturing assets which the producer's export sales bear to its total sales, and we have required that there be an investment by the borrower in its U.S. assets in the amount of the borrowed funds in the year the loan is made.

We think this is a reasonable and fair limitation. We further provide that the loans can be made for only a 5-year period so that this testing for any loan has to be redone every 5 years. We think this will insure that the company is maintaining or increasing its level of export sales or increasing its U.S. investment in order to continue to enjoy these benefits.

I can only say that overall we think that we have achieved a reasonable and workable limitation without getting into the difficulty of tracing dollars.

Senator NELSON. But it seems to me that you are creating the following situation, the parent company can create a DISC company and then can borrow from DISC profits on which no taxes are paid, to invest in inventory, machinery, equipment, fixed assets.

It seems to me that this is a device for giving a domestic company a cheap loan. It thus puts itself in a much better competitive situation vis-a-vis any company that does not establish a DISC.

Mr. NOLAN. I understand the argument, but any viable American company is also going to have funds flowing into the company from its current profits on its transactions, from its borrowings, from a variety of sources, and it is impossible to say which dollars are being used for which purposes. We feel that if we limit the total amount of these borrowings which are permissible to that portion of the assets of the company which are really devoted to export activities and if we require that this testing be redone every 5 years, we have achieved a reasonable limitation on the use of these profits. To the extent a company ties up its productive capacity for export activities financed out of DISC loans it is not competing with a company selling solely in the domestic market. We would certainly hope, however, that the proposal would encourage competitors to compete in the world market as well.

Senator NELSON. Maybe you can explain something to me. The Secretary listed among the purposes for which the loan may be spent, research and development expenditures. But any big corporation is doing all kinds of R. & D. Anything they do they claim as being related to export activities.

That is just wholesale evasion it seems to me.

Mr. NOLAN. The amount of loans that the DISC can make to the company to finance research and development expenditures is limited to the portion of its total research and development expenditures which its export sales bear to its total sales so that we are simply adopting a straight proportion and if the company is doing a substantial amount of research and development and is also engaged in export sales, we will view a portion of its research and development as being done for export related purposes in the same ratio that its export sales bear to its total sales.

That seems to us to be a reasonable limitation on the amount of loans that the DISC can make back to the parent company for this purpose.

Senator NELSON. I see my 10 minutes are up.

The CHAIRMAN. Senator Griffin.

Senator GRIFFIN. Mr. Chairman, I thank you for according the most junior members an opportunity to begin the questioning.

Mr. Secretary, I think you presented an excellent statement, one which I am going to insert in the Congressional Record because I want to be sure it is widely available in its entirety.

George Meany and others, needless to say, have criticized the President's package, particularly the investment tax credit, characterizing it as a bonanza for big business.

Your answer, as I understand it, is that the benefits will be shared by workers, consumers and investors, and your answer, it seems to me, ought to be entitled to as much prominence and attention as Mr. Meany's charge.

One of the things that disturbed me a little bit as I was sitting here listening to your testimony was that when you were saying workers will benefit because the number of new jobs will thereby be increased, reducing unemployment, and I quote:

"Permanent benefits from increased productivity as a result of giving workers the most modern machinery and equipment available will provide the basis for wage increases which are not eroded by higher prices," there was dead silence from the TV cameras behind me.

When you were saying, "Consumers will benefit because greater efficiency and productivity will help stabilize prices, and greater output will encourage the development of new products and services; U.S. industry will become more competitive, with obvious resulting benefit to consumers," there was not a sound back here.

But when you said, "Investors will benefit because the changes will help restore a reasonable level of corporate profits," the cameras were humming.

They got that on film. And I suspect that we probably will hear that tonight when we turn our TV sets on. Instead of your full answer to George Meany, only that part of it which tends to substantiate his charge will be played as the news.

I hope that I am wrong, and that this does not represent a typical report of your testimony.

Secretary CONNALLY. Thank you, sir.

The CHAIRMAN. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman. Mr. Secretary, I would like to take the 10 minutes allotted to me to try to understand some of the figures.

Now, if the House bill is approved by the Senate and by the Congress as a whole what will be the total revenue reduction for fiscal 1972?

Secretary CONNALLY. The net effect will be that there will be a reduction in the deficit by $2 billion. The revenue effect in 1972 as a result of the House approved version will be a revenue loss of $5 billion but because of the decreases in the expenditures as a result of the President's Executive actions, plus the estimated revenue to be derived from the temporary import surcharge of $2 billion, that will total $7 billion reduced expenditures and increased revenues——

Senator BYRD. With your permission what I would like to do is first get an understanding of what the revenue reduction would be.

Now, the House version would bring about a reduction in revenues of $5 billion; is that correct?

Secretary CONNALLY. That is correct.

Senator BYRD. Now what about fiscal 1973?

Secretary CONNALLY. Let me get the table on it, Senator. I want to say at that time that is not net reductions. The House bill does reduce revenues by $5 billion but as a result of executive action and the House bill, there will be a deferral or reduction in expenditures or $5 billion plus an estimated $2 billion of additional revenue in the import surcharge which total $7 billion of either increased revenues or decreased expenditures to offset the $5 billion loss of revenue from the House bill. The 1973 figure which you asked for is a loss of $6.1 billion.

Senator BYRD. What I would like——

Secretary CONNALLY. As opposed to $5 billion in 1972.

Senator BYRD. I would like to deal with either apples or oranges but not both. I would like to try to get an understanding of what will be the net reduction in revenue leaving out whatever might be expenditures, that is a separate case. What will be the reduction in revenues resulting in the changes in the tax code that has been recommended?

Secretary CONNALLY. $5 billion in fiscal year 1972, $6.1 billion in fiscal year 1973.

Senator BYRD. And do you have it for 1974?

Secretary CONNALLY. $6 billion in fiscal 1974, Senator.

Senator BYRD. $6 billion in——

Secretary CONNALLY. $600,010 million.

Senator BYRD. Now, if we could go to the elimination of the excise taxes on automobiles. The elimination of that tax will reduce the revenues by how much in fiscal 1972 and by how much in fiscal 1973?

Secretary CONNALLY. $2.5 billion in 1972 and $2.4 billion in 1973 and $2.2 billion again in 1974.

Senator BYRD. Well, now, $2.2 billion in 1974?

Secretary CONNALLY. Yes, sir; we are rounding these figures. Actually it would be——

Senator BYRD. That is all right.

Secretary CONNALLY. $2.160 billion in 1974.

Senator BYRD. Then you will have a reduction in revenues as a result of changes in the tax code of around $6 billion per year.

I refer to page 6 of your statement in which you say you will find that tax payments in this 5-year period by individuals will have been reduced by $36.4 billion?

Secretary CONNALLY. Yes, sir.

Senator BYRD. Tax payments of corporations in the same period will have actually increased by $3.2 billion, which as I understand it, would give you a net reduction in revenues during that period of time of $33.2 billion. Am I interpreting the figures correctly?

Secretary CONNALLY. That is right.

Senator BYRD. Roughly a little over $6 billion per year that we will be reducing the revenues?

Secretary CONNALLY. That is right.

Senator BYRD. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Hansen?

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

Mr. Secretary, I want to compliment you on your extremely lucid and clear explanation of what is intended by the President and by the Treasury Department in making the proposals which are now before the Finance Committee.

I, too, share Senator Griffin's dismay that sometimes not everyone is equally objective in trying to present the facts to the American people.

There has been a lot of criticism of the investment tax credit. I think you said in your statement that the proposal first became a fact back in 1962, is that correct?

Secretary CONNALLY. That is correct, sir.

Senator HANSEN. Do you recall who was President of the United States at that time?

Secretary CONNALLY. Yes, sir; I do.

Senator HANSEN. I think I do, too.

Secretary CONNALLY. May I add that the depreciation liberalization changes in the tax code were made at that same time.

Senator HANSEN. In 1969, with the Tax Reform Act, is it not a fact that the tax reform bill did accomplish some rather massive tax cuts for individuals in this country?

Secretary CONNALLY. No question about it.

Senator HANSEN. And is it not also true that corporations generally, across the board, were subjected to far heavier tax treatment than had formerly been the case?

Secretary CONNALLY. That is true.

Senator HANSEN. Do you not then find some equity in the present thrust of this proposal to recognize, as you point out in your testimony, that not only in America but throughout the rest of the world as well, civilized people have found it to their great advantage to organize corporations. What they really amount to, as we know so well in this country, is an increase in jobs, to permit people to live better, and to act in concert one with another so as to expand opportunities for everyone.

While you are looking, Mr. Secretary, I just might observe that I think anyone who is interested, and I suspect that includes most Americans, can't help but observe that there has been a steady erosion of jobs in this country because of a number of factors to which you have forcefully and effectively, I think, addressed yourself in recent days.

It occurs to me that the thrust of the initiative taken by this administration is to attain several objectives; one, to control inflation, which we know strikes those least able to bear it. Inflation falls most heavily upon older people, people on social security, people who must depend on welfare or people who are trying to live on what may have been laid aside by them during their productive years.

Also, and I think equally as important perhaps if not more so is the fact that we are concerned about jobs in this country, we are concerned about returning veterans, we are concerned about an unemployment figures that has edged up to an amount that most Americans find unacceptable.

Don't you believe that these steps which you have recommended will get twin handles on inflation; No. 1, and No. 2, will certainly be moving in the direction of assuring that there will be jobs for returning veterans, that there will be jobs for those persons now unemployed who want to go to work, that there will be opportunities for business in this country from which jobs will come thereby assuring more people than are now working an opportunity to work at good jobs so as to protect the high standard of living of which we are all so very proud?

Secretary CONNALLY. Senator, I do indeed agree with that. That is the thrust of the entire manner in which we have tried to present this tax bill to the Congress—to do precisely the things that you outline.

If I may, I would like to respond to part of what you were commenting on by simply saying in 1970, for every dollar of goods and services produced by the corporate sector, 10 cents were allocated to depreciation on the plant and equipment required to produce the output, another 10 cents went to interest payments to property and other indirect taxes, and 68 cents went to wages and salaries and other employee benefits.

This left only 13 cents for corporate before tax profits. Of this latter figure, about one-half was taken as corporate income taxes. That is the share the Federal and State and local governments got.

Senator HANSEN. Would that be about 6 and a half percent?

Secretary CONNALLY. That is right. It runs about 6 and a half percent. Six and a half percent is what is left.

Senator HANSEN. May I ask if you would be kind enough to put the whole thing in the record?

Secretary CONNALLY. All right.

Senator HANSEN. I don't know how much time I have taken, but I suspect I have used my time. Thank you.

(The document referred to follows:)

ALLOCATION OF THE GROSS CORPORATE PRODUCT, 1970

	Billions of dollars	Percent
Gross corporate product	541.6	100.0
Capital consumption allowances	56.2	10.4
Indirect business taxes plus transfer payments less subsidies	52.2	9.6
Net interest	1.1	.2
Compensation of employees	366.0	67.6
Corporate profits and inventory valuation adjustment	66.0	12.2
Corporate profits before tax	70.6	13.0
Profits tax liability	34.1	6.3
Profits after tax	36.4	6.7

Source: Survey of Current Business, July 1971.

The CHAIRMAN. Senator Harris.

Senator HARRIS. Thank you, Mr. Chairman.

Mr. Secretary, the late Rube Goldberg was a genius, dreaming up almost infinitely indirect and rather absurdly complex ways of accomplishing a given goal.

I understand that the investment of job development credit which you propose is designed to encourage business to spend for machines so that more people will be hired to make the machines so that these people with new jobs will spend more money on business products so that business profits can go up.

That appears to me to be kind of a Rube Goldberg way to go about creating new jobs.

Why not take the $6 billion or so subsidy for business, that is the accelerated depreciation and the investment credit—together it would be even more than that—and substitute a $6 billion tax cut for people earning less than $13,000 a year.

Wouldn't their spending create new jobs directly, rather than indirectly, by increasing the demand for business products?

Secretary CONNALLY. Well, Senator, obviously consumer spending does indeed increase demand for products and stimulates the economy.

The $36.4 billion in individual tax cuts over the 5-year period beginning in 1969 was designed to do precisely that and part of the $36.4 billion is contained in the bill that we are talking about.

But we don't think that is wise to expect that all of the stimulation should come by means of consumer spending from tax cuts for individuals.

We think that it should be a balanced program along the lines that we have suggested.

Senator HARRIS. Well, our chairman pointed out, I think correctly, Mr. Secretary, that the new tax cuts are primarily business oriented here and I believe that under your proposals and under this bill, individuals would receive $9.7 billion in tax relief over 3 years but corporations and other business would get more than $16 billion during the same period, calculating in the accelerated depreciation.

Now I think, first of all, that is unfair. If you can remember those Democratic speeches many of us used to make, we did use to talk about the trickle down. Remember the trickle down Hoover speech that was a rather standard Democratic speech some of us used to make?

It seems to me that it would be a lot better to put some money directly in the hands of the consumer. That would not only be fair but it is best economics because you have 28 percent idle plant capacity now.

It is not idle plant capacity that has caused this recession, it is too little money in the hands of the average consumer.

Wouldn't you agree with that?

Secretary CONNALLY. Obviously, as I said a moment ago, when you put money in the hands of the consumer and they spend it, this is obviously going to have an effect of stimulating the economy.

In connection with that, let me read a statement that I think clarifies it very well.

"Additional expenditures," (and I am quoting) "Additional expenditures on plant and equipment will immediately create more jobs in the construction, lumber, steel, cement, machinery, and other related capital goods industries. The staffing of these new plants and filling the orders for new export markets will require additional employees. Additional wages of these working will help create more jobs. The increase in jobs resulting from a full year's operation of such an incentive is estimated at half a million dollars." Those are the words of President Kennedy when he proposed the investment credit to the Congress.

Senator HARRIS. I think that we were wise to repeal the investment credit before and unwise to put it into effect when we did. How do you answer, Mr. Secretary, the fact that there is already 28 percent idle plant capacity?

Do you agree that that is an accurate figure, and if so, how do you think we would create so many more jobs by adding to plant capacity?

Secretary CONNALLY. I wouldn't argue about the 28 percent.

Senator HARRIS. May I say that 28 percent did not exist, that figure was about half that, I believe, when President Kennedy proposed the investment credit.

Secretary CONNALLY. In terms of the GNP the productive capacity was about what it is today. Unemployment was about the same. The conditions were remarkably similar in 1962 to what they are today.

I wouldn't argue about the 28 percent. I think that about 25 percent is the figure we commonly use in terms of excess plant capacity.

But I am not sure that anyone knows precisely what this excess plant capacity is. Unquestionably a large part of it is plant that is obsolete.

It is a question of obsolescence and of having a high percentage of uneconomical facilities that are available for productive use only in a boom period. In anything like normal times you don't use these uneconomical and obsolete facilities so you theoretically have an excess capacity in the manufacturing plant.

It is very clear if you go back and study the average age of the plant and equipment in the United States, that in times of economic expansion—in so called good times—that in times when the investment tax credit was in effect, the credit had a very marked effect upon plant and equipment purchases thus on and the average life, of plant and equipment in this country.

In the middle 1930's, the middle of the Depression, producer's durable equipment in the United States had an average age of approximately 10 years.

During the war, as a result of the war and the activity attendant to it, the average plant age in the United States on the average went down to around 6 years as I recall.

It built back up in the late 1950's and at about the time the investment tax credit originally went into effect it was building up again. When the investment credit went into effect, new plant, new facilities, new equipment was bought, and average life went down again. So the fluctuations are very clear.

In 1961–63 it was up, a mean average of 7 years—and that was the highest it had been in many, many years. So there is a direct correlation. There is no question in my mind about it.

Senator HARRIS. Well, my assistant just handed me the percentages and my recollection was roughly correct, whereas idle plant capacity today is 27 or 28 percent, in 1962 it was 15 percent, roughly one-half what it is now.

And so I think your case on the economic grounds, that the way to get jobs and get the economy moving and get millions of people back to work in the private sector of the economy is by stimulating investment, is simply unproved.

I also think it is unfair to the average taxpayer to burden him more by additional tax breaks for corporations, but let me take off on another point you have just made about the average age and obsolescence of a lot of machinery and equipment in the country.

I think that is because 35 percent of the industries in this country are not competitive with each other, they are dominated by shared monopolies. There was a Murray Weidenbaum who was Assistant Secretary of the Treasury for Economic Policy under this administration, maybe it is because of saying things like this he is now gone, but in December of 1970 he said this: "The Nation could not soon reach the twin goals of full employment and less inflation without reducing the concentration of private economic power."

Do you think, Mr. Secretary, that we can have a modern steel industry and so forth really compete, bringing down our artificially high prices which are exporting these jobs to other countries—can we have a good economy without permanent wage and price controls so long as we allow these shared monopolies to dominate so much of our industry? How can you have a freeze now, how can you have statements like that by Mr. Weidenbaum about the private economic power being concentrated and yet during this freeze have the Attorney General under this administration approve a merger of National-Granite City Steel Co., the fourth and 11th largest in the country, so that now that company becomes the third largest?

Aren't you going to have to do something about these concentrations of economic power, to make this economy work?

Secretary CONNALLY. Well, Senator, may I first comment on the opening sentence that you used when you said, "Now, let me take off on another matter."

I shuddered when you said that, because I know what happens when you take off on something. You are a very articulate and persuasive advocate.

Senator HARRIS. Do you agree with Mr. Weidenbaum?

Secretary CONNALLY. Not always; no. I want to comment on that, however. Murray Weidenbaum got a distinguished professorship at

Washington University in St. Louis and reluctantly left the Treasury. I assure you it was not because of any disagreement with respect to philosophy or recommendations which we have made to the Congress. He is indeed a very able man, and I am sorry he left. I wish we had him back.

But you touch on a number of things, Senator. First, none of us are here advocating monopoly. Far from it. We are here advocating revitalization of our economy and creation of jobs for American workers.

Now, when you get into things like National and Granite City Steel mergers, this, as you know, is a very complex subject. I am not an authority on it, but I think it is fair to say that there has been no diminution of effort on the part of the Department of Justice. Mr. Richard McLaren is about as aggressive an antitrust buster as there is in the country, or that has been in the country in the last several years.

As you know, sometimes a merger of two smaller companies can indeed result in greater competition and less monopoly, and I think that we should perhaps view the Granite City-National merger in this context.

But to answer your question in another way, no, I don't think we have to break up every big business in this country in order to have prosperity.

Senator HARRIS. I believe you restated the question a little; I didn't say break up every big business in America. I said break up these shared monopolies.

Secretary CONNALLY. I have difficulty responding to that because I don't believe we have monopolies to that extent.

Senator HARRIS. Do you believe the statement by Mr. Weidenbaum: "The Nation could not soon reach the goals of full employment and lessened inflation without reducing the concentration of private economic power"?

Secretary CONNALLY. I am not sure in what context he made the statement. But on the bare reading of it, I don't agree with it.

Senator HARRIS. I agree with Mr. Weidenbaum.

The CHAIRMAN. Senator Fannin.

Senator FANNIN. Thank you, Mr. Chairman.

Mr. Secretary, I commend you for an excellent statement and one that I think means a great deal to this Nation. I assume from what you have said today, that the goal you have is to increase employment in this country, and to make our Nation, to the greatest extent possible, competitive with the other countries of the world.

I think that you have pointed out the way this would be done.

Of course, that depends on whether they are buying American-made products or foreign products, as to what that really means as far as increasing jobs in America. Isn't that true?

Secretary CONNALLY. Yes. I must constantly, I think, remind the committee that we don't here have a choice. We are not advocating one against the other.

What we are saying is that we are asking for a balanced program that if you take the 5-year period, great reductions in taxes have gone to individuals—$36.4 billion—and corporate taxes have been increased by more than $3 billion.

So we are then not talking about either giving something to corporations or giving it to individuals. That isn't the point. Even if you analyze only this limited area about which we are now talking, that isn't true; it is a very balanced program.

Senator FANNIN. I agree with you and certainly agree with the 7-percent investment tax credit and the DISC proposition, too, if it is handled properly.

I want to comment on what it means to the country when we talk about consumer spending and jobs, and the consumer must have a job if he is going to have anything to spend, unless we have a welfare program passing it out to everybody.

But, as I say, for a 1-percent increase in the automobile imports, it takes about 22,000 jobs, as I understand it; is that the figure?

Secretary CONNALLY. That is right.

Senator FANNIN. Auto imports are increasing so rapidly—in fact, here we have on the Pacific coast since the first of the year, somewhere in the neighborhood of 30 to 35, maybe 40, percent of the new car sales have been foreign cars.

So what we have to look at is how can we help our manufacturers to be competitive so we will have more jobs in America. Isn't that true?

Secretary CONNALLY. Yes, sir.

Senator FANNIN. And this is going to pass right on down through the ranks if there are jobs, and I feel that we must look at it on that basis, and this committee has heard testimony pointing out the many advantages foreign trading partners have over domestic producers.

We are not just talking about whether or not they are producing for the world market in which we compete; we are talking about their competing in the American market.

We have been very lenient in letting these countries, foreign countries, into our markets. Adoption by your Department of the new depreciation system was a step in the right direction.

However, the action by the other body in narrowing the first-year convention was puzzling to me, what they have done from the standpoint of the depreciation schedules.

The President's Task Force on Business Taxation reported that U.S. rules permitted a cost recovery allowance of 7.7 percent in the first year against a first-year writeoff of 6.5 for Germany, West Germany; 20 percent for Italy; 21.5 for France; 34.5 for Japan; 57.8 for United Kingdom; so you are really not asking in your overall program for a base that would compete with those foreign countries. Isn't that true?

Secretary CONNALLY. That is true. We are trying to get a little closer to them, but we don't get even.

Senator FANNIN. Well, this certainly undermines our attempt to put our companies on a competitive basis. I commend you for what you are doing to try to change the picture, because it must be if we are going to be able to maintain the jobs we are all talking about and to pass that money back down through to the people that are so much in need in this country.

Mr. Secretary, opponents of the DISC have stated the proposal will reward large corporations engaged in exporting without increasing our exports.

Isn't this a two-way street? We have a great problem today in even maintaining our exports. So isn't your program also pointed in that direction as well as for increasing exports?

Secretary CONNALLY. Yes; and you have to look at it in terms of the alternative, Senator.

In my statement, I tried to point out that by advocating DISC, we are basically trying to say that we will give an American company the same tax breaks at home that we give it if it goes overseas and builds a plant and operates overseas. This is what happens today. It is not a new and different concept in the method of operation. What we are trying to do is devise a plan and a system that will provide an incentive for American companies to keep their plant facilities at home.

Senator FANNIN. I certainly agree with that, and I think that you are headed in the right direction. One of the great problems we have is to get our own people to realize when we talk about management and labor, your goal is to get cooperation of one as the other.

You are asking both to make sacrifices in trying to bring about a revival of our whole economic program, isn't that true?

Secretary CONNALLY. That is right.

Senator FANNIN. I think George Meany has been very narrow from a standpoint of benefits. The benefits will accrue to the worker more than to anyone else, and so I am really disappointed with the attitude he has taken in biting the hand that feeds him, is the way I look at it.

Is that what you think in this respect?

Secretary CONNALLY. Senator, I just have to believe he does not fully understand the real implications of the DISC proposal. Obviously you can take a view and you can make an argument if you look at just one side of the proposal or one side of an action, and make it sound as if indeed there is an attempt to give something away. But I don't think that that is a fair objective evaluation of the problem.

I think if he understood the entire problem that his attitude unquestionably would be different.

Senator FANNIN. I agree with you, Mr. Secretary, and I think we can refer to our records when Mr. George Meany was here and was being questioned and I asked him whether he would support this DISC and his answer to me was "What do you want us to do, compete with slave labor?" it was an answer so foreign to the question I couldn't understand it. So I agree with you, he at that time did not know what was intended by the DISC program and I hope that he knows by now or at least is giving some thought to it.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Ribicoff.

Senator RIBICOFF. Thank you, Mr. Chairman. Mr. Secretary, you keep mentioning that your basic objective is a balanced program.

And to get as many jobs as we possibly can. Personally, I think a lot of the liberal criticism of the Investment Credit and DISC is based on fuzzy thinking. I disagree and I go along with many of these administration proposals but there is one part that has been neglected here, if we are thinking of being balanced.

Is the President still committed to welfare reform in this country?

Secretary CONNALLY. Yes, sir.

Senator RIBICOFF. How hard does he want to fight for it?

Secretary CONNALLY. Well, I think certainly the welfare reform program is a matter of very high priority in this administration, Senator Ribicoff.

Senator RIBICOFF. Is it high priority with you, too, Mr. Secretary?

Secretary CONNALLY. Yes, sir; although it is not, as you know, my primary responsibility and I am not as knowledgeable about this certainly as many other people including yourself. It is a matter that Secretary Richardson handles in the Department of HEW.

But it certainly is a matter of very high priority in the Administration and we are going to fight for it.

Senator RIBICOFF. Now, on September 15, Secretary Richardson sent this telegram to each of the 50 Governors.

The President has asked me to communicate personally to each Governor his undiminished commitment to prompt passage of welfare reform legislation.

The administration is exerting every possible effort to achieve passage of H.R. 1 before Congress goes home this fall.

Now the President's program for welfare reform would place $5\frac{1}{2}$ billion a year in the lowest economic strata of our Nation. It is aimed to eliminate poverty and the people who would get this $5\frac{1}{2}$ billion would really be consumers who would be spending every dime of it. They have not enough money to keep body and soul together, they are going to have to spend it, isn't that correct?

Secretary CONNALLY. That is correct.

Senator RIBICOFF. So, therefore, if we are talking about giving something to business and the President is interested in welfare reform eliminating poverty, how do you react to putting this $5\frac{1}{2}$ billion into the hands of the neediest of our people?

Secretary CONNALLY. Well, Senator, my attitude about it is that welfare reform is badly needed in this country. Secondly that the President's proposal on welfare reform is indeed a matter of highest priority in this administration and nothing that I can say should be interpreted to diminish that in any respect.

Senator RIBICOFF. If that is the case——

Secretary CONNALLY. I would not want to take dollars out of this program though if you are indeed suggesting we put it in this particular tax bill.

I think the welfare program should be considered as an entity, as a package, as an entire measure within itself.

Senator RIBICOFF. Now, we have a very practical problem. The President and you and Secretary Richardson say we should have it this fall. My hunch is that that bill is the last train upon which we can possibly have a major piece of legislation before Congress goes home this fall.

My guess is, as I survey the committee here, that there is not too much sympathy for welfare reform in the finance committee. So if the President is committed to welfare reform and the country needs it and $5\frac{1}{2}$ billion will help our economy, what would your reaction be if I put the welfare reform package on as an amendment to this tax bill?

Secretary CONNALLY. Probably my first reaction would be consternation. [Laughter.]

Let me answer it more seriously this way: I start without really knowing all that I should know perhaps about the welfare reform package. In don't know what it contains, all of the aspects of it.

But I know that it is the administration position that it should be considered as a whole. I know that it is a matter of high priority with this administration but so far as I am concerned this tax bill is a matter of the very highest priority.

I can't answer the question which you asked, really. I wouldn't presume to judge the temper of this committee nor the time that would have to be required by this committee to fully consider all of the ramifications of the welfare reform bill.

If indeed they could do it in a very short period of time then I would certainly have no objection to the course which you propose. On the other hand, if it would be a time consuming undertaking and if it would delay the prompt consideration of these tax proposals, then frankly I would hope it would not occur.

But whether or not it would do that I don't know, that is a judgment for the committee itself rather than for me to make and that is the only answer I can give you.

Senator RIBICOFF. The committee spent months considering it, it was debated on the floor, the House has passed it. I think I would be willing to have a limitation of time, just a few hours, to let the Senate vote up and down the problem of welfare reform.

My time is up and I am sorry that I don't have a chance to pursue this further with you.

The CHAIRMAN. Did you care to comment on that, Mr. Secretary?

Secretary CONNALLY. No.

The CHAIRMAN. Senator Jordan?

Senator JORDAN. Thank you, Mr. Secretary. I want to talk a little bit with you about the 7-percent job development credit. When the President talked to the country on August 15, I believe at that time he recommended 10 percent the first year and 5 percent thereafter.

Isn't that the original?

Secretary CONNALLY. Yes, sir.

Senator JORDAN. My understanding is that the House passed bill allows a flat 7 percent. Is that correct?

Secretary CONNALLY. Yes, sir.

Senator JORDAN. From listening to your presentation this morning you have gone back to the President's original 10 percent for the first year but you have raised him 2 percent for the remainder. Is that what I understand?

Secretary CONNALLY. I said in effect that if the committee felt that the 7 percent was the right figure, which the House did, that we would accept the 7-percent level but that we would like to come back and have this committee very seriously consider the 10-percent figure for the first year.

Senator JORDAN. For the first year. Then you presented a very interesting table, table I, where you say in order to be competitive in the world market we ought to be reasonably on the same basis of cost for the use of machinery and equipment as our competing neighbors abroad.

And you presented a very interesting table here showing that when you take all things into account, and when you equate the acquiring and using of machinery and equipment in the United States, in 1970, to an index of one dollar you have in comparison 79 cents in the United Kingdom, 81 cents in Japan, 82 cents in Italy, 83 cents in Western Germany.

Then you ask a question and I would like you to expand on it a little bit.

Will the 7-percent job development credit and new depreciation system put U.S. business on equal footing with its competitors abroad? The answer is "No." Even taken together they will lower the cost only 7 cents in the United States.

And here is the thing I want you to talk about. It would take a long term credit of at least 10 percent plus the depreciation changes to bring us into their range of capital costs. The President says 10 and 5, the House says straight 7 percent, you are talking about this morning 10 percent the first years than 7, but you say that isn't enough, we need a 10 percent indefinitely to put us on a competitive basis.

If that is true, why don't you go for the 10 percent straight down the line?

Secretary CONNALLY. Well, frankly these matters always result in the question of judgment of what reasonably can be expected both from the Congress and from the country in terms of understanding the need for it.

Now, I have this table in here, not to say that we are not doing enough, I think under all of the circumstances we probably are doing enough at this moment. At this time we don't have any investment tax credit and we are recommending 10 percent for 1 year and 7 percent thereafter, and that is a pretty big step, but I am trying to make the point that even if we get this 10 and 7, we still are not going to be on a comparable basis with other countries.

Now, if your comments or criticisms, whatever they might be termed, are asking why don't you really equalize us, maybe we are timid.

I guess that would be the only answer I can give you.

Senator JORDAN. This leads me up to another question. If we went to 10 percent across the board what would be the response of our competitors abroad? Would it not be likely that this would develop into a kind of race to see who could give their industrial people the best break in the world market?

Secretary CONNALLY. The race is on and it has been on for quite some time. We just haven't been in it. We didn't start it. We wouldn't be starting anything new. We are just now joining the pack.

Senator JORDAN. It is your recommendation that we need 10 percent the first year and the 7 percent which the House took thereafter?

Secretary CONNALLY. Yes, sir.

Senator JORDAN. You made a very——

Secretary CONNALLY. Let me point out, Senator Jordan, that the House took some actions with respect to the standard deduction and personal exemption that will become a part of the permanent structure of the tax laws of the country and produce significant tax losses, so at this point in time, I would not recommend that 10 percent across the board, for instance, because we at some point—and Senator Byrd will be delighted to hear this—we are indeed concerned about the loss of revenue.

Senator JORDAN. Yes; getting to another matter in the brief minute or two I have left, I think it needs to be emphasized again and again. I have not been very high on this DISC proposal, but I am beginning to get your idea. It came out when Senator Fannin was interrogating you and on page 14 of your statement where you say:

> We strongly urge the Senate at this time to restore DISC to the form in which we recommended it so that it will be fully effective and encourage our companies to produce in the United States for export sale in foreign markets, rather than move their factories abroad to take advantage of more favorable tax treatment for manufacturing abroad.

Isn't that the thing that we are trying to do here?

Secretary CONNALLY. Yes, sir.

Senator JORDAN. That is the thing we want to do?

Secretary CONNALLY. Yes, sir.

Senator JORDAN. You think it takes the full implementation of the DISC program to achieve that rather than the watered-down version the House passed?

Secretary CONNALLY. I don't think there is any question about it. I think if we are going to do it all, we should have the full implementation of it.

Senator JORDAN. It makes sense to me.

Secretary CONNALLY. Furthermore, I would like to furnish if I may, a little memo to the committee that outlines basically how other countries work in this regard.

Other countries will say, we don't like this DISC proposal, it does this or it violates GATT, or it does something else, but the truth of the matter is in all of our conversations and our negotiations with a great many of these countries at the Treasury Department and in connection with international tax treaties they do at least this and more, administratively. No country in the world puts their tax programs and their policies out on top of the table like the United States does. None of them.

Now they do more in one day administratively than we can do in 6 months trying to get statutory authority to do something. And I would like to give you a memorandum that I think will shed a little light on the conversations that we have with individuals of various nations around the world.

Senator JORDAN. I wish you would.

Secretary CONNALLY. Because it has a direct bearing on whether or not we are going to indeed look at our business and look at the tax structure relating to our businesses in order to try to make them competitive in the world markets.

Senator JORDAN. Whether we are going to export the jobs or put the manufacturing plants in this country?

Secretary CONNALLY. That is right.

Senator JORDAN. And employ our domestic labor and export the merchandise?

Secretary CONNALLY. That is right.

And, Senator, this is getting to be a very big problem for this country. In my judgment, this country is going to have to recognize that we can't go back to the old ways in which we have done things. We are going to have to accommodate ourselves, we are going to have to adjust in our way of doing business around the world.

Now Senator Harris—I am sorry he isn't here—a moment ago alluded to the concentration of power and in some industries in the United States there is no question there is a concentration of power.

This is true when you talk about four companies making all of the automobiles in the United States. There are a limited number of steel companies. But compare it to what exists elsewhere in the world and in many, many areas of the world, steel production is very tightly controled by governments, if not owned by governments.

Generally speaking, the first thing a nation wants to do to achieve independence and economic viability is to own a national airline and to own a steel mill and they build one if they don't have one.

Now so that we are going to have to take a look at how we structure the tax laws and I frankly think that we are going to have to provide the type of incentive, the type of encouragement that DISC attempts to provide.

It is going to be subject to criticism and as Senator Nelson commented a moment ago, there were some criticisms. He can ask how do you know you are going to produce a billion and a half of new exports?

We don't know, we can't prove it, and we can't tell you precisely what the reduction in revenue will be. We think it will be about $300 million. But we can't be absolutely sure. If we waited until we were absolutely sure of everything we would do nothing, and every day that passes we would be in worse shape.

Senator Jordan. Will you provide for the record such memoranda as you think supports the case you are making for DISC here today?

Secretary Connally. Yes, sir.

(The documents referred to follow. Hearing continues on p. 47.)

Summary Explanation of DISC and Foreign Country Practices

The DISC proposal provides for tax deferral only on the income deemed allocable to the selling of U.S. products abroad. The amount deemed allocable to the foreign selling activity may be an amount up to 50% of the combined income from the manufacture of the product in the U.S. and the sale abroad. Thus, 50% of such combined income is deemed allocable to the U.S. manufacturing activity and would be currently taxed in full in the United States.

The DISC is proposed in the form of a domestic corporation, incorporated under the laws of the United States. As will be explained, the same tax deferral benefit may be obtained in many cases under present law by using a *foreign* subsidiary. If such benefits are to be available, there is no good reason to require that they be obtained by using a *foreign* corporation rather than a domestic corporation, with all the attendant added legal and accounting costs. However, the availability of the benefit through use of a domestic corporation is not essential to the proposal.

An understanding of the background of the DISC proposal requires some historical perspective. In 1961, the United States, alone among developed countries of the world, enacted legislation seeking to tax foreign sales companies currently on their income. No developed country has adopted comparable taxing provisions within the 10 years that have passed since that legislation. Ironically, even the United States law provided escape mechanisms for (1) certain United States exports sold through foreign based companies under severe limitations, and (2) a major escape mechanism known as "minimum distributions" which has the effect of permitting deferral in foreign sales subsidiaries where the United States corporate investor has substantial manufacturing activities outside of the United States.

For some years a policy has been advocated that the United States should be a model for other countries by fully taxing its export income. This position becomes increasingly more difficult to maintain when its effect is the erosion of production in the United States and the transfer of jobs to foreign manufacturing in those cases in which tax factors influence decisions on the source of production. After a decade the United States as a model of leadership has no followers. Developments within the last two years are instructive. During this period foreign sales company legislation was proposed in the Canadian White Paper on tax reform and in "tax haven" legislation proposed by the German Government.

1. Canadian proposal

The White Paper proposed that shareholders of controlled foreign subsidiaries would be subject to tax on the holding company investment income of the subsidiary and on income from the "trans-shipment" of products in sales transactions. This appeared to include base company sales income. The final Canadian Government proposal eliminated the "trans-shipment" income from the income subject to tax.

2. German legislation

The German legislation as originally proposed in 1970, included passive investment income and base company sales income. The rule had an objective test based upon the amount of sales company income. The revised proposal issued in the spring of 1971 substantially eliminates the tax haven sales company income provision. It provides that the income is taxable to the shareholders only if it is not earned in a commercial activity of the sales company. The German reasoning has been as follows: they are imposing, for the first time, a strict inter-company pricing rule on sales income. It is possible that some income would always be attributable to the wholesale function, even if the base company had no substance. Therefore, they have included in their tax haven rule a rule of substance requiring that the base company must perform a normal commercial activity. Clearly, this permits the continued use of intermediary subsidiaries in low tax countries where there is a significant sales function actually being rendered. In addition, the German rule has no application to sales by base companies on behalf of manufacturing companies controlled by Germans but producing in countries other than Germany.

In the world today, there is no effective limitation on sales by domestic manufacturers through low tax countries in Australia, Belgium, Canada, France, Germany, Japan, Italy, the Netherlands, Switzerland, Sweden. or any other developed country. If the DISC were a foreign sales subsidiary, it would correspond to foreign sales subsidiaries owned by shareholders in any of those countries.

In administrative practice, no other country exercises the surveillance on allocation of income between a manufacturing company and a related selling affiliate to the extent this surveillance is exercised by the United States. No other country has had the tendency to restrict exports by complicated intercompany pricing rules. Because of lack of manpower and/or conscious decisions to promote export activities, general rules of thumb permit allocations of income comparable to the DISC rules for allocating income between a manufacturer and its related subsidiary. For example:

"Incentive Exception For Exports. The exemption from the French corporation income tax of the income of a foreign branch, when earned and when remitted (11/2.5c), and of the income of a foreign subsidiary until remitted (11/2.5d), may put a great strain on the definition of foreign income, especially in the case of export sales. It may be to the fiscal advantage of a French exporter to make sales to a foreign branch or subsidiary at low prices in order to divert income abroad, but this diversion may run afoul of Code article 57.

The French government has had to weigh its interest in the proper allocation of income against its growing desire to increase exports (10/9.3). The interest in exports has won out. In 1959, the tax administration announced that "too strict" an application of Code article 57 might interfere with the establishment and operation of foreign sales branches or subsidiaries that might develop French exports "to the maximum." As a result, the administration announced that it would take into consideration all commercial conditions surrounding the operation of such overseas enterprises before it decided to apply the reallocation-of-income rules: especially in the case of a French firm whose volume of exports qualified it for an "exporter's card" (7/3.3e, 10/9.3c), the administration would not apply the reallocation rules if the French firm could demonstrate that it had made export sales to an affiliated foreign enterprise at "prices close to cost" out of commercial necessity rather than out of a desire to transfer profits beyond the reach of the French tax system." Source: Taxation—France, Harvard Law School International Tax Program, Commerce Clearing House, Inc., p. 787 (1966).

Other illustrative cases abound, such as a reported instance in which the subsidiary of a U.S. corporation in a developed country sold to its foreign affiliates at such low inter-company prices that it impaired the capital of the subsidiary, without being subject to questioning by the local tax authorities. It is possible that mutli-lateral agreement on principles of taxation applicable to foreign sales affiliates could permit uniform treatment of such income. Such agreement should also cover situations where tax holidays are granted by countries to induce the location of foreign manufacturers who will export from the country granting the tax holiday or other financial and tax inducements to locate in the country. Such inducements may include reduced tariffs on the import of raw materials, government loans on favorable terms, development of industrial zones, etc. When faced with a critical problem of exporting from the United States, it is not possible to act as if the rest of the developed countries do not create a stimulus for their exports and in many cases for the implantation of production in their countries by American companies.

PRESENT IMBALANCE FAVORING THE USE OF FOREIGN SUBSIDIARIES

The DISC proposal has been criticized as an incentive provision distorting economic activity. On the contrary, this proposal is intended to overcome a disadvantage for production in the United States and the export of United States products. The present tax structure favors international activity by our largest corporations, but even in this case depends upon foreign manufacturing and sales subsidiaries. This fact emerges from a complex web of taxing rules that are literally manipulated by large corporations with foreign subsidiaries and sophisticated tax computer planning. A summary of our rules throws considerable light on what in fact is happening.

U.S. TAXATION OF INCOME FROM DIRECT EXPORTS FROM THE UNITED STATES

A corporation incorporated under the laws of the United States, other than a Western Hemisphere Trade Corporation, and corporation subject to section 931 of the Internal Revenue Code, is subject to full current U.S. corporate income taxes on all of its income from the manufacture and sale or purchase and sale of property produced in the United States and sold by such corporation abroad.

U.S. TAXATION OF INCOME FROM FOREIGN OPERATIONS

A United States corporation is not subject to current U.S. income tax on income realized in the following circumstances:

1. Foreign manufacturing.—If the U.S. corporation creates a foreign manufacturing subsidiary, the income realized by that subsidiary on its sales, wherever they are made, is ordinarily not subject to current U.S. income tax on its non-U.S. source income, either directly or on the basis of a deemed distribution. See IRC sections 881, 882, and 951 *ff*. Only when such income is distributed as a dividend by the subsidiary to the U.S. corporation does the U.S. corporation have taxable income. At the time of distribution, a foreign tax credit is given by the United States (up to the full amount of the U.S. income tax on the dividend) for any foreign income taxes imposed on the income of the subsidiary out of which the dividend is paid and for the foreign withholding taxes imposed on the dividend itself.

2. Foreign sales intermediary.—If the United States corporation creates a foreign subsidiary, which handles the sales of products or commodities that were manufactured or produced by a related company in the United States or in a foreign country, the sales income received by such subsidiary on such products is not taxed currently by the United States if any of the following rules apply:

A. the sales are made in the country of incorporation of the subsidiary (IRC Section 954(d));

B. the manufacturing or production occurred in the country of incorporation of the sales subsidiary (IRC Section 954(d));

C. the sales of such products are made out of the country of incorporation of the subsidiary and the gross income from such sales (and other foreign base company income) is less than 30 percent of the subsidiary's gross income (IRC Section 954(b)(3)(A));

D. the subsidiary qualifies as a foreign Export Trade Corporation with 75 percent or more of its gross income from the sale of property grown, extracted, produced or manufactured in the United States, and the deferred income does not exceed the lesser of 1½ times the export promotion expenses of the export trade corporation, or 10 percent of its gross receipts for the year, to the extent the income is invested in "export trade assets" (IRC Section 970).

3. Minimum distributions—combining foreign manufacturing and a foreign sales intermediary.—If a U.S. corporation establishes a manufacturing subsidiary or subsidiaries in one or more countries with relatively high foreign tax rates, the products of such corporations and those of the U.S. parent corporation, may be sold through a foreign sales intermediary based in a jurisdiction with minimal local income taxes. If the rate of foreign taxes on the combined manufacturing and sales operations approximates 90 percent of the U.S. tax rate, U.S. corporate tax on the sales company income is deferred until its ultimate distribution. IRC Section 963. The considerable utility of this provision was summarized by corporate tax counsel in a professional tax publication as follows:

"U.S. companies that at present do not have foreign subsidiaries operating in low-tax-rate countries can now consider creating such companies, certain in the knowledge that they will be shielded from current U.S. tax, even if these companies earn substantial Subpart F income, so long as the requirements of this section are met. U.S. companies which presently have foreign companies of this nature can now consider creating additional companies of this type." "How to Determine Eligibility and Claim Exemption for Minimum Distributions," in *Practical Problems of Taxation of Foreign Income*, published by the *Journal of Taxation Inc.* p. 120 (1965).

4. Inter-company pricing.—Regulations under section 482 of the Internal Revenue Code apply a strict standard for arm's length inter-company pricing on sales by United States exporters to foreign affiliates, thus limiting the advantages of a foreign sales intermediary used for the distribution of U.S. exports. In comparison, inter-company sales between foreign manufacturing affiliates and related foreign sales companies are subject to foreign inter-company pricing rules which are often less strict than the U.S. section 482 regulations. The comparatively lenient foreign rules, in combination with the rules discussed above, and the possibility of organizing a sales company in a low tax country, provide an additional impetus for foreign manufacture by U.S. companies.

Summary—Effect of DISC

The DISC proposal is simply an effort to cut through all this maze of complexity and provide, in forthright fashion, the opportunity for tax deferral by use of a *domestic* corporation, rather than a foreign subsidiary. A firm inter-company transfer pricing rule is provided comparable to that applied in other countries (the prices may be established so that DISC earnings may amount to a maximum of 4% of its export sales or 50% of the combined income from manufacture and sale of the products (as previously explained), whichever is higher, plus 10% of its export promotion expenses). This is entirely reasonable, straightforward tax deferral treatment for export income, not unlike tax deferral benefits for export income granted by other countries.

Proposals to impose higher taxes on U.S. affiliates abroad, or to deny foreign tax credits for foreign taxes imposed on such affiliates, do not affect the problem of U.S. producers competing in foreign markets with producers controlled by foreign owners and who are able to take advantage of policies of their countries favoring export activity. Higher current U.S. taxation would have the practical effect of foreign countries obtaining the revenues, either by increasing their taxes to match the U.S. rate, or through withholding taxes, since U.S. companies would tend to distribute the income to obtain tax credits and reinvest it by way of capital contributions. Moreover, indiscriminate, punitive tax measures, such as denying tax credits and creating double taxation, could result in U.S. companies abandoning foreign markets altogether.

Tax factors are by no means the sole reason for foreign investment. There is a wide range of factors affecting a decision to invest abroad. In some cases local trade barriers may effectively prevent exporting to the country; in other cases shipping costs are a barrier to exporting. To eliminate foreign investment by indiscriminatory tax measures is too blunt an instrument of policy. The DISC proposal is merely intended to eliminate preferential tax treatment of production abroad relative to production in the U.S.

Practices in other countries

The following material describes certain provisions in foreign tax systems that affect export transactions in various countries of the world:

PROVISIONS IN FOREIGN DIRECT TAXATION LAWS AFFECTING EXPORT ACTIVITIES

On May 12, 1970, during the Treasury Department's presentation of its proposal for the Domestic International Sales Corporation to the House Ways and Means Committee, the Treasury Department was requested to submit information regarding the income tax laws and practices of other nations which operate to the advantage of export activities. The following description of foreign income tax law and practices is confined largely to other industrialized countries. It should be noted that in many foreign countries tax treatment favorable to export activities is frequently accorded on an informal, administrative basis and may, therefore, be difficult to identify.

This memorandum is intended to suggest some of the income tax provisions and administrative practices that can affect the export of products from various foreign countries. Some of the most significant provisions that would affect tax planning for export sales were not intended as export incentives when adopted but evolved from traditional theories of tax jurisdiction and taxation of foreign source income.

Devices having the effect of export incentives range well beyond income tax measures, including, among others, direct grants, government credit facilities, interest subsidies, insurance, guarantees, internal shipping subsidies, exchange control privileges, and tax measures other than those affecting income taxes. Some forms of government assistance may be available ostensibly for domestic as well as export activities, making it difficult to classify them solely as export incentives.

Rebates of value-added and other turnover taxes provide an export inducement to exporters in countries having such sales tax systems.

The following summary is not exhaustive nor has it been verified by counsel in each of the countries. It is nevertheless believed to be accurate and, except where specifically indicated, current. The summary consists of a list of seven specific types of provisions. Attached to the list are individual country summaries for 17 countries. It should be recognized that numerous U.S. corporations have established foreign subsidiaries which have benefited from the favorable treatment discussed in many of these countries.

The various laws and practices are as follows:

1. *Taxation of Foreign Source Income.* Unlike the United States, many industrialized countries impose income taxes on a territorial basis, which means that foreign source income is often wholly or partially tax exempt. Such exemption may apply not only to income from direct investments abroad, but also to foreign sales of domestically-produced products either through a foreign subsidiary or through a branch or dependent or independent agent.

In the case of most developed countries, exports can be made through controlled sales companies organized in low tax jurisdictions with a consequent tax shelter for the sales profits. For example, a manufacturing corporation, A, in country X, which may or may not be a subsidiary of a U.S. corporation may make its export sales through a related sales corporation, B, located in country Y where corporate taxes are minimal. To the extent Corporation B makes part of the profit that Corporation A would have made in direct sales, the tax burden is reduced.

While most countries have protective provisions in their tax laws that permit the local tax authorities to reallocate income between related entities, different countries have different rules as to such allocations, and considerable flexibility is often found in intercompany pricing. In at least some cases (as indicated below) it is understood that no reallocation would result from the prices charged by Corporation A to B as long as Corporation A earned at least one-half of the combined profits.

In some cases foreign sales corporations can establish purchasing and coordinating branches in the manufacturer's home country without affecting the income tax exemption of the foreign sales corporation, while facilitating exports through the sales corporation.

2. *Specific Export Income Exemptions.* Some countries, such as Ireland, have income tax exemptions for export sales. Such exemptions are sometimes limited to products produced in free-trade zones or depressed areas. As indicated below

some countries extend income tax exemptions or other benefits to companies locating in depressed areas, but in practice the benefits are offered largely to companies with a high export or import substitution potential.

3. *Accelerated Depreciation.* Several countries (e.g., Japan, France) permit or have permitted accelerated depreciation allowances for assets used in export production.

4. *Special Reserves (Market Development, Bad Debt).* Several countries, (e.g., Australia, France, Japan, Spain) have permitted special deductions for export market development or special bad debt reserves in connection with export credits.

5. *Special Deductions, Rate Reductions or Credits Related to Exports.* Australia reduces payroll taxes by an amount related to export increases. New Zealand permits a deduction from income taxes of 15 percent of increased export receipts. France permits deductions for the expenses of establishing foreign sales offices although income from such offices may subsequently be exempt.

6. *Favorable Inter-company Pricing Rules.* Either express rules or administrative practices frequently provide an additional incentive for export transactions through related foreign subsidiaries. In some countries, administrative practice permits considerable flexibility in inter-company pricing rules. In some jurisdictions, rule-of-thumb allocations permit 50–50 divisions of taxable income, even in cases when the foreign subsidiaries perform minimal functions.

7. *Discriminatory Allocation of Benefits Based on Export Production.* In addition to provisions related formally or informally to exports, there are often benefit (tax holidays, capital grants, investment allowances, interest subsidies, etc.) designed to attract new investments which are not always tied to exports in the legislative enactments, but potential exports are an important factor in the granting of such benefits. In some cases, the import substitution effect is also of importance in granting such benefits.

Not only are each of the devices listed above employed by one or more foreign countries, but the cumulative effect of these devices used by certain individual countries should not be overlooked. Thus, for example, Japan uses the following in combination:

1. Accelerated depreciation based upon export performance;
2. A deductible reserve for the development of overseas markets;
3. Special deductions for a variety of activities producing foreign exchange;
4. Liberal entertainment expenses to promote export sales.

AUSTRALIA

Foreign source income

Income derived by a resident Australian company from foreign sources is exempt from Australian income tax provided that it is not exempt from tax in the country of origin. The income earned by a foreign sales subsidiary of an Australian company is not subject to Australian income tax until distribution to Australian shareholders.

Export market development rebate

Australian law provides a tax rebate (credit) of 42.5 percent of an expenditure incurred for export market development and also permits the full deduction of the expenditure incurred. The combined effect, as computed under the tax laws. permits a total tax saving of 87.5 cents for each dollar of expenditure. Qualified expenditures include among others: market research, overseas advertising certain travel expenses, labels and packaging for export, protection of property rights, the preparation of tenders or quotations, and the supplying of technical data.

Payroll tax

A refund of payroll taxes is made in the event of an increase in export sales over a base period.

BELGIUM

Foreign establishments and subsidiaries

Income from a foreign establishment of a Belgian company is taxed at a reduced income tax rate equal to one-fourth of the ordinary rate; provided the income was generated and taxed abroad.

The income of a foreign sales subsidiary is not taxed until dividends are distributed. Upon distribution, the net dividends received (after deduction of foreign tax) are subject to a 10% tax withheld by the paying agent in Belgium. The amount remaining after the foreign tax and 10% Belgium tax is entitled to a 95 percent exemption in determining the Belgian company tax. The company income tax therefore applies to an amount equal to 5% of the net foreign source dividends.

Development subsidies

The Belgian government provides incentives for investment in certain areas of Belgium. The current provisions have a termination date of June 30, 1970. However, a new law to extend the provisions has been proposed. The incentives currently offered consist of interest subsidies, loan guarantees, capital, allowances (with tax exemption for such alowances), and exemption from the registration tax. It is understood that export projections are included in the criteria for determining the granting of such incentives.

CANADA

Foreign subsidiaries

Canada does not presently tax currently the undistributed earnings of foreign sales subsidiaries. Dividends from a nonresident foreign corporation acting as a foriegn sales subsidiary are exempt from Canadian income tax if more than 25 percent of the share capital is owned by the Canadian corporation receiving such dividends. A tentatively proposed Canadian tax reform would limit such exemption to foreign corporations in countries with which Canada has entered into the tax treaties.

Grants

Canada offers grants to companies, domestic or foreign, to locate in slow growth areas. These incentives are not expressly tied to export sales or import substitution. Most of the provinces also offer grants and loans to achieve the same desired objectives. The Province of Quebec has, however, an incentive program which is designed to aid companies who use "advanced technology" and "who are in position to supply world markets." Grants are also available to Canadian companies to encourage scientific research and development in Canada. To qualify for such assistance, recent amendments have required Canadian companies to be prepared to exploit the results of such research in Canada's export markets as well as in Canada. The grants are not available to companies excluded from selling to major export markets.

DENMARK

Foreign Permanent Establishment; Sales Subsidiaries

Where a resident Danish company has income from a foreign establishment, the proportion of total Danish tax payable with respect to such income is reduced. The reduction amounts to 50 percent of the Danish income tax applicable to the before tax net income of the foreign branch or other establishment.

A foreign sales subsidiary is not taxed currently on its sales profits. Dividends paid to a Danish corporation owning 25 percent or more of the shares of the subsidiary are taxed at a reduced rate of application for a refund with the reduction being computed in a manner comparable to the reduction for foreign branch income above.

FRANCE

Export Sales

Profits on sales of goods which are manufactured in France and shipped abroad by a French company are taxed only to the extent that they are realized through the allocable operations in France ("enterprise exploitée en France"). Profits are treated as foreign source income and not subject to current French income tax where they are:

derived from establishments abroad (Conseil d'Etat, March 9, 1960);

derived from operations abroad of dependent agents (Conseil d'Etat, June 5, 1937);

derived from operations abroad which constitute a complete commercial cycle ("cycle commercial complet") (Conseil d'Etat, February 14, 1944).

The territorial exemption applies to the foreign source profits when earned and when remitted to the French company.

Foreign Sales Subsidiary

Profits earned by a foreign sales subsidiary of a French company are not taxed currently in France. Upon distribution of a dividend from a foreign subsidiary to a French company, there is a 95% inter-company dividends received deduction. To obtain such deduction the parent must hold a minimum of 10% in the equity capital of the subsidiary or the cost acquisition of the participation must have been at least 10 million francs.

The 5 percent taxable portion of the dividends represents a lump sum deduction to cover business expenses attributable to the exempt dividends.

Distribution of Foreign Source Income to French Shareholders

The tax exempt foreign source income of a French corporation, including income exempt under the territorial rules or under the 95 percent inter-company dividends received deduction is not taxed until a distribution to shareholders. Upon distribution a French company must make a supplementary tax payment (*précompte*) equal to one-half of the dividend to the French Treasury with respect to profits that did not bear the normal 50 percent French corporate tax rate.

At the shareholder level, the shareholder is entitled to a credit equal to one-half the dividend, which is applied against his personal tax on the dividend grossed up by the credit.

Inter-company Pricing

Article 57 of the *Code General des Impots* provides that profits indirectly transferred to controlled enterprises outside of France through inter-company pricing are to be reallocated and that such adjustments may be based on comparison with the operations of similar enterprises operating normally. However, it is understood that, under administrative interpretation, Article 57 is not employed where exporting enterprises can establish that sales made by a parent French corporation to foreign subsidiaries at prices approximating cost do not have as their objective the shifting of income but are due to "commercial requirements."

Specific Export Incentive Provisions

1. A 1957 ministerial decision, amended in 1959, provided that depreciable assets (other than immovables) purchased or manufactured between January 1960 and January 1965, were entitled to special accelerated depreciation in the case of "exporting enterprises." The accelerated depreciation is equal to the straight-line depreciation multiplied by 150 percent of a fraction, the numerator of which is the export production and the denominator of which is total production. (Article 39A *Code General des Impots*).

2. French enterprises are allowed a special deductible reserve for middle term (2–5 years) loans extended to foreign customers (Article 39–1–5 *Code General des Impots*). The reserve allowance is more generous than normal bad debt reserves.

3. Expenses for establishing and operating foreign sales offices during their first three years of operation may be deducted against domestic income, even though future profits may be tax exempt. (See Article 39 *Code General des Impots*; Article 34 of the Law of July 12, 1965).

GERMANY

A resident German corporation is taxed on its worldwide income.

When business profits are derived through a foreign "business establishment" they are deemed to be from a foreign source. This rule is applied to any fixed installation or facility which serves the business activity of the German enterprise. A permanent representative (whether dependent or independent) is included in this concept whether physical facilities are present or not. Broadly speaking, a foreign business connection is generally sufficient to create foreign source income.[1] Some German commentators have stated that domestic source income is limited to profits derived from deliveries of goods to foreign countries by German enterprises which have no business connection whatsoever in the foreign country concerned.

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[1] Where there is no foreign connection, full German tax rates (without foreign tax credits) apply.

Foreign Tax Credit or Reduced Rate

Where a German company has foreign source income under the above rule, a tax credit is available for foreign income taxes imposed upon such income. As an alternative, German law authorizes the tax authorities to grant reductions of the German corporate tax with respect to foreign source income. A decree promulgated in 1959 provides for a flat rate of 25 percent on qualifying foreign source income. (Decree of July 9, 1959; BStB1 1959 11 132.) Sales profits derived through a foreign establishment qualify as foreign source income under this rule. This relief measure is applicable on request of the taxpayer and may be elected for specific foreign countries.

Exemption

Under its tax treaties, Germany ordinarily exempts the foreign source income allocable to a foreign permanent establishment as defined in the applicable treaty. Presumably such establishments have borne local corporate taxes. Recent amendments of the regulations permit foreign losses to be deductible from taxable income despite the potential exemption of future profits.

Foreign Subsidiaries

A German corporation may establish a foreign sales subsidiary and may not be subject to current taxation on the income of the foreign sales subsidiary, whether incorporated in a high or low tax jurisdiction. Dividends received from the foreign subsidiary are includable in the taxable profits of the German parent corporation. The parent may elect to have the dividends taxed at a flat 25 percent rate. Under certain circumstances, losses in foreign subsidiaries may be deducted by the German parent corporation.

Where a tax treaty is applicable, Germany ordinarily exempts the dividend income received by the German parent corporation from German tax. A 25 percent stock ownership is ordinarily required for such exemption.

IRELAND

Export Exception

A corporation, whether or not incorporated in or managed in Ireland, having a manufacturing operation in Ireland can obtain a 15-year exemption from Irish corporate taxes on all export sales, plus a reduced rate of tax for a further 5 years. Dividend distributions out of such profits are themselves exempt from all Irish income taxes. Cash grants of up to 50% of capital costs of plant and machinery are also available.

There is a separate scheme for the Shannon Airport area, including tax exemptions for the importing, handling, and reexporting of goods.

ITALY

Foreign Branches and Subsidiaries

Foreign source income of an Italian company is exempt where allocable to a foreign branch having separate management and accounting.

A foreign sales subsidiary of an Italian company is not subject to current income taxation in Italy. A ranch of such a corporation may be maintained in Italy if it does not sell in Italy. The non-Italian source profits of such a branch would not be subject to Italian income taxation.

JAPAN

Direct income tax incentives relating to exports fall under four general categories:

1. Accelerated depreciation
2. Reserve for development of overseas market
3. Export allowances, and
4. Entertainment expenses.

Accelerated depreciation in case of export sales

A. A corporation is allowed a tax deduction for accelerated depreciation based on export sales made in the immediately preceding year. The amount of additional depreciation is computed by applying the ratio of export sales over total sales to maximum ordinary depreciation available. In other words, if export sales are 30% of total sales, ordinary depreciation is increased by 30%. Ordinary depreciation is at generous rates in the first place.

B. The aforementioned increase in ordinary depreciation is further increased by 80% if the company is recognized as a type "A" export contributing corporation or 30% if a corporation is recognized as a type "B" export contributing corporation.

If a corporation satisfies both of the following two conditions, such a corporation will be recognized as an "A" export contributing corporation if condition (1) is satisfied, but (2) is not, the corporation will be recognized as a "B" export contributing corporation:

(1) The first condition is that export sales for the immediately preceding year increased 1% or more over export sales for the year immediately prior to that year.

(2) The second condition is that the ratio of export sales to total revenue for the immediately preceding year exceeds such ratio for the year immediately prior to that year, or the increase in exports as a percentage exceeds ⅔ of the nation's increase in exports, also stated as a percentage.

In other words, the factor used to establish whether or not a company is entitled to the extra depreciation over and above that provided by merely having exports includes consideration for both the amount of the increase in exports and the ratio of exports to total sales.

For example: Assuming a percentage of export sales against total revenue of the preceding year of 80%.

	Rank of corporation		
	(A)	(B)	Other
Maximum ordinary depreciation	100,000	100,000	100,000
Rate of accelerated depreciation (percent)		104	80
Accelerated depreciation	[1] 128,000	[2] 104,000	80,000
Total	228,000	204,000	180,000

[1] 160 percent multiplied by 80 percent.
[2] 130 percent multiplied by 80 percent.

The "special depreciation reserve" must be restored to taxable income in each of the next succeeding ten years at a minimum rate of 10% of the amount credit to the reserve. Thus, the relief is a deferral of taxes and increased cash flow.

Reserve for development of overseas markets

A. A corporation is allowd a tax deduction for a reserve for development of overseas markets to the extent of 1.5% (in case export of goods purchased from other, 1.1% if capital is more than ¥100 million) of export sales in the immediate preceding year. The rates are increased from 1.5% to 2.4% for a type "A" export contributing corporation, and to 1.95% for a type "B". The same conditions as those mentioned previously govern the type "A" or "B" classification. There is a decrease in these rates if the export is of goods purchased from others and an increase if the corporation is capitalized at less than ¥100 million.

B. The reserve is required to be restored to income, for tax purposes, at the rate of 20% of the amount originally provided, in each of the next succeeding five years. Thus, this provision represents a tax deferral mechanism. This reserve is not deductible for enterprise tax purposes.

Export allowance

A corporation may take an income deduction to the extent of the amount computed by applying various percentages to certain consideration earned in foreign currency during each qualified current accounting period. In most cases, the maximum deduction is 50% of taxable income for the period.

A. 20% of the consideration for rendering services regarding survey, and/or research, planning, advice, drawings, supervision or inspection for construction of manufacturing facilities, etc., which require scientific technical knowledge.

B. 30% of the consideration for transfer of motion picture films, copyrights and 30% of motion picture distribution revenue earned abroad.

C. 70% of the consideration for transfer and/or supplying of industrial technology, know-how, etc., created by a corporation.

D. 3% of the consideration for freight revenue on certain overseas export ship operations and repairing, processing or construction services.

Although deduction is not allowed for enterprise tax purposes, this item represents a permanent tax savings.

Export Related Entertainment Expenses

There is a generally severe limitation on the deductibility of entertainment expenses for tax purposes in Japan. Ordinarily a deduction is limited to about $11,000 per corporation plus ¼ of 1% of capital. The deduction for entertainment expenses in excess of this is limited to 40% of the expenditure. However, a reasonable amount of overseas and/or domestic travel and hotel expenses in Japan paid for non-resident visitors and entertainment expenses incurred abroad in connection with export transactions are not treated as entertainment expenses for purposes of determining the deductible amount of entertainment expenses, and are fully deductible for corporate income tax purposes.

THE NETHERLANDS

Foreign Establishments and Subsidiaries

Tax relief is granted to Dutch companies for certain foreign source income, including income derived through foreign branches and dependent agents and subject to foreign taxes. No minimum functions or payroll is required for the foreign establishment and the rate of foreign tax on such income is immaterial.

The undistributed income of a foreign sales subsidiary is not subject to Dutch tax currently. Dividends received from such subsidiaries are exempt in the Netherlands where the Dutch company owns at least 25 percent of the paid-in-capital of the foreign subsidiary.

NEW ZEALAND

Special Export Deductions

Certain expenditures incurred in promoting the export of goods and services, rights in patents, trademarks and copyrights, in addition to being an ordinary business deduction, qualify in certain circumstances for a further deduction of 50 percent additional to the actual cost.

In addition, 15 percent of the increase in a firm's exports of manufactured goods over a previous base period can be deducted from gross revenue for corporate tax purposes.

NORWAY

Foreign Branches and Subsidiaries

Income from operation of a permanent establishment abroad is reduced by 50 percent for purposes of Norway's income tax. The income of a foreign sales subsidiary is not taxed until distributed to Norwegian shareholders. A special election provision permits Norwegian shareholders to be taxed currently on 50 percent of the earnings of a foreign subsidiary with the dividends from such subsidiary being exempt from Norwegian tax.

Export Market Development Reserve

A tax-free reserve of up to 20 percent of taxable income each year may be established for purposes of future market development abroad to assist Norwegian exports. No similar reserve is allowable for domestic market development. The taxpayer must show evidence to the authorities that the allocated amount has been used for approved measures within 5 years from the date of allocation.

SOUTH AFRICA

Foreign Source Income

Foreign Source income from a foreign permanent establishment or foreign subsidiary is exempt when received by a South Africa corporation.

Exporters Allowance

An extra deduction from income of a percentage of market development expenditures is permitted for exporters. The percentage varies from 50 percent to 75 percent. Qualifying expenditures include market research, advertising, solicitation of orders, providing samples and technical information, preparing tenders and quotations and to certain sales commissions and fees. The foregoing expenditures are entitled to deduction as ordinary expenses and the additional percentage is also permitted as a deduction whether or not there were any exports; if the current year's exports exceed those of the preceding year, the percentage is increased.

EXPORTERS' ALLOWANCE PERCENTAGES

[In percent]

Tax year	If no increase in turnover	If current year's export turnover exceeds preceding year's turnover— By more than 10 but not more than 25 percent	By more than 25 percent
1963–67	25	37½	50
1968	37	50	62½
1969	50	62½	75
1970	50	62½	75

SPAIN

Export reserve

Spain permits the creation of an export reserve to which between 30 percent and 50 percent of the profits derived from exports may be transferred. Income taxes on such reserve are deferred as long as the amount is invested in machinery and equipment and other assets and activities related to exports.

SWITZERLAND

Foreign subsidiaries and establishments

The earnings of foreign subsidiaries of Swiss companies are not subject to current income taxation and dividend distributions are exempt from Swiss Federal income tax and from most cantonal and local income taxes.

A foreign branch of a Swiss company is also exempt from Swiss Federal income taxation on income allocable to such branch, although the rate of tax is determined on the basis of the total profits of the company including its foreign branches.

Cantonal arrangements

Certain cantons offer export incentives under their cantonal tax laws and certain cantons offer export trading companies reduced tax rates on a negotiated basis. Intercompany pricing arrangements are also subject to agreement on a basis favorable to exporters. As a result, Switzerland has become a leading center for export sales companies which are subject to nominal taxes on export income.

UNITED KINGDOM

Foreign sales subsidiaries

The income of foreign sales subsidiaries of U.K. companies is not taxed until distribution to a resident U.K. shareholder.

Investment grants

Under the Industrial Development Act of 1966 cash grants are made in respect of capital expenditure on new plant or machinery for use in Great Britain in the manufacturing, extractive and construction industries. The rate of grant is 20 percent. If the investment is in a "development area" the rate becomes 40 percent. The investment grant scheme is administered by the Board of Trade, which may accord additional incentives for industry in the designated "development areas." Tax exempt grants have been received by U.K. manufacturing affiliates of U.S. companies presumably manufacturing for sale not only in the U.K. but in the EFTA trade area and elsewhere.

Overseas trade corporation (1958–1966)

In 1958, the U.K. adopted an Overseas Trade Corporation provision in its tax laws which exempted qualifying corporations, incorporated in and managed from the U.K. from tax on their retained "trading profits," as distinguished from investment profits. Essentially, this provision was intended to defer the tax on earnings arising principally from export sales. Upon distribution to British shareholders, the profits were taxed in the same manner as other dividend profits. This legislation was repeated in 1966 as part of a general tax reform.

VENEZUELA

Exemption of foreign source and export income

Foreign source income of a Venezuelan corporation is ordinarily exempt from income tax in Venezuela. Export sales of Venezuelan manufactured products may be exempted by agreement for a period of 10 years. To obtain such agreement, the exporter may be required to reinvest profits on such exports in Venezuela.

Rate reduction in exports of extractive industries

A special provision provides for a reduction of .25 percent of taxable income for each one-percent increase in gross income from the exportation of minerals or hydrocarbons and related products over the average of the preceding two years. This reduction is limited to a maximum of two percent of taxable income in any year, with a three-year carry forward.

Questions Regarding the DISC Proposal

1. Does DISC involve a permanent tax deferral?

While deferral may be for a substantial period of time, it cannot be permanent. The proposal is in fact a form of deferral with ultimate taxation on dividend distributions just as in the case of the income of foreign subsidiaries. The DISC proposal merely provides that the corporation that has the deferred income may be a domestic corporation rather than a foreign corporation. The DISC is distinguishable, however, since it limits the use of the DISC funds to export-related investments, while foreign subsidiaries are free to invest in anything.

The primary objective of the proposal is to put the export trade of U.S. corporations on a more competitive footing with manufacturing through overseas subsidiaries, thereby helping to keep jobs at home and strengthen our trade position.

2. How, when and by what amount will DISC stimplate U.S. exports?

In some of our major markets, and for some broad categories of products, price elasticities for U.S. exports are estimated to be quite high. A reduction in U.S. prices in such markets and for such products could be expected to raise export proceeds substantially more than the revenue cost of DISC.[2]

For many products, however, U.S. companies could be expected to use other means for expanding their exports under the inducement of DISC. Such measures might include—

Increased promotional effort;
Technological improvement;
More attractive financial terms;
Delivery schedules;
Servicing facilities;
Quality control; and
Product tailoring.

One company, after an analysis of its major export lines and markets, concluded that 55% of its total exports could be increased through DISC benefits. It suggested the expansion could be achieved through—

Price reduction in the case of 13% of its exports;
Increased promotion effort in the case of 10% of its exports;
Combinations of price reduction and increased promotion effort, depending on the market, in the case of 23% of its exports; and
Capacity expansion in the case of 9% of its exports.

There is little quantitative information about the effect of non-price measures, such as those mentioned above, in expanding exports. But the fact that many U.S. business firms continue to use such measures energetically in an effort to expand or defend their domestic market suggests their belief in the effectiveness of these measures. Unfortunately, many U.S. firms do not seem to have pursued them with the same vigor in creating or expanding export markets as in expanding their domestic market.

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[2] Houthakker-Magee estimates of a −1.5 price elasticity of foreign demand for U.S. exports have been cited. Subsequent to the Houthakker-Magee study, Magee did a revised study (October, 1970) which resulted in a foreign average price elasticity for all U.S. exports of −2.0 as compared with the −1.5 of the earlier study. He also estimated price elasticities of certain of the major customers for U.S. exports. These range from −1.0 to −4.0. In the case of Japan, the elasticity was −3.0.

This failure is due, in part, to greater uncertainties connected with selling in a foreign country where language, laws, regulations, consumer tastes, etc., may differ considerably from those in the U.S. These uncertainties may make business firms hesitate to undertake extensive promotional measures (or make price reductions) to achieve a potential, but uncertain, expansion of export sales and profits. DISC will encourage the firm in this direction. Even if a firm should not immediately seek increased profits by making additional exports, as a result of DISC benefits, the increase in profitability of its current export business will induce a shift in the firm's allocation of resources as between production for the domestic market, production for export, and—if the firm has a foreign manufacturing affiliate—production abroad. More new firms will also be attracted into the export business.

Letters from several firms suggest that an expansion of exports may be rather prompt when DISC becomes effective. One firm figures that its exports affected by DISC will grow in the first year by 10.5% as compared with a normal growth rate of 7.5%. Another figures its annual export growth rate over a five-year period will jump from 15% to almost 22% as a result of DISC.

These projections do not seem unrealistic if DISC inspires a vigorous export drive. For example, one electronics firm which engaged in such a drive reached in average annual export level in the first two years 80% above its average level in the three preceding years.

On the basis of such examples, experience under the 1962 investment tax credit, experience in trade fairs and the reaction of the business community we estimate that the growth of U.S. exports, as a result of DISC, will be close to one percent higher on the average over the next few years than it otherwise would be, resulting by 1974, and thereafter in at least $1.5 billion of additional exports per year—two and a half times the revenue cost (excluding any allowance for additional revenues from DISC-generated income).

3. What is the expected employment effect of DISC?

The DISC-induced stimulus to U.S. production, besides generating additional revenues, will maintain and increase employment in our export industries by a substantial amount. With the $1.5 billion of incremental exports estimated for the third year of DISC, the employment effect on the basis of output per worker ratios will be in the neighborhood of 80,000 jobs. The respending of the income generated by DISC in the export industries will contribute further to U.S employment

4. Shouldn't DISC benefits be limited to incremental exports?

The Treasury after very careful consideration of tax deferral only for incremental exports found serious difficulties in this approach.

In an incremental system there is no way to identify firms that are struggling to maintain even their existing export level in the face of increased foreign competition Yet, continuation of existing export levels by these firms are quantitatively important, as indicated by the fact that over 20% of US exports showed declining or level trends in the period 1965–69. In recent years, one-third of our hundred largest exporters have had a declining or indefinite export trend Preserving a dollar of proceeds from existing exports is as important from a balance of payments viewpoint as achieving an additional dollar's worth of export proceeds.

A major purpose of DISC is to overcome the disincentive under existing law to devote resources to exporting as compared with manufacturing investment abroad. We want to remove that disincentive for all exporters, or potential exporters, even though some of them may not be able to show actual increases in exports—at least for a time. But if the latter are induced to do more to prevent further erosion of our existing export base, a real benefit for the balance of payments will result. Hence, considerations of both equity and effectiveness favor the Treasury approach.

Apart from these considerations are the administrative difficulties inherent in an incremental approach. Examples are the selection of an appropriate base from which to measure incremental performance, and the treatment of increases in exports of particular firms due to reorganizations, mergers, or changes in export channels. The incremental aspect was eliminated from the initial investment tax credit proposal in 1961 on the basis of its complexity, as well as its unfairness to struggling industries.

5. Are DISC benefits likely to be confined to large companies?

No. Many large companies are already shielding export earnings from U.S. tax because the breadth of their foreign operations enables them to use excess foreign tax credits to achieve this result. While all companies will have greater incentive to manufacture here and sell abroad, the principal beneficiaries are likely to be companies in a middle range which have not concentrated on export sales because of greater uncertainties and complexities in selling abroad.

But the proposal should also encourage smaller companies to enter the export market. The first act of business of the newly created *National Export Expansion Council Committee on Small Business* was to adopt on September 17, 1970, a resolution urging enactment of the DISC "as a matter of pressing importance and urgency."

6. Can DISC provide parent corporations with tax-free money for domestic use—or foreign investment—having nothing to do with exports?

A DISC may loan its tax deferred income, within a prescribed limit, for up to 5 years to domestic producers, including its parent firm, which are engaged in exporting, provided the borrower makes at least an equivalent addition to his plant and equipment plus research expenditures. The ceiling on loans from a DISC to a U.S. producer equals the value of the producer's U.S. plant, equipment and inventory, plus research and development expenditures, times the percentage that its exports are of total sales. Once the borrowing limit of a producer is reached, there can be no additional loans from a DISC unless the borrower either expands his percent of export sales or increases his U.S. plant, equipment and inventory, or his research and development expenditures. To the extent that the borrower neglects export expansion or invests abroad rather than at home, he limits his borrowing capacity from a DISC and this, in turn, reduces the possibility of continued use of DISC income in ways which qualify for tax deferral. When this possibility is exhausted the DISC is forced to distribute fully taxable dividends to its parent. This is a much simpler self-regulating system than the illusory attempt to determine whether or not specific funds have been utilized in a desired manner.

Proposal is inconsistent with our other tax rules and does not find any parallel in the tax rules of other countries

1. Foreign manufacturing subsidiaries tend to pay foreign taxes at a rate significantly below the marginal rate at which U.S. exports are taxed. In addition, a substantial number of countries offer tax holidays or other incentives for local production and export. The DISC may clearly be more favorable than operations under the laws of certain other foreign countries. We have announced our willingness to agree upon general rules for the treatment of exports under domestic tax laws. We believe that the United States should not be the only country pursuing a tax policy that places its exporters in a disadvantageous position.

2. No other foreign country taxes the undistributed income of foreign sales subsidiaries. Most developed countries do not tax the foreign branch earnings of sales subsidiaries. This is true regardless of the tax rate in the country of the foreign subsidiary or branch. The DISC provides comparable treatment, with the additional feature that the DISC will be established as a domestic corporation to assure greater facility and use, to make it available to smaller companies, and to permit the inspection of books and records in this country.

3. The inter-company pricing rule between DISC's and related manufacturing companies is more comparable to administrative practices in other countries than are our present regulations.

The CHAIRMAN. Senator Fulbright.

Senator FULBRIGHT. Thank you, Mr. Chairman. I am sorry I did not get to hear your statement; I have read part of it, but I had to conduct another committee meeting.

I have just a question or two. Mr. Secretary, you start out by saying you are very gratified with the success of the new economic policy. Have you already cited some specific examples supporting this optimism about the new policies?

Secretary CONNALLY. No, I have not, but I think it is fair to say that the thing that is most encouraging of all to me is the state of mind, Senator Fulbright, of the American people.

I think the American people accepted the wage and price freeze at all levels and in all sectors with amazing understanding——

Senator FULBRIGHT. I was thinking of specific economic matters, not the psychology, not the psychological aspects.

Secretary CONNALLY. The wholesale price index released this morning for all commodities is down 0.3, not seasonally adjusted. Seasonally adjusted it is down 0.4. And industrial commodities—this is the first time in several years that the industrial commodities have been down—and not seasonally adjusted, the industrial commodities, which are part of this wholesale price index, are down 0.1.

I think that is the first time in 3½ years. Let me confirm that.

About 3½ years is correct, Senator. Another matter of great significance that we can point to at this point is the decrease in interest rates which are down in every single category; 3-month Treasury bills—6 months, 12 months; Treasury coupons—1, 3, 7, and 10 years; Federal funds; Federal agency securities—1 year and 3 years. Every one of them is down.

Senator FULBRIGHT. Down from a pretty high level?

Secretary CONNALLY. Well, they are, nevertheless, down and they are down in very substantial amounts. Corporate bonds are down. I agree that they are down from a high level.

Municipal bonds are down from 6.03 to 5.24, that is down 79 basis points. That is a tremendous drop.

Double A corporate bonds are down 25 basis points. Three-year Federal agency financing is down from 7.32 to 6.23. That is 109 basis points.

One-year Treasury coupons from 6.09 down to 5.13, down 96 basis points and so forth. So I think there is every reason to believe that the program has worked and worked extremely well.

Senator FULBRIGHT. There is another matter that bothers me very much not only in this connection but in dealing with the foreign aid legislation in the Foreign Relations Committee and elsewhere.

The usual criterion against which the Government measures our economic position is the gross national product. Do you consider that the gross national product is the best measure of our fundamental strength and economic health?

Secretary CONNALLY. Senator, I would not want to say that it is the best. It obviously is one of the factors.

Senator FULBRIGHT. It is the one usually used.

Secretary CONNALLY. That is correct.

Senator FULBRIGHT. It is more commonly used than anything else?

Secretary CONNALLY. Yes, sir.

Senator FULBRIGHT. If I suggest that we are not as rich as we ought to be in order to sustain either the excessive expenditures for either the Military Establishment or foreign aid, I am always met with, "Look at our gross national product, a country with a thousand billion dollars, it is just in the greatest shape possible." It has occurred to me there is something wrong with this as a measure of the state of our economic health.

I wonder if you would be willing to have your staff supply for the committee, especially for my purpose, and I think it is useful in other connections, a detailed breakdown by categories of the components of the gross national products.

I have inquiried elsewhere and had some difficulty obtaining this information and I thought with your very competent, experienced staff that you would be able to do this with greater alacrity and ease than anyone else. I would be very interested to know how much of the gross national product is attributable to such categories as education, how much to public welfare, how much to the tobacco industry, to steel production, how much to soft drinks and alcoholic beverages, road construction, to cosmetics, to advertising, to garbage and sewage disposal.

I am under the impression that one of the very great contributions to our gross national product is the cost of disposing of our sewage and our garbage and it never occurs to me this is a sign of great strength of an economy.

I think it would be a great public service if your responsible staff would give the detailed analysis of just how significant the gross national product is as a measurement of the economic health of the country.

Would you do that?

Secretary CONNALLY. Senator, your flattery undoubtedly will get you some figures from my staff.

Senator FULBRIGHT. I would appreciate that.

(Material furnished by the Department follows:)

THE GNP AS A MEASURING ROD

Conceptually, gross national product (or expenditures) has as its objective a measure of the value of newly produced final goods and services over a specified interval of time. As such, the GNP should not be regarded necessarily as a measure or index of general welfare or "economic health", but simply as the total of dollars spent by consumers, business, and government. Accordingly, the GNP represents a measure of the preferences of consumers and businesses as expressed in market prices, while in the government sector, expenditures measure the outcome of decisions made in the political process. (Tables 1 and 2 show broad categories of expenditures made by these sectors. Table 3 shows some special categories which relate to so-called "welfare" aspects of measurements.)

On the basis of this official definition, the transactions (aside from some imputations) which are generated in the production and exchange of newly produced goods and services are summed in value terms, that is to say by prices. These provide the weights by which all the physical units are summed for a specified time period. Indeed, prices represent the only means by which the physical units of a nation's output can be valued and totaled in order to obtain a measure of GNP.

These prices reflect the demand and supply influences in the market place, the degree of competition, and the adaptability of the economy to respond to consumer or business preferences—all these are involved in calculating the value of GNP. Accordingly, prices represent a means by which consumer and business preferences are expressed and they explain why more or less of a particular good or service is produced. (The concept of "real" gross national product, i.e., gross national product deflated for price changes, also uses prices as weights.)

GNP AS A MEASURE OF SOCIAL WELFARE

Gross national product may not be ideal as a measure of social welfare. Along with economic growth, there may be increased air and water pollution and other environmental hazards, increasing generation of garbage and other such items, congestion in the cities, depletion of natural resources, and similar apparently detrimental factors affecting individuals and social welfare.

POSSIBLE DEDUCTIONS FROM THE GNP TOTAL

Accordingly, it has been urged by some that such costs be deducted from the gross national product to obtain an improved measure of economic growth, as adjusted for social welfare loss. The criterion would be that they represent "costs" rather than adding to the health and welfare of a country. However, if that position were taken, it would bring a host of uncertainties to the computation of the GNP. Among the items which would also fall into this category of costs to be deducted from GNP might be: physicians' services and other medical care; much of governmental activities, including police and fire protection, as well as sanitation; perhaps legal services and all repair services. In a certain sense, it has been pointed out that even food might be considered a regrettable necessity. In short, it would be most difficult to draw a line between what are allowable deductions from the GNP as against those expenditures which surely provide satisfaction and add to social welfare.

POSSIBLE ADDITIONS TO THE GNP TOTAL

On the other hand, if social welfare is the criterion, it is clear that much would need to be added to the calculation of the GNP dollar total. As progress in economic growth is made, more has been produced with fewer people, thereby creating for most people increased leisure, as compared with former years. The valuation of such leisure as a benefit of economic growth would be very difficult and, indeed, that is one reason why they do not show up in the national accounts. Its quantification would present a most difficult problem, because it does not bear a price tag upon which such a valuation could be made.

Another example of benefits which are not measured by the GNP are those provided in the development of public parks and other recreational areas, which surely adds more to social satisfaction than their costs of production. But, there is no easy way to measure this. Again, a greater selection of products which become available to consumers through increased economic growth surely is of great social benefit, but equally unmeasurable.

SOME ALTERNATIVES

The gross national product is not a very good measure of social welfare, but it is difficult to determine how an alternative and comprehensive aggregate intended for this purpose could be developed. Perhaps an index could be constructed of some specifications such as expenditures for environmental protection, employee protection, and the like. This would be useful in the interpretation of the growth of the GNP aggregates and productivity, as well as in its own right in knowing the trend in these expenditures.

TABLE 1.—MAJOR CATEGORIES OF GROSS NATIONAL PRODUCT

	Amount, 1970 (billions)	Percent of GNP
Total GNP	$974.1	100.0
Personal consumption expenditures	615.8	63.2
Durable goods	88.6	9.1
Nondurable goods	264.7	27.2
Services	262.5	26.9
Gross private domestic investment	135.3	13.9
Fixed investment	132.5	13.6
Nonresidential	102.1	10.5
Structures	36.8	3.8
Producers' durable equipment	65.4	6.7
Residential structures	30.4	3.1
Nonfarm	29.7	3.0
Farm	.6	.1
Change in business inventories	2.8	.3
Nonfarm	2.5	.3
Farm	.3	(1)
Net exports of goods and services	3.6	.4
Exports	62.9	6.5
Imports	59.3	6.1
Government purchases of goods and services	219.4	22.5
Federal	97.2	10.0
National defense	75.4	7.7
Other	21.9	2.2
State and local	122.2	12.5

[1] Less than 0.1 percent.

Source: Calculated from data of the U.S. Department of Commerce, Office of Business Economics.

TABLE 2.—MAJOR CATEGORIES OF CONSUMER EXPENDITURES

	Amount 1970 (millions)	Percent of GNP
Personal consumption: Expenditures	$615,840	63.2
Food	131.757	13.5
Tobacco products	11,188	1.1
Clothing, accessories, and jewelry	62,278	6.4
Personal care	10,101	1.0
Housing	91,224	9.4
Household operation	85,618	8.8
Medical care expenses	47,268	4.9
Personal business	35,497	3.6
Transportation	77,871	8.0
Recreation	39,049	4.0
Religious and welfare activities	8,826	.9
Foreign travel and other, net	4,810	.5
Private education	10,353	1.1

Source: Calculated from data of the U.S. Department of Commerce, Office of Business Economics.

TABLE 3.—SELECTED CATEGORIES OF EXPENDITURES IN THE GNP

	1970 (millions)	Percent of GNP
Consumer expenditures:		
Alcoholic beverages	17,714	1.8
Tobacco	11,188	1.1
Toilet articles and preparations	6,059	.6
Education:		
Public	54,131	5.6
Private	10,353	1.1
Sanitation:		
Public	2,696	.3
Private	2,362	.2
Highways	16,418	1.7
Government expenditures on welfare and social security:		
Public assistance and relief	16,646	1.7
Unemployment benefits	3,930	.4
Old age and retirement benefits	41,235	4.2
Other	4,048	.4

Source: Calculated from data of the U.S. Department of Commerce, Office of Business Economics.

Secretary CONNALLY. In the meantime I don't want to defend the GNP as a barometer of anything, in light of your comments.

Senator FULBRIGHT. I am not sure my picture is correct. This is what I suspect and I have tried to get it. I have written to several places, but it occurs to me that the Treasury is the best place of all to get this sort of thing, because it is used constantly by the President in his speeches and by all kinds of people. It is especially used against me as an argument that we can afford to do just anything we want to do.

We can give an unlimited amount to any country, X, Y, Z, because we have this great gross national product, and as I say I suspect it is a very flimsy criteria of our health and our capacity to do the things that we are expected to do.

I think it is a very poor measure by which to judge whether or not we can sustain 300,000 troops in Germany indefinitely. This is one example.

When we make the argument in the Senate that this is beyond our reasonable expectations we are confronted with this enormous gross national product and I don't think it is a good argument. I think it is quite relevant to what we are talking about here and I am very much in favor of doing something to increase what I consider the fundamental productivity of this country.

The column in the morning paper by Novak and Evans was very revealing. It concerned the steel strike in Japan. I don't know whether you had a chance to read it.

Secretary CONNALLY. No, sir; I did not.

Senator FULBRIGHT. But it is very discouraging, as to the competitiveness of their industry vis-a-vis ours and I know that is what you are trying to correct here.

Secretary CONNALLY. That is right.

Senator FULBRIGHT. In order to get our ideas a little more in line with what we were able to do in other lines I think this gross national product ought to be explored. If it is sound well and good. I don't think it is and I think we ought to have a better measurement of how well we are doing than the GNP.

That is the real point. I think it would be a real service to everybody if you would do it in a really expert manner.

Secretary CONNALLY. All right.

Senator FULBRIGHT. Thank you.

Senator HANSEN. Could I interrupt for a moment to be sure I heard the distinguished Senator from Arkansas?

I am not sure that I did. There was a little noise.

Was the thrust of your question that the cost of sewage disposal would indicate that our economy is going down the drain, Senator? [Laughter].

Senator FULBRIGHT. We don't understand how well off we are or how badly off we might be. We should be taking that into consideration in making our decisions on these other matters which I have mentioned such as the expenditures for arms and military affairs, or for foreign aid. I have been arguing in my committee trying to bring what I consider a little more restraint upon the enthusiasm of some of the members to give a much larger foreign aid program than I think our economy justifies.

This is the immediate question before me and it does not occur to me that this kind of program is a good index of just how well off we are to service this kind of a program.

You are quite right. In a way you are right about that.

The CHAIRMAN. Senator Hartke.

Senator HARTKE. Mr. Secretary, before I ask you a question I might make a comment. You know there was some conversations here today concerning the amount of time that was being given in this committee to a certain media over on our left. I am always glad the media is on my left. But I wonder would you make a recommendation to the media tonight that Mr. Meany be given equal time to respond to the three-network coverage that Mr. Nixon is going to receive?

Secretary CONNALLY. When he is President of the United States, I think he will be entitled to it, yes, sir.

Senator HARTKE. Yes, I think that is fair. No question about that. But let me ask you, what surprises does he have in store for us tonight?

Secretary CONNALLY. I really wouldn't characterize his anticipated appearance as an attempt on his part to surprise anyone.

Senator HARTKE. He is going to surprise me because he hasn't consulted me about it or even asked me my advice and I am not anticipating he ever will.

Senator CONNALLY. I am sure that is his loss, Senator. [Laughter.]

But I know that you, as a politician, Senator, know full well that he can't talk to everybody. You and I both have been through this. As you know, he has talked to the leadership of the Congress, the bipartisan leadership of the Congress about this program. He is asking for their suggestions, and from your position on this committee you are going to be in a position in not too many years when you are going to be in that group.

Senator HARTKE. Not with the President's help I am not.

Let me say are we going to have a long-term extension of wage and price controls? Is that what he is going to recommend?

Secretary CONNALLY. I would be presumptuous indeed in all seriousness if I tried to anticipate what he is going to say.

Senator HARTKE. He has not consulted you?

Secretary CONNALLY. I think it is fair to say that I have had some input in what he is going to say. I am not saying I am without knowledge or without any inkling of what he is going to say. I would say I would be presumptuous to reveal it.

Senator HARTKE. What about controls, some type of ceiling on interest payments? Will we have that? Would you be in favor of that?

Secretary CONNALLY. I have indicated all along, Senator, that I have no hesitancy whatever with respect to having both the power and using the power to control interest rates as well as other——

Senator HARTKE. In other words, if we put in a ceiling on interest rates in this bill you would agree to that, is that right?

Secretary CONNALLY. It depends on what it is.

Senator HARTKE. I mean some type of freeze similar to that which has been slapped on the workingman.

Secretary CONNALLY. If you get into that and write a controlled bill here, I am not sure that I would not want to enter some objections because I think if you get to that point you're going to be in a long discussion of it and delay the actions on this bill.

Let me point out, I responded to Senator Fulbright a moment ago by pointing out interest rates have gone down during the freeze; interest is the only thing I know of that has.

Wages have not gone down.

Senator HARTKE. Aluminum and copper prices have gone down?

Secretary CONNALLY. I don't recall.

Senator HARTKE. But I can say they have. Would you be willing to have a ceiling on excess profits control?

Secretary CONNALLY. Depending on what the base period is.

Senator HARTKE. If we come to an acceptable base period would you be willing to agree then to some type of interest ceiling and some type of profits?

Secretary CONNALLY. I think whatever program we have must apply equally to all segments of the economy and must be administered in a very fair and objective manner.

Senator HARTKE. I am not assuming we are going to be unfair. You know I am in favor of the investment tax credit, I have been for a long time, and it is not a new policy. I have been for it since 1962. But in good conscience I don't believe we can go for ADR and tax credit at the same time, do you?

Secretary CONNALLY. Yes, sir; I sure do and I sure hope you will.

Senator HARTKE. I won't.

Secretary CONNALLY. I think it makes a great deal of sense. The House knocked out the first year convention.

Senator HARTKE. I understand what they did. I am not interested in going into that at the moment, I am interested in asking you since July 22, can you tell me how many jobs ADR has provided, make that June 22?

Secretary CONNALLY. No; I can't give you a categorical answer.

Senator HARTKE. Can you tell me how many jobs would be created by the 10-percent investment credit which I advocate?

Secretary CONNALLY. No. I wouldn't want to quantify that.

Senator HARTKE. Here you are telling the American people it is going to create jobs and you have no idea how many jobs it is going to create?

Secretary CONNALLY. I think beyond any question it will, I think——

Senator HARTKE. But you have no estimates whatsoever?

Secretary CONNALLY. Oh, sure, we can and we will be delighted to give you all of the testimony you want dating back to 1962, Senator Hartke, when it was passed.

Senator HARTKE. I am not asking about 1962, I am asking about this proposal. I am asking for your judgment, I am not——

Secretary CONNALLY. You have my judgment. My judgment is——

Senator HARTKE. It will create some jobs?

Secretary CONNALLY. A great many jobs.

Senator HARTKE. Many jobs? How many? Ten thousand?

Secretary CONNALLY. We estimate that the program which we are recommending to the Congress will—Dr. McCracken testified before the Joint Economic Committee that it would increase GNP by approximately $15 billion next year and depending upon the makeup and reaction in the industrial sector of the economy that it would produce between 500,000 and 1 million new jobs.

Senator HARTKE. How much of that is attributable to the investment tax credit?

Secretary CONNALLY. I don't have a breakdown.

Senator HARTKE. Don't you think you should have?

Secretary CONNALLY. Well, this gets back, Senator Hartke, to what we said a moment ago, that a great many of these things are not subject to quantitative proof, you just must rely on past experience.

Senator HARTKE. Let's see whether it is or not. Wage and price controls went into effect on August 15, right?

Secretary CONNALLY. Right.

Senator HARTKE. What is the shortfall revenue estimate of taxes that are going to have to be refunded as a result of that since August 15? What is the estimate? Mr. Nolan I have high regard for; he ought to be able to give you that answer.

Secretary CONNALLY. Mr. Nolan informs me he has no figures on it and neither do I.

Senator HARTKE. Don't you estimate it will be a substantial shortfall?

Secretary CONNALLY. There will be——

Senator HARTKE. For refunds since August 15?

Secretary CONNALLY. There will be some because during the 90-day freeze——

Senator HARTKE. Is it going to be in the neighborhood of $5 billion?

Secretary CONNALLY. I wouldn't think so.

Senator HARTKE. I think Mr. Nolan would think so.

Secretary CONNALLY. I cannot give you a quantitative answer on that, Senator. We have to study it and supply some figures for the record but I doubt that it——

Senator HARTKE. Would you do that for me?

Secretary CONNALLY. Yes, sir.

(Material furnished by the Department follows:)

REVENUE IMPACT OF THE WAGE-PRICE FREEZE

The revenue loss resulting from the 90-day wage-price freeze is estimated to be $800 to $900 million. This estimate should be regarded as an upper limit since part of the loss will be offset by the increased economic activity generated by the freeze.

Senator HARTKE. In other words, what I am saying to you since August 15 has there been a shortfall in revenue due to decrease in export taxes?

Secretary CONNALLY. Yes, sir.

Senator HARTKE. That indicates quite conclusively that the optimistic statement you made has no justification in fact?

Secretary CONNALLY. What optimistic statement?

Senator HARTKE. The observation that this system is working, the so-called NEP.

I refer to NEP as Nixon economic propaganda and I expect we will have more of it tonight and I don't think it is going to work and I think this is concrete evidence that it is not working.

Now, you go ahead.

Secretary CONNALLY. Senator, if you judge the entire success or failure of the President's program on the basis of whether or not there is going to be a shortfall in revenues during the 90-day freeze period, which you apparently have just done, then there is no question it will be a failure, because everyone knows that the export profits will be less; revenues from export profits will be less and taxes from individuals will be less because the freeze that applies to wages and salaries will have, in the short run, an adverse impact on revenues.

No question about that. But I don't think that indicates that the program is a failure. This is only one small element.

Senator HARTKE. What about jobs? How many new jobs have been created since August 15?

Secretary CONNALLY. Well, Senator, I could not quantify the number of jobs created in the short time period. I do know that again we have approximately 79 million people fully employed in this country at the highest wages in the history of the United States and at a very high personal savings rate—at a rate of 8.2 percent.

Personal savings is running at the rate of $60 billion a year on an annualized basis. I do know a great many things are happening in the economy that gives us reason to believe that the President's program will work and is working, and obviously you can't expect an economy of this size, and you know this, Senator, to react and turn around in a matter of 90 days or a matter of 6 months.

Senator HARTKE. I could have expected it to turn around in 2½ years.

Secretary CONNALLY. Now if you were to judge it all on the basis of how much revenue we are going to get, what we would want is inflation; the more inflation we get the more revenue the Treasury gets.

If you are going to base it on that, we are indeed going in the wrong direction because we are trying to stop inflation and this means in the short run we will have a shortfall of revenues.

Senator HARTKE. I understand that and I understand you have the biggest deficit facing you in our history. Even with the full employment budget you are going to have an $8 to $10 billion deficit with an estimated $30 billion deficit for this fiscal year, isn't that true, compounded on top of the $25, $23½ billion deficit, which would have been $30½ billion if you had not taken $7 billion from the social security fund and treated it as revenue which you have to pay back, isn't that true?

Secretary CONNALLY. I would say the——

Senator HARTKE. Isn't that true? Didn't you take $7 billion from the social security——

Secretary CONNALLY. You want me to answer or not? You asked me if it is true. I would say, sir, no; it is not true.

Senator HARTKE. Would you be in favor of a $1,000 deduction for each individual?

Secretary CONNALLY. No.

The CHAIRMAN. Senator Curtis.

Senator CURTIS. Mr. Secretary, your statement had clarity and force and I commend you for it. I will try to be brief. Referring to your statement, on page 14, the last sentence there, I have a question. I want to make sure I understand it. It is in reference to DISC.

In the last sentence on that page when the amounts are paid, and I am assuming this is the part that has been deferred——

Secretary CONNALLY. That is right.

Senator CURTIS. When the amounts are paid as dividends to DISC shareholders or when the DISC ceases to qualify as such for any reason, the income is fully taxed as ordinary income to the U.S. shareholders. Is there a tax consequence on the export entity at that point?

Mr. NOLAN. No, Senator; the tax is applied to the shareholder. Now frequently the shareholder of the DISC will be the parent company and so the tax will be paid by the parent company as the shareholder. The DISC will not have any tax liability.

Senator CURTIS. The parent company?

Mr. NOLAN. The parent company will pay full ordinary income tax on the DISC earnings when they are paid out as dividends.

Senator CURTIS. That clears it up. I wasn't sure about that. That answers my question.

Mr. NOLAN. Well, let me make this clear: The DISC itself will ordinarily be a subsidiary of a U.S. parent company which is doing the manufacturing. When the DISC earnings are paid out from the DISC subsidiary to the U.S. parent corporation, the U.S. parent company will pay full U.S. tax on that income.

Senator CURTIS. Yes.

Mr. NOLAN. There is no intercorporate dividend deduction. The tax is paid in full at that time.

Senator CURTIS. I got the impression there that perhaps the expression might have meant just that it was the ultimate individual shareholders.

Secretary CONNALLY. We used the term "shareholder" and to that extent it might be confusing, but we use that term realizing that most often the parent will be the sole owner of the DISC.

Senator CURTIS. Now, not too long ago, the Federal Communications Commission ruled that a building for instance, whether it be a hotel and/or an industrial building or what not, could install its own communications system, such as a telephone system, and the telephone company would have to connect them up.

Now as this relates to the job-producing credit, under the House bill if a nonregulated utility, such as a hotel corporation or industrial plant, would buy and install its own telephone equipment, what rate of credit would it receive?

Mr. NOLAN. Assuming that they used that equipment only for their own purposes, for supplying their own telephone service they would get the full 7-percent credit.

Senator CURTIS. Now, if a regulated utility bought the same identical equipment and stacked and installed it in the same hotel, industrial plant or what-have-you, at what rate of credit would they pay?

Mr. NOLAN. Under the House bill they would get 4 percent.

Senator CURTIS. I am not pressing for a solution at this point but I want to make sure that our record is clear on that.

Secretary CONNALLY. That is right.

Senator CURTIS. Mr. Chairman, I will not take any more time. Thank you very much.

Senator ANDERSON (presiding). Senator Bennett?

Senator BENNETT. Thank you, Mr. Chairman, and as you know, Mr. Secretary, I am in support of the program, the President's program, so I have no questions to ask which might generate activity on the part of the television cameras on my left.

I have a little housekeeping question to ask for the record. The tax bill before us contains provisions to encourage employers to initiate on-the-job training and build child-care centers for their employees.

We have before us already a bill which is going to deal on a broader scale with this problem. This bill deals only with the question of depression areas. Would the administration be badly upset if we should leave that out and put it in H.R. 1?

Secretary CONNALLY. No, sir; we would not. This was a measure that was added in the House to which we acceded. It was not part of the original proposal which we made to the Congress and it might more properly be considered as a part of H.R. 1.

Senator BENNETT. And I am going to tell you a story and use it as a background for an observation and a question.

When the depression began, my father, who was the head of a small family-owned business, and I made a basic policy decision that we would not lay anybody off but as our income was reduced we would expect the employees to accept reduced compensation.

We reduced our own compensation to start with far below anything we expected to happen to them. We had a half dozen union members among our group of 70 or 75 employees and the morning after we had that meeting the union manager was in our office and he made a statement to me which I have never forgotten and which I think is involved in the discussion we have had here about the so-called trickle down theory.

He said to us, "We don't care what happens to the men, if you haven't any work lay them off, but don't cut the rate."

Now, here we have a situation where the President is saying to labor we want to increase the number of jobs, and the only way we can do it is by making it possible for industry through new equipment and through a better opportunity to penetrate the foreign export market, and yet there are those and we have heard it suggested this morning, don't give industry an opportunity to increase the number of jobs through tax adjustments, give the money to the employee directly.

Do you recognize that there is a similarity between those two, these two points of view?

Secretary CONNALLY. Well, Senator, again I try to respond when this point was made earlier this morning by simply saying that we felt that the President had recommended a very balanced program. If you view the actions of the Congress over the 5-year period since 1969, because many of the actions that were taken in 1969 have not yet gone into effect, they had a delayed beginning, if you take that then probably the results are unbalanced in favor of individuals as opposed to companies and businesses in the country which basically have to provide the jobs in this free enterprise system. This was part of the thrust of my statement this morning, as you well know, Senator Bennett, to try to get out on top of the table a lot of this discussion where people for one reason or another or for one purpose or another attempt to divide the peoples' minds in terms of their thoughts relating to individuals and to corporations.

The corporation is nothing except an entity through which individuals transact commerce and business. That is all. The only conceivable beneficiaries of any corporation are individuals, if there are benefits.

If there are detriments only, those who are done damage are individuals. A corporation is a legal entity on paper. The entity itself could not care less whether it makes a profit or loss.

The workers ought to be concerned and I just would point out again that 68 cents of every dollar goes to wages and salaries.

Senator BENNETT. Which is 10 times as much as goes to dividends.

Secretary CONNALLY. To the investor.

He gets about 6 percent if he is lucky.

Senator BENNETT. That is right.

Secretary CONNALLY. So I think the worst thing that can happen to the country is for us to be divisive in the type of comments that we make with respect to the entities through which we do business.

You can't separate them that way. We ought not to separate them that way. What we ought to be looking at is the overall prosperity, the overall well-being of this country and its economic strength and its economic viability because that is what we are up against.

Senator BENNETT. Mr. Chairman, my time—I have 15 seconds left and I am going to use it to read a couple of sentences from the Evans and Novak column in the Post this morning.

> It is a chilling experience to hear a top government economist, he is talking about Japan, say with a broad smile, "I am sorry to tell you this, but I think the United States is beginning its economic decline just as Great Britain began theirs twenty years ago," the delinquency is irreversible.

I think it is reversible and I think the President's program is an important step in reversing it.

My time is gone, Mr. Chairman.

The CHAIRMAN. Senator Anderson.

Senator ANDERSON. Thank you, Mr. Chairman. Mr. Secretary, there was mention of a memorandum that you were going to submit for the record. I look forward to reading it, and I might say you made a good statement this morning.

Secretary CONNALLY. Thank you. We are going to produce some additional data and a memorandum on our conversations with various representatives of other nations with respect to their treatment, the administrative treatment of tax policies. We told Senator Fulbright we would try to get him a breakdown on what goes into the GNP and I believe Senator Jordan asked us to bring some additional information to the committee.

We are also extremely grateful, Senator, for the kindness which this committee has extended to the Treasury Department and for the dispatch with which this committee works.

Senator ANDERSON. This bill has several interesting phases of it. There was an article saying tax cuts are——

Secretary CONNALLY. Senator, the bill provides that there will be a change in the withholding tax on November 15th of this year, 1971, so there will be an immediate impact of the bill if the committee can act and if the Senate itself can act on it with promptness.

Senator ANDERSON. Thank you.

The CHAIRMAN. Mr. Secretary, I am for what you are trying to achieve with this program and what you are trying to achieve in the foreign trade area. I believe the same thing is true of every member of this committee. I believe that we are unanimous in being for what you are trying to do to offset our unfavorable balance of trade and to stop inflation.

I am very much at loggerheads with you, however, when we come to one particular phase of this program and that has to do with interest rates.

Now, if we are going to have 6-percent inflation as we had last year and were in prospect of having for this year, the moneylenders of this country might be entitled to have an additional 6 points on the interest rate they charge.

On the other hand, if we are not going to have inflation, if we are going to have level prices for a year, then high interest works out to a tremendous windfall for the moneylenders. Quick calculations indicate that a person would not be charging too much at 12 percent on a housing loan if half of that were to be eaten up by a 6-percent inflation factor. But, if you are going to have level prices then 12 percent would be extortion.

Now, the mere difference of 4 points in interest rates, and I think we are entitled to expect that much on the average loan, against a public and private debt of $1,800 billion, would work out to $72 billion gross windfall for somebody.

So far it looks like the administration wants to pretend that is not happening or that is something where nature should take its course.

You say interest rates have gone down by almost 1 percent. They ought to be down by 4 percent if we are going to have stable prices. Now, this committee can do something about it—we can tax those large items of interest income if we cannot find a better way to handle it.

Frankly, if I were George Meany I would be screaming to high heaven about this matter—my workers are being called upon to do without the pay raises that their contract requires while bankers are being permitted to have this big windfall and while the insurance companies are getting a big windfall and every loan shark in America is getting rich out of this thing.

Why can't we have an effective rolback on interest rates? I am not talking about a freeze, I am talking about a rollback to take into account the fact that the moneylenders are not going to have to sustain a further 6-percent erosion in their principal this year—the money will be worth as much next year as it is now.

Secretary CONNALLY. Mr. Chairman, we have indeed had a rollback, not a mandatory rollback, but the net effect has certainly been a rollback in the last few months or last few weeks for that matter.

And I would like to insert into the record a tabulation on the major interest rate swings in 1969 through 1971 which very clearly points out what has happened in the last month and a half.

The CHAIRMAN. Will you give us a comparison, Mr. Secretary, in those same categories of what those interest rates were the last time we had controls? When Truman was President and Roosevelt was President we had a President who was fighting for the little fellow, as far as interest rates were concerned. He certainly was and he saw to it that the moneylenders had to make their share of the sacrifice. Now, that would show interest rates are far below the level you are talking about.

Would you mind providing that for the record?

Secretary CONNALLY. In that connection I would like to also in the same table show what the wages are that were being paid during the Truman administration and Roosevelt administration and other comparable costs of the Consumer Price Index.

(Material furnished by the Department follows:)

INTEREST RATES, WAGES, AND PRICES DURING WAGE-PRICE CONTROL PERIODS, ROOSEVELT AND TRUMAN ADMINISTRATIONS

	Beginning of control period	2 months later	6 months later
Roosevelt administration (general controls between Apr. 28, 1942, to Nov. 10, 1946):			
Interest rates (percent):			
Taxable Treasury bonds	2.44	2.43	2.45
High grade corporates	2.77	2.75	2.76
Wages of production and nonsupervisory workers in manufacturing industries:			
Weekly	$34.89	$36.04	$38.81
Hourly	$0.817	$0.84	$0.888
Consumer price index (1967=100)	48.2	48.8	49.9
Wholesale price index (1967=100)	59.9	59.9	51.6
Truman administration (general controls began Jan. 26, 1951. Wage controls eliminated Feb. 6, 1953, and the last of price controls eliminated Mar. 17, 1953):			
Interest rates (percent):			
Taxable Treasury bonds	2.39	2.47	2.63
High grade corporates	2.64	2.78	2.93
Wages of production and nonsupervisory workers in manufacturing industries:			
Weekly	$62.58	$63.14	$63.11
Hourly	$1.53	$1.54	$1.57
Consumer price index (1967=100)	76.1	77.3	77.7
Wholesale price index (1967=100)	91.2	92.5	90.7

Source: Office of the Secretary of the Treasury, Office of Debt Analysis.

MAJOR INTEREST RATE SWINGS IN 1969 THROUGH 1971

	1969 yield range				1970 yield range				1971 yield range				Recent rates		
	High		Low		High		Low		High		Low				
	Date	Yield	Date	Yield	Date	Yield	Date	Yield	Date	Yield	Date	Yield	Aug. 13, 1971	Oct. 6, 1971	Change
Treasury bills:															
3-month	Dec. 29	8.08	Apr. 30	5.87	Jan. 6	7.93	Dec. 17	4.74	July 19	5.53	Mar. 11	3.22	5.15	4.54	−0.61
6-month	do	8.09	do	5.96	Jan. 5	7.99	do	4.78	July 27	5.84	do	3.35	5.51	4.72	−.79
12-month	Nov. 24	7.86	Jan. 16	5.86	Jan. 30	7.62	Dec. 31	4.74	July 28	6.01	do	3.45	5.85	5.02	−.83
Treasury coupons:															
1-year	Dec. 29	8.40	Jan. 20	6.61	Jan. 2	8.28	Dec. 18	4.86	Aug. 10	6.28	do	3.48	6.09	5.13	−.96
3-year	do	8.51	do	6.02	Jan. 7	8.42	Dec. 4	5.60	July 28	6.91	Mar. 22	4.27	6.60	5.74	−.86
7-year	do	7.77	Jan. 16	6.09	May 26	8.12	do	6.10	Aug. 10	7.11	Mar. 23	5.15	6.86	6.09	−.77
10-year	do	8.05	Jan. 20	5.95	do	8.22	do	6.21	July 28	6.95	do	5.38	6.68	5.98	−.70
Federal funds [1]	Aug. 8	10.50	Dec. 31	5.00	Jan. 5	9.75	Dec. 31	3.00		5.75	Feb. 24	2.25	5⅝	5¼	−⅜
Federal agency:															
1-year	Dec. 30	8.76	Jan. 20	6.33	Jan. 2	8.75	Dec. 24	5.53	do	6.56	Mar. 16	3.93	6.52	5.67	−.85
3-year	Dec. 31	8.55	Jan. 28	6.53	do	8.54	Dec. 21	6.16	Aug. 12	7.33	Mar. 24	4.70	7.32	6.23	−1.09
New Aa Corporation bonds: (Teasury series) [2]	Dec. 5	9.29	Jan. 24	7.27	June 19	9.90	Dec. 31	8.02	May 21	8.42	Feb. 11	7.32	8.22	7.97	−.25
New Municipal bonds: (bond buyer series)	Dec. 18	6.90	Jan. 23	4.82	May 28	7.12	Dec. 10	5.33	June 24	6.23	Mar. 18	5.00	6.03	5.24	−.79
New home conventional (FHA series)	Dec.	8.36	Jan.	7.53	July	8.61	Dec.	8.28	Jan.	7.96	Apr.	7.55	[3] 7.82	[4] 7.83	+.01

[1] Effective daily rate.
[2] Series based on issues with no call protection, for 5 year call protected issues deduct (at present time) approximately 15 basis points.
[3] July.
[4] August.
[5] Preliminary

Source: Office of the Secretary of the Treasury—Office of Debt Analysis.

The CHAIRMAN. I am in favor of having it all in the record Mr. Secretary. But, back in the days when you used to work up on the Hill, you had a point of view that was about the same as mine—while asking everybody else to make a sacrifice, you shouldn't do business in such a way that money lending doesn't have to, and I don't think we can count on the Federal Reserve Board to do that for a moment.

In 23 years I have concluded that the large banks ought to pay the salary of the Federal Reserve Board because it looks like that is who they are working for. If someone is going to get the little people of this country their share out of what they expect out of the stabilization program, interest rates must come down by a lot more than 1 point.

Aren't you aware of the fact, this investment tax credit goes into effect, every major corporation in America will be lined up at those banks and those insurance companies offices to get their shares of this money for capital expansion programs and that has overheated the economy on two occasions so much so that President Johnson had to recommend that Investment Tax Credit be repealed? And so did President Nixon.

Now these large concerns, and I am not against them making a big profit, I want them to do well, but they have their people on those boards of directors, and telephone and telegraph companies seeking to borrow money. They have a director on the bank board to get them a good share of the credit and again the same thing is true of General Motors and General Electric. But a fellow trying to build a home does not have anybody in there representing him on that bank board, to guarantee he gets his share of the credit. It seems to me that we might not even need the Investment Tax Credit if we could drop interest rates to where they ought to be with stable prices and then have the controls that you are asking for. I am one of the fellows going to the Senate floor later today to give the President the right to freeze that pay raise for my own employees.

Some of us strictly among southern Democrats—are needed to uphold your hand on that or you probably would lose that vote today. I think we have a right, to call on you to do what I am not reluctant to do, and that is call on the money lenders to make their sacrifice. Why can't we get a program that puts the interest rates where they ought to be with a stable price level?

Secretary CONNALLY. I think I might have mislead you a moment ago when I was talking about this basic point. I did not intend to convey the idea that interest rates had gone down only 1 percent, and I misled you I am sure.

I think in that connection I was talking about the effect of various Federal agencies 3-year securities. They dropped from August 13 when they were running at the rate of 7.32 percent.

They dropped to 6.23 percent or a change of 1.09 in absolute terms. But that is not percentage. It dropped from 7.32 to 6.23, about 15 percent. So we have had a very substantial decline in interest rates but I grant your point and please let me associate myself with your basic view.

I assure you my views have not changed very much since I worked up here on the Hill many years ago. I don't want any misinterpretations of what my views are now. Obviously the rate that was in existence prior to the freeze was a high rate.

I think it was too high. I have said so. Now, part of it was attributable to the expectation of inflation that existed in the country. And this is one of the reasons why the President did what he did.

Now, I grant you that if we can break this back of inflation, if we can halt the inflation psychology, that has just permeated every aspect of American society, I think you will begin to see interest rates coming down and I think if you are going to control prices, if you are going to control wages and salaries and rent, then I certainly am not going to argue against some control of interest rates.

I do think then in fairness that we ought to point out that there has been a substantial drop in all of these categories, ranging from 10 to 15 percent in about 45 days.

The CHAIRMAN. Well, that is all fine, Mr. Secretary, but I must say the first time I raised this point down at the White House I gained the impression that the people were about ready to ask around the room, "Who let this fellow in here, to ask such a question about the interest rates."

This is a very big item and it is something that the average American, all these people who have done without this pay raise, are entitled to expect. I am for controls, provided that it is a fair program, and it applies across-the-board to everyone, but I don't think it is right for us to come in here and ask labor to go without a pay raise that was in a contract and then proceed to pretend that that loan shark does not exist over there and that we would know nothing about the tremendous windfall he is getting on all of this.

So much as I like to get along with the banks, goodness knows I am as vulnerable to what they can do as anybody in the room, at the same time I feel it is my duty to raise this issue.

The program I think should be across the board. I would be willing to negotiate with your administration on this basis: let's get a bunch of economists in here who don't belong to the banks and don't belong to labor, who claim to be independent and can show some credentials along that line. Let them suggest what a proper level of interest rates ought to be and try to bring this about as a part of the overall program and if we can I think I will be enthused. But without that it won't seem to me to be an equitable program. I am encouraged at least you are willing to indicate, you are willing to consider it.

Secretary CONNALLY. No question about it, and I think the only response I have to your comments is that money like many other things is a commodity in the open market, and the value of it is determined by the use to which it is put and the need for it.

Again, it is affected probably more directly and more instantly by this inflation situation than anything you can think of.

Take your example of a moment ago. If a banker or insurance company or whoever the lender is, if he thinks we are going to have 6-percent inflation, then he is going to ask 12 percent for his money because he thinks he has to get a 6-percent return.

And he is going to do it, unless you can control him. He is going to do it because he just believes in his heart that he is going to loan this money for a year or 5 years or in many cases, such as with the insurance companies for 20 years, and if he thinks we are on a treadmill of inflation, then it is really almost impossible for him to ask enough to make up for what he thinks inflation might do to him in the next 20 years. If you can indeed stabilize, if you can get into people's minds that we have some future other than a runaway inflation in this economy, then perhaps the lender will get down to a realistic 6-percent figure which you used in your illustration and I could not agree with you more.

The CHAIRMAN. Of course what I object to thus far about the program is that it proceeds upon the theory apparently that it is perfectly alright to let nature take its course where the money lenders are concerned, but where everybody else is concerned it is not alright to let nature take its course, we are going to freeze their wages, freeze their price.

In one case we have some people in my State who because of the way the thing works out, would appear to be stuck with a 1-year rollback where all of their costs have gone up and the way it works out they are being expected to roll their prices back for a year which they cannot afford to do.

So while we are looking at the details of all of this, I would think we ought to put those who are well able as anybody to make their share of the sacrifice—and I have in my mind the money lenders—they ought to be part of the package and we can agree what is fair for them. I think that will make labor feel more concerned and more kindly about the overall package, perhaps more likely to cooperate which I would like to see.

Now, you are aware of the fact I personally feel that these tax cuts so far are structured to where they do go too far, all together too far, in favoring business as compared to individuals.

Most of these tax reductions you have involving individuals are merely a mater of moving forward tax reductions that would go into effect anyway.

While on the other hand the reductions in taxes for business are new reductions that were not scheduled to go into effect. My analysis indictates that out of $7.6 billion in new tax cuts only one-seventh would go to individuals.

One-seventh. It would seem to me that is not a substantial share for the individuals and I might suggest to you that we ought to amend this bill in a fashion that individuals would get a larger share of this tax reduction.

Secretary CONNALLY. Well, again, Mr. Chairman, I think it is fair to say that many of the provisions of the 1969 act have not yet taken effect. Admittedly part of what the President recommended was moving from January 1973 to January 1, 1972, the increase in the personal exemption, but that is still money which is moved forward a year. I think it is fair to say that the figures which I have given you, the $36 billion, the $36.4 billion that you provided in 1969, and since then, for individuals, is a correct figure and what you have increased corporation's taxes by $3.2 billion.

You say the relief for individuals is only one-seventh. Obviously you are leaving out, these actions, and you are also leaving out the repeal of the auto and truck excise tax.

The CHAIRMAN. That was scheduled to be phased out.

Secretary CONNALLY. But over a long period of time. For 1981, I believe, was the last year—in other words over the next 12 years. What we are doing is doing it immediately so this action means $200 on the average to everybody that buys a car in the United States. There will be 10 million of them bought next year, and that is not people, that is automobiles, so you are affecting probably 35 million people.

And if you look at the incomes of those who buy automobiles, strangely enough it fits the pattern. You are going to have a reduction, like that which you have had over the past several years, to the lower-income groups, to the middle-income groups, they are the ones that are going to get the benefit of the $200 decrease in the price of the automobile. It works out that way.

The CHAIRMAN. You are assuming all of the benefits are going to be passed on.

Secretary CONNALLY. Yes, sir, we have commitments.

The CHAIRMAN. Commitments?

Secretary CONNALLY. We have commitments from the companies that the reduction absolutely will be passed on to the consumers.

The CHAIRMAN. That will be fine if it works out that way, but sometimes it works out contrarily and then over a period of time they phase into a new price structure.

But you have suggested also, Mr. Secretary, that we on this committee should not further increase the deficit by putting in additional tax cuts of our own. On the other hand, I notice that you have recommended here this morning that we provide a 10-percent investment tax credit compared to 7 percent with regard to what the bill provides, and also to apply the DISC rules to all export income. How much would those items increase the deficit?

Secretary CONNALLY. The first year, I think a very liberal estimate of the cost of the DISC program would be $300 million.

This is already in the budget; for budgetary purposes it would be no increase. The difference between the 7 and the 10 percent would be an additional $500 million in 1971.

The CHAIRMAN. Of course, you know with the House, they took some things out and they put other things in so the bill contained substantially the same balance, if we are going to put the item back in that would increase the deficit over the things they put into it.

Secretary CONNALLY. Yes, sir.

There is a reduction in the deficit by $2 billion as a result of the House action, the way the bill stands at the present moment.

The CHAIRMAN. Again let me say that while I very much differ with you on some items, I heartily applaud the objective in what you are trying to do on the whole. I think you are doing a great job for us in the national interest.

I think in fairness I should say that we applaud your efforts to get this country moving and restore at least some balance to what is a very unsatisfactory situation with regard to our international payments and international trade.

Any other Senators want to ask additional questions at this time?

Senator NELSON. I had a couple.

I wonder, Mr. Secretary, concerning the DISC program, why wouldn't it be a better approach to simply tax the U.S. corporations' subsidiaries overseas in the same way we tax the domestic corporations, here, that is to say, tax them as they make their profits, currently, rather than after they are repatriated? Is there any special reason why that wouldn't work?

Secretary CONNALLY. Let me answer simply that this indeed would involve a major change in the tax policies of this country but I would like for Mr. Nolan to respond to it in more specific fashion.

Mr. NOLAN. The Congress considered this at some length in 1962 and decided to tax American companies on the operations of their foreign subsidiaries only in so-called tax haven operations and decided not to go further than that.

Essentially, in the case of foreign subsidiaries, we are talking about income that is basically foreign source income, income which the foreign countries in which the operations are located have the primary right to tax.

We have always been concerned that if the United States extended its tax to income of that nature—to income that is essentially foreign source income—that the foreign countries would simply increase their rates of tax and soak up the additional U.S. tax and so that all we would have accomplished is to increase the taxes collected by foreign governments from our own companies.

We have not felt that that was a desirable way to proceed. Instead we feel that we must recognize as I say that the essential nature of this income is foreign source income, that the foreign countries, by and large, provide benefits to attract American companies into their countries and that under these circumstances the only real practical alternative from our standpoint is to provide in the case of export operations which we want to encourage—that is keeping the manufacturing here for sale abroad, rather than having the manufacturing activities go abroad—the only real practical alternative is to recognize as we have in the DISC proposal, that tax deferral should be granted as long as that income which is paid in is used in connection with the export activity.

Senator NELSON. I understand from reading the report prepared last year by the staff of the Joint Committee on Internal Revenue Taxation, that the loss of revenue under the DISC proposal would be about $600 million, when the exports got to a billion or a billion and a half.

Secretary CONNALLY. I think their figures were higher than that. The $600 million figure was our figure of what the revenue loss was.

Senator NELSON. I thought that was ther figure. In any event, doesn't this mean that for every dollar increase of exports there is a revenue loss of 45 to 60 cents?

Isn't that an unduly expensive way to increase exports?

Secretary CONNALLY. Senator, those figures do not take into account the feedback benefits to the economy. That is the increased tax revenues that we will get from increased business activity, we do not attempt to estimate those feedback benefits because they are speculative and it is difficult to fix a number.

So we have not estimated that. But we really feel that the increase in exports from the DISC proposal will be at least a billion and a half dollars a year, maybe considerably more than that. But a billion and a half is our firm estimate, and we feel, taking into account the fact there that there will be a feedback benefit to the economy that it is a good trade off, it is a worth while thing to do. And it has to be considered to be a deferral, not a loss, it is a deferral and not a loss.

Senator NELSON. Thank you.

Senator BYRD. Mr. Secretary, I am inclined to the administration's position and I want to support the administration's position on this matter.

I have not yet been able to convince myself that it is logical or wise to reduce taxes at a time when we are at a $30 billion general, Federal fund deficit last year, and $30 billion Federal fund deficit in the current fiscal year, but I want to try to understand the figures a little bit better than I do.

It was part of my question this morning as to the reduction in taxes that will take place if this bill is enacted as it was enacted by the House. You replied that therewould be a reduction over $6 billion in taxes.

Secretary CONNALLY. Yes, sir.

Senator BYRD. As I, and I am not sure that I am correctly reading the table on page 7 of your statement, but it appears to me that the reduction would be substantially larger than that, I take it from the figures I got the amount would be reduced under the 1969 act, but I assume all of the other figures should be included in the pluses and minuses, after you leave out the figures pertaining to the 1969 Tax Reform Act; is my understanding correct in that regard?

Secretary CONNALLY. This is a 5-year table, Senator, that I was using.

Senator BYRD. If we would take the year 1972 just for example, if I could get clear as to how read that table, would not the reduction, total reduction that would take place during 1972 be the addition of all of the figures plus or minus with the exception of the four figures 1969 act under "for individuals," and the 1969 act, "for corporations?"

Leaving those figures out, I assume you would add the rest of the figures, and add and subtract the rest of the figures to get the total reduction; would you not?

Secretary CONNALLY. I think that is correct and I think the table we are now talking about, table II (see page 9) includes the 1969 Tax Reform Act, the ADR and the Ways and Means Committee action in total, as opposed to the table on page 11 of the House committee report that deals only with the estimated effect of the Revenue Act of 1971 on calendar tax liability for 1971, 1972, 1973, and 1974.

And, the $6 billion that I alluded to in my remarks this morning, was the effect it was going to have in fiscal year 1973. As I recall you asked me about fiscal year 1973 and fiscal year 1974, this morning, and the effect of the 1971 Revenue Act as passed by the House is a loss of revenue of about $6 billion in each of those years.

Now when you go back it will be more than that, when you go back to 1969 and take the 5-year average.

Senator BYRD. But you actually refer only to the line marked 1972?

Mr. NOLAN. In the line marked "1972," there is also the effect of the depreciation system that was adopted by the administration in June of 1971 and against those figures you have to net out the elimination of part of this depreciation system in the House bill, so that you have there figures representing revenue losses from the administration action which have been partially reversed by the actions in the House bill.

Senator BYRD. That would not amount to a great deal.

Secretary CONNALLY. The first-year convention amounts to $2.1 billion this year.

Senator BYRD. Does the total that I get for a reduction for the 1972 is $11.2 billion, as compared to $6 billion which you gave before, but even if you take out the $2.1 billion you still substantially are above the $6 billion figure.

I am merely trying to understand these figures on table 2.

Mr. NOLAN. Also these are calendar year figures which vary somewhat from the fiscal year figures we were giving you earlier. The loss from the bill, from the House bill on a calendar basis for calendar 1972 is $7.8 billion.

The figure of $6 billion that we gave you is the effect in fiscal years 1973 and 1974.

Senator BYRD. Anyway, you are convinced yourself that $6 billion figure is the actual reduction in taxes that would occur under this proposal?

Secretary CONNALLY. Yes, sir. Specifically, in 1972 on a calendar basis, it will be $7.8 billion; in calendar 1973, it will be $5.9 billion, or roughly $6 billion. On a fiscal year basis in 1972 it will be $4.9 billion, about $5 billion; in fiscal year 1973, it will be $6 billion; and in 1974 it will be $6 billion.

Senator BYRD. What, then, I assume we should do is discard this table II, is it out of date?

Secretary CONNALLY. No, the point is, you can't reconcile the totals in table II in my statement with the table on page 1 is of the House committee report, because table II has too many other items in it, including the effect of the 1969 act over a 5-year period, and that is not reflected in table——

Senator BYRD. Now, neither is it reflected in the figures I have been adding and subtracting, you get $11.2 billion but I don't want to take the committee's time or your time.

Secretary CONNALLY. We will be glad to sit down with you and reconcile these figures.

Senator BYRD. If someone would reconcile the figures for me and send it to the office I would appreciate it.

Secretary CONNALLY. We would be delighted.

(The following letter was subsequently received for the record:)

THE DEPARTMENT OF THE TREASURY,
Washington, D.C., October 13, 1971.

Hon. HARRY F. BYRD, Jr.,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: At the public hearing of the Senate Finance Committee on October 7, 1971, I was unable to reconcile the revenue loss from H.R. 10947 shown on page 11 of the House Ways and Means Committee Report (net revenue loss for the fiscal year ending June 30, 1973, of $6.1 billion) with the amounts shown in Table II of the Secretary's statement to the Finance Committee (calendar 1972 revenue effect of $-14.8 billion, and calendar 1973 $-16.0 billion). As I noted at that time, Table II of the Secretary's statement includes the effects of 1969 Tax Reform Act provisions and the ADR System as well as the effects of H.R. 10947. Further, one set of amounts is on a fiscal year basis and one is on a calendar year basis.

The amounts are reconcilable as follows:

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

The calendar year effects of H.R. 10947 (revenue loss of $7.8 billion in 1972 and $5.9 billion in 1973 as set forth above) differ from the fiscal year effects (revenue loss of $5.0 in fiscal 1972 and $6.1 in fiscal year 1973) because some of the provisions of the bill correct the effect of other provisions after the close of the taxable year. Thus, increasing the minimum standard deduction increases the degree of underwithholding for calendar year 1972 which is corrected by April 15, 1973; accordingly, the revenue loss on a calendar year basis is over-stated for 1972, and is correctly reflected only by reference to fiscal year 1973 amounts. (The underwithholding problem is cured for the most part on a long-term basis by other provisions of the bill taking effect on January 1, 1973.)

The ADR amounts in the Table above are somewhat misleading. H.R. 10947 reverses part of the revenue loss from ADR to the extent of $1.7 billion in 1972 and $1.5 billion in 1973, so that the net loss from the new depreciation system is now only $1.7 billion in 1972 and $2.5 billion in 1973.

A more detailed reconciliation table is attached. If you have any further questions about this matter, please let me know.

Sincerely yours,

JOHN S. NOLAN,
Deputy Assistant Secretary.

Enclosure.

ESTIMATED EFFECT OF 1969 TAX REFORM ACT, ADR AND H.R. 10947 AS PASSED BY THE HOUSE ON CALENDAR YEAR LIABILITIES DIVIDED BETWEEN INDIVIDUALS AND CORPORATIONS

[In billions of dollars]

	Calendar Year					
	1969	1970	1971	1972	1973	Total 1969-73
Individual:						
1969 act:						
Reform and relief		−1.4	−5.2	−8.1	−10.8	−25.5
Termination of investment credit	+0.4	+.6	+.6	+.6	+.6	+2.8
Subtotal	+.4	−.8	−4.6	−7.5	−10.2	−22.7
ADR			−.6	−.7	−.8	−2.1
House bill:						
Eliminate ADR ¾-year convention			+.5	+.3	+.3	+1.1
Income tax reduction			−1.4	−3.2	−1.1	−5.7
Excise tax relief [1]			−.8	−2.3	−2.0	−5.1
New investment credit			−.3	−.7	−.8	−1.8
Subtotal			+2.1	−5.9	−3.6	−11.6
Total individual	+.4	−.8	−7.3	−14.1	−14.6	−36.4
Corporations:						
1969 act:						
Reform and relief		+1.0	+1.1	+1.2	+1.3	+4.6
Termination of investment credit	+.5	+1.9	+2.5	+2.7	+2.9	+10.5
Subtotal	+.5	+2.9	+3.6	+3.9	+4.2	+15.1
ADR			−2.2	−2.7	−3.2	−8.1
House bill:						
Eliminate ADR ¾-year convention			+1.7	+1.4	+1.2	+4.2
New investment credit			−1.2	−2.9	−3.1	−7.2
DISC				−.1	−.2	−.3
Excise tax relief [1]			−.1	−.3	−.2	−.6
Subtotal			+.4	−1.9	−2.4	−3.8
Total corporation	+.5	+2.9	+1.8	−.7	−1.4	+3.1
Total individual and corporation	+.9	+2.1	−5.5	−14.8	−16.0	−33.2

[1] Split as per Committee report.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Note: Figures are rounded and may not add to totals.

Senator HARTKE. Mr. Secretary, when I ran out of time awhile ago I left an unanswered question. In the last fiscal year we had a deficit which was reported as $235 billion; is that correct?

Secretary CONNALLY. I believe that is correct; $23.2 as I recall.

Senator HARTKE. $23.2 billion. In that of course and I am not saying that there anything was done illegally or wrong, that if you had used the over accounting system, not used the combined budget, isn't it true there was $7 billion borrowed from the social security trust fund which in fact was treated as revenue and in fact must be repaid with interest?

Secretary CONNALLY. There was a $6.9 billion surplus for the trust funds in total.

Senator HARTKE. I apologize for the $100,000 mistake.

Secretary CONNALLY. Call it $7 billion counted as trust fund surplus.

Senator HARTKE. And treated as revenue?

Secretary CONNALLY. Yes, sir.

Senator HARTKE. With interest?

Secretary CONNALLY. Yes, sir; I am sure it will. Yes, I don't know at what rate, but it will have to be paid back with interest.

Senator HARTKE. What we did we took the money which had been accumulating for the benefit of old people to pay off the other expenses of Government, isn't that true?

Secretary CONNALLY. No.

Senator HARTKE. I am not saying that the trust fund had been invaded in the normal sense but it has been invaded to the extent that $37 billion surplus which we have accumulated was reduced by $6.9 billion, roughly $7 billion in order to reduce the actual amount of the companion budget deficit from total of over $30 billion to a little over $23 billion.

Isn't that true?

Secretary CONNALLY. Well, Senator, there was no invasion of the trust fund, obviously we have had to borrow more money. We borrowed from the trust fund as we do all the time and we pay interest because we don't want the trust fund money to sit there not bearing interest. Social security trust fund assets were $44 billion at the end of fiscal year 1971.

Senator HARTKE. But it was treated as revenue.

Secretary CONNALLY. That is right, in the unified budget.

Senator HARTKE. That is a proper legal procedure but I think all people who are complaining to Social Security about the inadequacy of their payments today, ought to know that there is a $44 billion surplus in that fund at the present time, that $7 billion of this that was utilized by the Treasury, in a fashion in which they were able to reduce the actual stated amount of the budget deficit from $30 billion deficit down to $23 billion.

Isn't that true?

Secretary CONNALLY. Yes, sir.

Senator HARTKE. Now, another question which when you were here testifying on the trade bill we went into very short colloquy and very short question and answer statement about the effect of investing in the United States and investing overseas, in which you ended up with the conclusion that under the present tax laws there was the tax advantage investing overseas which was not in the same fashion available to domestic corporations investing here at home.

I gave you the specific example that under the situation that if you, at the present time, invest overseas you're entitled to a tax credit for foreign taxes paid and if you invest in Italy and pay foreign taxes to Italy you would be entitled to those credits; if you invest in India, you would not be entitled to a tax credit for the taxes paid but would be only entitled to tax deduction for tax paid as a result of the state tax levied which made it more advantageous to invest in Italy than it did in India; is that a fair summary of our little colloquy, when we had the hearings on the trade bill?

Secretary CONNALLY. I would certainly say that was my memory of it: yes.

Senator HARTKE. Then why wouldn't you be in favor of adopting the policies in the trade bill which I introduced here in the Trade and Investment Act of 1971, which would really perform the functions which you claim are partially accomplished by DISC, by repealing all tax credit for foreign taxes paid?

Secretary CONNALLY. No; sir.

Senator HARTKE. Why not?

Secretary CONNALLY. Again we get into a question I think Mr. Nolan responded to a moment ago. If we repeal all foreign tax credits, we endanger our best interests overseas and subject them undoubtedly to different tax treatment by foreign governments and it would wind up merely with a result of punishing American investors overseas and really help us not at all in terms of our revenue.

Senator HARTKE. Would it even damage the American investor to put his money back here, would it not?

Secretary CONNALLY. Not necessarily.

Senator HARTKE. If you take away the advantage of investing overseas you create an incentive to invest at home, do you not?

Secretary CONNALLY. Well, you do if you can successfully do it, Senator Hartke.

Senator HARTKE. Why wouldn't you also end tax-free treatment which is presently given which provides for no tax on the export of license and patents which is an exportation of our technology; why would you eliminate that tax bonanza for those people?

Secretary CONNALLY. I did not know, I would have to study that.

Senator HARTKE. Mr. Nolan, would you care to comment?

Mr. NOLAN. We do have limitations in the tax system on the extent to which patents and other taxable assets can be transferred abroad without recognizing gain. We have a provision in the tax law that I think you are aware of, section 367, which permits some transfers of assets to foreign corporations without recognizing gain, but we have generally not permitted transfers of patents and trademarks except where they go abroad connected with manufacturing activities of the company abroad.

I point out to you that for many U.S. companies, factors quite apart from taxes make it necessary to produce abroad if they are going to compete in the world markets.

They simply cannot compete with foreign producers in many cases with the differences in wage rates unless they have factories abroad and if we were going to deny the foreign tax credit, we would be effectively abandoning the foreign markets to foreign competitors.

Senator HARTKE. How does DISC help in this regard?

Mr. NOLAN. The DISC proposal favors U.S. production over foreign production under our tax laws; it reverses the present tax inducement to go abroad without handicapping foreign investment that is governed by factors other than tax factors. It will help in a large number of marginal cases where taxes make the difference, not in all of the cases but in a substantial number of cases; DISC will affect the marginal cases and make it worthwhile for the company to manufacture here for sale abroad where tax factors are the dividing line.

Senator HARTKE. That is debatable but I want to come to one other point, where, why didn't you repeal the special benefit to a person who lives overseas and is employed by a domestic corporation, if he lives overseas 17 out of 18 months, giving him that special break; why don't you take those three proposals in the tax credit for the foreign corporation in the special treatment in regard to patents and royalties in the special treatment for personnel who live overseas, wouldn't that really be effective deterrent to accomplish the end result which you have advocated in DISC?

Mr. NOLAN. I think it would be more than an effective deterrent. I think it would force most U.S. companies out of many world markets and I do not think that is advisable.

Senator HARTKE. It would encourage them to come to the United States to do their business, would it not?

Mr. NOLAN. Eliminating all U.S. controlled production abroad would have no effect on the difficulty of U.S. companies exporting in competition with foreign-owned companies which would continue to benefit from the tax policies of other countries that favor their exporters. It would force U.S. companies to give up their foreign operations in many cases. They would just simply lose the opportunity to continue selling in those markets.

Secretary CONNALLY. In the long run that has to be adverse to the interests of the United States.

Senator HARTKE. Well, I mean it is hard to square that with your stated purpose on DISC but let me say to you I am not willing to pursue that at the moment.

Mr. Secretary, now, I am for the tax credit; when you go into ADR on top of tax credit, you are adding an average of $2.7 billion a year additional in. What is the ADR cost?*

Mr. NOLAN. Over an average basis over 10 years, after the action of the House in cutting out the first year convention the net cost would be something like an average of $2.7 to $2.8 billion a year.

Senator HARTKE. That means in 10 years about over $20, $25 billion cut expense?

Mr. NOLAN. I have a hard time calling it a cut. In many cases——

Senator HARTKE. Let me——

Mr. NOLAN. The ADR recognizes in many cases that lives are indeed shorter than we have been allowing and companies are entitled to an allowance that will be allowed to everybody, not just some of the companies.

Senator HARTKE. But a total loss of revenue of $2.8 billion, right? I think you ought to make a choice. You ought to make an election, which case you want to pursue.

Now the advantage of a tax credit is simply that it does require an actual new investment whereas ADR does not, isn't that true?

Mr. NOLAN. No. You only get the benefit of the increased deductions of depreciation with respect to new assets you buy, ADR does not apply to old assets.

Senator HARTKE. The forcing of the action in this case is more effective on the tax credit than it is on the ADR, you do not agree with that?

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*The ADR system is discussed more fully in a letter from the Secretary of the Treasury to the chairman, pp. 755.

Mr. NOLAN. We do not. We think both of the items operate to reduce the cost of capital. They do it in different ways but they do have the same effect, they make it more profitable to buy the asset.

Senator HARTKE. What is the estimated cost of the tax credit on the 7 percent across the board?

Mr. NOLAN. On an annual basis it is something between $\$3\frac{1}{2}$ or $4 billion a year.

Senator HARTKE. In other words, if it is $\$3\frac{1}{2}$ that is in excess of close to $\$6\frac{1}{2}$ billion revenue?

Mr. NOLAN. Yes, sir.

Senator HARTKE. On an annual basis?

Mr. NOLAN. Yes, sir.

Senator HARTKE. Now, why wouldn't you on a tax credit, inasmuch as you want to go back to August 15—I do not believe anyone has really taken this Congress that it necessarily is going to put that tax credit into effect—why wouldn't you make it prospective as you always advocate in our tax laws instead of making it retroactive and make it prospective from the date that the actual bill becomes law?

Secretary CONNALLY. I think part of the problem stems from statements that the chairman of this committee made, and the chairman of the Ways and Means Committee made, and statements that I made back earlier in the year if indeed there was a request the investment tax credit be passed and if the Congress passed it, that it would be retroactive to April 1.

Senator HARTKE. Do you think people really made investments on the basis of the commitments of yours, and inasmuch as I recommend that and Senator Long and Congressman Mills?

Secretary CONNALLY. We had not originally recommended it.

Senator HARTKE. But I knew that you recommended, not you, when you were Secretary, Secretary Kennedy came in here and told me about the great evil of the investment tax credit. I can tell you he said it was absolutely no good, did not encourage investment, had nothing to do with investment and I asume that it is so much talk and it is gone.

Secretary CONNALLY. It means we can all be wrong at times. What I am referring to is that we had not this year recommended that we go back to April 1. The administration recommended that beginning date of August 15.

The House Ways and Means Committee moved the date back, made it retroactive.

The CHAIRMAN. If I might get into the act because I would like the record to reflect the situation as I understand it. You wanted to make a speech to some people, Mr. Secretary, urging them to go ahead and invest their money and not hold up waiting for the investment tax credit. You wanted to say to them that if it goes into effect orders placed after April 1 ought to get the investment tax credit and you informed the chairman of the tax writing committees that you wanted to make that statement.

Secretary CONNALLY. That is right.

The CHAIRMAN. You were not recommending it at that time but it went into effect. They ought to get the benefit of it because they knew you didn't want them to delay making contracts that they wanted to make, while waiting for something to happen that might never happen. We went along with you.

When you made your recommendation you had an August date but the August date was based on deliveries rather than on orders.

Secretary CONNALLY. That is right.

The CHAIRMAN. Chairman Mills and I both felt that all three of us should stand on just exactly what you said and what we agreed to go along with you on saying, that if we reinstated the credit, it ought to be effective with regard to orders made in April.

So it is a matter of one is date of order and the other is date of delivery, but in any event, everyone agreed we shouldn't encourage businessmen to hold up making investments, waiting for something to happen that might never happen.

Secretary CONNALLY. You are absolutely correct.

The CHAIRMAN. Pardon me, I wanted to get it straight for the record.

Senator HARTKE. I endorse your policy on interest rates so much I could not be upset by anything you said at this moment. I don't think this policy is going to work. And it reminds me too much of March 1931, when President Hoover made the same type of miscalculation as to how to put this country on its feet.

He did advocate the Reconstruction Finance Corp. and I would imagine that is what we are going to be doing again now, we are going to become some type of corporate structure that is to bail out failing businesses which I anticipate is going to continue in the future.

I wish that you had a policy which really would address itself to general consumption in the manner in which the chairman of this committee had indicated, and that is frankly you have to bring the interest rates down, you have to expand that pie, bigger than you have calculated and you can't do it merely by dealing with just the business side of the community.

That won't do the job. I would hope that you would come forward with substantial increases in Social Security, as a matter of fact, as much as 20 percent immediately would not be out of line; I think you ought to come with at least a thousand dollar deduction for individuals who are concerned, even on top of what you have. There is no question you were going to talk about cost, this country is in rough shape and you can talk all about the great economic condition that exists and number of people employed at higher wages but President Nixon did not make this statement to the Nation because he thought the country was heading in the right direction; he said "we are faced with a great crisis, and it is high time we recognize and deal with the crisis' proportions and not just with partial steps."

And I would hope that welfare reform as Mr. Ribicoff indicated he is interested in doing would come forward. But I don't know what you are going to do for an encore because after you burned yourself once there is not much living left and I am afraid there are not many more television stations going to be able to convince the American people, going to repeat what happened, I know you are not going to like this. I don't ask you. I know the President is not going to like it, but after his August 15th speech I talked to a young lady at a hotel at the desk, I said what did you think of the President's speech? She said, "I didn't hear it and I hadn't read about it in the paper, but I know it is good for him and bad for me and I think this way; I think the American people feel and you are going to have to correct that with something meaningful for these people, if you could have a thousand dollar deduction in 1939, for people with families, they would understand what you are talking about.

But if you give 20-percent increase in social security, they would understand what you are talking about: but since I endorse the tax credit, they don't understand why that means jobs to them, and I think they are right.

Senator BENNETT. I am tempted to ask for one more bit of information based on the Senator's last statement. By how much would you increase the deficit if you raised the deduction immediately to a thousand dollars and increased social security by 20 percent, assuming that you are not prepared to ask for additional taxes to cover the 20-percent increase in social security?

Secretary CONNALLY. That would be an interesting figure if we can get that.

Senator BENNETT. I realize that you could not be expected to have it at the tip of your tongue, but I would like to have it in the record.

Secretary CONNALLY. We think the personal exemption increase to $1.000 alone would run in the range of $8½ to $9 billion, over the proposed $750 figure.

Senator HARTKE. I think closer to $10. That would be over $700 for 1972 under present law.

Secretary CONNALLY. Ten? Thank you, Senator.

Senator BENNETT. And the other figure would be interesting for the record. That is all I have.

(The Department subsequently informed the committee that a 20-percent increase in social security benefit payments would increase expenditures by approximately $9 billion.)

Senator HARTKE. Let me say to you, I can give you those answers if they don't have it: it is $10, closer to $10 billion if you go to a thousand dollars.

That is if you operate from the present base. No question about that. I am not denying that. On the social security, let me say to you, if you take the present tax recommendations, which Mr. Burns has recommended in the House, you can give a 20-percent increase without invading the fund whatsoever, and you can give almost immediately between 9- and 10-percent increase without taking an additional penny out of the wage earner's pocket, due to the present overcharge because of the system we have been following, so long as that is why we could give the 15-percent increase which the chairman put onto the bill if you recall, without taking an additional penny out, and reduced the anticipated surplus from $50 billion to $37 billion, and that is nothing wrong with that.

I ask Mr. Nolan to verify that, or Mr. Woodward, that there was not a penny taken out, and there would have been a $50 billion surplus in the social security fund otherwise.

The CHAIRMAN. We will get the figures on that for those who want it. I would like to just touch briefly on another matter, because that has been raised, but I don't think adequately covered.

Last year, we passed this social security, public welfare bill that had something for all of the aged, disabled, and the blind. It had a lot to do with medicare and medicaid, as well as a big social security increase. After we passed it 83 to 0, the House wouldn't go to conference with us because they were trying to use that social security increase as a leverage to try to get the family assistance plan on the statute books. Now, we finally got the 10-percent social security bill through this spring, but it took almost to August for the House to get that so-called welfare reform package to us. There would be no problem in passing something to provide more money for the aged, the disabled, and the blind. I don't think we would have much difficulty passing something in short order to provide more money for the States in providing benefits for family categories.

But I am frank to tell you, Mr. Secretary, that some of us plan to give you the fight of your life if you try to add an amendment to this bill to put another 7 or 9 million more people on welfare, paying them to do nothing.

We are willing to pay $5 billion for people to do something, but to do zero, we are not for it. And we expect to fight on that. We will offer a simple alternative where we pay people to work, but we are tired of paying money for more and more people to not work, and we are tired of people making money on welfare. We are going to give you a real fight on that, and I think we will win.

I regret to say that the administration has been trying to force us to take their views for 2 years on that, and they have not succeeded. If you want the family assistance plan put on as an amendment to the bill, you ought to be anticipating that we will be fighting on that measure while you're up to your nose in snow climbing Capitol Hill to get your bill. We might be on it in the spring. When we get down to the question of whether we are going to pay for people not to work, and double up the welfare rolls, or whether we are going to pay the money for people to work, that is going to be one knock-down, drag-out fight, the way it lines up this moment. And I don't think that you can count on getting your bill through in time to do what you hope to achieve if you are going to wait until we get through fighting about the family assistance plan.

The administration says that even if they get their way about that, it will take 18 months to mail out the first check under the family assistance plan. I hope for your sake it does not take you 18 months to get your program into effect.

Senator BENNETT. I applaud your statement. It is the right statement but the wrong Secretary.

Secretary CONNALLY. Let me make it abundantly clear, I did not bring this subject up, as I remember. As I recall, a member of the committee brought it up, and I merely responded by saying the welfare reform was a matter of high priority. I would hope they would not attempt to tack it to this particular tax measure, if indeed the committee was going to get into a hassle about it, and I gather you have answered that question.

The CHAIRMAN. Mr. Secretary, in Senator Ribicoff's statement, if you want to put that family assistance plan on the bill, I hope he will give me time to go home and put my fighting clothes on; I came down in my best suit today.

Thank you very much, Mr. Secretary.

(Whereupon, at 1:10 p.m., the committee adjourned, subject to call of the Chair.)

THE REVENUE ACT OF 1971

TUESDAY, OCTOBER 12, 1971

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

The committee met, pursuant to notice, at 10 a.m., in room 2221, New Senate Office Building, Senator Wallace F. Bennett, presiding.

Present: Senators Long, Anderson, Talmadge, Hartke, Ribicoff, Nelson, Bennett, Curtis, Miller, Jordan of Idaho, Hansen, and Griffin.

Senator BENNETT. Ladies and gentlemen, the chairman will be a minute or two late but we have such a long list that he has asked me to begin the hearings.

I will open the hearings by reading the statement that was prepared for the chairman.

This morning the committee begins hearing public witnesses on the President's proposals to spur the economy. On each day this week and continuing through Monday of next week, the committee will hear 12 to 15 witnesses a day on various aspects of H.R. 10947. All witnesses have been advised to restrict their presentations to not more than 10 minutes. Those who can finish their statements in less time are urged to do so, and those whose statements go beyond the 10 minutes will be politely reminded and requested to put the balance of their statement in the record without using time to read it.

For the benefit of persons choosing to submit a written statement to the committee in lieu of a personal appearance, let me suggest that five copies of the written statement be delivered to the committee office not later than noon, Monday, October 18.

Our first witness today will be Senator Magnuson, so we will be very happy to hear you.

STATEMENT OF HON. WARREN G. MAGNUSON, A U.S. SENATOR FROM THE STATE OF WASHINGTON

Senator MAGNUSON. Thank you, Mr. Chairman. I took note of your warning about 10 minutes. I have two amendments so I will take 20, but one I will dispose of very quickly.

Senator Jackson and I, and some other Senators, have suggested an amendment to this committee which deals with the electric utility industry. It will retain the currently proposed 4-percent investment credit on eligible public utility property, but at the same time would impose a research and development fee upon the utility companies.

Most of these companies have been expanding regardless—they have to—and this would merely suggest that those who are eligible to take the tax credit would use it for R. & D. programs. These States were listed as eligible for the Emergency Extended Unemployment Compensation Act. I will submit my statement for the record on that particular amendment.

Senator BENNETT. Without objection, it will be received.*

Senator MAGNUSON. Now, of great importance to not only me but many Members of the Congress and others is the serious question of unemployment, not necessarily nationwide but certain pockets of unemployment that are so serious that we cannot afford to wait for an upturn of the general economic condition before acting.

I happen to come from a State that has over—well, on the western side, my last figures last week were 16.5 percent. That is serious. That comes close to the 22 percent in the 1930's. This is not true all over Washington State. The statewide unemployment is 13 percent but that is not good—it is bad enough as it is, but it is 16 and 17 percent in certain areas, pockets, where higher unemployment exists.

There are other States in the country that are also involved, and so we proposed an amendment that we think needs to be enacted as an emergency unemployment act. I know that this committee has got to act quickly on H.R. 10947, on the House bill, the Revenue Act of 1971, because of the enormous significance to the entire Nation.

The committee's hearings on the Revenue Act may present the only opportunity this year for the Finance Committee to consider the need for an Emergency Unemployment Compensation Act.

Your distinguished chairman has asked me to come here this morning to present my case to the committee so that you can consider this matter before reporting the act to the floor.

Chairman Long realizes the significance of the measure to not only the State of Washington but also to other places in the Nation that are well above the 7.5 percent unemployment figure.

As the committee knows, we introduced this bill, S. 2311, on July 21 of this year. The bill was introduced because of the critical situation which faces us now, and I got these figures last week—1,784,332 working Americans exhausted all unemployment benefits during fiscal year 1971. Several hundred thousand more workers have exhausted all their benefits since July 1, 1971, which brings the total over 2 million in the last 16 months.

This number compares with 954,000 workers who exhausted all benefits during fiscal 1970.

Mr. Chairman, this represents an increase of almost 90 percent and comes at a time when the rate of unemployment nationwide runs around 6 percent and when the prospect for unemployed workers finding new jobs is very, very bleak.

In my own State, now experiencing the Nation's highest rate of unemployment at 13 percent, except for Alaska, 99,564 workers exhausted all benefits during fiscal 1971 as compared with 16,000 during fiscal 1970. This is over a 500-percent increase in 1 year.

On October 2 of this year the State of Washington's emergency extended benefits program ended because the expiration date set in the

*See letter, p. 84.

original act had been reached; and another 10,000 workers were cut off benefits on that one day alone.

Washington State will exhaust its entire unemployment compensation trust fund next March unless something is done by the Federal Government. This fund totaled $322 million only 2 years ago and it will be all gone by March 1; I have talked with responsible officials in Washington State and they all agree that a Federal Emergency Extended Unemployment Act like I have offered presents the best
So I want to take this opportunity to briefly outline the major pro-
shortrun solution.
visions: (1) All States that have enacted an extended compensation law pursuant to the Federal-State Extended Unemployment Compensation Act are eligible for this emergency measure. Individuals are eligible who have exhausted under State law both their regular and all extended Federal and State unemployment compensation benefits.

An unemployment rate of, say, 7.5 percent, insured unemployment, plus total exhaustions, would trigger the emergency benefits in participating States.

Now, 7.5 is not necessarily a figure that I think is—I just don't know whether 7.5 is the right figure or whether we should make it, because of the cost involved, over 10 percent unemployment. The Federal Government would pay 100 percent of the emergency compensation paid by the State prior to July 1, 1972, and 80 percent of the compensation after June 30, 1973. This allows the States a period of time to enact a matching requirement of the 20 percent in order to maintain their eligibility.

A tax increase of 0.05 percent from employers will be levied to finance the act, an increase from 3.2 to 3.25 per centum.

Mr. Chairman, I must emphasize to the committee that Washington State is suffering a regional depression. The churches in Seattle will feed 8,000 hungry people a week. They all got together and have checkpoints where food is handed out; that is how bad it is getting. Twelve thousand hungry citizens have been turned away because there is simply not enough donated food available; and yet the Department of Agriculture—and I have discussed this with the distinguished Senator from Georgia—will not allow surplus commodities to be distributed to these people because Washington State has an existing food stamp program. They say that is sufficient.

Senator TALMADGE. Mr. Chairman, will the distinguished Senator yield at this point?

Senator MAGNUSON. Yes.

Senator TALMADGE. The law, as the distingiushed Senator knows, authorizes the food stamp program and a commodity program to operate in the same State simultaneously under extreme hardship conditions subject to the approval of the Secretary of Agriculture.

It would seem to me that figures cited by the distinguished senior Senator from Washington would warrant a dual operation in such program; and I am at a loss to understand why the Secretary of Agriculture won't permit it.

Senator MAGNUSON. Well, all I want to do is to have him work it out. But the Department of Agriculture contends that the food stamp program is sufficient. Now, this is not correct and no one will testify to that effect, because you take a person on social security——

Senator TALMADGE. The food stamp program, if the Senator will yield again, would probably be sufficient for a family that had some minimum income but unfortunately the stamps require a minimum investment.

Senator MAGNUSON. That's right.

Senator TALMADGE. And for a family that has no minimum income, they cannot make a minimum investment.

Senator MAGNUSON. That's right.

Senator TALMADGE. That was the reason for the commodity program.

Senator MAGNUSON. Well, I point this out to point out the problem that we have, and even though this Senate agreed and the House agreed and the President signed a bill for $20 million in emergency funds to be used in the hardest hit areas, the Office of Management and Budget callously states they will not do it.

Anyway, I point this out, and I appreciate what the Senator from Georgia said because I do hope something will be done. Twelve thousand people are turned away each week and this is only in the King County geographical area. There is no problem of distribution; the churches and the Goodwill and the Community Chest people—all these people—will distribute the food; and there is food in the warehouses.

The Senator from South Carolina and I went out there about 6 weeks ago, out to the Navy installation at Sand Point where they have huge warehouses and they are just stacked full with food, and three blocks away people were standing in line because of the bureaucratic problems. And I think the Department of Agriculture has been very callous about this.

I point this out to show what the problem is. This policy regarding commodity distribution certainly will not help those in need who have exhausted all unemployment compensation benefits and are employable. These people do not qualify for welfare benefits in Washington State.

Now, let's say you get a person who exhausts all of his benefits; he can't find a job. I suppose the State legislature is going to allow him to go on welfare. That is the only place he can go.

I handled the big appropriation for HEW and I will submit the figures to this committee; I am having them worked on this morning.

You take a person off unemployment compensation and put him on welfare—it is not only the loss of dignity that he suffers, the humiliation within his neighborhood, but it costs you almost twice as much to keep him on welfare. And I will submit those figures and the funds come right out of the Treasury. So, when you talk about the cost of extended unemployment compensation benefits you are saving the Treasury money.

I will use a round figure; it is between $3,000 and $3,500 per year per family for people on welfare considering the whole thing, particularly if they have two or three children. So it seems to me that in the long run we are going to save a great deal of money with this.

So I urge the Finance Committee to consider adding an Emergency Extended Unemployment Compensation Act to the bill presently being considered. I know of no other way to do it. If the committee in its wisdom figures they cannot add it to this bill, I am going to have to put an amendment on the floor; and I cannot guarantee what would happen to it on the floor, but I think it would pass. I think it would pass but I would rather have it be done the right way, the regular way.

So I submit this and I hope the committee will take a look at it. Somthing has to be done because we just cannot wait for the upturn of this economy; and I don't know what these people are going to do.

I hate to see—I have a neighbor who is a pretty good engineer, not a professional, not a college graduate, but he has worked his way up in his field. He has been unemployed for a year; he will exhaust his benefits next month and he is a fine person. I don't want to see him on welfare. I think it will break his spirit; but he figures that he is justified in talking unemployment compensation when he is looking for a job every day he can, because he helped pay for it since it is a fringe benefit and therefore he is justified, but he doesn't feel in this country he should be on welfare.

So I don't see any reason—may I put in the record certain documents, State by State statistics on this matter, Mr. Chairman?

The CHAIRMAN (now presiding). By all means.*

Senator MAGNUSON. I have listened to critics over the past few days and the past few weeks since the tax bill was submitted that it leans heavily toward business. All of you have heard that and it does; and that is what it will do if you are going to have this investment credit. But I think you are justified in doing something for these people, too, who are unemployed, and are trying to find jobs in areas where the unemployment rates are highest.

You get unemployed workers on welfare and you will break their spirit and they get used to it and some don't go back, do they? I know that. I know the cost. We have got a $29 billion bill on HEW right now—this last one—and supplementals that are going to run around $1.5 billion. It seems to me you could save some money from the Treasury until these people can find jobs rather than push them off into a welfare program with all its bureaucratic red tape.

I thank you.

The CHAIRMAN. Thank you very much, Senator Magnuson.

Senator MAGNUSON. I will put these in the record. It shows, State by State what is happening. I want to add, before I leave, if you do consider this, I used the figure of 7.5.

Now, that would cost a great deal of money originally but you would also spend it on welfare; you would have to take it out of the Treasury; I will tell you that.

A billion dollars down there is nothing on welfare; it comes up in every supplemental we have and maybe you might want to use the figure where the thing is so serious, like 10 percent. That would help these pockets of high unemployment.

The Senator from Connecticut has a couple of pockets up in his State—pockets of unemployment—where they are exhausting their benefits.

Senator RIBICOFF. May I ask one question?

Don't you find in the State of Washington that many self-respecting people who have worked hard all their lives and never thought they would ever see the day that they would go on welfare now just to keep body and soul together, are on welfare in the State of Washington?

Senator MAGNUSON. Sure. As I said, I happen to have a neighbor who is a good, hard worker, you know; he is—he isn't a graduate

*See p. 102.

engineer but he is an engineer; and it is almost heartbreaking to see people who want to work and help build America and have some talent who have to be relegated to welfare. I just think some of them—it is going to break their spirit and their faith in this country.

I thank the committee.

Senator MILLER. Mr. Chairman, may I ask a question?

Senator MAGNUSON. Yes.

Senator MILLER. I believe you made the comment that this situation out in your State was tantamount to a regional disaster, and I am wondering if the west coast dock strike hasn't seriously aggravated this.

Senator MAGNUSON. Would you repeat that?

Senator MILLER. You made a comment that this situation in your State amounted to a regional disaster, and I can understand that. Now, my question is, has not the west coast dock strike seriously aggravated that condition?

Senator MAGNUSON. Oh, it added to it.

Senator MILLER. All right; I am just going to pass this on to you.

I think all of us are sympathetic with the problem such as you have. I have introduced and testified on a bill before Senator Williams' committee which would extend the authority of the President under the Taft-Hartley law to cover regional emergencies as well as national emergencies; and I believe that if you would speak to Senator Williams it would be helpful in this connection because I was thinking precisely of situations such as you have.

Senator MAGNUSON. Such as the west coast strike?

Senator MILLER. In connection with that.

One further question: You made the comment that this neighbor of yours had paid into the unemployment compensation trust fund. Was that under State law that he did this? Do you know? Generally it is my understanding that the employer is the one who does this rather than the employee.

Senator MAGNUSON. You're correct; the employer pays the tax but it certainly is considered as a "fringe benefit" and is something the workers believes he has earned.

Senator MILLER. Thank you very much.

The CHAIRMAN. Thank you.

Senator MAGNUSON. We are faced with a situation and I just want to repeat. I don't think anyone knows any better than Senator Cotton and how much it costs to keep a person on welfare. The funds come right out of the Treasury. I thank you very much.

The CHAIRMAN. Thank you, Senator.

(Senator Magnuson's prepared statement and enclosures follow. Hearing continues on p. 103.)

U.S. SENATE,
Washington, D.C., October 8, 1971.

Hon. RUSSELL B. LONG,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: Section 106 of the Revenue Act of 1971, as passed by the House, would extend a 4 percent investment credit to eligible public utility property. As we understand it, this credit is designed to create additional jobs by encouraging expenditures for equipment and to assist utilities in raising the necessary capital for system expansion. We would invite you to consider an amendment to these provisions that is intended to better achieve important national goals in the electric utility industry and to improve the quality of the environment.

The amenment would keep electric utilities eligible for the investment credit as now contemplated under the Revenue Bill. But it would, at the same time, impose a research and development fee upon electric utilities in an amount equal to 90 percent of the investment credits received on public utility property used in electric operations. The purpose is to raise revenue for an innovative research and development program directed toward increasing efficiencies of existing equipment, encouraging basic examination into new means of producing reliable energy and discovering methods of reducing environmental impacts of present and future energy generation and transmission systems. Another possible option, if additional stimulation of the electric utility is desired, is to increase the investment credit available on electric utility property up to 7 percent while retaining the research and development fee at 4 percent.

The fund would be administered by a five member Federal Power Research and Development Board appointed by the President to staggered five year terms with the advice and consent of the Senate. After ten years the Board would cease to exist unless Congress renews its mandate.

The Board is to develop an overall program after annual hearings. It is anticipated that this process will enable the Board to benefit from the counsel and advice of environmentalists, consumers, public interest advocates, members of the scientific and technical community and the affected industries. Also required is a detailed annual report which is to include a description and appraisal of research and development activities funded during the preceding year, an evaluation of future funding needs, and an assessment of the impact of emerging technologies on the demand for electricity, the economy and the environment. A newsletter is to be published at least twice a month to provide basic and continuing information on the Board's activities to the scientific community, Congress, industry and the general public. The funds collected, while limited to use by the Board, will be suoject to the appropriation process so that Congress will be able to assure that funds allocated to the Board serve the objectives of the act. All of these provisions are designed to make the Board highly viable and guarantee that its activities are in the public interest.

We are recommending this approach for several reasons: The electric untility industry has not been suffering from a sluggish investment program as has plagued much of American industry. To the contrary, to meet rising demands for power, utilities have had to construct new facilities at record rates. The problem in the electric industry is not merely one of increasing investment, but it is one of making plants more compatible with a quality environment and acceptable to the people.

The industry alone cannot undertake the broad scale R&D program necessary to meet these needs. Adequate research efforts are prevented by unsympathetic utility commissions that have not encouraged R&D expenditures, by the nonexistence of a profit motive because a regulated industry must pass any savings on to customers, and by the fact that many promising devleopments require expenditures far beyond the resources of a single company or group of companies.

Voluntary industry-wide efforts are doomed to failure because non-contributors will benefit equally with those who finance industry activities. Thus a mandatory government program is required.

But the benefits of this proposal are not confined to the utility industry. Increased R&D expenditures will not only stimulate general employment but it will also provide jobs for highly skilled scientific and technical personnel. It could lead to the creation of a whole new industry concerned with promoting efficient use of existing energy resources and improving pollution control.

The mechanism of an investment credit combined with a fee of an equal amount presents a unique opportunity for Congress to increase energy R&D activities without increasing electricity rates for the consumer or increasing costs to the industry. It would substitute random uncoordinated investment activities of individual utility companies with a comprehensive R&D program under public control that would operate to assist the industry, increase employment and improve the quality of life.

Because of the special requirements of the electric utility industry, we hope that you will favorably consider this amendment.

Sincerely yours,

WARREN G. MAGNUSON, U.S.S.
HENRY M. JACKSON, U.S.S.

AMENDMENT Intended to be proposed by Mr. Magnuson to H.R. 10947, an Act to provide a job development investment credit, to reduce individual income taxes, to reduce certain excise taxes, and for other purposes, viz: At the end of the bill, add the following new section:

SEC. 18. The Federal Power Act is amended by adding at the end thereof the following new title:

"TITLE IV—FEDERAL POWER RESEARCH AND DEVELOPMENT BOARD ESTABLISHED

"SEC. 401. (a) There is hereby established the Federal Power Research and Development Board (hereinafter referred to as the 'Board'). The Board shall consist of five members oppointed by the President, by and with the advice and consent of the Senate, one of whom shall be so appointed as Chairman of the Board. The members first appointed under this section, as amended, shall continue in office for terms of one, two, three, four, and five years, respectively, from the date this section, as amended, takes effect, the term of each to be designated by the President at the time of nomination. Their successors shall be appointed each for a term of five years from the date of the expiration of the term for which his predecessor was appointed and until his successor is appointed and has qualified, except that he shall not so continue to serve beyond the expiration of the next session of Congress subsequent to the expiration of said fixed term of office, and except that any person appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed only for the unexpired term. Not more than three of the members shall be appointed from the same political party. No person in the employ of or holding any official relation to any licensee or to any person, firm, association, or corporation engaged in the generation, transmission, distribution, or sale of power, or owning stock or bonds thereof, or who is in any manner pecuniarily interested therein, shall enter upon the duties of or hold the office of member. Said member shall not engage in any other business, vocation, or employment. No vacancy in the Board shall impair the right of the remaining members to exercise all the powers of the Board. Three members of the Board shall constitute a quorum for the transaction of business, and the Board shall have an official seal of which judicial notice shall be taken. The Board shall annually elect a Vice Chairman to act in case of the absence or disability of the Chairman or in case of a vacancy in the office of Chairman. The members shall be appointed from among those persons with experience and competence in the following areas: the environment and its protection; electric power reliability; and scientific and technical research and development. The Chairman shall be compensated at the rate provided for by level III of the Executive Salary Schedule under section 5316 of title 5, United States Code. The remaining members shall be compensated at the rate provided for GS-18 under section 5332 of such title.

"(b) The authority under this title shall terminate ten years from the date of enactment of this Act.

"FEE ASSESSED

"SEC. 402. The Federal Power Commission shall assess and collect a fee from every person generating electric energy in an amount equal to 90 percent of all Job Development Investment Credits on public utility property received by that person in electric generation, transmission and distribution operations under the Revenue Act of 1971.

"TRUST FUND ESTABLISHED

"SEC. 403. Revenues collected by the Commission from such fees and interest on such revenues shall be deposited in a trust fund, to be known as the Federal Power Research and Development Trust Fund (hereinafter referred to as the 'fund') which is in the Treasury of the United States to be available through the appropriation process only to the Board for use in carrying out all the provisions including administrative expenses of section 404 and other provisions of this title. Separate appropriations requests shall be submitted by the Board to the President for transmittal to Congress.

"RESEARCH PROGRAM AUTHORIZED

"SEC. 404. (a) The Board is authorized to conduct either directly or by way of contract, grant, or other arrangement, a program of research and development for the improved means of production, transmission, distribution, and consumption of electric energy with minimum impact on the environment. Payments under this section shall not exceed the amount of the fees collected pursuant to this Act. Such program shall be coordinated with and shall supplement research and development programs conducted or assisted by other Federal agencies, universities, electric power companies or other companies or individuals. Funds appropriated pursuant to this Act shall be allocated on the basis of their contribution to the attainment of the following goals—

"(1) increasing the efficiencies of energy generation, transmission, distribution, and consumption processes;

"(2) decreasing the adverse environmental impact of present and future energy generation, transmission, and distribution processes;

"(3) achieving basic innovations for new means of reliably generating energy while protecting the environment;

"(4) making increased efficiencies and improved technology directly available to all electric utilities, regardless of size or nature of ownership;

"(5) other areas which the Board deems to be within the broad objectives of this title; and

"(6) in allocating the sums of the Fund under this title, the Board shall reserve not less than 5 per centum of such sums for projects which make a deliberate effort to search for adverse social, environmental, or economic effects of proposed present technologies. Reports on such projects by the principal investigators shall be compiled and furnished to the Congress and the public annually.

"ADMINISTRATIVE PROVISIONS

"SEC. 405. (a) In carrying out its functions under this title, the Board is authorized to—

"(1) prescribe such regulations as it deems necessary governing the manner in which such functions shall be carried out;

"(2) appoint such officers and employees as may be necessary, and supervise and direct their activities;

"(3) utilize from time to time, as appropriate, experts and consultants, including panels of experts, who may be employed as authorized by section 3109 of title V of the United States Code;

"(4) accept and utilize the services of voluntary and uncompensated personnel and reimburse them for travel expenses, including per diem, as authorized by law for persons in the Government service employed without compensation;

"(5) rent office space; and

"(6) make other necessary expenditures.

"(b) If, in carrying out its functions under this section, the Board from time to time should require the services of personnel engaged in the generation, transmission, and distribution of electric energy, it should seek such personnel from all segments of the electric power industry including investor owned, State and local public agencies, cooperatives, and Federal agencies.

"REPORT

"SEC. 406. The Board shall prepare and submit to the President for transmittal to the Congress not more than six months after the passage of this Act and on the same day annually after that, a comprehensive report on the administration of this title for the preceding calendar year. Whenever possible, judgments contained in the report shall include a clear statement of the assumptions and data used. Such report shall include—

"(1) a thorough analysis and evaluation of research and development activities funded under this title;

"(2) a comprehensive evaluation of the areas most in need of research and development funding in the future;

"(3) an analysis of the possible and probable impact of emerging technologies on the present and future aspects of the following:

"(A) both the supply of and the demand for electrical energy;
"(B) the economy; and
"(C) the environment.

"(4) the extent of cooperation with other Federal agencies and public and private institutions, indicating the difficulties and the Board's plans for improvement, including proposals for legislation if needed.

"NEWSLETTER

"SEC. 407. (a) Not less than twice each month, the Board shall publish a newsletter (hereinafter referred to as the 'Newsletter'), which shall be made available to all interested persons and include—

"(1) abstracts of all approved grants, including a statement on the general nature of the work;
"(2) announcements of hearings;
"(3) summaries of promising developments; and
"(4) the information required elsewhere in this title.

"(b) The Board shall give notice by publication in the Federal Register and in the Newsletter at least ninety days before approval of any grant of $5,000,000 or more and shall provide an opportunity for any interested party to comment on any such grant prior to approval. No grants may be approved until thirty days after completion of the time allowed for the comment of interested persons.

"PROCEDURE

"SEC. 408. At least once each year the Board shall conduct a hearing on its proposed budget for the following fiscal year. Notice shall be given by publication in the Federal Register and in the Newsletter at least sixty days prior to its occurrence, the scheduled date, time, and place of said hearing. In addition, at least forty-five days before the hearing date, the Board shall publish in the Newsletter a complete statement of proposed programs in the next fiscal year. All interested parties should be granted an opportunity to testify. The Board can deny the request to testify only on the basis of good cause publishing the reasons therefor. A record shall be made of all hearings, and said record shall be available for public inspection. All reasonable and germane inquiries made at the hearing of the Board, or of the principal investigators where possible, must be fairly responded to on the record. The Board shall wait at least thirty days after the completion of the hearings to allow for the comment of interested parties before submitting its budget to the President.

"PATENTS

"SEC. 409. Each contract, grant, or other arrangement for any research or development activity supported by this title shall contain provisions effective to insure that all information, uses, processes, patents, and other developments resulting from that activity will be made freely and fully available to the general public. Nothing herein shall be construed to deprive the owner of any background patent of any right which he may have thereunder.

"CIVIL PENALTY

"SEC. 410. Any person who violates any regulation established pursuant to this title shall be subject to a civil penalty of not more than $10,000 for each violation or for each day of a continuing violation. The penalty shall be recoverable in a civil suit brought by the Attorney General on behalf of the United States in the United States district court for the district in which the defendant is located or for the District of Columbia."

PREPARED STATEMENT OF HON. WARREN G. MAGNUSON, A U.S. SENATOR FROM THE STATE OF WASHINGTON

Mr. Chairman, I appreciate the opportunity to testify before the Senate Finance Committee on the need for enactment of an Emergency Unemployment Compensation Act. I realize that the Committee must act quickly on H.R. 10947, the Revenue Act of 1971, because of its enormous economic significance to the entire Nation. I will comment briefly on a further amendment to the Revenue

Act, suggested by Senator Jackson and me dealing with regulated companies that generate or supply electricity. First, let me discuss the question of unemployment compensation.

Mr. Chairman, I am concerned because of the Committee's schedule that the hearings on the Revenue Act may present the only opportunity this year for the Finance Committee to consider the need for an Emergency Unemployment Compensation Act. Your distinguished Chairman has asked me this morning to present my case to the Committee so that you can consider this matter before reporting the Revenue Act to the Senate floor. Chairman Long realizes the significance of this measure to the State of Washington and knows how strongly I feel about the need for such an emergency measure.

As the Committee knows, Senator Jackson and I introduced S. 2321, the Emergency Unemployment Compensation Act of 1971, on July 21, 1971. This bill was introduced because of the critical situation facing 1,784,332 working Americans who exhausted all unemployment benefits during F.Y. 1971. Several hundred thousand more workers have exhausted all their benefits since July 1, 1971, the end of F.Y. 71. This number compares with 954,191 workers who exhausted all benefits during F.Y. 1970. Mr. Chairman, this represents an increase of almost ninety percent and comes at a time when the rate of unemployment, six percent, makes the prospect very bleak for unemployed workers to find new jobs.

In the State of Washington, now experiencing the Nation's highest rate of unemployment (except for Alaska) at 13 percent, 99,564 workers exhausted all benefits during F.Y. 71 as compared with 16,413 during F.Y. 70. That is over a 500 percent increase in one year. On October 2nd, 1971, the State of Washington's emergency extended benefits program ended because the expiration date set in the original act had been reached; another 10,000 workers were cut-off from benefits on that date.

Mr. Chairman, Washington State will exhaust its entire Unemployment Compensation Trust Fund next March unless something is done by the Federal Government; this fund totaled 322 million dollars only two years ago. I have talked with the responsible officials in Washington State and they agree that a Federal Emergency Extended Unemployment Act like I have offered presents the best short-run solution.

Let me take this opportunity to briefly outline the major provisions of S. 2321.

All states that have enacted an extended compensation law pursuant to the Federal-State Extended Unemployment Compensation agreement are eligible for this emergency measure. Individuals are eligible who have exhausted, under State law, both their regular and all extended federal and state unemployment compensation benefits;

An unemployment rate of 7.5 percent (insured unemployed plus total exhaustions) would trigger the emergency benefits in participating states;

The Federal Government shall pay 100 per centum of the emergency compensation paid by the State prior to July 1, 1973 and 80 per centum of the compensation after June 30, 1973. This allows the States a period of time to enact a matching requirement of 20 per centum in order to maintain their eligibility.

A tax increase of .05 percent from employers will be levied to finance the "Emergency Unemployment Compensation Act of 1971"; an increase from 3.2 per cent to 3.25 per cent.

Mr. Chairman, I must emphasize to the Committee that Washington State is suffering a regional depression. The churches in Seattle feed 8,000 hungry people a week. 12,000 hungry citizens are turned away because there simply is not enough donated food available. The Department of Agriculture will not allow surplus commodities to be distributed to these people because Washington State has an existing food stamp program. Agriculture officials callously state that these hungry people have an "income maintenance" problem that cannot be solved by giving them free food.

This policy certainly will not help those in need who have exhausted all unemployment compensation benefits and are employable; these people do not qualify for welfare benefits in Washington State.

Mr. Chairman, I urge the Senate Finance Committee to consider adding an Emergency Extended Compensation Act to the bill presently being considered. I believe that it will provide a relief measure to those hardest hit by recent economic policies. Some economists have criticized the proposed economic incentives as being too heavily weighted in favor of business. Adding an

Emergency Extended Compensation Amendment would certainly help to balance these incentives and at the same time provide additional purchasing power to several hundred thousand workers. Mr. Chairman, I urge the Committee to adopt this measure which would bring immediate assistance to workers who have already exhausted all unemployment benefits, live in states with the highest rate of unemployment and face the bleakest prospects for finding a job.

On a second matter, Senator Jackson and I would also like to propose a further amendment to the Revenue Act dealing with regulated companies that generate or supply electricity. This amendment would retain the electric utilities' eligibility for a 4 percent investment credit as contemplated under Section 106 of the Revenue Bill. But it would, at the same time, impose a research and development fee upon electric utilities in an amount equal to 90 percent of the investment credits received on public utility property used in electric operations. If additional stimulation of the electric utility industry is desired, another possible option would be to grant up to a 7 percent investment credit to electric utilities that are subject to the research and development fee.

The R & D fee would go into a fund to be administered by a 5 member Federal Power Research and Development Board, appointed by the President with the advice and consent of the Senate. Many provisions, such as public hearings, a bi-weekly newsletter, and congressional appropriation of funds are all designed to make the Board highly visible and guarantee that its activities are in the public interest.

The Board is to conduct an innovative research and development program directed toward increasing efficiencies of existing equipment, encouraging basic examination into new means of producing reliable energy and discovering methods of reducing adverse environmental impacts of present and future energy generation and transmission systems.

I am recommending this approach for several reasons: The electric utility industry has not been suffering from a sluggish investment program as has plagued much of American industry. To the contrary, to meet rising demands for power, utilities have had to construct new facilities at record rates. The problem in the electric industry is not merely one of increasing investment, but it is one of making plants more compatible with a quality environment and acceptable to the people.

The industry alone cannot undertake the broad scale R & D program necessary to meet these needs. Adequate research efforts are prevented by unsympathetic utility commissions that have not encouraged R & D expenditures, by the nonexistence of profit motive because a regulated industry must pass any savings on to customers, and by the fact that many promising developments require expenditures far beyond the resources of a single company or group of companies.

Voluntary industry-wide efforts are doomed to failure because non-contributors will benefit equally with those who finance industry activities. Thus a mandatory government program is required.

But the benefits of this proposal are not confined to the utility industry. Increased R & D expenditures will not only stimulate employment and the economy but it will also provide jobs for highly skilled scientific and technical personnel. It could lead to the creation of a whole new industry concerned with promoting efficient use of existing energy resources and improving pollution control.

The mechanism of an investment credit combined with a fee presents a unique opportunity for Congress to increase energy R & D activities without increasing electricity rates for the consumer or increasing costs to the industry. It would substitute random, uncoordinated investment activities of individual utility companies with a comprehensive R & D program under public control that would operate to assist the industry, increase employment and improve the quality of life.

It is for this reason, Mr. Chairman, that I welcome the opportunity to propose this second amendment.

In closing, I want to again thank the Chairman for giving me this opportunity to discuss these two amendments.

Mr. Chairman, I ask permission to insert several documents for the record at this point.

STATES ELIGIBLE UNDER MAGNUSON PROPOSAL—ALASKA, CALIFORNIA, CONNECTICUT, MAINE, MASSACHUSETTS, MICHIGAN, NEW JERSEY, OREGON, PUERTO RICO, RHODE ISLAND, WASHINGTON

THE WASHINGTON LABOR MARKET

EMPLOYMENT SECURITY DEPARTMENT
STATE OF WASHINGTON

Issue No. 310 Olympia, Washington

AUGUST 1971

HIGHLIGHTS

Total employment changed little between June and July in Washington State. Farm employment rose 24,400 due to the raspberry and strawberry harvests; but this gain was mostly offset by a loss in state and local government employment, attributed to normal summer layoffs by public schools, and an increase in the number of workers involved in labor-management disputes. Mid-July payrolls totaled 1,285,800, representing a gain of 3,400 from June but a loss of 46,500 from July 1970.

The number of individuals involved in labor disputes increased from 4,600 at mid-June to 11,100 at mid-July. Longshoremen went on strike on July 1 with 3,600 involved in Washington State. A continuation of the dispute threatens to curtail logging employment since log shipments to Japan have been stopped. Involvement of construction workers in work stoppages increased from 1,600 at mid-June to 4,500 at mid-July. Other major disputes under way at mid-July included Weyerhaeuser pulp and paper workers and employees of the American Smelting and Refining Company in Tacoma.

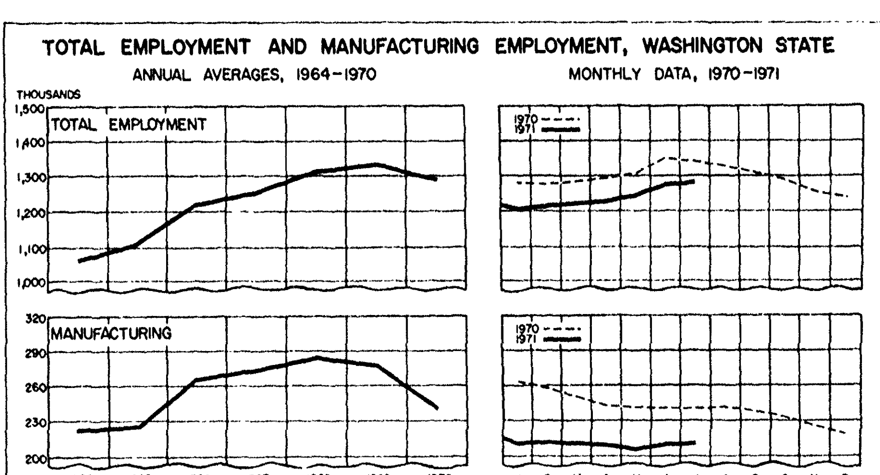
Unemployment Falls to 170,400

The number of unemployed workers in the state decreased from 181,600 and 12.4 percent of the labor force in June to 170,400 and 11.6 percent in July. The decline was mainly attributed to the temporary employment of thousands of youth in the western Washington berry harvests and the withdrawal of other youth from the labor force after unsuccessful attempts to find employment. The sudden drop in the seasonally adjusted unemployment rate form 12.6 to 11.8 percent between May and June proved only temporary as it increased to 12.4 percent in July.

Farm Employment High

The raspberry and strawberry harvests boosted farm employment to its annual peak in July. Gains in western Washington associated with the berry harvests more than offset a drop in seasonal farm activity in eastern Washington, which resulted from the completion of the asparagus harvest Over 36,000 workers were employed in the berry harvests alone; most were school-aged youth and housewives. Seasonal farm activity east of the Cascades in July included the apricot, cherry, early peach, and green pea harvests; sugar beet weeding; and apple and pear thinning.

Agricultural employment can be expected to fall in August because of the completion of the strawberry harvest and the near completion of the raspberry harvest but farm work will still be in high gear. Major activities in eastern Washington will include the peach, sweet corn, early potato, and Bartlett pear harvests. In



western Washington major activity will center around the completion of the raspberry harvest and the blueberry, cucumber, and pole bean harvests. Blackberry picking will start in late August and run into September.

Nonfarm Employment Trends

In contrast to the trend in total employment, nonagricultural wage and salary employment fell 22,100 between June and July. State and local government fell 19,000 as normal summer terminations of noncertificated personnel by public schools outweighed gains associated with the hiring of disadvantaged youth in special summer work programs. Construction employment dipped again in July due to increased involvement in labor disputes. To assess the complete effect of the disputes on the industry it is necessary to take into account not only those who were involved but to estimate the number of additional jobs which would have developed had there not been a dispute. A rough estimate is available from comparing the year-to year difference in construction employment before the disputes began and the year-to-year difference in July. In April 1971, the last normal month in the building trades, construction employment was 3,700 lower than one-year earlier. By July the year-to-year deficit was 10,900. Thus, the disputes have lowered July employment approximately 7,200—4,500 by direct involvement and 2,700 jobs by foregone expansion.

In other nonmanufacturing industries, a loss of 3,000 occurred in transportation, communications, and utilities. All of the loss resulted from the longshoremen's strike. The industry total was still affected by the Western Union dispute but not affected by the rail strike; both of these disputes have since been settled. Trade employment advanced 1,200 between June and July on the strength of seasonal gains at wholesale firms packing fruit and vegetables. The number of retail trade workers involved in labor disputes declined from 1,100 in June to 200 in July but cutbacks associated with the usual summer slowdown in consumer buying cut the overall gain in retail trade to 100.

Employment in the service and miscellaneous group was little changed over the month but wide seasonal changes were noted in the industry. Hotel and motel

LABOR FORCE AND EMPLOYMENT
(In thousands)

	EMPLOYMENT				CHANGE	
	July 1971 (preliminary)	June 1971	July 1970	June 1970	June 1971 to July 1971	July 1970 to July 1971
CIVILIAN LABOR FORCE	1,467.3	1,468.6	1,459.3	1,473.2	− 1.3	+ 8.0
WORKERS IN LABOR-MANAGEMENT DISPUTES	11.1	4.6	.6	1.0	+ 6.5	+ 10.5
UNEMPLOYMENT	170.4	181.6	126.4	133.0	−11.2	+ 44.0
Percent of Labor Force	11.6	12.4	8.7	9.0	....	....
Seasonally Adjusted Rate	12.4	11.8	9.3	8.6	....	....
EMPLOYMENT	1,285.8	1,282.4	1,332.3	1,339.2	+ 3.4	46.5
Agricultural	116.2	91.8	112.7	100.4	+ 24.4	+ 3.5
Nonagricultural	1,169.6	1,190.6	1,219.6	1,238.8	− 21.0	50.0
Employer, self-employed, unpaid, and domestics	138.8	137.7	140.0	139.3	+ 1.1	− 1.2
WAGE AND SALARY WORKERS, NONAGRICULTURAL①	1,030.8	1,052.9	1,079.6	1,099.5	22.1	− 48.8
TOTAL MANUFACTURING	212.0	211.7	240.3	241.8	+ .3	− 28.3
Durable Goods	140.3	141.5	162.6	165.0	1.2	22.3
Lumber and wood products	44.4	44.0	43.2	43.5	+ .4	+ 1.2
Furniture and fixtures	3.5	3.5	3.6	3.6	0	.1
Stone, clay, and glass products	5.7	5.6	6.2	6.0	+ .1	− .5
Primary and secondary ferrous metals	3.3	3.3	3.9	④ 3.0	0	− .6
Primary and secondary nonferrous metals	④ 9.4	10.3	10.8	10.7	− .9	− 1.4
Fabricated metal products	7.1	7.1	7.5	7.5	0	− .4
Machinery	14.0	14.1	14.0	14.2	− .1	0
Machinery (except electrical)	9.2	9.3	10.0	10.2	− .1	− .8
Electrical equipment	4.8	4.8	4.0	4.0	0	+ .8
Transportation equipment	49.9	50.5	70.3	73.4	− .6	− 20.4
Aerospace	38.2	38.8	57.8	60.3	− .6	19.6
Shipbuilding and repair	6.7	6.6	8.1	8.4	+ .1	− 1.4
Other transportation equipment	5.0	5.1	4.4	4.7	− .1	+ .6
Other durable goods②	3.0	3.1	3.1	3.1	− .1	− .1
Nondurable Goods	71.7	70.2	77.7	76.8	+ 1.5	− 6.0
Food and kindred products	28.0	27.5	30.8	30.1	+ .5	− 2.8
Canned and preserved foods	12.5	12.1	13.9	13.6	+ .4	− 1.4
Apparel and other textile products	5.6	5.4	5.7	5.7	+ .2	− .1
Paper and allied products	④ 18.1	④ 17.7	20.5	20.3	+ .4	− 2.4
Printing and publishing	10.3	10.2	10.7	10.8	+ .1	− .4
Chemicals and allied products	5.6	5.5	6.2	6.1	+ .1	− .6
Petroleum and coal products	1.6	1.5	1.2	1.2	+ .1	+ .4
Other nondurable goods③	2.5	2.4	2.6	2.6	+ .1	− .1
MINING AND QUARRYING	1.7	1.7	2.0	1.9	0	− .3
CONTRACT CONSTRUCTION	④ 47.8	④ 49.7	58.7	56.1	− 1.9	−10.9
TRANSPORTATION, COMMUNICATIONS, AND UTILITIES	67.8	70.8	73.8	74.7	− 3.0	− 6.0
Railroad Transportation	12.0	12.1	12.9	13.1	− .1	− .9
Other Transportation	④ 31.9	35.2	36.4	37.5	− 3.3	− 4.5
Communications and Utilities	④ 23.9	④ 23.5	24.5	24.1	+ .4	− .6
TRADE	232.8	231.6	241.6	242.7	+ 1.2	− 8.8
Wholesale Trade	62.7	61.6	63.9	63.5	+ 1.1	− 1.2
Retail Trade	④ 170.1	④ 170.0	177.7	179.2	+ .1	− 7.6
FINANCE, INSURANCE, AND REAL ESTATE	57.9	57.8	59.1	58.3	+ .1	− 1.2
SERVICES AND MISCELLANEOUS	171.8	171.9	172.3	173.0	− .1	− .5
GOVERNMENT	239.0	257.7	231.8	251.0	−18.7	+ 7.2
Federal	56.7	56.4	58.3	58.5	+ .3	− 1.6
State and Local	182.3	201.3	173.5	192.5	19.0	+ 8.8

Prepared in cooperation with the U. S. Bureau of Labor Statistics and the Manpower Administration.

①Excludes proprietors, self employed, members of armed forces, and private household employees. Includes all full and part time wage and salary workers receiving pay during pay period including the 12th of the month.

②Includes ordnance; instruments and related products; and miscellaneous manufacturing activities.

③Includes textile mill products; rubber and miscellaneous plastics products; and leather and leather products.

④Employment affected by labor-management dispute.

payrolls rose sharply in response to tourist business as did employment in health services, but the expansions were more than offset by typical seasonal cutbacks by private colleges and schools.

Manufacturing Employment Low

Manufacturing payrolls remained relatively stable between June and July, adding 300 to total 212,000 in the latter month. The total for basic industry was 2,600 lower than it would have been except for labor disputes, but even so, it was an extremely low level for July. After adjustment for the labor disputes, it was the lowest July total for manufacturing since 1955—16 years ago. In July 1968, manufacturing employment totaled 292,000.

Food and kindred products added 500 workers in July for the largest gain in the primary industries. The increase was basically due to the processing of western Washington berry crops although slight gains were also reported by beverage firms, meat packing houses, dairy product plants, and in other food manufacturing establishments. Lumber and wood products continued its recovery, adding 400 in July. At midmonth the industry total was 1,200 higher than one year ago. A few closures were reported by logging firms for the duration of the longshoremen's strike due to the stoppage of log exports to Japan. Additional shutdowns can be expected if the dispute continues. Fire hazard closures occurred in early August. Other than these two factors, the outlook for the lumber industry remains bright. Prices of nearby contracts (September delivery) for both plywood and lumber on the nation's commodity markets are higher than most more distant contracts (November and January); this inverse relationship occurs only when current demand exceeds supply.

Pulp and paper employment was also on the up side in July, adding 400 workers, although the industry total continued to be affected by the dispute at Weyerhaeuser mills. A gain of 200 was noted at apparel firms and several industries reported gains of 100 each.

Nonferrous metals and aerospace were the only manufacturing industries to show significant losses between June and July. Nonferrous metals dropped 900 because of a labor dispute while aerospace fell 600. The July loss in aerospace was relatively small compared with most earlier months of this year, but the July level for the industry was 68,100 below that of July 1968--the record high for aerospace.

Weekly Earnings Average $169.09

Average weekly earnings of manufacturing production workers in Washington State rose $2.35 from May to average $169.09 in June. The average workweek was 39.6 hours in the latter month and the hourly rate of pay averaged $4.27 Several industries posted substantial gains in weekly pay between May and June in spite of the small gain for manufacturing as a whole.

Weekly earnings in chemicals and allied products dropped over $10, but hours and earnings averages were high in May because of an exceptional amount of overtime work. Weekly hours averaged 42.1 in May compared with 40.1 in June. Earnings in canning and preserving fell $9.36 over the month because of the approaching end of processing activity for the asparagus crop in eastern Washington. Work at potato plants also slowed seasonally.

The most promising development in June occurred in the lumber and wood products industry which employs over one-fourth of the production workers in the state. Weekly hours in all segments of the industry averaged over 40 hours with the average for the industry as a whole increasing from 39.8 to 40.7 hours. Since June

ESTIMATED AVERAGE HOURS AND EARNINGS OF PRODUCTION WORKERS IN MANUFACTURING AND OF NONSUPERVISORY WORKERS IN NONMANUFACTURING ACTIVITIES, STATE OF WASHINGTON

	June 1971 Prod or Nonsupv Workers	Average Weekly Earnings			Average Weekly Hours			Average Hourly Earnings		
		June 1971	May 1971	June 1970	June 1971	May 1971	June 1970	June 1971	May 1971	June 1970
TOTAL MANUFACTURING INDUSTRIES	152,900	$169.09	$166.74	$160.74	39.6	39.7	39.3	$4.27	$4.20	$4.09
DURABLE GOODS	100,800	178.27	173.23	166.78	40.7	40.1	39.9	4.38	4.32	4.18
Lumber and wood products	39,900	179.08	169.55	160.16	40.7	39.8	38.5	4.40	4.26	4.16
Logging	12,200	214.80	196.80	187.40	42.2	40.0	38.8	5.09	4.92	4.83
Sawmills and planing mills	14,800	166.42	154.81	148.99	40.1	38.8	38.4	4.15	3.99	3.88
Millwork, plywood, and related products	12,000	161.20	162.37	150.16	40.2	40.9	38.7	4.01	3.97	3.88
Furniture and fixtures	2,700	170.37	150.54	150.10	42.7	38.6	40.9	3.99	3.90	3.67
Stone, clay, and glass products	4,600	196.24	194.46	180.18	41.4	41.2	40.4	4.74	4.72	4.46
Primary metal industries	10,800	176.92	172.98	163.60	40.3	40.7	40.0	4.39	4.25	4.09
Primary and secondary ferrous metals	2,700	169.22	161.83	159.36	38.9	37.9	38.4	4.35	4.27	4.15
Primary and secondary nonferrous metals	8,100	179.52	176.38	164.83	40.8	41.6	40.4	4.40	4.24	4.08
Fabricated metal products	5,600	182.36	185.18	175.67	38.8	39.4	39.3	4.70	4.70	4.47
Machinery	9,600	165.90	165.11	161.83	39.5	39.5	40.4	4.20	4.18	4.08
Machinery (except electrical)	6,500	180.11	180.50	179.55	40.3	40.2	40.9	4.47	4.49	4.39
Electrical equipment	3,100	137.20	132.21	124.02	37.9	38.1	39.0	3.62	3.47	3.18
Transportation equipment	25,200	183.50	182.90	176.80	41.8	41.1	41.6	4.39	4.45	4.25
Other durable goods	2,400	135.01	132.43	125.99	37.4	37.2	36.1	3.61	3.56	3.49
NONDURABLE GOODS	52,100	151.07	152.87	147.44	37.3	38.8	38.0	4.05	3.94	3.88
Food and kindred products	20,600	142.50	146.00	133.98	38.0	40.0	38.5	3.75	3.65	3.48
Canned and preserved foods	10,400	108.09	117.45	105.98	37.4	41.5	38.4	2.89	2.83	2.76
Apparel and other textile products	4,600	90.83	89.03	79.11	35.9	35.9	33.1	2.53	2.48	2.39
Paper and allied products	14,100	178.49	173.13	172.66	40.2	39.8	39.6	4.44	4.35	4.36
Printing and publishing	5,600	181.83	182.38	174.57	33.0	33.1	33.7	5.51	5.51	5.18
Chemicals and allied products	3,200	174.03	184.40	163.99	40.1	42.1	39.9	4.34	4.38	4.11
Petroleum and coal products	1,000	191.57	192.63	173.82	38.7	40.3	38.8	4.95	4.78	4.48
Other nondurable goods	2,000	112.88	106.51	115.63	37.5	36.6	37.3	3.01	2.91	3.10
SELECTED NONMANUFACTURING INDUSTRIES										
Mining and quarrying	1,400	207.82	213.27	185.93	41.9	42.4	39.9	4.96	5.03	4.66
Contract construction	42,000	242.36	243.83	225.16	36.5	37.0	36.2	6.64	6.59	6.22
Communications and utilities	19,000	156.67	156.67	147.84	38.4	38.4	38.6	4.08	4.08	3.83
Trade (except eating and drinking places)	165,800	131.72	130.64	123.88	35.6	35.5	35.7	3.70	3.68	3.47
Wholesale trade	53,500	157.50	154.50	145.92	37.5	37.5	38.0	4.20	4.12	3.84
Retail trade (exc. eating and drinking places)	112,300	119.72	119.37	113.83	34.7	34.6	34.6	3.45	3.45	3.29
Finance(1)	20,900	128.36	134.17	120.59		...	...	....	....	....
Hotels and other lodging places(2)	(3)	73.73	81.07	84.79	28.8	32.3	30.5	2.56	2.51	2.78
Laundries and dry cleaning plants	5,100	114.90	116.05	110.20	38.3	38.3	38.0	3.00	3.03	2.90

Prepared in cooperation with the U. S. Bureau of Labor Statistics and the Manpower Administration. Averages are based upon data for full and part time workers. They are not wage rates nor scheduled hours but are averages of the gross earnings and hours worked (or paid for) by all production and nonsupervisory workers and includes overtime pay and hours and premium rates for nightshift work.

(1) Average weekly hours and hourly earnings not available.

(2) Cash payments only; value of board, room, and uniforms, and tips not included.

(3) Not available.

1970, working hours in the lumber industry expanded 2.2 hours because of the resurgence of the homebuilding industry which is the major user of lumber products. Earnings of lumber workers rose $9.53 weekly from May to average $179.08 in June.

Unemployment Benefits Total $304 Million

Nearly one-quarter of a million workers received one or more unemployment benefit checks during the fiscal year which ended June 30, 1971. Payments under Washington State programs totaling $275.9 million were paid to 203,415 workers while federal benefits of $28.2 million were paid to 5,230 former federal employees and 15,752 ex-servicemen. The fiscal 1971 outlay for unemployment compensation was more than three times as great as during fiscal 1970 when payments totaled $97.4 million. Legislation raising maximum benefits and the addition of extended benefit programs as well as a higher incidence of unemployment were responsible for the increase.

A comparison of benefits paid by industry under state programs indicates workers from the aerospace, trade, and construction industries received the bulk of the payments. Former aerospace workers received $67.5 million to account for over 24 percent of the total. Workers last employed by wholesale and retail trade outlets were paid $54.7 million, or 19.8 percent of all state benefits; while construction workers received state unemployment checks amounting to $35.5 million, or 12.9 percent of the total.

The importance of unemployment benefits in maintaining purchasing power during the present economic crisis is pointed up by a comparison between benefits and wages earned in covered employment. The $304 million in state and federal benefits equaled 5 percent of total covered earnings reported in calendar 1970. (Data on covered earnings in fiscal 1971 are not yet available.) Moreover, fiscal 1971 statewide benefits exceeded calendar 1970 wages for covered employment in any of the state's 39 counties except King, Snohomish, Pierce, and Spokane. And aside from King County, the $304 million in benefits rivaled calendar 1970 earnings in Spokane County ($425 million), Snohomish County ($479 million), and Pierce County ($516 million). Fiscal 1971 benefits also exceeded 1970 covered earnings in several major industries such as pulp and paper, primary metals, machinery, or shipbuilding. In comparison with larger industries, benefits paid equaled 78 percent of the 1970 payroll in lumber and wood products or 55 percent of wages paid in contract construction.

UNEMPLOYMENT BENEFITS PAID BY LOCAL OFFICE AREA; ALL PROGRAMS, ALL ENTITLEMENTS
FISCAL 1971

Local Office Area	Benefits Paid
TOTAL	$304,123,474
Bellingham	5,551,119
Mount Vernon	4,185,184
Anacortes	1,964,750
Port Angeles	3,555,493
Bremerton	7,061,470
Seattle	79,469,119
Renton	29,724,937
Auburn	21,547,008
Everett	31,673,329
Tacoma	25,368,457
Olympia	5,195,726
Centralia	3,834,388
Aberdeen	4,999,348
Raymond	1,075,487
Vancouver	9,216,739
Longview	4,604,815
Wenatchee	4,232,401
Toppenish	3,149,455
Yakima	6,488,618
Ellensburg	1,760,734
Okanogan	1,963,018
Spokane	15,785,096
Colville	1,830,193
Walla Walla	3,995,209
Pasco	6,273,751
Ephrata	1,155,096
Moses Lake	1,503,848
Interstate	18,969,716

[From the Congressional Record, July 21, 1971]

By Mr. MAGNUSON (for himself and Mr. JACKSON):

S. 2321. A bill to assist States having an unemployment rate of 7.5 percent or more to provide up to 26 weeks of emergency compensation to unemployed workers who have exhausted their entitlement to both regular unemployment compensation and extended unemployment compensation. Referred to the Committee on Finance.

EMERGENCY UNEMPLOYMENT COMPENSATION ACT OF 1971

Mr. MAGNUSON. Mr. President, I am introducing today, along with my distinguished colleague from Washington (Mr. JACKSON), the Emergency Unemployment Compensation Act of 1971. This bill is offered because of the critical situation facing hundreds of thousands of American working people. This bill creates a program of emergency compensation to assist States having an unemployment rate of 7.5 percent or higher. The emergency period will begin after an individual has exhausted his regular and extended benefits and will last for 26 weeks. The program will be 100 percent federally financed until June 30, 1973. By that date, the States will have to enact legislation proving a 20-percent matching fund in order to maintain its eligibility after July 1, 1973.

Mr. President, there is no greater tragedy than an American workingman or workingwoman who has lost a job, who wants to find new employment, and discovers, after weeks of pounding the pavement and answering ads, that a new job simply does not exist. The individual caught in this dilemma first must consider providing for his family and must therefore apply for unemployment compensation. After a period of time, if the same individual has not found new employment, those unemployment benefits will be exhausted. If this worker's State has enacted an extended unemployment compensation program, he will be eligible for another short period of unemployment compensation benefits while continuing to look for a new job.

Mr. President, after the worker has exhausted both the regular and the extended unemployment compensation benefits, no other option exists except to apply for welfare.

This is a tragic situation and is usually one that the individual has little control over. This Nation has a greater responsibility to its working people and I believe that the responsibility includes providing "emergency unemployment compensation benefits" in those areas of the country where the rate of unemployment is the highest and the potential for finding new employment is the lowest.

Secretary John Connally recently stated that 4 percent unemployment is a goal which this Nation's economy cannot meet except when engaged in a war. Mr. President, if this is the case, then it is our duty to provide aid to those unable to find work.

The Congress has enacted S. 31, the Emergency Employment Act, which will create approximately 200,000 public service employment opportunities. This is certainly an important step but it will not help the other 5,200,000 workers who are still unemployed.

Incidentally, in the early part of this week, the Office of Management and Budget sent to my Committee on Labor, HEW Appropriations' a request for a billion dollars to implement the Emergency Employment Act. The committee will act promptly on this budget amendment, probably within the next week.

Mr. President, I would also like to inform Members of the Senate about the situation which exists in Washington State. This problem is not necessarily typical, but does apply to other areas.

Since January 1, 1971, over 25,000 citizens in Washington State have exhausted their extended unemployment compensation benefits. In the month of March, 34,000 workers across the Nation exhausted their extended benefits; 7,700 of those workers reside in Washington State. About 40 percent of these workers will qualify for welfare, the rest have no further source of income, except, in most cases, a few personal assets.

In 1970, 59,600 workers in Washington exhausted their regular benefits—13,400 in the first 4 months. In the first 4 months of 1971, 39,300 workers have exhausted their regular benefits, and as mentioned above, nearly 25,000 workers have already exhausted their extended benefits, which extends the benefits to 52 weeks. This is a very serious situation evidenced by the fact that Washington State officials have now found real pockets of serious hunger and malnutrition existing throughout the State among a citizenry that has never before faced this problem.

Nationally, 495,200 workers have exhausted regular unemployment benefits in the first 4 months of 1971 as compared with 253,300 during the same period in 1970. This illustrates the seriousness of the national problem and the need for this emergency measure.

Recently, Senator Jackson and I introduced the "Economic Disaster Relief Act of 1971" (S. 1832). I am very hopeful that this measure will be enacted in the very near future. I also believe that it is imperative that Congress enacts this "Emergency Unemployment Compensation Act of 1971" as a relief measure for those areas hardest hit by current economic conditions.

Mr. President, I introduce, for appropriate reference, for myself and Mr. Jackson, "The Emergency Unemployment Compensation Act of 1971" and ask unanimous consent that the bill be printed in full in the Record, together with a statement of purpose of the bill.

Mr. President, I also ask unanimous consent to insert in the Record two fact sheets regarding the current unemployment situation in Washington State and an article from the Seattle Times.

There being no objection, the bill and material were ordered to be printed in the Record, as follows:

"S. 2321

"A bill to assist States having an unemployment rate of 7.5 per centum or more to provide up to 26 weeks of emergency compensation to unemployed workers who have exhausted their entitlement to both regular unemployment compensation and extended unemployment compensation

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

"SHORT TITLE

"SECTION 1. This Act may be cited as the 'Emergency Unemployment Compensation Act of 1971'.

"FEDERAL-STATE AGREEMENTS

"SEC. 2. (a) Any State which desires to do so may enter into an agreement with the Secretary of Labor (hereinafter referred to as the "Secretary") under this Act, if the State law of such State contains (as of the date such agreement is entered into) a requirement that extended compensation be payable thereunder as provided by the Federal State Extended Unemployment Compensation Act of 1970.

"(b) Any such agreement shall provide that the State Agency of the State will make payments of emergency compensation—

"(1) to individuals who—

"(A) have exhausted all rights to compensation (including both regular compensation and extended compensation) under the State law;

"(B) have no rights to compensation (including both regular compensation and extended compensation) with respect to a week under such law or any other State unemployment compensation law or to compensation under any other Federal law; and

"(C) are not receiving compensation with respect to such week under the unemployment compensation law of the Virgin Islands or Canada;

"(2) for any week of unemployment which begins in—

"(A) an emergency extended benefit period (as defined in subsection (c)(3); and

"(B) the individual's period of eligibility (as defined in section 5(b)).

"(c)(1) For purposes of subsection (b)(1)(A), an individual shall be deemed to have exhausted his rights to regular compensation under a State law when—

"(A) no payments of regular compensation can be made under such law because such individual has received all regular compensation available to him based on employment or wages during his base period; or

"(B) his rights to such compensation have been terminated by reason of the expiration of the benefit year with respect to which such rights existed.

"(2) For purposes of subsection (b)(1)(B), an individual shall be deemed to have exhausted his rights to extended compensation under a State law when no payments of extended compensation under a State law can be made under such law because such individual has received all the extended compensation available to him from his extended compensation account (as established under State law in accordance with section 202(b)(1) of the Federal-State Extended Unemployment Compensation Act of 1970).

"(3) (A) For purposes of subsection (b) (2) (A), in the case of any State, an emergency extended benefit period.

"(i) shall begin with the third week after a week for which there is a State "on" indicator; and

"(ii) shall end with the third week after the first week for which there is a State "off" indicator.

"(B) (i) For purposes of subparagraph (A), there is a State "on" indicator for a week if the rate of unemployment (including both insured and uninsured unemployment) in the State (as determined by data published monthly by the Bureau of Labor Statistics of the Department of Labor) for the period consisting of such week and the immediately preceding 12 weeks equaled or exceeded 7.5 per centum, and if there is a State or National "on" indicator for such week (as determined under subsections (d) and (e) of section 203 of the Federal-State Extended Unemployment Compensation Act of 1970).

"(ii) For purposes of subparagraph (A), there is a State "off" indicator for a week if, for the period consisting of such week and the immediately preceding 12 weeks, the rate of unemployment (including both insured and uninsured unemployment) in the State (as determined by data published monthly by the Bureau of Labor Statistics of the Department of Labor) is less than 7.5 per centum.

"(d) For purposes of any agreement under this Act—

"(1) the amount of the emergency compensation which shall be payable to any individual for any week of total unemployment shall be equal to the amount of the regular compensation (including dependents' allowances) which would have been payable to him under the State law if he had not exhausted his rights to regular compensation under such law; and

"(2) the terms and conditions of the State law which apply to claims for regular compensation and to the payment thereof shall (except where inconsistent with the provisions of this Act or regulations of the Secretary promulgated to carry out this Act) apply to claims for emergency compensation and the payment thereof.

"(e) Payments of emergency compensation under an agreement entered into under this Act may not be paid to any individual for more than 26 weeks.

"(f) No emergency compensation shall be payable to any individual under an agreement entered into under this Act for any week prior to the week after the week such agreement is entered into, or if later, the week after the week in which such agreement becomes effective.

"PAYMENTS TO STATES HAVING AGREEMENTS UNDER THIS ACT

"SEC. 3. (a) (1) There shall be paid to each State which has entered into an agreement under this Act an amount equal to—

"(A) 100 per centum of the emergency compensation paid prior to July 1, 1973, to individuals by the State pursuant to such agreement; and

"(B) 80 per centum of the emergency compensation paid after June 30, 1973, to individuals by the State pursuant to such agreement.

"(b) No payment shall be made to any State under this section in respect of compensation for which the State is entitled to reimbursement under the provisions of any Federal law other than this Act.

"(c) Sums payable to any State by reason of such State having an agreement under this Act shall be payable, either in advance or by way of reimbursement (as may be determined by the Secretary), in such amounts as the Secretary estimates the State will be entitled to receive under this Act for each calendar month, reduced or increased, as the case may be, by any amount by which the Secretary finds that his estimates for any prior calendar month were greater or less than the amounts which should have been paid to the State. Such estimates may be made on the basis of such statistical, sampling, or other method as may be agreed upon by the Secretary and the State agency of the State involved.

"FINANCING PROVISIONS

"SEC. 4. (a) Funds in the extended unemployment compensation account (as established by section 905 of the Social Security Act) of the Unemployment Trust Fund shall be used by the Secretary for the making of payments to States having agreements entered into under this Act.

"(b) Section 3301 of the Internal Revenue Code of 1954 is amended—

"(1) by inserting '(except as otherwise provided in the succeeding sentence)' immediately after 'equal'; and

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"(2) by adding at the end thereof the following new sentence: 'In applying the preceding sentence for the calendar year 1972 and the calendar year 1973, the rate of tax shall, in lieu of 3.2 percent, be 3.25 percent.'

"(c) The first sentence of section 905(b)(1) of the Social Security Act is amended by striking out 'and in the case of any month after March 1972, to one-tenth,' and inserting in lieu thereof 'in the case of any month after March 1972 and before April 1974, to three-twentieths, and in the case of any month after March 1974, to one-tenth,'.

"DEFINITIONS

"SEC. 5. FOR PURPOSES OF THIS ACT—

"(a) The terms 'compensation', 'regular compensation', 'extended compensation', 'base period', 'benefit year', 'State', 'State agency', 'State law', and 'week' shall have the meanings assigned to them under section 205 of the Federal-State Extended Unemployment Compensation Act of 1970;

"(b) the term 'period of eligibility' means, in the case of any individual, the weeks in his benefit year which begin in an extended benefit period or an emergency extended benefit period and, if his benefit year ends within such extended benefit period, any weeks thereafter which begin in such extended benefit period or in such emergency extended benefit period; and

"(c) the term 'extended benefit period' shall have the meaning assigned to such term under section 203 of the Federal-State Extended Unemployment Compensation Act of 1970.

"PURPOSE

"This bill assists States having an unemployment rate of 7.5 per centum or more to provide up to 26 weeks of emergency compensation to unemployed workers who have exhausted their entitlement to both regular unemployment compensation and extended unemployment compensation.

"SECTION-BY-SECTION ANALYSIS

"Section 1. Short title.

"Section 2. Federal-State Agreements.

"All states that have enacted an extended compensation law pursuant to the Federal-State Extended Unemployment Compensation are eligible for this emergency measure. Individuals are eligible who have exhausted, under State law, both regular and extended unemployment compensation benefits. The emergency extended benefit period shall begin with the third week after a week for which there is a State "on" indicator (an unemployment rate of 7.5 per centum or above); and shall end with the third week after the first week for which there is a State "off" indicator (an unemployment rate of below 7.5 per centum).

"The amount of the emergency compensation shall be the same if the individual has not exhausted his rights to regular compensation under State law. Such benefits shall not be paid to any individual for more than 26 weeks.

"Section 3. Payments to States Having Agreements Under This Act:

"The Federal Government shall pay 100 per centum of the emergency compensation paid by the State prior to July 1, 1973 and 80 per centum of the compensation after June 30, 1973. This allows the States a period of time to enact a matching fund of 20 per centum in order to maintain eligibility for this program after June 30, 1973.

"Section 4. Financing Provisions:

"A tax increase of .05 per cent from employers will be levied to finance the "Emergency Unemployment Compensation Act of 1971".

"The existing tax, Section 3301 of the Internal Revenue Code of 1954, is increased from 3.2 per cent to 3.25 per cent.

"Section 5. Definitions.

STATE'S UNEMPLOYMENT HEADED FOR RED

(By Richard W. Larsen)

"The flow of payments to the jobless is shriveling the state's once-ample unemployment-compensation reserve fund. The fund is heading into a deficit next year.

"The fund, paid for by employers, contained about $318 million in early 1970. It was down to about $122 million at the end of last month.

"Carl G. Westine, assistant commissioner of employment security, said the projected payout of jobless benefits will take the fund into the red sometime next year.

"But Westine explained the fund's deficit will not affect continued payment of unemployment checks. Federal loans, interest free, are available when the state fund runs out.

"Westine noted that as employers begin paying a new, higher tax next year the fund is expected to begin rebuilding.

"Now employers in covered industries pay a 1.8 per cent tax on the first $4,200 earned by a worker in the year. That will increase to 3 per cent on the first $4,800 next year and climb to 3 per cent on the first $5,400 in 1973.

"Meanwhile, political sparring continued over one segment of the unemployment-pay program which expires October 2.

"That is the cutoff date for an emergency extended-benefit program approved by the Legislature earlier this year. It provides an added maximum of 13 weeks of unemployment paychecks for most recipients, boosting the total maximum eligibility for any one recipient to 52 weeks.

"The maximum weekly unemployment paycheck now is $75.

"Joe Davis, chief of the United Labor Lobby, and other labor leaders favor a special session of the Legislature to extend that October 2 cutoff date.

"They estimate 20,000 to 25,000 people now receiving unemployment compensation could lose all or part of that up-to-13-weeks benefit because of the October 2 cutoff.

"The State Labor Council convention in Spokane next month is expected to formally announce support for an immediate special session of the Legislature.

"Gov. Dan Evans said a special session was not the answer. He cited the sagging state fund and said any further unemployment-pay assistance program should come from the federal government.

Representative Sid Morrison, Zillah Republican, said today the October 2 cutoff date was considered "a realistic cutoff point."

"Morrison said there was consideration of removing that deadline from the law, but he added. 'The fund in no way could stand a continuing state emergency.'

" 'The state has a beautiful program, perhaps the best in the nation.' Morrison said. But he said it operates on an insurance principle, calculating payments against probable claims. 'We had no way of knowing we were going to face this sort of thing.' he said.

"The state's most recent report indicated that, including persons filing for extended benefits, the number of unemployment-compensation claimants was 102,400.

"The Legislature in January expanded the program.

"But the sagging fund is expected to provide an argument against further expansion.

"Carl Swenson, a businessman member of the Employment Security Advisory Board, said the board has been studying the problem. But he added that people who have been out of a job for a year probably cease to be a responsibility of the employer fund. Other programs with a broader public-fund base are more appropriate to help those people, Swenson said."

Mr. MAGNUSON. Mr. President, I am also extremely pleased that the distinguished chairman of the Senate Finance Committee, Mr. Long, has taken time out of his busy schedule to be here on the Senate floor to express his interest in this measure. Senator Long is chairman of the committee to which this measure will be sent. I am pleased that he could be here to participate in this colloquy. I know that he cannot determine in advance the fate of any measure, but I am confident that the able chairman will see to it that this measure is given very thorough consideration by the Finance Committee.

As chairman of both the Senate Commerce Committee and the Labor, Health, Education, and Welfare, OEO, and Related Agencies Appropriation Subcommittee, I am well aware of the busy schedule that every congressional committee faces. No committee has more significant matters pending before it today than does the Senate Finance Committee. So it is with that in mind that I wish to express my deep appreciation to the Senator from Louisiana.

Mr. JACKSON. Mr. President, my statement is in support of the Emergency Unemployment Compensation Act which my distinguished colleague, Senator Magnuson, and I introduced today.

This bill is both simple and essential. I urge my colleagues to support it and pass it promptly, for it holds out a lifeline to thousands of men and women who have no job, and no hope.

It is hard to find words and statistics that fully describe the human tragedy now prevailing in many parts of this Nation, and my own State of Washington.

The tragedy can perhaps best be measured this way: The director of Seattle's manpower programs has given up trying to find jobs for people who apply. Instead, he and his staff spend their time locating food, housing, clothing, and waivers from utility charges and mortgages for the jobless.

In Seattle, as elsewhere in the country, citizens and their officials have been relegated to a search for basic necessities.

For the real tragedy is that some 60 percent of the people whose unemployment compensation has expired do not qualify for any other form of relief. They are not eligible for welfare; food stamp programs are sharply restricted; savings, friends, relatives—these resources are quickly exhausted.

This situation leads to social despair, family disintegration, mental illness, acts of desperation. It cripples an individual's spirit, and a community's livelihood. It should not be tolerated in America—the richest country in the world.

The Emergency Unemployment Compensation Act is a good bill. It is a meaningful bill. It would provide help immediately to several hundred thousand persons across the country, and to at least 25,000 persons in Washington State, who have already exhausted their regular and extended benefits. It is the most effective way to inject some money, some basic necessities of life, and some sense of confidence into these families and their communities.

Unemployment compensation is a tried and proven form of Federal aid. Unfortunately, in this recession, it is becoming a way of life for some rather than a temporary adjustment between jobs.

Unemployment compensation is already too big a business. In Washington State it became the biggest "employer" in the State somehow last year. Tens of thousands of people in my own State and elsewhere have used their basic 39 weeks of relief, plus an additional 12 weeks. In the first 4 months of 1971 nearly half a million Americans exhausted their regular benefits. Some have been on unemployment compensation assistance for a solid year. Now, in growing numbers, their eligibility is expiring. They are losing even this form of help and minimum income.

In my judgment, the Emergency Unemployment Assistance Act is a vital extension of a successful Federal program—that is desperately needed by thousands of American citizens. It is an interim measure. It is no solution—but is a lifeline to those in need.

Congress should pass promptly, and the President should sign quickly, this extension. With it enacted, we should then move to enact an economic disaster relief bill which Senator Magnuson and I have introduced, S. 1779.

We must continue, beyond the emergency unemployment compensation bill, to help the administration understand the true nature of unemployment and economic recession in this country. I fear the administration lacks not only the knowledge to lead, but also the will to take effective action.

This emergency unemployment compensation bill would not be necessary if the administration had learned the lessons of postwar economics. The administration's success at throttling the American economy will only be measured in the despair of thousands of jobless men and women.

The Emergency Unemployment Assistance Act is a key form of assistance to Americans without jobs or income.

Mr. MAGNUSON. Mr. President, will my distinguished colleague yield to me?

Mr. JACKSON. I am happy to yield.

Mr. MAGNUSON. The real tragedy here is that when existing unemployment benefits are exhausted, there is only one place to go and that is on welfare, which is the most degrading thing that can happen to an individual who has skills and wants to work.

The distinguished occupant of the chair, the Senator from California (Mr. Cranston), knows that that applies in his State as well.

Actually, it costs more to keep a person on welfare—and no one knows that better than I do, after chairing the welfare portion of the fiscal year 1972 budget hearings. It is much less expensive to extend the unemployment compensation where the individual has the dignity of being under unemployment compensation—at least the individual is not on welfare he has helped pay for unemployment compensation benefits himself.

It costs 50 percent more to put a person on welfare than it does to keep that individual worker on unemployment compensation, with all the tragedy, the degradation and humiliation that goes with being on welfare.

That is why this bill should be passed promptly.

Mr. JACKSON. My colleague has made a very important point. The humiliation that goes with welfare is something that we in America should not countenance for those people who have the ability to make an important contribution at this point in our history. I am referring not just to the unskilled workers. I am referring to the tens of thousands of people with advanced degrees, Ph. D.'s and masters degrees, as well as special degrees in a particular discipline—these workers, together with the blue collar workers, who are highly skilled, whether that work be of a machinist, a toolmaker or a diemaker.

I mention this because we always have a certain percentage of unskilled workers out of work. But the real tragedy goes beyond the unskilled worker because it brings home this new factor of what I like to call, or best describe, as qualitative unemployment.

Never in the history of the country have we had so many people, as a percentage of the total labor force, with such outstanding skills who are unemployed. That is unique in our society, I believe.

It is of special concern in the Northwest, as it is in southern California, as it is in Boston, Mass.—the Route 28, MIT complex area, and as it is in the Cape Kennedy area in Florida. We could go on down the line and list the areas which are in truth, and in fact, not suffering from a recession but are suffering from regional depressions. We have a recession throughout the country, but within that context, we do have regional depressions.

That is what my senior colleague had in mind when he spoke about the deep concern which we have for the people who have no place to go because this recession, that was supposed to come to an end, has not come to an end. It is being extended.

It is about time that we extended the unemployment compensation benefits to cover that period of hardship which these people now suffer.

Mr. MAGNUSON. Mr. President, when we first passed the Unemployed Compensation Act, we used the figure of 39 weeks. Then we extended it. There is no magic in the number of weeks, for no one even thought, then, that it would take over a year for people who wanted to work and had skills to find jobs.

This, tragically, has not been the case and the economic outlook is still very bleak.

There is no reason why we should not extend emergency benefits. When we considered this measure before we did not believe that it would take over a year for a person who had a skill and wanted to work to find employment.

That is not true today. It does not look as though it will be true in the future.

Mr. MAGNUSON. Mr. President, I yield back the remainder of my time.

Mr. JACKSON. Mr. President, I yield the floor.

Mr. LONG. Mr. President, I want to compliment the Senators from Washington (Messrs. Magnuson and Jackson), on their diligence in searching for a solution to the very difficult problem of chronic high unemployment, which they, of course, are not responsible for creating. It is unfortunate that, through no fault of theirs, the State of Washington enjoys the very unenviable distinction of having the highest rate of insured unemployment in any State in the Union. May I say that if the majority of the Senators had voted as the Senator from Louisiana and the two Senators from Washington had voted, this deplorable situation might not have existed.

Last year, the Committee on Finance and the Senate thoroughly reviewed the unemployment insurance system and concluded that it was desirable to set up a program of an additional 3 months of benefits for unemployed persons in times of national or statewide economic recession. The extended benefit program that became law had been recommended by the Johnson administration and the Nixon administration, by business and labor.

As the Senators know, the extended benefit provisions of the 1970 law will not become effective nationally until next January. It seems to me that legislating now to add an additional period of benefits, before last year's provisions become effective nationally, will require the most careful consideration by the Congress and by the executive branch. I want to assure my colleagues that as soon as this proposal is referred to the Committee on Finance, we will seek the views of the appropriate executive agencies on the merits of the bill.

I want to compliment the sponsors of this measure for the fiscal responsibility they have incorporated in it. They have included financing provisions to raise the revenues needed to pay for the additional benefits. I mention this because Senators will recall that earlier this year an amendment was offered on the Senate floor proposing additional Federal expenditures for unemployment insurance while omitting any provision for raising the money to pay these additional costs. Fortunately, that amendment was defeated. So let me again compliment the sponsors of this bill for offering it as a serious legislative proposal, one that is fiscally responsible.

Mr. MAGNUSON. Mr. President, I want publicly to thank the Senator from Louisiana (Mr. Long) for giving us the encouragement that the Finance Committee will take this matter up just as soon as is possible.

ES-213 REPORT CLAIMS AND PAYMENTS ACTIVITIES, STATE UNEMPLOYMENT INSURANCE, NUMBER OF FINAL PAYMENTS FOR ALL UNEMPLOYMENT

[Period ending June 1971]

	Cumulative to date			12-month cumulative		
	Calendar year			Fiscal year		
	Current, 1971	Year ago, 1970	Percent change year ago	Current, 1971	Year ago, 1970	Percent change year ago
Alabama	12,599	8,110	55.4	23,421	14,283	64.0
Alaska	2,595	1,457	78.1	4,063	2,258	79.9
Arizona	5,551	2,304	100.0	9,351	3,975	100.0
Arkansas	8,525	6,067	40.5	14,734	9,467	55.6
California	195,103	105,715	84.6	326,773	173,794	88.0
Colorado	2,762	1,802	53.3	4,805	2,782	72.7
Connecticut	22,639	10,750	100.0	[1] 39,622	18,614	100.0
Delaware	2,409	1,383	74.2	3,918	2,293	70.9
District of Columbia	2,801	1,663	68.4	5,061	2,991	69.2
Florida	18,774	10,107	85.8	38,670	22,925	68.7
Georgia	15,123	8,668	74.5	27,619	14,972	84.5
Hawaii	3,671	1,496	100.0	6,056	2,688	100.0
Idaho	3,564	3,193	11.6	5,575	4,457	25.1
Illinois	49,898	26,167	90.7	84,762	42,921	97.5
Indiana	29,523	17,327	70.4	48,055	25,469	88.7
Iowa	10,933	6,573	66.3	17,613	9,819	79.4
Kansas	11,093	4,974	100.0	20,367	8,162	100.0
Kentucky	9,576	7,723	24.0	16,705	12,411	34.6
Louisiana	16,635	13,853	20.1	32,059	24,284	32.0
Maine	8,763	4,713	85.9	13,479	7,393	82.3
Maryland	11,311	5,550	100.0	19,599	9,414	100.0
Massachusetts	45,781	18,852	100.0	76,173	35,094	100.0
Michigan	64,303	35,272	82.3	105,046	52,343	100.0
Minnesota	23,777	11,221	100.0	35,836	15,092	100.0
Mississippi	4,856	3,539	37.2	8,509	5,790	47.0
Missouri	20,013	11,317	76.8	33,580	17,501	91.9
Montana	3,055	2,530	20.8	5,015	3,755	33.5
Nebraska	4,418	2,435	81.4	6,991	3,617	93.3
Nevada	4,138	2,378	74.0	6,935	3,808	82.1
New Hampshire	1,162	125	100.0	1,665	158	100.0
New Jersey	23,129	32,377	−28.6	[1]53,346	57,834	−7.8
New Mexico	2,807	1,628	72.4	5,295	2,772	91.0
New York	96,334	43,857	100.0	163,805	80,852	100.0
North Carolina	12,186	7,923	53.8	21,422	12,709	68.6
North Dakota	1,191	795	49.8	1,608	1,075	49.6
Ohio	33,248	11,788	100.0	53,231	18,094	100.0
Oklahoma	10,626	5,039	100.0	18,173	8,893	100.0
Oregon	12,167	7,114	71.0	21,866	10,703	100.0
Pennsylvania	38,135	16,426	100.0	64,316	29,449	100.0
Rhode Island	10,099	4,831	100.0	16,921	8,457	100.0
South Carolina	10,486	6,659	57.5	17,736	11,616	52.7
South Dakota	1,189	901	32.0	1,894	1,246	52.0
Tennessee	20,232	12,318	64.2	35,320	21,173	66.8
Texas	30,641	14,931	100.0	51,540	24,346	100.0
Utah	4,274	3,457	23.6	7,024	5,432	29.3
Vermont	2,217	598	100.0	3,384	1,096	100.0
Virginia	6,700	4,567	46.7	11,184	7,034	59.0
Washington	54,294	14,359	100.0	99,564	16,413	100.0
West Virginia	3,516	2,862	22.9	7,035	5,208	35.1
Wisconsin	16,638	9,008	84.7	25,444	12,876	97.6
Wyoming	648	460	40.9	916	686	33.3
Puerto Rico	20,616	21,528	−4.2	38,272	39,849	−4.0
Do	5,862	5,570	5.2	22,979	23,868	−3.7
Do	26,478	27,098	−2.3	61,251	63,717	−3.9
Virgin Islands	0	0	0	0	0	0
U.S. total [2]	1,026,724	560,690	83.1	[1] 1,761,353	930,323	89.3
U.S. total [2]	1,032,586	566,260	82.4	[1] 1,784,332	954,191	87.0

[1] Excl. Apr.-June Conb. May-June N.J.

[2] The 1st PU under regular State program excluding data for sugar cane workers; 2d totals sugar cane workers only.

Note: Preliminary total 1,797,061.

The CHAIRMAN. Rather than call on Senators in their turn, in view of the fact that we are trying to hear 15 prominent witnesses today, I would urge Senators to withhold questions if they can, and, if it is not possible, to submit their questions for the record if they can do it that way. I am not going to call on Senators in turn but if they want to ask a question let me know and I will recognize you.

The next witness is Hon. Alan Cranston, U.S. Senator from California.

We are very happy to have you today.

STATEMENT OF HON. ALAN CRANSTON, A U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator CRANSTON. Thank you, Mr. Chairman and members of the committee. I appreciate the chance to be with you. I will be quite brief.

I would first very strongly endorse the suggestions Senator Magnuson just made for extending emergency unemployment compensation to States where they have a 7.5 employment rate. I think it is very important to do that.

I would like to suggest one modification that the aid be extended to standard metropolitan statistical areas with the 7.5 rate of unemployment. Much of the worst unemployment exists in cities with a high unemployment rate which will be lost in the State's statistics. These cities, therefore, cannot get the help they need. I think this would be a very helpful revision.

I would like to call your attention also to a proposal for an employment tax credit which was developed by two economists at the University of California. I placed the text of their proposal in the Congressional Record on October 5, 1971, page S15829.

Without making any statement on the merits of their proposal, I think it deserves the attention of the committee to take a look at it.

The point I wanted to make today is in regard to an amendment that I will introduce today to the Revenue Act of 1971 that would suspend the automobile excise tax for 1 year instead of repealing it outright as proposed by President Nixon. At the same time I will introduce a second piece of legislation that would create a Federal trust fund for mass transportation similar to the one that has been used to finance the Nation's highway system.

The primary revenue source for the rapid transit fund would be the 7-percent excise tax on new cars which the President wants lifted to stimulate late 1972 model sales. The excise tax produced $2.2 billion in revenues in 1970. This trust fund, which would take effect on January 1, 1973, would more than double the amount of Federal money available for urban mass transit in fiscal 1974 and 1975. It would also require substantially less local matching funds than the present program. If instituted, the trust would create upward of 140,000 new jobs.

The President's proposed repeal of the excise tax is a deplorable step that will worsen traffic congestion and air pollution in our cities. At a time when our cities are pleading for Federal help, the administration is proposing a multibillion-dollar Federal tax loss that will make things tougher for people living and working in our metropolitan areas.

Income from the excise tax should go instead into a form of relevant revenue sharing that will help our cities meet their high priority mass transit needs. Under normal circumstance, I would not advocate even a 1-year suspension of the tax. But the President has, in effect, boxed us in. Some 8 million people may well think that he guaranteed them that they will get $200 off their 1972 cars retroactive to August 15. Many families are counting on that guarantee; the automobile industry has based sales campaigns on it. Congress cannot reverse history at this late date, I fear. All we can do is to try to set things aright for the future.

The President declared in a nationwide radio and television speech on August 15 in which he announced his new economic program:

> I will propose to repeal the 7 percent excise tax on automobiles, effective today. This will mean a reduction in price of about $200 per car. I shall insist that the American auto industry pass this tax reduction on to the nearly 8 million customers who are buying automobiles this year.

Two other bills have been introduced in the Senate calling for creation of a general trust fund for all forms of transportation, one by Senator Edward M. Kennedy and another by Senator Charles H. Percy.

Representative Edward Koch has introduced a similar proposal in the House. The excise tax is proposed as a source of revenue in each of these bills. The Senate Commerce Committee already has begun hearings on the Kennedy and Percy bills. Precipitous White House action should not be permitted to cut short congressional consideration of these proposals.

The mass transit trust fund proposal I am introducing today was originally introduced by Representative Koch in 1969.

Only $2.31 billion at the very most will be available for mass transit the next 3 fiscal years—1973–75—under the administration's plan of financing through general appropriations. In contrast, reinstituting the excise tax and earmarking the income for mass transit could mean $4.4 billion for fiscal 1974 and 1975 at the present level of revenue.

The automobile is the Nation's No. 1 polluter. Even if new cars are less polluting than old ones, the increase in numbers will more than offset the difference. While the Federal Government pours $5 billion a year into highways, our cities are being starved for mass transit funds.

Although the President recognized that even a minimal mass transit program would require a Federal commitment of at least $10 billion over a 12-year period, the President asked for and Congress approved a total authorization of only $3.1 billion, spread over 5 years beginning in fiscal 1971.

The inadequacy of this merger funding is underlined by the fact that the Urban Mass Transit Administration of the Department of Transportation itself estimates that mass transit plans already on the drawing boards will call for the Federal expenditure of 10 times that amount—$32.8 billion, in 1969 dollars, over the next 10 years. Clearly, neither property taxes, the most unfair tax of all, I think, nor fares can meet the monumental cost of modern rapid transit.

The administration estimates that with the stimulus of a tax cut, Detroit could increase its projected sales of 1972 cars by 600,000, for total annual sales of 8.6 million new automobiles. Since American motorists junk about 6.5 million old cars annually, the result will be a net increase of more than 2 million cars on the road.

More than 101 million new and used cars already are clogging up America's highways, 12.4 million of them in California alone. California normally accounts for 12 percent of all new cars sales. What are we going to do with 2 million more?

One-fourth of the Nation's population, which includes many elderly, young, handicapped, and poor people, do not drive cars and must depend entirely on the availability of buses, trains, and subways. But they aren't the only ones who need better mass transit systems. Inexpensive and convenient rapid transit service is essential if innercity residents are to get jobs, especially now that more and more companies are moving to the suburbs. By the same token, suburbanites also are looking for more sensible alternatives to fighting traffic jams twice a day, 5 days a week, to get to their jobs in the city.

Those who keep on driving to work for one reason or the other would benefit from the excise tax for mass transportation for it would surely lead to less congestion in the rush hours.

Only the financial stability of regular revenue income which a trust fund provides will enable our cities to conduct the long-range planning and construction that mass transit systems necessitate. A trust fund assured this Nation it would have the ability to build the highways the people wanted; we have no similar assurance that we can now build the mass transit system the people need.

More than 41,000 miles of Federal highways have been constructed since the trust fund was created in 1956. Some $5 billion is deposited into the fund annually, mainly through the 4 cents a gallon Federal tax on motor fuel.

The revenue from the automobile excise tax should go into the mass transit trust fund, but the fund should not be limited to that single source. Congress would appropriate additional money to the fund to meet rising city needs. The mass transit matching formula would be the same as for highway funds: 90 percent Federal to 10 percent local. The present administrative ratio for mass transit grants is 67 percent Federal to 33 percent local money.

I thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator HANSEN. Mr. Chairman, I do have a couple of questions if the Senator would be kind enough.

Senator Cranston, were you in here when the senior Senator from Washington, Mr. Magnuson, testified?

Senator CRANSTON. Yes, during the latter part of his testimony.

Senator HANSEN. Do you support his proposal?

Senator CRANSTON. I support his proposal for the extension of unemployment compensation for jobless workers in the seven-State area, plus, I suggest we extend unemployment compensation to cities with a 7.5 ratio—because some of those cities that need help would be lost in the State averages and not get help.

Senator HANSEN. Did the unemployment in Washington result, in your opinion, primarily from the depression in the aircraft industry?

Senator CRANSTON. That would be one of the major factors.

Of course, we have had a recession generally that has caused unemployment everywhere.

Senator HANSEN. I happen to be one who voted against the SST. I was wondering how——

Senator CRANSTON. I voted against it also.

Senator HANSEN. Thank you, Mr. Chairman.

I do believe you made a powerful case for assistance to mass transit. I must tell you I have a reservation about using the automobile excise tax as a means of financing it. My understanding is that by taking the excise tax off, it would amount to roughly $200 per automobile, and that one very major effect of this would be to enable our own domestic producers to better meet the competition from imported automobiles; and I understand your State has an awful lot of them.

Senator CRANSTON. Yes, we have.

Senator HANSEN. Have you thought about that competitive situation which this should greatly improve?

Senator CRANSTON. I have thought about that, but I think that we have an incredibly great need to develop rapid transit. We need to relieve congestion on our highways for those who drive and provide decent transportation for those who don't drive. I think that point puts the balance in favor of what I am suggesting here.

Senator HANSEN. Well, if you can get this money out of the general fund of the Treasury, wouldn't that be better than to——

Senator CRANSTON. I beg your pardon?

Senator HANSEN. If you could get this money out of the general fund of the Treasury, wouldn't that be a better approach than to diminish the competitive position of our own domestic manufacturers?

Senator CRANSTON. Actually, I question whether we get that advantage against foreign competitors because I believe the excise tax applies to imported cars also.

Senator HANSEN. My understanding is it doesn't.

Senator CRANSTON. Well, I guess that would depend on how this committee writes it. My understanding was that the proposal would apply to all new cars regardless of where they are produced. I don't think we are going to get the money for rapid transit unless we come up with an assured formula such as the one I am suggesting, and I think the car drivers would benefit by the lesser congestion that will come if we do have an assured form of revenue that will guarantee we start producing rapid transit.

Senator HANSEN. I take it you would not want to detract from our competitive position from imported automobiles?

Senator CRANSTON. No, I do not wish to do that. I am not at all convinced that price is the entire reason for the very stiff competition. I think there are other factors at work.

Senator HANSEN. Thank you.

The CHAIRMAN. Thank you very much, Senator.

Senator CRANSTON. Thank you very much.

The CHAIRMAN. The next witness is Mr. Melvin C. Holm, chairman of the National Association of Manufacturers. He will be accompanied by Edward A. Sprague, vice president-Government Finance.

STATEMENT OF MELVIN C. HOLM, DIRECTOR, BOARD OF DIRECTORS, NATIONAL ASSOCIATION OF MANUFACTURERS; ACCOMPANIED BY EDWARD A. SPRAGUE, VICE PRESIDENT—GOVERNMENT FINANCE, NAM

Mr. HOLM. Thank you, Mr. Chairman. I apparently have been given an undeserved promotion. I am not chairman of the National Association of Manufacturers, although it so indicates on the list.

The CHAIRMAN. Would you mind getting me straight. That memo says you are chairman.

Mr. HOLM. I am chairman of the board of Carrier Corp., and a director of the National Association of Manufacturers. Mr. Dwyer, who is chairman, might be upset if I usurped his position this morning. I do appear here on behalf of the National Association of Manufacturers as a members of its board of directors and chairman of its taxation committee.

I am accompanied by Mr. Edward A. Sprague, vice president, Government Finance, of the NAM.

The association is a voluntary association of industrial business firms, large and small, with members located in every state and representing the major part of the manufacturing output of this country.

Because of our common interest, a number of organizations which are listed in my full statement—incidentally, my remarks will be brief as we have filed a full statement—a number of our organizations which are listed in my full statement has asked to be associated with it.

We support most of the major provisions of H.R. 10947, including the job development investment credit legislation of major elements of the ADR system, the repeal of the 7-percent auto excise tax and individual income tax deductions.

As to the modification of the DISC proposals, I will have more to say about that later.

We have detailed comments on some of these provisions in our statement for the record. But I would like to cover two aspects of the investment situation which we feel were not developed sufficiently in previous hearings and public consideration of the tax program.

They are: (1) The need for a longer term focus and (2) the interdependency of the investment credit and the Asset Depreciation Range or ADR system.

First, with respect to the longer term focus, in evaluating both the proposed job development credit and ADR, we feel that too much attention has been paid to strictly short-term implications. Detailed comparisons have been made with the mid-1962 period as to how many months it took for the effect of the original 7-percent credit to show up in machinery and equipment orders, as to the curve of the monthly unemployment rate, the wiggles of the capacity utilization rate, at cetera. In our view, this concentration on the short term needlessly complicates policy formulation.

In part, of course, these complications stem directly from the administration's own proposal to split the rate of the investment credit, 10-percent short-term and 5-percent permanent. The provision in H.R. 10947 for a flat 7-percent rate now facilitates a better perspective over the longer term. In view of both the investment credit's past history and capital formation requirements over the future, this is exactly what is needed, in our opinion.

Now, I would like to turn to investment credit and ADR.

We do not believe that the ADR system should be considered as a tradeoff for the investment credit, that if one is adopted the other should be dropped or drastically curtailed. This would be completely counterproductive of the intent to reduce the tax bias against capital formation. As over a period of years the tax relief value of the ADR system, as adopted by final regulations last June, is approximately the same as the 7-percent credit, it makes no sense to take away with one move what is provided by another one.

H.R. 10947, in fact, would eliminate a significant portion of the ADR system which is the liberalization of the first-year convention.

Fortunately, the House bill has preserved what we consider the most important elements of ADR : the 20-percent range within the new class life system and repeal of the reserve ratio test. In addition to the stimulative effect on investment, this will help avoid many time-consuming audit problems and disputes between taxpayers and the Internal Revenue Service. In addition, congressional action on the issue will serve to dispel uncertainties as to the legal status of ADR and business' ability to utilize the system.

We respectfully and strongly urge your committee to restore the liberalization of the first year convention to the ADR system so that the economy may obtain the full benefits of a modernized cost-recovery system. But in any even the proposed new credit should be considered a natural complement to, and definitely not a substitute for, the ADR system.

Our industrialized foreign competitors now employ very modern and productive plant and equipment facilities, encouraged by generous tax treatment, far more generous than ours in some cases. This was well documented in the "Report of the President's Task Force on Business Taxation" as well as in other independent studies.

Although this is one of the dominant factors in our international trade position today, it has been virtually ignored in the formulation of tax policy until this year. It is noteworthy from the ADR system, as now in effect, and a permanent 7-percent investment credit, with the two of them together, our cost recovery position would be just about even with the average of 11 leading industrialized foreign competitors. Without the first-year convention liberalization, it would be somewhat less favorable.

Now, I would like to turn to DISC, if I may.

The NAM and other business associations have supported the DISC tax regime proposal since it was unveiled in early 1970. As our trade balance has completely deteriorated since then, there is all the more reason for implementing it as a means to encourage U.S. exports and combat the tax advantages our foreign competitors now enjoy.

Previously, on behalf of the NAM, we have submitted material on DISC to your Subcommittee on International Trade. We take note of some criticism of the DISC proposal and estimates of revenue losses from it as high as $1 billion annually. We feel the Treasury Department has presented ample material to refute this claim and we strongly concur with its judgment that there would be a substantial increase in exports due to DISC of $1.5 to $2.5 billion per year.

Unfortunately, by restricting the tax deferral benefits of DISC to export income increments on the 1968–1970 base, the House has, in effect, gutted the measure. The incremental provision raises questions of equity of tax treatment with respect to those firms who have been making substantial export efforts over the years and certainly would greatly diminish the effectiveness of the proposal. We recognize there would be some marginal benefit in export stimulation, particularly for firms developing export markets or engaging in export business for the first time, under the House bill, but strongly urge elimination of the incremental limitation and restoration of the original provisions. Mr. Chairman, that is the end of my remarks. I will be glad to answer any questions if I can, sir.

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

Senator RIBICOFF. I am just curious, sir. Do you have plants overseas?

Mr. HOLM. Yes, we do. Yes, Mr. Senator. You are talking about the company with which I am associated?

Senator RIBICOFF. Yes; and many of your manufacturers who are members of the association are part of a multinational complex with factories in various countries?

Mr. HOLM. That is correct.

Senator RIBICOFF. DISC, of course, would help local manufacturers, American manufacturers who export; is that correct?

Mr. HOLM. That is correct.

Senator RIBICOFF. What do you do about the American manufacturer who has a plant in the United States, plants in different places in the world? Who moves the production of his American plant to one of his European or Asian plants and then sends the merchandise that he manufacturers back to the United States? How do we stop that?

Mr. HOLM. Well, first, because you started off by asking a question with respect to my company, we do not practice that procedure.

Senator RIBICOFF. I know. I am talking generally. First, I want to get the background whether you have plants abroad?

Mr. HOLM. Yes.

Well, I think how do we stop bringing products back to this country——

Senator RIBICOFF. How do we discourage it? Do we tax those manufacturers as their income is earned abroad before it is repatriated and brought back here? How do we discourage a manufacturer from doing that?

Mr. HOLM. I really cannot answer your question, Senator. I would think that most, if not all American manufacturers have as their first objective and their first desire—that is the case on our part, certainly—are exports from this country; and we need every tool and aid we can to promote and increase exports from this country, to provide jobs in this country. There are some companies obviously, in order to be able to compete in this country either with other American manufacturers or with foreign manufacturers, who have to make parts and bring them back and assemble the products here. I don't know how you "discourage that practice."

Senator RIBICOFF. I am just curious. Personally, I am going to support most of the proposals that you suggest, but I would like a proposal from the manufacturers' association that you represent as to how we should treat the American manufacturer who moves his plant to a foreign country and then places many Americans out of work and then exports the same goods back to the United States. You must have—your organization must have some ideas on it.

Mr. HOLM. Do you want to comment, Ed?

Mr. SPRAGUE. Senator, I might just mention the extent to which this is a common practice. There is some question. I notice there has been some comment that it is widespread; but just the figures we see from the Commerce Department as to sales of U.S. affiliates that are directed back to this country have been fairly small.

Now, the figures, most recent figures, I think, are 1968, so there was some lapse.

Senator RIBICOFF. You see, it may be small in the country at large but it may be a fantastic blow to the community that is on the receiving end of the situation.

Mr. SPRAGUE. That is possible.

Senator RIBICOFF. I have a question like that in Hartford, Conn., where a 65-year-old manufacturing company called the Royal Typewriter Co. was taken over by Litton Industries and now they are talking about taking that plant and moving it to Hull, England, and placing 1,900 blue-collar workers and some 800 white-collar workers out of a job.

Now, I know Royal intended to sell their typewriters in the United States.

How do we discourage Litton Industries from moving the Royal Typewriter Co. to England and sending those typewriters back to the United States?

Mr. HOLM. Perhaps another way to put your question, Senator, is, how do we encourage them not to do it?

Senator RIBICOFF. No, I am willing to do that; but I want the stick as well as the carrot.

Mr. HOLM. Yes.

Senator RIBICOFF. I think what you are driving at here and what the President proposes is sound and it will have my support; but how about the opposite? I think during the hearings questions like this have been raised by the Senator from Arizona, the Senator from Wyoming. They have raised that question, and I think it is becoming a major concern.

Mr. HOLM. Well, I am sorry, Senator; I am not able to give you a more specific answer.

Senator RIBICOFF. Mr. Chairman, I would like to have some suggestions on that from the Manufacturers Association.

Mr. HOLM. Thank you.

The CHAIRMAN. Thank you very much, sir.

Mr. HOLM. And thank you very much.

(Mr. Holm's prepared statement and a further response to Senator Ribicoff follows:)

PREPARED STATEMENT OF MELVIN C. HOLM REPRESENTING THE NATIONAL ASSOCIATION OF MANUFACTURERS—ASSOCIATION OF COMMERCE AND INDUSTRY OF NEW MEXICO, CONNECTICUT BUSINESS AND INDUSTRY ASSOCIATION, ILLINOIS MANUFACTURERS' ASSOCIATION, MANUFACTURERS ASSN. OF BERKS COUNTY, PA., MANUFACTURERS ASSN. OF THE CITY OF BRIDGEPORT, CONN., THE NATIONAL ASSOCIATION OF HOSIERY MANUFACTURERS, NATIONAL ELECTRICAL MANUFACTURERS ASSOCIATION, NATIONAL KNITWEAR MANUFACTURERS ASSOCIATION, NAUGATUCK VALLEY INDUSTRIAL COUNCIL, AND STEEL PLATE FABRICATORS ASSOCIATION

SUMMARY

1. The business community strongly supports H.R. 10947. The major provisions of this bill will act to revitalize the economy by reducing the *adverse effect of both past inflation and the bias in the tax structure against capital formation and productive investment.*

2. The proper focus for considering and evaluating the likely effect of the job development tax credit on investment and employment is not the next two or three quarters, but the next five years. Comparisons of experience with the previous 7 percent credit should be drawn for the 1962–1968 period as a whole.

3. Greatly intensified foreign competition is the dominant factor in necessitating better domestic productivity performance. To modernize our cost recovery system for productive investment *both the investment credit and the ADR system* are required. The Senate Finance Committee is urged to restore the liberalization of the first year convention to the ADR system.

4. Stiffening and very expensive standards for air and water pollution control, which divert funds from other investments providing a financial return, heighten the need for a modernized cost recovery system. The Senate Finance Committee should provide that both the 7 percent investment credit and the five-year amortization under the 1969 Act should be allowed on qualified pollution control facilities.

5. The DISC proposal, gutted in the House bill, should be made whole to provide an effective stimulus for U.S. exports.

Mr. Chairman and members of the Senate Finance Committee: My name is Melvin C. Holm, and I am Chairman of the Board of Carrier Corporation of Syracuse, New York.

I appear here on behalf of the National Association of Manufacturers as a member of its Board of Directors and Chairman of its Taxation Committee. I am accompanied by Edward A. Sprague, Vice President—Government Finance of the NAM. The Association is a voluntary organziation of industrial and business firms, large and small, with members located in every state and representing the major part of the manufacturing output in the country.

Because of our common interest, the following organizations, all affiliated with the National Industrial Council, have asked to be associated with the statement I am presenting: Association of Commerce and Industry of New Mexico; Connecticut Business and Industry Association; Illinois Manufacturers' Association; Manufacturers Association of Berks County, Pennsylvania; Manufacturers Association of the City of Bridgeport, Connecticut; The National Association of Hosiery Manufacturers; National Electrical Manufacturers Association; National Knitwear Manufacturers Association; Naugatuck Valley Industrial Council; and the Steel Plate Fabricators Association.

We support H.R. 10947, the Revenue Act of 1971, which we believe will help revitalize the economy, not by tomorrow, but over a reasonable period of time during which its investment incentives can be expected to work. We support all the major provisions of H.R. 10947 including the job development investment credit, "legislation" of major elements of the ADR system, the repeal of the 7 percent auto excise tax, the individual income tax reductions, and what is left of the DISC proposal.

We have detailed comments on some of these provisions, but I would like to cover first three aspects of the investment situation which we feel were not developed sufficiently in previous hearings and public consideration of the tax program. These are:

(1) The extent of inflation's impact on the investment sector.

(2) The need for a longer-term focus.

(3) The interdependency of the investment credit and the Asset Depreciation Range (ADR) system.

INFLATION AND INVESTMENT

Much material has been put into the record concerning the depressed state of corporate profits—both the level and in relation to other economic indicators such as my personal income, wage and salary payments, etc. Our own testimony before the House Committee on Ways and Means and the Joint Economic Committee dealt in some detail on the profit impairment over the last five years, and I see no reason to repeat it here.

However, more than a few opponents of the tax program have down-played the importance of the profits trend claiming that since corporate depreciation allowances are large and rising, sufficient investment would be financed anyway, without regard to profitability. The question is important because in fact cash flow of corporate enterprise—retained earnings and depreciation allowances—is the direct source for approximately two-thirds of its funds available for capital and other investments.

It's true that capital consumption allowances have been steadily increasing and comprise an increasing share of the funds available for capital investment. But while it is seldom measured, the impact of inflation since the mid-1960's has had a particularly devastating effect on the corporate sector. Table I attached to this statement shows total cash flow of the corporate sector, that is, depreciaion and retained earnings, *deflated* for the change in prices of fixed investments to which that cash flow is directed. The trend is down sharply, not just over the past recession but since early 1966 when inflation became much more of a problem in general.

No official government publication or statistical source keeps track of inflation's impact on corporations and it tends to be obscured in the welter of statistics and concern over other price measures, particularly the consumer price index. But the message is clear. *Under-depreciation from inflation and profit squeeze have seriously crippled the business sector's ability to finance job-creating productive investment over the last several years.*

This should be a far more important consideration in the formulation of tax policies for overall economic performance than a somewhat artificial dividing up of what sector gets what in the way of tax reductions or adjustments. If such accounting is necessary, however, the Administration has demonstrated convincingly that individuals as taxpayers have "fared" much better than the corporate sector, particularly as a result of the 1969 Tax Reform Act. Furthermore, of course, the House has adjusted the mix of the tax reduction in H.R. 10947 to give further benefits to individuals at the expense of part of the ADR system.

LONGER TERM FOCUS NEEDED

In evaluating both the proposed job development credit and ADR, we feel that too much attention has been paid to strictly short-term implications. Detailed comparisons have been made with the mid-1962 period as to how many months it took for the effect of the original 7 percent credit to show up in machinery and equipment orders, as to the curve of the monthly unemployment rate, the wiggles of the capacity utilization rate, etc. In our view, this concentration on the short-term needlessly complicates policy formulation.

In part, of course, these complications stem directly from the Administration's own proposal to split the rate of the investment credit, 10 percent short-term and 5 percent permanent. The provision in H.R. 10947 for a flat 7 percent rate now facilitates a better perspective over the longer-term. In view of both the investment credit's past history and capital formation requirements over the future, this is exactly what is needed.

Essentially, the 7 percent investment credit is a reduction of the existing income tax structure's bias against capital formation and investment in producers durables. *Much the same result could obtain by reducing the corporate income tax rate, and in that form relief would be more diffused throughout the economy.* However, IRS data indicate that the impact of the previous 7 percent credit was widespread throughout the economy and by no means limited to capital-intensive industries.

As numerous people knowledgeable in corporate capital planning have indicated, the credit by itself will not cause new investment in anything. Its effect is at the margin—to qualify as go-ahead investments those that might not otherwise. As such, it is quite understandable that its impact is gradual—some immediately, but more over time.

Clearly, the previous 7 percent credit was successful in encouraging capital investment, employment and increased productivity over its lifetime in the 1960's. While other factors were involved, it was not just coincidental that from 1962 to 1968 investment in producers durables increased 10½ percent per year, output per manhour in manufacturing industries rose at better than 3 percent per year, and employment in manufacturing went up by 2.8 million. Currently employment in manufacturing is over 1 million *below* its 1968 average. Part of this loss can be attributed directly to the loss of the investment credit and the slackening of capital spending.

Today it takes well over $25,000 in capital investment to create one new industrial job. The total labor force is expected to grow by some 15 million during the 1970's and it will require at least $30 billion annually in new expenditures just to employ this net addition to the work force. A more favorable public policy climate to enable the corporate sector to provide such investment flows is certainly needed now and throughout the 1970's.

INVESTMENT CREDIT AND ADR

There is a tendency in public discussions of the Administration tax program to consider the ADR system as a "trade-off" for the investment credit—and if one is adopted, the other should be dropped or drastically curtailed. This would be completely counterproductive of the intent to reduce the tax bias against capital formation. As over a period of years the tax relief *"value" of the ADR system, as adopted by final regulations last June,* is approximately the same as the 7 percent credit, it makes no sense to take away with one move what is provided by another.

H.R. 10947 in fact would eliminate a significant portion of the ADR system, the liberalization of the first year convention. Fortunately, the House bill has preserved what we consider the most important elements of ADR—the 20 percent range within the new class life system and repeal of the reserve ratio test. In addition to the stimulative effect on investment, this will help avoid many time-consuming audit problems and disputes between taxpayers and the Internal Revenue Service. In addition, Congressional action on the issue will serve to dispel uncertainties as to the legal status of ADR and business' ability to utilize the system.

We strongly urge your Committee to restore the liberalization of the first year convention to the ADR system so that the economy may obtain the full benefits of a modernized cost recovery system. But in any event, the proposed new credit should be considered a natural complement to, and definitely not a substitute for, the ADR system.

Our industrialized foreign competitors now employ very modern and productive plant and equipment facilities, encouraged by generous tax treatment, far more generous than ours in some cases. This was well documented in the *Report of the President's Task Force on Business Taxation* as well as in other independent studies. Although this is one of the dominant factors in our international trade position today, it has been virtually ignored in the formulation of tax policy until this year. It is noteworthy from the ADR system, as now in effect, and a permanent 7 percent investment credit, our cost recovery position would be just about even with the average of eleven leading industrialized foreign competitors. Without the first year convention liberalization, it would be somewhat less favorable.

Another critical reason for an effective cost recovery system was not so evident back in 1962. The rules of the game for controlling air and water pollution have changed drastically over the last ten years. Industry now must spend billions of dollars—an estimated $3.6 billion in 1971 alone—to comply with new air and water quality standards which are getting stiffer all the time. Industry will not shirk its responsibilities to reduce pollution levels but there is no denying that the huge sums required are diverting funds from other investment providing a financial return. It is obviously that much harder to finance new machinery and equipment to increase overall productivity, at the same time meeting these pollution control commitments.

Congress gave some recognition to this problem in the five-year amortization provision for pollution control equipment under the Tax Reform Act of 1969. This is a constructive, albeit limited, measure. Unfortunately Section 104 of H.R. 10947 would deny most of the benefit of the investment credit on otherwise qualified property if the five-year amortization is elected, thus vitiating the 1969 relief provision. The Ways and Means Committee report indicates that the intent of the special amortization provision was to serve as a substitute for the 7 percent credit repealed in 1969 and an "additional" incentive should not be allowed now. We contend that the case for more significant tax relief for pollution control investment is controlling, and strongly recommend that *both* the five-year write-offs and the 7 percent credit be allowed for qualified pollution control facilities.

REPEAL OF THE 7-PERCENT AUTOMOBILE EXCISE TAX

Repealing the auto excise tax will provide over $2 billion of tax relief to consumers in fiscal 1972, and encourage increased production and employment in the automobile industry. In addition to these immediate benefits, it will remove one of the few remaining selective Federal excise taxes—permanently, we now hope. Such excises are inherently discriminatory and inappropriate when designed for general revenue purposes. The proposal to remove the auto excise tax, which was scheduled to be phased out anyway, is consistent with a broadly-based tax structure and fair distribution of tax burdens.

DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

The NAM and other business associations have supported the DISC tax regime proposal since it was unveiled in early 1970. As our trade balance has completely deteriorated since then, there is all the more reason for implementing it as a means to encourage U.S. exports and combat the tax advantages our foreign competitors now enjoy.

Previously, on behalf of the NAM, we have submitted material on DISC to your Subcommittee on International Trade. We take note of some criticism of the DISC proposal and estimates of revenue "losses" from it as high as $1 billion annually. We feel the Treasury Department has presented ample material to refute this claim and we strongly concur with its judgment that there would be a substantial increase in exports due to DISC of $1½ to $2½ billion per year.

Unfortunately, by restricting the tax deferral benefits of DISC to export income increments on the 1968–1970 base, the House has gutted the measure. The incremental provision raises questions of equity of tax treatment with respect to those firms who have been making substantial export efforts over the years and certainly would greatly diminish the effectiveness of the proposal. We recognize there would be some marginal benefit in export stimulation, particularly for firms developing export markets or engaging in export business for the first time, under the House bill, but strongly urge elimination of the incremental limitation and restoration of the original provisions.

OTHER PROVISIONS—JOB DEVELOPMENT INVESTMENT CREDIT RELATIONSHIP TO THE MINIMUM TAX

To implement the full investment incentive effort of the new investment credit, we recommend that the income tax liability used in the minimum tax calculation should be applied before reduction by the credit, and that the minimum tax should be taken into account in applying the 50 percent of tax liability limitation.

Under present law, the taxable base for minimum tax purposes is the sum of the taxpayer's tax preference income over $30,000 reduced by the taxpayer's regular income tax liability remaining after credits. If this same formula is retained with the institution of the new investment credit, the intended benefit will be partially offset by an increase in minimum tax liability. This would occur because in computing the taxpayer's minimum tax base under the formula, the total of tax preference income would only be offset by regular income tax liability after such liability is reduced by the investment credit. The credit should be fully effective without being impaired by the minimum tax and should reduce the total of regular income tax and minimum tax liabilities.

Also, present law excludes the minimum tax from the tax base to which is applied the 50 percent limitation in determining the amount of credit allowed in a year. But precedent for *including* the minimum tax in the tax base can be found in the fact that the recently expired income tax surcharge was allowed as an add-in for the purpose of the limitation.

OTHER SPECIAL AMORTIZATION

Again, with respect to Section 104 of H.R. 10947, the bill denies the investment credit on property for which a special five-year write-off has been elected for railroad rolling stock, low income housing, coal mine safety equipment, job training and day care facilities (a special amortization proposed under the new bill) as well as for pollution control facilities referred to earlier.

We recognize that some additional tax relief may be obtained by having the option of electing a five-year write-off or the credit, depending mostly on the life of the particular asset. However, without attempting to assess the merits of these special write-offs, it still seems somewhat inconsistent to offer such tax relief and then largely cancel it out, particularly when some of these assets were eligible for carryovers of the investment credit repealed in 1969.

TABLE I.—CORPORATE CASH FLOW

[In billions of dollars]

	Current dollars	Deflator[1] 1963-65=100	Constant 1963-65 dollars		Current dollars	Deflator[1] 1963-65=100	Constant 1963-65 dollars
1960	38.2	96.1	39.8	1966	68.6	103.9	66.0
1961	39.7	96.5	41.7	1967	68.3	107.7	63.4
1962	46.1	97.5	47.3	1968	71.0	111.3	63.4
1963	48.3	98.5	49.0	1969	71.3	117.5	60.7
1964	54.5	100.0	54.5	1970	72.4	123.2	58.8
1965	63.1	101.6	62.1				

[1] Index of fixed investment prices.

Source: Department of Commerce, Conference Board.

COST RECOVERY ALLOWANCES FOR MACHINERY AND EQUIPMENT IN LEADING INDUSTRIAL COUNTRIES

	Representative cost recovery period (years)	Aggregate cost recovery allowances (percentage of cost of asset): First taxable year	First 3 taxable years	First 7 taxable years
Belgium	10	20.0	48.8	89.0
Canada	10	20.0	48.8	79.0
France	8	31.3	67.5	94.9
Italy	6	20.0	65.0	100.0
Japan	11	34.5	56.9	81.4
Luxembourg	10	28.0	60.4	101.9
Netherlands	5	10.0	42.4	77.1
Sweden	5	30.0	65.7	100.0
Switzerland	6⅔	15.0	58.4	90.0
United Kingdom[1]	12	57.8	78.1	102.1
Western Germany	9	16.7	49.6	88.8
Average percentage		25.7	58.3	91.3
United States:				
Without ADR or investment credit	13	7.7	33.9	66.1
With ADR only		14.0	44.0	76.0
With investment[2] credit only:				
10 percent		27.7	53.9	86.1
7 percent		21.7	47.9	80.1
5 percent		17.7	43.9	76.1
With ADR and investment credit of:				
10 percent		34.0	64.0	96.0
7 percent		28.0	58.0	90.0
5 percent		24.0	54.0	86.0

[1] Does not reflect changes in United Kingdom as of October, 1970.

[2] Includes 20 percent, 14 percent and 10 percent allowance equivalent to 10 percent, 7 percent and 5 percent investment credits, respectively, at effective 50 percent income tax rate. Credit does not reduce recoverable base cost.

Source: Report of the President's Task Force on business taxation and U.S. Department of Treasury.

NATIONAL ASSOCIATION OF MANUFACTURERS,
October 20, 1971.

Hon. ABRAHAM A. RIBICOFF,
Senate Office Building,
Washington, D.C.

DEAR SENATOR RIBICOFF: At the Senate Finance Committee Hearings on H.R. 10947 last week you asked for our suggestions as to how to deal with the "runaway plant" problem—i.e. the U.S. firm which establishes manufacturing facilities abroad for the specific purpose of importing to U.S. markets formerly supplied by domestic operations. This letter attempts to augment our comments at the time with a more complete statement of views.

We indicated that the incidence of this type of operation, while perhaps increasing, is still quite small. The last available figure on sales of U.S. affiliates abroad to U.S. markets was only about 8%, half of which represented the special case of transportation equipment manufactured in Canada. Also included in these sales would be a significant volume of parts and finished goods which serve only to *complement*, and not to compete with, product lines of domestic manufacture. In many cases these items are imported only because sales volume is too low to justify local production.

We stress the point because we feel that national policies, particularly tax policies, should be formulated on the basis of the overall economic and other conditions. As you know, there has been a tendency in some quarters to call for sweeping "solutions" that would penalize all business with overseas operations.

You asked what could be done for the individual communities, such as Hartford, which may be adversely affected by this type of import competition. As you know, the Administration has asked for a liberalization of adjustment assistance provisions under the Trade Expansion Act, which, by breaking the nexus between assistance and tariff concessions, could be applied to employees displaced by imports regardless of the specific cause of the increase in such imports. These provisions were included in the Trade Act of 1970 which was not enacted.

From our viewpoint the real solution to this problem has several dimensions rather than a single legislative one. Among these dimensions are:

1. Quick enactment of the provisions of H.R. 10947 with its incentives for investment in new productive equipment domestically—and hence its encouragement to U.S. employment across the board—and restoration of the original DISC proposal also to increase domestic employment.

2. Realignment of foreign exchange rates to reflect actual international conditions and eliminate trade advantages enjoyed in particular by Japan. This is now in process.

3. Winding down of our domestic inflation so that we can regain control over our costs of production.

4. Finally, a step-up in domestic productivity, as outlined by the first report of the National Commission on Productivity.

Any progress on these fronts would help improve our trade position and the progress that is reasonable to expect, in combination, should minimize the "runaway plant" problem as well.

We appreciate the opportunity to expand our views on this matter and suggest that this letter be included in the record of the hearings.

Very truly yours,

MELVIN C. HOLM,
Chairman, Taxation Committee.

Senator GRIFFIN. Mr. Chairman, I have asked for the privilege of introducing the next witness because he happens to be a very distinguished citizen from my State. There are those who come before the committees of Congress who need no introduction, and Mr. Arthur Summerfield is one of them. He has been before this committee and other committees in various capacities in the past, most notably as a cabinet member in the Eisenhower Administration. You will recall that then he was Postmaster General Arthur Summerfield.

He is now—and has been for some years—an automobile dealer in Flint, Mich., and has been working for many years to convince Congress that the discriminatory auto excise tax ought to be repealed.

I think he is particularly well qualified, and I am pleased to present him and his son to the committee.

The CHAIRMAN. We will be very pleased to hear from you, Mr. Summerfield.

STATEMENT OF ARTHUR E. SUMMERFIELD, SR., CHAIRMAN OF THE BOARD, SUMMERFIELD CHEVROLET CO., FLINT, MICH., ACCOMPANIED BY ARTHUR E. SUMMERFIELD, JR., PRESIDENT, SUMMERFIELD CHEVROLET CO.

Mr. SUMMERFIELD Sr. Thank you, Mr. Chairman, Senator Griffin and members of the committee.

Mr. Chairman, distinguished members of this committee: My name is Arthur E. Summerfield, Senior, and I have been an automobile and truck dealer for 42 years in the City of Flint, Mich. With me today is my son, Arthur E. Summerfield, Jr., who has been a motor vehicle dealer and my partner for 25 years in Flint, and for the last 11 years in Gary, Ind.

We are here today representing ourselves, our employees—275 men and women—and our customers, to urge the repeal of the 7-percent excise tax on new automobiles and light trucks, as esentially proposed by Senator Robert Griffin of Michigan, and joined by Senator Philip Hart and the entire Michigan delegation and now embodied in the bill before you today, H.R. 10947.

We appeared before the Ways and Means Committee of the House on September 16 in support of the repeal of the excise taxes and are indeed grateful for the opportunity to appear before this committee, and congratulate you, Mr. Chairman, for the dispatch with which you have called these hearings.

The motor vehicle industry has long been a bellweather of the national economy; a drop in vehicle sales generally is the first indication of economic decline, while renewed sales volume usually heralds the beginning of a recovery period.

The importance of the economic activity generated throughout the Nation by the manufacture of motor vehicles cannot be overemphasized. This industry purchases goods and services from some 50,000 supplier firms and is the greatest single consumer of the products of other great industries such as steel, rubber, coal, iron, aluminum, petroleum products, and many others.

It is estimated that more than 13 million persons holding one of every six jobs in the Nation are employed in highway transport industries. Over 800,000 businesses are directly dependent upon motor vehicles for their continued existence.

When S. 2285 was introduced 12 weeks ago, the economic situation facing our Nation gave cause for grave concern. Inflation was gathering momentum at a time of rising unemployment, a balance-of-payments deficit, heavy overseas spending, and wide discounting of our currency. The economy was faltering and consumer confidence was low.

We could ill afford then, nor can we now, to have the motor vehicle industry, a prime creator of jobs and of spendable income, also falter.

Yet on July 7, unsold new 1971 automobiles in dealers' hands—domestic cars only—reached an alltime record high of more than 1,800,000 cars, in a declining market. Many dealers already stretched financially, certainly were in no position to order and arrange payment for additional new cars.

In September, the unsold national inventory was still over 1,600,000 cars, with over 1 million of these 1971 models, not 1972 models. On October 10 it had fallen slightly to approximately 1,500,000 cars, based on preliminary figures.

Sales, however, have picked up somewhat—mainly, we feel, because of the public's expectation that the excise tax will indeed be removed and partially because of the confidence generated by all aspects of the President's economic program.

The domestic vehicle industry was clearly reaching the very limit within which we could even hope to maintain the present levels of production and employment in this country.

Increased competition from abroad, which is still growing, coupled with mounting costs of labor and materials, and mandatory safety and ecology requirements presented and still present an ominous set of circumstances, truly indicating a crisis in the automobile industry and casts serious doubts about the industry's ability to continue without help as an economic nucleus of this Nation. Repeal of the excise tax will partially provide this assistance.

The impact and problems of our present situation are beyond the control of the business community alone.

During the past year sales of cars from abroad rose to 14 percent of total sales in this country—16 percent for the first 6 months of 1971, 18 percent in July, 22 percent in August and are still going up. On a basis of a 10-million-car year, this means a foreign car sales rate of 2 million.

Mr. Henry Ford II has estimated that for every 1 percent increase in foreign car penetration it has meant and still means a loss of 20,000 jobs in this country. To be realistic, without help from you the aggressive distribution plans of foreign car manufacturers could well cause them to dominate the American car market.

Import sales are running 40 percent and higher on the west coast of the United States and the Japanese cars as a group are the No. 1 seller in the Los Angeles area today. Import sales are running 20 percent on the east coast and all foreign companies are now greatly expanding their distribution in the greatest car market of all, the great Middle West of the United States.

As dealers of domestic cars and trucks, we must compete against vehicles built in Japan where labor scales are reported to be one-quarter of the wage scales that exist in this country. We must also compete with vehicles built in West Germany where wages are approximately one-half of the wages paid in this country. And we must remember that today we are faced with new labor contracts with large built-in annual increases plus cost-of-living increases in many basic industries, including the auto industry.

This, of course, results in unequal competition and is reflected in the automotive employment trend in each of these countries. For example, according to the U.S. Department of Labor, direct employment in the manufacturing of motor vehicles in this country declined by 91,000 jobs last year, 1970, but in West Germany jobs in the motor vehicle industry climbed from 560,000 in 1969 to 731,000 in 1970.

Current Japanese employment figures are not available, but it is noted that from 1960 to 1969 the number of jobs in Japan's transportation industry rose from 514,000 to 754,000. We do not think that this Nation and its jobholders can stand to have this exporting of jobs continue.

Fair, spirited competition is always welcome and so is a true reciprocal trade policy, such as envisioned by the late and revered Secretary of State Cordell Hull who first saw the vital necessity for reciprocal world trade.

But we ask you to consider these startling figures that show how one-sided the trade picture really is:

Germany: a 13.2-percent tariff, plus an 11 percent added value tax, plus a so-called road tax that penalizes larger cars. A $3,860 Chevrolet Impala in this country sells for $8.164 over there.

Japan: a 10-percent tariff, plus a commodity tax ranging from 15 percent to 40 percent, depending on size and an annual road tax from $50 to $250 depending on size. A $2,200 Chevrolet Vega here would sell in Japan for $4,000.

United Kingdom: a 14-percent tariff, plus a 36.6 percent purchase tax. A $3,860 Chevrolet Impala would sell for about $8,000 over there.

France: a 13.2 percent tariff plus a 33⅓ percent value added tax, plus a 2-percent duty stamp.

So, what have been the results of their version of reciprocal trade in 1970? West Germany exported 674,945 cars to the United States, but we only exported 2,476 to Germany; Japan exported 381,338 cars to the United States but we only exported 159 cars into Japan; the United Kingdom exported 76,257 cars to the United States but we only exported 434 into the United Kingdom; France exported 37,114 cars to the United States but we only exported 394 into France.

Dealers of domestic cars and our employees have been among the first to feel the thrust of this competitive disadvantage.

During 1970 and early 1971 approximately 850 domestic automobile outlets have been lost.

An average dealer employs 25 people and has an annual payroll of $175,000, so this decline in dealerships has meant the loss of some 21,000 job opportunities and $148 million in employee income.

You have already heard estimates on the favorable impact on new jobs from Secretary Connally resulting from the increased manufacture of more cars. To this should be added, at the very least, two employees per dealer, or 56,000 more jobs.

For these reasons we urge a favorable report from this committee and immediate enactment of legislation to eliminate the excise tax on automobiles and light trucks. We also respectfully suggest that Congress consider seriously and quickly granting the executive branch the right to raise import duties beyond the 10-percent limit so that true reciprocity on automotive and perhaps other products in the genuine meaning of the word can be implemented. So, indeed, if Japan, Germany. France, and other strong, affluent automotive-producing countries wish to continue to tax our products at rates from 20 percent to

50 percent, that we be afforded the same treatment and protection.

It is clear that the continuing exporting of American capital, coupled with the free flow of foreign goods into America, and continuing foreign restrictions on our products abroad is courting a disastrous loss of jobs and economic health.

The time for subsidizing these nations at the expense of American workers' jobs is past and it must be ended.

The automobile excise tax was first enacted in 1917 and has remained with us almost continuously ever since as a so-called luxury tax and/or war tax. Other consumer durable goods such as radios, television sets, washers, refrigerators, et cetera, have been cleared of this outdated tax, but despite the welcome action for relief by this committee in 1965, it still remains to discriminate unjustly against every new car buyer in the average amount of $200. Passage of this bill retroactive to August 15, 1971, would return to purchasers of new vehicles since that time an average of $200 in cash.

We emphasize the rebate would be to the car buyer not to the automobile dealer and not to the manufacturer and it would not be inflationary.

Any question as to whether this tax saving will be passed on to new car buyers should be answered by the record. A Federal study ordered by President Johnson in 1965, after the tax on automobiles was reduced from 10 percent to 7 percent, showed that the tax reduction was indeed passed on to the purchaser. The Bureau of Labor Statistics also showed at that time a similar reduction in used car prices benefiting the consumer who generally needs economic help the most. I also understand that the presidents of the major domestic manufacturers have written to Congressman Chamberlain and probably to many others committing their companies to passing this tax reduction on.

As we view it, removal of this tax would have a twofold impact: it would help create and maintain new jobs through increased motor vehicle production and it would make available additional noninflationary funds for consumer use.

Repeal of this tax also would in some measure improve the competitive position of domestic car dealers despite the fact that imported products would share in the excise tax elimination. With our vehicles costing more to build the tax is presently levied on a higher figure than it is for imports.

We feel that it is logical and safe to say that reduced prices on automobiles will have a lowering effect on the consumer price index and that this will tend to reduce the pressure of the wage-price spiral.

At this time we also would urge this committee to take action for the repeal of excise taxes on light-duty trucks. The popularity of these vehicles continues to grow annually because primarily of their use for personal transportation and for recreational purposes. A recent study shows that 10 percent of the Nation's households own one or more trucks with two-thirds of these used for nonbusiness reasons. For many families, particularly those in rural areas, these light-duty trucks provide the sole means of transportation.

Here again lower production costs in other countries have led to the importation of more and more vehicles seeking to capture even this expanding market. The same arguments for tax relief made earlier for automobiles are equally applicable for light trucks.

In summing up, Mr. Chairman, and members of the committee, we strongly feel that repeal of these automotive excise taxes in total would have the greatest all-around benefits of any single action to stimulate our economy. The effect on new job opportunities in vehicle manufacturing, auto dealerships and supplier industries on creation of more favorable balance of payments, on reduction of trade deficits, on consumer price indexes and on spendable income would extend to every corner of this Nation and, in our opinion, would have no inflationary impact.

As mentioned earlier, we also urge that the executive branch be given authority to more closely realine import duties in line with the duties levied on our products as a part of the rebuilding of our economy.

We stand ready as citizens and as businessmen to support this committee in any way we can to advance this program to restore the economic health of the Nation. We recognize that the responsibility of this committee and of Congress is indeed great, and we are confident, based on your record and experience, you will prove equal to the task of providing the leadership so urgently needed to help steer our Nation on a constructive and realistic course, a course designed to eliminate inflation, provide full employment and restore confidence and stability in our economy both home and abroad.

Thank you, Mr. Chairman and members of the committee for a courteous hearing. If my son and I can answer any questions, we would be glad to try to. Thank you very much.

The Chairman. Thank you very much.

Senator HANSEN. Mr. Chairman, Mr. Summerfield, let me first congratulate you on your excellent statement. Let me ask you just one question.

You observe that Germany, Japan and France, among other countries tax our products at a rate of 50 percent. In your summary you say you strongly feel that repeal of these auto excise taxes in total would have the greatest benefit of any single action to stimulate our economy.

Would you feel, if the excise tax might be left on foreign made cars it would approach more nearly the sort of balance and fairness that you think is indicated?

Mr. SUMMERFIELD SR. Senator, I don't think that is quite enough.

Senator HANSEN. But you don't go that far, do you? I mean, I was wondering—here you say to repeal these automotive excise taxes in total—are you talking about on all cars or domestically made cars?

Mr. SUMMERFIELD SR. We have advocated repeal of the tax for all cars. However, we respectfully suggest that this committee and the Congress seriously consider making it possible for the executive branch of the Government to proceed where we can be over and above the 10 percent import surcharge now invoked, up to the point where we can be competitive with the foreign countries.

If other countries are going to charge us 50 percent and absolutely prohibit, in effect, the exporting of automobiles produced by American workmen to those countries, then I think it is time that we get on a dry track; we need true reciprocity. And, gentlemen, if I might be permitted to make a further comment, right at this moment, this

Government of ours is in the process of very delicate negotiations on the matters of foreign trade and all of these related problems; but the people who are speaking for us and doing the negotiating are doing it on the basis of a 10 percent, so-called border tax, while the other negotiators are sitting there with 50 percent. Our people have got a pair of deuces to negotiate against a full house on the other side.

We need to strengthen the hand of the people who are negotiating for this Government.

Let's look at the record for a moment: We have given those countries over there, gladly and willingly, something reported to be about $140 billion since the end of World War II to rehabilitate their industries. As a result they have the most modern equipment and plants that you can buy today, as against what we have in this country. We have exported the genius of America, our know-how and we have let others set up trade barriers against us while leaving the gates wide open for them.

I am not one of those who fails to recognize that we are literally on a collision course, an economic collision course, with the countries that I have mentioned earlier in this statement, and Mr. Chairman, I recall what happened when this country back in the late 1930's got on an economic collision course with other countries. I remember very well, and I am not one of those who feels that we can afford to permit the Japanese and the Germans to dominate the automobile industry of this country. I do not want to see the automobile dealers of this country being only service stations to provide service for automobiles built in other countries. What we are principally interested in here are jobs for American workers.

Senator BENNETT. Mr. Chairman, I hate to do this but I am afraid our witness has had 20 minutes and we have got a lot of others behind us.

Mr. SUMMERFIELD, SR. Thank you very much.

The CHAIRMAN. Thank you very much.

Senator HARTKE. Can I ask a question or is it against the rules?

The CHAIRMAN. Go ahead.

Senator HARTKE. Let me ask you, are you as much interested in keeping the 10-percent duty? Wouldn't it be better to have a quota system, let them share in our abundance; if we have an abundance of sales here, and if we have depression here at home, the sales drop off, they share also in our depression? Wouldn't that be a better system?

Mr. SUMMERFIELD, SR. Senator Hartke, I would leave that to the discretion of Congress.

Senator HARTKE. You would not be opposed to such a system?

Mr. SUMMERFIELD, SR. I am not opposed to any system that restores equality of competitive forces of this country with every other nation on the face of this earth. But we need a chance. This thing has gone far enough, and we cannot permit it to go any further.

Senator HARTKE. He is one of my constituents now, from Gary.

The CHAIRMAN. I would like to ask just one question: How much of a tariff do you think it is going to take if we try to maintain our position, just to maintain it now? Let them keep what they have got but maintain our position on a competitive basis. How high a tariff wall will we need to maintain the position of the American automobile manufacturing industry in its own market?

Mr. SUMMERFIELD, SR. Just as high as others impose against us, whether that is 10 percent or whether it is 50 percent or nothing at all.

The CHAIRMAN. You think that is high enough in view of the fact they have wage rates far below ours? You think if we had the same tariff rate they had that we could hold our own?

Mr. SUMMERFIELD, SR. That is a subject that I am deeply concerned about. As I mentioned in my prepared statement, despite the situation which we face today with labor costs in Japan 25 percent of those in the United States, we have a 10-percent wage increase coming this next year and another 10 percent the following year. I don't know what it is based on, but it certainly isn't based on the needs of our economy.

Mr. Chairman, at least we shouldn't be compelled to compete against a 50-percent barrier with only a 10-percent surtax.

The CHAIRMAN. Thank you very much.

Mr. SUMMERFIELD, SR. Thank you.

The CHAIRMAN. The next witness is Mr. George Strichman, chairman of the Ad Hoc Committee for an Effective Investment Tax Credit.

Senator BENNETT. Mr. Chairman, the suggestion has been made to me that those who stay within 10 minutes will have their requests considered; those who exceed the 10 minutes, we save our time by ignoring their request. [Laughter.]

STATEMENT OF GEORGE A. STRICHMAN, REPRESENTING THE AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT

Mr. STRICHMAN. Mr. Chairman, under those circumstances I guarantee I will stay within 10 minutes.

Mr. Chairman and distinguished members of the committee, my name is George Strichman and I am chairman of the board of directors and chief executive officer of Colt Industries.

I appear today on behalf of the Ad Hoc Committee for an Effective Investment Tax Credit. The committee is a voluntary group of over 80 firms representing a broad cross-section of U.S. industry and business and the membership list as of October 6th is included in the appendix presented to your committee. Prior to the closing of your hearing record, I would appreciate permission to include a list of companies that have joined that list since that date.

This Ad Hoc Committee was formed out of our shared belief that an effective investment tax credit is an essential component of a program for the problems that now face our economy.

The basic objective of the Ad Hoc Committee has been the speedy enactment of a permanent tax credit at a rate sufficient to accomplish national objectives and with equitable rules for implementation.

More specifically, I would like to comment on H.R. 10947.

Basically, we feel that it deserves support and favorable action by the Finance Committee and the Senate. However, I would like to take some time today to address four points and offer some suggestions with relationship to that bill.

If you do not mind at this point I will depart from my formal oral testimony.

I think the first thing that is of extreme importance and which must be recognized is that speed of enactment is paramount. Conditions in the marketplace, particularly in the heavy equipment type marketplace, are far worse than is realized. To give you a for instance, I will put it in terms that I can speak of directly from my own company.

In 1968 we had 28,000 employees. Two years later at the beginning of 1971 we had 24,000 employees. As of the beginning of last month we had 22,000 employees. Now, this has been aggravated by this very legislation which is being considered today because as of the moment it appeared to be considered or it appeared that it would be considered we and many members of our committee receive hold orders and cancellations from companies that immediately said, "Let us wait and see what this legislation will be before we continue and buy the equipment that has been ordered."

The net result of this, gentlemen, is that between now and the end of the year we will probably drop between 1,000 and 2,000 more employees, and this is not only us; a lot of the members of our committee who are facing the same type of problem. So speed is paramount to stop this type of thing from happening.

In addition, the timelag of this bill in taking effect is considerable.

My understanding is when it was done under the Kennedy administration it took almost two years to have full effect. Based on our own leadtimes, if it were passed today it would be approximately 1 year before it began to show a significant effect that would continue for another year before it became fully effective. So the sooner this legislation starts the better, because that will get rid of that timelag at the earliest possible date. It will also get rid of the holdups that have been placed on orders because of the pending legislation.

The second item I would like to talk about is the size of the credit.

As a background, you know better than I, of course, that this credit has been like a yoyo for the past 7 or 8 years, and each time it has gone off it has had deleterious effects; and this time the economy has deliberately been slowed down and I think it has been slowed down to the point where it is beyond what most people truly recognize is happening in the marketplace. Order input is at an alltime low from 1968 when it was at an alltime high; and in case you don't know it, since the first of August it has been decreasing at an accelerated pace again.

Under these circumstances we believe that Secretary Connally's suggestion of a 10-percent credit to help change this course that we are going on is required for two reasons:

The first reason is the state that business has already reached. In some cases it has gone beyond recession; it is a depression.

Let's take the machine tool business, for example. As of right now, not on a dollar basis but on a unit-shipped basis, the total machine-tool business is not shipping any more machines than it was shipping in the mid-1930's. Now, dollarwise, of course, it is much higher because of inflation since that time, but they are not in a state of recession; they are in a state of depression.

The other reason that is involved is that we must be, following what we just heard from Mr. Summerfield, in some kind of competitive position with those countries with which we must compete. An analysis of the kind of credit they get to encourage them to have up-to-date, modern, productive equipment that improves employment and improves, moreover, productivity indicates that with all ADR's promulgated by the Treasury Department and a 10-percent credit, we would still be behind three of the countries that are our biggest competitors, namely, Japan, Great Britain, and Italy; and we would just about become equal with Germany, West Germany.

I think it is absolutely incumbent upon us to be in the same position of encouraging our own organizations here as our competitors abroad if we are to truly face up to making the balance of payments come out even.

Let me repeat that even with a full unmodified ADR, as adopted by the Treasury, and with a 10-percent tax credit, the package is less than the Japanese and British incentives and only about equal to West Germany.

There is a third area, that of pollution control, in which I think a serious error has been made. The House bill, as reported out and as you well know—you have passed before a bill in which pollution equipment can be written off in 5 years—the House bill allows either the 5-year writeoff or the tax investment credit, the incentive credit. The amount of money that must be spent on pollution-control equipment out of the cash that we can generate in our businesses during the next 5 years is sizable. In the case of our own company, it will be about 20 percent per year. Other companies are higher; it runs about 25 percent per year; some are perhaps lower, but in total it is a large amount. So here, on the one hand, we have a nation which I believe seriously is trying to improve its ecology, which is going to take a lot of money available for equipment; at the same time it wants to improve its productivity.

Now, obviously, every penny that goes into the ecology for the buying company does nothing to improve their productivity or the employment. So it is important that this cash be turned around as fast as possible so that it can get back into the stream of buying equipment that is necessary for productivity and employment; and we would suggest that both be available, both the 5-year write-off, and the tax credit, and we would suggest if you really wanted to improve the ecology fast and the other end fast, productivity, that whatever you arrive at as being a proper incentive tax credit be double for the spending of money on equipment for antipollution devices.

Last, but not least, we would like to address the effective date.

As I said before, the time consumed in getting this total package so that it really does turn the economy around is quite long. The real problem, of course, is cash formation because although 7 or 10 percent or whatever may be granted by tax relief, the other 90 or 93 percent has to be put up by the buying company.

In order to get the thing going, the name of the game is order input, because those orders have to be placed to get things started and that is what is lacking in the economic marketplace today.

So we would suggest that as the bill is now written it applies to equipment ordered after April 1 or acquired or constructed after August 15, we believe it would give a real shot into the arm to getting the marketplace moving if the total package were simplified by making it all effective as of the first of April 1971.

So, Mr. Chairman, if we are, in fact, to lick inflation, if we are in fact going to produce jobs for those who are now unemployed and for those who are coming into the labor market in increasing numbers, if we are in fact going to restore this Nation's competitive position in the world economy, then we have no alternative but to enact truly effective investment incentives in our tax structure the same as our foreign counterparts have done for years.

Sweden, for example, has had a 10-percent credit, to the best of my knowledge, since 1936.

We urge your consideration of the suggestions of the ad hoc committee for an effective investment tax credit as I have outlined them here and as explained in greater detail in our prepared statement.

We commend this committee and its prompt action on the House bill, and we hope that your good example will prevail throughout the consideration by the rest of the Senate.

Thank you.

The CHAIRMAN. Thank you very much.

Senator MILLER. Mr. Chairman, I would like to ask the witness a question just as a matter of theory.

If in a given case the one who would otherwise be able to obtain an investment tax credit were to lay off 100 employees as the result of putting in some new, modern equipment and if it could be shown that probably only 10 employees had to be hired to produce that equipment, so you have a net loss of 90 jobs as a result of that particular plant situation, would you support the investment tax credit in that situation?

Mr. STRICHMAN. Senator Miller, one of the bugaboos that has happened ever since 1850 when the industrial revolution started was that if you have better equipment its displaces manpower, that everything is going to go to rack and ruin.

As a matter of fact, exactly the opposite has happened. There is a problem of dislocation of labor when that type of thing happens but the net result has been and will continue to be that the higher productivity equipment that we can put in place the more jobs are totally created eventually.

Now, there is always a lagtime and there is always a leadtime on these kinds of things, but that has been the history of what has happened in the past and there is no reason to believe it will be different in the future.

Senator MILLER. I am very familiar with that history but my question relates to a specific case and I would like your answer as to that specific case.

Mr. STRICHMAN. All right, in that specific case, I would say yes, because there can be many, many of those specific cases and if you were to say we wouldn't do it in every case you in effect would have to say we would have to sit here stagnating in productive capability while those around us in the world are not, and truly we would not be competitive.

Senator MILLER. All right.

The CHAIRMAN. Thank you very much, sir.

Mr. STRICHMAN. Thank you, gentlemen.

(Mr. Strichman's prepared statement follows:)

PREPARED STATEMENT OF GEORGE A. STRICHMAN, REPRESENTING THE AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT

INTRODUCTION

My name is George A. Strichman. I am Chairman of the Board of Directors and Chief Executive Officer of Colt Industries, Inc. I appear on behalf of the *Ad Hoc Committee for an Effective Investment Tax Credit.* The Committee is a voluntary group of industrial firms which share the belief that an effective investment tax credit is a necessary part of the United States tax system. The current members of the Committee are listed on the attached appendix.

We are grateful to you for providing us an opportunity to testify on the proposals in the House Bill (H.R. 10947). We will limit ourselves to comments on the proposed Job Development Credit and Asset Depreciation Range ("ADR") System.

The Ad Hoc Committee was formed because of the belief of its members in the importance of improving the rate of U.S. domestic capital formation through enactment of an effective investment tax credit and through adoption of realistic depreciation policies. These actions would arrest unemployment and would increase both employment and productivity. They would permit greater price stability with less reliance on economic controls; and they would have other beneficial economic consequences. Experience has proven that an effective investment credit and liberalized depreciation are appropriate methods for achieving such objectives.

The immediate effects of the enactment of an effective credit, coupled with adequate depreciation policies, will be to stimulate orders for machinery and equipment, thereby creating new jobs in the machinery and equipment industries and new demands for raw materials. These effects will, in turn, generate increased employment in other industries. They will contribute directly to increased productivity through modernization of plant and equipment. As a consequence, wage increases will become relatively noninflationary and our ability to complete against foreign producers, here and abroad, will be improved.

SUMMARY OF VIEWS

We have encouraged by the prompt passage of H.R. 10947 by the House. We are particularly pleased that the credit adopted by the House is permanent in its form. However, we respectfully suggest that the need for aggressive investment stimulus is so great that the minimum credit level should be 10% rather than the 7% in the House Bill.

We support the absence of any scheduled reduction in credit level. Moreover, a predetermined reduction in credit level would almost assure a reduction in business activity in the period following the scheduled reduction since the natural tendency would be to bunch activity into the preceding period.

Although we recommend below certain modifications in the House Bill, the features of it which we particularly support in addition to a level, nonreducing credit, are:

1. The April 1, 1971 effective date.
2. The denial of the credit for foreign-produced goods, subject to Presidential discretion, as long as the 10% surtax on imports is in effect.
3. The reduction (from 4–8 to 3–7) in the minimum useful life for eligible property.
4. The increase (from 3% to 4%) in credit level for public utility property.
5. The lengthened life for carryovers and their application prior to newly generated credit.
6. The statutory approval of major features of the ADR System.

We cannot stress too much the need for prompt Senate action. Merely because this legislation is pending, many orders for goods are being deferred out of caution, to insure eligibility for credit. This unquestionably aggravates an already bleak economic and employment picture. Your immediate action is essential to arrest further deterioration of this situation.

DISCUSSION

1. The American Economy Is Lagging, and Facilities Obsolescence Is Increasing

The United States invests a substantially smaller proportion of its gross national product in business-fixed investments annually than do its principal foreign competitors. The percentage of GNP represented by gross private investment in the years 1968 through 1970 averaged 13.7%. This compares with the 18.3% for the U.K. and 30% for Japan. In Western Germany, while the only years available were 1968 and 1969, the average is 28.7%. [See Exhibit 1 attached].

In considering these figures, it should be recognized that, although the percentage of U.S. GNP so invested is low, it would be still lower but for the liberalization of depreciation rules and the enactment of the investment tax credit in 1962. [See Exhibit 2].

Not only is our investment-to-GNP ratio not improving anywhere near rapidly enough when compared to foreign countries, our absolute dollar levels of investment are also discouraging. The annual dollar outlay for manufacturing plant and equipment was about $28 billion from 1966 to 1968. It moved up to just over $31 billion from 1969 to 1970, and planned 1971 expenditures have fallen to $30.1 billion. However, after adjusting for price inflation since 1966, the real manufacturing capital expenditures planned for 1971 are $22.5 billion, or 12% below the 1966 level.

Similarly, obsolescence, as measured by the average age of equipment installed in the United States, indicates a need for greater stimulus for replacement activity. [See Exhibit 3]. The upward trend in the average age of equipment, which reversed itself soon after the changes in depreciation and the enactment of the investment tax credit in 1962, has again shown signs of a reversion toward a higher average age of equipment. One survey undertaken in the last quarter of 1970 showed that U.S. business considers 12% of its facilities technologically obsolete, and estimates that it would have to spend $144.5 billion for their replacement by the best available new plant and equipment*.

It is true that a portion of U. S. plant and equipment is currently idle. But, as indicated above, a large part of this is obsolete and becoming more so. Critics have said that this so-called "excess capacity" shows a lack of need for the credit. In our view, in the present circumstances it shows the opposite. Only recently have I seen tools and equipment brought into this country that were superior to the U.S. models. Not until we again achieve leadership in productivity will we be able to increase output and employment and thus absorb the capacity that we have the power to employ for the benefit of the consuming sector of the economy. Past experience indicates that when production of equipment increases, jobs also increase. For example, in the 1960's producers durable equipment increased by over 10% per year and employment in the economy as a whole increased by 2.8 million. The Administration now estimates that employment will rise by over 500,000 jobs in the first year the credit is enacted. In today's climate these jobs are sorely needed.

It is clear that the rate at which American business will get rid of its high cost, marginally competitive factories and machines will be strongly influenced by the terms of the proposed 1971 investment tax credit legislation.

2. An Effective Investment Tax Credit Can Contribute Importantly to Achievement of Economic goals

Corporate net cash flow (retained earnings plus depreciation and depletion charges) is a major source of funds for new plant and equipment investment. In the late 1960's and in 1970, when corporations had to resort increasingly to external sources to meet their financing requirements, the growth rate of capital spending slackened considerably. [See Exhibits 4 and 5]. Inasmuch as the investment tax credit expands internal funds available for capital expenditures, it directly contributes to increased machinery and equipment investments.

It has been estimated that with each additional dollar spent on equipment, the gross national product expands about $3.50 within a year and a half. Thus, employment in industries across the board benefits by capital intensive investment of the type stimulated by the investment credit.

The availability of incentives such as the investment credit directly stimulates spending on plant and equipment. This is evident from statistics of the

*Source: Rinfret-Boston Associates, Inc.

machine tool industry, a bellwether of industrial activity. The rate of production in the machine tool industry in January 1971, measured on a dollar basis, fell to the lowest rate experienced in the past 13 years. The rate of production, measured on a unit basis, was only 6% above the level of the mid-1930's. The resulting severe reductions in cash flow have forced the entire industry in turn to cut back vital research and development. The decline has fed unemployment; the machine tool work force throughout the nation has undergone a series of cuts. Many plants throughout the industry have been closed. This sort of machine tool depression prevents the developments of the new machining techniques vital to productivity and technological advance.

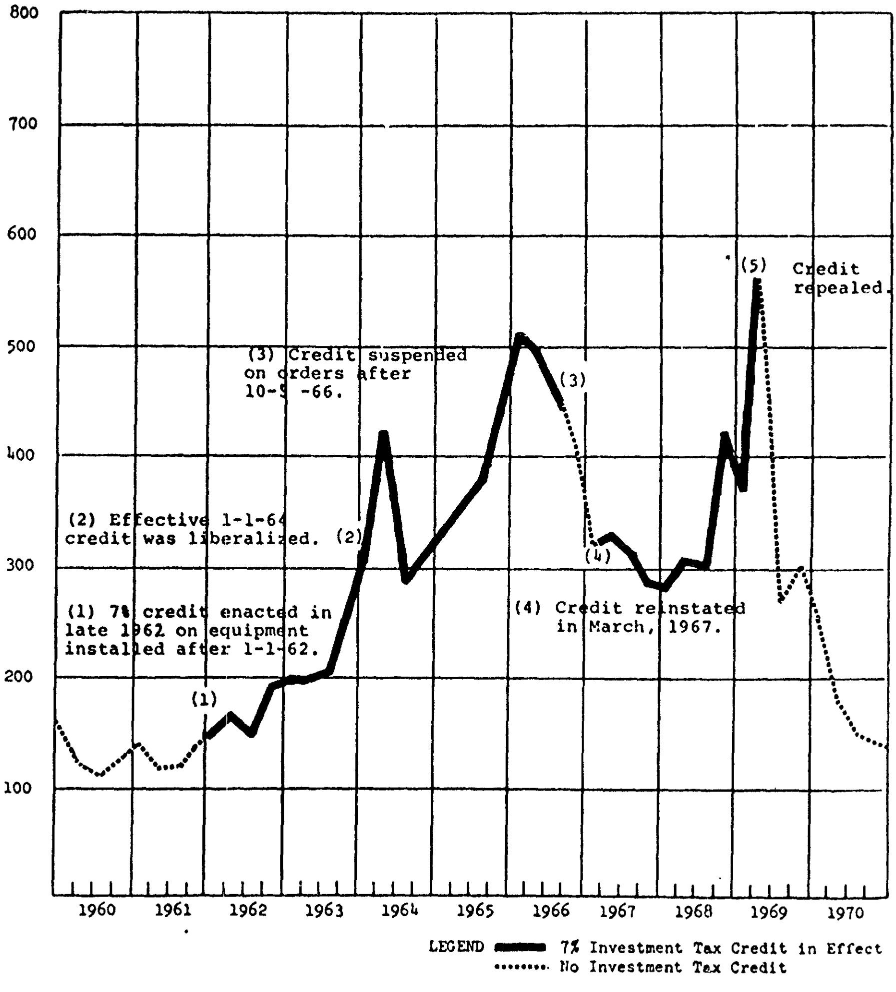
On the other hand, prior enactment of investment incentives has had a direct stimulative effect in this industry, as is evident from the following chart, which was included in our testimony before the House Ways and Means Committee and which was reproduced by that Committee in its report (Source: National Machine Tool Builders Association).

MACHINE TOOLS

Domestic New Orders

Quarterly

Millions of Dollars



These figures establish the effectiveness of the credit in achieving the intended economic goals.

3. The Legislation Under Consideration Does Not Unduly Favor Business Interests, Rather It provides a Strong Job-Creating Economic Stimulus

The Tax Reform Act of 1969 included many needed reforms. However, the structural changes included in that legislation, including termination of the investment credit, heavily favored consumption over investment. The ensuing decline in capital formation and the current inflation problems are a consequence of this deemphasis on investment incentives.

Prompt action must be taken to reestablish incentives for capital investment. If new jobs are to be created, if productivity is to be increased, and if our high standard of living is to be extended to all citizens without inflationary results, American business must be encouraged constantly to improve and modernize its plant and equipment. New jobs result only from greater productive activity. Higher wages result only from (1) reduced profits, (2) higher selling prices, and (3) increased productivity. Profits are already at unusually low levels. Higher prices can compound inflation. Thus, the only acceptable route to higher wages is through greater productivity, and the key to this is new investment.

If individual citizens are to have the benefits of economic prosperity on a sustained basis, the proposed incentives must be enacted. However, even the direct tax relief in the bill is heavily weighted in favor of non-corporate taxpayers. Based on data from the Office of Tax Analysis, the combined tax effect of the 1969 Reform Act, ADR (as originally proposed) and the House Bill (including ADR modifications) strongly favors individual taxpayers. (See Exhibit 6). The cumulative effect of these provisions over the 1969–1973 period will result in a tax *decrease* of $36.4 billion for individuals versus a tax *increase* of $3.2 billion for corporations. Leaving out the 1969 Reform Act, the net effect of the House Bill and ADR in the calendar year 1972 would be a tax reduction of $6.6 billion for individuals and $4.6 billion for corporations.

These figures, coupled with the clear necessity for investment stimulus to create jobs and improve productivity, establish that the House Bill does not favor business interests at the expense of individual interests. On the contrary, it wisely benefits the entire interrelated complex of national interests.

4. The ADR System Should Be Retained

The ADR system is a logical culmination of the guideline system of depreciation initiated in 1962. The guidelines were adopted to provide flexibility, to bring depreciation lives closer to reality, and to reduce the area for taxpayer/IRS dissention.

These objectives continue to be served by the ADR system. The optional 20% shortening or lengthening of lives gives added flexibility, makes the system suitable to a greater range of taxpayers, and provides a useful incentive to tax payers to elect to use the systems. The elimination of the reserve ratio test removes an unnecessary and highly complex hazard to use of this depreciation system. The test was unnecessary because excessive depreciation is recoverable under Section 1245 when sale occurs, and its complexity challenged even the most sophisticated tax experts. The "repair allowance" concept of ADR is highly significant in narrowing the area of dispute between taxpayers and IRS in distinguishing capital expenditures from deductible repairs. It is clearly uneconomic for both industry and the Government to have protracted disputes over such matters, which generally involve difficult conceptual questions but are productive of little revenue. The first-year averaging convention should be retained at 75% rather than being reduced to 50% since it constitutes an additional investment incentive.

5. The Combined Investment Credit/ADR Incentive Package Still Leaves the U.S. Behind Competing Nations

In terms of export capability and our ability to compete against imports, the investment incentives offered by other industrialized nations are highly significant. We have been behind for some time. We will continue to be behind even if the investment credit and ADR provisions as proposed by the House are enacted.

If the capital cost of manufacturing machinery and equipment in the U.S. in 1970, as influenced by income tax policies, is expressed as 100%, the comparative cost in other countries is as follows [Exhibit 7]:

Country:	Percent
United Kingdom	79.1
Japan	81.1
Italy	81.9
West Germany	82.8
Sweden	83.0
Belgium	84.7
France	89.7
The Netherlands	94.1
Canada	97.2

Thus, without ADR, we were behind every other industrialized nation. With ADR (as modified by the House Bill) and the level 7% credit proposed by the House, the U.S. figure would be 87.1, placing it behind six nations and ahead of only France, The Netherlands, and Canada. If ADR were not modified, the U.S. figure with a 7% credit would be 86.2, which is still lower than six major nations. Only with the full ADR system and a 10% credit do we move to 82.1 and fourth place.

We must take action, but equally important, we must take *sufficient* action to move production forward *aggressively*. We are already late—we should not also be timid.

6. Need for greater incentives in the case of pollution control facilities

In recent years the need for special incentives to encourage the construction of and in part defray the enormous costs of pollution control facilities has been recognized. For this reason, the Tax Reform Act of 1969 included a provision for special five-year amortization of such facilities.

The House Bill, however, denies investment credit for these facilities which the taxpayer elects to amortize under the five-year provision. This effectively removes any special incentive for investment in these facilities by placing them on a par with all of the property eligible for the credit. This is not the time, considering mounting concern with the environment, for us to take a backward step in this area.

The need to sitmulate investment in pollution control facilities is certainly as great today as it was in 1969. Yet these expenditures do not directly increase the marketability of products. They do divert capital from other uses which might directly increase productivity and create jobs. For these reasons, a very high rate of capital recovery for these expenditures is clearly warranted. As an example of the magnitude of this problem, it is estimated by members of the Committee that planned 1972 capital expenditures for pollution control facilities in the paper industry will approach 25% of total capital expenditures. Therefore, we recommend that five-year amortization be allowed in the case of pollution control facilities and that an investment credit be allowed on such facilities at a rate higher than that applicable to other types of property. Further, the five-year amortization of pollution control facilities should not constitute preference income.

7. The Credit Should Not Contain Built-In Future Disincentives

The House Bill recognizes the disincentive which results where a taxpayer has unused carryovers of credit which will expire if additional credit is generated in the current year. The House Bill solves this problem with respect to carryovers existing before 1971 by giving them a ten-year life and by providing for their application prior to credits generated by current year investments.

However, the House Bill does not go far enough because a similar disincentive will exist in the future with respect to credits generated under the new law. Accordingly, the rule that carryovers are used prior to current-year credits should be adopted on a permanent basis.

8. Future Studies

The House report instructs the Joint Committee and Treasury staffs to study and deevlop a mechanism for adjusting basis to reflect the credit, and also to study the advisability of retaining the useful life eligibility limitations and the percent-of-tax limitations. We oppose the concept of basis reduction without other substantial adjustments in the credit itself.[1] However, we support studies which have as their objective finding ways to make the credit more effective.

The study should include the problem of investment incentives for taxpayers suffering losses or who have low levels of income. These taxpayers today receive little benefit from the credit because of the 50%-of-tax ceiling. It is not unlikely that these are the taxpayers who are most in need of plant and equipment modernization and yet, ironically, the principal stimulative tool for such activity is available to them only through leasing transactions.

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[1] In order to achieve the same economic effect, the level of the credit would have to be at least doubled if basis reduction were required. (See Exhibit 8.)

9. Effective Date of Credit

The House Bill provides a dual effective date for the credit. The credit is made applicable to property acquired or constructed after August 15, 1971. In addition, it applies to property acquired or constructed after March 31, 1971, provided such property was ordered (or construction was commenced) after March 31, 1971. Thees dual effective dates result in unnecessary confusion and complexity. The credit should apply to all property acquired or to the portion of property constructed after March 31, 1971. The cash flow benefits to taxpayers from this change would make additional funds available for further investment and thus increase the effectiveness of the credit.

10. Conclusion

Few legislative enactments can have as telling an effect upon the two major economic problems facing us today—inflation accompanied by relative economic stagnation—as the enactment of the House bill with the suggested modifications. This legislation is a practical proven means of creating jobs and fighting inflation through improved productivity.

It is respectfully submitted that present economic circumstances in light of the experience of the Sixties indicate that an effective investment credit and the complete ADR system should be enacted at the earliest practical time. The credit should be in an amount of at least 10% with the features suggested.

CURRENT LIST

AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT

ACF Industries, Inc.
AMF, Inc.
AMP, Inc.
A. E. Staley Manufacturing Co.
Air Products Chemical Inc.
Allis Chalmers Corporation
Amerace Esna Corporation
American Can Company
American Metal Climax, Inc.
American National Insurance Company of Galveston
American Standard, Inc.
Bekins Company
Burroughs Corporation
CPC International, Inc.
Carpenter Technology Corporation
Collins Radio Company
Colt Industries Inc.
Conagra
Consolidated Foods Corporation
Control Data Corporation
Crowell Collier & Macmillan, Inc.
Dana Corporation
De Soto, Inc.
Diamond International Corporation
Eaton Corporation
Emerson Electric Company
The F. & M. Schaefer Brewing Company
Fruehauf Finance Company
Gardner-Denver Company
Georgia-Pacific Corporation
Giddings & Lewis, Inc.
Gould, Inc.
Great Western United Corporation
Guardian Life Insurance Company of America
Handy & Harman
Hoover Ball & Bearing Company
Houdaille Industries, Inc.
I-T-E Imperial Corporation
Ingersoll-Rand Corporation
Insilco Corporation
Joy Manufacturing Company
Libbey-Owens-Ford Company
McGraw-Hill, Inc.
Martin Marietta Corporation
Mellon National Bank & Trust Co.
Midland-Ross Corporation
Miles Laboratories, Inc.
Monsanto Company
National Gypsum Company
National Life Insurance Company
National Presto, Inc.
Nekoosa Edwards Paper Co., Inc.
Norton Company
Norton Simon Company
Outboard Marine
PPG Industries
Peter Eckrich & Sons, Inc.
Phelps Dodge Corporation
Philip Morris, Inc.
Revere Copper & Brass, Inc.
Riegel Paper Corporation
Rohm & Haas Company
Roper Corporation
Ryan Aeronautical Company (Teledyne Ryan Aeronautical)
Seaboard Coast Line RR. Co.
Seattle First National Bank
Signal Companies, Inc.
Sheller-Globe, Inc.
Smith, Kline & French Laboratories
Spencer Foods
Studebaker-Worthington, Inc.
Sundstrand Corporation
Tecumseh Products Company
Texas Instruments, Inc.
Thiokol Chemical Corporation
Todd Shipyards Corporation
Trane Company
United Merchants & Manufacturers, Inc.
United Utilities Incorporated
U.S. Plywood Champion Papers, Inc.
Valley National Bank of Arizona
Wallace-Murray Corporation
Warner & Swasey
Western Union Corporation

EXHIBIT 1

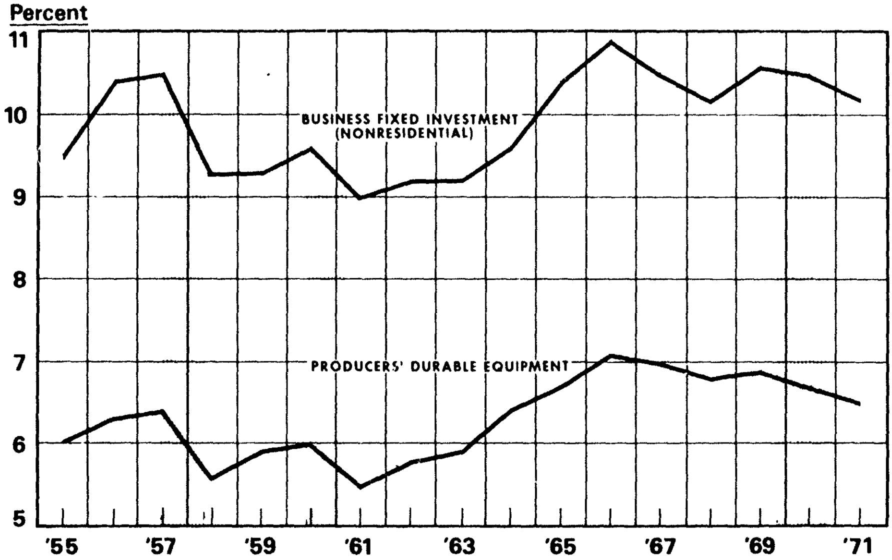
GROSS PRIVATE INVESTMENT AS PERCENTAGE OF GROSS NATIONAL PRODUCT

	JAPAN	FRANCE	WESTERN GERMANY	ITALY	UNITED KINGDOM	UNITED STATES
1968	29.1	25.0	23.1	20.5	17.3	13.5
1969	30.4	25.3	24.3	19.4	21.7	14.1
1970	30.7	N.A.	N.A.	N.A.	16.3	13.7

Source: Rinfret-Boston Associates, Inc.

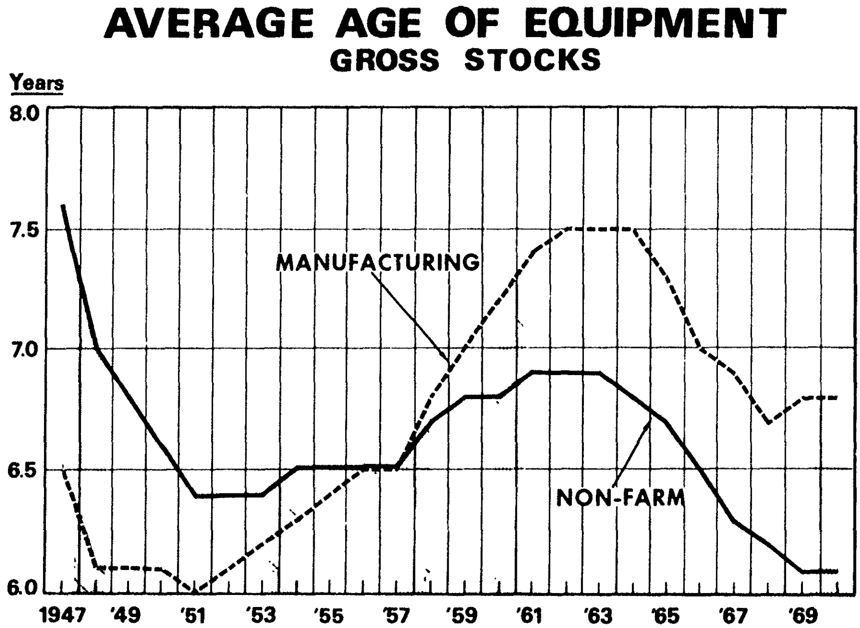
EXHIBIT 2

BUSINESS FIXED INVESTMENT AS PERCENTAGE OF GNP



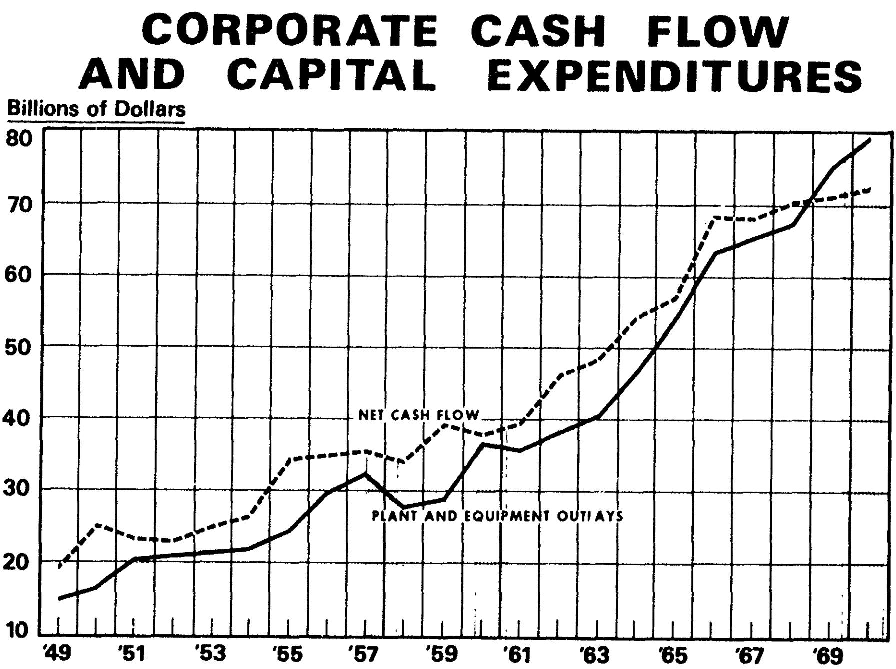
Source: Rinfret-Boston Associates, Inc.

EXHIBIT 3



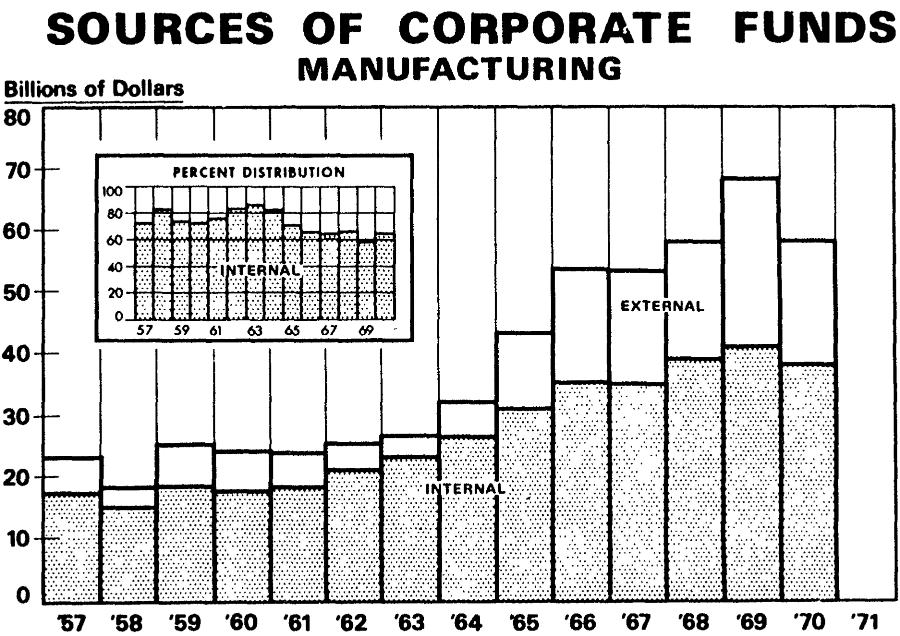
Source: Rinfret-Boston Associates, Inc.

EXHIBIT 4



Source: Rinfret-Boston Associates, Inc.

EXHIBIT 5



Source: Rinfret-Boston Associates, Inc.

Estimated Effect of 1969 Tax Reform Act, ADR and Ways and Means Committee Action on Calendar Year Liabilities Divided Between Individuals and Corporations

($ billions)

Calendar year	Individual								Corporations								Total Individuals and corporations
	1969 Act		Committee Action						1969 Act		Committee Action						
	Reform and relief	Termination of investment credit	ADR	Eliminate ADR 3/4 year convention	Income tax reduction	Excise tax relief 1/	New investment credit	Total	Reform and relief	Termination of investment credit	ADR	Eliminate ADR 3/4 year convention	New investment credit	DISC	Excise tax relief 1/	Total	
1969	--	+0.4	--	--	--	--	--	+0.4	--	+0.5	--	--	--	--	--	+0.5	+0.9
1970	-1.4	+0.6	--	--	--	--	--	-0.8	+1.0	+1.9	--	--	--	--	--	+2.9	+2.1
1971	-5.2	+0.6	-0.6	+0.4	-1.4	-0.8	-0.3	-7.3	+1.1	+2.5	-2.2	+1.7	-1.2	--	-0.1	+1.8	-5.5
1972	-8.1	+0.6	-0.7	+0.3	-3.2	-2.3	-0.7	-14.1	+1.2	+2.7	-2.7	+1.4	-2.9	-0.1	-0.3	-0.7	-14.8
1973	-10.8	+0.6	-0.8	+0.3	-1.1	-2.0	-0.8	-14.6	+1.3	+2.9	-3.2	+1.2	-3.1	-0.2	-0.2	-1.4	-16.0
Total	-25.5	+2.8	-2.1	+1.1	-5.7	-5.1	-1.8	-36.4	+4.6	+10.5	-8.1	+4.2	-7.2	-0.3	-0.6	+3.2	-33.2

Office of the Secretary of the Treasury
Office of Tax Analysis

September 30, 1971

1/ Split as per Committee Report.

EXHIBIT 6

EXHIBIT 7

Comparative Capital Costs of Manufacturing Machinery and Equipment as Influenced by Income Tax Policies: Corporation Income Tax Rates, Depreciation Allowances, and Investment Allowances and Credits; Major Industrial Countries, 1971

Country	Comparative Cost of Capital
	(U. S., 1970 = 100)
United Kingdom	79.1
Japan	81.1
Italy	81.9
West Germany	82.8
Sweden	83.0
Belgium	84.7
France	89.7
The Netherlands	94.1
Canada	97.2
U. S. (1970)	100.0
U. S. with ADR	95.6
plus 5% investment credit 1/	88.9
plus 7% investment credit 1/	86.2
plus 10% investment credit 1/	82.1
U. S. with ADR, less modified first-year convention	96.6
plus 5% investment credit	89.8
plus 7% investment credit	87.1
plus 10% investment credit	83.0
U. S. without ADR	
but with 5% investment credit	93.2
but with 7% investment credit	90.5
but with 10% investment credit	86.4

Office of the Secretary of the Treasury
Office of Tax Analysis

October 6, 1971

1/ Effective credit assumed to be unaffected by income limitation for purposes of international comparisons.

EXHIBIT 8

Comparison of Alternate Proposal (10% Credit and 5-Year Accelerated Depreciation on Entire Basis) With Task Force Recommendation (20% Credit and 5-Year Accelerated Depreciation on 80% of Basis)

	(1) 10% Credit With 5-Year Double-Declining-Balance Depreciation(x) on Entire Basis		(2) 20% Credit With 5-Year Double-Declining Balance Depreciation(x) on Remaining 80% of Basis				
Year of Life	Investment Credit	Depreciation	Investment Credit	Depreciation	Tax Savings at 50% Rate Col (1) Over (Under) Col(2)	Interest on Ending Funds Compounded at 12% Before Taxes	Cumulative Ending Funds
	$	$	$	$	$	$	$
1	10,000	20,000*	20,000	16,000*	(8,000)	-0-**	(8,000)
2		32,000		25,600	3,200	(480)	(5,280)
3		19,200		15,360	1,920	(317)	(3,677)
4		11,520		9,216	1,152	(221)	(2,746)
5		11,520		9,216	1,152	(165)	(1,759)
6		5,760		4,608	576	(106)	(1,289)
Total	10,000	100,000	20,000	80,000	-0-	(1,289)	(1,289) or (1.3)%

*Assumes $100,000 asset placed in service in the middle of the first year.

**Assumes funds available at the end of the year.

(x) Assumes switch to straight line depreciation at appropriate time.

The CHAIRMAN. Next we will hear from Mr. Warren J. McEleney, president of the National Automobile Dealers Association, accompanied by Frank McCarthy, executive vice president.

Senator MILLER. Mr. Chairman, I would like to take this opportunity to state that Mr. McEleney comes from my home State of Iowa and more particularly Clinton, Iowa. I believe he is the first Iowan so honored to be the president of the National Automobile Dealers Association and I just want to make sure that the committee understood we have an Iowan testifying before us at this time.

The CHAIRMAN. We are happy to see that Iowa is well represented in more places than in the U.S. Senate. We are glad to have you.

STATEMENT OF WARREN J. McELENEY, PRESIDENT, NATIONAL AUTOMOBILE DEALERS ASSOCIATION, ACCOMPANIED BY FRANK McCARTHY, EXECUTIVE VICE PRESIDENT, NADA

Mr. MCELENEY. Thank you, Senator Miller and Senator Long.

As Senator Miller indicated, I am Warren J. McEleney, a Chevrolet, Oldsmobile, and Cadillac dealer in Clinton, Iowa, and president of the National Automobile Dealers Association.

On behalf of over 20,000 franchised new car and truck dealers who are members of NADA, I welcome the opportunity to express our view on the subject of the automobile and truck excise tax.

With me this morning is Frank McCarthy, executive vice president of NADA.

We wholeheartedly support provisions of H.R. 10947 to repeal the 7 percent automobile excise tax retroactive to August 16 on domestic and imported cars and the 10 percent excise tax on light-duty trucks, those having gross vehicle weights of 10,000 pounds and under, retroactive to September 23.

Repeal of these taxes will result in a substantial reduction in the price of new and used vehicles. This will increase sales, stimulate production and generate desperately needed new jobs throughout the country. Equally important, repeal of these excise taxes will be noninflationary.

The American people will benefit directly from the elimination of the Federal excise tax on automobiles and light-duty trucks at this time. Removal of these taxes will stimulate sales in an industry that exerts an immediate impact on the entire American economy.

Treasury Secretary John Connally has predicted that the resulting increase in new car sales alone would be on the order of 600,000 new units, generating 150,000 new jobs, not including dealer employees. While many of these new jobs will be created in the automobile manufacturing industry, a large number will also come in key industries such as rubber, steel, zinc, and aluminum.

The total impact of elimination of the excise taxes on passenger cars and light trucks will be far greater when its effect is transmitted throughout the economy. The retail automobile industry is a very important element in the Nation's economy. In 1970 there were 740,000 people employed in dealerships with an annual payroll of $5.3 billion. Sales by dealers totaled over $50 billion in the same period.

As sales increase, thousands of dealers throughout the country will certainly employ additional people. More employees mean more paychecks and increased prosperity in every town in America.

Excise tax repeal will put money in car buyers' pockets, create tremendously expanding consumer purchasing power and generate additional jobs. Tax repeal will mean a cut of roughly $125 on small cars to approximately $300 on large cars, an average of $200 per car.

The price cut will be passed on to customers. Dealers will furnish manufacturers with the names of all buyers between August 16 for new cars and September 23 for light trucks and the date of repeal by Congress so that refund checks can be sent directly from the manufacturers to the buyers.

Dealers will pass the reduction on to their customers when the excise tax is repealed. They did this in 1965, as Government studies show, when the tax on new cars was reduced from 10 to 7 percent and we pledge they will do it again.

In its July 29, 1965, release, the Bureau of Labor Statistics provided in its Consumer Price Index data regarding the cost to the consumer of new passenger cars. This data was significant despite the very short period of time which had elapsed since the excise tax cut was in effect since it provided identical data for June of 1964 as well as for May and June of 1965. In May of 1965 the Consumer Price Index for new cars was 100.2. In June the figure was 97.4—a month later. This represented a reduction of 2.8 percent, clearly illustrating that the excise tax reduction was passed through to the benefit of the purchaser.

President Nixon proposed that repeal of the automobile excise tax be effective August 16. Since that date, new car buyers have counted on a tax refund as one of the deciding factors in their decision to buy. It is essential, therefore, that Congress make repeal retroactive to this date.

Dealers know from experience that there is a direct relationship between new and used car prices. Price reductions on new cars as a result of excise tax repeal will quickly result in lower prices for used cars, as noted by Secretary Connally in his appearance before this committee last week. This is particularly important to a large proportion of the American population that depends on used cars for economical and dependable transportation. Not only will 9 million new car buyers benefit from excise tax repeal, an additional 14 million used car buyers will equally benefit.

Additionally, the effect of repeal on new and used car prices will contribute to highway safety by hastening the removal of older cars from the highways and replacing them with newer cars incorporating recent engineering and safety innovations. Furthermore, vehicles manufactured since 1966 have also been equipped with increasingly more efficient emission controls that make a substantial contribution to reducing air pollution.

Excise tax relief on automobiles should be extended to light-duty trucks of 10,000 pounds or less gross vehicle weight, which are primarily passenger-oriented vehicles. Repeal should be retroactive to September 23, the date set in H.R. 10947.

Light trucks should no longer be classified and treated differently than passenger cars. Government census figures demonstrate that over two-thirds of the light-duty trucks registered in the United States are used for personal transportation, both on the farm and in the city, and for countless recreational pursuits. Additionally, as Secretary Connally noted in his testimony before this committee last week, the truck tax on these vehicles, which is allocated to the highway trust fund, generates more tax than is appropriate in light of their cost responsibility for the highway system.

Secretary Connally has recommended that dealers receive excise tax refunds on all new automobiles in stock on the date of enactment of repeal by Congress. This is essential if all customers who buy such cars are to realize price reductions on purchases made after the date of repeal.

We also strongly support Secretary Connally's recommendation that demonstrator cars be eligible for excise tax refunds, as they were in 1965 when the tax was reduced by 3 percent. To eliminate consumer confusion in this area, it is important that customers be assured they will receive the benefits of tax repeal on demonstrator cars. However, the tests for qualification of demonstrators set forth in the Ways and Means Committee's report on the bill raise certain technical problems which may preclude most purchasers of demonstrators from receiving a refund.

We believe a slight change in these tests would make it possible for most of these purchases to receive the benefit of excise tax relief. We have discussed this matter with Treasury officials and the staff of your committee and we do request permission to submit a brief memo on this point for the record.

We also urge the excise tax relief be extended to driver education cars made available by dealers at no cost to local school districts. This voluntary program is a major dealer contribution to community highway and traffic safety. Last year dealers made over 58,000 new cars available to school driver education programs. Presently an estimated 25,000 cars would qualify for the tax relief.

I would just like to digress from my statement for a moment.

It is true manufacturers do give dealers assistance on these cars in the forms of rebate to take care of the installation of controls, the wear and usage by the school district and sometimes this is considerable. Likewise, the interest on the investment, because there has to be a minimum of 90 days that the car has to be used by the school to qualify for this assistance, and the thing that we are so concerned about in this area is that while dealers have voluntarily donated these cars over the years in increasing amounts, that failure to give the dealers relief on the excise tax on these cars could jeopardize the voluntary participation of dealers in the future on this program.

I would also like to add that these cars were sold in the same fashion as demonstrators and new cars and do carry a good portion of the new car warranty remaining on these vehicles that the purchaser of these cars does receive.

So, in conclusion, repeal of the Federal excise tax on automobiles and light-duty trucks will contribute immeasurably to a noninflationary increase in national employment.

Excise tax repeal will provide the greatest possible economic impact in the shortest possible time; it will immediately reduce prices on new and used vehicles; it will stimulate sales; it will generate increased production in many key industries; it will create thousands of new jobs throughout the economy and the total impact of excise tax repeal will be a massive and immediate stimulus to the American economy.

Thank you, Senator Long.

The CHAIRMAN. Thank you, Mr. McEleney. We appreciate your statement very much here today, sir.

The CHAIRMAN. The next witness will be——

Senator MILLER. Mr. Chairman, could I ask whether or not they plan to submit to the committee their proposed change relating to the dealer.

Mr. MCELENEY. I would ask Frank McCarthy to answer the question.

Mr. MCCARTHY. That is correct, Senator Miller.

Senator MILLER. Provide it for the record so our staff would have the benefit of it.

Mr. MCCARTHY. We would like to submit it for the record before the end of the week and we have discussed it with your staff. Thank you very much.

The CHAIRMAN. Thank you very much, sir.

(Supplementary memoranda submitted by the NADR follow. A subsequent letter received by the committee from Mr. McEleney appears at page 899.)

SUPPLEMENTARY MEMORANDUM OF NATIONAL AUTOMOBILE DEALERS ASSOCIATION

In his appearance before the Senate Finance Committee on October 12, Warren J. McEleney, President of NADA, requested permission, which was granted, to submit a memorandum for the record on certain problems raised for dealers and customers alike as a result of the excise tax treatment of automobile and light-duty truck demonstrators by the House Ways and Means Committee in its Report on the bill.

This memorandum is submitted to explain the nature of the problem and to suggest a modification by the Senate Finance Committee of the tests for excise tax relief on such demonstrators as set forth by the Ways and Means Committee.

NADA feels that consumer confusion and dissatisfaction will be widespread if excise tax relief is provided only for automobile demonstrators placed in service prior to August 16 and light-duty truck demonstrators placed in service prior to September 23 which meet the rigid requirements set forth by the Ways and Means Committee (H. Rept. 92–533, pp. 55, 56). Since the President recommended the elimination of the automobile excise tax on August 15, thousands of purchasers of demonstrators are under the impression that they will receive a refund of the tax if Congress approves its repeal. These purchasers have assumed that they would receive the refund whether they bought a car off the showroom floor or a demonstrator.

The Committee Report states that a "demonstrator" (including passenger car demonstrators and light-duty truck demonstrators of 10,000 pounds gross vehicle weight or less) will be treated as " new" and eligible for consumer or floor stocks refunds if intended to be sold as a new vehicle rather than a used one. This intent, in the case of automobile demonstrators, is evidenced by the dealer showing that the price label was on the vehicle at the time of sale (or in his inventory on the tax repeal date) and was sold or was to be sold either under a "*full* written or express warranty" or by showing "newness" by other evidence acceptable to the Internal Revenue Service (emphasis supplied). The Committee then notes that it is anticipated that IRS "will provide that a written or express warranty will not be considered to be a full warranty unless more than 80 percent of the mileage and time-period coverage is unexpired on the date the vehicle is sold (or is held for sale in the dealer's inventory on the tax repeal date)."

In the case of light-duty trucks used by the dealer as demonstrators, there is no statutory requirement for a price label. Otherwise, the tests for light-duty truck demonstrators are the same as for automobile demonstrators.

Since new cars now customarily carry a 12-month and 12,000-mile manufacturer's warranty, this means that any demonstrator placed in service prior to August 16 with more than 2,399 miles or 2.39 months usage at the time of sale would not qualify. Furthermore, no demonstrator placed in service prior to August 16 and held in dealer inventory on the date of repeal would be eligible for tax relief regardless of mileage, if, as appears likely, the actual date of repeal of the tax occurs after the last week of October. This is so because the retroactive period from August 16 to the date of repeal will have exceeded 2.39 months.

NADA representatives have called this matter to the attention of Treasury Department officials who have advised us that they would be willing to support a modification of the 80 percent unexpired warranty test. We recommended, and the Treasury Department indicated that it would accept, a provision that, so long as the demonstrator has more than 50 percent of the mileage and time-period coverage of the warranty remaining on the date of sale (or in the dealer's inventory on the tax repeal date), the demonstrator would be assumed to carry a full warranty and excise tax relief would therefore be available. This modification would insure that more purchasers of demonstrators would reap the benefits of excise tax repeal and thereby serve to reduce what we feel may be considerable confusion and misunderstanding on the part of customers if the 80 percent test is retained.

SUPPLEMENTARY MEMORANDUM OF THE NATIONAL AUTOMOBILE DEALERS ASSOCIATION IN SUPPORT OF THE EXTENSION OF EXCISE TAX RELIEF TO DRIVER EDUCATION CARS

In its statement before the Senate Finance Committee on October 12, NADA urged that excise tax relief be extended to driver education cars made available by dealers at no cost to local school districts. In the interest of conserving the Committee's time, we made no attempt to explain in any detail the justification for such relief but merely pointed out that in 1970 dealers provided over 58,000 new cars to high school driver education programs on a free loan basis.

The purpose of this memorandum is to offer some of the more important reasons to support the extension of excise tax relief to such driver education cars placed in service before August 16, 1971. We estimate that approximately 25,000 driver education cars placed in service by dealers prior to August 16 would be eligible for excise tax relief—a revenue loss to the Government of only $5 millon. (The House Ways and Means Committee Report on H.R. 10947 indicates that the dealer will be treated as the "ultimate purchaser" of a driver training car placed in service after August 16 where he retains ownership [House Report 92–533, p. 54].)

The driver education program was initiated in 1935. Since 1947, when such records were first kept, dealers have made available on a free loan basis for high school driver education courses more than 262,000 new cars, with an estimated value of nearly $700 million. In 1970 alone, as we noted in our testimony, over 58,000 new cars worth over $184 million were provided without charge to driver education programs. This has enabled more than 2.2 million students to receive driver education training.

While manufacturers provide some financial assistance to dealers in making driver training cars available to schools, the cost to the dealers of these programs generally exceeds this assistance. NADA feels that the Federal Government, which is vitally interested in all aspects of automobile safety, would give strong impetus to even greater participation by dealers in driver education programs by extending the 7 percent excise tax repeal to driver education cars placed in service prior to August 16, at a relatively small amount of revenue loss to the Government.

Dealers who have participated in driver education programs would be unfairly penalized if the excise tax refund is not made applicable to driver education cars. It would add approximately $200 to the cost of driver education cars purchased by customers, making these units more difficult to sell in competition with other new cars.

Attached is a state-by-state list of the number of students completing driver education programs during the 1969–1970 school year. Also attached is a list showing the number of cars loaned by dealers in each state for use in high school driver education programs during the same period, as compiled by the National Safety Council.

Student participation in driver education

[Number of students completing driver Education program]

State	
Alabama	28, 514
Alaska	1, 707
Arizona	12, 010
Arkansas	12, 022
California	314, 411
Colorado	32, 251
Connecticut	21, 499
Delaware	8, 474
District of Columbia	3, 542
Florida	86, 253
Georgia	34, 302
Hawaii	4, 700
Idaho	15, 639
Illinois	111, 471
Indiana	NR.
Iowa	52, 101
Kansas	34, 848
Kentucky	20, 000
Louisiana	35, 208
Maine	13, 000
Maryland	54, 145
Massachusetts	70, 000
Michigan	162, 564
Minnesota	54, 380
Mississippi	23, 000
Missouri	33, 681
Montana	9, 558
Nebraska	20, 500
Nevada	3, 742
New Hampshire	12, 205
New Jersey	61, 000
New Mexico	13, 598
New York	170, 000
North Carolina	95, 105
North Dakota	NA.
Ohio	114, 683
Oklahoma	40, 366
Oregon	NA.
Pennsylvania	105, 000
Rhode Island	15, 000
South Carolina	17, 045
South Dakota	8, 723
Tennessee	NR.
Texas	122, 110
Utah	23, 275
Vermont	7, 039
Virginia	54, 715
Washington	70, 000
West Virginia	11, 212
Wisconsin	64, 123
Wyoming	4, 573
Total	2, 283, 294

NOTE.—10th to 12th grade figures.

Cars used in high school driver education—School year 1969–70

[Loaned by auto dealers]

State	
Alabama	246
Alaska	12
Arizona	246
Arkansas	281
California	2, 117
Colorado	345
Connecticut	306
Delaware	73
Florida	940
Georgia	475
Hawaii	48
Idaho	325
Illinois	1, 328
Indiana	1, 060
Iowa	1, 041
Kansas	669
Kentucky	341
Louisiana	623
Maine	85
Maryland	668
Massachusetts	582
Michigan	2, 518
Minnesota	1, 221
Mississippi	373
Missouri	626
Montana	237
Nebraska	380
Nevada*	45
New Hampshire	76
New Jersey	520
New Mexico	179
New York	929
North Carolina	1, 159
North Dakota	192
Ohio	1, 440
Oklahoma	698
Oregon	260
Pennsylvania	923
Rhode Island	7
South Carolina	274
South Dakota	302
Tennessee	432
Texas	1, 920
Utah	365
Vermont	145
Virginia	860
Washington	805
West Virginia	244
Wisconsin	1, 748
Wyoming	94
District of Columbia	30
Total	30, 813

*1968–69 figures—1969–70 figures not available.

The CHAIRMAN. The next witness will be Mr. Michael L. McWilliams, president, National Office Machine Dealers Association.

STATEMENT OF MICHAEL L. McWILLIAMS, PRESIDENT, NATIONAL OFFICE MACHINE DEALERS ASSOCIATION, ACCOMPANIED BY ROBERT M. WOLETZ, PRESIDENT, BOLEN INDUSTRIES, INC.

Mr. McWILLIAMS. Gentlemen, it is a pleasure to be invited to speak before you this morning. I would like to say, in addition to being president of the National Office Machine Dealers Association, I am also a dealer myself in Little Rock, Ark., handling both imported and domestically manufactured machines.

I do have in my company Mr. Woletz, who is also a past president of our association and he himself is an office machine dealer in New Jersey.

Our testimony is being offered on behalf of the National Office Machine Dealers Association, which represents over 10,000 independent office machine dealers throughout the United States. Without exception, these dealers fall into the category of small business. They are businessmen who got their start in the office machine industry by either servicing or selling office machines for one of the major manufacturers of office machines or another office machine dealer.

Since a successful office machine dealer must sell a wide range of merchandise, he did have to search and work very hard to get the financing for opening his business in the first place.

For many years our dealers were able to offer only used equipment for sale. The American manufacturers for the most part offered their products for sale only through their own direct sales organizations, refusing to sell higher volume items through the independent dealer in the larger market areas. During those days, our average dealer employed four people and his volume was approximately $100,000.

In recent years the dealer has been able to offer his customers new equipment by selling imported office machines. It has now become his means of livelihood in that over 80 percent of the products sold and serviced by the independent dealer are manufactured abroad. Some of these imported products carry old-line American office machine company names such as Royal and Remington, Smith-Corona, while others bear brands that are relatively new to our business community. Nevertheless, they are all manufactured abroad.

However, those American manufacturers who marketed their machines through their own direct sales organizations have continued to do so; therefore, domestically manufactured machines are still unavailable for the independent dealer to market.

Even though these facts be true, through the sale, service and supplying of imported office machines, our dealers have been able to grow to an average of eight employees and will do an annual volume slightly in excess of $200,000. Thus, more than 320,000 Americans derive their livelihood through the 10,000 independent office machine dealers throughout the United States. In addition thereto we estimate there are probably another 100,000 Americans that get their income through the distribution of this dealer network.

Now, on August 15, 1971, the President of the United States proclaimed a surtax of 10 percent on all dutiable articles imported into the United States. He also at that time released the controls on the dollar to cause foreign currencies to be more realistic in their values as compared to the dollar.

His steps were vitally necessary to our overall economy. However, it will cause a hardship on our dealers by virtue of increased inventory values, which will be impossible for the dealer to recover. He can charge his customer the amount of the surtax, but he will be unable to charge for those additional costs that he will have by virtue of handling the increased value of his inventory. What we are saying is, he won't be able to get that percentage of markup on those additional costs but as good Americans and believing in the American way of life we are willing and do accept this challenge in our marketplace.

Additionally, the President proposed that a tax credit be extended to all purchases of domestically manufactured capital goods and equipment in the amount of 10 percent; and, of course, the Revenue Act of 1971 has reduced this tax credit to 7 percent. However, the combined effect of the surtax, the reevaluation of foreign currencies and the tax credit allowance will remove the independent office machine dealer from the market as a viable competitor. He would be at a minimum price disadvantage of 27 percent in competition with the products of domestic manufacturers. We arrive at that percentage by virtue of taking the 7-percent investment credit which really amounts to a 14-percent credit whenever you consider it before taxes, 10-percent surtax which brings us up to 24 percent, and finally most of the currencies have now been reevaluated to at least an 8-percent differential so as a result we are at the 32-percent level at this point.

The National Office Machine Dealers Association feels very strongly that placing our dealers at such a disadvantage in comparison with direct selling organizations may result in tremendously weakening thousands of independent machine dealers, thus strengthening these direct selling organizations, who already can be classified as large, vertically integrated monopolies.

Just two examples are the National Cash Register—NCR—which presently has far more than 70 percent of the U.S. cash register market and the International Business Machines—IBM—which has well over 70 percent of the electric typewriter market and over 55 percent of the dictating machine market.

Only in recent years has the independent dealer been capable of reducing their monopolies to these percentages. The story has been much the same in the calculator field. In fact, only in the last 5 years has the dealer had a nonprinting calculator to sell to his customer.

The passage of the investment tax credit, as proposed, can only result in the independent dealers' sales suffering a drastic reduction and these domestic monopolies acquiring more of the market. The end result would also drastically limit the choices available to the consumer in the future.

Cash registers, dictating machines, and electric typewriters represent the higher volume items for the office machine dealers. Both IBM and NCR flatly refuse to market these products through the independent dealer. One hundred percent of their new cash registers, new dictating machines, and new electric typewriters are sold through their wholly owned branches, in direct contrast to the automobile industry where we also have giants but they do market through dealers.

The dollar revenue for repair service and supplies furnished by our dealers during the useful life of a business machine will be approximately the same as the original selling price of the machine itself. If the independent dealers are deprived of the original sale of an imported machine because the investment tax credit is not extended to purchasers for business use, then the dealers will not only have lost the volume of the original sale but also an equal volume of the repair service and supplies. This can only result in the layoff of employees by the 10,000 independent dealers, thus contributing to a greater percentage of nationwide unemployment rather than decreasing unemployment as was the President's goal.

A survey recently run in our association indicates that we can expect as much as a 30 percent layoff plus reduction in plans of expansion.

Our dealers feel that they can survive the competitive disadvantage imposed by the surtax and the increased values of foreign currencies; however, the additional pressures created by the investment tax credit covering only domestic equipment purchases would prove to be too much for the independent dealer.

Since the tax credit is a very important factor toward accelerating our economy and decreasing unemployment, the national Office Machine Dealers Association humbly requests that your votes be cast in favor of a motion that would extend the 7 percent investment tax credit to all purchases of business equipment, whether domestically of foreign manufactured, and thereby preserve the independent dealer and the people who rely upon him for sustenance.

We certainly appreciate the opportunity to be able to speak before your group this morning and I would be happy to field any questions that you might happen to have.

The CHAIRMAN. If I might just say first I had a question that Senator Fulbright wanted to submit and ask of the witness and I would suggest—I will submit it and you answer it for the record, if you would, please.

Mr. McWILLIAMS. All right.

(Material referred to follows:)

Question: Would the independent office machine dealer derive any relief from the problems we have explained by virtue of the authority granted to the President in the Revenue Act of 1971 to exercise exceptions for the investment tax credit to be extended to certain imported machines where a domestic manufacturer has a monopoly?

Answer: It would possibly help our dealers and customers in the cash register, dictating, and electric typewriter markets. However, I say "Possibly" because there are a number of danger areas in the House bill:

> The revenue act of 1971 leaves the possibility of no relief being granted to our dealers. If the imported business machines are not eligible for the tax credit, then our dealers will be forced to reduce their staffs or possibly be forced out of business.
>
> Let me assure you that since the President presented his message on August 15th, the domestic monopolistic giants have been telling our customers they are paying a premium of as much as 32% by buying imported machines. This is just one example of the huge disadvantage we are experiencing.

There is another situation which could restrict our country's ability to create jobs, and stimulate the economy. Although, there is a limited number of domestic manufacturers of figuring machines who market through the independent dealer, there are justified reasons to believe that the domestic manufacturers will be unable to supply the market demand for adding machines and calculators. Most of these domestic manufacturers have consistently run four to six weeks behind on deliveries, a greater increase in the sales of domestic business machines would only further complicate this delivery situation. Therefore, the consumer would be forced to purchase imported equipment in order to expand. However, these consumers should not be forced to give up their investment tax credit to buy an imported machine in order to expand their operations.

The National Office Machine Dealers Association respectfully asks that your legislation include a provision that all office machines, both domestically produced and imported, be eligible for seven (7) per cent investment tax credit retroactive to April 1st, 1971.

Senator CURTIS. It is my understanding that the bill reported out by the House Ways and Means Committee did do something about some foreign manufactured machines and the investment credit. Are you familiar with that?

Mr. MCWILLIAMS. Yes, sir, we surely are, and I guess possibly it can help our dealers and customers in the cash register, dictating and the electric typewriter area where the giants are.

Senator CURTIS. What did they do as you basically understand it?

Mr. MCWILLIAMS. What they did was to provide the President can make a determination as to where the problem may exist and grant the 7-percent investment credit. However, there may be an element of doubt there. Decisions may be made after the bill is passed and we stand in fear of the fact that it may not come either at all or it may come too late to save the dealer.

To give you one example, we are already running into situations where the domestic giants who are marketing through their own direct sales operations have been out on the street saying they are paying a premium as much as 32 percent by buying imported equipment.

The other part of the problem, too, that exists is the fact that our domestic manufacturers of figuring machines may not be able to take care of the market that we have. We have justified reasons for believing this. Most of these domestic manufacturers consistently run 4 to 6 weeks behind on their deliveries, as it stands right now, on figuring machines. A greater increase in the sales of domestic business machines would only further complicate this delivery situation; therefore, the industrial consumer could be forced to purchase imported equipment in order to expand and, of course, we would be denied the investment credit during this period of time because, as the bill now stands out of the House, the investment credit would only be applied as of the date of the approval of the extension, so if it took 3 or 4 months from now for the extension to be approved, then anybody who has purchased equipment during this time then he would lose his 7-percent investment credit.

The CHAIRMAN. Thank you, sir.

Mr. MCWILLIAMS. Thank you, sir.

The CHAIRMAN. The next witness will be John A. Creedy, president of the Water Transport Association, accompanied by Mr. Jesse J. Friedman, economist.

STATEMENT OF JOHN A. CREEDY, WATER TRANSPORT ASSOCIATION OF NEW YORK; ACCOMPANIED BY J. W. HERSHEY, BOARD CHAIRMAN, AMERICAN COMMERCIAL BARGE LINE CO., HOUSTON, TEX., AND JEFFERSONVILLE, IND., AND JESSE J. FRIEDMAN, ECONOMIC CONSULTANT

Mr. CREEDY. Mr. Chairman, I am the president of the Water Transport Association of New York, a trade association of ICC-certificated inland barge operators, and I am accompanied here by Mr. J. W. Hershey, board chairman, American Commercial Barge Line Co., Houston, Tex., and Jeffersonville, Ind., who is the leading operator in the barge industry, and Mr. Jesse J. Friedman, our economic consultant.

If I may, I would like to file our brief statement and then Mr. Hershey and myself will cover the material orally.

We are an organization that has been studying the question of revitalization and improvement of efficiency in surface transportation for some time. We came early to the conclusion that of first importance was the need to stimulate investment in order to improve efficiency and, of course, as a result of our improved efficiency there would be an increase in employment to meet the needs of our economic growth.

In order to stimulate efficiency, stimulate investment, we also concluded very quickly that the restoration of the 7-percent tax credit was a key factor, would be a key factor; and we also concluded that a 5-year amortization for barge equipment would be very helpful and in the public interest.

As the bill came over from the House, the Revenue Act of 1971 came over from the House, it provides the tax credit, of course, and for railroad rolling stock in the alternative of the tax credit a 5-year amortization program with certain restrictions.

We believe that it would be in the public interest for the inland barge lines and the railroads to have the—both the investment tax credit and the 5-year writeoff, but in any event that both the railroads and ourselves should have the alternative of the investment tax credit or the 5-year writeoff.

We have some proposed language that would accomplish the addition of the inland barge lines to the privilege of the 5-year writeoff, and which would also accomplish both for the railroad and for the island barge lines the removal of certain restrictions.

I would like to introduce Mr. Hershey at this point to discuss the public interest reasons for this proposal.

Mr. HERSHEY. Well, gentlemen, I know that Senator Long and Senator Hartke, in particular, don't need any description of the barge line industry. The large Port of New Orleans and Jeffersonville, Ind., have got a lot to do with the industry. But we are, by all odds, the cheapest type of carrier in the United States of general commodities. In the field of transportation we are probably—this industry is probably the most anti-inflationary force that exists in the United States.

We move commodities for about one-third of a cent per ton-mile which is undoubtedly the cheapest form of interior transportation that exists, not only in the United States but any place in the world. Our freight rates are about that—one-fourth that, on the average, of any competing mode.

Our industry is a growing industry. Projecting its growth in the future on about the same basis as it has in the past, we are looking for about a 5-percent increase, and we made a study of what the capital requirements would be on that basis for six of the largest principal public for-hire carriers.

We have ascertained that if the funds were available these six carriers would expect to spend about $336 million over the next 5 years; and in attempting to finance this we find that about $175 million could be financed internally from cash flow, about $89 million externally from the issuance of securities and borrowing, leaving about $72 million to come from some other source if it were available.

Now, projecting these figures nationwide, if all of the fore-hire carriers would have the same experience, and there is no reason to believe that it would depart particularly from this, we would have to multiply that figure, those figures, in fact, by about four; and if we included the private carriers we would have to multiply them by about five.

From practical experience as an operator of a barge line, I can definitely say that the application of the investment credit would not only aid statistically in eliminating or partially eliminating this capital deficit, but it would also very definitely stimulate the construction of new equipment.

I do believe, however, that some of the restrictions which exist in the House bill tend to frustrate this benefit, particularly the restriction which limits the application of the investment tax credit to one-half of the profit.

The investment tax credit would supply for just these six companies $29 million of additional investment funds. If all the fore-hire carriers are included, which we certainly would recommend, it would supply $116 million additional investment funds; and if all, including the private carriers, were included, the figure would be about $145 million.

Now, most of the other surface transportation modes do have, in effect, the right to write off their capital assets in 5 years. The motor carriers, of course, turn over their capital or their rolling stock generally in about 5 years; and the railroads under the House bill 10947 have the right to select either the existing 5-year writeoff or the investment tax credit.

I believe that there is such a requirement for new equipment in the transportation field, and there is so much obsolescence, that this committee might well give serious consideration to granting both the investment credit and the 5-year write off to the surface transportation modes.

Finally, let me point out that projecting the study of the six large carriers to the entire fore-hire shallow-draft carrier industry for the next 5 years, there is an indicated deficit of capital funds of about $360 million which can be reduced by $147 million if the investment tax credit were granted to all and if it could be fully used. This does leave, however, over $200 million of additional funds which should be spent to optimize the condition and the size of the fleet.

This brings me to one last subject: The inland water carriers are the only water carriers not now included in the tax shelter construction reserve provisions of existing law. I would like to respectfully suggest that this committee might seriously consider extending the tax reserve provision to the inland water carriers just as it now applies to the Great Lakes carriers and to the coastwise deep-draft industry.

Thank you very much.

The CHAIRMAN. Thank you very much.

Senator HARTKE. I might just say I do feel this is probably a discrimination against one form of carrier which may not necessarily be intended and probably should be corrected somewhere along the line.

The CHAIRMAN. Thank you gentlemen.

Mr. HERSHEY. Thank you very much.

(Mr. Creedy's prepared statement follows:)

STATEMENT OF JOHN A. CREEDY, PRESIDENT, WATER TRANSPORT ASSOCIATION

My name is John A. Creedy, president of the Water Transport Association of New York. WTA is a non-profit trade association representing I.C.C. certificated inland barge operators on the inland rivers and canals. Our membership also includes I.C.C. certificated operators on the Great Lakes and in the coastwise and intercoastal trades.

We are here to suggest that H.R. 10947 be amended to include inland barge operators in the five-year tax depreciation privilege so that barge operators will have the option of taking either the seven percent investment tax credit or the five-year write-off. This privilege has been accorded to our competitors, the railroads. In addition, other transport modes have write-off privileges which are analagous to the five-year tax depreciation privilege. Thus, the barge lines have been the only segment of the transportation industry not to have available an investment incentive privilege. In the water carrier industry itself, the construction reserve is available to Great Lakes, coastwise and intercoastal operators under the Merchant Marine Act of 1970. Only the inland barge lines of the entire transportation industry are left out of any tax incentive program. Our proposal provides an opportunity to repair what probably is a simple legislative oversight.

Adequate and efficient transportation service is indispensable to national economic growth and productivity. Transportation costs are a significant factor in total production costs, particularly in the case of basic industrial and agricultural commodities, and substantially affect not only the total burden of costs borne by American consumers but the ability of the U.S. economy to compete on a cost basis in world markets.

The for hire barging fleet is a vital component of the nation's transportation capacity, and its inherent efficiency enables it to carry substantial volumes of such commodities over the country's great network of navigable rivers and inland waterways at extremely low rates. Despite the heavy pressure of increased wage, fuel, equipment, capital and other costs, average barging rates per ton mile are less than they were in 1960. The record of lower rates in the face of increasing costs in a period of rapidly expanding demand has been made possible only by investment in modernization and improvement of barges and towboats and in expansion of capacity on a scale which has strained the financial resources of the barge lines to their limit.

The present investment plans of the bargelines fall short of providing the expanded and improved service which the nation's growing economy requires and which advanced technology permits. Optimum economic performance requires that on the average equipment be replaced after 15 years of service. Engineering studies demonstrate that repair and maintenance costs, which accelerate with vessel age, rise sharply after 10 years, and operation becomes highly and increasingly uneconomic after 15 years. Despite heavy past investment, approximately one-half of the barges now in service are either already overage or will become so before 1975. In addition, a substantial portion of the fleet is now obsolete technologically and needs replacement with the most modern equipment available in order to facilitate the larger tows and higher speeds required to hold down operating costs and shipping rates.

Borrowing capacity is already stretched as far as it can safely go, and capital funds in prospect are insufficient to finance the needed outlays. The privilege of depreciating equipment on a 5-year basis for tax purposes would provide an important supplement to such funds and would contribute significantly to the attainment of investment objectives.

Although the bargelines must meet vigorous railroad competition in which relatively small differences in rates can be decisive, the present revenue law permits accelerated depreciation on a 5-year basis for freight cars and locomotives but not for barges and towboats. Liberalizing depreciation allowances in a manner paralleling that enjoyed by railroads would directly increase the flow of funds available to finance the acquisition of needed barging equipment and, at a minor cost in revenue, make an important contribution, both directly and indirectly, in the battle to control the cost-price inflation spiral. Advancing the efficiency of water transportation not only serves to hold down the costs borne by those moving goods by water but, as attested by the long history of vigorous water-rail competition, exerts healthy pressures upon rail transportation for technological innovation and operating efficiency which produce lower cost for movements by rail as well. Thus, extending this type of tax treatment to the barge lines would be justified not only for compelling reasons of competitive equity but also because it would serve the public interest well.

Granting the barge lines the 5-year tax depreciation privilege now enjoyed by the railroads would not open the door to loss of revenues contributed by other froms of transportation. Airlines are already permitted to depreciate their equipment for tax purposes in 5 years or less. Many trucking companies do the same. The Great Lakes and ocean carriers already receive a substantial analogous benefit under the construction reserve provisions of the recently passed Merchant Marine Act.

The tax guideline life applicable to barging equipment is 18 years. Under the "asset depreciation range" system recently announced, the economic life of such equipment for tax purposes will be reduced to 14½ years. This will be helpful to some carirers, but not to others which were already depreciating on the basis of 15 years or less in conformance with demonstrable economic life.

A special survey conducted by the Water Transport Association shows the magnitude of barging equipment acquisition requirements during the five-year period 1971–75. This survey covered the six largest barging companies, and is based upon a projection of traffic growth at the rate of 5 per cent annually, which is conservative in relation to recent levels of demand, and replacement of equipment at a rate to maintain the fleet at a 15-year age.

In the 5-year period 1966–70, these six companies acquired 998 barges and 28 towboats at a total cost of about $95 million. During the 1971–75 period, by contrast, the projected requirements are for acquisition of 2,410 barges and 61 towboats at an aggregate cost of $354 million. After allowing for proceeds from sale of equipment, the net cost is $336 million. Over this 5-year period, cash flow (defined as net income after taxes plus depreciation and other noncash expenses) is expected to total about $175 million, assuming no changes in levels of rates or of wages and other items of expense. Of this $175 million, the change to ADR depreciation is expected to provide about $7 million. The total external financing required to acquire the needed equipment totals $161 million.

Given the limitations imposed by prudent financial management upon the debt-equity structure of these companies, however, their independent estimates indicate that only about $89 million of this requirement is expected to be available from external capital funds, leaving a deficit of about $72 million to be financed. If 5-year tax depreciation were approved, the effect would be to reduce this indicated deficit by about 40 percent, or approximately $29 million.

Attached as exhibit one is the financial data for the six major barge lines surveyed.

Exhibit two represents proposed language to implement the proposal. This proposal is already before the Senate as part of S. 2362, the Surface Transportation Act of 1971. As such it has the support of the Association of American Railroads and the American Trucking Associations.

The attached proposal, if adopted, would remove for the railroads certain present restrictions. The rationale for doing that is simply that the investment tax credit proposal has no such restrictions and if the five-year amortization is to be an alternative it should not have restrictions either.

The legislation as proposed offers to the Committee a method of limiting the privilege to public "for hire" carriers and excluding the so-called private carriers, those carriers wholly owned by a shipper. In order to qualify a carrier must be doing 90 percent of his business on a "for hire" basis. We would not, however, oppose having the privilege extended to the so-called private carriers.

To provide the Committee with a measure of the impact of the proposal, we have relied on the vessel inventory of the Corps of Engineers, Transportation Series, Volumes 3, 4 and 5, published in New Orleans. The latest publication which provides information as of January 1, 1970 shows non self-propelled vessels (barges and scows) totalling 19,377 with a total carrying capacity of 24,028,024 net tons.

The six companies surveyed own a total of 3,861 barges with a carrying capacity of 5,378,426 net tons. Thus, based on carrying capacity, the six companies represent slightly less than a fifth of the carrying capacity of the nation. Hence the potential tax impact calculated for the six companies should be multiplied by five to get the total for the nation. Although no government statistics exist for the proportion of private carriers, a survey of the listed companies in the Corps of Engineers vessel inventory, makes possible an informed estimate. In our opinion, the private companies represent about one fifth of the entire fleet of non-self-propelled barges and scows. Restricting the five-year amortization to the public "for hire" carriers would thus reduce the tax impact by about one fifth.

In closing, may we say that we are greatly encouraged by the prompt action of the House of Representatives on the President's proposal for restoration of the investment tax credit. This is a well tested method of stimulating investment and creating jobs. We sincerely hope that the Revenue Act of 1971 will get favorable action from the Senate.

EXHIBIT 1.—COMBINED FINANCIAL DATA FOR 6 MAJOR BARGE COMPANIES

[Dollars in thousands]

		Cost	Total
Book value of transport equipment, Dec. 31, 1970:			
Acquisition cost		$229,657	
Reserve for depreciation		119,339	$180,318
Type	Number	Acquisition cost	Total
Total equipment outlays, 1966–70:			
Barges	998	$74,950	
Towboats	28	20,870	$95,820
Projections, 1971–75: [1]			
Gross cost of equipment acquisition requirements:			
Barges	2,410	268,678	
Towboats	61	84,345	$353,023
Proceeds from sale of equipment			17,002
Net cost of equipment acquisition requirement			336,021
Total cash flow, using ADR tax depreciation:			
Cash flow using old tax depreciation		167,651	
Increased cash flow due to ADR		7,290	174,941
Total external financing required			161,080
External capital funds prudently available			89,083
Indicated deficit in equipment outlays using ADR depreciation			71,997
Reduction of indicated deficit by use of 5-year tax depreciation			29,426

[1] Basic assumptions: annual traffic growth rate, 5 percent; equipment replacement at 15 years; no change in rate levels; projected equipment prices and capital funds prudently available estimated independently by each company.

EXHIBIT TWO

SEC. 503. EXPANSION OF 5-YEAR AMORTIZATION OF ROLLING STOCK TO SURFACE TRANSPORTATION EQUIPMENT

(a) IN GENERAL.—Part VI of subchapter B of chapter 1 (relating to itemized deductions for individuals and corporations) is amended by striking out section 184 and inserting in lieu thereof the following new section:

"SEC. 184. AMORTIZATION OF CERTAIN TRANSPORTATION EQUIPMENT

"(a) ALLOWANCE OF DEDUCTION.—Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any qualified transportation equipment (as defined in subsection (d)), based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the qualified transportation equipment at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction provided by this section with respect to any qualified transportation equipment for any month shall be in lieu of the depreciation deduction with respect to such transportation equipment for such month provided by section 167. The 60-month period shall begin as to any qualified transportation equipment, at the election of the taxpayer, with the month following the month in which such transportation equipment was placed in service or with the succeeding taxable year.

"(b) ELECTION OF AMORTIZATION.—The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the month following the month in which the qualified transportation equipment was placed in service, or with the taxable year succeeding the taxable year in which such transportation equipment is placed in service, shall be made by filing with the Secretary or his delegate, in such manner, in such form, and within such time, as the Secretary or his delegate may by regulations prescribe, a statement of such election.

"(c) TERMINATION OF AMORTIZATION DEDUCTION.—A taxpayer which has elected under subsection (b) to take the amortization deduction provided by subsection (a) may, at any time after making such election, discontinue the amortization deduction with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Secretary or his delegate before the beginning of such month. The depreciation deduction provided under section 167 shall be allowed, beginning with the first month as to which the amortization deduction does not apply, and the taxpayer shall not be entitled to any further amortization deduction under this section with respect to such transportation equipment.

"(d) QUALIFIED TRANSPORTATION EQUIPMENT.—The term 'qualified transportation equipment' means, for purposes of this section:

"(1) rolling stock of the type used by a common carrier engaged in the furnishing or sale of transportation by railroad and subject to the jurisdiction of the Interstate Commerce Commission if—

"(A) such rolling stock is—

"(i) used by a domestic common carrier by railroad on a full-time basis, or on a part-time basis if its only additional use is an incidental use by a Canadian or Mexican common carrier by railroad on a per diem basis, or

"(ii) owned and used by a switching or terminal company all of whose stock is owned by one or more domestic common carriers by railroad, and

"(B) the original use of such rolling stock commences with the taxpayer after December 31, 1968,

"(2) any water vessel of the type used for the transportation of property on the navigable rivers and inland waterways of the United States (including tugs, towboats and barges, whether or not self-propelled) if—

"(A) such vessel is used on a full-time basis by common carrier of property by water, or

"(B) at least 90 percent of the use of such vessel is to transport property by water for compensation,

"(3) trucks (including tractors, trailers, and semitrailers) of the type used on a full-time basis for transportation of property by a common or contract carrier subject to the jurisdiction of the Interstate Commerce Commission.

"(e) SPECIAL RULES.—

"(1) PLACED IN SERVICE IN 1969.—If any qualified railroad rolling stock is placed in service in 1969--

"(A) the month as to which the amortization period shall begin with respect to such rolling stock shall be determined as if such rolling stock were placed in service on December 31, 1969, and

"(B) subsections (a) and (b) shall be applied by substituting '48' for '60' each place that it appears in such subsections. This section shall not apply to any qualified railroad rolling stock placed in service in 1969 and owned by any person who is not a domestic common carrier by railroad, or a corporation at least 95 percent of the stock of which is owned by one or more such common carriers.

"(2) PLACED IN SERVICE IN 1970.—If any qualified railroad rolling stock is placed in service in 1970 by a domestic carrier by railroad or by a corporation at least 95 percent of the stock of which is owned by one or more such common carriers, then subsection (a) shall be applied, without regard to paragraph (2), as if such rolling stock were placed in serviee on December 31, 1969.

"(3) ADJUSTED BASIS.—

"(A) The adjusted basis of any qualified transportation equipment with respect to which an election has been made under this section, shall not be increased, for purposes of this section, for amounts chargeable to capital account for addition or improvements after the amortization period has begun.

"(B) Costs incurred in connection with a used unit of qualified transportation equipment which are properly chargeable to capital account shall be treated as a separate unit of transportation equipment for purposes of this section.

"(C) The depreciation deduction provided by section 167 shall, despite the provisions of subsection (a), be allowed with respect to the portion of the adjusted basis which is not taken into account in applying this section.

"(4) CONSTRUCTIVE TERMINATION.—If at any time during the amortization period any qualified transportation equipment ceases to meet the requirements of subsection (d), the taxpayer shall be deemed to have terminated under subsection (c) his election under this section. Such termination shall be effective beginning with the month following the month in which such cessation occurs.

"(5) METHOD OF ACCOUNTING FOR DATE PLACED IN SERVICE.—For purposes of subsections (a) and (b), in the case of qualified transportation equipment placed in service after December 31, 1970, the taxpayer may elect to begin the 60-month period with the date when such transportation equipment is treated as having been placed in service under a method of accounting for acquisitions and retirements of property which—

"(A) prescribes a date when property is placed in service, and

"(B) is consistently followed by the taxpayer.

"(6) TRANSPORTATION FOR COMPENSATION.—For purposes of subsection (d) (2) of section 184, transportation of property for a component member of a controlled group of corporations (as defined in section 1563) which includes the owner or lessee of a vessel shall not be treated as transportation for compensation.

"(f) LIFE TENANT AND REMAINDERMAN.—In the case of qualified transportation equipment leased to a carrier, and held by one person for life with remainder to another person, the deduction under this section shall be computed as if the life tenant were the absolute owner of the property and shall be allowable to the life tenant.

"(g) CROSS REFERENCE.—

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

(b) CONFORMING AMENDMENT.—The table of sections for part VI of subchapter B of chapter 1 is amended by striking "Sec. 184. Amortization of Certain Rolling Stock" and inserting in lieu thereof "Sec. 184. Amortization of Certain Transportation Equipment."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1970, and shall apply with respect to property placed in service in taxable years beginning after December 31, 1970.

SEC. 504. ELIMINATION OF MINIMUM TAX ON FIVE-YEAR AMORTIZATION.

(a) IN GENERAL.—Section 57 (relating to items of tax preference) is amended—

(1) by striking out paragraph (5) of subsection (a) and

(2) by renumbering paragraphs (6), (7), (8), and (9) of subsection (a) as paragraphs (5), (6), (7), and (8).

(b) EFFECTIVE DATE.—Amendments made by subsection (a) of this section shall apply to taxable years ending after December 31, 1969.

The CHAIRMAN. The next witness will be Mr. Theodore F. Brophy, counsel of the U.S. Independent Telephone Association.

STATEMENT OF THEODORE F. BROPHY, ESQ., COUNSEL, U.S. INDEPENDENT TELEPHONE ASSOCIATION

Mr. BROPHY. Chairman Long, honorable members of the Senate Finance Committee, my name is Theodore F. Brophy. I am executive vice president and general counsel of the General Telephone & Electronics Corp. and I am appearing here on behalf of the U.S. Independent Telephone Association.

We are seeking no special privileges for the telephone industry but we are seeking to avoid discrimination against the telephone industry.

H.R. 10947 as passed by the House limits telephone companies to a 4-percent investment tax credit as against the 7 percent given to their competitors.

As Chairman Long well knows, from the debates on the 1964 act, and particularly section 203(e), at that time the distinction between the 7-percent credit utilities and the 3-percent credit utilties under the 1962 act was based upon the concept that certain utilities were more subject to competitive pressures than others.

Since 1962 there have been strong new competitive pressures developed in the telephone communications industry. These competitive pressures fall into two classes: competition in the provision of service and competition for the raising of capital.

Since 1962 in the competition for the provision of service there are various forces which are new. Private microwave systems are today competing with the systems provided by telephone companies. For example, ARINC, Aeronautical Radio, Inc., recently announced a proposed $250 million private communications system to serve the airline industry. This business would, of course, be taken away from the telephone industry.

Customers may now, after the decision of the FCC recently in the Carterfone case, own their own telephone equipment and attach it or connect it to the telephone system. The equipment may be in terms of a major system or it may be a small, individual item of equipment.

Special purpose common carriers may be licensed by the Federal Communications Commission to provide long distance voice or data communications over microwave systems in competition with the telephone companies; and the administration has recommended the licensing of satellite systems in competition with communications systems of the telephone industry.

In short, since 1962 a whole new competitive atmosphere has developed.

In our testimony before the House Ways and Means Committee we emphasized this service competition, and we believe that we were successful at least in bringing this matter to their attention and they attempted to remedy the discrimination which we suggested would exist if telephone companies were not given the same credit as other industrial companies.

They attempted to remedy it by, first of all, increasing the investment tax credit from 3 percent to 4 percent and also by changing the definition of public utility property.

The definition, however, is not broad enough to protect the telephone companies from discrimination in favor of other modes of communication service; but in addition the 4 percent credit obviously was discriminatory as compared to the 7 percent credit and no relief was provided for the competition in the money market.

Telephone companies are capital-intensive and by this I mean telephone companies cannot conceivably raise from their own earnings the amount of money that they need to provide service. In my own company, General Telephone & Electronics Corp., over the next 5 years our estimated construction budget will run $6.3 billion. Of that amount only $2.7 billion can be internally generated whereas the balance of $3.6 billion will have to be raised through the sale of securities to the public.

For these funds we will be in competition with other companies, companies which are getting the 7 percent investment tax credit.

Telephone companies, perhaps, beyond all other industries have been the victims of, rather than the cause of inflation. We have been victims in terms of high costs of capital and higher costs of equipment.

In preparing for this testimony I ran across some rather shocking figures.

In 1960 our average investment in plant in our company for each new telephone main station was $477.

In 1970, it cost us $3,313 to put in each new main station. This meant that our average investment in telephones from 1960 to 1970, went from $455 per station to $1,036 per station, while at the same time our imbedded cost of capital was going from 4.46 percent in 1965 to 6.10 percent in June of 1971, with the current cost of bonds in June of—cost of money on the sale of bonds in June of 1971, at 8.45 percent.

Now the result of these ravages of inflation upon the telephone industry has been that the market for our securities has recognized the problems that are being created by inflation. Our interest coverage in our company, for instance, since 1966 when it was 3.74 times earnings of interest, in other words, the earnings before taxes were 3.74 times the interest requirement, had dropped to 2.5 times earnings interest requirements in 1970. That is a reduction of 9.6 percent a year and trending that on we would reach a point in the first quarter of 1973, where we would no longer be able to finance construction through the sale of debt security having fallen below the 2.5 times coverage required by our indentures.

The same phenomenon, of course, is being experienced by all other telephone companies; we are not unique in this respect. Our ability to raise capital in the future and the health of the telephone industry depends on our ability to compete with other industry. It is imperative that we not be saddled with taxes that are unfairly weighted against the telephone industry.

Telephone companies have a competitive disadvantage in providing service by reason of the—or would have a competitive disadvantage of providing service by reason of the 4-percent credit provided in the House bill as against the 7-percent credit available to our competition. The fact that we would have this disadvantage would also be reflected in the market's evaluation of our securities.

The effect of the 4-percent credit versus the 7-percent credit, of course, would be that larger users of communications services would elect to provide their own services, and the burden would therefore be shifted to the smaller user. As the cost of communication service increased in this manner there would be a snowballing effect with smaller and smaller users able to afford their own equipment, and the ultimate burden remaining on those people, the homeowner who could least afford to bear the burden.

The marketplace has already recognized the effect of inflation on the telephone industry in the devaluation of their view of the utilities' securities value. In 1963, utilities, as a whole, commanded a premium over industrials, and their price/earnings ratios were 113 percent of the average price/earnings ratios of industrials. In this year that percentage has dropped to 65 percent so that utilities' price/earnings ratios are approximately 65 percent of the price/earnings ratios of industrials.

We believe communications services are vital to this country. We believe that the telephone company common carriers, if permitted a fair opportunity to compete, can provide that service in the most economical manner to the people of the United States, and all we ask is that fair opportunity to compete.

If the Government's concern is, as we expect it may be, the revenue effect of granting the 7-percent credit to the telephone companies, we suggest that it should not solve this problem by discrimination against the telephone companies but by making whatever adjustment may be necessary in the rate of the credit so that it may be spread fairly and equitably over all industry.

Thank you, Mr. Chairman. If there are any questions I would be glad to answer them.

Senator CURTIS. Would you give us some illustrations that we can understand of where business or individuals provide their own communications systems?

Mr. BROPHY. Yes, Senator Curtis. I think probably the most dramatic one was the one I mentioned of ARINC. That proposes to construct a $250 million system to serve the airlines rather than take their service from us.

Senator CURTIS. Will that be radiotelephone?

Mr. BROPHY. That would be microwave, radio, landlines, switching systems, a complete internal communications system.

Senator CURTIS. Now, that would be the combined airlines or a single airline would do that?

Mr. BROPHY. ARINC serves as the communications arm for all the airlines.

Senator CURTIS. As the House bill is written, what investment credit would they get for that?

Mr. BROPHY. They would get a 7-percent credit.

Senator CURTIS. But if the regulated telephone company provided it, they would come under the 4?

Mr. BROPHY. They would get a 4-percent credit.

Senator CURTIS. Are there any smaller illustrations that are occurring in most of our communities?

Mr. BROPHY. Yes; yes, there is strong competition in the provision of PABX's, private automatic branch exchanges, the kind of a switchboard you find in an office or hotel or motel.

There has been a trend in the hotel and motel business of buying their own switchboards rather than taking the switchboard service from the telephone company. Under the circumstances if the House bill were enacted into law the motel or hotel would have an incentive to purchase rather than take from the telephone company since the purchaser of the switchboard would get the 7-percent credit whereas the telephone company would have only 4-percent credit providing the same equipment and service.

Senator CURTIS. You use the term "switchboard;" does that include telephone instruments and wiring and other things in the building? What is usually meant by the term?

Mr. BROPHY. That would include the entire installation within the building; yes, Senator Curtis, the telephone instruments, the wiring.

Senator CURTIS. Before these recent decisions whereby they could do that and demand and receive a hookup from a regulated utility, what was the custom?

Mr. BROPHY. Prior to 1968, when the Federal Communications Commission decided the *Carterfone* case, there were tariff prohibitions against the interconnection of customer-owned equipment with the telephone network and, therefore, it was not practical or possible for the customer to own his own equipment and interconnect it with the telephone network; and this is one of the major changes in the competitive nature of the industry that I mentioned in the beginning of my testimony.

Senator CURTIS. Prior to 1968, if someone built a new hotel, the wiring and the telephone instruments, exclusive of the switchboard, who built that?

Mr. BROPHY. Prior to 1968, the telephone instruments, wiring, and switchboard would all be owned by the telephone operating company. If the hotel elected to own its own switchboard it would not at that time have been able to get into the outside world, even to the telephone network, so as a practical matter it would not own its own equipment.

Senator CURTIS. That is all, Mr. Chairman.

Senator BENNETT. I have just one question, while we are waiting for the chairman.

It seems to me about 10 years ago I spent a night in a Las Vegas hotel and that hotel had these foreign telephones which are activated when you lift them up. It was the first time I had ever seen them. You mean to say when they purchased instruments of that kind they shut themselves off from the outside connection? I am sure they didn't.

Mr. BROPHY. I believe those were foreign instruments that were purchased by an independent telephone company serving in that area, Senator, and were not owned by the hotel at that time.

Senator BENNETT. I see.

Mr. BROPHY. There is increasing foreign competition in the sale of telephone equipment and our competitors the Japanese have been making a market in the sale of telephone equipment in the United States, and I think this is another reason why the American manufacturer in selling to the telephone company and to the telephone company's competitors need the 7 percent credit to encourage the purchase of American-made equipment. Japanese switchboards are now being offered and sold to hotels and motels and even being used by some operating telephone companies because they have an obligation to the public to provide equipment at the lowest possible cost.

Senator BENNETT. That satisfies my curiosity. I began these hearings and I might as well close them.

Mr. BROPHY. Thank you.

Senator BENNETT. Thank you, very much.

(Mr. Brophy's prepared statement follows:)

PREPARED STATEMENT OF THEODORE F. BROPHY ON BEHALF OF UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION

The United States Independent Telephone Association has asked to appear before this Committee because it is vital to the health and development of the dependent telephone industry that the proposed job development investment credit not discriminate in rate against telephone companies in favor of their unregulated competitors. H.R. 10947, as passed by the House of Representatives, limits telephone companies to 4%, a discrimination that cannot be rationally or fairly justified in 1971.

(1) *In view of the revolutionary development of competition in the communications industry since 1962, telephone companies should receive the job development credit at the same full rate applicable to other competitive businesses;*

(2) *If, however, the full job development credit is not made available to telephone companies, the lesser rate should be made applicable to all property of the type used by telephone companies in furnishing communications services to the public so that telephone companies and their competitors, regulated and unregulated, compete on the same basis;* and

(3) *No fixed deadline should be imposed on regulatory commissions for adapting their ratemaking treatment to the standards required of public utilities in the bill.*

* * * * * * *

The United States Independent Telephone Association (USITA) is a trade association representing 95% of the Independent (*i.e.*, non-Bell) segment of the telephone industry consisting of 1843 companies serving over one-half the geographical service area of the United States. Its companies, which have 1,380.000 stockholders, employ directly 150,900 employees in telephone service alone. The entire telephone operating industry, including the Bell System, employs a million persons, with hundreds of thousands more involved in equipment manufacture, directory production and distribution, and related activities. The size of USITA's member companies ranges from General Telephone & Electronics Corporation, which currently serves nearly 10,000,000 telephones, to members which have as few as 100 telephones or less in service.

Appearing on behalf of the Association today is Theodore F. Brophy, Executive Vice President and General Counsel of General Telephone & Electronics Corporation, a nationwide telephone company with headquarters in New York City, who is intimately familiar with the competitive situation facing the telephone industry today.

Introduction. In testimony before the Ways Means Committee on this bill, USITA presented testimony on the rapid growth of competition facing regulated telephone companies in all phases of their activity. Apparently, the Ways and Means Committee was in agreement with this presentation, for it found that the telephone companies are encountering ". . . increased competition from other regulated companies and, in the case of many of their products, from unregulated companies as well." See H. Rep. No. 92–533, p. 24. The Committee on Ways and Means did not make the full 7% rate applicable to telephone companies, but it attempted to meet the competition problem by providing that the 4% rate would be applicable to others providing *regulated* "communications services". The method, however, does not meet adequately the problem occasioned by the wide-spread nature of the increased competition, inasmuch as the 7% rate will be available with respect to competing communications equipment in the hands of *non-regulated* companies, and private industrial users.

The Bill as passed by the House of Representatives does not impose the 4% rate on all regulated utilities, rather it excludes those that were thought to be competitive back in 1962. Regulated transportation companies, for example, were then (and would now be) given a full credit because they are "not only competitive among themselves at given regulated prices, but also must compete with private truck fleets, private airplanes, and other transportation facilities operated by industrial corporations which would be eligible for the [full] credit." Testimony of former Secretary of the Treasury C. Douglas Dillon at Hearings Before House Committee on Ways & Means on President Kennedy's 1961 Tax Recommendations. 87th Cong., 1st Sess. (1961), 256–257. The same description applies to the telephone industry in 1971.

The Telephone Industry Today is Highly Competitive and Will Become More Competitive in the Near Future. An examination of the facts will show that a dramatic change has taken place since 1962, particularly within the last 3 years, that has transformed the regulatory and competitive environments in which telephone companies operate. The telephone industry today is faced with substantial competition from unregulated competitors, competition that is sure to increase even more rapidly in the future under a new regulatory philosophy. Today, unlike 1962, industrial corporations may purchase voice and data equipment that interconnect with the telephone network, and indeed entire private communications systems, to replace facilities once provided exclusively by telephone companies. Unless these facts are recognized, many telephone companies will be unable to compete with unregulated suppliers of such equipment under a tax structure with a built-in competitive disadvantage against the telephone industry—and consequent detriment to the public.

Until recently, it had long been thought that competition in the field of communication services was wasteful and inefficient. Public regulatory agencies were created to substitute for the market forces that ordinarily govern economic decisions in a free enterprise economy so that the efficiencies of a monopoly could be realized while safeguarding the public interest.

The "information explosion" and extraordinary technological progress in the communications field in recent years have shattered traditional modes of thought about the telephone industry. Economists and regulatory bodies are no longer so certain that the public is best served when government rather than open competition determines the price of communications services. As a result, a new competitive philosophy is emerging which already has placed the telephone companies in competition with unregulated firms in the most rapidly expanding areas of the communications business.

The new competitive philosophy and its impact on the future of the telephone business was succinctly put to members of USITA by the Chief of the Federal Communication Commission's Common Carrier Bureau at USITA's 72nd Annual Meeting in Washington, D.C. on October 21, 1969:

"You are a vital part of an industry which is going through a period of change unlike anything that has been experienced in the past. The changes I refer to affect the basic structure and pattern of communication supply and demand in this nation. They are changes which tend to have far-reaching and lasting impact upon the future role of the telephone industry and at the same time are generating a number of basic regulatory and policy issues.

* * * * * * *

"Your industry is being put to the test as to its ability to rise to the challenge of the new technologies and the customer demands they stimulate for efficient and economic new services. You must be expected to meet these challenges or to stand aside that others may do so. And it is becoming more apparent every day that in both the areas of local and inter-city services, there are others who are willing and capable of entering the field and who will contest your claim to exclusive occupancy. It is also apparent that they are prepared to enter and compete for the new, as well as existing markets."

Events have more than justified the prophecies made to USITA at its 1969 meeting.

Actually, the FCC began to implement the new competitive philosophy in 1968 with its landmark decision in the *Carterfone* case, 13 F.C.C. 2d 420 (1968), pet. for recon. denied, 14 F.C.C. 2d 571 (1968). In *Carterfone* the Commission subjected regulated telephone companies to competition from outside suppliers of devices designed to interconnect public telephone systems with privately-owned systems of communication. This decision has led to increasing and intensive competition on billions of dollars worth of telephone equipment and communications systems formerly owned and supplied exclusively by regulated telephone companies. For example, the monthly interconnection reports filed by the Bell System with the Federal Communications Commission disclose that as of February 27, 1969 it supplied 141 units to permit interconnection of customer-owned equipment with its system. By May 1971 it provided 27,776 such units. No doubt, there has been further increase since May and the phenomenal rate of increase can be expected to continue over the next few years.

In another revolutionary decision, the FCC has granted an application to construct a radio relay system on the high-volume route between Chicago and St. Louis for the availability of the general public, even though this route is presently served by telephone and telegraph companies. *Microwave Communications, Inc.*, 18 F.C.C. 2d 953 (1969), *affirmed* 21 F.C.C. 2d 190 (1970), and 27 F.C.C. 2d 380 (1971). As of June 30, 1970, there were 6,280 authorized microwave stations operated by regulated telephone and telegraph companies. Since the decision in *Microwave Communications, Inc.*, applications have been filed for more than 1800 microwave stations on high volume routes to be operated by competitors of the regulated communications companies.

This field was further opened to unbridled competition in a May 1971 FCC policy decision allowing virtually unlimited entry into the "specialized communications field." *See* 36 Fed. Reg. 11144 (1971). It is significant that the Commission stressed in this policy decision that existing carriers (*i.e.*, telephone companies) would be permitted to compete fairly and fully in the sale of specialized services, and that in directly competitive situations, the Commission would not oppose departure from uniform nationwide pricing practices. The Commission stated that there should not be any "protective umbrella" for the new entrants, nor any "artificial bolstering of operations that cannot succeed on their own merits."

Developments in microwave communications have enabled large companies to by-pass the existing telephone network by building their own systems. For example, it has recently come to public attention that the airlines, through Aeronautical Radio, Inc., are considering establishing their own nationwide communications network which would require a capital investment on the order of a quarter of a billion dollars.

Communication by industrial radio (not including aviation and marine) has increased from 92,713 authorizations on June 30, 1962 to 220,732 on June 30, 1970. *Compare* F.C.C. Annual Report 1962, page 97, *with* F.C.C. Annual Report 1970, page 262. Since the FCC decided in February 1971 (*Preston Trucking Company, Inc.*, Docket No. 19309) that a non-regulated licensee could share its facilities with other users, this category can be expected to expand further, both in terms of number of authorizations and volume of business.

The new competitive philosophy is also embodied in open competition among regulated and unregulated firms for satellite communications systems. The Economic Report of the President transmitted to Congress in February 1970 stated in this regard that:

"Long-distance communications may be entering a new and more competitive era with the development of satellite communication systems. Economies of scale in the operation of satellites do not appear to be sufficient to bar competitive operations. Hence the Administration has recommended to the FCC that multiple domestic satellite systems be authorized and that restrictions on entry be applied only where they are necessary to prevent undue interference. *It is the Administration's hope that increased competition will eventually make it possible to let market forces assume more of the role of detailed regulation.*" (Emphasis added).

It is evident that a discriminatory tax credit for the telephone industry works at cross-purposes with the Administration's and the FCC's new competitive philosophy. For, "market forces will not be able to assume the role of detailed regulation" if the telephone companies' unregulated competitors are given an "artificial bolstering of operations that cannot succeed on their own merits" that the FCC recently eschewed. Indeed, dual and discriminatory rates will distort the very purpose underlying the new competitive philosophy.

It is not possible to identify or quantify areas of telephone company services which are free from the impact of competition. This evolving competition has been so pervasive that we have been unable, despite earnest effort, to define or segregate the portion of telephone business now open to competition. As we stated in response to direct questions during the Ways and Means Committee hearings:

"The nature of competition facing telephone companies today is such that it affects literally the entire telephone network and all its facilities, including transmission equipment, switching equipment and terminal equipment. Recent Federal Communications Commission decisions and policy statements have enabled the establishment of communication facilities and networks not owned by the telephone companies, which can satisfy virtually all the needs of customers throughout the country in direct competition with the existing telephone network . . .

Further, . . . the loss of the high volume business presently available to the telephone companies from large users of communications services, which would be accelerated by a discriminatory job development credit, will necessarily make it more expensive for the telephone companies to serve the small user. Indeed, for many of the smaller telephone companies which depend upon a few large users in their areas to support low cost telephone services to the rest of the public, the loss of large users could have a disastrous impact. For many of these companies, the issue here could well be a question of survival."

It would Be Inconsistent with Past Practice to Establish a Tax Credit that Favors Unregulated Competitors. Both Treasury and the Congress have been sensitive to discriminatory application of the tax laws. As pointed out earlier, the 1962 investment credit carefully distinguished between regulated utilities that faced competition from unregulated industries (to whom the full credit was available) and the so-called "monopolistic" utilities that, in 1962, did not face a competitive disadvantage as a result of a smaller investment credit.

In fact, this Committee and the Congress have previously shown concern for the effect of the tax laws on developing competition between telephone companies and unregulated manufacturers with regard to privately-owned communications systems which was evident as far back as 1965. In relieving telephone company subscribers of the 10% telephone excise tax on telephone-company-provided private communications facilities in the Excise Tax Reduction Act of 1965, the Committee explained that:

"[The 10% excise tax] has presented problems under present law because of competition from untaxed private equipment performing similar services. The telephone companies presently are losing intrapremise business (and interpremise business within local areas) to those providing telephone and microwave equipment which can be purchased and operated by the users themselves. Installation of equipment in this manner is accompanied by a reduction in the service from the local telephone company. Businesses installing their own internal communications systems in this manner avoid the tax on the telephone company's charge for both equipment and services. With the ever-increasing number of varied services which modern science makes it possible for telephone companies to provide, the tax on private communications systems represents a severe competitive handicap to the expanded use of these new and varied services." Sen. Rep. 324, 89th Cong., 1st Sess. (1965) p. 36.

As noted above, the area of competition has expanded greatly since that time and will expand even more in the near future. Certainly at the time of enactment of a new credit, Congress will wish to make sure that it is not weighting the scales of competition against the telephone companies by holding them to a lesser rate.

The Burden of Discrimination Against Telephone Companies Will Fall on Small Business and Individual Users. If there is discriminatory application of the investment credit against the telephone companies, the weight will not fall evenly on all customers. Large business users will be able to get the benefit of the full credit by using their own telephone equipment or turning to nonregulated suppliers. Individual and small-business telephone users, who cannot as a practical matter take such a step, must pay the higher cost.

In fact, the cost effect on the small users would be magnified. The full investment credit would siphon off the large-volume customers and heavy users of long-distance toll service, leaving the telephone companies to serve the low-volume customers. By skimming off the cream of telephone users, the competitors would necessarily force the telephone companies to increase their rates to cover the higher cost of providing service to the balance of the public.

A Full Job Development Credit Will Promote Use of Domestic Telephone Equipment. The United States telephone equipment manufacturing industry is facing increasing competition from equipment manufacturers in foreign countries. United States imports of foreign-made switching equipment and other telephone equipment has increased dramatically in recent years. The competitive position of United States companies manufacturing telephone equipment would be improved by granting the full investment credit, and telephone operating companies would be encouraged to purchase equipment manufactured in this country.

A Job Development Credit Will Increase Telephone Company Investment. One argument advanced in 1962 for providing a lower tax credit for "monopoly" utilities was that the growth of utilities was dictated by the demand for their services subject to the guiding hand of the regulatory commissions; thus it was suggested that the growth would not be affected by a tax stimulus.

It was assumed in 1962 that utilities already had sufficient plant and access to capital to meet the present and future needs of customers without a full tax credit. For example, the Treasury memorandum which attempted to justify discriminatory treatment of utilities stated that there were already high levels of excess capacity in the case of electrical utilities. Senate hearings on H.R. 10650, 87th Cong., 2d Sess. (1962), 129 (Part 1). The blackouts and brownouts that have occurred since that time show just how fundamental a misunderstanding that was. While the United States has long been the world leader in standard of telephone service, we all know that in a number of places in this country, telephone companies have been unable to make the capital investment necessary to give customers the quality and volume of service which the companies wish to provide and to which their customers are entitled.

In theory, the regulatory agencies should be able to set telephone company rates at a level adequate to enable the companies to receive and attract sufficient capital to provide for modernization and expansion of service. As a practical matter, regulatory agencies have recently been no more able to provide an adequate level of capital for modernization and expansion than have the board of directors of unregulated industries. The regulatory agencies are faced with political pressures to keep rates as low as possible at a time at which interest rates have risen to extraordinary heights and the capital needs of the telephone companies are at unprecedented levels. Even where a regulatory agency attempts to balance these requirements, there is the inevitable "regulatory lag" between the time that the need for greater funds arises and the time at which rates to produce these funds can be put into effect.

As a result, telephone companies are faced with an acute need to raise capital in competition with unregulated industry. But at the same time we are entering an era when some telephone companies are encountering difficulties in meeting interest coverage requirements because of higher interest rates and lower earnings. A discriminatory job development credit would compound the problem by enhancing the attractiveness of non-regulated companies in the eyes of investors and placing securities of the telephone companies at a competitive disadvantage in the securities markets.

A full direct tax credit will be of substantial assistance in meeting these problems by offering a prompt assured source of capital and lessening demands on the capital market. The response of telephone companies, no less than in the case of unregulated business, will be to respond with the increased capital investment that is the objective of the job development credit.

The Prohibition Against Flow-through Embodied in the House Bill Insures That the Tax Savings from the Credit Will Be Available for Capital Investment. Another major argument advanced in 1962 to justify discriminatory treatment of regulated utilities was that the credit would be passed on to consumers in the ratemaking process and thus would not be available for capital investment as intended by Congress. But experience has shown that the solution to that problem is not to discriminate against utilities by denying them benefits offered to other taxpayers but rather to limit the "flow-through" of the credit through Congressional action.

When Congress learned in 1964 that some Federal agencies were requiring an immediate flow-through of the 1962 investment credit to customers of regulated industries, it responded by prohibiting such action in Section 203(e) of the Revenue Act of 1964.

A somewhat similar situation arose in 1969. Regulatory agencies were succumbing to the lure of lowering rates by flowing through the tax savings from accelerated depreciation to utilities' customers. Indeed, some agencies had gone so far as to impute accelerated depreciation to companies that had remained on a straight-line basis for tax purposes. This undercut the reasons for accelerated depreciation and had an immediate significant adverse effect on the Federal revenue because the Government lost not only the tax attributable to the additional depreciation but also the tax it would have received had the rates not been reduced. Initially the Committee on Ways and Means concluded that it would be necessary to limit public utilities to straight-line depreciation for future property acquisitions. Press Release, July 25, 1969, p. 8.

However, on further consideration the Committee concluded that "this would place regulated utilities at an unfair competitive disadvantage, both in terms of the sale of their products or services and their attractiveness to equity investors." H. Rep. No. 91–413, p. 132. Accordingly, the Committee adopted what has now become Section 167 (*1*) of the Code which had the effect of "freezing" the then-existing situation by preventing any further shift to flow-through.

Similarly, when the Treasury announced earlier this year its proposal for an Asset Depreciation Range system ("ADR"), it was stated that ADR would not apply to public utility property pending further study. When the utilities made clear to the Treasury that their capital requirements and depreciation needs were similar to those of unregulated industries, the Treasury in its final regulations provided that public utility property would be included in the system if the tax savings therefrom were not flowed-through to customers.*

The House of Representatives has wisely followed these precedents in H.R. 10947 to adopt provisions which insure that the benefits of the job development credit are equitably shared by investors and customers. We strongly approve this approach, but we have an important technical amendment with respect to the timing of regulatory action which we think is necessary to insure that the credit not be lost inadvertently due to an omission of a regulatory commission to act promptly and correctly.

The Proposed April 1, 1972 Date for Conforming Action by Regulatory Bodies May Become a Trap to Deprive Telephone Companies and Their Customers of the Credit on Procedural Grounds. The Ways and Means Committee Report (page 26) gives the reason for the use of the April 1, 1972, date (after which the ratemaking accounting conditions are to be applicable, but not before) as follows:

"The wide variety of practices followed among the States and local regulatory agencies, makes it imperative that some time is allowed for those agencies to conform their practices to one of the permited options under this bill. In recognition of this matter, your committee had determined that these provisions are not to apply until April 1, 1972."

While we agree that it is reasonable to allow the various regulatory agencies a reasonable time "to conform their practices to one of the permitted options under this bill," the nature of the regulatory process requires that the regulatory agencies have ample time for this purpose without regard to any arbitrary cut-off date.

Ratemaking involves the determination of rates to be charged in the future, based upon the experience of a past test period, with adjustment for known or reasonably forseeable changed conditions to be experienced in the future, *e.g.*, wage increases. The application of an arbitrary cut-off date for regulatory action is entirely inapposite to this process. (It is not clear, for example, what regulatory steps would be required to qualify a telephone company now operating under a test period during which there was no investment credit.) It

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*It should be noted that if necessity arises for choosing between ADR and the job development credit, telephone companies participate fully in ADR and must participate fully in the job development credit to make equitable any trade-off between the two approaches.

should be sufficient that the company's election of one of the options in the bill be accepted in the *next* rate proceeding.

Further, in rate proceedings pending upon enactment of the bill, a determination of the rate treatment to be accorded the credit would normally not actually be implemented until final decision. In some pending cases, this could not be accomplished by April 1, 1972. Where no proceeding is pending, the danger of delay is even more acute. Even where the regulatory commission takes interim acton to approve practices conforming to one of the permitted options under the bill, there may be a question whether such action is truly effective prior to the final rate decision.

Insertion of an effective date dependent on formal affirmative action by the agency may actually have the effect of postponing such rate treatment to a period beyond that contemplated as necessary for the regulatory commissions to conform their practices to one of the options set forth in the bill, since as a practical matter, it is difficult to make a telephone rate order truly retroactive, *i.e.*, to April 1, 1972.

The essence of what is required to protect the public, the tax revenues, and the telephone companies is that *henceforth no regulatory body shall take affirmative action to use the job development credit to adjust rates*, except to the extent permitted in the bill. We do not believe a cut-off date is necessary to accomplish this result.

We point out that, although a similar problem existed with respect to accelerated depreciation under Section 167(1) in the 1969 Act, no separate effective date was included in the law or regulations. The favorable experience of the telephone industry and the Treasury in this regard under the 1969 Act indicates that some flexibility is required and there should not be a separate effective date or separate ratemaking periods imposed on adoption of necessary accounting rules.

This is a complicated technical subject which requires a great deal of regulatory expertise as well as knowledge of legislative drafting. Our representatives will make themselves available to the staff of the Committee in an effort to work out language that will preserve the intent of Congress without setting unnecessary traps dependent on the vagaries of the regulatory process.

Senator BENNETT (now presiding). The last witness is Mr. J. W. Van Gorkom, president of the Trans Union Corp.

STATEMENT OF J. W. VAN GORKOM, PRESIDENT, TRANS UNION CORP., CHICAGO, ILL.

Mr. VAN GORKOM. Mr. Chairman, thank you. I am not going to read my statement but I am here to call attention of the committee respectfully to an inequity that exists in the law as presently drafted on the investment tax credit, which tends to discourage rather than to encourage investment in new equipment.

I have presented a statement which I ask to be received.

I want to amplify that statement because there is a rather peculiar situation, unique in our industry perhaps that gives rise to this inequity and I would like to explain it and also give the committee members a chance to ask questions if they wish to.

I am the President of Trans Union Corp., and our largest subsidiary is known as Union Tank Car Co. Its business is the manufacture and leasing of railway tank cars. We lease these to petroleum, chemical, food, and fertilizer companies.

Our business grows out of the peculiar fact that the railroads do not supply tank cars. If you want to ship any product on a railroad other than a liquid, the railroad will almost invariably supply the car. In the case of liquids, for historical reasons they have never supplied these cars, so for over 80 years we have been providing tank cars to the petroleum, chemical, and other industries that need them.

Our supplying of these cars, I want to make clear, is on a leasing basis. We have some 40,000 of them, incidentally, and it is not a financing lease. We don't just provide capital. We build these cars. We have a string of repair shops throughout the United States and we spend over $10 million a year in repairing these cars. We ourselves have approximately 23 percent of all of the tank cars in the United States; other leasing companies have most of the rest.

Senator CURTIS. May I ask a question?

Do you get into the increased depreciation allowance that was enacted within the last 2 years?

Mr. VAN GORKOM. You mean that the 5-year depreciation for railroad equipment?

Senator CURTIS. Yes.

Mr. VAN GORKOM. No, we do not obtain that benefit. It is restricted to the railroads.

The tank car is an unusual piece of equipment; it has an average physical life of about 25 to 30 years and probably close to 30 years. We keep it in full repair so that when it is 20 years old or 25 it is for all practical purposes as good as a new one and performs the same function.

Our rents for these cars are based on the assumption that we will be able to keep that car leased over most of its life with short periods of inactivity.

As the bill is now drafted, and growing out of the same situation that existed in the prior investment tax credit, the lessee can receive the investment tax credit and he can keep the entire credit if he uses the equipment for at least 7 years under the proposed bill.

The philosophy of letting the lessee have the credit is based on the assumption that in many cases it is the lessee, the man who leases the equipment, who provides the stimulus to industry to build that equipment; and in many cases that is true. Certainly in the case of a finance lease, it is the lessee who bears the real burden of ownership.

Unfortunately, that is not true in our case. We have the basic disparity of a 30-year useful life of an asset with rents based on that life, and yet a credit earning period of only 7 years.

The problem arises in this way: If one of our lessees leases a car from us for 7 years he can earn the entire investment tax credit. At the end of the 7 years he then wants a new car, even though the old car is prefectly good, because if he gets a new car he gets a new credit and we are left with the car which has been used for only 7 years and which has considerably less value in the marketplace for future leasing. The car, for all practical purposes, has suffered a substantial amount of premature and artificial obsolescence.

If we keep the credit, we have reduced the rent; we have done so during the entire existence of the past investment tax credit. When we were permitted to keep the credit we reduced the rent.

We still are in favor of the lessee getting the credit if he assumes enough of the responsibility of the asset in order to earn it and, frankly, our proposed correction is merely to require that a lessee who wants the credit must take a lease that covers a substantial portion of the life of the asset.

We have provided in my statement some proposed language which we believe would do that.

I want to emphasize that I feel so strongly about this inequity and the problems which it creates in our industry and the disincentive it creates for investment that I would personally prefer not to have the investment tax credit at all rather than have it in its present form.

That is all I have to say.

Senator CURTIS. Is the language that you suggest language that is frequently used?

Mr. VAN GORKOM. We have——

Senator CURTIS. The regulations and elsewhere?

Mr. VAN GORKOM. We have tried to use terms which would be easy to administer by the Treasury Department; yes, if that is what you mean.

Senator BENNETT. Is it contained in your statement?

Mr. VAN GORKOM. It is contained in the statement at the end, the last page, I believe.

Senator BENNETT. Any other questions?

Senator CURTIS. Well, your recommendation goes to who gets the credit, the investment credit. It will not add to nor detract from the revenue picture either way; will it?

Mr. VAN GORKOM. That is correct, sir.

Senator BENNETT. We thank you very much.

Mr. VAN GORKOM. Thank you.

(Mr. Van Gorkom's prepared statement follows:)

PREPARED STATEMENT OF J. W. VAN GORKOM, PRESIDENT, TRANS UNION CORPORATION, CHICAGO, ILL.

I am J. W. Van Gorkom. I am President of Trans Union Corporation, Chicago, Illinois. The problem with which I am dealing in this statement arises in connection with Trans Union's wholly owned subsidiary, Union Tank Car Company, and the business of that subsidiary, which is the manufacturing and leasing of railroad tank cars.

INVESTMENT CREDIT ABUSE IN THE CASE OF SHORT TERM LEASES OF LONG-LIVED ASSETS

In the case of a short term lease of long-lived assets—which is the case with most Union Tank Car leases—permitting the investment credit to pass to the lessee creates a situation in which the credit operates as a *dis*incentive rather than incentive to investment.

The situation arises because:

(1) There has been created an artificial situation in which the credit does not necessarily reside with a party who realistically "creates the demand" for production. In the case, for example, of a 5 year lease of a car which will last 25 years, the lessee may *contribute* to the demand for production but demand is really *created* by the lessor, who must decide whether to take the economic risk for the remaining 20 years.

(2) The financial accounting rules relating to the investment credit provide a major incentive for the short term lessee to insist upon an artificial and uneconomic substitution of new assets for old, which will in turn discourage investment in new assets by causing leases of new equipment either to carry higher rentals or be less profitable to the lessor.

The artificial situation described does not exist in lessor-lessee relationships where the lease is sufficiently long that the lessee is carrying a major part of the economic risk of ownership. Thus the legislative proposal which is submitted with this memorandum is intended to deal with short term leases of long lived assets (where the lessee carries little risk) and are designed to place all lessors and lessees on equal footing—namely, to permit the credit to pass to the lessee only where the lessee deserves it by substantially "creating the demand" for production.

LEASES IN THE RAILROAD TANK CAR INDUSTRY

The tank car industry is one in which the economic life of the equipment is extremely long. The expected physical life of tank cars is 25 to 30 years. Under typical leases the leasing companies keep the cars continuously up to date, with the result that there may be little if any economic difference between a 15 or 20-year old car and a brand new one.

It is the present practice for lessors engaged in the active business of leasing large numbers of such cars to establish attractive rental rates which reflect a recovery of the lessor's cost not over the term of the lease, but over the entire 25–30 year physical life of the cars. This is true notwithstanding that each individual lease negotiated by the tank car leasing company is for a relatively short period, usually 5 years or less—occasionally as long as 15 years. In order to successfully operate a leasing business of this type, the leasing company must be able to count upon obtaining renewed leases from the first lessee or other leases from a succession of lessees for each car over its long life. If a new investment credit is enacted as proposed, tank car lessees will have a totally artificial incentive to turn cars back at the end of the recapture period (7 years under the House Bill) and insist upon a new car. This will completely disrupt the basic assumption on which attractive tank car rentals are now based—i.e., that leases will normally be renewed and the costs of investment comfortably recoverable over the long life of the asset. It would make the leasing of new cars at existing rentals less profitable and lead inevitably to an effort by lessors to recover a greater portion of the cost over the initial lease period. As a consequence, the economics of tank car leasing would be seriously and adversely affected by such a provision.

Such a provision would also adversely affect the entire railroad transportation of liquid commodities. This is because the railroads do not own such cars and must depend upon the private lessors for this equipment. Anything which results in less favorable leasing arrangements for railroad tank cars will contribute to the competitive advantage of other forms of transportation.

INCENTIVE TO TERMINATE LEASES

An example of the manner in which the proposed new credit would provide an incentive to terminate leases is as follows:

S (a shipper) leased a tank car in 1964 from L (a leasing company). The term of the lease was 7 years. Purchase price of the car was $16,000 and the amount of the 7% credit was $1120. L offered to keep the credit and reduce the rental, but that reduction in rental would have been reflected over the real life of the car, roughly 30 years. S insisted, however, on having the credit itself, since it produced an immediate tax benefit of $1120 to S and under financial accounting practices the entire $1120 was reflected as additional after tax income on S's 1963 financial statements.

In 1971 the 7 year lease term expires and under H.R. 10749. S can turn the old car back without any recapture of the investment credit. L has maintained the old car and made all expenditures necessary to keep it completely up to date, with the result that there is no pratical difference between the old car and a new one. However, if a new 7% credit has been enacted, S could by leasing a new car again produce an *immediate* $1120 increase in its financial earnings in 1971. Therefore, S terminates the lease of the old car and insists upon a new lease of a new car eligible for the credit. Substitution of the new car for the old one serves no real economic purposes, but it does artificially boost S's 1971 reported financial earnings.

The potential for abuse arises because both the lease term and the 7 year recapture period are short in comparison to the actual physical life of the tank car and is accentuated because of financial accounting practices. The credit produces a major incentive to replace at a point in time when replacement does not represent modernization, but is, on the contrary, economically wasteful.

However, S can ignore the economic waste since it has no further obligations after the lease term and the economic loss falls on the owner. It is only the owner which must balance the economic waste against the benefit of the investment credit.

REASONS FOR ELIMINATING ABUSE

In summary, the potential abuse described should be eliminated for the following reasons:

(1) The purpose of the investment credit is to speed modernization by making it profitable at an earlier date. However, it should not operate artificially to create economic waste.

(2) The lessee for a short term of long lived assets is unjustifiably encouraged by existing rules to secure an investment credit every 7 years. Because he is a lessee he can ignore the true economics of whether replacement is desirable.

(3) The investment credit was originally extended to lessees on the assumption that the lessee in fact "generates the demand" for new production. (See Sen. Rep. No. 1881, 87th Cong., 2d Sess. (1962) pp. 10 ff.) That is undoubtedly the case where the lease is for most of the life of the asset. However, where the lease is for a very short term compared to the asset life, it is not the lessee but rather the owner—the company which is willing to take the risk of purchasing a new car and of holding it for short term leases—which in fact creates the demand for new production. Thus, the reason for extending the credit to lessees does not exist in such a case.

(4) In the case, for example, of railroad tank cars, present car rentals reflect the lessors' expectation of recovering their costs from the lessee fairly evenly over the physical life of the car. If lessors are subjected to artificial pressures to take back new cars after 7 years, they will normally try to recover costs more rapidly over that initial 7 year period, which will tend to produce artificially higher rentals on new cars. If such higher rentals are prevented—by competition, controls or whatever—the lessors who in fact produce or purchase new cars will find it less profitable to do so. Either way, the result is a *dis*incentive to production.

(5) The problem presented will, of course, be the subject of negotiations between lessor and lessee, but those negotiations cannot solve the problem. Negotiations will not center on whether tank car leasing companies will make the credit available to lessees, for as a competitive matter they will have to do so if the law permits it. Rather, negotiations will center on rentals. The availability of the credit to the lessee tends to artificially obsolete cars over 7 years of age, thus increasing the cost of leasing such cars. Negotiations will center on whether the lessor or lessee will bear that cost. Whatever the outcome, the additional expense to one party or the other will be a distinctive to investment.

(6) Pass-through of the credit to lessees in all cases would create, in the case of short term leases of long lived assets, disadvantages to the lessor and windfalls to the lessee which do not exist in other cases.

PROPOSED AMENDMENT

A proposed amendment is attached. In general, it would change prior law by requiring the credit to stay with the lessor in the case of short term leases of long lived assets. However, where the term of the lease is sufficiently long, or where the lessee in reality assumes the risks of ownership, the lessee can realistically be said to "generate the demand" and a pass-through of the credit would continue to be allowed.

Lessees under "finance leases", where the lessee is, in reality, the owner, would not be affected.

Leaving the credit with the lessor will maximize the benefit of the credit to the railroad transportation industry and the public generally. Under existing competitive practices the value of the credit, where retained by the lessor, is reflected in lower rentals to the shipper over the long life of the shipment. The proposed amendment would continue to permit those lower rental rates to be extended to all lessees (not just the initial lessee) of cars eligible for the credit.

AMENDMENT TO LIMIT AVAILABILITY OF CREDIT TO CERTAIN LESSEES

Amend H.R. 10947 in the Senate by inserting immediately after section 109 thereof the following new section:

"Sec. 109A. Availability of Credit to Certain Lessees.

"(a) In General.—Section 46(d) (relating to limitations with respect to certain persons) is amended by revising the second sentence thereof to read as follows:

'The election provided by the preceding sentence may be made only with respect to property which would be new section 38 property if acquired by the lessee, *and, in the case of assets included in a class for which the class life prescribed by the Secretary or his delegate pursuant to section 167(m) exceeds 14 years, only if (1) the lease is noncancellable for a term (computed without regard to options to renew) at least equal to such class life, or (ii) the lessor is either guaranteed a specified return or is guaranteed in whole or in part against loss of income.*' (New matter underscored.)

"(b) Effective Date.—The amendments made by this section shall apply to leases entered into after the date of enactment of this Act."

Senator BENNETT. We will recess until 10 o'clock tomorrow morning.

The CHAIRMAN. Ten o'clock tomorrow morning. Thank you very much, Senator Bennett.

(Whereupon, at 12:25 p.m., the hearing was adjourned, to reconvene at 10 a.m., Wednesday, October 13, 1971.)

THE REVENUE ACT OF 1971

WEDNESDAY, OCTOBER 13, 1971

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

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

Present: Senators Long, Anderson, Talmadge, Byrd, Jr., of Virginia, Nelson, Bennett, Curtis, Fannin, and Hansen.

The CHAIRMAN. This hearing will come to order. The first witness we are pleased to have is the Honorable Charles McC. Mathias, Jr., senior Senator from Maryland. Senator Mathias, we appreciate your views on this revenue measure.

STATEMENT OF HON. CHARLES McC. MATHIAS, JR., A U.S. SENATOR FROM THE STATE OF MARYLAND

Senator MATHIAS. Mr. Chairman, I have a statement prepared and I would suggest, in view of the large number of distinguished witnesses who are prepared to testify before the committee this morning, I would request that the commitee accept my statement and let it appear in the committee record.

The CHAIRMAN. We will print the entire statement.

Senator MATHIAS. I will comment very briefly on it.

I think what this committee has in its hands here is something which is perhaps more than simply a matter of dollars and cents in finances and economics.

The Bible has said and I think experience of mankind confirms that man does not live by bread alone but needs a sense of purpose and a feeling of community and fundamental belief in the justice and fairness of the institutions that surround him.

And I think that really is the heart and soul of what this committee must wrestle with as it considers the final structure of our country which will influence the final financial structure of the world.

The President has said we want prosperity without war and without inflation and I think we all share that aspiration, but I think it sets in highlight some of the goals that we have to look for, the goal of prosperity without war and without inflation perhaps being the first of these goals.

Another being the achievement of international economic harmony and progress without which we can't have any real economic progress or stability.

I would suggest that we in the Senate give speedy approval to the bills that are now before the committee which involve acceleration of standard personal income tax exemptions, repeal of the automobile excise tax, as a first step.

Secondly, I would hope that we can have soon end to ten percent import surcharge which the administration believes was necessary to impose as a bargaining tool for the current monetary negotiations.

I think we should direct our attention to that before the international repercussions set in and the surtax begins to accelerate and becomes a permanent kind of fixture.

Thirdly, I would hope we could give increasing emphasis to economic conversion in the months ahead. I introduced a bill, Senate 1191, which would provide aid for retraining workers and for helping communities, affected by conversion and I hope that some measure of this sort which is now pending before the Commerce Committee can be considered by the whole Senate.

Fortunately, I think that the United States should issue a call during the coming months for an international conference on trade which would followup the agreements of the current international monetary conference.

This again is going to be a structure which will affect the success of work of this committee.

Fifth, I think we must face up to two of our most critical domestic problems, the growing gap between the revenues and the responsibilities of the State and local government is in the plight of millions of Americans who through no fault of our own are not able to earn an adequate income.

And so to this end I hope the committee will soon report favorably to the Senate the proposals that it is now considering on welfare reform and revenue sharing.

In this context, Mr. Chairman, I am urging that the investment tax credit bill, one version of which I introduced on the 7th of July of this year, Senate 2225, be adopted by this committee.

The details of the bill that I offered differ from the provisions of the measures that were sent to us by the House but I think the fundamental thrust of the bills is identical and I would strongly urge this committee to endorse and report favorably the provisions of the House bill involving the investment tax credit.

Thank you very much.

The CHAIRMAN. Thank you very much, Senator.

Because we are so pressed for time to try to move this bill on out we are going to try to hold down our questions and study the statements, so I am not going to interrogate you.

Senator MATHIAS. I am very happy to cooperate with the committee and will vacate the chair.

The CHAIRMAN. Thank you very much.

We appreciate your statement.

(Senator Mathias' prepared statement follows:)

STATEMENT OF HON. CHARLES McC MATHIAS, JR., A U.S. SENATOR FROM THE STATE OF MARYLAND

Mr. Chairman and Members of the Committee. It is always a pleasure to appear before this distinguished Committee which has so many vital responsibilities affecting the aspirations and the means of every American. I consider myself particularly fortunate to speak to you at this time when you are considering legislation which is a key element of an economic package perhaps more far-reaching and ambitious in both its goals and consequences than any series of economic proposals put forward by the Executive branch in the last generation.

For this reason, I would like to set forth very briefly for your consideration my views concerning, first, the goals we should strive to achieve, second, the problems currently facing our economy and third, the steps necessary to surmount these problems and achieve our goals.

Mr. Chairman, America is today the richest nation on this planet and the richest nation in the history of our civilization. But, as the Bible says, "Man does not live by bread alone." Man needs a sense of purpose, a higher meaning in his life, a feeling of community with his fellow citizens and a fundamental belief in the justice and fairness of the economic, political, and social institutions which surround him.

In structuring economic programs in these times of relative hardship we must strive to meet, not only the needs of the theorists' "economic man," but these more fundamental needs of the whole man.

Given this most fundamental goal, I believe the President has quite succinctly stated a second goal. That is, the achievement of balanced and widespread prosperity without war and without inflation. Prosperity alone can be neither equitable nor just, nor can it respond to the deeper needs of mankind, if it is bought at the expense of young soldiers dying in a far-off land or at the expense of elderly and retired persons whose fixed income is sapped by runaway inflation.

The goal of prosperity without war and without inflation can only be achieved if we remain fully cognizant of our international responsibilities. We have been reminded in recent months by many, many citizens that we live on "spaceship earth". This catch-phrase makes vivid the fact that we are inevitably affected by the actions—concerning the environment, concerning peace, concerning the worth of our culture, and concerning the productivity of our economic system—of peoples on every continent of this planet. Therefore, Mr. Chairman, the third major goal must be the achievement of international economic harmony and progress. In this line, I heartily endorse the President's efforts to achieve fair and free trade.

Given these goals, let me now mention a number of major problems which are currently confronting our economy. First, there is unacceptably high unemployment throughout America, now at 6 percent of the potential working force. Secondly, there is an unacceptably high rate of inflation. Third, there is a depressingly low trade balance, or imbalance. Fourth, there is a growing obsolescence of the industrial equipment being used in many of our major industries. Fifth, there is, on the surface, a decreasing competitiveness of many American goods in foreign markets and, indeed, in our own domestic market. Sixth, as a result of several of the above factors, American industry and labor are not working at their full capacity and American productivity is not increasing as rapidly as we would want or as rapidly as history would suggest we should expect. Seventh, as the President continues to wind down the war in Vietnam and decrease our military commitments abroad, we are faced with a growing need for economic conversion of our industries from military to civilian production. Eighth, we see around us a loss of pride by many American workmen, a sense of meaninglessness in their toil, and a questioning of the basic values inherent in our system of production.

These are some of the major problems which I believe all of us must address ourselves to in the coming weeks. Let me now discuss some proposals to alleviate these problems. First, the job development credit. Mr. Chairman, I strongly believe that a moderate job development credit, or investment tax credit as it is also called, could help in meeting each of the problems I have mentioned if it is coupled with the type of broad-based economic program suggested by the President and perhaps including some proposals put forward by the members of the committee.

It was for this reason that I introduced into the Senate on July 7 of this year S. 2225, which would restore the 7% investment tax credit. Some details of my bill differ from the provisions of the measures sent to us by the House, but the fundamental thrust of the bills is identical and I would strongly urge this committee to endorse and report favorably on the provisions of the House bill involving the investment tax credit. I believe this credit will encourage American industry to overcome the creeping obsolescence in American productive equipment. I believe the credit also will help increase American productivity, make our products more competitive at home and abroad, create new jobs, improve our balance of payments, and aid industries in converting from military to civilian production. As it helps accomplish these goals, then I believe the credit will also help give the American worker more pride in his daily toil and more confidence in the fundamental soundness of our economic system.

I know that some have expressed doubts about the effectiveness of job development credit. For this reason, I went to a number of the economic leaders in the State of Maryland and discussed with them very seriously and in great depth whether a credit at this time would be of great benefit to all Marylanders. Their response was almost unanimously positive.

Moreover, the facts show clearly the need for and the worth of the job development credit. American investment in new machinery and equipment has been sagging badly in recent months. Last year, expenditures for new equipment were abnormally low. This year, the latest survey indicates expenditures will rise by only two percent. This means that, in terms of real dollars, expenditures for new equipment this year will be less than expenditures last year.

America cannot expect a rapid rate of economic growth if it continues to decrease expenditures in new and improved equipment.

The report of the House Committee contains information which shows very dramatically that, since 1960, domestic new orders for machine tools have decreased strikingly every time we have not had a job development credit. On the other hand, new orders have risen sharply during periods when we have had the credit. What has been true in the past will, I feel, remain true for the future.

The question might arise, "If the investment tax credit is so good, why was it repealed in 1969?" One reason, I think was the widespread belief in the spring of 1969 that investment in new equipment was already very high and was about to soar even higher. But the economic situation today is very different than the situation in 1969. Then, investment in new equipment was very high, now it is very low. Then we were in a business boom, now we are experiencing an economic slowdown. While the repeal of the tax credit may have seemed wise in 1969, I believe restoration of the credit is imperative today.

For all these reasons, I have no hesitation whatsoever in supporting the measure which I introduced in legislative form to the Senate in July, which the President recommended to the nation in his message of August 15, and which the House has agreed to and has sent over this committee for its consideration.

Beyond this one measure, though, there are a number of other steps which I believe should be taken. First, I hope that we in the Senate can give speedy approval to the bills now before this committee involving acceleration of the standard personal income tax exemptions and the repeal of the auto excise tax. These measures would mean additional money in the pocketbook of every American. It would mean additional buying power for all Americans and additional demand for American products.

Secondly, I hope that our country can end very soon the 10 percent import surcharge which the Administration believed was necessary to impose as a bargaining tool for the current monetary negotiations.

Third, I hope we can give increasing emphasis to economic conversion in the months ahead. To this end I have introduced a bill, S. 1191, which would provide aid for retraining workers, and for helping communities affected by conversion, and would require industries to prepare plans for a smooth transition from military production This bill is now pending before the Commerce Committee.

Fourth, I believe the U.S. should issue a call during the coming months for an international conference on trade which would follow-up on the agreements of the current international monetary conference.

Fifth, we must face up to two of our most critical domestic problems: the growing gap between the revenues and the responsibilities of our state and local governments and the plight of millions of Americans who, through no fault of our own, are not able to earn an adequate income. To this end, I hope that this committee can soon report favorably to the Senate the proposals it is now considering on welfare reform and revenue sharing.

Mr. Chairman, these are some of my thoughts as I have been reflecting on our current economic situation. I want to thank you and the members of this committee once again for the opportunity to appear before you and present my views for your consideration.

The CHAIRMAN. Mr. Andrew J. Biemiller, director of legislation, AFL–CIO; we are pleased to have you, Mr. Biemiller. I notice you are accompanied by Nat Goldfinger. We regret we don't have Mr. George Meany here. He is a very able advocate but I am sure you will represent him very well in his absence.

STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR OF LEGISLATION, AFL–CIO, ACCOMPANIED BY NATHANIEL GOLDFINGER, DIRECTOR OF RESEARCH

Mr. BIEMILLER. Thank you, Mr. Chairman.

We welcome this opportunity to present the views of the AFL–CIO on the proposed Revenue Act of 1971.

When the details of the President's tax proposals were first unveiled, we saw them as a shocking example of the doctrine of inequality.

In the name of economic stabilization and ending unemployment, the President proposed a radical redistribution of the Nation's tax resources in favor of the rich, and at the expense of the public interest.

His program would create few jobs, if any; give no healthy stimulus to the economy and make the tax burden of all American families even more inequitable.

In our opinion, then he has proposed a giant raid on the Treasury that would transfer billions of dollars of badly needed public funds into the private treasuries of big business. It is geared to the trickle down economic theory which contends that enriching the already rich is the way to economic progress.

Unfortunately, the bill that passed the House and is now before the committee reflects—with minor exceptions—the proposals of the President. Our original indictment still applies.

The bill guts the corporate tax structure.

From 1972 on the corporate tax reductions of this bill would result in a permanent cut in the effective tax rate of approximately 15 percent.

The annual business tax loss is $2.2 billion in 1971 rising to almost $10 billion by 1980.

In contrast, an average family of four would receive a tax cut of about 36 cents per week in 1971, slightly over $1 weekly in 1972, and no more cuts thereafter. The reductions for individuals in the bill, with one single exception—the low income allowance—would have been received in any event under the Tax Reform Act of 1969.

Obviously, instead of furthering the tax justice steps that were begun in 1969, this tax bill would establish new loopholes for corporations.

The unrelenting needs for increased public investment and the billions of dollars that escape full taxation through loopholes of special tax privilege for wealthy people and corporations would continue to be overlooked.

And the fact that a fair tax structure could contribute enormously to an immediate strengthening and a balancing of the Nation's economy would again be ignored.

The 13.6 million Americans and their families we represent are taxpayers. They cannot see what sense of priority, what national need, or what concept of fair play can justify putting $75 billion in public funds over the next 10 years into the hands of corporations and their wealthy stockholders.

They cannot accept the loss of or postponement of the badly needed public investments that would be the inevitable result of such a decimation of the Federal budget, and they cannot accept the utterly inequitable, business rigged manner in which the proposed revenue act would conduct this raid on the Treasury.

We are here to urge the Senate to recognize that this tax bill is rigged overwhelmingly in favor of big business—and against workers, taxpayers, and the public interest. And to recognize that public investment and tax justice are precisely what America needs in order to strengthen the economy and provide millions of much needed jobs.

We hope that the Senate will redress these inequities and reject the myopic and regressive view that what's good for America is only what's good for the wealthy.

We believe that firm steps must be taken to preclude any further erosion in the Federal Government's ability to meet the Nation's public investment needs.

We believe firm steps must be taken to further the goals of tax justice and pave the way to a healthy balanced economic recovery.

In summary form, our position on the proposed revenue act is as follows:

1. The AFL-CIO supports the concept of tax reductions for individuals in the low- and middle-income groups. We, therefore, support the individual tax relief provisions in the House bill.

However, it is our view that these reductions should come about as the result of tax reforms that close existing loopholes and abuses and bring additional, necessary funds into the U.S. Treasury.

2. It is our view that excise taxes are sales taxes—direct levies upon consumers.

We, therefore, support the elimination of excise taxes on automobiles and light duty trucks, for this is a long overdue move toward getting the Federal Government out of the sales tax business.

3. We urge the complete overturning of the Treasury's accelerated depreciation ruling. By halting this giveaway, Congress could recoup $700 million in 1971, and $1.7 billion would be saved in 1972. Over the decade a $27.5 billion business tax bonanza would be avoided.

4. The Congress should reject the proposal to reinstitute the business investment tax credit. The administration has failed to prove that this giveaway would create any significant number of jobs. If rejected, Congress would save the U.S. Treasury $1.5 billion in 1971, $3.6 billion in 1972, and an estimated $45.1 billion between now and 1980.

5. The DISC gimmick should be rejected. The administration has failed to prove that this giveaway would increase exports. By refusing

to allow corporations to spin off into tax deferral export subsidiaries, Congress could save the U.S. Treasury some $2.4 billion between now and 1980.

6. We call for immediate enactment, retroactive to July 1, 1971, of an excess profits tax which could be modeled after that in effect during the Korean war period and which raised some $7 billion during the 3½ years of its existence. Such a tax would remain in effect during any period of freeze, controls, or restraints.

7. We urge speedy congressional action toward completion of the unfinished business of tax reform. The major reforms we recommend are as follows:

(a) Close the capital gains loopholes.

The preferential tax rate which applies to gains on unearned income from stocks or other property sold at a profit and the zero tax that applies to such gains when passed on at death, are the most disruptive and unfair elements in our tax structure. We believe that there cannot be tax justice so long as unearned income from capital gains in half taxed while earned income is taxed in full.

Elimination of the capital gains loophole for both individuals and corporations, and taxing capital gains on property transferred at death, would yield an annual revenue gain of approximately $10 to $12 billion.

(*b*) Enact new tax measures to halt the export of U.S. jobs, remove the incentive to establish production and assembly facilities abroad, and create tax disincentives to curb expanded production abroad.

Profits earned by the foreign operations of U.S. corporations should be taxed at the time that they are earned. Under present law, corporations are allowed to defer U.S. taxes until they are repatriated to the U.S. and distributed, which may never happen. Foreign tax payments should be allowed a deduction on U.S. taxes, but the present allowance of a tax credit should be halted.

(*c*) The tax abuses of the oil, gas, and other mineral industries should be completely ended. The approximate revenue gain would be $2.5 billion.

(*d*) The 10-percent minimum rate included in the 1969 Tax Reform Act should be strengthened. This tax requires some tax payments on the part of individuals with large amounts of income from certain tax sheltered sources. For example, doubling the rate would provide a revenue gain of $600 million.

(*e*) The maximum tax provisions of the 1969 act should be eliminated, and this provides an uncalled-for tax bonanza to top corporate executives and others, whose incomes come from astronomically high fees and salaries. The approximate revenue gain would be $200 million.

(*f*) The tax exemption for interest income from State and local bonds should be disallowed. Such income should be taxed in full, with the Federal Government guaranteeing the bonds and providing an interest subsidy to assure that the fiscal powers of the State and local governments are not hampered.

(*g*) In addition to the reforms in the Federal individual and corporate income tax, a major overhaul of Federal estate and gift taxes is a prerequisite to the achievement of tax justice.

Those badly needed tax reforms could bring into the Federal Treasury as much as $15 to $20 billion annually.

It is the AFL–CIO's firm belief that America's needs are too critical to be cutting the Federal Government's income at this time.

America cannot afford huge and ever-enlarging tax windfalls to big business. The Nation's tax structure must be used in the public interest.

America cannot tolerate any further postponements in the achievement of tax justice, nor any further chipping away at the thin margin of equity that remains in the tax structure.

I ask permission to have my statement and the appendixes included in the record.

The CHAIRMAN. Yes.

Mr. Biemiller, I think you made your position very clear and concise. One point does occur to me that perhaps should be added to what you're saying here. If the purpose of repealing this 7-percent tax is to provide American jobs, at least protect the jobs of American automobile workers. What is the point in repealing the 7-percent tax on the foreign automobiles?

Mr. BIEMILLER. It is a very interesting question, I agree.

The CHAIRMAN. In other words, it would seem to me, all we would be doing is helping to put Americans out of work with that tax law, because I think Mr. Henry Ford said every 1-percent increase in the sale of foreign automobiles costs 20,000 American workmen their jobs.

I noticed, for example, Datsun having had a 67-percent increase last year, plans to flatten out their increase somewhat and have only a 25-percent increase per year hereafter.

But even that puts a lot of Americans out of jobs, doesn't it?

Mr. BIEMILLER. If we take Mr. Henry Ford's statement, I think it ought to have some value, at least he must know what he is talking about, and apply it to the imports that are going on today, including Canadian imports, it means that about 400,000 jobs for American workers have gone out the window. There is nearly 20 percent imports of foreign cars now, including Canadians.

The CHAIRMAN. Thank you very much, Mr. Biemiller. We will study what you have had to say here, as well as your supporting memorandums.

Senator FANNIN. Mr. Chairman.

The CHAIRMAN. Yes.

Senator FANNIN. Mr. Biemiller, why is that you are so determined that our industries do not have a tax incentive?

Here every major trading nation in the world allows a manufacturer a form of accelerated depreciation, investment credit, or export incentive. Why are you so opposed to our companies not being competitive?

Mr. BIEMILLER. Mr. Goldfinger?

Mr. GOLDFINGER. Senator, as we look at the American economy, we are convinced that the major long-term incentive for business investment and for technological improvement and high profit is then not tax gimmicks but is high rates of capacity utilization and high levels of economic activity.

We think that the whole record of the 1960's shows this, and we think that the present situation shows it. At present, American industry is operating at something like 73 percent of capacity, according to the Federal Reserve Board, and this is the crucial problem.

The problem is a lack of enough customers, a lack of enough employment, a lack of enough purchasing power, a lack of enough orders.

This is the crucial problem and this is the incentive in our opinion as we see it.

Senator FANNIN. Well, you certainly answer your own question by saying that it can't be done under our present system. In other words, how can we do all of these things you are talking about?

Here you don't want to give accelerated depreciation, you don't want our plants to be as modern as the other plants.

Mr. BIEMILLER. That is not true.

Senator FANNIN. Let me finish. And here you say that—I am not talking about what you say, what Mr. Biemiller says, he is condemning everything we are trying to do to help promote jobs in America and to try to bring our country, our manufacturers in this country in line with the manufacturers of other countries of the world.

How can we possibly compete now with the automotive industry as mentioned? Until recently we had a three and a half percent tariff on foreign cars. Until not too long ago the Japanese had a 17 percent to start in with and then beyond that they had a 15 percent on small cars and 40 percent on large cars.

Here we are talking about trying to be competitive so we put on a 10-percent surcharge.

When we take the 7 percent off the foreign cars on the excise tax there they are in one-half percent better position than they were before, but I don't see how you can say that we should eliminate all of these incentives to industry and then expect to create jobs, who will buy the products if we don't have jobs here to buy American products, if we are going to let all of the foreign products come in promiscuously, what good is it going to do to dish out this money to buy foreign products?

Mr. GOLDFINGER. On the latter point we agree with you.

We think that the import problem and the whole foreign trade and investment problem is a serious one, but a key factor here once again is not the tax gimmicks and tax incentives but is the export of American technology, exports of American capital and export of American jobs but American business.

For example, only a few weeks ago the New York Times reported about the Chrysler Mitsubishi deal, and which goes along the following lines. Within a period of 3 years Chrysler will buy 35 percent interest in the Mitsubishi Motor Corp. of Japan. Now, in return Chrysler is distributing through its distributorship in the United States the following, the Dodge Colt, which is an American brand name for a Mitsubishi Japanese product.

But then the third part of it is that the Mitsubishi Co., will distribute the Plymouth Valiant not produced in the United States, but produced by the Chrysler subsidiary in Australia.

Here you have an example of one of the key problems that confronts us and it is the operations of these U.S.-based multination corporations.

Senator FANNIN. That's exactly what I am thinking about. I am very much in agreement with what you are saying. I am opposed to our country going abroad and shipping back. The DISC program is one of the incentives, I can't understand why you are against giving our companies incentives.

It seems to me that Mr. Biemiller and his colleagues are more interested in trying to damage the position of business and industry than they are to help their own workers——

Mr. BIEMILLER. Well, we don't want to damage American business. We want to give American business a real incentive and in our opinion the major incentive here is customers and the need to increase capacity utilization.

Senator FANNIN. Well, of course, the plant utilization, how are you going to increase if you don't have sales, and if you're not competitive how are you going to have sales?

Look at the automotive industries, what has happened, what you were talking about a few minutes ago?

Mr. BIEMILLER. The key to sales here in the United States is domestic market and we have to strengthen this domestic market.

Furthermore, Senator, the estimates of the U.S. Department of Commerce indicate that nearly 50 percent of manufacturing equipment in the United States is less than 5 years old.

So that we fail to see the argument——

Senator FANNIN. Would that be true of United States Steel?

Mr. BIEMILLER. This is for industry in general. Now it varies from industry to industry. The steel industry has been modernizing rapidly within the past 5 years. However, it is true that over a period of the previous 15 to 20 years the steel industry had permitted its equipment to become quite aged.

Senator FANNIN. Well, of course now let's look to the steel industry. The increase was given to the steelworker here in this country in the last contract for a 3-year period was approximately $1.80 is that right?

Mr. BIEMILLER. I believe that is true.

Senator FANNIN. And that is within 10 cents of the total pay that is received by the Japanese worker. We admit their plants are more modern than ours. How are we going to compete unless we can increase productivity, unless we can give incentives, unless we can do more to modernize, because you know many of our steel plants in the United States are obsolete. We all admit so. I can't understand why you are coming in here and opposing doing what is for the best interests of the American worker.

Mr. BIEMILLER. Well, we differ with you on this issue because once again we think that the major incentive for business investment and major incentive for the good of business, as well as for the good of the economy is customers and we think that the whole record of the 1960's shows that.

That is operation of the accelerated depreciation and the investment credit put into effect in 1962 had practically no impact whatsoever until the 1964 tax cuts and the "Great Society" programs of 1964 and 1965 boosted demand, boosted sales, boosted orders.

Senator FANNIN. When we are talking about boosting sales we want to try to boost sales of American products, I feel that certainly I could work with you gentlemen very amicably.

How do you feel about the surcharge of 10 percent? Do you feel it should stay on?

Mr. BIEMILLER. We feel the 10-percent surcharge is at best a temporary stopgap. It is not an answer to the problem, to the major problems that we briefly discussed, and the major problems are that the U.S. position in world trade has deteriorated rapidly during the sixties, that we are confronted by a flood of imports not simply from foreign companies but to a great extent, an increasing extent from subsidiaries, foreign subsidiaries of U.S. companies, from licensees of U.S. companies patent holders, and other foreign companies with joint venture agreements, and we don't think that the surcharge gets at that problem.

Furthermore, the surcharge has an uncertain, uneven, and unlimited impact product by product and country by country. So that, as we say, this is at best a temporary stopgap, it is not a policy. We are looking for a policy, a long-term policy and a permanent policy in the whole area of foreign trade and foreign investment and we believe that the bill that was recently introduced in the Senate by Senator Hartke on foreign trade and foreign investment addresses itself to the key problems that we confront in this area.

Senator FANNIN. I think your approach is very narrow. I do not have any sympathy for the multinationals which have plants overseas in Taiwan, Korea, and shipping back to this country.

I think this is certainly very damaging to our economy.

Here we shipped into Japan in the last year 157 cars. They shipped to our country 357,000 cars and look at the Volkswagen and the cars that have come in from the European countries, so you are just scratching the surface when you are talking about what our companies are doing and I don't like it, but that is scratching the surface.

Do you favor the value added tax?

Mr. BIEMILLER. No, we do not. A value added tax is a sales tax, and it is a tax on consumers and it is a price increase.

Senator FANNIN. Well then what are we going to do if the European economic community are talking about stabilizing on a 15-percent value added tax?

France has had 23.

Mr. BIEMILLER. It is our judgment, sir, that we have to defend our own national interests, we have to protect the jobs and the industrial base of this economy in our own way and not necessarily copy what other people are doing, which maybe is good or maybe is bad in their terms but do not necessarily fit our own needs.

Senator FANNIN. But don't you think we must try to compete? If they give some special privileges to their manufacturers then you don't think we should try to compete?

Mr. BIEMILLER. Oh, I think we have to try to compete. I think we have to try to do a lot of things, but we don't necessarily have to try to do those things in the exact same way that they, the other countries are doing.

Because what another country does in its regard may be good, may be bad, in terms of that country, but it may make no sense here.

Senator FANNIN. Well, surely I agree with you that that could be true, but at the same time if that gives them an advantage in a manufactured product we must do something about it if we are going to compete.

Would you be in favor of having the foreign corporations subject to our antitrust laws?

In other words, the companies operating in the United States, foreign corporations operating in the United States would be under our antitrust laws.

Mr. BIEMILLER. I would have to look at that.

Senator FANNIN. If you would.

I introduced a bill to bring that about, that feeling that we certainly should have that.

Mr. BIEMILLER. We will be glad to look at that bill, Senator.

Senator FANNIN. I would appreciate that. Well, I just hope that you take another look at the incentive we are trying to give our companies to modernize and be able to compete in the world market and also to be able to compete in the domestic market because we are losing jobs every day. I have seen several estimates about what the AFL-CIO thinks as far as job losses.

Do you have an estimate as of 1970 as to how many jobs we lost, from the standpoint of imports?

Mr. BIEMILLER. No, we do not, Senator, but we agree with you that there was a continued loss in 1970. From 1966 through 1969, based on estimates of the Department of Labor, we figure that something in the area of 500,000 jobs on net were lost, that is after netting out some small gains as a result of increased exports and very large gains, very large losses due to the surge of imports, that the net loss was about 500,000 jobs, job opportunities in those 3 years alone.

So that there must have been another loss of about 100,000 jobs or so, maybe more.

Senator FANNIN. We have the figure of 700,000, a figure was given to us of 700,000.

Mr. BIEMILLER. 700,000 jobs lost from 1966 through 1969 on the basis of the surge of imports. The Department of Labor claims that there was an increase, a job gain of about 200,000 through the small increase in exports so that on a net basis there was something like 500,000 job opportunities lost.

But regardless of the precise number, and the numbers are not precise, I think that we are in absolute agreement that there is a very serious problem here and that there have been substantial net job losses.

Senator FANNIN. Well, consider the automotive industry, on the Pacific coast the sales of foreign cars having gone up now to almost a third of the total sales. Then I think we have something to be concerned about and I hope you will look at it from the standpoint of what you can do, management-labor working together to correct some of these problems.

I am not saying this is all one sided, I am not saying it is all labor's fault, but I say we are headed for deep trouble if we don't start cooperating and working together.

We must coordinate our efforts and stop this bickering and fighting and jealousy as to whether or not the companies are making a little more profit than you expect them to or whether the wage rates are a little bit lower than you expect them to be.

I think we have to look at them from the standpoint of the seriousness of this problem of practically bankruptcy for this country if we keep things going the way they have been going.

Thank you very much.

The CHAIRMAN. Thank you very much.

(Mr. Biemiller's prepared statement follows:)

PREPARED STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

We welcome this opportunity to present the views of the AFL-CIO on the proposed Revenue Act of 1971.

When the details of the President's tax proposals were first unveiled, we saw them as a shocking example of the doctrine of inequality.

In the name of economic stabilization and ending unemployment, the President proposed a radical redistribution of the nation's tax resources in favor of the rich, and at the expense of the public interest.

His program would create few jobs, if any; give no healthy stimulus to the economy and make the tax burden of all American families even more inequitable.

In our opinion, he has proposed a giant raid on the Treasury that would transfer billions of dollars of badly needed public funds into the private treasuries of big business. It is geared to the 19th century trickle down theory which contends that enriching the already rich is the way to economic progress.

Unfortunately, the bill that passed the House and is now before this committee reflects—with minor exceptions—the proposals of the President.

Our original indictment still applies.

This bill will create few, if any, jobs at a time when there are over 5 million persons ready, willing and able to work, but unable to find employment. This bill ignores the pleas of the great majority of Americans for tax justice and would hamstring the federal government's ability to fulfill American's needs:

For schools and hospitals, parks and recreation areas.

For a vast expansion of medical facilities and medical personnel.

For 25 million new housing units.

For new, efficient, low-cost transit systems in every major city.

For new waste-disposal systems, new technology and new hardware to extract poisons from the air, the water and the soil.

The 13.6 million Americans and their families we represent are taxpayers.

They cannot see what sense of priority, what national need, or what concept of fair play can justify putting some $75 billion in public funds over the next 10 years into the hands of corporations and their wealthy stockholders.

They cannot accept the loss of postponement or the badly needed public investments that would be the inevitable result of such a decimation of the federal budget, and they cannot accept the utterly inequitable, business-rigged manner in which the proposed Revenue Act would conduct this raid on the Treasury.

In terms of hard numbers, the business-rigged bias in this package is revealing and shocking.

From 1972 on the corporate tax reductions of this bill would result in a permanent cut in the effective tax rate of approximately 15%.

The annual business tax loss is $2.2 billion in 1971 rising to almost $10 billion by 1980.

In contrast, an average family of four would receive a tax cut of about 36 cents per week in 1971, slightly over $1 weekly in 1972, and no more cuts thereafter. The reductions for individuals in the bill, with one single exception—the low income allowance—would have been received in any event under the Tax Reform Act of 1969.

Obviously, instead of furthering the tax-justice steps that were begun in 1969, this tax bill would establish new loopholes for corporations.

The unrelenting needs for increased public investment and the billions of dollars that escape full taxation through loopholes of special tax privilege for wealthy people and corporations would continue to be overlooked.

And the fact that a fair tax structure could contribute enormously to an immediate, as well as permanent, strengthening and balancing of the nation's economy would again be ignored.

We are here to urge the Senate to recognize that this tax bill is rigged overwhelmingly in favor of big business—and against workers, taxpayers and the public interest. And to recognize that public investment and tax justice is precisely what America needs in order to strengthen the economy and provide millions of much-needed jobs.

We hope that the Senate will redress these inequities and reject the myopic and regressive view that what's good for America is only what's good for the nation's weathly.

Our specific comments on the major provisions of the proposed Revenue Act are as follows:

THE BUSINESS-INVESTMENT TAX CREDIT

Under the blatantly deceptive labor "job development investment credit," the House bill would revive a major business-tax loophole which the Congress wisely repealed in the Tax Reform Act of 1969.

The credit would allow the nation's businessmen to reduce their federal taxes—dollar for dollar—by 7 percent of the cost of new machinery and equipment placed in service after August 15, 1971, or earlier if orders were placed after April 1, 1971. Up to $65,000 of used machinery an dequipment purchases would also be eligible.

For the first 12 months of its operation, reopening this loophole would cost the American taxpayer over $4 billion. Between now and 1980 the revenue loss would be over $45 billion—$18 billion more than the credit originally proposed by the Administration.

Importantly, this giveaway is in addition to the $3 billion per year tax bonanza of the so-called asset depreciation range system (ADR). This system was put into effect by the Administration retroactive to January 1, 1971, under cover of the Treasury rulemaking procedure. The House trimmed the rule slightly and as a result, the revenue loss under the House bill is $27.5 billion between 1971 and 1980—compared to the $37 billion that would have been lost under the Treasury's action.

This proposal is not the remedy for the present economic ills that have pushed the number of unemployed up to 5.1 million, or 6 percent of the labor force, and cut industry's operating rate down to 73 percent of productive capacity. And equally important in the longer run, it presents a serious danger of adding to the national economy's instability.

Every dollar of taxes given away to business and industry is a dollar more that must be paid by someone else, or a dollar's worth of public facilities and services that are foregone. In the main, that "someone else" is the American wage and salary earner. He now pays more than his share as a result of an unfairly rigged tax system. Increasingly, he finds it difficult to convince himself that he is getting a fair shake from the government.

Ten years ago the corporate share of the federal income-tax burden was one-third; individuals paid the balance. In 1968 and 1969, the corporate share was approximately 29.5 percent. Now the Treasury estimates that only about 28 percent of the federal income-tax burden will be borne by corporations in the year ending June 30, 1972.

And, of course, passage of the business tax cuts of the House bill would serve to accelerate this shifting of the nation's tax burden.

Thus, reinstituting the investment credit would add further to the unfair tax burden that is now borne by middle- and low-income taxpayers. It would not only add to the loopholes in the federal tax structure, it would also add to the regressive flow of income and wealth by increasing the income shares of business and major stockholders while reducing the share that goes to the great majority of Americans.

What the economy and corporations lack at present is customers and jobs—not labor-saving machinery and equipment.

An attempt to induce businesses to significantly boost outlays for machinery and equipment, when over one-fourth of productive capacity is currently idle, and over half is 5 years old or less, is fantasy. Businessmen don't invest money just for the sake of investing money; they're not going to buy machines merely for the sake of buying machines. Businessmen invest money in new machinery and equipment in the hope that they will be able to use the machinery and equipment to produce goods more economically.

Because of the lack of customers and purchasing power, business won't be investing in additional and expansionary new equipment, but will be receiving billions of dollars in tax credit for routine and previously-made machinery and equipment programs.

In the short run, therefore, the proposed investment credit will be almost entirely a windfall to business and to major stockholders, with the probability that part of the tax bonanza will be exported for foreign subsidiary operations, with the loss of American jobs and displacement of U.S. production. Corporate after-tax earnings would rise, as would dividend payments and opportunities for capital gains for wealthy stockholders.

These points were made eminently clear in a survey taken by the *New York Times*, which reported:

"Most companies said they will replace machinery and equipment at about the same rate they had planned . . ."

The *Times* also noted: "for the next six months to a year at least its impact will be more strongly felt on corporate profit-and-loss statements . . . " and "Few new jobs will be created quickly through plan expansion or in the industries supplying new machinery." (*New York Times*, September 20, 1971).

In the long run, after capacity utilization improves, the investment credit presents the serious danger of another lopsided, inflationary capital-goods boom, as in 1963–69, followed by another recession.

America's recent problems are in no small measure related to the high rate of capacity accumulation that took place during most of the years between 1963 and 1969—spurred by misguided tax policies such as the investment credit, depreciation gimmickry and the failure to enact a corporate tax increase soon enough and high enough to stem the capital-goods boom.

The American economy needs greater stability and balanced expansion. It needs increased revenues for critically important public services and public investments. It does not need the instability and the eroded tax base that would result from reinstituting the investment-credit loophole.

Most important of all, there is nothing here that will create the jobs that are needed to spur a genuine expansion of our economy and put to work the millions of Americans who are now unemployed or under-employed. There is nothing in this so-called job development investment credit that will put the Viet Nam veteran to work. There is nothing here for those Americans who have been laid off in war-geared industries. There is nothing here to stimulate unused plant capacity, expand work forces and increase production to meet a newly developed purchasing power.

The Madison Avenue gimmick of a catchy label—"job development investment credit"—is false advertising to those Americans who will have to foot the bill. But worse, it is deceptive and cruelly misleading to those millions of Americans who are looking to their government for genuine job-creating programs in which they can return to work, do a day's work and again be a part of the so-called work ethic of America.

THE DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

A DISC tax-giveaway proposal was originally a part of the 1970 trade legislation that failed enactment and though time did not make it more palatable, the Administration continued its attempt to exempt one whole industry from federal taxation—the export industry.

Under the proposal, corporations could set up a new form of subsidiary through which all of a company's export operations would flow. The total profits of such a subsidiary—in other words, all of a company's profits on its exports—would be free of federal taxes. The only responsibility for federal taxation would come if the DISC's profits are transferred back to the parent company as dividends, which may never occur.

Under the Administration's DISC, the tax windfall, according to the Treasury, would have been some $600 million annually, and other sources estimated the annual tax loss to be as high as $955 million.

Not only would DISC fail to lessen the serious trade problems that this country suffers, it would further distort the tax structure by creating a wholly new tax loophole. In addition, under the DISC proposal companies would receive a tax windfall for doing what they are doing now.

The DISC provision in the current bill is somewhat less onerous than the Administration's proposal—only because the dollar amount of this tax giveaway was trimmed a bit. Under the House bill, the tax deferred on export profits is limited to sales in excess of 75% of average exports for the years 1968 through 1970.

As a result, corporations will receive somewhat less tax windfall for doing what they would do anyway. And thus, the revenue loss over the short run period would be trimmed in comparison to the Administration's original proposal. But, over time, the annual loss will continue to grow—from an estimated $.1 billion in 1972 to $.4 billion in 1980. Between now and 1980, the revenue los would be $2.4 billion.

The AFL-CIO commented in detail on the DISC in testimony in 1970 and a fuller exposition of our opposition to this blatant tax giveaway is included in the appendix to this statement.

EXCISE TAX REPEAL

Under the House bill, the 7% excise tax on automobiles would be eliminated on sales that took place after August 15, 1971, and the 10% on light duty trucks (10,000 lbs. or less) would be repealed effective September 22, 1971.

Under the Tax Reform Act of 1969 the auto excise tax would have dropped to 5% in 1971. It was scheduled to fall to 3% in 1972, 1% in 1973, and to be eliminated in 1974.

This scheduled phase-out was postponed in legislation requested by the President in 1970, and under present law the auto tax would have been phased out by 1982. It would have dropped from 7% to 6% in 1973, and 5% in 1974. It would fall by 1% per year from 1978 until 1982, when it would be eliminated.

The present law 10% tax on trucks, buses, etc., would have dropped to 5% on October 1, 1977, under present law.

It is our view that excise taxes are sales taxes—direct levies upon consumers. They increase prices and, to the extent they curtail the consumption of those who cannot afford to pay the increased price, they contribute to unemployment and a drop in living standards. Thus, they unfairly burden those who must buy and they have little effect on those fortunate enough to be able to buy without regard to price. In short, they are regressive taxes and represent the least desirable method to raise needed public revenues. They do not help to solve the problems of inflation and unemployment, and they could potentially add to them.

We therefore support this long-overdue move toward getting the federal government out of the sales tax business.

We do, however, urge that the Committee carefully study the provisions in the bill which seek to assure that the consumer receives the full benefit of the excise tax elimination. At minimum we urge that the legislation should clearly note that it is the intent of Congress that there should be no attempts to evade passing his reduction on to the consumer through subterfuge such as reducing trade-in allowances, or discounts, or charging for equipment or accessories that were formerly provided at no extra charge.

REDUCTIONS IN INDIVIDUAL INCOME TAXES

The House bill would speed up the present law's scheduled increases in personal exemptions, standard deduction and low-income allowance. In addition, the low-income allowance would be increased to $1,300 in 1972. Under curent law, personal exemptions will rise from the present $650 to $700 in 1972 and $750 in 1973. The standard deduction, under present law, would increase to 14% (maximum $2,000) in 1972 and 15% (maximum $2000), in 1973. It is currently 13% with a maximum $1,500. The low-income allowance is $1,050 for 1971 reduced by a phase-out and $1,000 for 1972 and thereafter with no phase-out.

Under the proposed Act:

In 1971:

(1) Personal exemptions would be increased to $675.

(2) The phase-out of the low-income allowance would be removed.

In 1972:

(1) Personal exemptions would be increased to $750.

(2) Standard deduction would be increased to 15% (maximum of $2,000).

(3) The low-income allowance would be $1,300.

In terms of what these actions mean to people:

In 1971:

(1) A family of four earning $10,000 would receive a tax cut of $19.

(2) A family of 4 with income of $3,750 would be removed from the tax rolls—under present law this family's tax would have been $15.

In 1972:

(1) A family of four earning $10,000 would receive a tax cut of $57.

(2) A family of 4 with income up to $4,300 would be removed from the income tax roles—under present law this family would have paid $70 in income taxes in 1972.

In 1973 and thereafter:

(1) No additional tax reductions would apply to any moderate or middle income families.

(2) Low income families would continue to receive tax cuts up to a maximum of $42 over those already scheduled in the 1969 tax act.

The effect of these actions would be a revenue loss of about $1.4 billion for 1971. $3.2 billion for 1972 dropping to somewhat over $1 billion per year for 1973 and thereafter.

Cuts in individual income taxes and especially cuts which benefit low and moderate income individuals are an effective means to add to consumer purchasing power and bolster the economy. The AFL-CIO has fought continuously for a just tax structure which would provide sufficient revenues to permit a reduction in the relative tax burdens of low- and middle-income individuals. And we have always felt that the poor should be removed from the federal income tax roles.

On Aug. 9, 1971, the AFL-CIO Executive Council stated:

We believe that quick and effective achievement of tax justice is essential to strengthen the performance of the nation's economy and to increase the amount of federal revenue, needed to eliminate the public-investment shortages that are a source of many of America's critical social problems.

America needs the added tax revenues and improved public facilities that tax justice could provide—rather than continued and expanded windfalls for the rich. Effective loophole-closing would also raise sufficient additional revenue to enable a reduction in the relative tax burden of low- and moderate-income families.

Thus it has been our position that such tax reductions should not be financed out of the monies that could and should be used for rebuilding urban areas, expanding mass transit, education, health care, pollution controls and other needed public investments. Rather, they should be financed out of the billions of dollars that presently are beyond the reach of the federal Treasury because of the loopholes of special privilege to wealthy individuals and corporations.

The AFL-CIO supports the concept of tax reductions for individuals in the low- and middle-income groups. And we therefore support the individual tax relief provisions in the House Bill.

However, it is our view that these reductions should come about as the result of tax reforms that close existing loopholes and abuses and bring additional necessary funds into the U.S. Treasury. This is the sort of personal redistribution of tax burden that can help spur an economic recovery and boost purchasing power.

It should also be pointed out that the major relief provisions in the revenue art are small, one-shot proposals that result in the main from moving up measures which Congress has already scheduled to become effective by 1973. These small reductions can in no way, shape or form balance the hugh new giveaways to corporations. These small cuts must be viewed for what they are—thinly veiled sops to low- and middle-income Americans, calculated to obscure the impact of huge corporate tax giveaways.

THE AFL-CIO PROPOSALS

When all of the tax proposals are examined closely—who will be the recipients, who will be the losers, who will have to pay out more in taxes, and who will pay less in taxes—it is clear that the tax bill before this committee is an unconscionable example of tax injustice.

It would reverse the progress made by every prior Administration that has placed the public good ahead of private gain. More important than greater corporate wealth are the needs of the nation and its people—and they should come first, not the corporations.

The American people have been told repeatedly by this Administration that public treasury money cannot be spent in behalf of worthwhile projects that are badly needed and will create new jobs. Such expenditures would be inflationary, they are told. Yet public funds diverted or credited to private corporations, allegedly to spur investment and private spending, are considered by the Administration to non-inflationary.

A clear illustration of this is the refusal by this Administration to spend $12 billion of funds appropriated by Congress for public purposes. At the end of

1970, there were about 3,000 applications for federal approval of waste treatment facilities. There were 800 applications for water and sewer projects, 1,500 applications for hospitals and public health centers and hundreds of other public facilities in all 50 states.

All of these public improvements will cost money to build—money that will pay wages, buy materials, create sound economic expansion. But this Administration refuses to spend public money for the public good.

America has seen the President veto measures passed by Congress for housing and urban development; for health, education, welfare and anti-poverty programs. The President has vetoed manpower programs and public works programs—job-creating programs of all kinds. All of these programs have been rejected by this Administration. Indeed, the billions of dollars that would fund these programs will go into the corporate coffers as tax credits, tax deferrals on exports and depreciation allowances that have no relation whatsoever to the nation's actual needs and are of doubtful economic stimulation.

We believe that firm steps must be taken to preclude any further erosion in the federal government's ability to meet the nation's public investment needs. We believe firm steps must be taken to further the goals of tax justice and pave the way to a healthy balanced economic recovery. The AFL–CIO, therefore, urges the Congress to take the following action:

1. Completely overturn the Treasury's accelerated depreciation ruling. Creation of the so-called asset Depreciation Reserve System has speeded up business depreciation writeoffs by 20 percent and ended the requirement that business actually replace machines and equipment at about the same rate they are written off. By halting this giveaway, Congress could recoup $700 million in 1971, and $1.7 billion would be saved in 1972. Over the decade a $27.5 billion business tax bonanza would be avoided.

2. Completely reject the proposal to reinstitute the business investment tax credit. If rejected, Congress would save the U.S. Treasury $1.5 billion in 1971, $3.6 billion in 1972 and an estimated $45.1 billion between now and 1980.

3. Completely reject the DISC gimmick. By refusing to allow corporations to spin off into export subsidiaries and defer taxes, Congress could save the U.S. Treasury some $2.4 billion between now and 1980.

4. Immediately enact, retroactive to July 1, 1971, an excess-profits tax modeled after that in effect during the Korean War period which raised some $7.0 billion during the 3½ years of its existence. Such a tax should remain in effect during any period of freeze, controls, or restraints. Tax rates must be high enough to ensure fair and even-handed application of stabilization policies. Effective machinery should be established to ensure enforcement.

5. We urge speedy congressional action toward completion of the unfinished business of tax reform. The major reforms we recommend are as follows:

(a) Close the capital-gains loophole.

The preferential half-tax rate which applies to gains on unearned income from stocks or other property sold at a profit and the zero tax that applies to such gains when passed on at death are the most disruptive and unfair elements in our tax structure. We believe that there cannot be tax justice so long as unearned income from capital gains is half-taxed while earned income is taxed in full. Elimination of the capital gains loopholes for both individuals and corporations and taxing capital gains on property transferred at death would yield an annual revenue gain of approximately $10 to $12 billion.

(b) Enact new tax measures to halt the export of U.S. jobs, remove the incentive to establish production and assembly facilities abroad and create tax disincentives to curb expanded production abroad.

Profits earned by the foreign operations of U.S. corporations should be taxed at the time that they are earned. Under preesnt law, corporations are allowed to defer U.S. taxes until they are repatriated to the U.S. and distributed, which may never happen. Foreign tax payments should be allowed a deduction on U.S. taxes, but the preesnt allowance of a tax credit should be halted.

(c) The tax abuses of the oil, gas and other mineral industries should be completely ended. The 22% oil depletion allowance and the intangible drilling allowance are out-and-out abuses that deserve immediate repeal. The approximate revenue gain would be $2.5 billion.

(d) The 10% minimum-tax rate included in the 1969 Tax Reform Act should be strengthened. This tax requires some tax payments on the part of individuals with large amounts of income from tax-sheltered sources, such as capital gains, real estate depreciation, oil depletion, and hobby farms. For example, doubling the rate would provide a revenue gain of $600 million.

(e) The maximum-tax provisions of the 1969 Act should be eliminated. This provides an uncalled-for tax bonanza to top corporate executives and others whose income comes from astronomically high fees and salaries. The approximate revenue gain would be $200 million.

(f) The tax exemption for interest income from state and local bonds should be disallowed. Such income should be taxed in full with the federal government guaranteeing the bonds and providing an interest subsidy to assure that the fiscal powers of the state and local governments are not hampered.

(g) In addition to the reforms in the federal individual and corporate income tax, a major overhaul of federal estate and gift taxes is a prerequisite to the achievement of tax justice. Present law provides a host of opportunities to minimize or entirely avoid these taxes or postpone payment for generations through devices such as family trusts.

These badly needed tax reforms could bring into the Federal Treasury as much as $15–20 billion annually.

It is the AFL–CIO's firm belief that America's needs are too critical to be cutting the federal government's income at this time.

America cannot afford huge and ever-enlarging tax windfalls to big business. The nation's tax structure must be used in the public interest.

America cannot tolerate any further postponements in the achievement of tax justice nor any further chipping away at the thin margin of equity that remains in the tax structure.

APPENDIX

APPENDIX TABLE 1.—DISTRIBUTION OF INCOME TAX REVENUE LOSS, REVENUE ACT OF 1971 (H.R. 10947)

[In billions of dollars]

Calendar year	Business				Individuals			
	ADR	7 percent investment credit	DISC	Total business	Personal exemptions	Standard deductions	Low-income allowance	Total individuals
1971	0.7	1.5		2.2	0.9		0.4	1.3
1972	1.7	3.6	0.1	5.4	.9	0.3	1.0	3.2
1973	2.4	3.9	.2	6.5			1.1	1.1
1974	2.9	4.2	.2	7.3			1.1	1.1
1975	3.5	4.5	.2	8.2			1.2	1.2
1976	3.7	4.8	.3	8.8			1.2	1.2
1977	3.4	5.1	.3	8.8			1.3	1.3
1978	3.1	5.5	.3	8.9			1.3	1.3
1979	3.1	5.8	.4	9.3			1.4	1.4
1980	3.0	6.2	.4	9.6			1.4	1.4
Total	2.75	45.1	2.4	75.0	2.8	.3	11.4	14.5

Sources: U.S. Treasury, Joint Committee on Internal Revenue Taxation, AFL–CIO Research Department.

APPENDIX TABLE 2.—DISTRIBUTION OF REVENUE LOSS, REVENUE ACT OF 1971 (H.R. 10947)

[In billions of dollars]

Calendar year	Total business	Total individuals	Excise [1]	Total revenue loss
1971	2.2	1.3	0.9	4.4
1972	5.4	3.2	2.6	11.2
1973	6.5	1.1	2.3	9.9
1974	7.3	1.1	2.2	10.6
1975	8.2	1.2	2.3	11.7
1976	8.8	1.2	2.4	12.4
1977	8.8	1.3	2.5	12.6
1978	8.9	1.3	2.0	12.2
1979	9.3	1.4	1.6	12.3
1980	9.6	1.4	1.2	12.2
Total	75.0	14.5	20.0	109.5

[1] These estimates reflect revenue changes over those which would have occurred under existing law.

APPENDIX TABLE 3.—INDIVIDUAL INCOME TAX CUTS—IMPACT OF THE REVENUE ACT OF 1971 (H.R. 10947)

[Family of 4 [1]]

Wage or salary income	1972 Income-tax liability under 1969 tax Law	1972 Income-tax liability H.R. 10947	1972 tax reduction
$3,000	0	0	
$5,000	$170	$98	$72
$7,500	561	484	77
$10,000	962	905	[2] 57
$12,500	1,371	1,309	[2] 61
$15,000	1,864	1,820	[2] 44
$20,000	3,060	3,010	[2] 50
$50,000	14,660	14,560	[2] 100

[1] Assumes joint return, standard deduction, or low-income allowance, whichever is higher.
[2] This tax reduction applies only to 1972 tax returns—these same reductions would apply for 1973 and future years under existing (Tax Reform Act of 1969) law.

APPENDIX TABLE 4

Effect of depreciation speedup and 7 percent investment credit on corporate Income-tax liability

Purchase of $100,000 worth of machinery and equipment, 10-year life

Under 1970 law:	
Purchase of machinery equipment	$100,000
Depreciation writeoff (10 years)	10,000
Reduction in tax liability due to purchase (48 percent of $10,000)	4,800
Under ADR plus 7 percent investment tax credit:	
Purchase of machinery and equipment	100,000
Depreciation writeoff (changed to 8-year life by ADR)	12,500
Reduction in tax liability (48 percent of $12,500)	6,000
Plus 7 percent investment credit	7,000
Total reduction in tax liability	13,000

APPENDIX 5

THE NEED FOR AN EXCESS-PROFITS TAX

The AFL-CIO calls upon the Congress to enact immediately an excess-profits tax. Such a tax could be modeled after the Korean war excess-profits tax. It should be made retroactive to July 1, 1971, and should remain in effect so long as the wages and salaries are subject to any form of freeze, controls, or restraints.

The AFL-CIO has emphasized in Executive Council Statements and by Convention Resolutions over the past six years that if economic controls are necessary and are applied equitably and across the board to wages, prices, rents, profits, dividends and interest rates, we would support such a program.

1. So long as profits are unchecked while wages and salaries are restrained, the test of equity is not met.

Profits are the incomes of corporations; wages and salaries are the incomes of people. Wage controls or restraints, without accompanying controls on the incomes of corporations and stockholders, are grossly inequitable. They result in a one-sided shift in the nation's income and wealth into the hands of corporations and shareholders.

2. The only effective way that profits can be restrained is through taxation. Wages and salaries can be immediately and effectively controlled because every employer acts as an enforcer. Corporate profits can only be effectively controlled through the tax structure.

3. Effective restraints on profits, through the tax structure, must accompany any restraints on wages if there is to be balanced economic growth as well as equity.

These points were made conclusively by Lawrence R. Klein and V. G. Duggal in a detailed study of economic stabilization alternatives (Wharton Quarterly, Summer 1971). These renowned economists stated that: "Since prices respond sluggishly to a slower growth in wage rates, corporate profits, calculated residually, rise. Profits cut into the extra funds taken from wage earners. The additional profits, except for a small part that goes into dividends, are not spent and have no impact effect on the system."

They recommend a profit tax formula which would assure that after tax profits are no greater than they would have been in the absence of wage restraints.

The study concludes by stating that: " * * * it is imperative that wage guidelines be accompanied by profit guidelines, not only because of implied fairness in burden sharing among different socioeconomic groups, but because of the need to return the additional profit to the income stream where it will work most efficiently to increase economic activity."

4. An excess-profits tax, fairly applied, adds balance to recovery and provides urgently needed revenues for public investment.

During the Korean period, for example, a 30% tax was applied to excess profits as part of the stabilization program. At the same time, to avoid hardship situations alternative methods of calculating excess profits were provided and a ceiling was placed on the total tax burden a corporation could be required to pay.

This tax, in effect between July 1, 1950, and December 31, 1953, raised $2.5 billion in its first full year of operation—equivalent to 11% of total corporate income tax revenue. The combined corporate income tax revenue was $22 billion. Over the 3½ years of its operation, $7 billion in needed public revenues were raised.

There is also the probability of a profit windfall in 1971 resulting from the 90 day freeze which has nullified duly negotiated wage increases of millions of Americans which are already reflected in the pricing structure of American corporations.

5. During periods of recovery, sharp increases in productivity and plant and equipment utilization result in sharp and immediate increases in profits.

Again, because of this, stabilization measures which fail to include profit restraints result in a one-sided shift in income between workers and owners—even if prices remain stable.

During all recent periods of recovery, profits rose quicker and faster than any other major sector. For example, from 1954 to 1955, profits rose 27%—employee compensation 8%, and from 1958 to 1959, corporation profits increased 26%—employee compensation only 8%. And during those periods there were no restraints on wages or salaries.

Data now appearing for the present period indicate the same phenomenon. Corporate profits have bounced back to about 1968 peak level while operating rates are still 27% below capacity and 5.1 million people are unemployed.

The First National City Bank of New York, for example, in its August 1971 "Economic Letter" notes that " * * * virtually all of the 22% decline in manufacturing earnings during the recession has been made up during the first two quarters of the recovery."

The Bank goes on to note that reports from 1300 nonfinancial corporations showed an 11% increase in after tax profits between the second quarter of 1970 and 1971 and that "only four quarters in the past two decades have shown a more widespread advance in profits."

Under such circumstances the failure to enact profit restraints while wages are controlled would inevitably result in a massive profits boom, would add inflationary pressures and pave the way for another and perhaps deeper recession.

CORPORATE TAX ACTIONS—KOREAN STABILIZATION PERIOD

The Korean excess-profits tax was effective between July 1, 1950 and December 31, 1953. The bill (Excess Profits Tax Act of 1950) was signed into law January 3, 1951, retroactive to July 1, 1950.

The tax was applied as follows:

(1) The excess-profits tax rate was 30 percent.

(2) There was a ceiling rate of 62 percent. That is, the total corporate tax liability could not exceed 62 percent of income.

(3) The base period could be calculated in either of two ways:

(a) 85 percent of the average profit levels from 1946 to 1949 with one year allowed to be dropped, or

(b) A rate of return on investment according to the following schedule: Less than \$5 million, 12 percent; \$5–\$10 million, 10 percent; over \$10 million, 8 percent.

Investment was equity capital, retained earnings plus borrowed capital.

OTHER CORPORATE TAX ACTIONS

From July 1, 1950, to March 31, 1951, the corporate tax rate was raised to 47 percent from the 45 percent level.

On April 1, 1951, the rate was raised to 52 percent. Also the tax on corporate capital-gains was raised on April 1, 1951, to 26 percent—it was 25 percent.

The revenue generated by the excess profits tax was as follows:

[In billions of dollars]

Year	Excess-profits tax revenue	Corporate income tax (excluding excess profits)
1950	1.39	15.9
1951	2.46	19.6
1952	1.55	17.6
1953	1.61	18.3

APPENDIX 6

CORPORATE PROFITS—FIRST HALF, 1971

From the August 1971 issue, Monthly Economic Letter of the First National City Bank of New York:

"Earnings in the second quarter rebounded almost to pre-recession peaks. Both sales and margins improved * * *."

"Reports from nearly 1,300 nonfinancial corporations tabulated by the First National City Bank's Economics Department showed an average year-to-year increase of 11% in after-tax earnings in the second quarter. In the first quarter, this same group of firms had a 7% rise in profits * * *.

"Only four quarters in the past two decades have shown a more widespread advance in profits.

"For the most part, the rise in earnings paralleled the boost in sales volume that characterized the recovery. In addition, profit margins showed a moderate but encouraging advance, reflecting the benefits of extensive cost cutting. Profit margins rose to 5.3 cents per dollar of sales, compared with 5 cents in the first quarter and 5.1 cents a year ago * * *.

"Altogether, after-tax profits of manufacturers rose 12% over the same quarter a year earlier. Compared with the previous quarter, earnings were also 12% higher * * *.

"After adjustment for seasonal variation * * * virtually all of the 22% decline in manufacturing earnings during the recession has made up during the first two quarters of recovery."

The article in the bank's newsletter also explains why the bank examines company reports to stockholders, rather than depend on the Commerce Department's reports on profits. It explains that the Commerce Department's reports on profits are essentially based on corporate tax reports to IRS and, therefore, are less valid descriptions of corporate profitability. (There are also some questions about the accuracy of the reports to stockholders, but the article states that these reports "are probably closest to the concept of earning power used explicity or implicitly by management * * *").

The article states:

"The idea of a separate set of books for the tax collector is nothing new in human history. This country's complicated corporate tax structure has today made this almost a necessity. Corporate management would be derelict in its duty to stockholders if it did not utilize every legal means of minimizing reported income and therefore taxes. Yet just because this method of reporting taxable profits is hedged about by laws and regulations, that does not mean that it is the "true" picture of what is happening to business and its earning capacity."

These are some of the reasons why the AFL–CIO, as well as some investment counselors, emphasize the importance of changes in the corporate cash-flow (after-tax profits plus depreciation allowances) as a more accurate indicator of the financial ability of corporate enterprise.

APPENDIX 7

THE CORPORATE CASH-FLOW SINCE 1960

The inflation problem of recent years started with a profit inflation, which persisted through most of the past decade.

The cash-flow to corporations (after-tax profits plus depreciation allowances) shot up sharply in the 1960s, much faster than wages and salaries. By the first half of 1969, before the recession started, the corporate cash-flow had skyrocketed far out of line with improvements in workers' wages.

Between 1960 and the first half of 1969, before the onset of the recession: The cash flow to corporations shot up 87%.

But the after-tax personal income of all Americans was up only 77%—about one-eighth less than the corporate cash flow. And that includes the effects of a large increase in employment and substantial increases in income from interest payments, rent and dividends, as well as the income gains of wage and salary earners.

The after-tax weekly earnings of the average non-supervisory worker in private, non-farm employment were up merely 34%—three-fifths less than the corporate cash flow. In terms of buying power, the gain was only about 10%.

The cash flow to corporations soared from 1960 to 1966 and continued up at a somewhat slower pace through the first half of 1969. From the latter half of 1969 through the end of 1970, the recession—combined with the sharp rise of interest rates and lagging productivity—brought a decline in the profits of nonfinancial corporations and their cash flow leveled off.

However, in the late 1960s and particularly in 1969–70, interest rates shot up—resulting in rising costs and prices and sharply increasing bank profits. So, while the cash flow of nonfinancial corporations rose more slowly in the late 1960s and leveled off between the first half of 1969 and the end of 1970, bank profits soared.

As a result, the cash flow to corporations generally (including banks) moved up a bit, even during the recession of 1969–70.

In the first half of 1971, despite sluggish conditions in most parts of the economy, profits and the cash flow rebounded—moving up much more rapidly than the gross national product. There has been a widening of profit margins and a rise in the volume of sales, as well as a continuing increase of depreciation allowances.

By the first half of 1971—with industry operating at only 73% of productive capacity—the cash flow to corporations was 108% above 1960.

Corporate cash-flow after tax profits plus depreciation allowances:

	(In billions of dollars)
1960	$51.6
1961	53.5
1962	61.3
1963	64.8
1964	72.3
1965	82.9
1966	89.5
1967	89.6
1968	94.6
1969	95.8
First half 1969	96.4
1970	97.4
First half 1971	107.1

Source: U.S. Department of Commerce.

APPENDIX TABLE 8.—INTEREST PAID BY ALL SECTORS OF THE ECONOMY, 1960-70

[Dollar amounts in billions]

			Percent of GNP	
	1960	1970	1960	1970
Total interest paid	$44.9	$135.6	8.9	13.9
Business interest paid	27.8	94.7	5.5	10.0
Consumer interest paid	7.3	16.9	1.4	1.7
Government interest paid	9.8	21.3	2.0	2.2

Source: U.S. Department of Commerce, Office of Business Economics.

APPENDIX 8

THE INVESTMENT TAX CREDIT

The investment-credit tax privilege—at 7%—was added to the Internal Revenue Code in 1962, liberalized in 1964, suspended temporarily between October 1966 and March 1967, and eliminated in December 1969.

When offered in 1962, the rationale was the same as today. That is, such a scheme would improve our trade position, increase productivity, and promote jobs and economic growth.

At the time, it was the position of the AFL-CIO that the proposal was "ill conceived" and it was our view that such incentives set the stage for unsustainable one-sector capital-goods booms that serve to distort and disrupt the economy.

Our objections proved valid, for the causes of our current inflation, excess capacity and high unemployment are in no small measure due to the capital-goods boom of 1963–1969. In almost every year of that period, business outlays for fixed investment shot up much faster than the gross national product or any other sector of the private economy. In the six years 1963-69 the real volume of such outlays soared almost 56%, close to 9% per year. Spending on machinery and equipment in real dollars leaped by 67%. Corporate profits increased 33% and cash-ows (profits and depreciation allowances) shot up 48%. In contrast, the average weekly take-home pay of non-supervisory workers (over half the labor force) rose less than 30% and, after adjustment for price changes, the increase was only 8%.

This unsustainable capital-goods boom generated inflationary pressures in the economy. It was inevitably building up for a leveling off or decline since it was adding to the economy's productive capacity at a much faster pace than the demand for goods and services.

The 7% investment credit was first instituted in 1962; yet it was not until the massive tax cut of 1964 and the increases in public invesments that grew out of the Great Society programs that any appreciable effect on unemployment was felt. For example, between 1962 and 1964 the unemployment rate continued to stick around the 5.5% level and actually rose between 1962 and 1963. It was not until the end of 1963 that the rate began to ease.

Furthermore, in 1962 industry was operating at 82% of capacity—compared to today's situation where 27% of capacity lies idle. This same mistake must not be repeated.

The fact that the real volume of business investment outlays has declined somewhat since the end of 1969 stems clearly from the existing substantial excess capacity.

Though corporate profits are down somewhat from 1968 peak levels, cash-flows—a much better indicator of the availability of funds for business investment—have increased substantially despite the recession. In the second quarter of 1971 corporations were generating cash at an annual rate of $108.6 billion, 15% above even the third-quarter 1968 rate—the peak period of the corporate-profit boom.

The clear relationship between industry's operating rate and the volume of demand for capital goods was recently indicated in a report in *The Wall Street Journal.* According to the April 26 issue of that newspaper, J. T. Bailey, President of Warner & Swasey Co., stated: "Historically, an operating rate of 80% is required to produce a good level of orders for machine tools." And a good level of orders for other types of capital goods may require operating rate of 85% or more.

Obviously, what the economy and corporations lack at present is customers, not machinery and equipment.

INVESTMENT TAX CREDIT FOR SELECTED CORPORATIONS

[Dollar amounts in millions]

	General Electric	Percent tax rate reduction	Union Carbide	Percent tax rate reduction	PPG industries	Percent tax rate reduction	General Motors	Percent tax rate reduction	U.S. Steel	Percent tax rate reduction
1962	$5.5	2	(1)	(1)	$1.2	2	$16.9	2	$8.2	6
1963	7.4	2	(1)	(1)	2.5	6	29.1	(2)	12.0	6
1964	6.0	4	$12.6	9	1.1	3	35.1	2	13.4	6
1965	9.0	2	13.5	7	1.7	5	39.7	2	13.7	6
1966	13.9	4	18.1	12	2.1	5	49.8	4	20.8	10
1967	14.3	4	19.3	18	2.5	8	31.5	2	33.4	31
1968	17.6	6	17.7	17	7.2	18	39.4	2	38.6	28
1969	10.3	4	7.4	9	3.0	5	35.8	4	35.3	35
1970	3.0	0	(1)		2.0	14	19.9	9	31.3	(1)
Total	87.0		88.6		21.3		297.2		206.7	

[1] Not available.
[2] Nil.

APPENDIX 9

THE AFL-CIO POSITION IN OPPOSITION TO THE DISC PROVISION OF H.R. 10947

1. The DISC provision would create a new tax loophole which in the main would benefit large corporations.

Under present tax law profits from export sales are subject to U.S. income taxes in the year earned. U.S. income taxes on profits of foreign subsidiaries are deferred—they do not have to be paid until such time as dividends are brought back to the U.S.

Through the DISC the existing tax deferral loophole would be widened and extended to profits from export sales of domestic corporations. The DISC would, therefore, widen an existing loophole, entrench it further into the law and postpone or preclude any opportunity to eliminate this preference.

2. The benefits of DISC tax deferral would flow to all firms exporting goods—regardless of whether their export sales increase.

3. The DISC proposal would be a windfall tax bonanza to many corporations.

A major beneficiary of the tax provision would be large U.S.-based multinational corporations. Those corporations export semifinished goods and components to foreign plants which in turn compete with U.S. goods.

Similarly a major purpose of the DISC provision, according to the Treasury, is to permit smaller firms to enter the export market or expand export sales. In our view, the rise of huge multicorporations is a major factor in precluding smaller firms from developing markets abroad. These huge corporations produce for export as well as operate through foreign subsidiaries. Hence, the opportunity to establish DISC's would enhance the financial position of these huge, internationally-based operations. Their ability to control international markets would be reinforced and smaller firms could not improve their competitive position.

4. The DISC proposal would open opportunities for tax avoidance through bookkeeping gimmickery between the DISC and its parent corporation. The Treasury's proposal would permit tax-free reorganizations into DISCs, provide additional opportunity for corporations to accumulate tax-free funds, and permit the DISC to lend these tax-free accumulations to parent corporation or any other U.S. exporter.

5. The DISC provisions would cost the U.S. Treasury initially about $100 million according to Treasury estimates. The loss however will increase each year rising to $400 million by 1980. Losses that will have to be made up by individual taxpayers and businessmen that do not produce for international markets.

6. The DISC proposal would do nothing to eliminate the basic factors which have led to the deterioration of the U.S. trade position. These factors include the spread of managed national economies, with direct and indirect government

barriers to imports and aid to exports; the internationalization of technology; the skyrocketing rise of investments by U.S. companies in foreign subsidiaries; and the spread of U.S.-based multinational corporations.

In sum, it is our judgment that if the DISC provision were enacted, a gaping new corporate tax loophole would be created and there would be little if any improvement in our trade position. Moreover, there is a distinct possibility that this proposal would serve to encourage a further export of U.S. capital, technology, and jobs and forestall the adoption of the many measures necessary to rationalize our foreign economics policies.

HOW DISC BENEFITS CORPORATIONS WHETHER EXPORTS INCREASE, DECREASE OR REMAIN STABLE[1]

	Tax Deferral,[2] end of year: 1	2	3	4	5
No increase in exports over base period	$120,000	$120,000	$120,000	$120,000	$120,000
5 percent annual decrease from base period	96,000	72,000	48,000	24,000	0
5 percent annual increase from base period	144,000	168,000	192,000	216,000	240,000

[1] Example: Corporation with average of $1,000,000 in export income during base period (1968-70).
[2] Assumes income tax rate of 48 percent.

APPENDIX 10

POSTPONEMENT OF INCREASES IN SOCIAL SECURITY PAYROLL TAX AND WAGE BASE

The AFL–CIO believes postponement of the increase in the wage base to $9000 as scheduled in present law would aggravate an already serious actuarial imbalance in the hospital insurance trust fund. Passage of H.R. 1 and postponement of its scheduled contribution and wage base increases would exhaust that fund in 1973. It is imperative to raise the payroll tax or the wage base or both or at the very least reallocate income between the cash and hospital insurance trust funds.

Under the present law, the total social security contribution rate of 5.2 percent each for employees and employers is scheduled to remain in effect for 1972. However, the wage base is scheduled to increase in 1972 from $7800 to $9000. H.R. 1 would increase the wage base from 5.2 percent to 5.4 percent in 1972 and the wage base to $10,200. The 5.2 percent rate under present law consists of 4.6 percent for cash benefits and 0.6 percent for hospital insurance. The 5.4 percent rate under H.R. 1 consists of 4.2 percent for cash benefits and 1.2 percent for hospital insurance. The payroll tax is cut for the cash benefit programs because of a surplus in the trust fund and in order to increase the hospital insurance rate without substantially increasing the combined rate for cash and hospital insurance.

Though there is some latitude in the timing and magnitude of increases in the contribution rate and wage base, the financing of the Social Security program should not be based upon countercylical and related economic considerations. Once we deviate from this principle, it is inevitable that considerations other than the legitimate needs of social security beneficiaries will be major factors in determining if and when changes in the law will be made. The needs of beneficiaries and the actuarial soundness of the system should be the criteria and they should not be subject to the fluctuations of economic policy. The Congress has a myriad number of ways of influencing the economy in a desired direction and there is no overriding need to use the social security contribution rate for that purpose.

The large bulk of the funds for financing H.R. 1 in 1972 comes from raising the wage base to $10,200. But postponing increases in the wage base scheduled in H.R. 1 or under present law will have no immediate impact in stimulating the economy. The social security tax is applied to the total salary at the beginning of the year and deductions for an individual cease when the wage base is reached. Thus, regardless of whether increases in the wage base are postponed, no significant economic impact can result until the fourth quarter of next year—much too late for achieving the immediate economic results required.

A more effective way to immediately stimulate the economy and put money into the hands of people who will spend it would be to begin paying increased benefits in January 1972 instead of for June 1972 as now scheduled in H.R. 1. This would put nearly an additional $200 million a month into immediate stimulation of the economy or more than one billion dollars in the first half of the year. Raising the benefit increase from the inadequae 5 percent to a higher amount would, of course, provide even greater stimulation. We believe this would be the preferable approach because it achieves both an important social goal and provides a more effective, immediate impact on the economy.

The CHAIRMAN. Our next witness will be Mr. Charles Stewart, president of the Machinery and Allied Products Institute.

STATEMENT OF MR. CHARLES STEWART, PRESIDENT, MACHINERY AND ALLIED PRODUCTS INSTITUTE, ACCOMPANIED BY MR. WILLIAM HEALEY, STAFF COUNSEL

Mr. STEWART. Mr. Chairman, members of this distinguished committee, by name is Charles Stewart. I am the president of the Machinery and Allied Products Institute and chairman of its affiliate organization, the Council for Technological Advancement. We represent the capital goods and allied equipment industries of the United States. I am accompanied by Mr. William Healey, staff counsel of the institute.

I think I would be remiss in a broader sense if I did not pay my respects this morning to the passing of Dean Acheson, whose wisdom, judgment, and contributions to public policy have been extraordinary over the years. I think he might have been helpful as to the important issues that are before you today.

I would like to commend the rules of this committee in terms of forbidding reading of statements. I have often wondered why Congress let this happen for so many years. I congratulate the chairman and the committee on insisting on this rule even though we have to live with a 10-minute limit.

I would like to ask that our principal statement be accepted for the record in its entirety.

The CHAIRMAN. That will be done in all cases.

Mr. STEWART. Secondly, anticipating the testimony you have just heard, we have prepared a document entitled: "Cost, Price, and Profitability Trends in the Manufacturing and Capital Goods Industries, 1948–70."

I shall read a brief summary of that document shortly and I ask that you consider it as a supplement to the statement or, at the minimum, for staff use.

The CHAIRMAN. I believe we can print all of this in the record and I think in view of your interest in this matter it is justified.

So I will ask that that be done.

Mr. STEWART. Thank you, sir.

I would like to make brief comment on the reference to Chairman Long's statement covered by a press release of the committee on October 7, with regard to his concern that restoration of the investment tax credit might "drive up" interest rates. I recognize the issue as an important one, but in all candor it is our judgment that the contrary would be true.

The adoption of the class life system of depreciation and reenactment of the investment tax credit would enhance corporate cash flow significantly and improve the return on investment so that business would not be forced to go to the money market to any substantial extent.

Moreover, the favorable effect of new capital investment on productivity should restrain inflation and its elements including interest rates.

In other words, I share, at least to some degree, the chairman's concern about the level of interest rates but we feel, and believe that experience bears us out, that increasing the internal funds of corporations which are made up of depreciation accruals, retained earnings and any special incentives such as the investment tax credit, will buttress the ability of a company to finance capital investments without placing a large burden on the money markets and thereby contribute to holding down interest rates.

Next I should like to allude to the almost inevitable attitude of the labor movement toward liberalization of depreciation, reinstatement of the investment tax credit or other measures designed to strengthen American industry, its ability to compete domestically and internationally, its ability to increase productivity and thereby dampen inflationary trends, and its ability to employ men and women and afford wage increases of the dimensions we have been experiencing over the last several years.

Contrary to the dogma which you have just listened to from the AFL-CIO representatives labor cannot have it both ways. If its bargaining strength and government policy enable it to force wage rates up to a very high level and on a continuing trend, labor must become more modern and objective in thinking about what enables business to carry such a load.

As to how we can improve the ability of our economy to offset wage push inflation, I am baffled by the economics of the labor movement on this subject.

I can only attribute their conclusion to what might be called a visceral antagonism toward any government action or any action by industry itself which appears to benefit industry.

I think also that, as the Secretary of the Treasury indicated in his testimony, we have been hampered by a contest which pits individuals against business in terms of developing corporate tax policy.

At this point I would like to read a summary of the new economic study of MAPI to which I referred earlier:

> The history of profits and prices in manufacturing during 1948–70 shows that accelerated price inflation has normally been associated with declining profits. This has tended to be true for the capital good industries as well. This phenomenon reflects the *unsuccessful* efforts of manufacturers to pass on to their customers in the form of increased prices rapidly rising unit labor costs during periods when wages and salaries are rising at an accelerated rate and productivity performance is poor.
>
> As a result of poor productivity and a rapid rise in hourly compensation since 1965, both all manufacturing and the capital goods sector have experienced the most extended profit squeeze in the post-World War II period despite an accelerated rise in prices.
>
> Clearly the cost impact of increased employee earnings during this period has substantially outweighed any benefits which would otherwise have accrued in the form of expanded demand. This is reflected in the employee compensation share of value added by manufacturing which has risen to its highest level in the entire 1948–70 period.
>
> It seems clear in view of these developments that measures are needed to correct the present imbalance in value-added shares. In that regard, steps to

restore the profitability and cash flow of manufacturing to more reasonable levels can go far toward reversing recent adverse trends in prices and employment.

I turn now to a point not directly discussed in our written presentation but one which has a substantial bearing on why this country is in trouble at the present time with respect to its industrial plant and its ability to compete internationally.

As you are aware, we have lost our surplus position in trade balance in the current period and our balance-of-payments situation is in tragic condition.

This country has been moving in the last several years steadily toward a service-oriented economy. That is not desirable for management or labor in a large sense. Obviously, particularly in a society which has a very high standard of living, the demands for services must be met. They should not be met, however, in a manner which preempts or circumscribes either the interest or policy of the government toward our base of manufacturing of goods in the United States.

In meeting this trend, I don't believe that we are going to see a drastic change politically with respect to control on excessive wage increases except under such a temporary program as the freeze now in effect.

I say that realistically. In addition, I do not believe that the answer to this matter lies in building a tariff wall around the United States or engaging in other long-term restrictionist measures.

I think what we have to do in this country is to build the most modern, the most viable, and the most competitive industrial base that the United States can possibly put together. The tax proposals before this committee are important steps in the right direction.

The prior witness oversimplified the matter by saying our problem is that we are operating at a low level of capacity and argued that we don't need tax relief for corporations. Senator Fannin very properly asked what are we going to do about the problem of operating at a low level of capacity?

The answer is that you have to improve capital investment and you have to improve productivity; you have got to give business a better competitive position with our trading partners. Then the orders will flow, but you just can't answer the problem by saying that we have a low rate of capacity utilization.

As a matter of fact, that point has been overworked as we indicate in our statement, because we really don't know how to measure capacity utilization in a meaningful way.

We need to remember another thing. The United States confronting a catchup by competitor nations in the research and development and technology fields. That is one of the reasons we look forward with interest to the recommendations of the President in this area which he has promised to send to the Congress.

I am not going to read the summary of our statement. It is before you. We favor an investment credit reinstatement of at least 7 percent, preferably higher. We believe that the dates for eligibility that are in the present bill, particularly with regard to the cut-in, have been improved by the Ways and Means Committee. We oppose a two-step credit. We urge continuation of the ADR depreciation system.

We support the original proposal of DISC, as submitted by Treasury, with certain modifications, as distingushed from the watered down version in the House-passed bill.

I have already referred to R. & D. We commend this committee's sense of timing in respect to prompt enactment of this legislation. We have reason to believe that there is an additional cloud hanging over the order boards of companies in the United States now in the form of the question: What is the final version of this bill going to be? And I think the chairman is to be commended for pushing this legislation.

I don't believe that in the short period of time that has been assigned me I can add very much except to restate a point for emphasis.

American industry in the manufacturing sector has a very serious problem at the present time. We are not going to solve it by the recommendations that were offered to you by the prior witness.

It is absolutely mandatory that we beef up our plant and equipment in the United States so that we can improve our productivity, so that we can put more men to work and so that we can compete with our friends abroad.

The answer does not lie in trade restrictionist measures in the long run even though it may be felt that those restrictive measures can be tolerated for a short period of time.

With respect to the relationship between benefits to industry versus the individual taxpayer, I think the figures offered by the Secretary of the Treasury are dramatic when he said that over the most recent 5-year period, tax payments by individuals (mainly in the low- and middle-income brackets) will have been reduced by $36.4 billion while tax payments of corporations in the same period will have actually increased by $3.2 billion.

Whether those figures are precise or not the general thrust of them is certainly accurate.

In my judgment, representing a sector of American industry which at least in a number of major product lines is not only in a recession but in a depression, the basic content of this legislation is absolutely essential. It is naive to suggest that all we have to do is raise the level of utilization of capacity in American industry and that will solve the problem. The question is "How?"

I must confess that the prior witness also said that we need to put more money in the pockets of the consumer. We are finding some funny things about our traditional economic theories. Chairman Arthur Burns said the other day that some of the theories we used to follow are not working. For example, consumers, for a fairly long period of time, have not been spending additional amounts of moneys that are placed in their pockets except for the very disadvantaged people or people in old age brackets who have to spend every nickel they can get. The balance of the consumer public is nervous, is unhappy, is weary, and they are not putting their money on the line; they are not putting their money on the line because we have not solved our economic problems.

To repeat, I think that the reinstatement of the investment tax credit is absolutely crucial and it ought to be at a level of at least 7 percent, preferably higher. We oppose definitely the notion of two steps. It is going to create more problems than it solves. It is going to complicate the situation and create an air pocket after whatever zoom we get from this two-step approach.

With deference to our time schedule, I will leave my oral comments at that point.

The CHAIRMAN. Thank you very much, Mr. Stewart, you made a very fine statement. As you can see we are trying to move along.

Senator FANNIN. Mr. Stewart, your statement generally supports the administration position. However, I would like to get the reaction of your Institute to the section of the Job Development Credit which provides a buy America clause tied to the duration of 10 percent surcharge?

Mr. STEWART. Our organization as an organization does not have a formal position on that subject and related matters such as quotas largely because we are constituted in a manner that we have underlying associations representing various product lines which have their own views about their product lines.

We do not have an institutional position. My response to you as an individual, and I like to think a student of the subject for a period of time, is that I do not believe that trade restrictionist measures will solve the M.S. trade problem for the long run. I think that as a part of a package which the President presented, industry and Government can live with that type of policy for at least a period of time and I have one very definitely affirmative reaction to it despite my reservations in terms of the long pull. My affirmative reaction is that it is about time the United States began to act in the light of its self-interests and in the light of its economic power, even though that may be diminished as I have indicated, in terms of international negotiations.

We threw away a real chance in the Kennedy Round to deal with nontariff barriers; we lost our leverage at that point. And Secretary Connally, I think, said it more bluntly than I can say it. He said in effect we want the world to know that the United States cannot carry all of the burdens that we have been carrying in trade policy, military commitments, and so forth.

He said we shocked some of our friends abroad and perhaps now we are in better position to negotiate in order to arrive at a policy which will make sense for the long run in the United States, including the issue that you mentioned.

Senator FANNIN. Don't you agree that we cannot continue work under GATT if these inequities are carried forward?

Here we are with a very unrealistic position and then we have the nontariff barriers added on to that with the value added taxes and all of these others, barriers to our trade, but incentives to their trade.

Then GATT is just out of the question, if we are going to correct those inequities under this present arrangement where the voting power is so much against us.

Mr. STEWART. Well, I am not that pessimistic about working under GATT. One of the things we have to learn, beyond what I have said, is that our trading friends and partners work under GATT in a different way than we do.

They take liberties with GATT. Sometimes they do it with approval, sometimes they do it within a narrow technicality such as the value added tax and how it affects trade, which they argue is valid under GATT and yet it is a debatable question if you look at the spirit of GATT.

So that I am not suggesting we throw in the towel on GATT I am suggesting that the United States should act like a grown up man in terms of its relations and its negotiations with our foreign partners and that we do something about these barriers.

You know some of these barriers are not even out on the table. Try to sell a turbine to England. There is not any rule or any regulation that says to an English concern you shall not buy from the United States in the turbine field. I haven't seen one sold to England for a long time, which is another example of the fact that we are—I don't want to use the word too often—naive in terms of how we handle ourselves in international negotiations on commerce. One of the things that most pleased me about the total economic program that was offered by the President was the fact that we were assuming a different posture in this regard.

So I don't give up on GATT, I think GATT undoubtedly has been a vehicle for bringing about some international agreements that make sense. It has also been a vehicle for misuse, and a vehicle that the United States has not very imaginatively worked under.

Thank you.

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

Mr. STEWART. Thank you.. It is always a privilege to appear before this committee.

(Mr Stewart's prepared statement with attachments follows:)

PREPARED STATEMENT OF CHARLES W. STEWART, PRESIDENT, MACHINERY AND ALLIED PRODUCTS INSTITUTE

SUMMARY

1. Increased capital investment is required in the United States to foster necessary economic growth, to increase real personal income, and to assist in overcoming our adverse international balance of payments.

2. Capital expenditures are showing no real growth even as America's productive plant becomes increasingly obsolescent by comparison with those of international competitors.

3. To accomplish badly needed growth in capital investment, it is necessary both to provide an incentive for such investment and to augment the supply of capital funds.

4. To achieve these goals, we recommend adoption as a permanent part of the Internal Revenue Code of a Job Development Tax Credit at a *level, unchanging* rate of at least 7 percent, preferably higher, applicable to eligible property acquired after August 15, 1971, or ordered after March 31, 1971 (comparable effective date should apply in the case of constructed property). If Congress feels, as the Administration apparently does, that a 10 percent credit is necessary at this time, we certainly would accept and endorse that judgment provided it does not involve a subsequent reduction to 7 percent as recommended by the Secretary. Achievement of these goals also requires retention of the Asset Depreciation Range (ADR) System of tax depreciation, including the 20 percent reduction in equipment class lives and abolition of the reserve ratio test. We note that the House-passed bill, H.R. 10947, accomplishes legislative adoption of ADR under a "Class Life Depreciation System."

5. We support the proposal to encourage U.S. exports by authorizing exporters to establish Domestic International Sales Corporations, but tax deferral should be

available on *all* of a DISC's export income and not merely on so much of that income as exceeds 75 percent of a 1968–1970 base-period level.

6. We endorse the President's plan to propose new tax incentives for the purpose of stimulating industrial research and development and trust that the Congress will be sympathetic to this policy and its implementation.

7. Although we do not treat these matters in detail in our statment, we do wish to register our support for the provisions for individual tax reductions and repeal of the excise tax on automobiles and small trucks as contained in H.R. 10947 as passed by the House. In addition to the stimulative effect of such measures on the economy at this time, we believe that both individual and corporate tax rates are too high.

8. We commend the Administration's sense of timing in respect to prompt enactment which is joined in by House views as reflected in its timetable and in Senator Long's schedule announcement. It is absolutely essential to move and enact this legislation promptly or the cloud of uncertainty will make a weak order picture even worse.

Statement

The Machinery and Allied Products Institute, the national organization of capital goods and allied product manufacturers, appreciates this opportunity to present its views on H.R. 10947, the proposed Revenue Act of 1971, which relates to the President's tax proposals of August 15, 1971, as a part of his New Economic Program. Much of the Institute's economic research over the years has been devoted to problems of capital investment to which one element of the President's tax program included in this bill—the Job Development Tax Credit—is directly related. Accordingly, our principal concern is with that subject. We appear in support of the Job Development Tax Credit not only in behalf of capital goods producers but in recognition of the interests of *all users* of machinery and equipment, including in addition to the manufacturing industries, the farmer, retail merchant, etc., who would benefit from its adoption.

Enactment of the proposed Job Development Tax Credit, of course, would continue the investment tax credit which was adopted in 1962, suspended in 1966, reinstated in 1967, and repealed in 1969. We believe that repeal of the investment credit was an error and its history, including the current proposal for reinstatement, argues for permanency and against the on-and-off approach. Before examining the details of the bill now before this Committee, we think it would be useful to consider briefly the economic circumstances which demand this type of incentive for new capital investment.

THE NEED FOR CAPITAL INVESTMENT

There are at least five major considerations of national policy which underlie the need for increased capital investment in the United States at this time.

1. *Economic growth.*—If our economy is to grow at the desired rate—as it must if we are to meet the many new demands (both quantitative and qualitative) being made on it and *to provide the necessary job opportunities*—a prerequisite is an expansion of our productive capability in the form of more and improved machinery, equipment, and plant. Within this framework we must achieve maximum employment and maximum utilization of plant and equipment.

2. *Increase in the real incomes of workers.*—If we are to afford the demands for increases in the *buying power* of workers' wages and salaries—and certainly reasonable demands should be met—we must invest in the machinery, equipment, and plant necessary to provide the required productivity of labor. Certainly by now we should have learned the lesson that it is a high level of productivity which is the source of a high and rising standard of living and which is the key to our efforts to control inflation.

3. *Balance-of-payments oconsiderations.*—If we are to overcome our adverse trade balance and our balance-of-payments deficits, we must become more competitive. The ability to compete is in turn based on the two factors noted above: adequate rates of economic growth and productivity growth. As noted, indispensable to both of these is the proper base of plant and equipment.[1]

4. *Enlarged burden on corporate cash flow.*—We are now at a stage when, as discussed in more detail below, industry is encountering a serious problem of capi-

[1] Other elements of productivity growth such as worker education and training and research and development already receive considerable federal support.

tal supply. This is aggravated by the cost to business of compliance with socio-economic programs—the merits of which we do not question—including pollution abatement, strict safety and health standards in manufacturing facilities, product safety, equal employment opportunity programs, etc.

5. *Relationship of capital investment and interest rates.*—We note that Chairman Long in his opening statement in these hearings expressed concern that the investment tax credit would "drive up" interest rates. It is our judgment that the contrary is true. The adoption of the class life system of depreciation and the investment tax credit would enhance corporate cash flow significantly so that business would not be forced to go to the money markets. Moreover, the favorable effect of new capital investment on productivity should restrain inflation and its elements, including interest rates.

One can only conclude that it is fundamental that the United States achieve and maintain the most modern technology and industrial plant in the world. It is only in this way that we can conserve the progress we have made, protect our national security and our international competitive position, and ensure the highest level of job opportuniites with rising incomes and stable prices.

WHERE ARE WE NOW?

The level of capital expenditures.—While a number of indicators presage a resumption of growth in aggregate economic activity in 1971, this is not true for capital expenditures. The most recent expectations for business capital outlays were those reported in the September Department of Commerce-Securities and Exchange Commission survey; namely, an increase for 1971 to 2.2 percent (from $79.7 billion to $81.4 billion). In real terms this would mean no increase at all. Further, even the gain in money terms is entirely attributable to the nonmanufacturing sector of the economy. Manufacturing anticipates a decline in outlays (5.8 percent), following only a small rise in 1970. Broken down still further and looked at from the point of view of orders for individual industries producing capital goods, new orders in 1970 for machine tools, to take one case, were off 47 percent compared with 1969. Nor does the current rate of orders (on an annual basis) suggest that the industry will have a strong forward movement in 1971. Certain other capital goods industries also have experienced a significant downturn. These include steel mill equipment, textile machinery, railroad equipment, and aerospace, which affects not only end-product manufacturers but a broad range and substantial number of capital equipment suppliers, large and small.

The "capacity" argument.—Despite the story told by these data, it is frequently said that new equipment is not necessary since our manufacturing plant is operating at rates significantly below capacity. It is interesting to note, however, that there is little or no agreement as to the definition of capacity. To take one example, the often-cited McGraw-Hill annual survey of business' capital expenditure plans asks its manufacturing respondents to give their own year-end capacity-use rates, but leaves it to them to define capacity as they see fit.[1] A major stumbling block in measuring and defining capacity is that the limits of capacity are primarily economic, rather than physical. In other words, cost normally (i.e., in peacetime) is the controlling factor, and changing economic conditions can, over a period of time, lead to changes in economic capacity without a comparable change in physical facilities.

More importantly, a figure representing the percentage of capacity utilization gives no indication of the quantity of equipment in use beyond the proper economic life for the function or service performed (i.e., that proportion which is obsolescent). Age is one indication of obsolescence. A recent McGraw-Hill survey, "How Modern Is American Industry?" showed that the percentage of productive facilities 10 years of age or younger had actually *decreased* (65 percent to 56 percent) over the past four years. When compared to other leading industrial nations our "obsolescence gap" is not only showing, it is growing. There is also a gap in terms of the percentage of GNP accounted for by capital investment.

Further it should be pointed out that since capacity utilization is very uneven from one industry to another, improved cash flow can be an important factor despite an overall low average figure for capacity utilization. In this connection, the investment tax credit can be useful in facilitating change from a war-oriented to a peace-oriented economy.

[1] This is not to imply that the survey results are not useful for observations of *changes* in capacity levels.

Finally, it is not only interesting but highly significant that the capacity utilization figure (FRB) for 1961, the year the investment tax credit was first introduced, was 79 percent. Certainly on the basis of these data there is no reason to expect that the introduction of the Job Development Tax Credit would not be similarly successful in stimulating capital investment.

THE FINANCING OF CAPITAL INVESTMENT

Assuming the need for capital investment is evident, the obvious question is, "Where will the money come from?" Let us look first at internally generated funds. (See table below.)

CAPITAL EXPENDITURES OF NONFINANCIAL CORPORATIONS AS A PERCENTAGE OF THEIR INTERNAL FUNDS

[In billions of dollars]

	Fixed investment (1)	Internal funds (2)	(1)÷(2)
1947	16.0	12.6	127.0
1948	18.2	18.7	97.3
1949	17.0	19.1	89.0
1950	19.3	17.9	107.8
1951	21.4	19.9	107.5
1952	22.2	21.2	104.7
1953	23.8	21.1	112.8
1954	23.6	23.3	101.3
1955	26.6	29.2	91.1
1956	31.0	28.9	107.3
1957	34.1	30.6	111.4
1958	29.8	29.5	101.0
1959	32.8	35.0	93.7
1960	36.0	34.4	104.6
1961	35.1	35.6	98.6
1962	39.3	41.8	94.0
1963	41.2	43.9	93.8
1964	46.2	50.5	91.5
1965	54.9	56.6	97.0
1966	62.7	61.2	102.4
1967	64.7	61.5	105.2
1968	69.7	61.7	113.0
1969	78.4	59.5	131.8
1970	81.6	61.5	132.7
1971 (1st half)[1]	83.4	67.6	123.4

[1] Seasonally adjusted annual rate.

Note: From the Flow of Funds Accounts of the Board of Governors of the Federal Reserve System.

These data are most revealing. The surge in capital expenditures which began in 1965 was accompanied for that year, and for 1966 as well, by such a rapid increase in internal funds that the ratio of the expenditures to those funds rose only moderately. The rise was moderate also for 1967 and 1968, although for different reasons: a slowdown in the growth of expenditures in the face of a sidewise movement of internal funds. Only in 1969 did the ratio soar beyond the previous range of variation, here because of soaring expenditures and a decline in internal funds. In 1969 it spurted to 131.8 percent. In 1970 it advanced still further to 132.7 percent. The ratio for the first half of 1971 was still well above the pre-1969 high.

It is clear that if corporate capital investment is to be higher relative to corporate output than in the pre-1965 period, internal corporate funds will also have to be relatively larger, since, for a number of reasons, a greater degree of dependence on outside capital—even if available at reasonable rates—is not likely to occur.[1]

Two further points deserve emphasis in considering the necessity of enlarging internal corporate funds. This means in addition to increased depreciation—now accomplished in part by the newly established Asset Depreciation Range

[1] For a fuller discussion of this subject, see *New Norms for Business Capital Investment*, George Terborgh, MAPI, May 1970.

System—increased corporate profits. According to Secretary Connally in testimony before the Ways and Means Committee, "Measured as a percentage of Gross National Product, profits today are lower than at any time since 1938.

"During the past five years, while total wages and salaries have increased 37 percent, from $394 billion to $541 billion—a jump of $147 billion, corporate profits have decreased over 10 percent, from $84 billion to $75 billion—a drop of $9 billion."

The Job Development Tax Credit can help greatly to accomplish the very necessary reversal of this alarming trend. The proposed tax credit is also a realistic step toward compensating for the effects of the anti-capital bias of the Tax Reform Act of 1969. We cite the testimony of Secretary Connally before this Committee. He made the point that to be complete, the record must include the impact of the Tax Reform Act of 1969, plus the Administration's change in depreciation regulations and the tax proposals of the New Economic Policy. If the impact of these measures is spread over the five years, 1969 through 1973, the result is startling:

Federal income tax payments of individuals (mainly in the low- and middle-income brackets) will have been reduced by $36.4 billion. Tax payments of corporations in the same period will have actually increased by $3.2 billion.

Finally, before leaving this subject, we should take cognizance of a widely expressed point of view that the major thrust of any stimulative program should come by means of expanding individual incomes to generate increased demand for products and in turn stimulate production, expand employment, and increase prosperity. At the same time, to promote employment by improving cash flow and thereby encouraging the expansion of corporate operations in general, and investment in particular, has been deprecatingly referred to as the "trickle down" theory.

We would like to respond to this point by referring to a recently completed review by the Institute of trends in cost, price, and profitability in the manufacturing sector over most of the post-World War II period.[1] A review of the data shows, among other things, that the accelerated rise in manufacturing prices during 1965–70 was accompanied by the most extended profit squeeze in the post-World War II period.

The same reason for this phenomenon is not hard to find. Poor productivity performance during this period was accompanied by an accelerated expansion in the hourly compensation of employees, and the accelerated rise in prices was not sufficient to offset the resulting increase in unit labor cost.

The rapid rise in wages and salaries since 1965, together with the sharp decline in profit rates, demonstrates that the cost impact of increased earnings has substantially outweighed any benefits which would otherwise have accrued in the form of expanded demand. As a consequence, the employee compensation share of total value added by the manufacturing sector[2] rose to its highest level in the entire period under review (71.7 percent in 1970) and the results can be seen in the adverse movement of profits, prices, and employment. Clearly, measures are needed to correct the present imbalance in value-added shares.[3] In that regard, steps to restore the profitability and cash flow of manufacturers to more reasonable levels can go far toward reversing these adverse trends.

RECOMMENDATIONS ON THE JOB DEVELOPMENT TAX CREDIT

We strongly endorse the Job Development Tax Credit, but at a flat rate rather than the two-stage credit. The Institute's recommendation stands unchanged from that presented in our testimony before the Ways and Means Committee:

Congress should adopt as a permanent part of the Internal Revenue Code a Job Development Tax Credit at a *level, unchanging rate of not less than 7 percent and preferably higher.* The ADR depreciation system should be retained as a necessary and vital companion program.

We welcome the decision of the House of Representatives to adopt by law the essential parts of ADR and to introduce the concept of a Class Life Depreciation System. (See a later section of this statement.)

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[1] "Cost, Price, and Profitability in the Manufacturing and Capital Goods Industries, 1948–70." The study, based upon unpublished data of the U.S. Department of Commerce, is currently in draft form and is available to the Committee.

[2] Value added can be equated with the cost of production and include employee compensation, net interest, depreciation, profits, and taxes.

[3] Passage of the Tax Reform Act of 1969 contributed to the imbalance by repealing the investment tax credit while providing substantial tax relief for individuals.

Our reasons for favoring the flat-rate approach go to the basic philosophy of the investment tax credit and what in our view it should be expected to accomplish. In the first place, it seems fairly clear that the two-tier credit proposed by President Nixon would create some very difficult problems on the "downside," that is, with respect to orders for credit-eligible equipment when the rate of the credit was scheduled to drop from 10 percent to 5 percent (or 7 percent under the Administration's revised recommendation) for acquisitions after August 15, 1972.[1] It will be recalled that the Administration had proposed that the reduction take place with respect to acquisitions (and construction) after that date, except that the full 10 percent credit should be extended to acquisitions (and construction) before February 16, 1973, if pursuant to a binding contract executed before August 16, 1972. This six-month extension would cover with the full 10 percent credit only those items with a lead time of 18 months (August 16, 1971 to February 15, 1973) or less; equipment with a longer lead time would be eligible for only the reduced 5 percent (or 7 percent) credit. It is our conclusion, after some study of the situation in terms of the capital goods and allied equipment manufacturers whom we represent, that virtually any reasonable extension of the February 15, 1973 cutoff with respect to the 10 percent credit would still prove inadequate because certain long lead time items would not be covered. And, more importantly, there would almost certainly be a "vacuum" in orders for the period immediately following the reduction in the credit as a direct consequence of the bunching of orders and/or acquisitions just before the reduction took place. Finally, the concept of a two-tier credit is in our judgment inconsistent with what we think is the strong desirability of ensuring that the credit be made permanent in nature and that industry and the general public be able to rely on this assumption. In our view the experience with the 1966 suspension and the 1969 repeal of the credit has been dismal indeed. If it is undesirable as a matter of policy to turn the credit on an off as economic conditions change—and we think it is—it is in our view equally undesirable to vary the rate of the credit and for the same reasons.

As this Committee knows, the Ways and Means Committee reached the same conclusion on almost identical grounds (see pp. 6–7 of House Committee Report No. 92–533).

EFFECTIVE-DATE PROVISIONS

The Administration supported the concept of providing the credit for eligible property acquired after August 15, 1971 and also with respect to property constructed after that date. The Ways and Means Committee extended credit eligibility to cover cases where property was ordered (or construction began) after March 31, 1971, and acquired (or construction completed) before August 16, 1971. This action was taken to reflect public commitments made by Secretary Connally and ranking members of this Committee and the Ways and Means Committee last spring that, although the Administration did not then support restoration of the credit, if any credit were ultimately to be enacted it would cover commitments made on or after April 1, 1971. For reasons of equity alone, we urged the Ways and Means Committee to make this revision; we think that its action in this regard was highly desirable and we continue to support it.

INVESTMENT CREDIT CARRYOVERS

The credit included in the House bill would apply, as it did under the old investment credit, with respect to only up to $25,000 in complete tax liability. Beyond that amount, it would apply only to 50 percent of tax liability. In addition, the former three-year carryback and seven-year carryforward of credits—which are used because of the 50 percent limitation—would be continued and the carryforward would be extended to ten years in the case of pre-1971 credits.

Under these provisions, problems would be created for many taxpayers because of what would be the normal order of priority in applying the credits—that is, the taxpayer would apply against his tax liability credits for current-year acquisitions and then, to the extent that credits could still be applied against the 50 percent limitation, the unused credits beginning with the third preceding year. The difficulty is that, under this approach, the requirement to start with the current year's credit might well mean that some of the credits resulting from prior

[1] For purposes of this discussion, it does not make any significant difference whether the reduction amounts to 3 percent or 5 percent. In either case, the effect will be the same.

years' acquisitions would be lost because of the carryover time limitations. As a consequence, taxpayers might be motivated to decrease rather than increase current-year acquisitions of credit-eligible property in order to fully utilize their old investment credits. In order to prevent this from happening, the House bill provides that the taxpayer may use pre-1971 credits before applying the current year's credits against the 50 percent limitation. Ideally, as we suggested to the Ways and Means Committee, it might be better simply to remove the three-year and seven-year limitations and provide that carryovers be available without any such limitations. However, if it is decided that some type of specific time limitation on carryovers must be retained, the technique of changing the order of priority to use old credits before current credits would appear to be responsive to the problem.

BASIS ADJUSTMENT PROPOSAL

The Ways and Means Committee has instructed the Treasury Department and Joint Committee on Internal Revenue Taxation staffs to study the possibility of developing a "basis adjustment" mechanism to the investment credit for consideration by the Committee and the Congress within the next two years. It will be recalled that under an amendment offered by the distinguished Chairman of the Finance Committee a basis adjustment—that is, a reduction in the basis of the property, for the purpose of subsequent depreciation, to reflect the investment credit—was added to the original investment credit as enacted in 1962. This requirement caused great complexities in the mechanics of using the credit. It also decreased the value of the credit and caused considerable difficulty in connection with the proper accounting treatment for the credit. On the basis of this experience we oppose any contemplated new imposition of a basis adjustment requirement. However, we are aware of the colloquy during the House hearings involving Congressman Byrnes, Secretary Connally and Deputy Assistant Secretary Nolan, and of the fact that such as basis adjustment requirement has been related to other possible structural reforms of the investment credit. These include possible liberalization of useful life limitations, the limitation on tax liability, and the recapture rules.[1] What is contemplated, as we understand it, is that if such modifications appear feasible they might be adopted in order to improve the mechanics of the investment credit and with the end objective of making it plain that the investment credit is to be a permanent part of the Internal Revenue Code. While, as noted, we are opposed to a basis adjustment *per se*, we strongly favor making it clear that the investment credit is to be a permanent part of the Code and we support any proposals which may, taken as a whole, improve the mechanics and administration of the investment credit.

CLASS LIFE DEPRECIATION SYSTEM

The House bill includes what it terms a Class Life Depreciation System which, in effect, incorporates most of the so-called Asset Depreciation Range (ADR) System announced by President Nixon last January and adopted in Treasury regulations published in June. The only change, as we understand it, that would be made is that the modified half-year convention (referred to in the House bill as the three-quarter year convention) permitted under the regulations would be disapproved and the taxpayer would be limited to depreciation not in excess of that provided under the standard half-year convention. This would mean that his depreciation would be limited to an amount which would result from assuming that all assets in an account during that year were actually placed in service on July 1.

We assume that the adoption of the new system, and the statement by the Ways and Means Committee that it contemplates "these elements of the ADR system [including the repeal of the reserve ratio test] will be incorporated by the Treasury into the class life system" indicates the Committee's disapproval of the reserve ratio test as a valid measure of the depreciation to which an individual taxpayer should be entitled. We strongly support what we construe to be this indication of legislative disapproval of the test and we recommend that the

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[1] *Tax Proposals Contained in the President's New Economic Policy*, Hearings Before the House Ways and Means Committee, 92nd Congress, 1st Session, Part 1 of 4 Parts, pp. 107–108.

Finance Committee concur. Frankly, we think it might be desirable to express this disapproval in even more explicit language so that there could not possibly be any misunderstanding as to what is intended.

In addition, we generally support the concept of providing what amounts to legislative approval for the ADR system (even though it would be retitled the Class Life Depreciation System), including the critically important 20 percent asset depreciation range which would allow a 20 percent reduction in the previously established guideline lives and which is, in our judgment, a complementary and necessary adjunct to the restored investment credit. With respect to the classification system, however, we suggest that it be made clear that the Treasury is to have the authority to make appropriate modifications in classes when desirable. We think, for example, that it may be desirable not only to make adjustments from time to time as to lives in existing classes, but that new classes might be added where appropriate. Indeed, we believe that there is a definite need for some new classes at the present time. For example, we think that it would be desirable to provide separate classes (which do not currently exist in the ADR regulations) for subsidiary assets and for leased equipment including automatic data processing equipment. Copies of recent correspondence with the Treasury Department relating to these problems are enclosed.

Another matter of significance is to assure taxpayers that they may depreciate pre-1971 accounts (which are not included in the ADR System under the regulations) with "guideline" class lives.

We submit also that it would be desirable to try to ensure that the record-keeping requirements which are very detailed under the ADR regulations are held to the minimum necessary to proper administration of the Class Life Depreciation System and that legislative history reflect this point.

Finally, we urge that this Committee give careful consideration to the restoration of the so-called three-quarter convention if it appears possible in the light of revenue considerations and other factors involved in this legislation.

THE PROPOSED DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

We endorse the Domestic International Sales Corporation (DISC) proposal which is included among the tax measures recommended by the Administration. This proposal recognizes and responds to the difficult and deteriorating trade position of American business, a position which has resulted in significant part from the special encouragement provided for exports by many foreign governments.

We note that the form of the proposal as included in H.R. 10947 is substantially identical with that proposed by the Administration with the very important exception that the tax deferral extended to DISC income would cover that income only to the extent that the DISC's (and related companies') export gross receipts for the current year exceed 75 percent of their average gross receipts for the base period, 1968-1970.

We understand the motivation for trying to narrow the DISC proposal by adoption of the "75 percent" bench mark which obviously would make a significant reduction in its revenue cost and largely limit the benefits to increased exports. On the other hand, the introduction of this type of bench mark test would add considerably to the complexity of what has already been a highly complicated tax proposal. Moreover—and of greater importance—we think that it would be grossly unfair to those companies which, over the years, have succeeded in building up their level of exports. For such companies, the bench mark would be quite high. thus minimizing their opportunities for tax deferral. The company, on the other hand, that has done relatively little in promoting its exports would receive the maximum benefit because its bench mark, based on its export levels during the base period 1968–1970, would be low. Thus there would be little or no reward, in terms of the tax benefits, to those companies who have worked hard on the export problem over the years. It seems to us that for reasons of equity the base-period incremental approach included in the House bill should be rejected. This approach, it seems to us, also ignores the realities of the present international economic situation. What is needed by many companies in light of present foreign competition for export markets is a tax incentive not merely to increase exports but also to enable them to sustain existing levels. We urge that this test be deleted and that deferral be provided on all such undistributed DISC export income. In this connection, in these hearings we find Secretary Connally's discussion of DISC and the "incremental limitation" highly persuasive.

In addition to this basic recommendation, we have the following supplemental suggestions:

1. DISC, like the Job Development Tax Credit, should be considered a permanent part of the Internal Revenue Code.
2. The proposed limitation formulas on the amount of profit which can be attributed to the DISC—the higher of four percent of sales or 50 percent of the combined taxable income from manufacture in the United States and export sales by the DISC—should be liberalized.
3. The 95 percent requirements with respect to gross receipts from export sales activities and export assets are too high and should be lowered.
4. The sale of export services should qualify without reference to any limitation that such services must be "related and subsidiary" to the selling or leasing of export property by the DISC.
5. There should be an expedited rulings procedure under which questions concerning the use of the DISC concept might be resolved quickly.
6. There should be liberlization of the rules concerning DISC investments in a foreign manufacturing subsidiary.
7. The provisions on relationships between DISC loans and export sales should be modified.

The detail and rationale for our recommendations concerning the specific aspects of the DISC proposal, noted in summary form above, can be found in our statement on this subject presented to the Committee on October 12 ,1970.

Finally, we hope that adoption of the DISC proposal will not foreclose future consideration by the Committee of the need for fundamental reform in the area of U.S. taxation of foreign source income.

THE ENCOURAGEMENT OF RESEARCH AND DEVELOPMENT

In annoucing his New Economic Program, President Nixon directed the Secretary of the Treasury to recommend to Congress in January new tax proposals for stimulating research and development of new industries and new technologies to help provide additional jobs. The theme was repeated in the President's address to a joint session of Congress on September 9 when he said, "*In the next session of Congress*, I shall present new proposals . . . [for] tax reform to create jobs, and new approaches toward ensuring the maximum enlistment of America's technology in meeting the challenge of peace."

Although concrete tax proposals designed to encourage research and development are not yet before the Committee, we desire to register our support for the concept of providing appropriate tax incentives for industrial research and development. It is hard to conceive of anything more likely to create jobs, to improve the state of our domestic economy, and to restore our international competitive position than legislation designed, in the President's words, ". . . to ensure that America's enormous wealth of scientific and technological talent is used to the fullest."

Other provisions in H.R. 10947.—Understandably, this statement concentrates on those provisions of the pending legislation to which the Institute has given extensive study currently and over the years. We do wish, however, to register our support for the provisions for individual tax reductions and repeal of the excise tax on automobiles and small trucks as contained in H.R. 10947 as passed by the House. In addition to the stimulative effect of such measures on the economy at this time, we believe that both individual and corporate tax rates are too high.

In closing we desire to reemphasize the need for prompt legislative action if the President's legislative proposals are to achieve their goals. On this point, we are reassured by Chairman Long's schedule commitment in the Committee's press release of October 7. If the proposed Job Development Tax Credit is not enacted promptly, the proposal could tend to become counter-productive if taxpayers feel that their reasonable expectations concerning new tax incentives in connection with the President's New Economic Program have not been fulfilled. Specifically with regard to capital goods producers and users, there is already some evidence that corporate buyers are "holding back" pending final enactment of H.R. 10947.

MACHINERY AND ALLIED PRODUCTS INSTITUTE,
Washington, D.C., July 30, 1971.

Mr. JERRY L. OPPENHEIMER,
Associate Tax Legislative Counsel, Office of the Assistant Secretary of the Treasury for Tax Policy, Department of the Treasury, Room 4212, Main Treasury Building, Washington, D.C.

DEAR JERRY: This is in response to our telephone conversation of last week concerning the treatment of jigs, tools, dies, and fixtures under the Asset Depreciation Range (ADR) System. Consistent with our conversation, we have discussed this matter informally with a representative group of MAPI member companies and our comments are based in major part on their reactions.

First, we should point out that there appears to be some considerable misunderstanding in industry as to how jigs, tools, dies, and fixtures (hereinafter referred to as "tooling" or "subsidiary assets") are to be treated for purposes of tax depreciation under ADR. A number of companies with whom this matter has been discussed are of the opinion that tooling can be excluded from an ADR election, notwithstanding the "all-or-nothing" rule, on the grounds that no "asset guideline class and period are in effect" for such assets pursuant to Section 1.167(a)-11(b)(2)(i) of final ADR regulations. No doubt this misunderstanding persists elsewhere—and perhaps widely—throughout industry. This suggests to us the desirability of publication by Treasury of interpretative "Questions and Answers" concerning ADR as was done after the issuance of *Depreciation Guidelines* in 1962.

As you know, *Depreciation Guidelines and Rules*, Revenue Procedure (Rev. Proc.) 62-21, as revised, provided in Class 5, Group one, a special guideline class—Subsidiary Assets—to cover not only tooling but " . . . other subsidiary assets which are commonly and properly accounted for separately from those assets falling within the guideline classes in Group Two, Three, or Four." No such special asset guideline class has been established under Rev. Proc. 71-25 issued in connection with the promulgation of ADR. It is our understanding that, for purposes of ADR, such assets are to be included in the asset guideline class in Rev. Proc. 71-25 assigned to longer-lived assets to which such subsidiary assets are related.

We believe that special provision—similar to that in Rev. Proc. 62-21—should be made for tooling and other subsidiary assets under the ADR System. If this is not done, two unfortunate results seem to us inevitable:

1. Many taxpayers may not avail themselves of ADR; and,
2. Realization of those desirable ends sought to be attained by ADR and identified in President Nixon's message of January 11—increased employment, promotion of economic growth, enhanced international competitiveness and greater certainty in tax depreciation—will have been frustrated.

Under *Depreciation Guidelines*, Rev. Proc. 62-21, where tax depreciation on subsidiary assets is taken "under a method of depreciation using a life expressed in terms of years, the life shall be determined according to the facts and circumstances." Such lives will vary, of course, according to the nature of the business in which such assets are employed, but for capital goods manufacturers at least they will be considerably shorter than those of the items of production machinery and equipment to which they relate. For any such company the inclusion of its subsidiary assets in an ADR guideline class of 9.5 years (12 years less 20 percent) will represent a significant "stretch-out," the impact varying according to the relative importance of subsidiary assets within the total of depreciable assets.

We have no doubt that a requirement which would increase substantially the depreciable lives of subsidiary assets by lumping them with related and much longer-lived assets in a single asset guideline class will significantly affect corporate decisions to elect or not elect the use of ADR. As a consequence, it seems probable that, in many cases, the taxpayer would be worse off if he were to elect the use of ADR than if he were to continue under his present depreciation practice. Such a result, we feel sure, would be altogether at variance with that intended by the President and the Treasury in their praiseworthy attempt to effect a much needed liberalization of depreciation by means of ADR.

What should be done?

We suggest two alternative possibilities for the Treasury's consideration. Perhaps the simplest solution would be to permit, at the option of the taxpayer, the exemption of tooling and other subsidiary assets from the ADR election. Alternatively, there could be established under Rev. Proc. 71–25, a single, all-purpose guideline class for "subsidiary assets," corresponding to the similar guideline class which was added by amendment to Rev. Proc. 62–21, and with lives thereunder ". . . determined according to the facts and circumstances." If Treasury considers it necessary or desirable to assign useful lives by guideline class to all depreciable assets covered by an ADR election, the adoption of this suggestion could serve as an interim or temporary solution. Thereafter, useful lives could be assigned to subsidiary assets, either collectively or by appropriate class, upon the basis of studies by the newly-established Office of Industrial Economics.

No doubt other possible solutions will suggest themselves to the Treasury staff. The important thing, in our judgment, is not so much the precise nature of the solution as the fact that a solution is reached. Moreover, because fiscal year taxpayers will be facing very soon the ADR election decision, we think that a solution is needed promptly.

If the Institute or its staff can be of assistance in the definition of this problem or in the search for its solution, we trust that you will not hesitate to call upon us.

Cordially,

CHARLES I. DEBB,
Senior Vice President.

MACHINERY AND ALLIED PRODUCTS INSTITUTE,
Washington, D.C., September 3, 1971.

Mr. SEYMOUR FIEKOWSKY,
Acting Director, Office of Industrial Economics, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, D.C.

DEAR MR. FIEKOWSKY: We should like to express again and somewhat more formally our sense of appreciation for the kindness of you and your associates at yesterday's conference on problems connected with the treatment of subsidiary assets and leased assets under the Asset Depreciation Range (ADR) System.

Let me restate very briefly the problems confronted in these two situations by members of the Machinery and Allied Products Institute and particularly those companies represented at yesterday's meeting. Under ADR, subsidiary assets are to be included in the general ADR guideline class or classes applicable to a particular taxpayer. Inasmuch as subsidiary assets have been generally written off on the basis of all facts and circumstances under the authority of Rev. Proc. 62–21 in a considerably shorter period of time than that provided for by the general guideline classes to which they would now be transferred for purposes of depreciation, the effect is a significant "stretch-out" in the lives of subsidiary assets. The further result is, of course, a lessened—or no—advantage in the election of ADR and the probability that some, and perhaps many, taxpayers will for that reason choose not to use the ADR System.

As for leased assets, you will recall that at least two problems are presented. Final ADR regulations (Section 1.67(a)-(11)(e)(3)(iii)) provide that "The asset depreciation range and the asset depreciation period for eligible property subject to a lease shall be determined without regard to the period for which such property is leased, including any extensions or renewals of such period. . . . In the case of a lessor or property, unless there is an asset guideline class in effect for lessors of such property, the asset guideline class for such property shall be determined by reference to the activity in which such property is primarily used by the lessee." Where a capital asset is customarily leased for use in many differing industries having different guideline lives, the result will be numerous guideline classes for identical items of capital equipment and, where the repair allowance is elected, an equal number of differing repair allowances applicable to identical pieces of machinery or equipment. As was pointed out yesterday, this problem of establishing an applicable asset guideline class upon the basis of primary use by the lessee is made difficult if not, in fact, unadministrable where equipment is leased for uses of a secret or confidential nature. Moreover, even where an asset guideline class has been established for general purpose equipment customarily leased—as in the case of asset guideline class 00.1 which covers among other things "data processing machines"—the actual uses to which such equipment is put in the hands of lessees may bear no relation whatever to those uses contemplated in defining the basic guideline class.

All those problems sketched so briefly above, as well as others, were discussed, as you will recall, in the course of yesterday's conference. It is our understanding that your office is now considering at least the possibility of developing individual asset guideline classes, presumably by individual user industry in the case of subsidiary assets and by lessor industry in the case of leased asset. As we suggested yesterday, the Institute is anxious to help the Office of Industrial Economics in this effort in any way possible. We hope to provide you shortly with some direct contacts with trade associations but as an initial reference point, we suggest the three-volume "Encyclopedia of Associations" published by the Gale Research Company, Book Tower, Detroit, Michigan 48226. The Library of Congress catalog number is 74-123631.

Let me conclude by reemphasizing the need for prompt interim relief, the necessity for which was underlined by the testimony of participants in yesterday's conference. Many companies, as you know, must make immediate decisions involving ADR and, in the absence of some modification of ADR rules presently applicable to subsidiary assets and leased assets, it seems evident that many major taxpayers are likely not to avail themselves of ADR. We believe that yesterday's conference supports the soundness of the interim solution which we have suggested: Pending development by the Office of Industrial Economics of those guidelines necessary for full application of the ADR concept to subsidiary assets and leased equipment, we recommend that companies be permitted to exempt both classes of such assets from the "all-or-nothing" election which is otherwise required under the ADR System.

Once again our thanks to you and your associates for the full hearing which you gave us yesterday.

Cordially,

CHARLES I. DERR,
Senior Vice President.

COST, PRICE, AND PROFITABILITY TRENDS IN THE MANUFACTURING AND CAPITAL GOODS INDUSTRIES, 1948–70

The history of profits and prices in manufacturing during 1948–70 shows that accelerated price inflation has normally been associated with declining profits. This has ended to be true for the capital goods industries as well as. This phenomenon reflects the *unsuccessful* efforts of manufacturers to pass on to their customers in the form of increased prices rapidly rising unit labor costs during periods when wages and salaries are rising at an accelerated rate and productivity performance is poor.

As a result of poor productivity and a rapid rise in hourly compensation since 1965, both all manufacturing and the capital goods sector have experienced the most extended profit squeeze in the post-World War II period despite an accelerated rise in prices. Clearly the cost impact of increased employee earnings during this period has substantially outweighed any benefits which would otherwise have accrued in the form of expanded demand. This is reflected in the employee compensation share of value added by manufacturing which has risen to its highest level in the entire 1948–70 period.

It seems clear in view of these developments that measures are needed to correct the present imbalance in value-added shares. In that regard, steps to restore the profitability and cash flow of manufacturing to more reasonable levels can go far toward reversing recent adverse trends in prices and employment.

The recent imposition of the President's "New Economic Program" reflected in part a growing concern over limited success in bringing inflation under better control, a slow rate of economic expansion, and the continuation of a relatively high rate of unemployment. In the wake of its imposition, it is timely to review trends in major factors influencing economic growth and employment—namely, prices, productivity, costs, and profits—comparing the recent record with that of the earlier post-World War II period.

Accordingly, this *Review* focuses on these developments during the period 1948–70, confining its attention to the manufacturing sector and three manufacturing subgroups of particular interest to capital goods companies—machinery except electrical, electrical machinery, and transportation equipment and ordnance, excluding motor vehicles.[1]

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[1] The categories are those of the Standard Industrial Classification (SIC). They are, respectively, SIC groups 35, 36, and 37+19−371. Machinery except electrical includes products sold primarily to the private investment sector. In contrast, electrical machinery includes a substantial volume of consumer durable products and products destined for the government (defense) sector, including household appliances, communications equipment, and electronic components. The transportation equipment and ordnance category also includes a substantial volume of products manufactured for the defense sector, including aircraft, missiles, and parts.

Our discussion is based upon unpublished value-added data[1] developed by the Office of Business Economics (OBE), U.S. Department of Commerce. Value added is, of course, the value which a particular sector of the economy (e.g., manufacturing) adds to goods purchased from other sectors prior to their resale. It is equivalent to that sector's sales plus accumulation of inventory less the cost of intermediate goods and services purchased from other sectors. Viewed in terms of factor payments and nonfactor costs of production, it comprises employee compensation, net interest, depreciation, profits, and taxes.[2]

The availability of these data, which are shown in both current and constant dollars, makes it possible to review changes in productivity, prices, employee compensation, cash flow, and profits in each of the designated industry sectors over the period 1948–70.

RATE OF RETURN ON VALUE ADDED

Our first step will be to review trends in profitability before turning our attention to some of the factors underlying these trends. For this purpose we define profitability as the "rate of return on value added."

Usefulness of the concept.—Profits as a percent of value added or the return on value added is a useful concept. Typically, profitability is considered in relation to equity or sales. However, both of those concepts have their disadvantages. The return on equity is influenced by the degree of capital intensity in the industry in question, for example, tending to be lower in capital intensive industries and to overstate true profitability in labor intensive industries. It can also be influenced by the relation of debt to equity in a particular industry. In a period when profits are high relative to interest rates, the return on equity tends to be greater in industries with larger debt-equity ratios and vice versa. As for return on sales, this is strongly influenced by the production cycle. Industries which have a relatively short production cycle and a rapid sales turnover can be highly profitable despite showing a low return on sales. Many establishments in the retail sector are highly profitable, for example, although their rate of return on sales is typically low.

Value added, on the other hand, is a good measure of an industry's contribution to the nation's total output, and the ratio of profits to value added is not so strongly influenced by the nature of its operations. Accordingly, it is appropriate that profits be measured in terms of this particular yardstick. Further, in avoiding the biases which are inherent in the other two measures, this measure facilitates inter-industry comparisons.

Profitability trends in manufacturing.—Chart 1[3] shows after-tax profits as a percent of value added for all manufacturing and for the three capital goods subgroups referred to earlier.[4]

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[1] Alternatively referred to as "gross product originating."

[2] The cost of production data are relied upon by OBE in the development of its value-added estimates. The estimates relate solely to operations located within the United States. The data include unincorporated enterprises which represent a negligible proportion of total value added in the manufacturing sector. They are on an establishment rather than on a company basis with the result that classifications are much "cleaner" than they would be otherwise.

[3] The charts referred to here and on the following pages are not yet available. However, figures underlying the charts are contained in the appendix at the end of this *Review*.

[4] Profits in the Commerce Department's value-added study comprise corporate profits (including inventory valuation adjustment) and income of unincorporated enterprises. Government subsidies are subtracted. Accidental damage to fixed capital is included in the depreciation figures. Both corporate profits and depreciation data, which are reported on a company basis, have been converted to an establishment basis in the value-added study to make them comparable with the other value-added data. While there are important limitations in the resulting figures, the industry classifications are, as a result, much "cleaner." A description of the methodology used in converting from a company to an establishment basis is available from MAPI upon request. For a further discussion of the value-added estimates, see "Comparison of Federal Reserve and OBE Measures of Real Manufacturing Output, 1947–64" by Jack J. Gottsegen and Richard C. Ziemer in *The Industrial Composition of Income and Product*, National Bureau of Economic Research, 1968.

The profits data are shown on a pre-tax basis in the Commerce Department series. We developed our own estimate of after-tax profits. Profit taxes were estimated by computing ratios of value-added profits to corporate profits—national income accounts (NIA) basis—and applying them to NIA corporate profit taxes. NIA corporate profit taxes were not shown for the three capital goods subgroups for 1969 or 1970. For these years we computed the 1968 ratios of the estimated value-added profit tax to pre-tax value-added profits and applied them to pre-tax value-added profits in 1969 and 1970. In the case of transportation equipment and ordnance, which suffered pre-tax losses in both 1969 and 1970, we made separate tax estimates for those two years.

After-tax profitability in the manufacturing sector, which approached 14 percent in 1948, trended downward through 1953 despite the economic recovery from the 1948–49 recession. This was due primarily to the increase in corporate profit tax rates with the advent of the Korean War. Conversely, there was an improvement in the 1954 after-tax rate of return despite the 1953–54 recession, and this was accounted for by *reduced* corporate tax rates.[1]

After improving further in 1955 the profit rate trended downward during 1956–58, reaching its lowest level in at least a decade in the latter year and after showing substantial recovery in 1959 it declined again in the following two years. Following the introduction of the investment tax credit effective at the beginning of 1962 and additional stimulative tax measures in 1964, the profit rate climbed steadily as we enjoyed four years of expanding output, declining unemployment rates,[2] rapidly rising productivity, and price stability. However, although the economic expansion continued until 1969 with manufacturing output reaching a peak in July of that year, the profit rate peaked four years earlier in 1965 and by 1969 had declined to its lowest level in the 1948–69 period. It declined substantially further in 1970.

Nonelectrical machinery.—Although the pattern traced by nonelectrical machinery did not parallel exactly that of manufacturing, it was generally similar. The profit rate was in a declining trend between 1949 and 1953 and after moving generally sidewise for three years, declined further to a new low in 1958. After showing substantial improvement in 1960, it declined again to levels somewhat above that of 1958 during 1960–61 and then trended strongly upward to a 1965 peak. As in the case of manufacturing, the rate of return for nonelectrical machinery declined substantially between 1965 and 1970, reaching its lowest point in the 1948–70 period in the latter year.

Electrical machinery and transportation equipment.—Both electrical machinery and transportation equipment and ordnance showed distinctly different patterns of movement during much of the period under review. However, both have experienced substantial declines in return on value added since the mid-1960s. Further, the profitability performance of both groups has been substandard throughout the period under review when compared with that of overall manufacturing and the machinery except electrical sector.

Profit performance.—While all manufacturing experience an average rate of return of 9.3 percent on value added over the period and nonelectrical machinery a return of 8.8 percent, in the case of electrical machinery the return averaged 7.1 percent and in transportation equipment only 4.4 percent.[3]

The return on value added in electrical machinery, after declining sharply to less than 8 percent in 1951, ranged between 6 and 8 percent during 1951–59 and then declined further to 5 percent in 1960, approximating that figure during the ensuing four years. After experiencing relatively good years in 1965–66 with profits exceeding 8 percent of value added, the return on value added moved into a strongly declining trend, again approximating 5 percent in 1969 and 1970.

The transportation equipment group showed the greatest volatility. The highest rate enjoyed was in 1950 when it exceeded 7 percent. It reached a low of only 1 percent in 1960, trended upward during 1961–65 peaking at slightly less than 6 percent, and has since trended strongly downward with the industry group experiencing large losses in both 1969 and 1970. The profit experience of this heavily defense-oriented industry would seem to suggest, parenthetically, that doing business with the defense sector is considerably less profitable than dealing with the private sector of the economy.

Summary.—The most conspicuous feature of Chart 1 is the poor profit performance of all four groups since the mid-1960s. Three of the four saw their rate of return peak in 1965, while the rate rose only slightly further to a 1966 peak in the case of electrical machinery. Profitability subsequently declined to new lows by 1970 in the case of all four categories with the transportation equipment and ordnance group suffering large losses in both 1969 and 1970—the only time that any of the four sectors suffered losses during the period under review.

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[1] The corporate profits tax rates were increased in 1950 and 1951 and an excess profits tax was imposed in 1950. The excess profits tax terminated at year-end 1953.

[2] The unemployment rate showed a small rise in 1963 from a sharply reduced rate in 1962 and then continued in a declining trend through 1969.

[3] The transportation equipment average is exclusive of 1969 and 1970 when the industry suffered losses.

PRICES, PRODUCTIVITY, AND PROFITS

We turn now to a discussion of trends in total value added per man-hour,[1] measured in current and constant dollars. These data permit a review of changes in prices and productivity in the industry sectors in question.

Constant dollar value added is one measure of physical output[2] and, accordingly, when divided by man-hours gives us a measure of an industry's productivity. Further, by dividing current dollar by constant dollar value added, we can derive a so-called implicit price deflator or price index for the products of the industry category in question. The top curve of each panel in Chart 2 shows the price index for the designated industry category. The middle curve in each panel shows value added per man-hour in current dollars, and the bottom curve shows it in constant dollars.

It will be seen that the rate of inflation has been substantial throughout the 1948–70 period for three of the four groups in Chart 4. The fourth group, electrical machinery, shows a notably different pattern of movement which will be discussed in a moment.

Manufacturing prices rose at an accelerated rate in 1951, following the outbreak of the Korean War. There was also a notable acceleration in prices during 1956–58 and again during 1967–70. It is noteworthy that during most of the latter two periods productivity showed only limited improvement. As a consequence, the rising cost of labor and materials was accompanied by a substantial increase in cost per unit of output. Manufacturers strived to offset these increases by passing them on in the form of higher prices, which accounts for the accelerated growth in price inflation. The price increases were not sufficient, however, to prevent a deterioration in profitability during both periods as is clear from Chart 1.

A similar relationship between productivity and the rate of price inflation can be observed in the case of the machinery except electrical and transportation equipment categories. That is, price increases tended to accelerate with a slackening in the expansion of productivity. The electrical machinery group, on the other hand, shows a notably different pattern from the others. Prices leveled out in 1959 and trended downward for seven years before turning up in 1967. This remarkable performance might, at first glance, be attributed to productivity improvement as constant dollar value added per man-hour moved strongly upward during this period. However, the unit cost benefits derived from rising productivity were more than offset by the decline in prices between 1959 and 1964 as indicated by the group's poor profit performance during these years. It appears, in short, that the casual factor was severe price competition within this industry sector in the early 1960s. There was a notable improvement in profitability during 1965–66, but this was followed by another downturn as the return on value added declined to 1964 levels in 1969 and 1970.

TRENDS IN CASH FLOW, PROFITS, AND EMPLOYEE COMPENSATION

Having reviewed trends in prices, productivity, and profits, we turn next to a consideration of changes in the factors making up total value added. Chart 3 shows the three major components of the total—employee compensation, cash flow, and "other."[3] Chart 4 further divides cash flow into its two components—depreciation and after-tax profits. All of the data are shown on a "per man-hour" basis.

Employee compensation represents roughly two-thirds of total value added in the case of all manufacturing, while the figure is three-fourths for the machinery group and close to nine-tenths for the transportation group. The higher

[1] Man-hour data are from the U.S. Bureau of Labor Statistics.

[2] Constant dollar value added is derived by means of a so-called "double deflation" method. An industry's output and its purchases are deflated separately. The latter is then subtracted from the former to derive a constant dollar estimate of value added. The Commerce Department study showed constant dollar value added in 1958 dollars. We converted the data to a 1948 dollar basis.

[3] Employee compensation includes fringe benefits. The "other" category includes net interest, indirect business taxes, and corporate profit taxes.

ratios in the capital goods sectors reflect the fact that these are generally labor-intensive industries. Cash flow absorbs roughly one-half of the remaining value added.

Hourly compensation has shown an uninterrupted increase during the entire 1948–70 period in the case of all four groups shown in Chart 3. As is to be expected, cash flow per man-hour is considerably more volatile. In the case of all manufacturing, it showed a net decline between 1950 and 1953 as reduced after-tax profits more than offset the rise in depreciation. As noted earlier, there was an increase in corporate tax rates with the advent of the Korean War which accounts for the decline in profits. The impact of rising taxes can readily be seen from the large increase in the gap between "other" vaule added and cash flow between these two years as shown in Chart 3. The gap was substantially narrowed in 1954 as corporate tax rates were reduced and after-tax profits increased in spite of the recession of that year, accounting for the rise in cash flow.

Between 1955 and 1958 cash flow again showed a small net decline as reduced profits more than offset rising depreciation. The reason for the decline in profits is not hard to find. The poor productivity performance during this period, which has already been referred to, was accompanied by an accelerated expansion in the hourly compensation of employees, and increased prices were not sufficient to offset the resulting rise in unit labor cost. A similar phenomenon is observable between 1965 and 1970. Cash flow shows a net decline as reduced profits more than offset rising depreciation cost despite an accelerated growth in depreciation over this period. Again, productivity increased only slowly while employee compensation rose at an accelerated rate and, again, the accelerated rise in prices was not sufficient to offset the increase in unit costs.

The pattern of movement in the value-added components has varied considerably among the three subgroups shown in Charts 3 and 4. However, it has been similar for all three groups since the mid-1960's. They all show an accelerated growth in hourly employee compensation, while productivity has been growing at a notably slower rate. As a consequence, despite a faster rise in prices during this period, profits per man-hour declined.[1] The decline in profits more than offset increased depreciation in the machinery except electrical and transportation equipment categories with adverse effects for cash flow. In the case of electrical machinery, cash flow showed only a small net gain between 1965 and 1970.

CONCLUSION

The record of the past five years has been a dismal one so far as manufacturing profits are concerned. While hourly compensation of employees rose at an accelerated rate between 1965 and 1970, productivity showed only limited improvement and cost per unit of output climbed sharply with the result that profits have been severely squeezed in spite of accelerated price increases. The profit squeeze occurred in the fact of a continuing economic expansion which extended well into 1969. With the continuing decline in profits per man-hour, output finally peaked in August of that year, and a downturn in manufacturing employment began two months later.[2] As a consequence, we have confronted the unfortunate phenomenon of rapidly rising prices together with growing unemployment.

Two observations are warranted on the basis of the above review. First, accelerated price increases have not been associated with rising profits. On the contrary, setting aside 1951 when accelerating price increases were attributable primarily to the Korean conflict, the two periods during which we have experienced a notable acceleration in price increases (i.e., 1956–58 and 1965–70) have been accompanied by severe profit squeezes.[3] In both periods, the increase in prices reflected the unsuccessful efforts of business to offset rising unit labor

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[1] The decline in profits was even more pronounced when one considers the understatement of depreciation resulting from historical-cost accounting in an inflationary economy. See, in this connection, *Underdepreciation From Inflation—A Ghost Returns*, George Terborgh, MAPI, November 1969.

[2] *Total* manufacturing profits peaked in 1966 and showed a modest recovery in 1968 from substantially reduced 1967 levels. However, they resumed their decline in 1969 and by 1970 had reached their lowest levels in eight years.

[3] *After-tax* profits also declined in 1951, but this was attributable to increased tax rates, as noted earlier.

cost resulting from a combination of rapidly rising wages and salaries and reduced productivity increases.

Secondly, the rapid rise in wages and salaries since 1965, which has been accompanied by the most extended profit squeeze in the post-World War II era, demonstrates that the cost impact of increased earnings has substantially outweighed any benefits which would otherwise have accrued in the form of expanded demand. The result of the rapid wage and salary increases has been to raise the employee compensation share of value added to its highest level in the entire 1948–70 period (71.7 percent in 1970) and the results can be seen in the adverse movement of costs and profits. The efforts by manufacturers to counter the decline in profits by raising prices and reducing labor costs accounts in a large degree for the adverse trend in both prices and employment. Clearly, measures are needed to correct the present imbalance in value-added shares.[1] In that regard, steps to restore the profitability and cash flow of manufacturers to more reasonable levels can go far toward reversing these adverse trends.

APPENDIX

COST, PRICE, AND PROFITABILITY TRENDS IN THE MANUFACTURING AND CAPITAL GOODS INDUSTRIES

TABLE 1.—AFTER-TAX PROFITS AS A PERCENT OF VALUE ADDED, ALL MANUFACTURING AND SELECTED CAPITAL GOODS SUBGROUPS, 1948-70

[Percent]

Year	All manufacturing	Machinery, except electrical	Electrical machinery	Transportation equipment and ordnance [1]
1948	13.69	11.86	8.88	3.52
1949	13.25	13.17	10.85	5.56
1950	13.02	12.69	11.59	7.46
1951	10.40	10.21	7.57	3.74
1952	9.23	9.72	8.11	3.96
1953	8.57	7.86	6.46	3.64
1954	8.94	8.75	7.82	6.63
1955	10.54	7.92	6.29	5.12
1956	9.45	9.03	6.28	3.79
1957	8.88	7.97	5.52	5.34
1958	7.44	6.01	7.11	4.65
1959	9.06	7.97	7.90	1.70
1960	8.19	6.47	5.43	1.26
1961	7.60	6.66	5.03	2.34
1962	8.34	8.20	5.23	4.88
1963	8.54	7.80	5.32	4.33
1964	9.42	9.87	5.04	5.51
1965	10.64	10.77	8.46	5.81
1966	10.44	10.56	8.63	5.06
1967	9.22	9.42	7.70	4.12
1968	8.30	7.75	6.37	3.76
1969	6.44	6.31	4.99	(2)
1970	5.36	5.10	4.93	(2)

[1] Excludes motor vehicles.
[2] Loss.

Source: U.S. Department of Commerce.

[1] Passage of the Tax Reform Act of 1969 contributed to the imbalance by repealing the investment tax credit while providing substantial tax relief for individuals.

TABLE 2.—CURRENT AND CONSTANT DOLLAR VALUE ADDED PER MAN-HOUR AND PRICE DEFLATORS, ALL MANUFACTURING AND SELECTED CAPITAL GOODS SUBGROUPS, 1948-70

Year	All manufacturing			Machinery, except electrical			Electrical machinery			Transportation equipment and ordnance [1]		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	Current dollar value added per man-hour	Constant dollar value added per man-hour	Price deflator, column (1)÷(2) (Index, 1948=100)	Current dollar value added per man-hour	Constant dollar value added per man-hour	Price deflator, column (4)÷(5) (Index, 1948=100)	Current dollar value added per man-hour	Constant dollar value added per man-hour	Price deflator, column (7)÷(8) (Index, 1948=100)	Current dollar value added per man-hour	Constant dollar value added per man-hour	Price deflator, column (10)÷(11) (Index, 1948=100)
1948	2.30	2.30	100.0	2.28	2.28	100.0	2.14	2.14	100.0	2.01	2.01	100.0
1949	2.44	2.39	102.1	2.52	2.37	106.3	2.33	2.26	103.1	2.20	2.12	103.8
1950	2.61	2.55	102.4	2.66	2.42	109.9	2.50	2.40	104.2	2.36	2.23	105.8
1951	2.85	2.61	109.2	3.00	2.50	120.0	2.66	2.44	109.0	2.38	1.98	120.2
1952	2.93	2.62	111.8	3.20	2.63	121.7	2.88	2.70	106.7	2.53	2.13	118.8
1953	3.04	2.70	112.6	3.19	2.58	123.6	2.87	2.65	108.3	2.67	2.24	119.2
1954	3.15	2.75	114.5	3.33	2.63	126.6	2.96	2.70	109.6	2.95	2.44	120.9
1955	3.39	2.91	116.5	3.33	2.57	129.6	2.97	2.76	107.6	3.00	2.42	124.0
1956	3.51	2.88	121.9	3.63	2.61	139.1	3.11	2.79	111.4	3.04	2.22	136.9
1957	3.69	2.93	125.9	3.74	2.51	149.0	3.41	2.86	119.2	3.37	2.32	145.3
1958	3.78	2.94	128.6	3.86	2.55	151.4	3.62	2.97	121.9	3.67	2.46	149.2
1959	4.05	3.09	131.1	4.17	2.70	154.4	3.82	3.11	122.8	3.70	2.44	151.6
1960	4.16	3.15	132.1	4.19	2.69	155.8	3.80	3.15	120.6	3.94	2.57	153.3
1961	4.27	3.23	132.2	4.39	2.79	157.3	3.93	3.29	119.4	4.11	2.67	153.9
1962	4.51	3.41	132.3	4.66	2.93	159.0	4.06	3.52	115.3	4.45	2.87	155.1
1963	4.70	3.55	132.4	4.75	2.97	159.9	4.22	3.75	112.5	4.65	2.98	156.0
1964	4.97	3.72	133.6	5.17	3.19	162.1	4.36	3.97	109.8	5.02	3.16	158.9
1965	5.19	3.86	134.4	5.33	3.25	164.0	4.59	4.30	106.7	5.13	3.19	160.8
1966	5.35	3.92	136.4	5.51	3.30	167.0	4.61	4.39	105.0	5.16	3.10	165.4
1967	5.49	3.91	140.4	5.63	3.26	172.7	4.91	4.56	107.7	5.29	3.08	171.8
1968	5.89	4.10	143.7	6.01	3.38	177.8	5.20	4.77	109.0	4.59	3.21	174.1
1969	6.05	4.15	145.8	6.24	3.43	181.9	5.41	4.95	109.3	5.48	3.09	177.3
1970	6.32	4.21	150.1	6.44	3.46	186.1	5.87	5.19	113.1	5.82	3.13	185.9

[1] Excludes motor vehicles.

Source: U.S. Department of Commerce.

TABLE 3.—EMPLOYEE COMPENSATION, CASH FLOW, AND OTHER VALUE ADDED PER MAN-HOUR, ALL MANUFACTURING AND SELECTED CAPITAL GOODS SUBGROUPS, 1948–70

[Dollars]

Year	All manufacturing			Machinery, except electrical			Electrical machinery			Transportation equipment and ordnance [1]		
	Employee compensation	Cash flow	Other value added	Employee compensation	Cash flow	Other value added	Employee compensation	Cash flow	Other value added	Employee compensation	Cash flow	Other value added
1948	1.521	0.403	0.377	1.696	0.358	0.225	1.615	0.245	0.278	1.775	0.128	0.105
1949	1.590	.433	.416	1.776	.451	.293	1.684	.320	.325	1.862	.193	.140
1950	1.669	.449	.493	1.855	.460	.348	1.698	.354	.445	1.913	.244	.203
1951	1.840	.414	.600	2.055	.422	.519	1.875	.268	.517	2.051	.148	.176
1952	1.957	.404	.568	2.223	.443	.535	2.010	.308	.560	2.147	.157	.226
1953	2.066	.411	.559	2.345	.396	.447	2.105	.265	.499	2.281	.159	.233
1954	2.160	.471	.524	2.426	.480	.422	2.207	.336	.420	2.410	.272	.264
1955	2.243	.559	.591	2.485	.472	.375	2.293	.303	.375	2.541	.241	.220
1956	2.387	.545	.573	2.642	.537	.453	2.408	.318	.380	2.665	.201	.175
1957	2.530	.568	.592	2.759	.530	.438	2.555	.392	.465	2.845	.277	.252
1958	2.638	.560	.585	2.918	.514	.433	2.738	.425	.461	3.105	.303	.261
1959	2.749	.637	.664	3.053	.626	.491	2.872	.447	.499	3.297	.209	.198
1960	2.864	.624	.671	3.145	.574	.473	2.996	.358	.444	3.482	.225	.229
1961	2.953	.633	.684	3.254	.629	.504	3.100	.368	.462	3.578	.277	.253
1962	3.075	.723	.715	3.386	.746	.528	3.212	.393	.453	3.741	.405	.302
1963	3.177	.760	.763	3.491	.714	.541	3.316	.430	.472	3.934	.403	.314
1964	3.323	.848	.802	3.657	.886	.625	3.441	.437	.482	4.154	.500	.370
1965	3.409	.936	.844	3.753	.948	.624	3.484	.605	.499	4.238	.529	.382
1966	3.563	.947	.836	3.909	.933	.663	3.526	.619	.465	4.335	.472	.356
1967	3.738	.932	.822	4.075	.945	.613	3.782	.634	.491	4.477	.497	.317
1968	4.008	.946	.931	4.383	.917	.708	4.009	.624	.565	4.713	.556	.323
1969	4.264	.872	.916	4.715	.883	.646	4.269	.608	.528	4.971	.326	.183
1970	4.534	.886	.901	4.943	.866	.631	4.569	.694	.602	5.289	.284	.290

[1] Excludes motor vehicles.

Source: U.S. Department of Commerce.

TABLE 4.—DEPRECIATION, AFTER-TAX PROFITS, AND TOTAL CASH FLOW PER MAN-HOUR, ALL MANUFACTURING AND SELECTED CAPITAL GOODS SUBGROUPS, 1948-70

[Dollars]

Year	All manufacturing			Machinery, except electrical			Electrical machinery			Transportation equipment and ordnance [1]		
	Depreciation	Profits	Cash flow	Depreciation	Profits	Cash flow	Depreciation	Profits	Cash flow	Depreciation	Profits	Cash flow
1948	0.088	0.315	0.403	0.088	0.270	0.358	0.055	0.190	0.245	0.058	0.071	0.128
1949	.110	.323	.433	.119	.332	.451	.067	.253	.320	.071	.122	.193
1950	.109	.340	.449	.122	.338	.460	.065	.289	.354	.068	.176	.244
1951	.117	.297	.414	.116	.306	.422	.066	.201	.268	.059	.089	.148
1952	.134	.270	.404	.132	.311	.443	.074	.233	.308	.057	.100	.157
1953	.151	.260	.411	.146	.251	.396	.080	.185	.265	.061	.097	.159
1954	.189	.282	.471	.189	.291	.480	.105	.232	.336	.077	.195	.272
1955	.201	.358	.559	.208	.264	.472	.116	.187	.303	.087	.154	.242
1956	.214	.331	.545	.209	.328	.537	.122	.195	.318	.086	.115	.201
1957	.240	.328	.568	.232	.298	.530	.136	.256	.392	.097	.180	.277
1958	.278	.281	.560	.282	.232	.514	.167	.258	.425	.132	.171	.303
1959	.271	.367	.637	.293	.333	.626	.145	.302	.447	.146	.063	.209
1960	.283	.341	.624	.302	.271	.574	.152	.206	.358	.176	.050	.225
1961	.308	.324	.633	.337	.292	.629	.170	.198	.368	.181	.096	.277
1962	.346	.277	.723	.365	.382	.746	.180	.212	.393	.188	.217	.405
1963	.359	.401	.760	.344	.370	.714	.205	.225	.430	.201	.202	.403
1964	.379	.469	.848	.376	.510	.886	.217	.220	.437	.223	.277	.500
1965	.384	.552	.936	.374	.574	.948	.217	.388	.605	.231	.298	.529
1966	.389	.558	.947	.352	.581	.933	.221	.398	.619	.211	.261	.472
1967	.426	.506	.932	.414	.531	.945	.256	.378	.634	.278	.218	.497
1968	.457	.488	.946	.451	.466	.917	.293	.331	.624	.345	.210	.555
1969	.482	.390	.872	.489	.394	.883	.338	.270	.608	.363	([2])	.326
1970	.547	.339	.886	.536	.328	.865	.405	.289	.694	.425	([2])	.284

[1] Excludes motor vehicles.

[2] Loss.

Source: U.S. Department of Commerce.

The CHAIRMAN. The next witness will be Mr. Robert Statham, taxation manager of the Chamber of Commerce of the United States.

STATEMENT OF ROBERT R. STATHAM, TAXATION AND FINANCE MANAGER OF THE CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY PENN B. CHABROW AND LAWRENCE M. BRAUER

Mr. STATHAM. My name is Robert R. Statham. I am taxation and finance manager of the Chamber of Commerce of the United States. With me is Mr. Penn B. Chabrow and Mr. Lawrence M. Brauer, both tax attorneys on the staff of the national chamber.

Mr. Chairman, we appreciate this opportunity to present the national chamber's views on H.R. 10947—the Revenue Act of 1971. I will summarize our statement, but it is respectfully requested that it be placed in the record in full.

It is the view of the chamber that:

First, the job development investment credit should be enacted by the Congress. At the same time the Congress should fully sanction the Asset Depreciation Range (ADR) system so as to end any question of its desirability or legality. In addition, the ADR system should be extended by legislation to include the recommendations of the President's Task Force on Business Taxation regarding capital cost recovery.

We believe that the job development investment credit as proposed by the administration should be immediately enacted into law by the Congress. In the past we have urged meaningful depreciation reform in preference to an investment credit. However, the current circumstances are far different than those prevalent in 1967 and 1969. A major effort is needed to bring about an economic recovery and provide the jobs for our country's unemployed. Both the credit and depreciation reform should be enacted by this Congress and made permanent features of the tax law.

With regard to the rate of the credit, we believe there is ample reason for the adoption of a 10 percent credit, at least in the first year. We further believe that the credit should be no less than 7 percent in succeeding years. This time it should be made a permanent feature of the tax law—rather than just a faucet to be turned on and off to spur the economy.

In the past this country has been able to compete with products made by cheaper labor of other countries because American business has had the most modern and efficient machinery and equipment. Now we are competing with cheap labor that is using the most modern machinery and equipment—in many cases more modern than our own. If you adopt a tax policy that encourages the replacement of obsolete and inefficient plant machinery and equipment, American enterprise will outproduce its rivals, provide jobs at the highest wages on earth, and maintain American leadership in the world marketplace.

For many years, the national chamber has urged meaningful depreciation reform to insure the continued modernization of American industry and to enable American business to compete more effectively in world markets. We have long called for permanent improvement in our inadequate depreciation structure that would make it comparable to the capital cost recovery allowances of other industrialized nations.

This country's present depreciation practices are grossly inadequate. Although the adoption of the asset depreciation range regulations have eased the situation, it is far from being corrected. It is imperative that the recommendations of the President's Task Force on Business Taxation be enacted into law. These recommendations include: Substituting a capital cost recovery allowance system for the present system of deductions based on the useful life of property; eliminating the reserve ratio test; and, allowing full recovery of cost, unreduced by salvage value, in a period 40 percent shorter than would be allowed under the 1962 Treasury guidelines for determining useful lives.

While the job development investment credit will have an immediate effect on the economy, the Task Force recommendations should be adopted for their long-range permanent effect.

The Task Force included in its report a table comparing the capital cost recovery allowances for industrial machinery and equipment in leading industrial countries with similar allowances in the United States. A copy of that table is attached and it is requested that it be made a part of this testimony. The Treasury Department in its July 1971 publication on ADR expanded that table and prepared a chart, a copy of which we have also attached to our testimony for the record. This chart shows the aggregate cost recoveries allowable on machinery and equipment for tax purposes in the United States and in 11 foreign countries. It should be noted that without the three-quarter-year convention, eliminated by the House, the comparison would be even more unfavorable for the United States.

A major change should be made in our capital cost recovery allowance system. The job development investment credit will help, but it is not enough to solve the entire problem. What is needed is not only the enactment of the credit, but also a major overhaul and liberalization of our entire depreciation system.

Secondly, the automobile excise tax should be eliminated.

In essence, our economy will receive a triple benefit from repeal of the 7-percent automobile excise tax. First, a highly discriminatory tax will be removed from the books. Second, the price of new cars will drop, thereby enabling more Americans to afford new cars. And third, the increased demand for new cars will create new jobs for unemployed Americans in a broad range of industries. Not to be overlooked is that the purchase of the new cars will permit the replacement of older cars not meeting today's antipollution standards.

Third, the scheduled increases in the standard deduction and the personal exemption should be accelerated.

In testifying before this committee on the Tax Reform Act in 1969, we expressed support for the increase in the regular standard deduction as "the clearest way to simplify compliance with the tax laws for a large number of taxpayers."

Congress has already made the decision to increase the personal exemption and the standard deduction. The additional purchasing power produced by the speedup of the tax cuts should help spur the economy. The national chamber generally favors the acceleration of these items.

Finally, provision for a Domestic International Sales Corporation should be enacted into law as proposed by the administration.

Coupled with the job development investment credit and further depreciation reform, DISC will help our serious unemployment problem. It will encourage American business to build up export sales and provide export facilities by using the undistributed DISC income. The result will be the creation of new jobs for many Americans—almost 80,000 according to one estimate.

In the bill passed by the House, the tax deferral of DISC is to be available for export income only to the extent of 25 percent of a company's average level of export income in the base period 1968 through 1970, plus any of its current export income over this average level.

The national chamber supports the DISC concept. However, we believe the incremental approach taken in this bill will weaken the effectiveness of DISC.

We believe that enactment of the full DISC proposal of the administration will play a major role toward economic recovery.

It will place the American exporter in a more competitive position in world trade.

It will provide tax deferral for domestic exporters equal to that now available to American exporters using foreign subsidiaries.

It will allow firms that are too small to operate through foreign subsidiaries to enter the export field.

Thank you for the opportunity to present our views.

The CHAIRMAN. Thank you very much. Let me compliment you for the fine work your organization is doing. This was a very good statement you presented.

Mr. STATHAM. Thank you, Mr. Chairman.

Senator FANNIN. Mr. Statham, your organization recommended that the excise tax should be eliminated. What are your thoughts regarding keeping the excise tax on foreign autos? I say that why should we take that 7 percent off when Germany has a 13.2-percent rate, Japan a 10-percent tariff plus a commodity tax ranging from 15 to 40 percent, and France 13.2. Why should we take off the excise tax on foreign cars?

Mr. STATHAM. Senator, I think our position is taking the excise tax off fully. I don't know that we have a position specifically with the point you have raised. However, I think our position would not be in favor of doing that. Our organization has been in favor of attempting to keep away from using tariff barriers. I think the ultimate result of doing such a thing would be that other countries would retaliate by placing similar types of barriers for American goods perhaps in other lines.

Senator FANNIN. They already have.

Mr. STATHAM. Yes, sir.

Senator FANNIN. Any line you talk about they have. Why don't we get tough about it, why should we take off the 7-percent excise tax on foreign cars when they retain all of these barriers to our shipments?

Mr. STATHAM. Senator, our position is that these other countries should be reducing their barriers and if we go into a permanent situation of doing what you suggest——

Senator FANNIN. Why don't we get a quid pro quo, then?

Mr. STATHAM. I agree with what you are saying and I think that perhaps in the past we have attempted at times to bluff other countries into reducing their tariff barriers.

Senator FANNIN. I am not talking about bluffing, I am talking about doing it, leave the 7-percent tax on and just say, fine, when yours comes off ours comes off.

Mr. STATHAM. This is one answer.

The CHAIRMAN. Since Senator Fannin brought up the point, might I suggest even if they do reduce their barriers we are not going to put more than a handful of automobiles into Germany and Japan. Our automobiles are too big for their highways. You have to have two consecutive parking spaces to park one of our automobiles on their streets. And their wage rates are far below ours.

So rather than delude ourselves by thinking that we are going to negotiate reciprocal reductions of some such things and with the result that you only put a handful of automobiles over there anyway, why not look after America's interests and leave the 7-percent tax on those automobiles? Why pay $300 or $400 million to help them capture our market, they have captured enough of it the way it is now. We should simply say, "Look, fellows, you have got all of these tariffs and road taxes and discrimination of every sort against our automobiles anyhow, so if it is all right with you we will leave the 7 percent on your automobile." Don't ask them to cut theirs. You can't put automobiles into Japan anyway. Last year we sent 150 automobiles over there. That is probably for the American Embassy alone. As a practical matter, don't fool around with asking them to reduce their impediments to the American automobile. They won't take but a handful anyhow. Simply leave the 7-percent tax on their automobiles and take it off of ours and give us a chance to compete in our own market. You might sell some automobiles here in this market but in theirs you aren't going to sell but a handful.

Mr. STATHAM. Senator Long, you know my feelings. I am entirely sympathetic with the problems of American exporters and very much favorable to anything that would bring about greater sales of American automobiles. The point I am trying to make is that when you do put up trade barriers you will have retaliation by other countries.

I think you made a good point and I don't think there is any question about the fact that we might be put in a greater position to be able to bargain, but I think ultimately what we are talking about is placing ourselves in a bargaining position rather than a permanent type of thing.

The CHAIRMAN. I am like Senator Fannin, I am not talking about putting one up, I am talking about not taking one down. Theirs is 10 miles higher than ours. Why take ours down? It seems to me we would do just as well to leave the tax on theirs and take it off ours and that would give us a chance to compete in our own market.

They have already waged war on our automobiles. They keep our automobiles out of their market. Let's give us a little additional help by taking the tax off of ours but not off theirs and that is where we could save money to provide American jobs. Taking $400 million tax off of the foreign automobile is to help provide more jobs for the other guy over there. Why do we want to spend any more money to provide jobs for Japanese, they have a labor shortage now?

Mr. STATHAM. I think American business can generally compete with any other country as far as that is concerned. I think the answer lies in giving American business the same opportunities that their competitors have in other highly industrialized countries.

The CHAIRMAN. I will make you a fair proposition. I can afford to do this, be entirely generous about this. If the Chamber of Commerce of the United States wants me to do it, I will vote for 100 percent free trade in automobiles. We don't produce any in Louisiana. It is all right with me if you can persuade the chamber of commerce to go along with that and I will make you a gentleman's suggestion. By the time we get through with this you aren't going to compete successfully; they are going to hire those people at 10 percent of your wage and put you out of business so fast it will make your head swim. They are doing a good job on it now.

Mr. STATHAM. Yes, sir; I agree with you that they are. I am concerned about the fact that there has been a question brought up about goods which are taken outside of this country and assembled and brought back in. I think you brought up that question this morning with regard to Mr. Biemiller's statement.

I thing a recent study by the Commerce Department shows that about 8 percent of the goods of foreign affiliates are sold back into this country. About half of that amount is from Canadian manufacturing which is done, I think, with wage rates that are very close to our own.

Senator FANNIN. Well, of course, we are talking about different programs. Consider the Mexican border. We are benefiting by jobs on both sides of the border and money being spent in the United States. But when you consider the jobs going to Taiwan and Korea, I don't think that your figures would be right.

Mr. STATHAM. That is a general statement.

Senator FANNIN. But the big problem, as I see it, we are not going to compete. When you say we are going to compete, when we can sell cars to Japan.

Mr. STATHAM. I am not suggesting that.

Senator FANNIN. You can't do it. You can't pay four times the wages and still build a car and sell it in Japan. What we must do is be sure that the products we can compete with can get into Japan. You talk about a trade war; why, they have closed us out completely and put up a wall against us. Anything that they could produce they want to produce or if they want to build a market they go ahead and keep our products out until they can build the market. They would not have a car, as competitive as it is, if they had not had the American market and American technology and all to go forward. So when you start talking about a trade war, they won that war; that is over with.

Mr. STATHAM. Well, again, I think the ultimate result of such an activity would be that there would be foreign barriers to other goods, which we are selling outside of this country in competition with other countries and, by the way, doing a good job.

Senator FANNIN. But they won't let those products into their country. Look what we ship in there. We ship in raw materials; we can ship in 707's and something they can't build. But you take the computer industry; look how they are closing us out there. We shipped many thousands of dollars of computers into Japan but they are gradually building to where they will do the same things with computers they have done with everything else. In other words, there is no quid pro quo with them so we have to be as tough as they are. So why should we take the excise tax off?

Mr. STATHAM. Well. I think you made a good point. I am not questioning that. The only thing I am trying to say is there are other approaches.

(Mr. Statham's prepared statement with attachments follows:)

PREPARED STATEMENT OF ROBERT R. STATHAM FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES

My name is Robert R. Statham. I am Taxation and Finance Manager of the Chamber of Commerce of the United States.

Mr. Chairman, we appreciate this opportunity to present the National Chamber's views on H.R. 10947 -- the Revenue Act of 1971. This legislation contains the President's tax proposals of August 15, 1971, as modified by the House of Representatives.

Summary of the National Chamber's Position

The National Chamber generally supports the tax proposals embodied in H.R. 10947, but is of the opinion that they do not go far enough to solve the immediate and long-range needs of the nation's economy. It is the view of the Chamber that:

1. The job development investment credit should be enacted by the Congress. At the same time the Congress should fully sanction the Asset Depreciation Range (ADR) system so as to end any question of its desirability or legality. In addition, the ADR system should be extended by legislation to include the recommendations of the President's Task Force on Business Taxation regarding capital cost recovery.
2. The automobile excise tax should be eliminated.
3. Provision for a Domestic International Sales Corporation (DISC) should be enacted into law as proposed by the Administration.
4. The scheduled increases in the standard deduction and the personal exemption should be accelerated.

The Administration's Proposals

In his economic message of August 15th, the President announced a combination of tax and expenditure reductions to help the economy. The tax proposals included:

1. A job development investment credit,

2. Repeal of the automobile excise tax,

3. Legislation providing for a Domestic International Sales Corporation (DISC), and

4. Acceleration of the scheduled increases in the personal exemption and standard deduction.

The total revenue reduction resulting from these proposals for fiscal year 1972 is estimated by the Administration to be approximately $5.8 billion. This estimate includes revenue reductions of $2.7 billion from the job development investment credit, $2.2 billion from the repeal of the automobile excise tax, and $0.9 billion from the acceleration of the increases in the personal exemption and standard deduction. DISC has already been reflected in the budget for fiscal year 1972, so that it is anticipated there would be no revenue reduction beyond that already accounted for in the Administration's budget.

To offset the foregoing revenue reductions, the Administration indicated that it would reduce presently planned expenditures by $4.9 billion in fiscal year 1972. These cuts would be accomplished by deferring the effective date of general revenue sharing for three months, reducing federal employment by 5%, postponing for six months the federal salary increase scheduled for January 1, 1972, and delaying the effective date of the welfare reform proposal and some of the special revenue sharing bills variously from three months to one year. In addition, $2 billion in new revenue would result from the 10% import surcharge now in effect.

Some have contended that the net effect of the 1969 Tax Reform Act, the ADR and the Administration's tax proposals would result in a "windfall" for business. This is not the case. As Secretary Connally stated in his testimony before the Ways and Means Committee last month:

> If the impact of these measures is spread over the five years, 1969 through 1973, the result is startling: Federal income

> <u>tax payments of individuals will have been reduced by almost $34 billion. Tax payments on corporate profits will have declined by slightly more than $1 billion.</u>

For the same five-year period, with the modifications to the Administration's proposals made by the House, Secretary Connally stated in his testimony last week that tax payments by individuals "... will have been <u>reduced</u> by $36.4 billion. Tax payments of corporations in the same period will have actually <u>increased</u> by $3.2 billion."

<u>Modifications of Administration's Proposals by the House</u>

The House made a number of modifications in the Administration's tax proposals. These modifications included:

1. A one-tier 7% job development investment credit instead of the two-tier credit proposed by the Administration. The one-tier credit would be available with respect to property acquired by the taxpayer after August 15, 1971. It would also be available for property ordered after March 31, 1971, and acquired before August 16, 1971.

2. Eliminating the three-quarter year convention in the ADR system provided for by administrative action earlier this year.

3. Stepping-up the $700 personal exemption allowance that was to have been effective in 1972 to July 1, 1971, thereby having an effective personal exemption of $675 for 1971, as well as adopting the Administration's recommendations to accelerate the $750 personal exemption for 1972 and to accelerate the standard deduction to 15% of adjusted gross income up to a maximum of $2,000 for 1972. The House also modified the minimum standard deduction.

4. Extending the excise tax repeal to the 10% tax on light-duty trucks having a gross vehicle weight of up to 10,000 pounds, as well as repealing the 7% excise tax on passenger automobiles as proposed by the Administration. Refunds for the automobile excise tax would be available for those purchasing cars after August 15, 1971, and refunds for the light-duty trucks would be available to those purchasing such trucks after September 22, 1971.

5. With regard to the DISC proposal, allowing tax deferral for export income in the current year only to the extent of 25% of a company's average level of export income in the years 1968 through 1970, plus any of its current export income over this average level.

According to the House, the job development investment credit would make $1.5 billion available to businesses to expand and modernize their equipment and facilities in 1971. This would rise to $3.9 billion in 1973. The modification of ADR, on the other hand, offsets the initial revenue impact of the investment credit by forestalling tax reductions that would otherwise occur. These reductions amount to $2.1 billion in 1971, $1.7 billion in 1972, and $1.5 billion in 1973.

The individual income tax reductions proposed in the House bill are estimated to amount to approximately $3.2 billion. This is in addition to a reduction of $2.7 billion which occurs automatically in 1972 as a result of the Tax Reform Act of 1969. The elimination of the automobile and light-duty truck excise taxes is expected to reduce tax liabilities by $900 million in calendar year 1971, $2.6 billion in 1972, and $2.3 billion in 1973.

The DISC proposal is estimated to reduce tax liabilities by $100 million in 1972 and by $200 million in 1973.

It has been suggested that business might receive some sort of windfall from the tax bill passed by the House. It should be noted that for calendar year 1971 individuals would be given a tax reduction of over $2 billion, while during the same period corporate business would be paying $390 million more in taxes. For calendar year 1972, individuals would benefit by over $5 billion while corporations would benefit by about $1.9 billion. Business is certainly not getting any "windfall" from these proposals.

Immediate Action is Needed

In the first half of 1971, our economy grew at a real rate of only about 3%. A major factor contributing to this inadequate rate of growth has been an abnormally low rate of capital spending. A recent survey indicates an increase of only about 2% this year in spending for plant and equipment.

Unemployment levels also have remained quite high. In May of this year, it reached 6.2%. After a slight decline in June and July, the unemployment rate rose to over the 6% level in August. Furthermore it has shown no inclination to return to the 4% level which is generally considered to be a level of full employment.

Despite these unsatisfactory levels of employment and production, prices have continued to rise. Over half of the increase in the GNP in the first half of this year is attributable to price increases. Between July of 1970 and July of this year, the consumer price index rose 4.4% and the wholesale price index rose 3.3%. In the first seven months of this year, this index rose 3.2%, indicating possible future rises in the consumer price index.

Our balance of payments position has also deteriorated. As of the second quarter of this year, our deficit was over $23 billion and our balance of trade showed a deficit of $4.2 billion, both on an annual basis.

Our economic problems have now reached major proportions. We must solve these problems and solve them now. We must consider what is in the best interests of the nation. A bold new approach is required. The world leadership of the United States and its economic well-being demand a major change in tax policy -- a policy to revitalize individual achievement and the productive forces of the country. If the situation is as serious as the Administration and many members of Congress say it is -- and we agree that it is serious -- then it is time for the Congress, the Administration and the American people to work together to find a solution.

We Must Overhaul Our Capital Cost Recovery System

A nation's tax policy plays a significant role in the growth and efficiency of its production capabilities and its ability to compete in world markets. It is exceedingly important that the tax policy of a nation not discourage the modernization and expansion of its productive facilities. The other highly industrialized nations understand these principles and are applying them. Their capital cost recovery systems are highly favorable to the modernization and improvement of their productive facilities. They know the importance of being in a favorable competitive position.

Although the other industrialized nations have high income tax rates, their capital cost recovery allowances and capital investment incentives are much more favorable than ours. Even with the tax credit, we were in an unfavorable position. The repeal of the investment credit in 1969, though perhaps advisable at the time because of the excessive competition for investment capital, has now placed us in an even worse position. Reenactment of the credit -- even at the proposed rate -- will not give American industry the same level of capital cost recovery allowances that are available to its competitors in Europe and Japan.

Last year the President's Task Force on Business Taxation included in its report a table comparing the capital cost recovery allowances for industrial machinery and equipment in leading industrial countries with similar allowances in the United States. A copy of that table is attached and it is requested that it be made a part of this testimony. The Treasury Department in its July 1971 publication on ADR expanded that table and prepared a chart, a copy of which we have also attached to our testimony. This chart shows the aggregate cost recoveries allowable on machinery and equipment for tax purposes in the United States and in 11 foreign countries. It should be noted that without the three-quarter-year convention, eliminated by the House, the comparison would be even more unfavorable for the United States.

A major change should be made in our capital cost recovery allowance system. The job development investment credit will help, but it is not enough to solve the entire problem. What is needed is not only the enactment of the credit, but also a major overhaul and liberalization of our entire depreciation system along the lines set forth by the Task Force. The ADR system should be given the full sanction of the Congress to erase any possible question of its advisability or legality, and the reserve ratio test should be eliminated.

Job Development Investment Credit

The President's Task Force pointed out a year after the repeal of the investment credit in 1969:

> Congress' repeal of the investment credit was in large part motivated by the desire to curb inflationary pressures and, although any increase in income tax may have some short-range effect in this direction, we think the long-range result of increasing the tax on business, particularly if the increase results in curbing the growth of the productive capacity, will be to hinder efforts to reduce or stabilize the price level.

Confirmation of the validity of that prediction is apparent. Repeal of the investment credit without replacing it with another form of capital cost recovery allowance contributed to our problem rather than alleviated it.

In 1969, we appeared before this committee and said that the Chamber would acquiesce in the repeal of the investment credit if there were a firm commitment to a tax structure which through more liberal depreciation provisions and reduced taxes on business income, would insure the continued modernization of American industry and enable us to compete more effectively in world markets. This plea was made in an effort to salvage some sort of capital cost recovery allowance. The Administration had second thoughts as to the wisdom of what was being done. Its witnesses suggested a reduction in the corporate tax rate of two percentage points, and indicated that it was going to give consideration to depreciation reform. The Administration was accused of recommending a windfall for business. Congress eliminated the credit and did not reduce corporate tax rates. Business profits dropped, a more serious inflation psychology developed, unemployment became greater, our balance of payments position became even more unfavorable, and the competition from foreign business became even more acute.

Let us not make the same mistakes that have been made before. Let us stimulate rather than stifle the mighty productive forces of American industry in order that we may fight inflation, provide more jobs, and increase the standard of living of the American people.

A major part of our problem has been the inability of American industry to replace its obsolete machinery and equipment. For instance, prior to ADR a piece of equipment which might be written off for tax purposes in the United States in 13 years could typically be written off in 10 years or less in most of the highly industrialized nations of the world. ADR has narrowed this portion of the problem by allowing the United States user to depreciate such a piece of equipment in 10.4 years. Calling your attention again to the attached chart, even with ADR it is obvious that American business is still at a disadvantage.

The steel industry is a good example. During World War II the Japanese steel output at its peak was only 9 million tons compared to 90 million in the United States. In 1960 Japan's steel output was 24 million tons, in 1968 it was 74 million tons, and by 1973 it is estimated to have a steel-making capacity of 125 million tons. This compares to a current capacity of approximately 195 million tons in the United States. Approximately two-thirds of the Japanese steel capacity is eight years old or less. By comparison, only about one-third of the steel manufacturing plant of the United States is less than 10 years old -- and approximately 25% is actually obsolete.

According to a McGraw-Hill survey released at the end of last year, one-fifth of the plant and equipment of American business is over 20 years old, 56% of its facilities is 10 years old or less, and one-eighth of its facilities is considered by business to be technologically outmoded. According to the survey, it would cost business $144.5 billion to replace its outmoded facilities with the best new plants and equipment. According to a similar survey, four years before, business had reported that 65% of its facilities were 10 years old or less, compared to 56% in the 1970 survey. To say the least, the situation is acute, and the trend is unfavorable.

An example of how the investment credit can affect productivity in the United States can be seen from the apparent impact of the previous credit on a major segment of American industry. New orders for domestically produced machine tools, after a slight decline in orders in 1964, strongly increased until October of 1966 when the old 7% investment credit was temporarily suspended. During the period of the suspension orders dropped more than 25%. When the investment credit was restored in 1967, orders began increasing, reaching a peak in April of 1969, when the credit was terminated. Since the termination, new orders for machine tools have decreased tremendously. In the first quarter of 1971, orders were over 70% less than their all-time high in 1969.

Part of the key to our economic growth is increasing our productivity. Since World War II, United States manufacturing productivity has increased on the average of about 3.2% per year. Since 1965, however, our productivity gains have fallen sharply below this post-war average.

Since 1965 productivity in the United States has been increasing at an average annual rate of only 2.1%. In Japan, one of our major industrial competitors, productivity during this same period increased by 14.2% annually. According to Labor Department statistics, during this period the United States had the worst record among the major free-world nations in productivity gains.

President Nixon, in his economic message to Congress this year, stated:

> Improvement in our levels of living, including improvement of our physical environment, depends on productivity gains. The stakes here are high. If we could, for example, increase the rate of productivity growth by only one-tenth of 1 percent a year, we could produce $15 billion of additional output per year by the end of this decade.

We believe that the job development investment credit as proposed by the Administration should be immediately enacted into law by the Congress. In the past we have urged meaningful depreciation reform in preference to an investment credit. However, the current circumstances are far different from those prevalent in 1967 and 1969. A major effort is needed to bring about an economic recovery and provide the jobs for our country's unemployed. Both the credit and depreciation reform should be enacted by this Congress and made permanent features of our tax laws.

With regard to the rate of the credit, we believe there is ample reason for the adoption of a 10% credit, at least in the first year. We further believe that the credit should be no less than 7% in succeeding years. This time it should be made a permanent feature of the tax law -- rather than just a faucet to be turned on and off to spur the economy.

Furthermore, the credit should be made applicable to used machinery and equipment. If the credit is not made available for used machinery and equipment, many small businesses, which can modernize their plants only with used equipment, would not be encouraged to do so. Extending the credit to used equipment will also directly facilitate the purchase by others of new equipment. With regard to the "buy America" feature of the credit, it should apply only during the time the 10% surcharge is in effect. We do not believe it should apply to any period prior to the effective date of the surcharge.

A further suggestion has to do with the minimum income tax. As you know, the minimum tax is a flat 10% of the total of the tax preference items of the taxpayer reduced by the sum of $30,000 and the income tax liability of the taxpayer for the tax year, after credits. Retention of the minimum tax computation as now in the law, reducing the tax liability by the amount of the job development investment credit, will have the effect of watering down the impact of the credit.

We believe that the job development investment credit should be fully effective without being impaired by the minimum tax, and that the credit should reduce the total of the regular income tax and the minimum tax liabilities combined. Furthermore, we believe that the minimum tax should be included in the tax base for application of the 50% limitation in determining the amount of the credit allowed for the taxable year.

In the past this country has been able to compete with products made by cheaper labor of other countries because American business had the most modern and efficient machinery and equipment. Now we are competing with cheap labor that is using the most modern machinery and equipment -- in many cases more modern than our own. If you adopt a tax policy that encourages the replacement of obsolete and inefficient plant machinery and equipment, American enterprise will outproduce its rivals, provide jobs at the highest wages on earth, and maintain American leadership in the world market place.

Basis Adjustment

When the previous investment credit was first enacted, it contained a provision for reducing the basis for depreciation by the amount of the credit. In the Revenue Act of 1964, the basis adjustment provision was deleted. In its report on this Act, this committee made the following statement with regard to the basis adjustment provision:

> This provision has proved troublesome to taxpayers since it requires a downward basis adjustment with respect to eligible property, whether or not an investment credit is claimed for the property. Moreover, making this adjustment has presented recordkeeping problems for taxpayers, especially in the case of early retirements, and also severely complicated the statutory language of the investment credit provision....
>
> To remove the recordkeeping and accounting problems which have arisen in connection with the basis adjustment provision and also to provide a greater stimulus with respect to the investment credit, the bill, both as passed by the House and as reported by your committee, repeals this basis adjustment provision.

We believe that the bill presently under consideration should not provide for an adjustment to basis for the investment credit, since such a provision would have similar problems to those encountered in 1962. In addition, we concur with the Committee on Ways and Means, in its report on H.R. 10947:

> Your committee has not provided a basis adjustment mechanism, at this time, such as that employed in the past, in view of your committee's concern that the investment credit provided by the bill have as great a stimulative effect on the economy as possible. Generally, a basis adjustment mechanism provides for a reduction in the depreciation base of property for which an investment credit is allowed by the amount of the credit, and it would be necessary to provide a larger credit subject to a basis adjustment to obtain the same overall stimulative effect.

Need for Long-Range Depreciation Reform

For many years, the National Chamber has urged meaningful depreciation reform to insure the continued modernization of American industry and to enable American business to compete more effectively in world markets. We have long called for permanent improvement in our inadequate depreciation structure that would make it comparable to the capital cost recovery allowances of other industrialized nations. The United States cannot afford to fall further behind our major competitors and still hope to recover from our precarious balance of payments position which, as of the second quarter of this year, showed a deficit of $23.4 billion. As was stated by the President's Task Force on Business Taxation:

> ...it is very much in the long-term interest of the United States to modernize and enlarge the nation's production facilities, and that the adoption of the capital cost recovery system for machinery and equipment proposed in this report would serve to further this end and help to put and maintain United States business on a more competitive basis with the other industrial nations of the Free World. The capital cost recovery system proposed would have the additional advantage of reducing the complexities associated with the present depreciation system of the Federal income tax law.

We cannot afford further to handicap American business at a time when modernization and expansion of our production facilities are so necessary. Until the time that the United States can close the gap between the systems of capital cost recovery used by our competitors and that which is allowed by our own taxing system, there will be little chance for improving our trade balance.

Because of advances in technology, the American industrial community is continually faced with a need to replace obsolete machinery and equipment. In some cases, machinery and equipment become obsolete, from a technological standpoint, even before they become fully operative.

This country's present depreciation practices are grossly inadequate. Although the adoption of the Asset Depreciation Range regulations have eased the situation, it is far from being corrected. It is imperative that the recommendations of the Task Force be enacted into law. These recommendations include:

1. Substituting a capital cost recovery allowance system for the present system of deductions based on the useful life of property;
2. Eliminating the reserve ratio test; and,
3. Allowing full recovery of cost, unreduced by salvage value, in a period 40% shorter than would be allowed under the 1962 Treasury Guidelines for determining useful lives.

While the job development investment credit will have an immediate effect on the economy, the Task Force recommendations should be adopted for their long-range permanent effect.

Reserve Ratio Test Termination

The National Chamber has urged the elimination of the reserve ratio test since its inception. Last year, the President's Task Force on Business Taxation recommended that:

> ...the reserve ratio test and/or any similar device be eliminated with respect to existing facilities as well as facilities acquired after these recommendations become effective. A reserve ratio test, or any similar measure for comparing the cost recovery period used for tax purposes with the actual period of retention of assets by the taxpayer, is clearly irrelevant under the conventionalized cost recovery system we have recommended.
>
> Even under the present depreciation system, the reserve ratio test contributes little in determining whether the depreciation allowances claimed by a taxpayer on his return are equal to the true depreciation sustained during the taxable year....
>
> We are convinced, therefore, that the reserve ratio test serves no useful purpose under the present depreciation system and should be eliminated even if our other recommendations are not adopted.

Late in 1970, members of the National Chamber's Taxation Committee representing various industries, including airlines, automobiles, chemicals and pharmaceuticals, electronics, food products, gas and electric companies, heavy machinery, petroleum, railroads, retailers and steel and metal producers, distributed to their counterparts in the other major companies of their industry questionnaires concerning depreciation under the reserve ratio test.

Of the 101 responses received, 66.3% indicated that they used the depreciation guideline lives for most of their assets. The others did not use the guideline lives.

Among those who indicated they used the guideline lives, 91% indicated they had or anticipated problems in passing the reserve ratio test. Eighty-seven and one-tenth percent said they would have difficulty in passing the tabular form of the test as provided for in Rev. Proc. 62-21, and 66.2% said they would have difficulty in passing the test with the leeways and modifications provided for in Rev. Proc. 65-13 -- the guideline form of the test.

Of the respondents who used depreciation guideline lives for most of their assets, 68.6% indicated that they anticipated an extension of lives under the guideline rules would be required due to failure to meet the reserve ratio test. While some experienced extension of their guideline lives during the period of 1965 to 1969, the majority stated they expected an extension in the years between 1970 and 1976.

Fifty-two and three-tenths percent of the respondents who did not use guideline lives did not use them because they were too long; 36.4% did not use guideline lives because the lives they used for depreciation purposes were longer than the guideline lives and were adequate; and 11.3% used regulatory agency procedures.

Those who responded that longer than guideline lives were in use or were adequate were queried whether they would use the guideline lives if the reserve ratio test were eliminated. Thirty-two percent said they would and 68% said they would not. Of those who responded they would use the guideline lives but for the reserve ratio test, 62.5% indicated that they do not use the guideline lives because of inability to pass the test. Twenty-five percent said they do not use the guideline lives because of the complexity of the test.

Of those who said they could not adopt guideline lives even if the reserve ratio test were eliminated, 94.1% based their response on the fact that there would be no tax advantage to them to adopt the guideline lives.

The results of the questionnaire indicate that a vast majority of the businesses using guideline lives had or anticipated trouble in passing the reserve ratio test, in either of its forms. They also anticipated an extension of lives under the guideline rules would be required due to their failure to meet the reserve ratio test.

The President's Task Force indicated that there would probably be little future revenue loss involved in the elimination of the reserve ratio test. This was borne out by our survey. It indicated that even if lives were extended under the guideline rules due to failure to pass the test, the estimate of reduction of depreciation allowance resulting from the extension of such lives would be a little over 2% of present depreciation allowances for federal income tax purposes.

The reserve ratio test should be eliminated in conjunction with the adoption of the Revenue Act of 1971.

Inflation

By using more modern and efficient production facilities more goods can be produced at a lower cost per unit. By encouraging American industry to invest in the most modern machinery and equipment available, an effort can be made to reduce inflation.

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Due to inflation, American business has underdepreciated its assets. This underdepreciation has led to an overstatement of profits and an overpayment of taxes based on those profits.

What occurs is that a piece of equipment is often depreciated at its cost over a long period of time. When the time comes to replace that piece of equipment, the cost of replacing it has greatly increased due to inflation. As a result, the increased cost of replacement must be paid for primarily from earnings.

For example, assume a $20,000 asset is depreciated using the straight-line method over a period of 12 years, and an inflationary effect of 7% is compounded annually. By the time that asset is depreciated and replaced, the cost of replacement will have risen to approximately $45,000. Twenty thousand dollars of this amount can be accounted for by depreciation, but the additional $25,000 must come from the taxpayer's earnings or newly invested capital if this asset is to be replaced. Had the asset been depreciated over a shorter and more realistic period of time, the effect of inflation would have been reduced and the replacement would cost appreciably less. This story has been repeated over and over again.

In actuality, American business has been paying taxes on its capital. In order to lessen the effects of inflation on replacement costs, shorter and more realistic lives should be available for use in computing depreciation.

Automobile Excise Tax

The Excise Tax Reduction Act of 1965 repealed many of the manufacturers excise taxes that were imposed as emergency measures during wartime and the depression years. The Act provided for the gradual phase-out of many of the excise taxes which were not repealed outright. One of these was the excise tax on new automobiles. Prior to the 1965 Act the rate was 10%. The rate was reduced immediately from 10% to 7% and it was further provided that it would be gradually reduced and expire after 1969.

When the rate had dropped to 6%, the Tax Adjustment Act of 1966 restored it to 7%, and again provided for gradual reduction until 1969 when it was slated to be a permanent 1%. Both the Revenue and Expenditure Control Act of 1968 and the Tax Reform Act of 1969 further postponed these scheduled reductions. Then again, last year, the Excise, Estate, and Gift Tax Adjustment Act of 1970 postponed the repeal until 1982 by providing that the present 7% rate be phased-out gradually.

Consistent with its long-standing position, the National Chamber supports the proposed repeal of the 7% automobile excise tax on all new passenger cars sold at retail after August 15th of this year. Repeal of this highly discriminatory tax will provide a powerful stimulus to our sagging economy. It is expected that some eight million people will be buying new automobiles in this country over the next year. It has been estimated that each new car purchaser will save an average of $200. Since this tax savings will be passed on to the automobile buyer, more Americans will be able to afford the purchase of a new automobile, producing an increased demand for new cars. The Ways and Means Committee estimates that repeal of this tax alone will save new car buyers $800 million in calendar year 1971, $2.2 billion in 1972 and $1.9 billion in 1973. Even if consumers continue to save at the rate of 8%, the spending of the balance of this tax savings would provide a powerful stimulus to our economy.

But by far the most significant effect of the repeal of this tax would be the rippling effect on our economy as a whole. Because the manufacture of automobiles affects so many related industries, the expected increased demand would be a strong business stimulus. It has been estimated that one out of every six businesses is automotive related. Of all the retail sales in this country, 24% are related to the automotive industry. In addition, 13 million people in the United States are employed in jobs related to the automobile. The Administration has estimated that this repeal will result in 600,000 additional domestic automobile sales and 150,000 additional jobs, not counting dealer employees.

In essence, our economy will receive a triple benefit from repeal of the 7% automobile excise tax. First, a highly discriminatory tax will be removed from the books. Second, the price of new cars will drop, thereby enabling more Americans to afford new cars. And third, the increased demand for new cars will create new jobs for unemployed Americans in a broad range of industries. Not to be overlooked also by the environmentalists is that the purchase of the new cars will permit the replacement of older cars not meeting today's anti-pollution standards.

Speed-Up of Individual Income Tax Cuts

In testifying before this Committee on the Tax Reform Act in 1969, the National Chamber expressed support for the increase in the regular standard deduction as "the clearest way to simplify compliance with the tax laws for a large number of taxpayers."

Congress has already made the decision to increase the personal exemption and the standard deduction. The additional purchasing power produced by the speed-up of the tax cuts should spur the economy. Accordingly, the National Chamber generally favors the acceleration of these items provided, that as proposed by the Administration, sufficient cuts are made in federal expenditures to meet the anticipated revenue losses.

Domestic International Sales Corporation (DISC)

As part of its comprehensive program to solve the economic problems presently confronting our nation, the Administration has recommended the enactment of a special tax provision known as the Domestic International Sales Corporation (DISC). As proposed by the Administration, a DISC would be a United States corporation engaged in the business of export sales. This corporation would be permitted to postpone the payment of federal income tax on earnings from the sale of goods abroad until such time as the earnings are distributed to the DISC's shareholders or the stock of the DISC is sold.

In 1970, the House of Representatives passed the DISC proposal. In June of that year, the National Chamber, in its statement to the Ways and Means Committee, expressing its support for the DISC concept, pointed out that United States domiciled exporters were suffering from two major disadvantages. First, they were not receiving the tax deferral benefits presently available to foreign subsidiaries of United States corporations. Second, domestic exporters were often competing against exporters in foreign countries who were given more liberal tax benefits by foreign governments.

These two disadvantages continue to exist today. The only difference is that now our economy is in greater need of remedial measures to promote export sales and domestic employment. We suffer today from a 6.1% rate of unemployment and an ever-worsening balance-of-payments deficit. As of the second quarter of 1971, this deficit was $23.4 billion on an annual basis. Even our balance of trade has begun to show a deficit. Second quarter data indicate that our balance of trade deficit was $4.2 billion on an annual basis.

DISC is expected to encourage exports. It has been estimated, for example, that enactment of DISC as proposed by the Administration will provide the stimulus to increase export sales about $1.5 billion per year. The potential for our country to increase its exports is certainly there. Although during the past five years our exports increased at an annual average of 7.6%, according to the Department of Commerce, the annual increase in world import demand was 9%. Furthermore, it can be seen that our export potential is being only partially realized, in view of the fact that exports constitute only 4% of our gross national product.

Coupled with the job development investment credit and further depreciation reform, DISC will help our serious unemployment problem. It will provide the incentive to American businessmen to build up export sales and provide export facilities by using the undistributed DISC income. The result will be the creation of new jobs for many Americans -- almost 80,000 according to one estimate.

This will help reduce the very high rate of unemployment. In this connection, we call the committee's attention to the remarks of Secretary of Commerce Stans in his testimony before this Committee on the Trade Act of 1970:

> It is incomprehensible to me that labor should find any difficulty with the DISC proposal. The sole purpose of it is to provide incentives to American companies to build their plants in the United States and export from here to other countries instead of building plants in other countries and depriving American labor of the jobs.

The President's Task Force said that it is of utmost importance for American business to maintain, and, if possible, to improve its competitive position in international trade. It pointed out that the present provisions of the tax law "present unnecessary obstacles to American business in selling goods or services in foreign markets," and concluded by recommending enactment of the DISC proposal.

In the bill passed by the House, the tax deferral is to be available for export income only to the extent of 25% of a company's average level of export income in the base period 1968 through 1970, plus any of its current export income over this average level.

The National Chamber supports the DISC concept. However, we believe the incremental approach taken in this bill will weaken the effectiveness of DISC. The President's Task Force considered the question of this incremental approach and concluded that it was not appropriate:

> The objections to an incremental approach are, however, very great from the standpoint of both equity and administration. For example, it would be difficult to justify the imposition of a tax at a higher rate on a taxpayer that had an established

export business than on a competitor just entering the export field. Such a tax differential would have the effect of subsidizing the development of the newcomer's business. The complexities of a law requiring comparison between current results and past experiences are still remembered by those who had to cope with the excess profits tax laws of World War II and the Korean War. The Task Force is of the view, therefore, that the DISC proposal properly avoids the incremental approach.

In summary, we believe that enactment of the full DISC proposal of the Administration will play a major role toward economic recovery. Some of its expected advantages are:

-- It will place the American exporter in a more competitive position in world trade;

-- It will provide tax deferral for domestic exporters equal to that now available to American exporters using foreign subsidiaries; and

-- It will allow firms that are too small to operate through foreign subsidiaries to enter the export field.

Conclusion

In conclusion I wish to reiterate the position of the National Chamber on H.R. 10947. It is the view of the Chamber that:

1. The job development investment credit should be enacted by the Congress without delay and made a permanent part of the tax structure. At the same time the Congress should fully sanction the Asset Depreciation Range system so as to end any question of its advisability or legality. In addition, ADR should be extended by legislation to include the recommendations of the President's Task Force on Business Taxation regarding capital cost recovery, including elimination of the reserve ratio test.

2. The automobile excise tax should be eliminated.

3. The Domestic International Sales Corporation proposal should be enacted into law as proposed by the Administration.

4. The scheduled increases in the standard deduction and the personal exemption should be accelerated.

Attachment A

TABLE II.*—*Comparison of Cost Recovery Allowances (1) for Industrial Machinery and Equipment in Leading Industrial Countries with Similar Allowances in the United States*

	Representative cost recovery periods (years)		Aggregate cost recovery allowances (percentage of cost of asset) First taxable year		First 3 taxable years		First 7 taxable years	
Belgium	10	(2)	20.0	(3)	48.8		89.0	(4)
Canada	10	(2)	20.0	(3)	48.8		79.0	
France	8	(5)	31.3	(3)	67.5		94.9	(6)
Italy	6	(7)	20.0	(8)	65.0	(9)	100.0	
Japan	11	(10)	34.5	(11)	56.9		81.4	
Luxembourg	10	(2)	28.0	(12)	60.4		101.9	(13)
Netherlands	5	(14)	10.0		42.4		77.1	(15)
Sweden	5	(16)	30.0	(3)	65.7		100.0	
Switzerland	6⅔	(2)	15.0		58.4		90.0	
United Kingdom	12	(2)	57.8	(17)	78.1		102.1	
Western Germany	9	(18)	16.7	(19)	49.6		88.8	(20)
United States:								
With investment credit	13	(2)	21.7	(21)	47.9		80.1	
Without investment credit	13	(2)	7.7		33.9		66.1	

*Capital cost recovery allowances set forth on this Table were gathered by the Task Force and have been reviewed and approved in writing by a leading international firm of public accountants and reviewed and accepted by the U.S. Treasury Department.

NOTES

(1) The capital cost recoveries for each of the foreign countries have been computed on the assumption that the investment qualifies for any special allowances, investment credits, grants or deductions generally permitted. The deductions in the United States have been determined under the double declining balance method without regard to the limited first year allowances for small businesses.

(2) Double declining balance method.

(3) Full year allowance in first taxable year.

(4) Method changed to straight line in fifth taxable year. Straight line rate applied to original cost for fifth, sixth and seventh taxable years.

(5) 250% declining balance method.

(6) Method changed to straight line in sixth taxable year.

(7) Straight line method.

(8) Includes additional foreshortened allowance of 15%.

(9) Includes additional foreshortened allowance of 15%, 15% and 10% in first, second, and third taxable years, respectively.

(10) Modified double declining balance method; 18.9% per Japanese Government rate table, salvage value built into rate.

(11) Includes special first year allowance of 25%; allowance reduces recoverable base cost in second and succeeding taxable years.

(12) Includes 18% allowance equivalent to 9% investment credit at effective 50% income tax rate; credit does not reduce recoverable base cost.

(13) Method changed to straight line in fifth taxable year. Straight line rate applied to original cost for fifth, sixth and seventh taxable years.

(14) 100% declining balance method.

(15) Method changed to straight line in seventh taxable year.

(16) Modified declining balance method—30% rate; accumulated cost recovery may not be less than total of 20% of cost for each year asset is in service.

(17) Full year allowance in first taxable year; includes 44.4% allowance equivalent to 20% investment grant at effective 45% income tax rate; grant reduces recoverable base cost.

(18) The average cost recovery period for machinery and equipment in Western Germany is 8 to 10 years to which additional allowances are permitted for multiple shift operations: 25% of allowance for two shift operations and 50% of allowance for three shift operations. Allowances may be further increased when plant is located in certain areas such as Berlin, areas bordering on iron curtain countries, and undeveloped areas.

The above Table II sets forth cost recovery allowances based on an average cost recovery period of 9 years. The double declining balance method is used. A 25% additional allowance for two shift operations is taken into account beginning with the fifth year when the method is changed to straight line. The corporate depreciation rate thus computed is slightly over the maximum 20% rate permitted on a declining balance method to reflect that:

(A) The straight line method produces more depreciation than does the double declining balance method for certain short-lived assets; and

(B) Items of machinery and equipment costing under U.S. $200 can be expensed.

No other incentives have been taken into account.

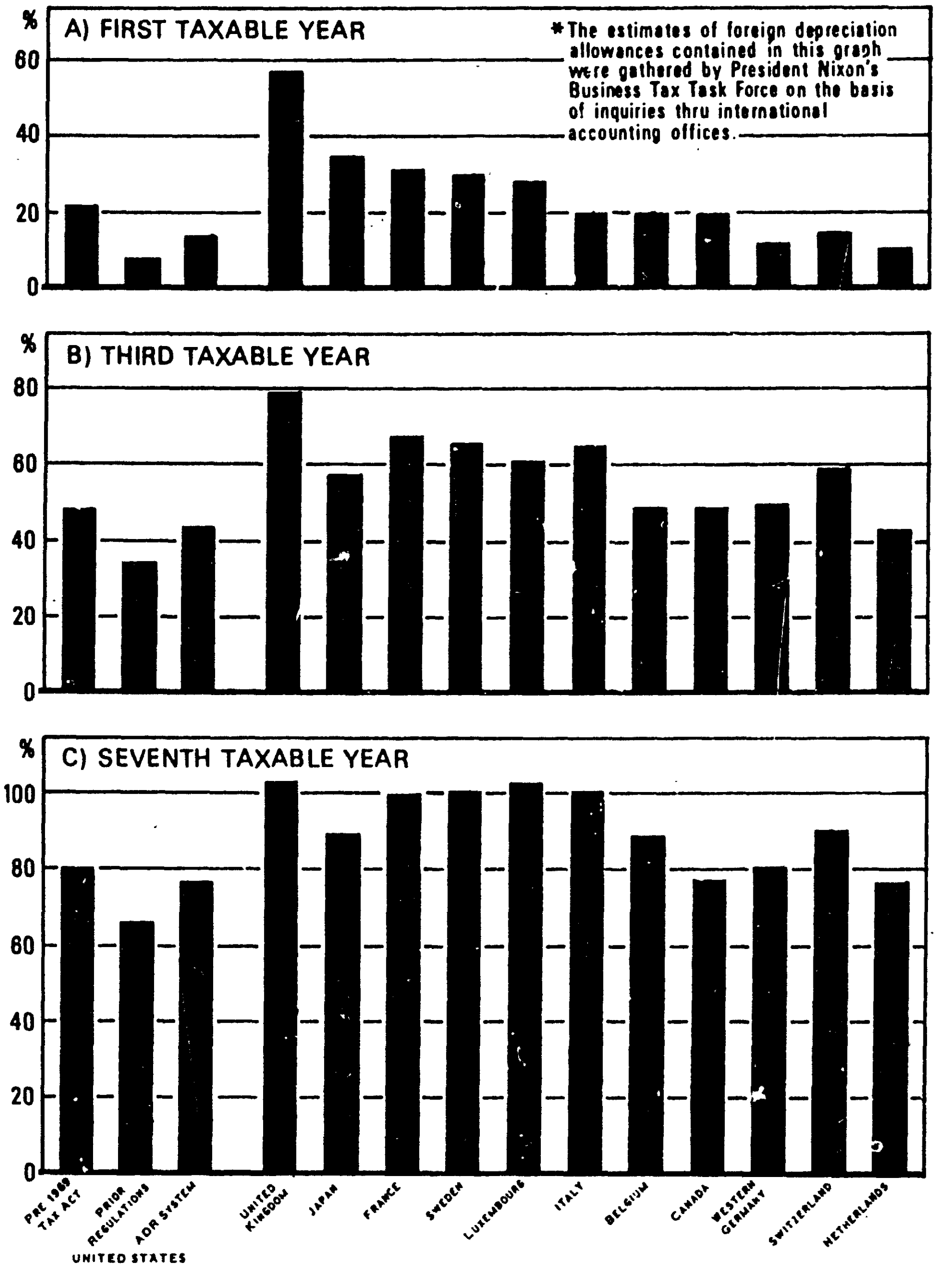
(19) Full year allowance in first taxable year for assets acquired in first half of such year; half year allowance for assets acquired in second half.

(20) Method changed to straight line in fifth taxable year. See (18) above.

(21) Includes 14% allowance equivalent to 7% investment credit at effective 50% income tax rate. Credit does not reduce recoverable base cost.

Attachment B

AGGREGATE COST RECOVERIES ALLOWABLE FOR TAX PURPOSES IN THE UNITED STATES* AND IN ELEVEN FOREIGN COUNTRIES ON MACHINERY AND EQUIPMENT



The CHAIRMAN. The next witness will be Mr. Leon Keyserling, Former Chairman, Council of Economic Advisers.

We are pleased to welcome you here, Mr. Keyserling. For some reason or other everything you say about economics always finds a responsive chord with this Senator, so I am particularly pleased to have you here.

STATEMENT OF LEON KEYSERLING, FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. KEYSERLING. Mr. Chairman and members of the committee, I appreciate the gracious remarks of the chairman. I would like to make one preliminary remark. Whenever I have been before this committee during the most recent years, I have always impressed the committee until the time when he took action.

Without being prideful, I would like to call this to the attention of the committee through my prepared testimony, as there is not time to do it orally. It might be well to make a little score card of how much trouble the American economy, business and labor alike because I favor neither at the expense of the other, has gotten into by persistently doing in the recent past the things which I oppose here today, as I have done before. The same things were done and tried over and over again, and found to be wrong, not in the philosophy of labor groups, not in the philosophy of industry groups, not in the economic textbooks, but in the great laboratory of the trillion-dollar American economy in action.

Therefore, let me first summarize what I propose here today, and than bring the facts to bear.

At this time, I think it would be very unwise to enact and investment tax credit proposal as it now stands. I am here giving only my conclusions by way of summary, then I will get to a few facts, and I will keep within the time limit.

I am opposed to extending the investment tax credit at this time. But as a practical man, I guess there is going to be some extension, and insofar as it is extended, I would not grant it entirely to those who need it least, but also to those who need it more, particularly those engaged in building in our great cities, and I will come to the reasons for that.

I have previously called to the attention of this committee, without avail, the gross discrimination against that vital sector in every tax and every subsidy and every other action we take, although we continue to identify this sector as one of our greatest national priority.

Second, I believe that all of the tax incentives granted at this time, or stimulus granted at this time, with the exception of expanding the investment tax credit to include housing and related construction, should be focused upon consumption stimulus, I believe that the consumption factor should get the entire saving achieved through the desirable reduction in the investment tax credit.

In doing this, it is also essential to look carefully at the composition of the personal tax cuts. The very valid question was raised, if we want to increase consumer spending, how is it that people are saving so much and not spending enough, so what is the use of increasing their after-tax incomes? The answer is, we are not looking at who has the savings any more than we are looking at who has the income. Income distribution is so askew that savings are more askew. The preponderance of the saving is being done by the people in the top half. The people in the middle income groups aren't saving any 6 or 7 percent, they are saying 1 or 2, and at least a third of the population is dissaving, they are borrowing more than they are spending.

So concentrating the personal tax cuts on those in the lower half of the income structure stimulates spending much more, and therefore helps business, and therefore helps the whole economy, very much more than providing tax cuts for the upper-income groups.

This is utterly neglected, in general, by those who talk about the high rate of savings. The highest rate of frozen savings was during the great depression.

Now, let me refer to a few facts. I want to refer to the facts, because I have appreciated what the previous witnesses have said, but they talked mostly theory. They have debated the relative merits of investment cuts and consumption cuts, but they haven't looked at the facts very much, at least not here. So very briefly, I think I can do this in 2 or 3 minutes.

I have a chart, which shows what the House bill would do if it were enacted into its present form.* And here on my chart 1, I look at the percentage increase in income after taxes. After all, it isn't the cut in tax rates that counts, nobody spends that, they spend what they get by virtue of the cut.

This shows that, under the House bill for the years 1971 and 1972, the family with an income under $3,000 would get 0.6 percent increase in its disposable income and a family with income over $50,000 would get over 5 percent. So there is practically no progressiveness in it. The whole thing is small also, and doesn't amount to much in a million dollar economy. It is also interesting to note the family with over $50,000 would get a higher percentage increase in its disposable income than any of the families between $10,000 and $50,000, in other words, the middle and upper middle income families.

Now it will be said, of course, that due to the mathematics of the tax structure, if the higher income people are paying higher rates, when you reduce taxes, they have to get more help in percentage terms. This begs the whole question. The question is, Whether as a matter of national policy, we should continue to use tax policy to give more disposable income help and more dollars of income help through tax policy to those at the top who need it least. And if we could not through taxation give the most to those lower down, which in fact we can, then we need some policy other than tax policy to keep those who need help most.

In my second chart, I have done something which I think nobody has done, although we have had an orgy of tax reduction since 1963. I have taken all of the tax legislation from 1963 through 1973, including the House bill through 1973. And when I add it all up, and include this bill if enacted in the House form, the people with incomes over $50,000 will have gotten a higher percentage increase in income taxes than anybody lower down. It is fantastic. They have gotten

*Charts referred to appear on pp. 269ff.

6 percent. Those under $3,000 have gotten 5 percent, and those in between have gotten less.

Now, an even more important way of looking at it is shown on my chart 4, which shows the percentage distribution of tax returns and the dollar value of the tax cuts. I show it all the way from 1964 to 1973, and here is the result we get when we view it all. I am talking about the personal tax cuts.

The family under $3,000, who are 16 percent of the families, will have gotten 7.5 percent of the total tax cuts. So they have gotten help of less than one-half in ratio to their number.

The families above $50,000, or 0.6 percent of the population, have gotten 0.8 percent of the cuts. So they have gotten help in excess of their number. So if you adjust it on a numerical ratio basis, they have gotten more than twice as much as those below $3,000. And those in between, on this ratio-to-numbers basis, will all have gotten more than those in the lowest income group. This is another example of the regressiveness of the cuts.

Now, another thing to be taken into consideration is that the Federal income tax structure should be made increasingly progressive, because of the nature of the total nationwide tax structure, which very few observe.

If you look at my chart 5, it shows that, when you take all kinds of taxes into account, the family below $2,000, which is supposed to pay no taxes, is paying 50 percent of its income in taxes. The family with $50,000 is paying only 45 percent, and those in between are paying between 35 and 30 percent compared with 50 percent for those below $2,000. When we add up the payroll taxes and excise taxes and indirect taxes and State and local property taxes, we have a fantastically unprogressive tax system. And this is all the more reason, since the Federal income tax is the only progressive tax we have, that this tax should be made more progressive when any additional action is taken. And it has been made more nonprogressive since 1964, which incidentally reverses the course of our whole previous history in this respect.

Chart 6 shows the distribution of family income, which has a great bearing on this. Multiperson families, 41 percent of the income for the highest fifth, 74 percent to the highest two-fifths, 6 percent to the low fifth, and 12 percent to the second fifth, or 18 percent to the lowest two-thirds and 74 percent to the highest two-fifths.

I don't believe in equal income. I am against that. I am not for perfect income distribution. But certainly, the very unwholesome distribution now, and the extremely regressive nature of the nationwide tax system, does not call at this time for any tax reduction, except concentrating on those who need the help most, especially since there is so little now for tax cutting in any event.

Now, coming over to the allocation between investment and consumption. I have here on chart 7 an estimate different from that, I think, furnished by anyone else as to the distribution between the two in the current bill as passed by the House, because I have counted everything. I have counted the Treasury action earlier in the year. In the personal tax cuts, I have allocated some of it to the investment, namely, the portion of the savings of those in the high income brackets that they invest rather than spend, et cetera. And for the years 1971–72, taking them all into account, $4.5 billion would go to investment, and 3.3 to consumpiton. But in 1973 and thereafter, if the House bill were passed in its present form, 7.9 percent would go to investment and 2.5 percent to consumption. More than 3 times as much to investment as to consumption.

Why should we avoid such action? Sure, we should have more investment in plant and machinery. But let's turn to the history rather than to the theory. Several times since 1952, and especially since 1960, we have been confronted with this age-old problem of how to allocate tax cuts between investment and consumption. My chart 15 shows exactly what has happened. It shows that every time we had a boom in the economy, the investment grew many times as fast as the consumption. Consequently, we had an economic reverse. Of course, when the economy moved sharply downward, investment contracted. And this has happened over and over again and this was the reason why in 1964 I urged against piling so much of the tax reduction on the investment side. It worked for a year, created a boom, but really in 1966 the economy began to shrink again. Now we are in the same kind of situation today.

I am for good profits. But the per unit return is high enough, and since the per unit return is high enough, the reason the profits aren't high enough and the reason the funds aren't high enough is that the volume isn't high enough, and you do not stimulate volume by putting in a still more favorable funding position those who are not now in shortage of funds but rather in a gross excess of capacity over use.

I don't believe there are many large corporations in the United States today that can make a valid claim that it wants to make investment on grounds of the market condition, but is unable to do so because of lack of funds.

My next point is that, if this committee, or some other committee, doesn't deal with the interest rate problem, tax policy is unavailing. We have since 1952, through rising interest rates, and this is my chart 25, transferred $405 billion in national income out of the pockets of the homeowner and average consumer and small businessman and governmental borrowers, and even the utilities, and into the pockets of those who lend the American people back their own savings, about which we talk so much. That $405 billion of income transfer upward is inflationary because the rising interest rates have pyramided and costs and charges. They are unconscionable. They have stunted economic growth. They are doing the same thing as if you transferred $405 billion of tax reductions regressively upward. We will never get adequate economic growth with investment tax credits favored over consumer tax benefits, and with this gargantuan monetary burden upon growth and upon spending power of the people. Therefore, I recommend to this committee, since everything else is neglecting it, to consider an excess interest tax. It is a lot more logical than an excess profits tax. It is just as easy to enact, and a workable formula could be devoted for doing it.

Finally, not to take the time of the committee excessively, I have a number of charts on investment in housing and urban development which show that, in spite of the housing boom this year, it is all being built for the upper-income groups. It is going to saturate the market again. When you take any longer period of time, housing and commercial construction has grown only about half as fast as the economy. Our urban areas are run down. The rate of growth in future housing and commercial construction needs to be much higher to create jobs. One dollar of investment credit or any kind of tax stimulus on housing and commercial construction would have a multiplier effect 10 times as great as an investment tax credit to General Motors.

Thank you very much for your attention.

The CHAIRMAN. Thank you, Mr. Keyserling. I am going to take your statement and your charts home with me tonight and spend an hour or so studying them because I think you have made a very impressive presentation and I tend to agree with your argument.

Would you be so kind as to submit to us a suggestion or two as to how we could go about taxing excess interest? Personally, I am interested in that.

Mr. KEYSERLING. I would be glad to do that if you so wish, and will make such a suggestion available to the chairman.*

The CHAIRMAN. Well, I would like to do something about it.

Do you agree with my argument that the last time we had the investment tax credit it tended to bring about higher interest rates and to have the effect of business muzzling the homeowner away from the money market to the extent—

Mr. KEYSERLING. Without being prideful, I think that I would particularly like to address my comment to Senator Fannin, because I respect his views and have the same objectives as he has, although a different approach as to how to achieve these objectives.

Again, not being prideful, but perhaps some young assistant to this committee, who is where I was 35 years ago, before I got on social security, to make a check of what I said before this committee and other committees about the investment tax credit in 1964 and other times. I said it is going to do a number of things. First of all, not much of it is going to be used, because when we are in vast overcapacity, when business has ample funds, they are not going to use that investment tax credit fully, and there was a big consumption gap even then. As I said at that time, a lot of it is going to go overseas for overseas investment, making our balance-of-payments problem much worse. Because when you have idle plant capacity of a large amount in the United States and the Government for some perverse reason continues to give you tax bonanzas of all kinds, you can't use it here so you send it overseas.

I predicted that would happen, and then the balance of payments got worse, generally speaking, every year. I said that is what would happen to it. And the situation is the same today, only in more magnified form because there is more idle plant.

The CHAIRMAN. Thank you very much.

Senator HANSEN. Could I ask one question. I am sorry I didn't get to hear your full statement, Mr. Keyserling. But your recommendation for an excise interest tax, would you recommend also a limitation on where money could be put on deposit? I am wondering if we were to

*Mr. Keyserling subsequently submitted additional material which appears at pp. 305ff.

restrict the interest that could be paid here in the United States would not that encourage its flight abroad?

Mr. KEYSERLING. Well, first, I haven't yet responded to the study involved in examining what kind of formula could be used. Offhand, I would say that I do not think it would be necessary or desirable to attempt to get into legislation prescribing and apportioning where money should be deposited in the United States, but let me say this as to your related question and some of the other questions raised here.

I am for a lot of the things that are being done to improve our competitive position, and also to proscribe in the short run undue competition from others, but it is not a long-range solution. In the first place, we must remember that everything that we buy from other countries results, broadly speaking, in things that they buy from us. Actually, in the goods and services account, we have had a surplus 76 years out of 77, which is a pretty good record.

In other words, trade has to move along a two-way street. But the main thing is that we have constantly made the mistake of overemphasizing the relationship of our international trade and the inflow of goods to the size of the American domestic economy. We are a tremendous continental empire. Most of our markets are here, predominantly. We are not like England which has to sell to live and Japan which has to sell to live or Scandinavian countries that have to sell to live. Therefore, when in the name of taking care of that tail on the elephant's behind, we plunge whole elephant into recession and depression, we are giving a dollar to get a nickel. That isn't the way to do it. Even if, through the maintenance of high interest rates, we can gain a few billion dollars a year on our international transaction, at the expense of a policy that helps to cause 6-percent unemployment at home and a $70 to $100 billion production gap at home, this is a mighty, mighty poor tradeoff.

Moreover, the American capital hasn't flown overseas because of higher interest rates. It is flown overseas because there has been a prolixity of capital here relative to the economy at large. It couldn't be used here, because we weren't fully employed. If we increase public and private consumption of American products sufficiently, we will find that we will not be sending money overseas in such large amounts. There is an exact correlation between the trouble in the American economy and the increase in our balance-of-payments problem and the flow of capital overseas. It is going overseas because it can't be used fully here.

Ford and Chrysler don't go to France and Japan because of higher interest rates there. They go when they believe that fundamental economic growth conditions are better there, as they have been during recent years.

Senator HANSEN. May I say Dr. Keyserling's response leaves no doubt in my mind as to his feelings about the importance which he attaches to international trade, but I am sorry that he didn't give me a yes or no answer on my question because it seems to me that while he may feel that it has no bearing, there seems to be some in the country who do not agree with him.

Mr. KEYSERLING. Excuse me, I am sorry, if you will state what you want me to answer yes or no I will try to answer.

Senator HANSEN. I asked if you would favor a prohibition on the placing of American capital on account so as to draw interest in foreign banks or on any foreign account. That was my question.

I assume that, if you are to limit your rate of interest that can be changed here and a higher rate of interest may be available elsewhere outside of this country, I would feel there could be a flow of capital. Do you share that feeling?

Mr. KEYSERLING. No; I don't feel that that would greatly change the flow of capital, because I think those are not the real reasons for the flow. Chrysler doesn't go to Japan to get higher interest rates. They go to get an opportunity for production and production and investment and employment that the shortage of demand in the American market does not give them.

To answer your question in a few words, I would see no great objection to what you proposed if it proved needed. But I do not deem what you propose to be a main approach today.

(The statements of Mr. Keyserling, and additional material submitted follows. Hearing continues on p. 314.)

SUBMISSIONS OF LEON H. KEYSERLING[1]

SUMMARY FOR COMMITTEE USE

Basic proposals

(1) The investment tax credit should be drastically reduced, because the economy now needs vast direct expansion of consumption, which would more soundly and widely stimulate investment;

(2) Any investment tax credit enacted should be applied even more liberally than elsewhere to housing and related commercial construction, especially in urban areas. Despite the current housing "boom" for upper-income families, there is very little being built for the lower half of the income structure, only a token slum clearance program, and constant urban deterioration. These are far higher national priorities, and would contribute far more to employment and economic growth, than new machinery in plants which are now 25-30 percent idle;

(3) The net saving from reduced investment tax credit should be used entirely to provide larger personal tax cuts to those in the lower half of the income structure, who should also receive the tax cuts now being contemplated for those higher up. These changes, in addition to considerations of equity, would provide much more stimulus to employment and economic growth, because consumers in the lower half of the structure spend immediately a much higher portion of their disposable income than others;

(4) If the tax policy is sound, and if prices are properly restrained, there is no economic need for an excess profits tax, but one may be highly desirable to obtain nationwide acceptance of wage restraint by Government;

(5) Whatever may be done on the tax side, economic restoration cannot be attained, nor inflation curbed, without reversal of the policy of right money and extremely high interest rates, which since 1952 has transferred more than 150 billion dollars of national income in a regressive and inflationary manner. Consideration should be given to an excess interest tax, in view of the need to reduce interest rates on domestic priority programs by 30-50 percent.

Supporting facts

In the House bill, the percentage increase in personal income after taxes, for 1971 and 1972, is 0.6 percent for incomes under $3,000, and 0.5 percent for incomes over $50,000. Thus, the tax relief and stimulus is pitifully small, and hardly progressive. Those under $3,000, comprising 16.1 percent of all taxpayers in 1969, would receive 5.3 percent of total dollars of personal tax relief, while

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

5.2 percent would go to incomes over $50,000, comprising only 0.6 percent of all taxpayers. Meanwhile, in 1968 (latest available data), those under $2,000 paid 50 percent of their income in all types of Federal, state and local taxes, while those above $50,000 paid only 45 percent.

To be sure, tax-cutting tends toward these percentage results. But as an orgy of tax cutting since 1962 has moved in this direction, it is high time to help those who need help most by progressive rather than regressive tax changes, and by recognizing in addition the need for selective increases in Federal spending in lieu of incontinent tax reductions. Among multiple-person families in 1969, the highest income fifth received 41 percent of total multiple-person family income and the highest income two-fifths 64 percent, while the lowest income fifth received only 6 percent and the lowest income two fifths only 18 perecnt.

During 1971–1972, counting both the House bill and the Treasury tax concessions earlier in 1971, 4.5 billion dollars would be allocated to investment, and only 3.3 billion to consumption. Looking at the permanent effects in 1973 and thereafter, 7.9 billion would be allocated to investment, and only 2.5 billion to consumption. These allocations ignore all the lessons of similar errors since 1962; if enacted, they offer no prospect for full economic restoration, but only for repetition of the repeated cycles of inadequate economic growth, stagnation, and recession.

A vigorous expansionary program would net less price inflation without controls that a stagnant economy even with "voluntary" controls. During 1961–1966, with the real economic growth rate 5.8 percent and unemployment down from 6.7 percent to 3.8 percent, the average annual increase in consumer prices was 1.7 percent. But since then, real growth has been more than cut in half, unemployment risen to 6.0 percent, and consumer price inflation averaged annually close to 5.0 percent.

Summary of Testimony of Leon H. Keyserling

Mr. Keyserling made these proposals for changes in the tax bill as enacted by the House:

"(1) The investment tax credit should be drastically reduced, because the economy now needs vast direct expansion of consumption, which would more soundly and widely stimulate investment;

"(2) The investment tax credit should be applied to housing and related commercial construction, especially in urban areas, even more favorably than elsewhere. Despite the current home construction 'boom' for upper-income families, there is very little new construction for the lower half of the income structure, only a token slum clearance program, and constant urban deterioration. These are far higher national priorities, and would contribute far more to employment and G.N.P., than new machinery in plants which are now 25–30 percent idle;

"(3) The net saving from reducing the size of the tax investment credit should be used entirely to provide larger personal tax cuts to those in the lower half of the income structure, who should also receive the tax cuts now being contemplated for those higher up. These changes would involve no net change in the total tax revenues on paper, and they would greatly increase them in actuality by promoting much more stimulus to higher economic growth because consumers in the lower half of the structure spend immediately a much higher portion of their disposable income than others;

"(4) If the tax policy is sound, and if prices are properly restrained, there is no economic need for an excess profits tax, but one may be highly desirable to obtain nationwide acceptance of wage restraint by Government;

"(5) Whatever may be done on the tax side, economic restoration cannot be attained, nor inflation curbed, without reversal of the policy of tight money and exremely high interest rates, which since 1952 has transferred more than 150 billion dollars of national income in a regressive and inflationary manner. Congressional legislation should roll back by 30–50 percent the interest rates on the great domestic priority programs, and bring the Federal Reserve System under the effective control of the President and the Congress. Consideration should be given to an excess interest tax, which is more needed than an excess profits tax;

"(6) Whatever may be done on the tax and money side, greatly increased Federal spending is needed for full economic restoration and to meet priority needs, focusing on more private and public consumption of goods and services. The Federal Budget in calendar 1972 should be about 38 billion dollars higher than that proposed by the President for fiscal 1972. A restored Federal economy would bring us much closer to a balanced Federal Budget."

In support of his proposed shift from more investment stimulus to more consumption stimulus, Mr. Keyserling cited the following facts:

"In the House bill, the percentage increase in personal income after taxes, for 1971 and 1972, is 0.6 percent for those with incomes under $3,000, and 0.5 percent for those with incomes over $50,000. Thus, the tax relief and stimulus is pitifully small, and can hardly be called progressive. Those with incomes under $3,000, comprising 16.1 percent of all taxpayers in 1969, would receive 5.3 percent of the dollars of tax relief, while 5.2 percent would go to those with incomes over $50,000, comprising only 0.6 percent of all taxpayers. Yet, looking at all types of Federal, state, and local taxes, in 1968 (later comprehensive data not available), those with incomes under $2,000 paid 50 percent of their income in taxes, while those with incomes of $50,000 and over paid only 45 percent.

"It is no answer to point out that the mathematics of tax cutting necessarily has these unfortunate economic and social results, for as an orgy of tax cutting since 1962 has produced the wrong results, it is high time to help those who need help most by selectively increased Federal spending in lieu of incontinent tax reductions. Among multiple-person families in 1969, the highest income fifth received 40 percent of total multiple-person family income nad the highest income two-fifths 64 percent, while the lowest income received only 6 percent and the lowest income two-fifths only 18 percent."

Turning to the allocation between investment and consumption, Mr. Keyserling presented these facts:

"During the period 1971–1972, counting both the House bill and the Treasury tax concessions earlier in 1971, 4.5 billion dollars would be allocated to investment, and only 3.3 billion to consumption. Looking at the permanent effects in 1973 and thereafter, 7.9 billion would be allocated to investment, and only 2.5 billion to consumption. These allocations ignore all the lessons of similar errors since 1962; if enacted, they offer no prospect for full economic restoration, but only for repetition of the repeated cycles of inadequate economic growth, stagnation, and recession."

Mr. Keyserling insisted that "a vigorous expansionary program would net less price inflation without controls than a stagnant economy even with 'voluntary' controls, because the whole experience of the past two decades has been that inflation rises when idle plant and manpower rise, and falls when idle plant and manpower falls."

Testimony of Leon H. Keyserling

Mr. Chairman and Members of the Committee, I appreciate very much this opportunity to appear before you again, as you consider a tax proposal designed fundamentally to reactivate the economy toward higher real economic growth, and toward maximum employment, production, and purchasing power. But I am convinced that the proposal now before you, in its current form, needs vast alteration to bring it into line with these great purposes. The composition of the proposed tax changes in the bill as it now stands are socially unjust, and they are also unsound in purely economic and financial terms. The total amount of stimulus provided is also too small, and involves too limited a concept of the appropriate role of tax policy, spending policy, and monetary policy in achieving the needed economic restoration.

In summary, I respectfully propose that the investment tax credit as set forth in the bill passed by the House be greatly reduced (but for practical considerations, I would suggest its abandonment). I propose that the savings thus accomplished be translated predominantly into tax changes designed directly to enlarge after-tax consumer income and therefore consumer spending, along lines which concentrate all of the new tax benefits upon those in the lower half of the income structure. I propose to the extent that the investment tax credit is retained at all (as it is almost certain to be), that it be applied at least as favorably, and preferably much more favorably, to housing and related commercial construction, especially in urban areas, as to those other sectors of the economy to which it is now intended to apply. I propose that this Committee make such efforts as it can, through tax legislation, to move against the socially unconscionable and economically unsound high rates of interest which now persist, through something akin to an excess interest tax, on the ground that even the most beneficial tax changes can be counteracted by the errors of the current monetary policy. I strongly insist, although this Committee does not deal directly with Federal spending, that no program of tax and monetary change, even along the soundest lines, can restore the U.S. economy, deal with the problem of poverty and income maldistribution, and meet the greatest priorities of our domestic needs, without vast increases in public spending at the Federal level.

I am absolutely convinced that the New Economic Policy of the Administration, even with the relatively slight changes in it made by the House action on the pending tax bill, will prolong the economic stagnation, make no large reduction in idle manpower and plant, result in progressively increased deficiency of action toward serving our great domestic priorities across the board, and contribute further to fundamental inflationary pressure which "freezes" and guidelines can suppress temporarily but not overcome enduringly.

I am firmly convinced that the comprehensive program, tax and otherwise, which I propose in this testimony can and would serve to meet these towering needs of our economy and our people, and also result in far less price inflation in the long run.

Without being prideful, I thing that a fair check list of what I have testified recurrently before this Committee during the past quarter century, and especially during the past 5 to 10 years, would demonstrate, although I frequently represented a minority viewpoint and sometimes stood alone, that I was nonetheless correct, as shown by subsequent event, to a degree justifying attention to what I say here today.

First of all, I should like to offer my quantitative analysis of the tax bill enacted by the House and now before you. My Chart 1 shows the percentage tax cuts offered to various income groups, and then shows the percentage increase in income after taxes which would result, first during 1971–1972, and then permanently. Looking at the precentage tax cuts, these range from 28.4 percent for 1971–1972 and 42.0 percent permanently for those with income under $3,000 to 0.9 percent during 1971–1972 and 1.1 percent permanently for those with incomes over $50,000. But this appearance of progressiveness is entirely superficial and misleading.

What really counts to the tax payer and to the economy is not the percentage tax cut, but the percentage increase in income after taxes. On this basis, the percentage increase in income after taxes is 0.6 percent during 1971–1972 and 0.7 percent permanently for those with incomes under $3,000, and 0.5 percent during 1971–1972 and 0.3 percent permanently for those with incomes over $50,000. Thus, the amount of real tax relief and stimulus to the economy is really extremely small and inadequate, and could hardly be called progressive at all. Indeed, those with income over $50,000 get larger percentage increases in their income after taxes than those with income between $10,000 and $50,000.

It is no answer to this objection to say that one would naturally expect those high in the income structure to receive a higher percentage addition to their after-tax incomes when tax reduction is undertaken, because their tax payments and tax rates are so much greater than among those lower down in the income scale. For such a mathematical exercise has nothing whatsoever to do with the economic and social fact that any and all changes in Federal policies at this time should be directed to helping those lower down in the income scale much more in percentage terms than those higher up in the income scale. And if this cannot be accomplished sufficiently by tax policy, then other policies should be used, as I shall subsequently discuss. Tax policy is not a total tool.

This point is made much clearer, and much more startling, by looking at my Chart 2, which consolidates the effects of all reductions in the Federal personal income tax structure from 1963 through 1973, with the first personal income tax reductions taking place in 1964, and assuming enactment of the House bill in its present form. Looking at the percentage tax cuts, they range from 89.4 percent from income groups under $3,000 to 10.3 percent for income groups over $50,000. But looking more properly at the percentage increases in after-tax incomes, these range from 6.0 percent for those with income over $50,000 to only 5.0 percent for those under $3,000, 5.4 percent for those at $3,000–$5,000, 4.4 percent for those at $5,000–$10,000, 4.8 percent for those at $10,000–$20,000, and 5.9 percent for those at $20,000–$50,000. Thus, Federal income tax change subsequent to 1953 to date has been used to distribute income upward, when it should have been used for the opposite purpose. Moreover, as I shall subsequently show, other forms of tax policy, and policies other than tax policy, have been used to distribute income upward far more grossly than the income tax policy alone has done.

My Chart 3 makes the same point from still a different perspective, by examining the percentages of the total tax relief, in dollar terms, going to various income groups under the bill as enacted by the House. During 1971–1972, those with income under $3,000, comprising 16.1 percent of all tax payers in 1969, would receive 5.3 percent of the dollars of tax relief, while those with incomes over $50,000, comprising only 0.6 percent of the tax returns, would receive 5.2 percent of the dollar relief, or an enormously higher percentage relative to their number.

Permanently, those under $3,000 would receive only 10.5 percent of the dollar relief, while those over $50,000 would receive 9.1 percent of the dollar relief, or somewhere in the neighborhood of twenty times as much as the lowest income group in ratio to their respective numbers. To take another example, those with incomes at $10,000–$20,000 would receive, on a permanent basis, 12.0 percent of the total dollar relief, compared with the 9.1 percent for those above $50,000, even though the lower income group comprise about 50 times as many tax payers on a numerical basis.

My Chart 4 develops the same analysis for the entire period 1964–1973, assuming enactment of the House bill in its current form. Looking at the period as a whole, those with incomes under $3,000 would be receiving only 7.5 percent of the dollar value of the personal tax cuts during the period 1964–1973 as a whole. Those with incomes at $3,000–$5,000 would be receiving 12.4 percent of the total dollar cuts, although they are considerably less numerically than those below $3,000. Those with incomes at $5,000–$10,000 would be receiving 38.3 percent of the total dollar cuts, or more than five times as much as those below $3,000, although they are only slightly above twice as many in numerical terms. Those with incomes at $10,000–$20,000 would be receiving about four times as much dollar tax cuts as those below $3,000, although they are fare less than twice as many in numerical terms. Those with incomes of $20,000–$50,000 would receive in the neighborhood of 25 percent more in dollar tax cuts than those below $3,000 although they are not much more than one-fourth as many in numerical terms. And those with incomes of $50,000 and over would be receiving almost one-ninth as much in dollar cuts as those below $3,000, although they are less than one-twenty-fifth as many in numerical terms. Again I say, the mechanical mathematics of tax cutting is no excuse for transferring incomes in the wrong direction through the taxcutting process. Insofar as taxcutting can go only part of the way toward transferring income in the right direction, other methods should be used.

This position is further fortified by my *Chart, 5* which shows how regressive our nationwide tax system is, when account is taken of all types of taxes, and not merely of Federal income taxes. And this is another unanswerable reason why any and all changes in the Federal income tax now should be only of a highly progressive nature; and doubly so, when the Federal income tax structure itself has been made so much less progressive by the relentless orgy of ill-designed taxcutting since 1964. As Chart 5 shows for 1968, the latest year for which I have comprehensive data, if one looks at Federal income taxes alone, those with incomes under $2,000 paid only 1.2 percent of their income in taxes, while those with $50,000 and over paid 19.8 percent. But when one looks at *all* types of taxes, Federal, State and local, including even payroll taxes, those with incomes under $2,000 paid 50 percent of their income in taxes, while those with incomes of $50,000 and over paid only 45.0 percent, and those with incomes at $2,000–$50,000 paid taxes in ranges of only 30.0–32.8 percent of their incomes. Those at $4,000–$50,000 paid a smaller percentage than those at $2,000–$4,000.

My position is fortified immensely further by looking at the income distribution picture on Chart 6, 1969 being the latest year for which I have comprehensive data. In that year, among multiple-person families, the highest income fifth received 41 percent of total mutiple-family personal income and the highest income two-fifths received 64 percent, while the lowest income fifth received only 6 percent and the lowest income two-fifths only 18 percent. Among unattached individuals in the same year, the highest income fifth received 51 percent and the highest income two-fifths 75 percent, while the lowest income fifth received only 3 percent and the lowest income two-fifths only 11 percent.

Thus far, I have been analyzing the tax situation in terms of Federal personal income tax policy as it bears upon the past and current gross inequalities and inequities in the Federal income tax structure, taking into account only the regular tax rates and no account of opportunities for legitimate avoidance and illegitimate evasion on the part of the higher income groups. Even in this limited perspective, the situation is unconscionable, and calls for "reform" in the true use of that word. But such reform would also contribute to economic performance, and toward restoration of optimum economic growth and maximum employment, production, and purchasing power. This is because, at least since the end of the Korean war to date, the huge deficiency in consumer income and spending, coupled with the propensity of consumers lower down in the income structure to spend immediately a higher proportion and save or invest a lower proportion of their incomes than families higher up in the income structure, has been the predominant explanation of the entire range of economic difficulties which we have experienced, and are still experiencing now. I shall develop this thesis later on in detail, but first I want to turn to a separable aspect of the errors embodied in Federal tax action from 1962 to date, including the current bill as enacted by the House.

My Chart 7 depicts the allocation of the 1971 tax concession granted to investors by the U. S. Treasury earlier in 1971 as modified by the House bill in its present form, plus the tax reductions and concessions embodied in the House bill in its current form. I classify as allocations to investment the portion of the personal tax cuts granted to those with incomes over $15,000 which I estimate they would save for investment purposes; the investment tax credit; the portion of the repealed auto and truck excise taxes which I estimate would be allocated to business use of vehicles; the tax deferral by the Domestic International Sales Organizations; and the ADR system, or changes in Treasury regulations as modified by the House bill. Correspondingly, I classify as allocated to consumption the balance of the personal tax cuts, and the portion of the repeal of the auto and truck excise taxes estimated to be used for vehicles not used for business purposes. On this basis, for the period 1971–1972, with total tax cuts and concessions estimated at 7.8 billion dollars, 4.5 billion are allocated to the investment function, and only 3.3 billion to the consumption function. Looking at the permanent effects in the year 1973 and thereafter, with total tax cuts of 10.4 billion, 7.9 billion are allocated to the investment function, and only 2.5 billion to the consumption function.

In sheer terms of economic effects, for reasons which I have already discussed fully, these allocations are utterly irresponsive to our current and foreseeable economic needs. In the short run, a substantial portion of the allocations to investment will be wasted, or sent overseas or into the stock market, because the current amount of idle plant capacity will not prompt full domestic use of these investment tax concessions until ultimate demand in the form of private consumer spending plus business outlays for goods and services catch up. In the longer run, that is in 1973 and thereafter, the allocations to the investment function of more than three times as much as to the consumption function offer only the prospect of a short and excessive investment boom, followed by the reactions which, as I have already depicted, followed similar mistakes in the tax field during the past decade, and also earlier.

At this point, I should stress again that I have many times, during the past decade, made essentially the same protest against essentially the same mistakes in tax policy, although less egregious than in the current instance. My Chart 8 runs a similar exercise for the period 1962 through 1973, assuming enactment of the House bill in its current form. With 44.4 billion of total tax cuts and concessions during this period as a whole, 15.5 billion dollars were allocated to the investment function, and 28.8 billion dollars to the consumption function. Even this distribution caused the recurrent development of greatly excessive idleness of manpower and plant, accompanied by enormous deficiencies in ultimate demand. This happened a sufficient number of times, and happened so clearly, that I am hopeful that it will prompt this Committee and the Congress to avoid the same mistake again in the form embodied in the bill passed by the House plus the Treasury tax concessions earlier this year.

Nor is this all. The repeated tax-policy mistake allocating far too much to the investment function and far too little to the consumption function has been aggravated greatly by the restrictive Federal spending policy. This has added a great deficiency in ultimate demand in the form of public outlays or public consumption to great deficiencies in ultimate demand in the form of private consumer spending.

As I now come to the economic analysis in support of my conclusion that all new tax policy, and other powerful economic policies, should focus upon direct stimulation of consumption rather than direct stimulation of investment. And first of all in this connection, let us look at where we now stand, and what this imports for national economic policies, including tax policy.

My Chart 9 shows that, as of August 1971, full time unemployment was 6.0 percent, while the true level of unemployment was 8.5 percent. In second quarter 1971, according to my estimates, G.N.P. was more than 17 percent, or almost 200 billion dollars, short of maximum production, based upon projection of where we would have been by second quarter 1971 if we had maintained the maximum goals of the Employment Act from 1953 forward.

My Chart 10 shows that, during 1966-1970, we forfeited 547 billion dollars of total national production through stagnation and recession, measured in 1969 dollars, and forfeited also more than 6 million man-years of employment opportunity. In second quarter 1971 alone, we were forfeiting 3.4 million man-years of employment opportunity. At existing tax rates, we have since 1966 forfeited, very roughly, about 150 billion dollars of Federal, state, and local tax collections, or enough to serve well all of those great priorities of our domestic needs which we say we cannot afford to serve, even assuming defense outays at current levels. During 1971-1980, the chart also shows that, if the real economic growth rate is no better than that averaged during 1953-1970, and I see no better prospects in view of current trends and proposed policies, we will forfeit during this decade, measured again in 1969 dollars, more than a trillion dollars of national production, or an average of more than 100 billion a year, and we will forfeit also almost 22 million man-years of employment opportunity. Equating with these, we will forfeit, at existing tax rates, very roughly, about 250 billion dollars of tax collections at all levels of government.

My Charts 11, 12, 13, and 14 depict balanced goals for the main components of G.N.P. and for employment, as well as balanced goals for a Federal Budget which would help to achieve the fundamental goals, and also serve the great priorities of our domestic needs without sacrificing whatever defense outlays are really desirable in terms of our national security and the worldwide situation. These charts also show that, with this well-rounded performance effort, Federal spending will increase very little relative to total national production, and that over the years we will come immensely closer to a balanced Federal Budget than the outlandish and onerous deficits which we are now progressively suffering through economic default. The purport of this phase of my testimony is to underscore that, without a new Federal spending policy in addition to changes in tax policy, we can come nowhere near achieving full economic restoration, and certainly cannot ever begin to meet the great priorities of our domestic needs. The incontinent orgy of tax reduction, at the expense of almost all else, has failed dismally for many years; if repeated through authorization of the President's New Economic Policy, including its tax aspects, the failure will continue.

Let us now proceed further with my analysis of why the economy has behaved so erratically, averaged so deficient a rate of real economic growth, and spawned so much idle manpower and plant. The core explanation, which has tremendous bearing upon tax policy and pinpoints the errors in tax policy since 1962, are depicted on my Chart 15, which runs back as far as the beginning of 1957, that being sufficient for the purposes of my analysis here today. In each period of so-called "boom," investment in the plant and equipment which add to our productive capabilities ran immensely ahead of the ultimate demand for products in the form of private consumer expenditures plus public outlays for goods and services. When the excess plant capacity endured for so long and became very severe, there were large cut backs in investment. This, combined with the more enduring deficiencies in ultimate demand, brought on the periods of stagnation and recession. During these periods, it was inevitable, and in fact corrective to a degree, that the expansion performance of ultimate demand was greater in absolute terms than the rate of investment growth. But this corrective was never enough, and thus we never got back to maximum production and employment and optimum economic growth. Thus, from the first half of 1966 to the first half of 1971, while ultimate demand grew more rapidly than investment in absolute terms, the latter grew relatively too fast and the former relatively too slow in terms of the requirements for satisfactory economic restoration.

This analysis continues on my Chart 16. During 1960–1966, when the real economic growth rate was high and the unemployment rate was reduced, the distortions appeared which did so much damage later on. Measured in constant dollars, while total national production rose only 34.9 percent, private consumer spending only 32.2 percent, and Government outlays for goods and services only 33.4 percent, private investment in plant and equipment rose 60.1 percent. Thus the advance in our ability to produce was about twice as fast as the advance in private consumer spending and Government outlays, which together constitute ultimate demand. Supporting these disparate trends, corporate profits in real terms rose 46 percent, and personal interest income, used substantially for investment, rose 65.4 percent, while wages and salaries rose only 33 percent and farm proprietors' net income only 23.6 percent. These trends explain the stagnation and recession thereafter, accompanied by accelerating inflation for the reasons already stated.

From 1966 to second quarter 1971, total national production and ultimate demand in the form of private consumer spending and public outlays rose more rapidly than private investment in plant and equipment, and wages and salaries rose while corporate profits declined. Farm income fell sharply. This always happens during the "corrective" process occasioned by stagnation and recession, following relative excesses in investment and profits at the expense of consumption and wages. But the "corrective" process has not yet gone far enough, as must be manifest from the huge idleness of manpower and plant even today. The footnote to my Chart 16 shows that, during the most recent year, the total economy ha grown far too lowly and the real growth rate in wages and salaries of 1.9 percent is blatantly out of line with the 6–7 percent real growth rate which would be required to support the necessary real growth rate in the total economy, to get us toward reasonably full resource use.

Meanwhile, during this twleve-month period, investment growth was negative, but we still have 25–30 percent idle plant. Corporate profits began to move up again, and are now moving up more rapidly, even though business now has ample funds to support the amount of investment needed until consumption and public outlays catch up. It follows that, in purely economic terms, a "freeze" on wages for a quarter of a year was entirely unsound, and doubly so without control of investment and profits, and no equal control even of price movements.

The proper policy for the months and year ahead would be to focus on vast increases in consumer incomes and spending, and also on Federal spending for priority needs. This would, in line with all previous experience, reactivate private investment and business profits to adequate or even overebullient levels.

My Charts 17 and 18 provide additional confirmation of my general thesis. Chart 17 shows that, during 1960–1966, when the real rate of economic growth was high and when idleness of manpower and plant were reduced greatly, profits after taxes and investment in plant and equipment grew enormously more than wage rates in total manufacturing and other key sectors in the economy. It follows that the price increases during this period, far from being occasioned by wage rate trends, were for the most part unjustifiable, and that such price declines as occurred in some sectors were not nearly big enough.

My Chart 18 reviews the record from 1966 to second quarter 1971, and also during the twelve months through second quarter 1971. In total manufacturing from 1966 to date, wage rates grew much more rapidly than profits after taxes or investment, for reasons already stated. But considering the amount of idle plant and manpower, wage rates were growing too slowly for economic restoration, while the profits supporting investments were ample in view of the amount of idle plant. This means that the huge price advances were unjustified in the main. During the most recent twelve-month period reviewed, profits after taxes grew more rapidly than wage rates, despite the fact that the investment growth rate was negative, this last trend being entirely acceptable in view of idle plant and manpower. Essentially, the trends in the various key sectors depicted are consistent with those in total manufacturing. The main thrust of this Chart 18 is that current price levels are more than high enough to support a fantastic rate of investment and profits if the economy is restored to reasonably full resource use, and that the rate of real wage advance during the most recent year has been far below the rate needed toward this restoration.

My Charts 19, 20, and 21 depict the enormous size of the consumption deficiency in second quarter 1971 (and also the size of the wage deficiency as the main element in consumer spending). In this quarter, at an annual rate, according to my careful and empirical analysis, the deficiency in wages and salaries came to 81.9 percent of the deficiency in consumer income before taxes, and the deficiency in consumer spending came to 38.6 percent of the deficiency in total national production. The absolute deficiency in gross private investment was also very large, but a major portion of this was the deficiency in priority investments occasioned in large measure by the restrictive policies, while the absolute deficiency in plant and equipment investment was induced entirely by the deficiency in ultimate demand, and would be cured entirely by the restoration of adequate ultimate demand.

Another lopsided consequence of the emphasis upon investment at the expense of consumption is this: It has defeated one of the very purposes sought to be obtained, namely, promotion of higher productivity gains in the economy.

My Chart 22 shows the long-term tendency of productivity gains over the decades to accelerate greatly under full resource use, but to decline enormously when stagnation and recession set in. The average annual rate of productivity gains in the U.S. private economy was 4.1 percent during 1947–1953 and 3.8 percent during 1960–1966, but became very low from 1966 forward when the contraction of the real economic growth rate set in, and averaged annually only 0.8 percent during 1968–1970. In other words, a national policy favorable to investment at the expense of consumption has torpedoed productivity growth.

It is also important to note the connection between the productivity issue and the consumption-wage issue. This is shown on my Chart 23. During 1960–1966, when the rate of real economic growth was high and unemployment was reduced from 5.5 percent to 3.8 percent, productivity in the total nonfarm private economy increased at an average annual rate of 3.4 percent, while real wages and salary rates per hour grew at an average annual rate of only 2.7 percent. In manufacturing, the distortion was even more severe, when the figure for productivity gains was 3.8 percent, and for wages and salaries only 2.0 percent. These disparities were a signal factor in the lag of consumption behind the growth in our ability to produce, substantially through the investment process which helped to enlarge productivity gains. This was the prime reason for the economic troubles which accelerated from 1966 forward and are still with us. The tax policies prior to 1966, which aggravated the investment imbalance, must share a large part of the blame.

During 1966–1970, as the same Chart 23 shows, with the average annual rate of real economic growth being more than cut in half, and with unemployment increased from 3.8 percent to 4.9 percent, the average annual increase in productivity fell to 1.2 percent, while wage and salary rate increases averaged annually 2.7 percent. In manufacturing, the figures were 1.9 percent and 2.1 percent, respectively. During this period, with the productivity gains repressed by economic stagnation and repression, real wage grew faster than productivity gains. But they did not grow fast enough to support the consumption expansion needed for economic restoration. Wage and salary real rate gains should increase faster than productivity gains when there is huge idleness of manpower and plant.

From second quarter 1970 to second quarter 1971, with the beginnings of economic recovery, but in a very faint and uncertain way, the average annual rate of productivity gains in the private economy and in manufacturing exceeded considerably the average annual rate of real wage and salary gains on an hourly basis. This is one of the most serious aspects of the current situation. For even while productivity gains are even now less than they should be, the proper method of lifting them to their full potentials is to lift real wage and salary gains sufficiently so that consumption will expand enough for full use of plants and manpower. With profit margins per unit where they are now, this in itself would provide ample or even excessive investment and profits, even with the prices in general staying where they are now.

But the New Economic Policy of the Administration is following the opposite course. It is seeking to bring productivity gains higher, first by freezing wages, and then by restricting them unduly, a self-defeating course even as to productivity gains, for they will not be satisfactory in an underconsuming and therefore stunted economy. The Administration is also seeking to increase investment and production capabilities by favoring the investment process at the expense of consumption, and favoring high income consumers who invest as against lower income consumers who spend all or more of their incomes for direct consumption. This is a terrible mistake.

The tax program recommended by the President is an aspect of this mistake. The tax bill passed recently by the House is not quite so bad, but it is not nearly good enough. The efforts of the President to compensate for the tax reductions by a restrictive Federal spending policy adds further to the prospects for continued stagnation and intolerably high unemployment of manpower and plant. Neglect of the great priorities of our domestic needs is explicit in the Administration's policy, and not yet sufficiently corrected by the Congress. And there are other mistakes in national economic policies, aside from tax and spending and wage-price policies, to which I will discuss shortly.

Despite these stark facts, we still hear it said that the New Economic Policy will bring about the needed expansion by restoring confidence. Undoubtedly, for a few weeks, the "freeze" restored almost everybody's confidence, just like the 32-point rise in the stock market the first day after the "freeze." But since then, the market has declined a great deal, I think probably reflecting the unfavorable fundamental business reports during the past few months, and this very month. Restoration of confidence requires, first of all, a large reduction of unemployment. And this cannot result without much more stimulative policies.

Further, the belief that consumers will save much less and spend much more when confidence is restored ignores the distribution of saving. My earlier Chart 6 demonstrated the intolerable maldistribution of income in the U.S., which indeed has worsened during the most recent years. It has worsened in consequence of many errors in national policy, including tax policies whose adverse effects upon economic performance have hurt distribution far more than the mere changes in tax rates. The distribution of saving is even worse than the distribution of income. The people in the high income groups, in the main, are not going to increase their spending much. The people in the lower income groups are not going to be able to increase their spending much, until the economy picks up speed first, and unemployment is greatly reduced, and real wage rates and incomes go up considerably. In this connection, those who say that we should put reemployment ahead of real wage-rate increases of those already employed, forget that greatly increased real incomes among those already employed is a condition precedent to greatly increased employment.

But whatever we may do to correct the recent and current tax and spending policies, this will not be sufficient, without complete abandonment of the prevalent monetary policy of tight money and rising or fantastically high interest rates. This policy has turned out to be an economic monstrosity and a social crime. To be sure, there have been some downward undulations in interest rates since 1953 and during the past year; but these have been negligible when measured against previous increases. For the average family seeking to finance a home, an effective 7½ percent rate is hardly any better than an effective 8½ percent interest rate: the needed interest rate is 4½ percent. The so-called housing boom today is not sustainable. It is saturating the market for high and middle-income groups, and is doing virtually nothing to clear slums or restore our cities.

As shown on my Chart 24, recurrent contractions in the growth of the money supply, and consequently higher interest rates, have been "successful" in their contrived intent to stunt the economy and to increase idleness of plant and manpower. This process in itself, for reasons already indicated, has greatly accelerated inflation. Further, an increase in the cost of borrowed money is an increase in the cost of doing business or an increase in the cost of living, and both of these are inflationary by very definition. Utility regulatory commissions throughout the nation are now necessarily increasing the cost of energy for every factory and home because the utilities are financed largely out of bonded indebtedness, and their current borrowing is at 7.5-8.5 percent, where it used to be 5-6 percent. The same principle applies to housing.

My Chart 25 shows that the average interest rates on total private and public debt more than doubled from 1952 to 1970, involving an aggregate increase in interest cost of more than 400 billion dollars, imposed upon borrowers both private and public. This is just 400 billion dollars of inflation plus income redistribution upward.

My Chart 26 shows that, in 1970 alone, the excess interest cost in the Federal Budget amounted to 8.2 billion dollars, even while those who have deliberately increased these interest costs in the Federal Budget proclaim erroneously that the increase in the Federal deficit is the main cause of inflation. As the chart shows, the 8.2 billion dollars excess interest cost in the Federal budget in 1970 was two to four times as high as the outlays in the same Budget for some of the most important of our domestic priorities which are being so severely starved.

As my Chart 27 shows, if the economically unsound and socially vicious redistribution of income upwards through rising interest rates had been abandoned in favor of retaining the same amount of dollars toward the reduction of poverty, we could bear the total cost of wiping out poverty completely at an annual cost coming to only a fraction of the cost of the rising interest rates.

Meanwhile, those who want to clamp down on so-called wage inflation, contend that interest rates should not be controlled. One has nothing to do with the other, for whatever may be done in future about interest rates, they have been and now are traditionally controlled by the Federal Reserve System. The only question is for what purposes they should be controlled. The Congress should enact very large rollbacks in the interest rates charged, at least with respect to the financing of the great domestic priorities. The Federal Reserve System should be controlled by the President and the Congress, because it is absurd to say that the money power of the nation should be in independent hands, even while there are so many who seek to transfer from private to public hands the making of prices and wages, and thus to rob our economic system of one of its prime sources of strength and enterprise.

The question may be raised as to why I am discussing monetary policy before this Finance Committee. In the first place, I am firmly convinced that we cannot have an effective tax policy without considering the entire range of our economic problems, and of our national economic and social policies designed to deal with them. In the second place, the role of tax policy, in allocating resources and its impacts upon income distribution, cannot be properly appraised, nor the proper tax policies determined upon, without looking at the other great national economic policies, including monetary policy, which so profoundly affects the allocation of resources and the distribution of income. To put this in a nutshell, our recurrent monetary and tax policies really both represent the mistake of watering the economic tree at the top rather than the bottom—a policy that has been ghastly in its consequences whenever it has been tried. In the third place, even well-shaped tax reductions would continue to be thrown down a rat hole, so long as the current monetary policy persists in promoting economic stagnation and recession, high unemployment of manpower and plant, and the further maldistribution of income. In the fourth place, while it is not a very artistic proposal, I propose that this Committee give very serious consideration to whether tax policy might not be used against the unbearably high interest rates of today, and still in prospect. An excess interest tax is quite as feasible, and at times quite as desirable, as an excess profits tax.

Thus far in my testimony, I have been urging more stimulation of consumption and less stimulation of investment. Although not nearly all of this result may be obtained solely by the tax legislation before you, the main thrust of my argument is that the investment tax credit as enacted by the House should be reduced greatly (but for practical considerations, I would urge the desirability of eliminating it entirely at this time), with the savings thus obtained applied to the direct stimulation of consumption.

However, the bill now before this Committee could also be improved very greatly by changing the impact of the investment tax credit itself. Two years ago before this Committee, I pointed out the high undesirabilty, on all economic and social grounds, of continuing through tax policy and other national economic policies to discriminate so severely against housing and related commercial construction in urban areas. Despite two years of additional experience which have yielded additional demonstration of how right I was in 1969, the current House bill commits the same error again. It proposes a large investment tax credit, in some instances where only a small one is needed and in most instances where none is needed at all, and does not extend that tax credit to investment in housing and related commercial construction, especially in urban areas.

The utter lack of wisdom of this policy is demonstrated by my *Charts 28–35*. Despite widespread misinformation to the contrary, neither the housing industry nor the related commercial construction industry have enjoyed exorbitant nor even adequate profits in the main; and meanwhile they have been subjected persistently to grossly discriminatory treatment by the Federal Government with regard to tax and subsidy policy. Time prevents me from going into these matters in detail, but some comment is essential.

My charts show that, despite the current boom in home construction for middle and higher income families, the recent years have witnessed a very dangerous decline in investment in housing and commercial construction, whether measured as a percent of total national production or as a percent of gross private domestic investment. They show that, during 1970–1980, to meet balanced goals for economic and social development in accord with priorities already announced by the Federal Government, investment in residential and commercial structures needs to advance an average annual rate of 9.4 percent in real terms, contrasted with an average annual rate of advance of 5.5 percent for G.N.P. and 4.8 percent for investment in producers' durable equipment. They show that, in ratio to total fixed investment, investment in commercial and residental structures needs to be lifted from 34.8 percent during the first half of 1971 to 38.7 percent in 1980. They show that housing and commercial construction have been egregiously shared out of Federal benefit programs in the form of depreciation and depletion allowances, and in the form of Federal subsidy programs. This was notoriously true of the so-called Tax Reform Act of 1969; and, in its current stage in the Congressional process, investment tax credits are contemplated for nonregulated industry and for the utilities, but not for housing and other aspects of real estate investment.

Measured by all fair tests, the income accruing to real estate has compared very unfavorably with that accruing to other key sectors, and these activities have been hurt much more than other sectors by tight money and rising interest rates. It follows conclusively that no direct controls should be imposed upon housing and supportive real estate investment in urban areas.

Deficiencies in housing and commercial construction have accounted for a tremendous proportion of the deficiencies in total national production and employment during recent years, and threaten to repeat the same performance during the years ahead unless these activities are stimulated much more greatly than they have been to date.

It follows that whatever investment tax credits are granted by this Committee and by the Congress should not continue to discriminate against housing and commercial construction. To the contrary, an investment tax credit for these purposes is more desirable by far than for any of the purposes that would be abetted by the House bill in its current form.

Throughout my testimony, I have stressed the need for expansionary measures on all fronts—tax, spending, and monetary—far beyond any now under active consideration, and almost diametrically opposed to the *New Economic Policy* of the Administration. Why would such a course not add to inflationary pressures?

The answer is that efforts to contain inflation since 1966 to date have been based upon the so-called "trade-off," the idea that deliberately contrived idleness of manpower and plant will reduce inflationary pressures. Strangely, the "trade-off" is still embedded in the *New Economic Policy*, with its paucity of expansionary policies on net balance. But the "trade-off" has already failed disasterously, because it is really based upon the causes of inflationary pressures during earlier periods when the economy was running too fast in real terms, and when all of our productive resources were greatly overstrained. The recurrent inflation since 1953, and especially since 1966, has had absolutely no causal similarity to the inflation during either World War II or the Korean war. This new inflation has never appeared when our resources were overstrained, but on the contrary, has appeared and accelerated as our resources became more and more idle. The reasons for this may be shown by a simple analogy.

An automobile burns more gas per mile, and therefore operates less efficiently, when it is running at 90 miles an hour than when it is running at 50 miles an hour. But is also burns more gas per mile when running at 20 miles an hour than at the optimum speed of 50, because it is inefficient to go too slow as well as to go too fast. In precisely the same manner, just as the U.S. economy growing at the forced pace of 9 percent per year in real terms during World War II generated inflationary pressure, so the U.S. economy growing at the abysmally low real annual rate of 2 percent generates more inflationary pressures when the economy is in reasonably full use than at an average annual growth rate of bout 5 percent in real terms. I have been insisting upon this since the early 1950's, based upon empirical observation of the realities of the American economy in action. But most of the economists have been so bound up in their textbook diagrams, or so prone to fight the last war instead of to observe what is actually happening under their noses, that they perpetrated, and still perpetrate, the absolute nonsense of the so-called "trade-off."

It follows that, unless we quickly get the economy running at the optimum growth rate, about 7 percent a year in real terms until maximum production and employment are restored, and about 5 percent thereafter, voluntary controls will not stop excessive inflation, and direct controls will merely suppress it at unbearable costs in terms of idleness of plant and manpower.

My Chart 36 brings the entire experience to light, with respect to the new inflation and the "trade-off." It depicts fully the periods from 1952 through second quarter 1971, selecting the main periods characterized by low or declining plant and manpower use and high or rising plant and manpower use. It demonstrates an inverse rather than a positive correlation between these trends and the amount of price inflation. To take only the most striking examples: During 1958–1966, when the real rate of economic growth averaged annually 4.9 percent, and when unempolyment was reduced from 6.8 percent to 3.8 percent, the average annual increases were 1.5 percent for consumer prices, 0.7 percent for wholesale prices, and 0.6 percent for industrial prices. But during 1966–1970, when the average annual rate of real economic growth was reduced to 2.3 percent and when unemployment rose from 3.8 percent to 4.9 percent, the average annual inflation was 4.6 percent for consumer prices, 2.6 percent for wholesale, and 2.8 percent for industrial. During the twelve-month period from second quarter 1970 to second quater 1971, when the real economic growth was only 2.4 percent, or not enough to work down the idleness of plant, and when unemployment rose from less than 5 percent to about 6 percent, consumer prices adavnced 4.4 percent, wholesale rose 3.4 percent, and industrial rose 3.7 percent.

These incontestable figures render ridiculous the presistent claim that runaway inflation as late as early 1971, and indeed up to the "freeze," was due to mistakes made by not increasing taxes in 1966 when Vietnam spending increased. For at that very time in 1966, the rate of economic growth was already declining, and sharply increased taxes would merely have accelerated the process which has been going on since then. Nor do I see the logic of most of the economists who today assert that increased taxes in 1966 would have stopped the inflation which occurred in 1969–1971, when they are now admitting that fiscal restraints do not get at the new type of inflation. And if these economists do believe that fiscal restraints are the main break against inflation, which is their reason for blaming the most recent inflation on what was done or not done in 1966, why then have most of them argued for tax reductions from 1969 forward, in the face of rising inflation? The contradiction which characterizes what is going on now explains the complete misdirection of current thought and action.

Viewing the entire experience from 1953 to date, these two things are clearly irrefutable, as I stated at the outset: *First*, if we now use fiscal and monetary policies, and the wide range of other public policies of a traditional nature, to speed up to the maximum the rate of employment and production, we would achieve without any direct control whatsoever, and even without voluntary Guidelines, the very reasonable degree of price stability which we achieved several times since 1952 when we moved in these directions. *Second*, if we do not follow this course, whatever kind of so-called controls we are likely to get cannot suppress for long the resurgence of the new type of inflation, and we will again get the worst of all possible worlds by all sensible tests.

My policy conclusions are quite thoroughly revealed by what I have thus far said, but I will now summarize them.

(1) The current tax bill as enacted by the House should be drastically revised. The investment tax credit should be substantially reduced, and indeed I believe it an unwise proposal in its entirety. As a practical matter, since some investment tax credit appears certain, it should be granted to housing and commercial construction, especially in urban areas, at least as favorably and preferably more favorably than its application to other forms of investment. The savings which would be achieved by reducing the investment tax credit should be used entirely to provide personal tax benefits to those in the lower half of the income tax structure, and benefits for those in the lower half should also be substituted for the tax benefits now being contemplated for those in the upper half of the structure. These changes would involve no net change in the

total tax take on paper, and they would greatly increase the tax take in actuality by promoting a much real higher rate of real economic growth;

(2) Whatever may be in the range of practical action on the tax side, Federal spending should be greatly increased, to a calendar 1972 level about 38 billion dollars above the level proposed originally in the President's original Fiscal 1972 Budget (measurement in fiscal 1972 dollars). This is required toward full economic restoration by the end of 1972 at the latest. With such full restoration, the ratio of Federal spending to total national production is estimated at 22.8 percent in calendar 1972 contrasted with 20.5 percent estimated for fiscal 1972 under the President's program for the economy and the Budget. But the vast increases in total national production would set us toward that balanced Budget which economic stagnation cannot possibly achieve. In addition, much of the increased Federal spending could be covered by lifting some of the personal tax rates in the high income brackets and some of the corporate tax rates which were excessively reduced during the 1960's, and by closing the worst loopholes;

(3) The policy of tight money and extremely high interest rates should be drastically reversed by Congressional legislation. Interest rates applicable to the great domestic priority programs should be rolled back 30–50 percent. The Federal Reserve System should be brought under the effective control of the President and the Congress. Consideration should be given to an excess interest tax, in view of the proven reluctance to achieve the needed remedies through other methods;

(4) Both the wage-price "freeze" and the policies now indicated to follow it are extremely repressive of the consumption expansion required for economic restoration, and are also highly inequitable. As economic stagnation generates more inflationary pressures than a full economy, and because the temporary suppression of inflation through controls is not a substitute for more solid and enduring remedies, we would be better off if neither the "freeze" nor "voluntary" controls had been brought into the picture, and if all efforts had been concentrated upon full economic restoration instead of resorting to extremely inadequate efforts in this direction. But since some economic controls are on the way after the "freeze," wage rate gains should be related to the gains in productivity registered when the economy was in full use, plus partial allowance for cost of living adjustments not yet achieved, plus full allowance for any further cost of living advances. Prices in the main should be held stable, because in general *per unit* profit margins are now large enough to cover the policy I suggest and to promote levels of investments and profits sufficient to be compatible with any levels of ultimate demand which are actually achieved;

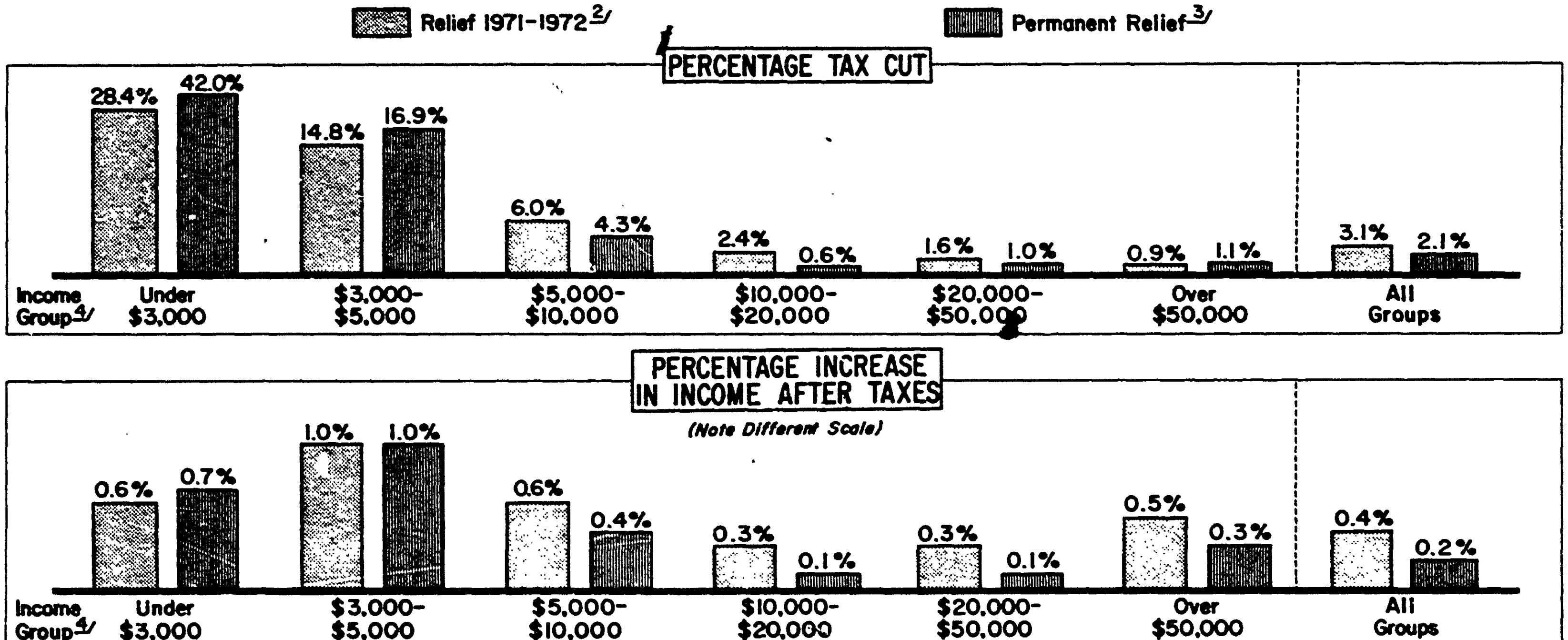
(5) Profit control is best effectuated through tax policy. I have indicated the desirable tax policy. Although an excess profits has some undesirable aspects, it should be enacted if any kind of "tough" wage and price restraints are put into effect, in order to make the whole public feel that its treatment is fair and equitable;

(6) The necessary expansion of consumer spending cannot come entirely through Federal tax and spending policies. Social security benefits should be increased greatly, with the increases financed through progressive taxation. A universal system of welfare should promptly be enacted, more liberal than that proposed by the Administration. Enlarged Federal aid should be extended to the cities, with appropriate priority strings. Much greater efforts are necessary to restore the farm and rural situation; replace obsolete transportation systems; deal with pollution problems; and bring educational health, and housing facilities and services into line with goals vigorously announced but never pursued;

(7) The confusion of helter-skelter and improvised Federal policies and programs should be replaced with a unified national economic and social policy and program under the Employment Act of 1946. The first step toward this is development of a long-range U.S. Economic and Social Performance Budget by the Council of Economic Advisers, and promulgation of it by the President through his Economic Report to the Congress under the Employment Act of 1946. As I have described this Performance Budget in detail to this Committee and to others on many occasions, it seems unnecessary for me to do so again at this time.

Again, I thank the Committee for this opportunity to be heard, and hope that my testimony will be of use to it in its momentous deliberations and decisions.

HOUSE BILL, PERCENTAGE TAX CUT AND PERCENTAGE INCREASE IN INCOME AFTER TAX, VARIOUS INCOME GROUPS [1]



1/ Excluding impact on personal taxes of removing first year convention from ADR system.

2/ Relative to taxes and incomes during 1971-1972 under present law.

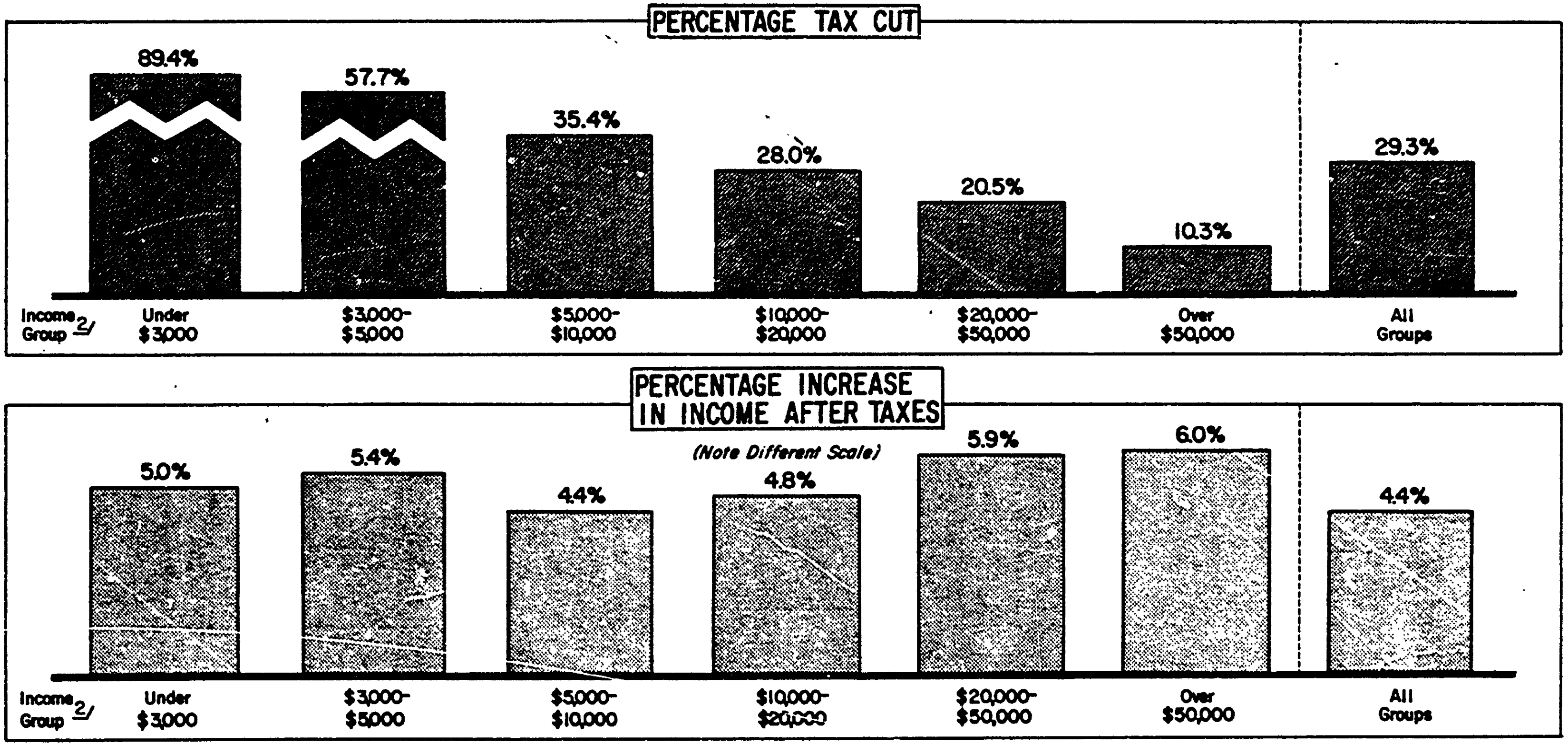
3/ Relative to taxes and incomes during 1973 under present law. Note that taxes under present law will be lower in 1973 than in 1971-1972, so that a larger percentage cut in 1973 may result from a smaller decrease in the absolute tax liability, and thus yield a smaller increase in after-tax income.

4/ Adjusted gross income class.

Basic Data: House Report No. 92-533, accompanying H.R. 10947

Chart I

PERCENTAGE TAX CUT AND PERCENTAGE INCREASE IN INCOME AFTER TAX, VARIOUS INCOME GROUPS, 1963-1973[1]



1/ Effects due to changes in personal tax under Revenue Act of 1964, Tax Reform Act of 1969, and present House Bill (excluding from the House Bill the effect on personal taxes of removing the first year convention under the Asset Depreciation Range system).

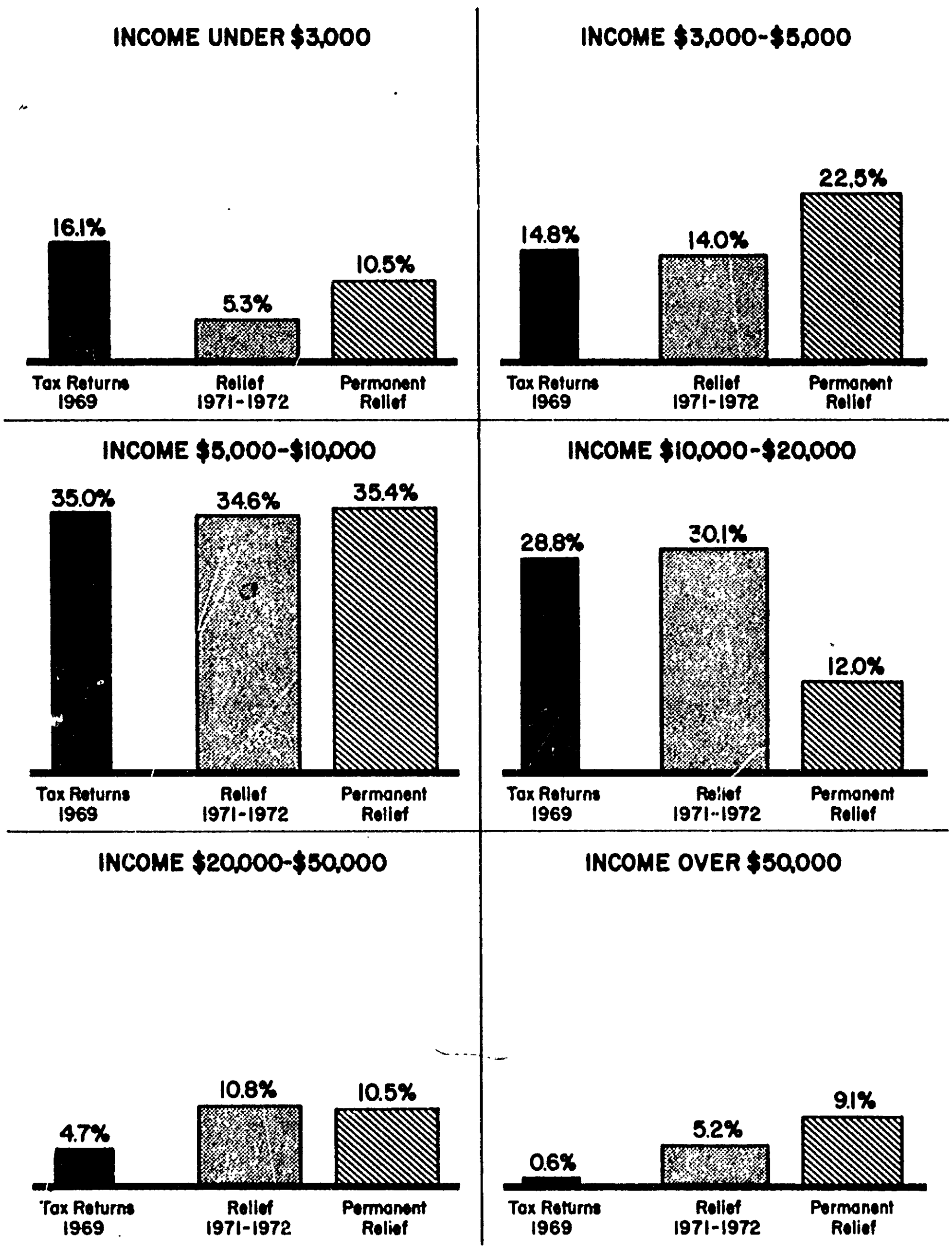
2/ Adjusted gross income class.

Basic Data: House Ways and Means Committee and Senate Finance Committee Reports, accompanying various bills

Chart 2

Chart 3

PERCENTAGE DISTRIBUTION OF TAX RETURNS, 1969[1] AND OF PROPOSED TAX CUTS IN HOUSE BILL[2] AMONG VARIOUS INCOME GROUPS[3]



1/ All 1969 individual income tax returns (latest year available): Treasury Dept., Internal Revenue Service, Statistics of Income.

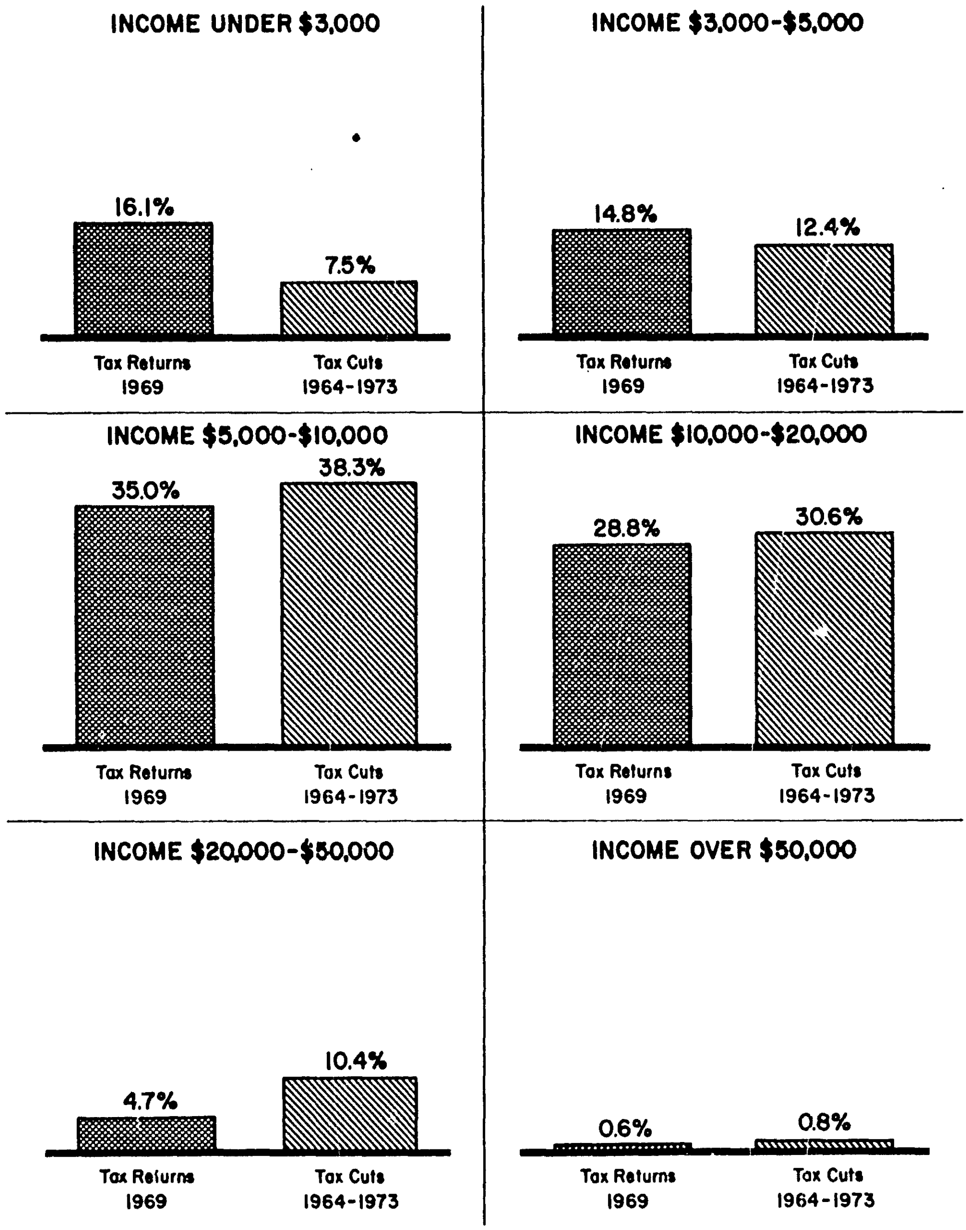
2/ The Revenue Act of 1971, H.R. 10947. Chart excludes impact on personal taxes of removing the first year convention from the Asset Depreciation Range System.

3/ Adjusted gross income classes.

Basic Data: House Report No. 92-533, accompanying H.R. 10947

Chart 4

PERCENTAGE DISTRIBUTION OF TAX RETURNS, 1969 AND OF TAX CUTS, 1964-1973[1] AMONG VARIOUS INCOME GROUPS[2]



1/ Weighted average of percentage distributions of tax cuts in Revenue Act of 1964, Tax Reform Act of 1969, and present House Bill. Weights are relative size of three tax cuts, each expressed as a percentage of total personal income: 1.93 percent for 1964, 0.99 percent for 1969, and 0.32 percent estimated for 1971.

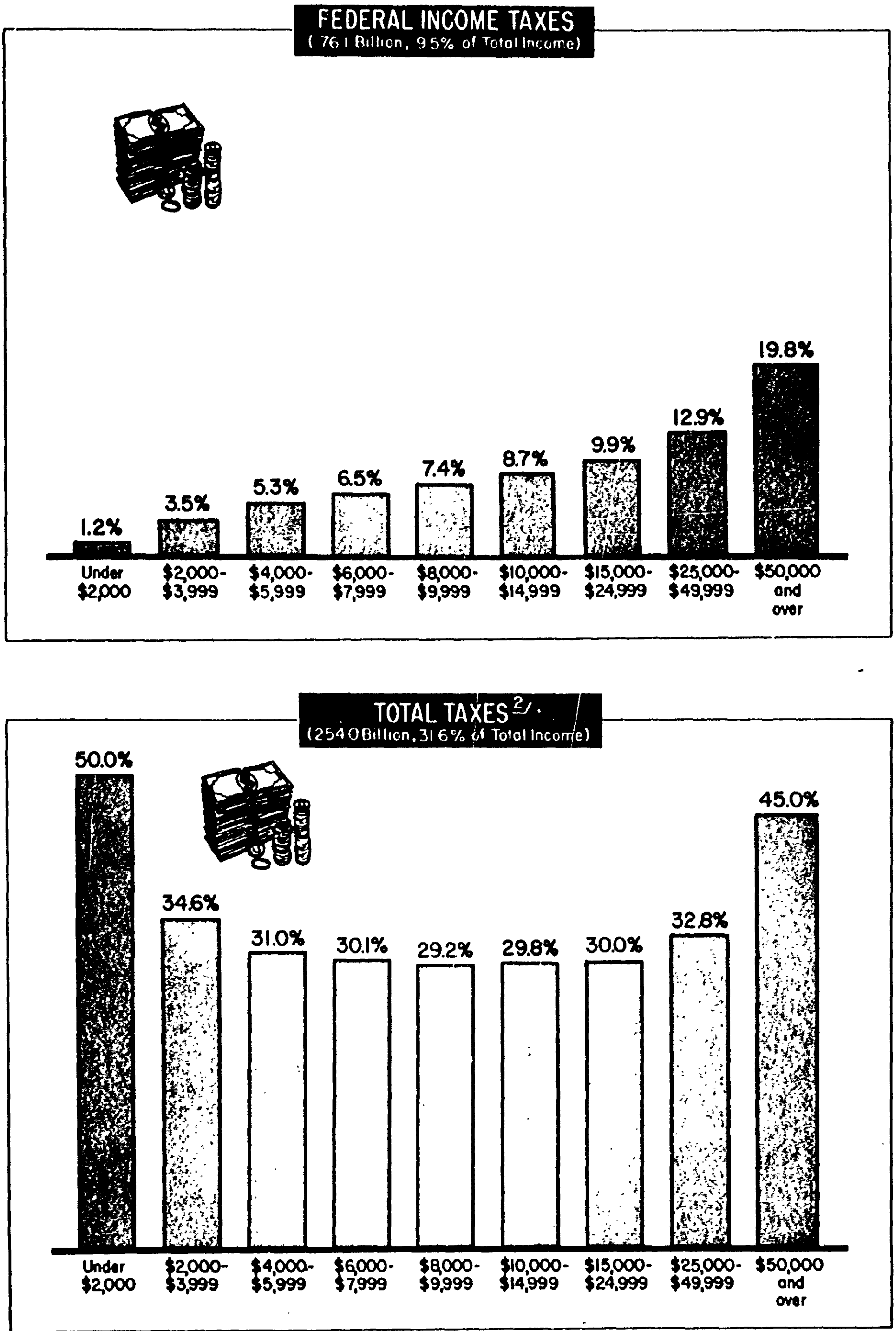
Tax cuts in each bill are net permanent effect, ignoring any phase-ins and (in the present House Bill) accelerations of previously scheduled tax reductions.

2/ Adjusted gross income classes.

Basic Data: House Ways and Means Committee and Senate Finance Committee Reports, accompanying various bills.

Chart 5

TAXES PAID AS % OF INCOME, U.S. 1968 1/



1/ Income relates to total income of all persons in the adjusted money income classes shown. Total income is adjusted money income, plus imputed income, less direct taxes, plus retained corporate earnings, plus taxes minus transfer payments, plus realized capital gains.

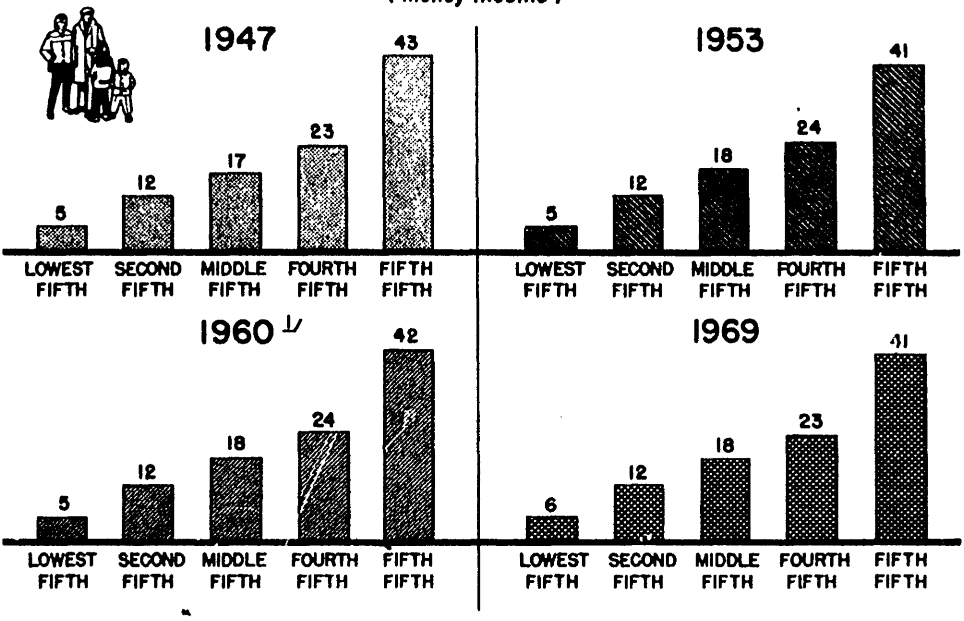
2/ Includes the following Federal and State and Local taxes: Individual income, estate and gift, corporate profits, and social security. Also includes Federal excise and customs taxes, and State and Local sales taxes, motor vehicle licenses, property taxes, and miscellaneous other taxes.

Basic Data: Dept. of Commerce, Bureau of the Census

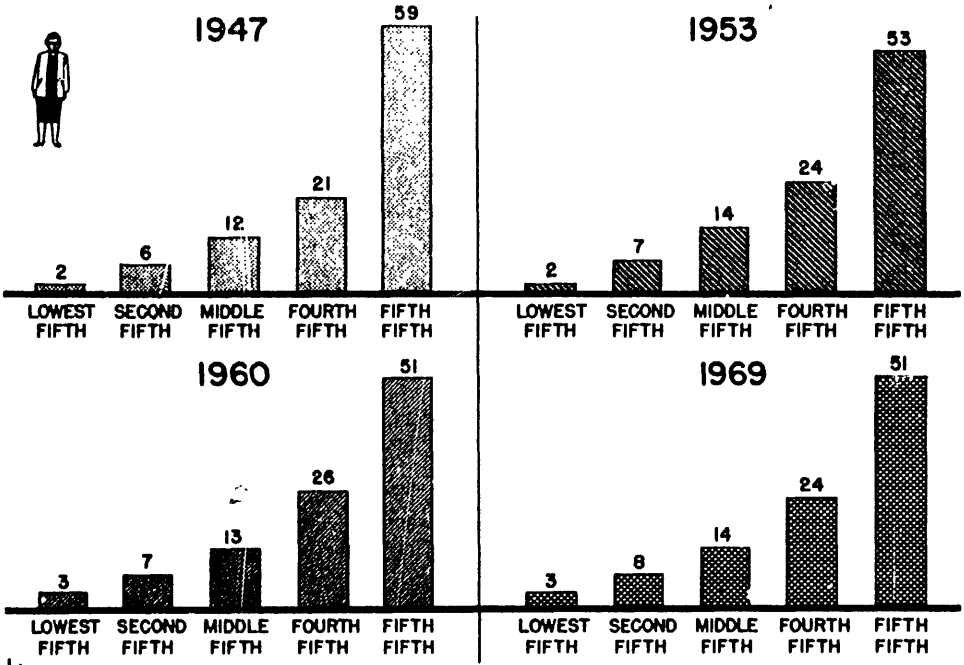
Chart 6

SHARE OF FAMILIES IN TOTAL FAMILY INCOME BY QUINTILES, 1947, 1953, 1960, and 1969

(Money Income)



SHARE OF UNATTACHED INDIVIDUALS IN TOTAL INCOME OF UNATTACHED INDIV., BY QUINTILES, 1947, 1953, 1960, and 1969

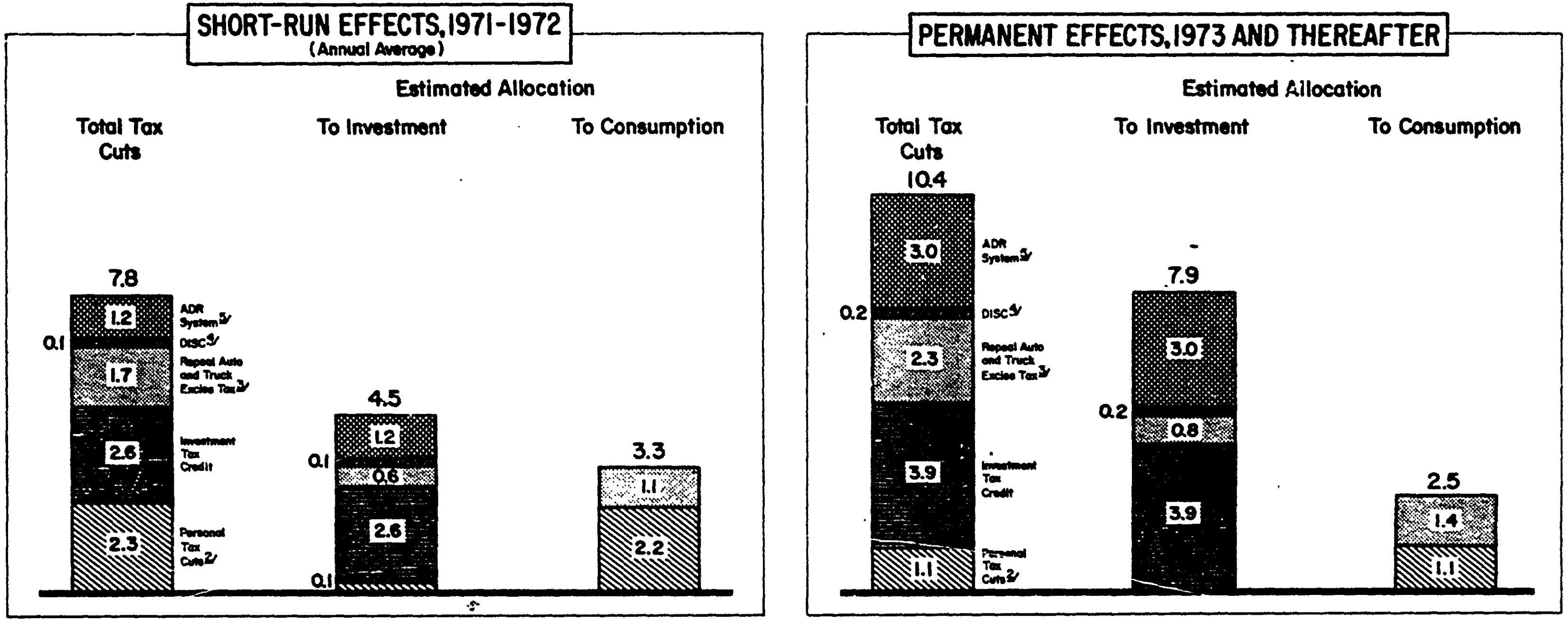


1/ Figures do not add to 100, owing to rounding.

Data: Bureau of the Census.

ALLOCATION OF 1971 TAX CUTS[1/]
BETWEEN INVESTMENT AND CONSUMPTION

(Billions of Dollars)



1/ House Bill (H.R. 10947) and Asset Depreciation Range (ADR) System promulgated by the Treasury Department.

2/ Allocation to investment based on portion of cuts for those with income over $15,000, which they would save; remainder allocated to consumption.

3/ Allocation between investment and consumption based on business or nonbusiness use of vehicles.

4/ Tax deferral by Domestic International Sales Corporations (DISCs).

5/ Treasury regulations as modified by the House Bill.

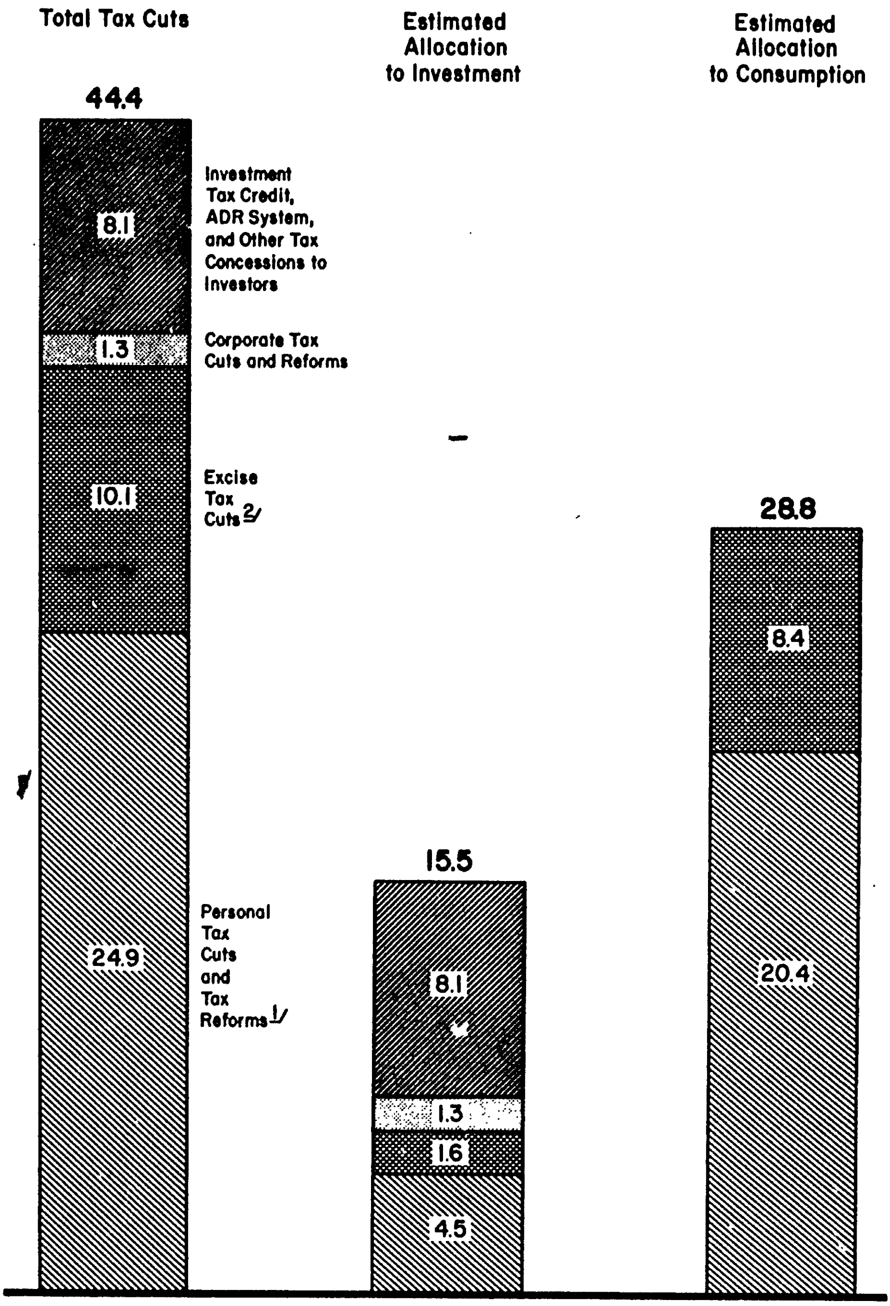
Note: Components may not add exactly to totals, owing to rounding

Chart 7

Chart 8

ALLOCATION OF TAX CUTS, 1962-1973 BETWEEN INVESTMENT AND CONSUMPTION

(Billions of Dollars)



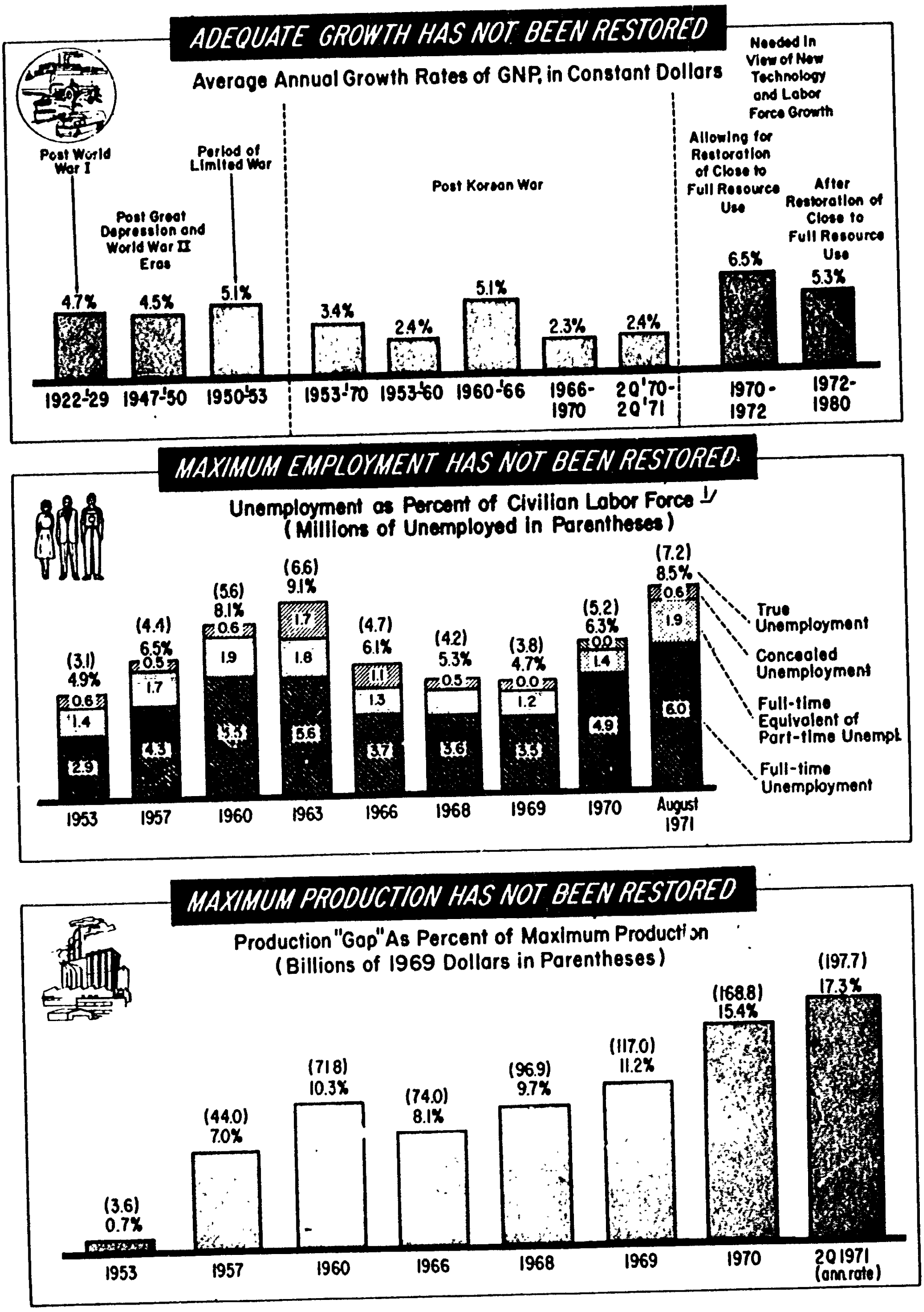
1/ Allocation to investment based on estimated saving by those with high incomes.

2/ Allocation to consumption based on amount estimated to be passed on to purchasers of goods for nonbusiness use.

Note: Components may not add to total owing to rounding.

Chart 9

BASIC U.S. ECONOMIC TRENDS, 1953- 2nd Q 1971



1/ In deriving these percentages, the Civilian Labor Force is estimated as the officially reported Civilian Labor Force augmented by concealed unemployment. Thus, some of the percentage figures on full-time unemployment vary very slightly from the official reports, which do not take account of the augmented labor force. Full-time unemployment of 2.9% and true unemployment of 4.1% would be consistent with maximum employment. All data relate to persons 16 years of age and older. Components may not add to total, owing to rounding.

Basic Data: Dept. of Commerce; Dept. of Labor

Chart 10

COSTS OF DEFICIENT ECONOMIC GROWTH U.S. ECONOMY, 1960-1970 AND 1971-1980

(dollar items in billions of 1969 dollars)

1960-1970

Total National Production (GNP)	Man-years of Employment 2/	Personal Consumption Expenditures	Gov't Outlay for Goods and Services
1960-1966: $557.9 1966-1970: 547.1 2Q 1971: 197.7	1960-1966: 21.1 Million 1966-1970: 6.1 Million 2Q 1971: 3.4 Million	1960-1966: $285.4 1966-1970: 225.4 2Q 1971: 76.3	1960-1966: $125.2 1966-1970: 138.1 2Q 1971: 61.1
Private Business Investment (Incl. Net Foreign)	**Average Family Income**	**Wages and Salaries**	**Unincorporated Business and Professional Income**
1960-1966: $147.3 1966-1970: 183.5 2Q 1971: 60.3	1960-1966: $5,733 1966-1970: 4,569 2Q 1971: 1,294	1960-1966: $361.4 1966-1970: 295.3 2Q 1971: 88.9	1960-1966: $48.5 1966-1970: 35.9 2Q 1971: 12.6

1971-1980 3/

Total National Production (GNP)	Man-years of Employment 2/	Personal Consumption Expenditures	Gov't Outlay for Goods and Services
1971-1980: $1,072.1 1980: 204.1	1971-1980: 21.6 Million 1980: 2.6 Million	1971-1980: $697.6 1980: 139.5	1971-1980: $114.7 1980: 22.6
Private Business Investment (Incl. Net Foreign)	**Average Family Income**	**Wages and Salaries**	**Unincorporated Business and Professional Income**
1971-1980: $259.8 1980: 42.0	1971-1980: $12,330 1980: 2,267	1971-1980: $576.0 1980: 109.9	1971-1980: $50.2 1980: 9.0

1/ All deficits are calculated from a 1953 base, in that growth rates since then have averaged far too low. Quarterly deficits are shown at annual rates.

2/ Based upon true level of unemployment, including full-time unemployment, full-time equivalent of part-time unemployment, and concealed unemployment (nonparticipation in civilian labor force) due to scarcity of job opportunity.

3/ These deficits are projected from a 1970 base, writing off the cumulative deficit-1953-1970.

Basic Data: Dept. of Commerce; Dept. of Labor

Chart 11

GOALS FOR THE U.S. ECONOMY, 1975 & 1980 PROJECTED FROM LEVELS IN 2ndQ 1971

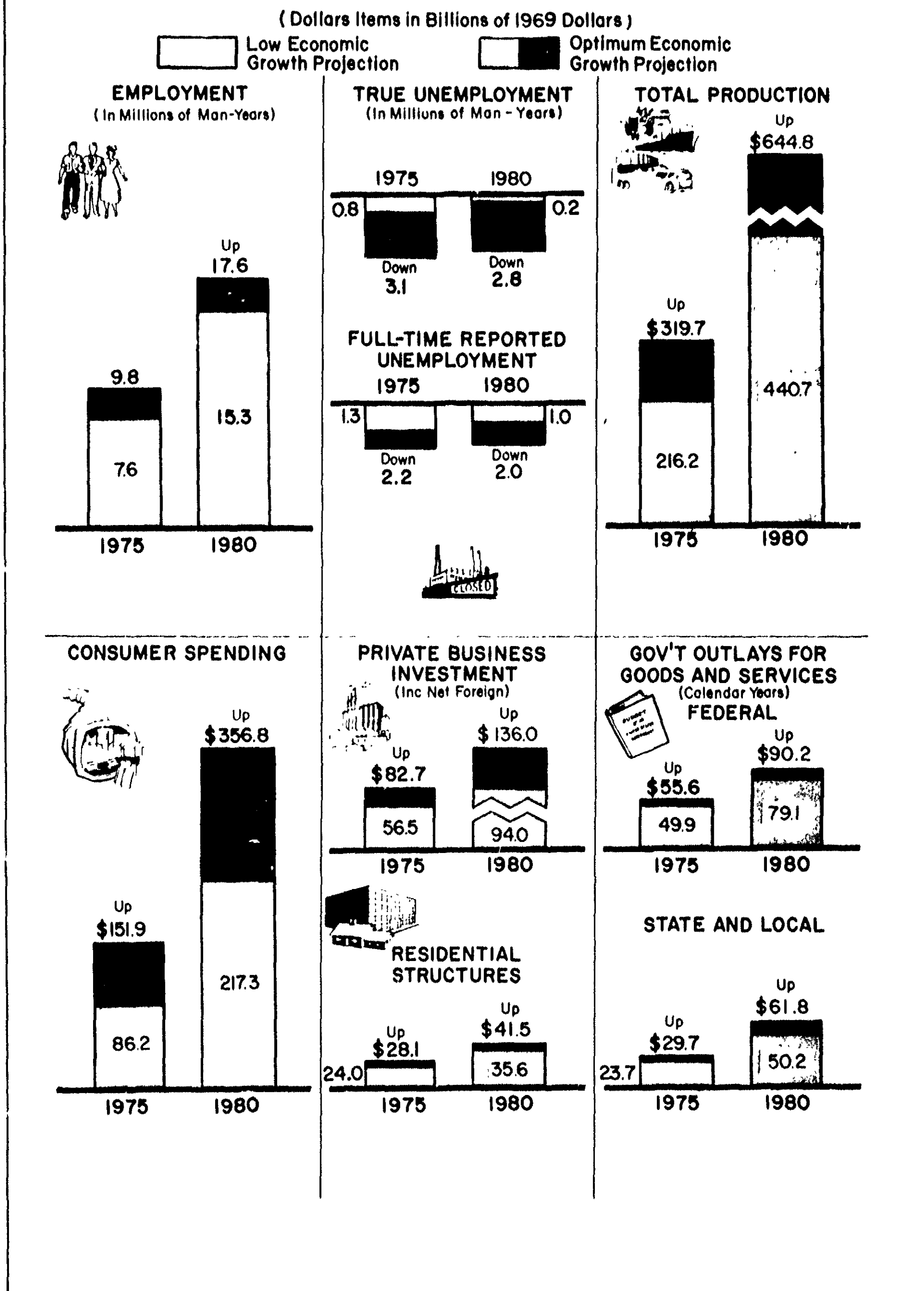
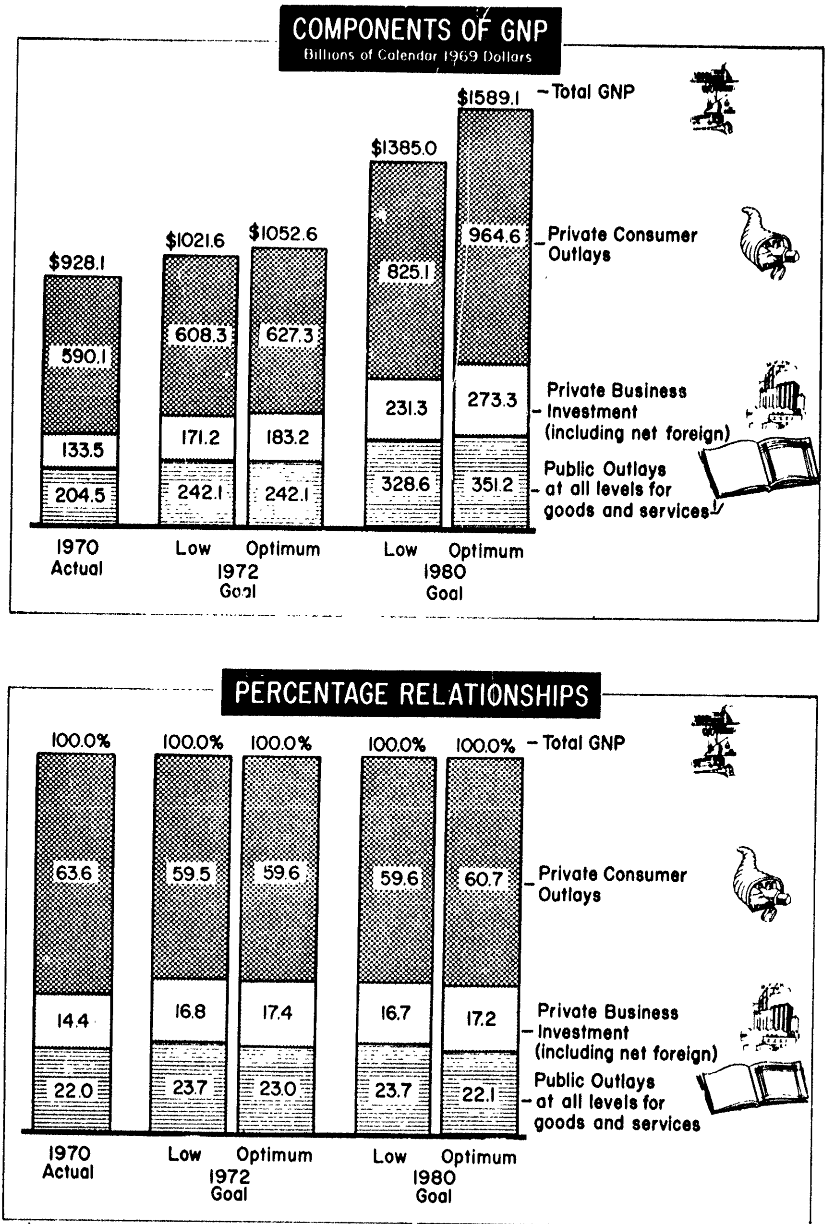


Chart 12

THE GOALS FOR 1972 AND 1980 MAINTAIN BALANCE OF PUBLIC AND PRIVATE RESPONSIBILITIES



1/ Public outlays are of such high priority that they are projected identically for the lower and higher GNP goals for 1972, with modifications of other goals accordingly.

Chart 13

GOALS FOR A FEDERAL BUDGET, 1972 AND 1980, GEARED TO ECONOMIC GROWTH & PRIORITY NEEDS

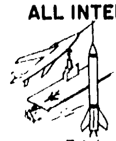
1972, fiscal year; goals for 1972 and 1980, calendar years

All figures in fiscal 1972 dollars [1]

ALL FEDERAL OUTLAYS

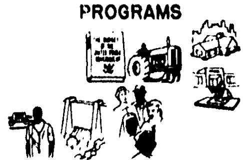
Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1972 [2]	229.232	108.16	20.47
1972	267.300	1270.26	22.78
1980	406.700	1717.47	22.96

NATIONAL DEFENSE, SPACE TECHNOLOGY, & ALL INTERNATIONAL



Year	Total Expend (Bil. $)	Per Capita ($)	% of GNP (%)
1972 [2]	84.695	399.63	7.56
1972	106.900	507.91	9.11
1980	157.900	666.88	8.92

ALL DOMESTIC PROGRAMS



Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1972 [2]	144.537	682.00	12.91
1972	160.400	762.35	13.67
1980	248.800	1050.59	14.05

RETIREMENT AND SOCIAL INSURANCE

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1972 [2]	49.012	231.26	4.38
1972	50.100	238.14	4.27
1980	90.400	381.95	5.11

HOUSING AND COMMUNITY DEVELOPMENT

Year	Total Expend. (Bil $)	Per Capita ($)	% of GNP (%)
1972 [2]	4.495	21.21	0.40
1972	11.700	55.83	1.00
1980	14.100	59.70	0.80

AGRICULTURE; AND NATURAL RESOURCES

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1972 [2]	10.047	47.41	0.90
1972	11.300	53.85	0.96
1980	20.000	85.17	1.14

EDUCATION

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1972 [2]	6.344	29.93	0.57
1972	6.500	31.13	0.56
1980	12.900	54.44	0.73

HEALTH SERVICES AND RESEARCH

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1972 [2]	16.010	75.54	1.43
1972	17.600	83.50	1.50
1972	26.600	112.39	1.50

MANPOWER PROGRAMS AND WELFARE SERVICES

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1972 [2]	14.191	66.96	1.27
1972	25.800	122.53	2.20
1980	30.400	128.20	1.72

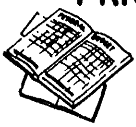
[1] Dollars of purchasing power apparently assumed in President's fiscal 1972 Budget.

[2] Administration's Proposed Budget as of Jan. 29, 1971.

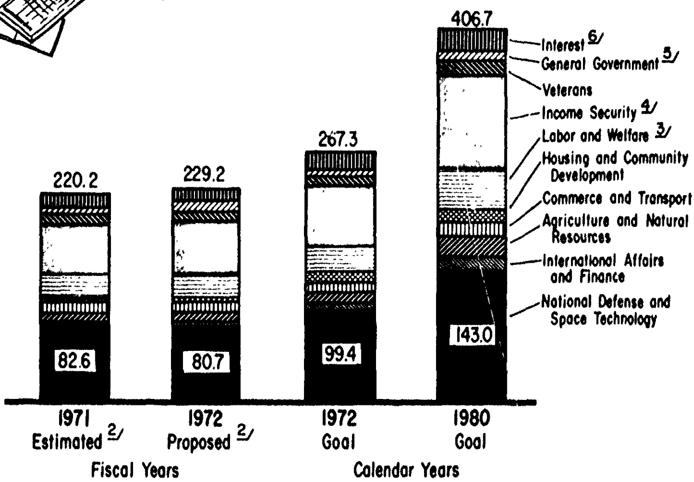
Projections by Leon H. Keyserling

Chart 14

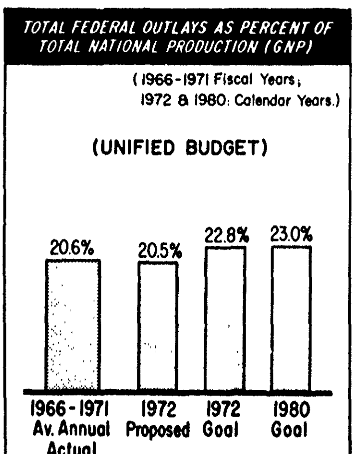
TOWARD A FEDERAL BUDGET CONSISTENT WITH MAXIMUM EMPLOYMENT AND THE PRIORITIES OF NATIONAL PUBLIC NEEDS

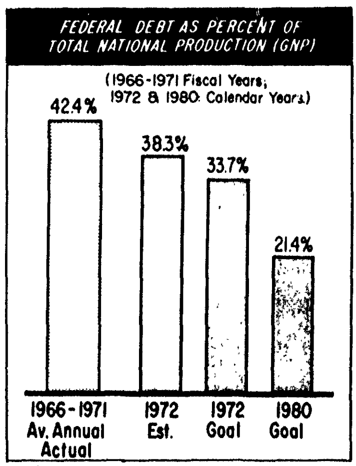


All Figures in Billions of Fiscal 1972 Dollars 1/



BURDEN OF FEDERAL OUTLAYS IN A FULLY GROWING ECONOMY WOULD BE WELL WITHIN OUR MEANS

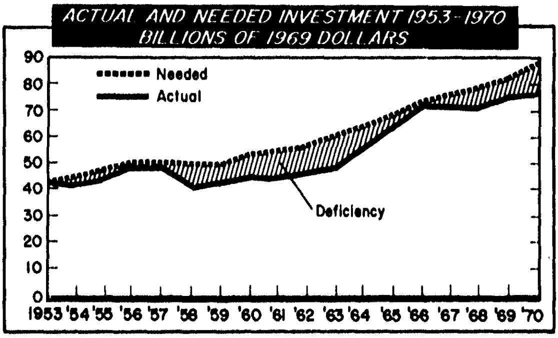


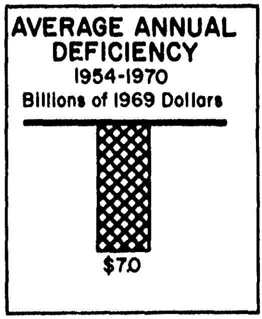


1/ Dollars of the purchasing power assumed in the President's Fiscal 1972 Budget.
2/ As of Budget Message of Jan. 29, 1971.
3/ Including education and health services.
4/ Less government share of government employees' retirement contributions.
5/ Including contingencies, civilian and military pay increases, and revenue sharing.
6/ Less interest paid to trust funds

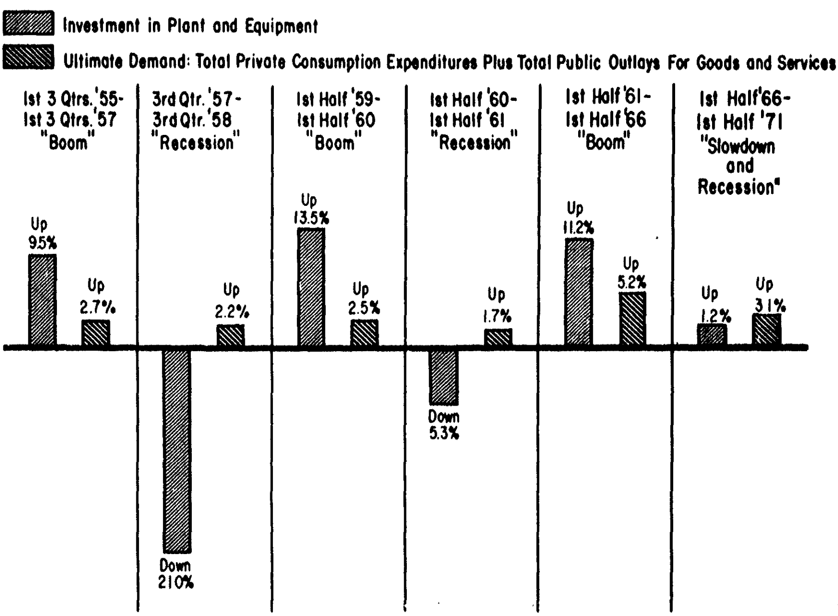
Chart 15

INVESTMENT IN PLANT AND EQUIPMENT WAS DEFICIENT, 1954-1ST HALF 1971 AS A WHOLE



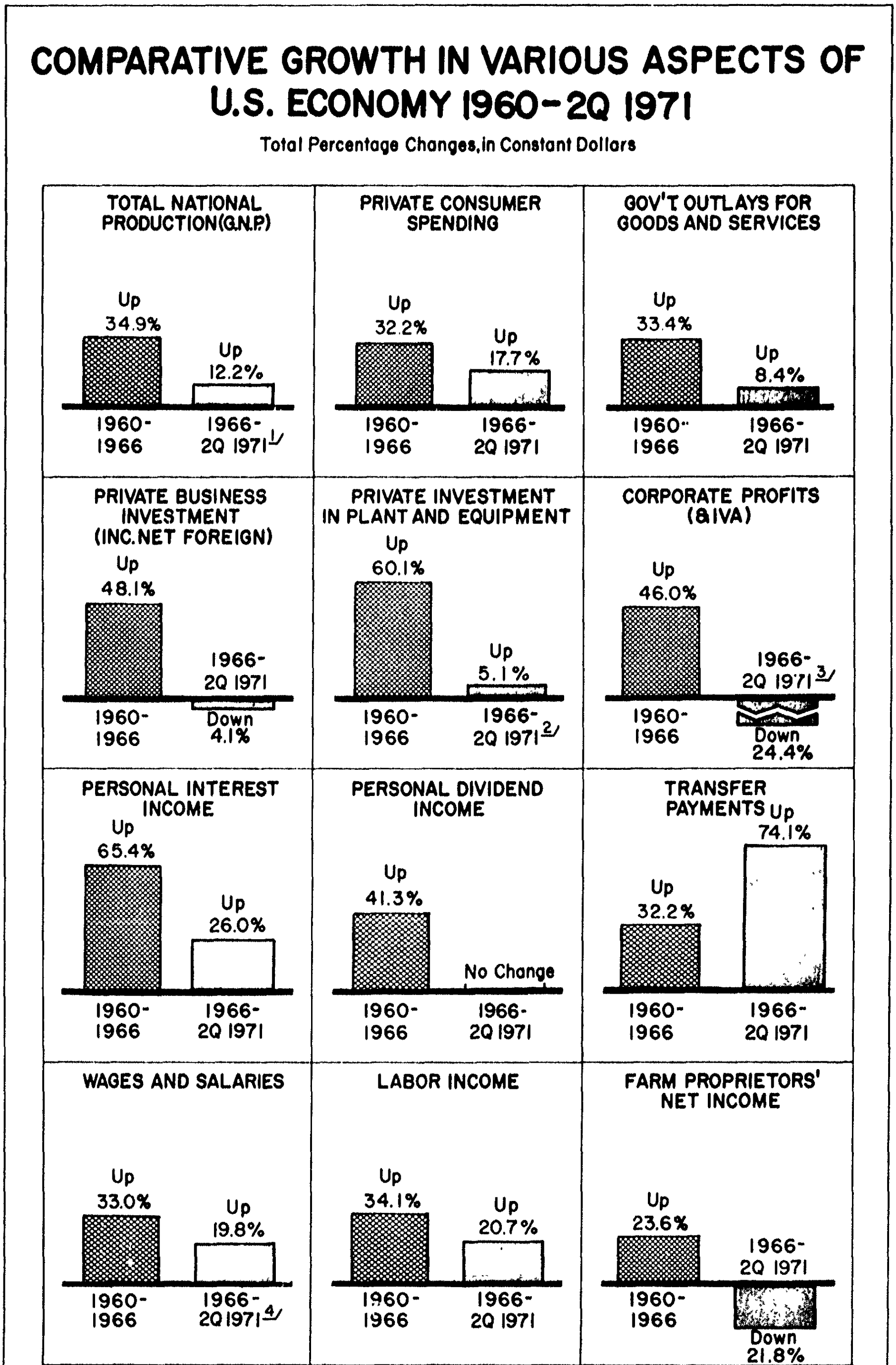


BUT INVESTMENT IN MEANS OF PRODUCTION AT TIMES OUTRAN DEMAND; HENCE INVESTMENT CUTS AND RECESSIONS



AVERAGE ANNUAL RATES OF CHANGE
In Uniform Dollars

Chart 16



1/ Growth from 2Q 1970-2Q 1971 is 2.4%.
2/ Growth from 2Q 1970-2Q 1971 is minus 2.9%.
3/ Growth from 2Q 1970-2Q 1971 is 1.1%.
4/ Growth from 2Q 1970-2Q 1971 is 1.9%.

Source: Dept. of Commerce, Office of Business Economics

Chart 17

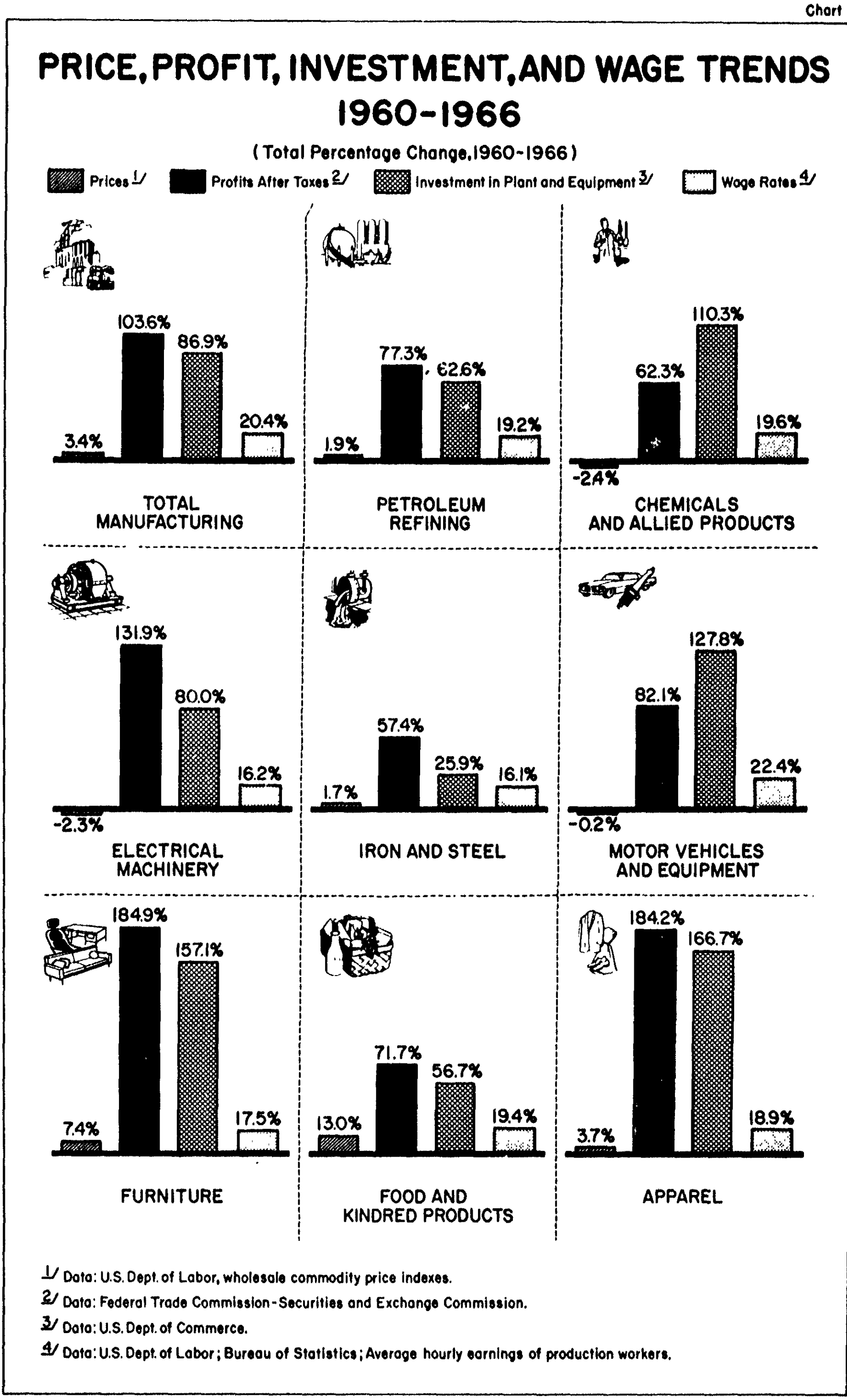
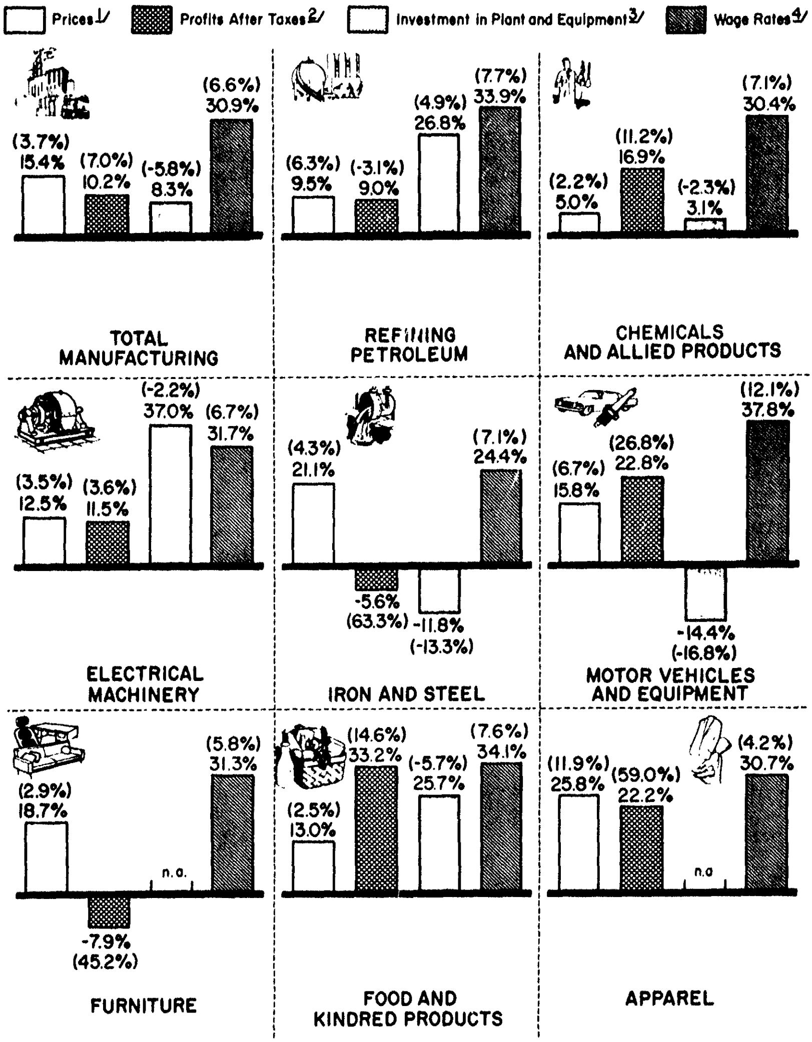

PRICE, PROFIT, INVESTMENT, AND WAGE TRENDS
1960-1966
(Total Percentage Change, 1960-1966)
Prices 1/
Profits After Taxes 2/
Investment in Plant and Equipment 3/
Wage Rates 4/
3.4%
103.6%
86.9%
20.4%
TOTAL MANUFACTURING
1.9%
77.3%
62.6%
19.2%
PETROLEUM REFINING
-2.4%
62.3%
110.3%
19.6%
CHEMICALS AND ALLIED PRODUCTS
-2.3%
131.9%
80.0%
16.2%
ELECTRICAL MACHINERY
1.7%
57.4%
25.9%
16.1%
IRON AND STEEL
-0.2%
82.1%
127.8%
22.4%
MOTOR VEHICLES AND EQUIPMENT
7.4%
184.9%
157.1%
17.5%
FURNITURE
13.0%
71.7%
56.7%
19.4%
FOOD AND KINDRED PRODUCTS
3.7%
184.2%
166.7%
18.9%
APPAREL
1/ Data: U.S. Dept. of Labor, wholesale commodity price indexes.
2/ Data: Federal Trade Commission-Securities and Exchange Commission.
3/ Data: U.S. Dept. of Commerce.
4/ Data: U.S. Dept. of Labor; Bureau of Statistics; Average hourly earnings of production workers.

Chart 1

PRICE, PROFIT, INVESTMENT, AND WAGE TRENDS 1966-2Q1971 AND 2Q1970-2Q1971

Total Percentage Change, 1966-2Q 1971

(Percentage Change 2Q1970-2Q1971 in Parentheses)



1/ Data: U.S. Dept. of Labor, wholesale commodity price indexes.

2/ Data: Federal Trade Commission-Securities and Exchange Commission.

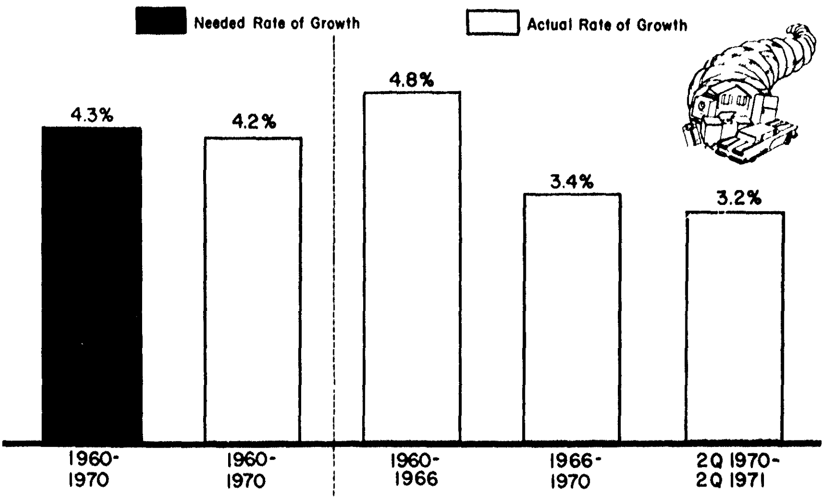
3/ Data: U.S. Dept. of Commerce.

4/ Data: U.S. Dept. of Labor; Bureau of Statistics; Average hourly earnings of production workers.

Chart 19

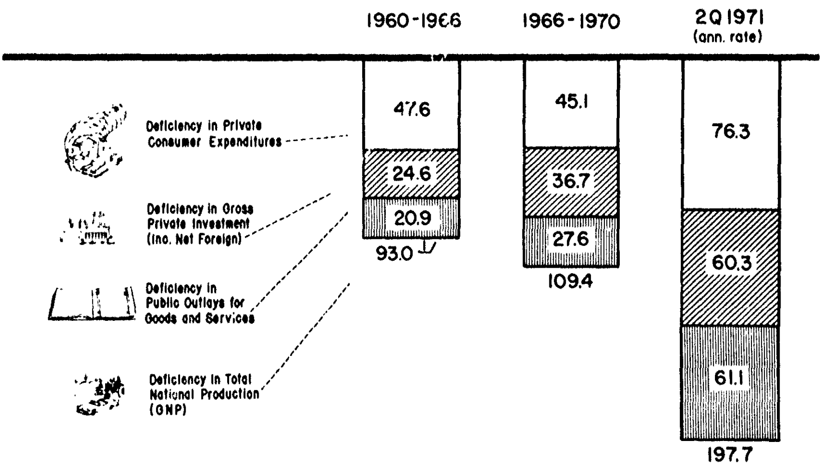
THE GROWTH IN CONSUMER SPENDING HAS BEEN MUCH TOO SLOW, 1960-2Q 1971

(Average Annual Rates of Change, Constant Dollars)



AND THE LAG IN CONSUMER SPENDING DOMINATES THE TOTAL GAP IN GNP

(Average Annual Deficiency in Billions of 1969 Dollars)



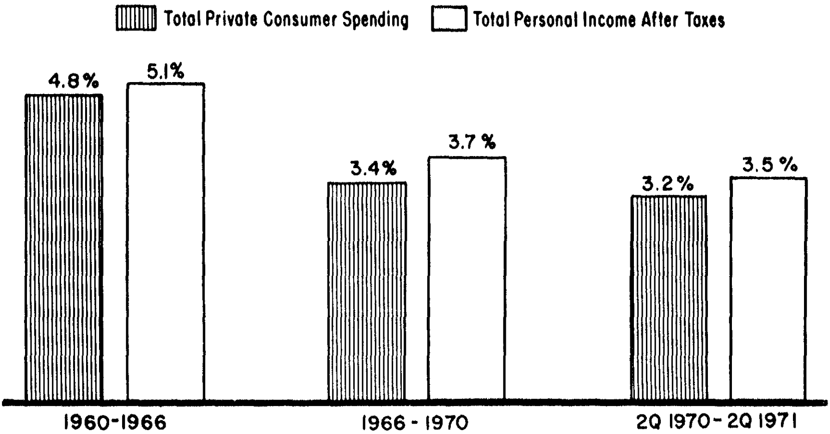
1/ Components do not add to total due to rounding.
2/ More than half the investment deficiency in recent years has been due to inadequate residential construction

Basic Data: Dept. of Commerce, Office of Business Economics

Chart 20

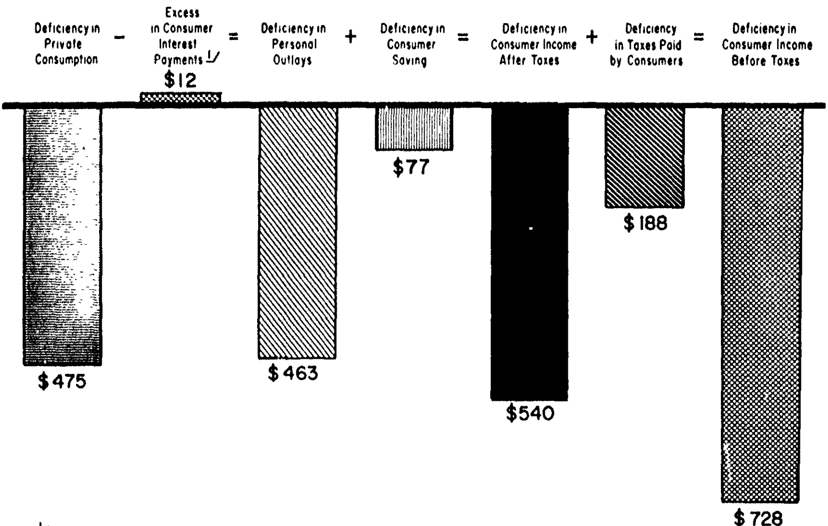
INADEQUATE CONSUMPTION GROWTH STEMS FROM INADEQUATE INCOME GROWTH

Average Annual Rates of Change in Constant Dollars



THE PRIVATE CONSUMPTION DEFICIENCY OF $475 BILLION, 1960-1970, REFLECTED A $728 BILLION INCOME DEFICIENCY

Billions of 1969 Dollars



1/ Also includes personal transfer payments to foreigners, which is a minimal amount.

Chart 21

DEFICIENCIES IN WAGES AND SALARIES ARE LARGE SHARE OF DEFICIENCIES IN TOTAL CONSUMER INCOMES BEFORE TAXES

Billions of 1969 Dollars

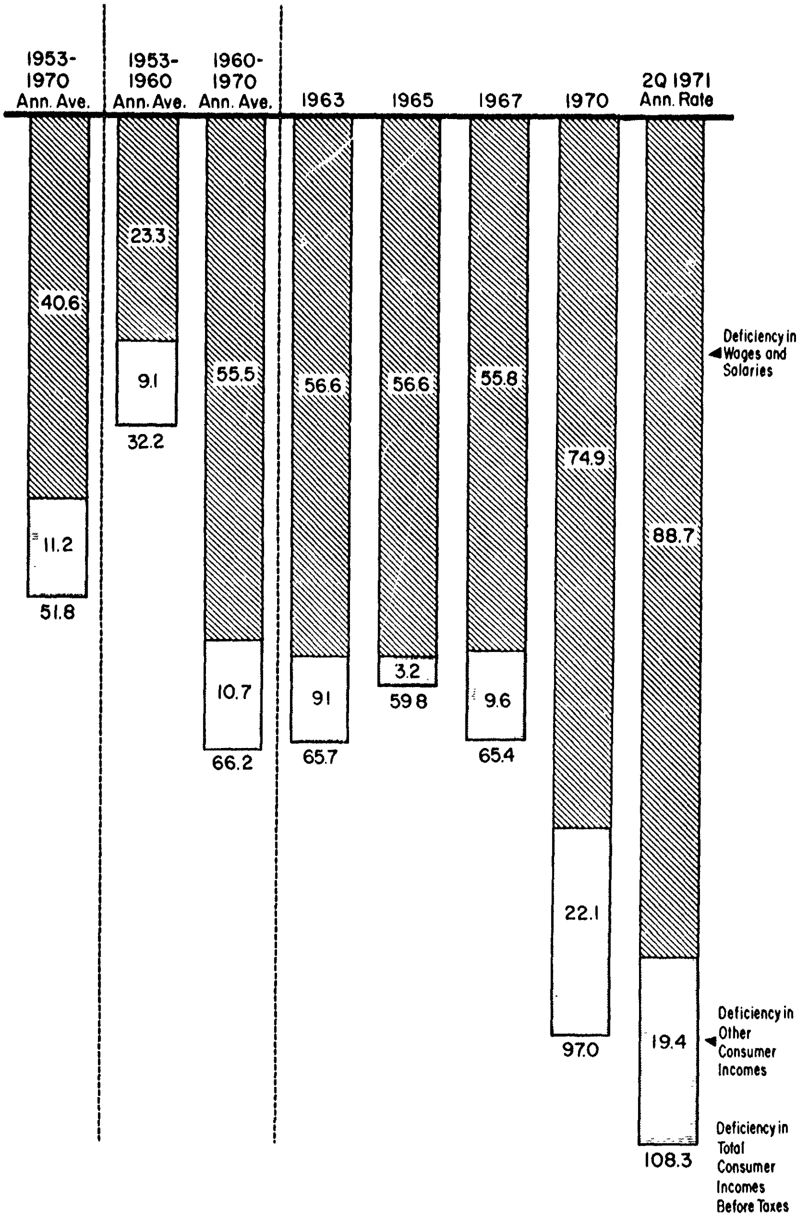
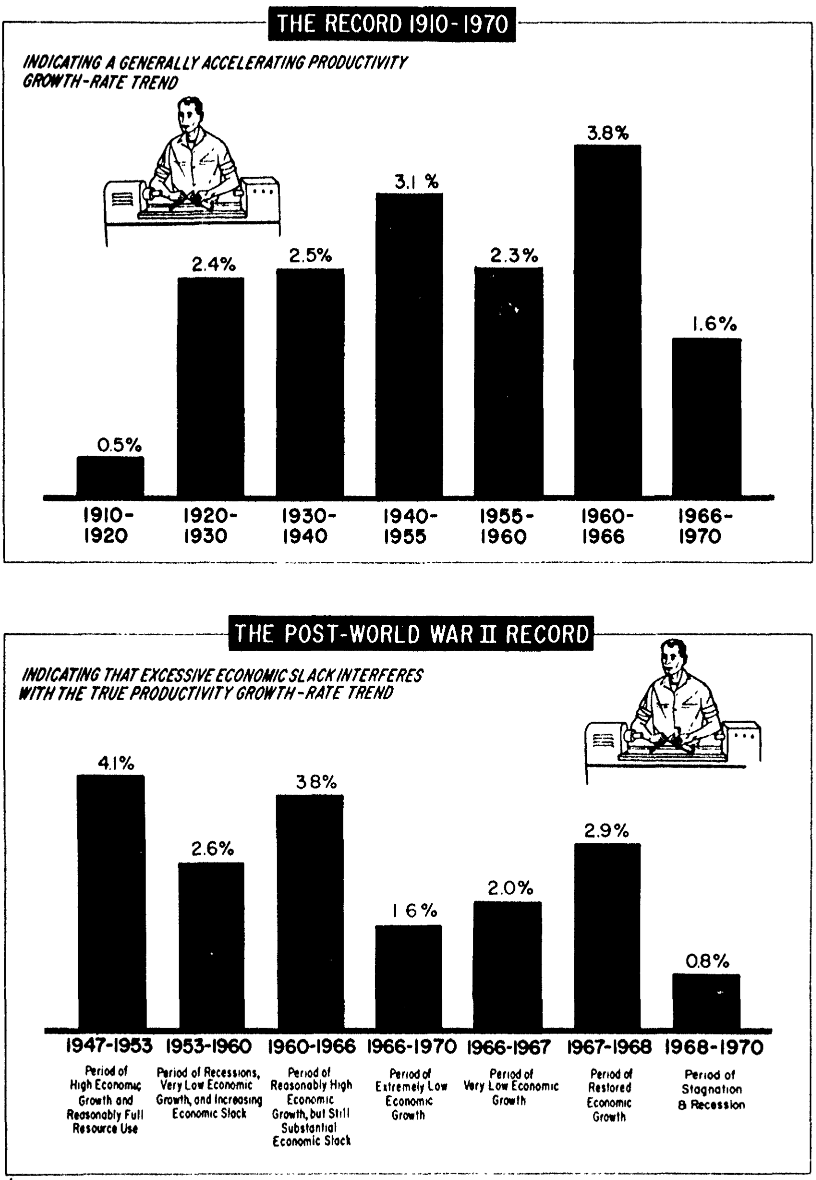


Chart 2 1/

LONG-TERM TRENDS IN PRODUCTIVITY U.S. PRIVATE ECONOMY, 1910–1970[1]

Average Annual Rate of Growth in Output per Man-hour for the Entire Private Economy

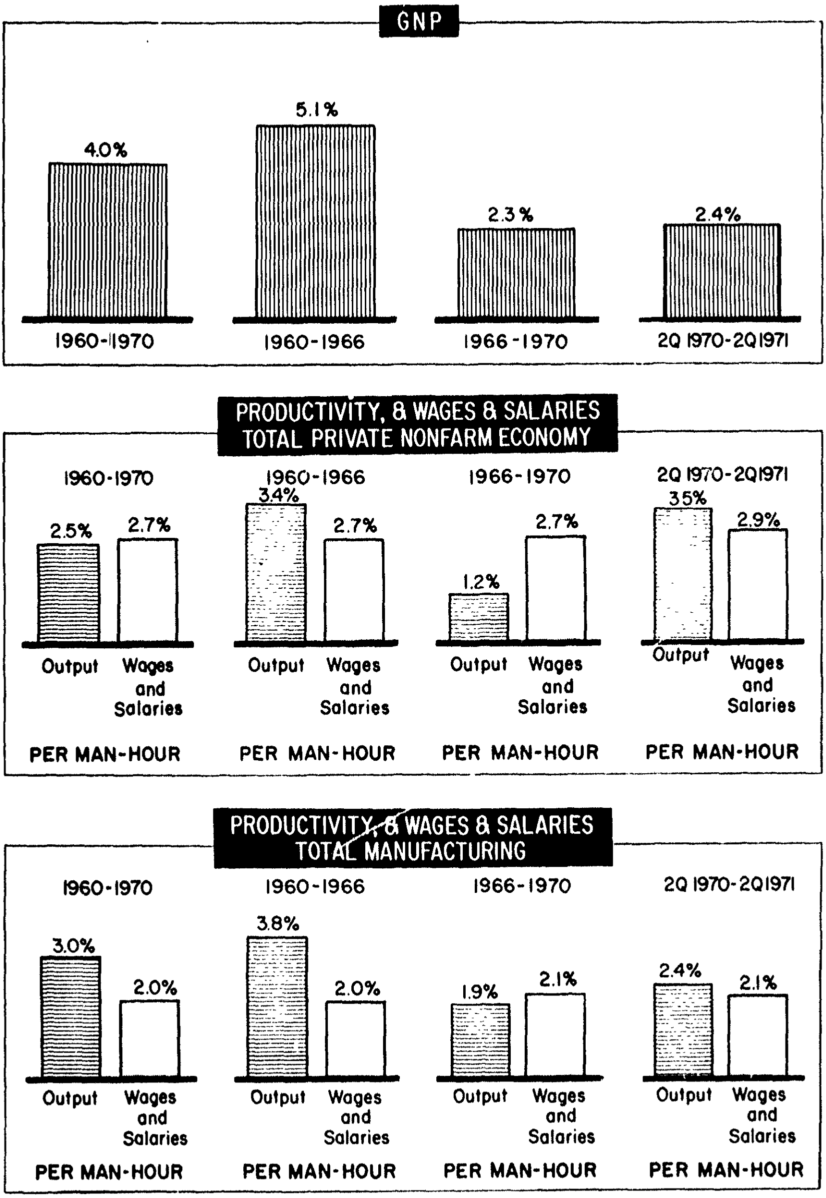


[1] 1970 preliminary.
Source: Dept. of Labor estimates relating to man-hours worked (Establishment basis)

Chart 23

THE LAG IN WAGES AND SALARIES BEHIND PRODUCTIVITY GAINS, 1960–2nd Q 1971

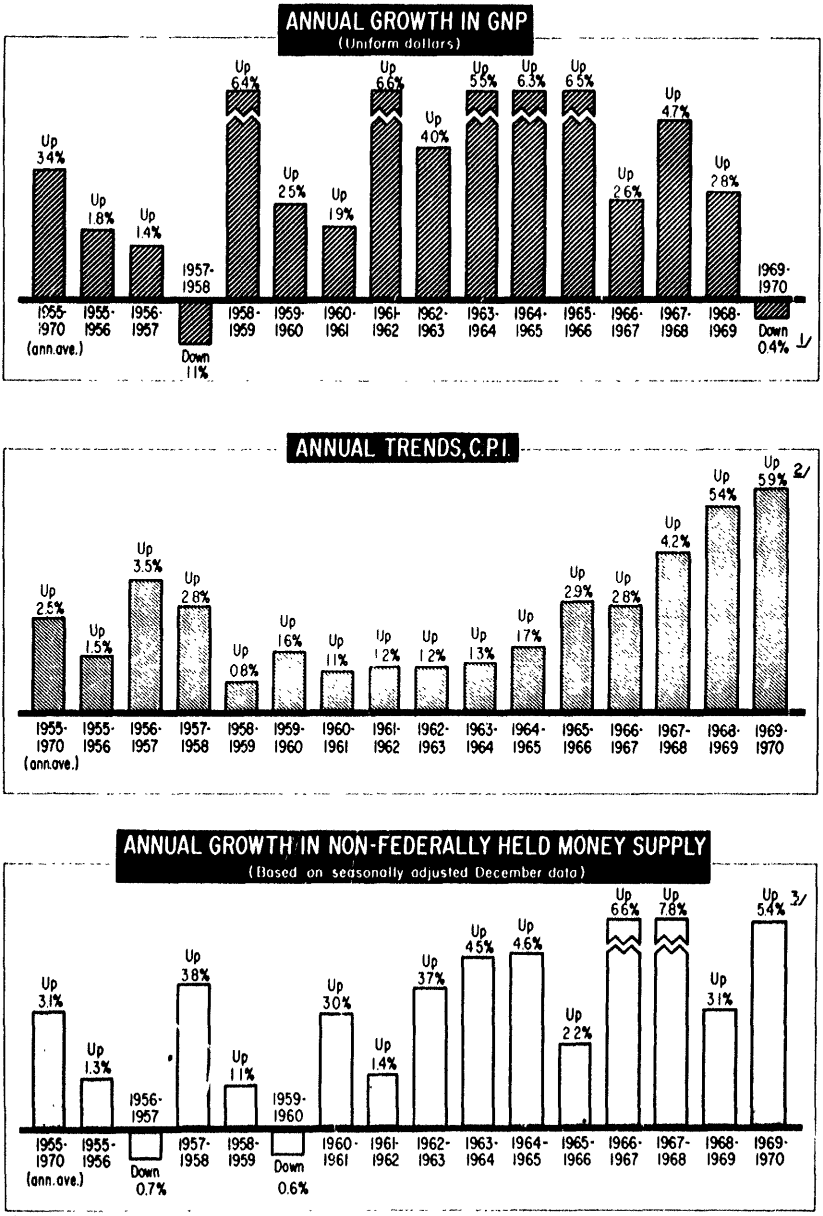
(Average Annual Increases, Constant Dollars)



Basic Data: Dept. of Commerce; Dept. of Labor

Chart 4

COMPARATIVE TRENDS IN GNP, PRICES, AND NON-FEDERALLY HELD MONEY SUPPLY, 1955-1970



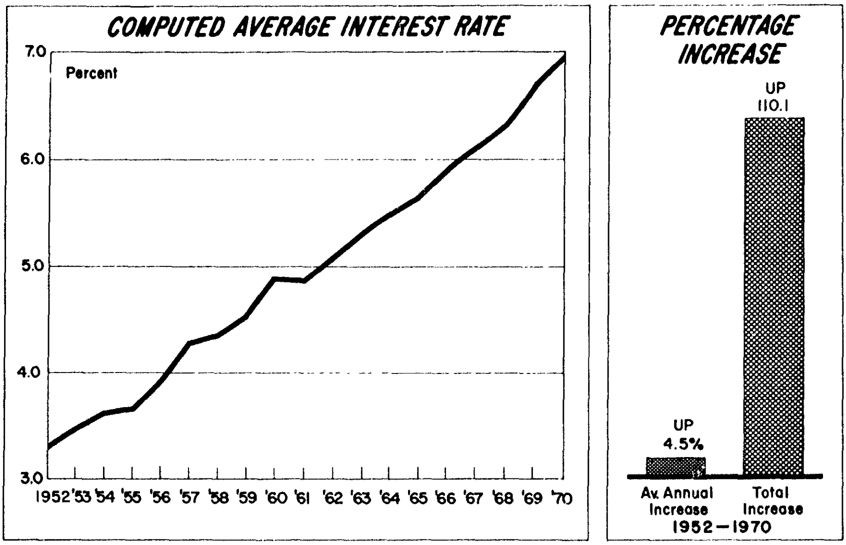
1/ Growth 2Q1970-2Q1971 is 2.4%.
2/ Growth 2Q1970-2Q1971 is 4.4%.
3/ Growth 2Q1970-2Q1971 is 6.9%.

Data: Dept. of Commerce; Dept of Labor; Federal Reserve System

Chart 25

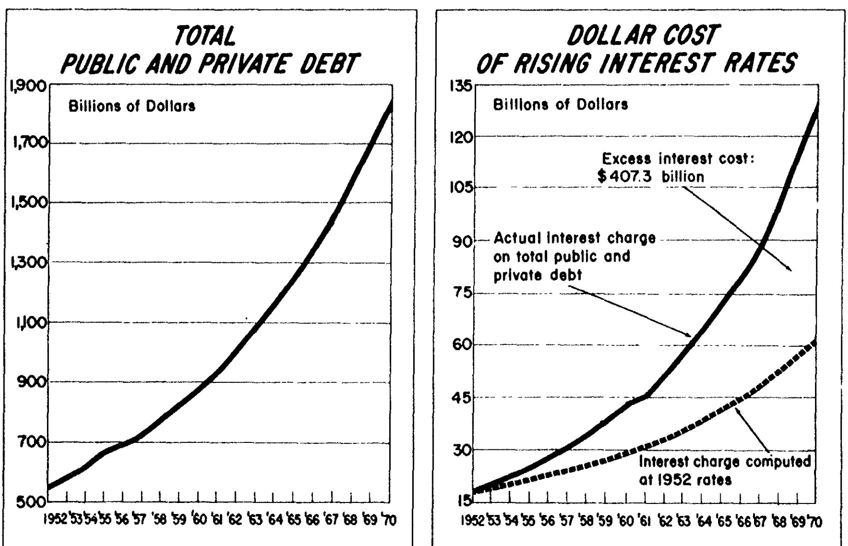
AVERAGE INTEREST RATES ON TOTAL PUBLIC AND PRIVATE DEBT, 1952 - 1970 1/

Calendar Years



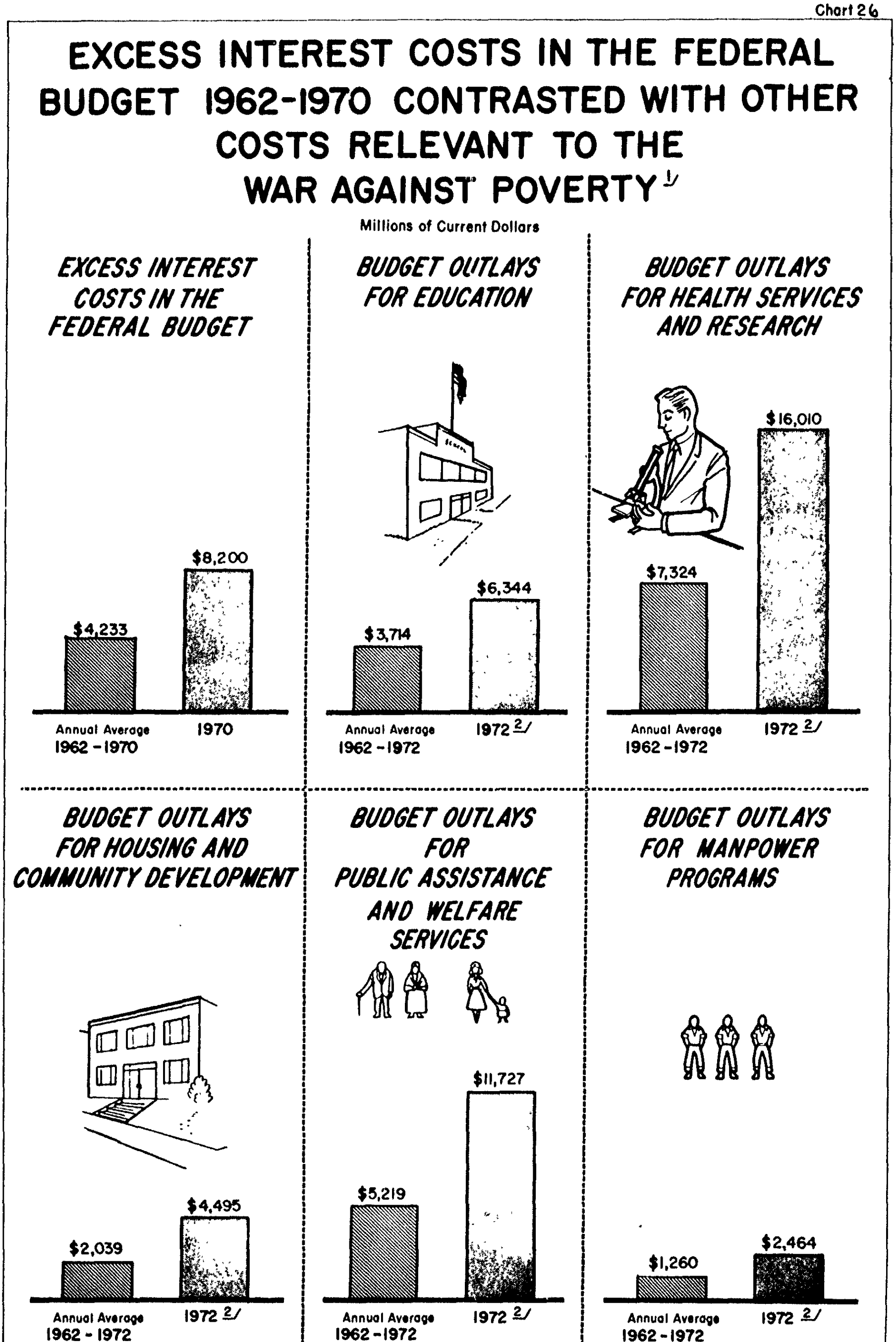
TOTAL PUBLIC AND PRIVATE COST OF RISING INTEREST RATES, 1953-1970 1/

Calendar Years



1/ 1970 estimated.
Data. U.S. Treasury and Department of Commerce, Office of Business Economics

Chart 26

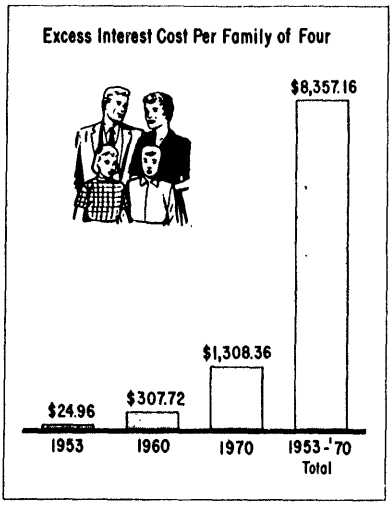


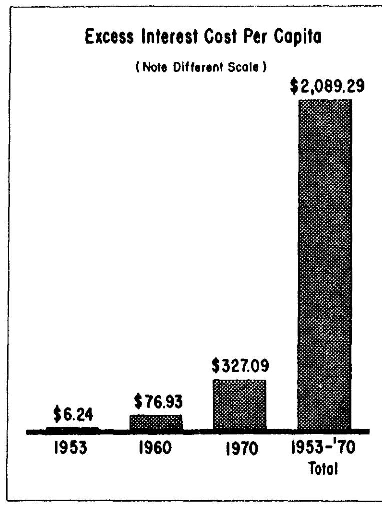
1/ Interest costs, calendar years; budget outlays, fiscal years.
2/ Proposed in fiscal 1972 Budget.

Chart 27

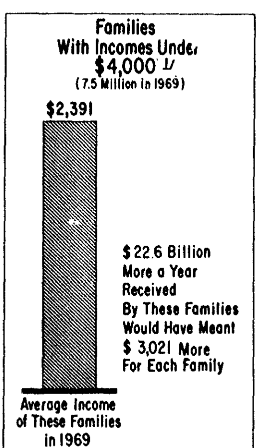
THE BURDEN OF $407.3 BILLION IN EXCESS INTEREST COSTS, 1953-1970 UPON THE AMERICAN PEOPLE

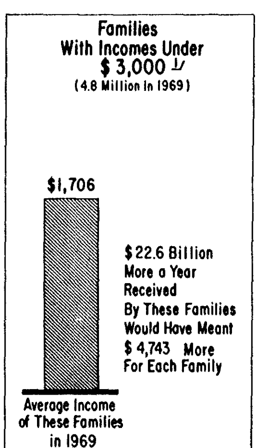
Calendar Years

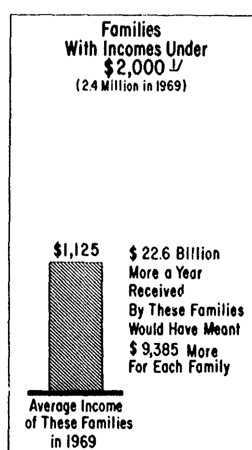




HOW $22.6 BILLION A YEAR, 1953-1970 -EQUAL TO ANNUAL EXCESS INTEREST- MIGHT HAVE RELIEVED POVERTY





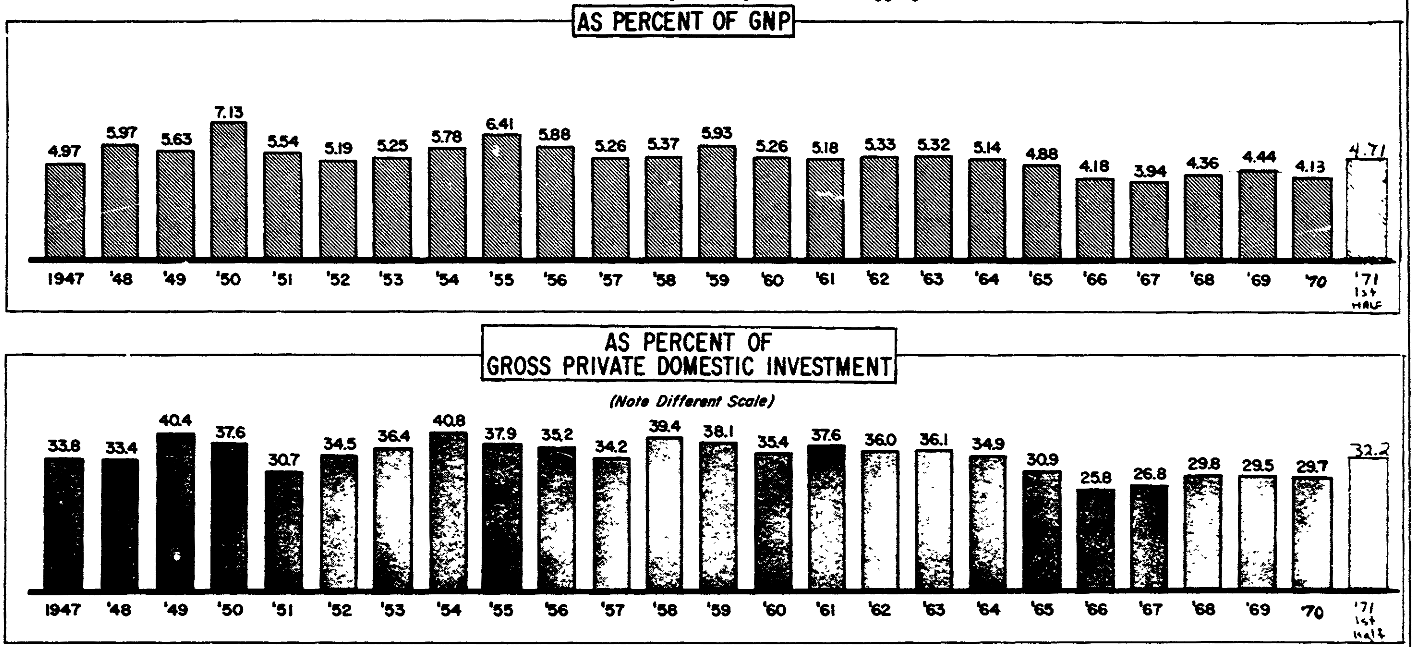


1/ Includes families with no income and income loss.

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

ROLE OF HOUSING AND COMMERCIAL CONSTRUCTION IN THE NATIONAL ECONOMY, 1947- 1st HALF 1971

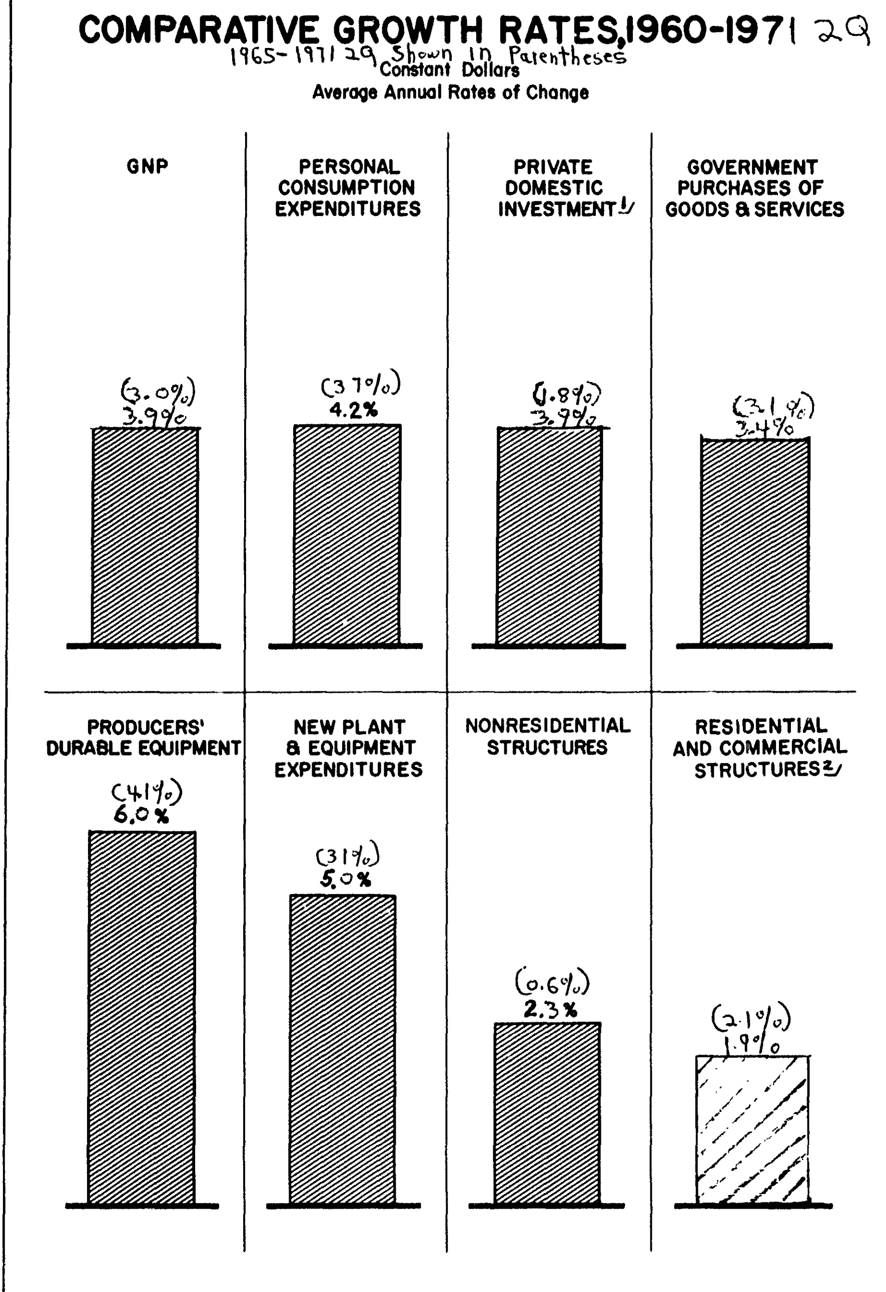
(New Construction as Percentage of Major Economic Aggregates)



Source: Dept. of Commerce, Office of Business Economics, Survey of Current Business

Chart 28

Chart 29



1/ Gross private investment, including net foreign 3.2%, (0.3%).

2/ Residential structures alone, -1.4% (1.8%).

Basic Data: Dept. of Commerce, Office of Business Economics

Chart 30

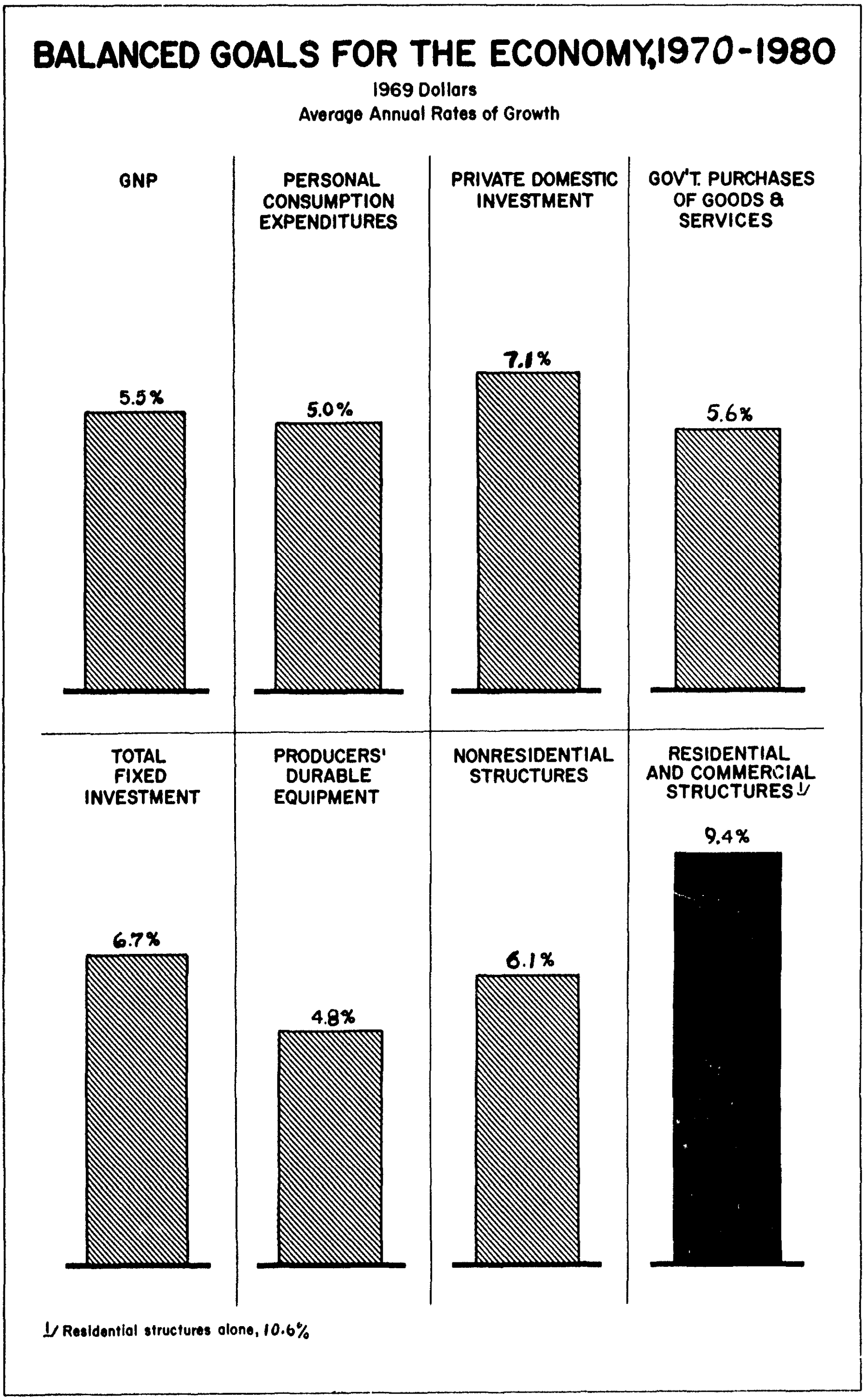

BALANCED GOALS FOR THE ECONOMY,1970-1980
1969 Dollars
Average Annual Rates of Growth
GNP
5.5%
PERSONAL CONSUMPTION EXPENDITURES
5.0%
PRIVATE DOMESTIC INVESTMENT
7.1%
GOV'T. PURCHASES OF GOODS & SERVICES
5.6%
TOTAL FIXED INVESTMENT
6.7%
PRODUCERS' DURABLE EQUIPMENT
4.8%
NONRESIDENTIAL STRUCTURES
6.1%
RESIDENTIAL AND COMMERCIAL STRUCTURES 1/
9.4%
1/ Residential structures alone, 10.6%

Chart 31

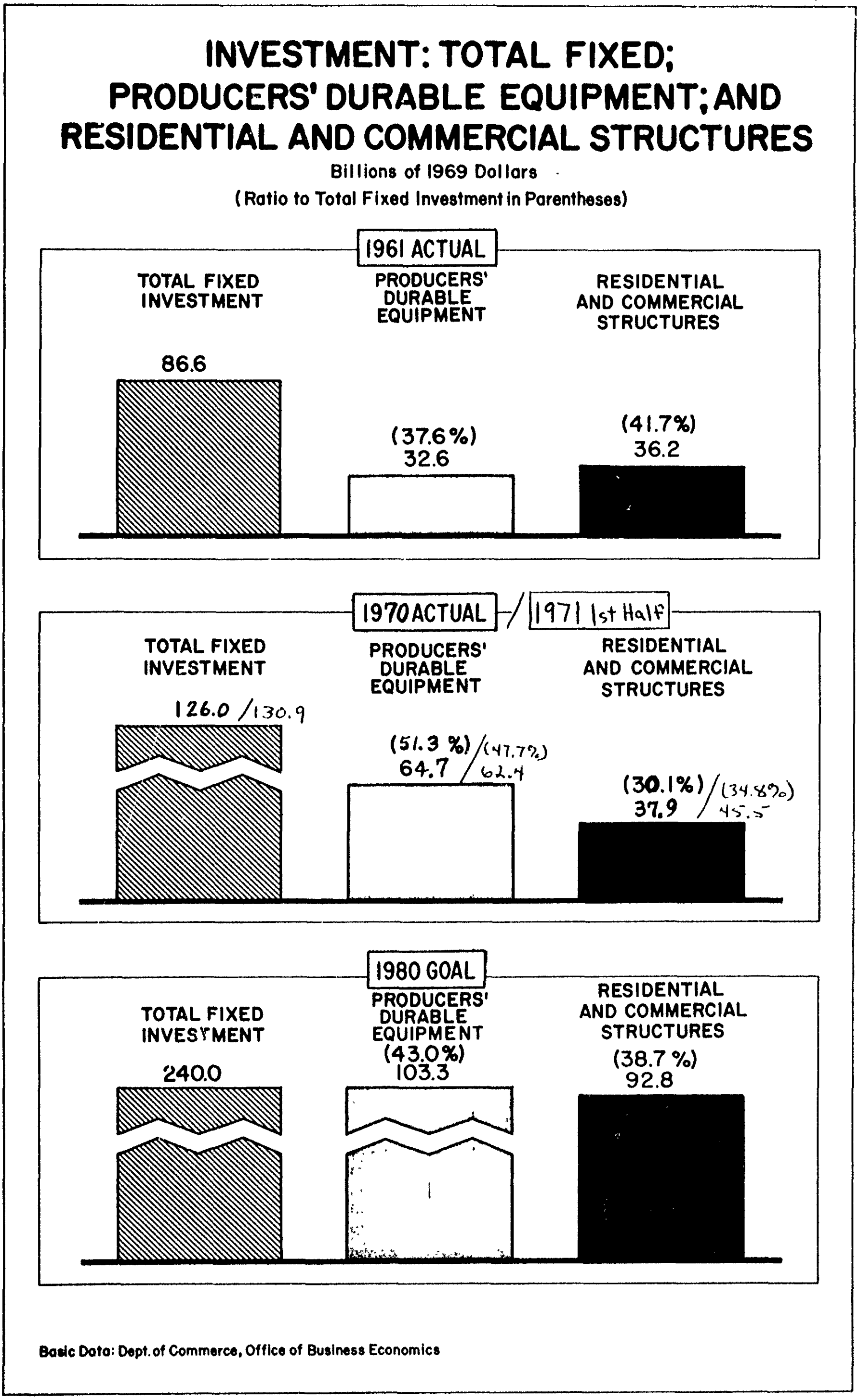
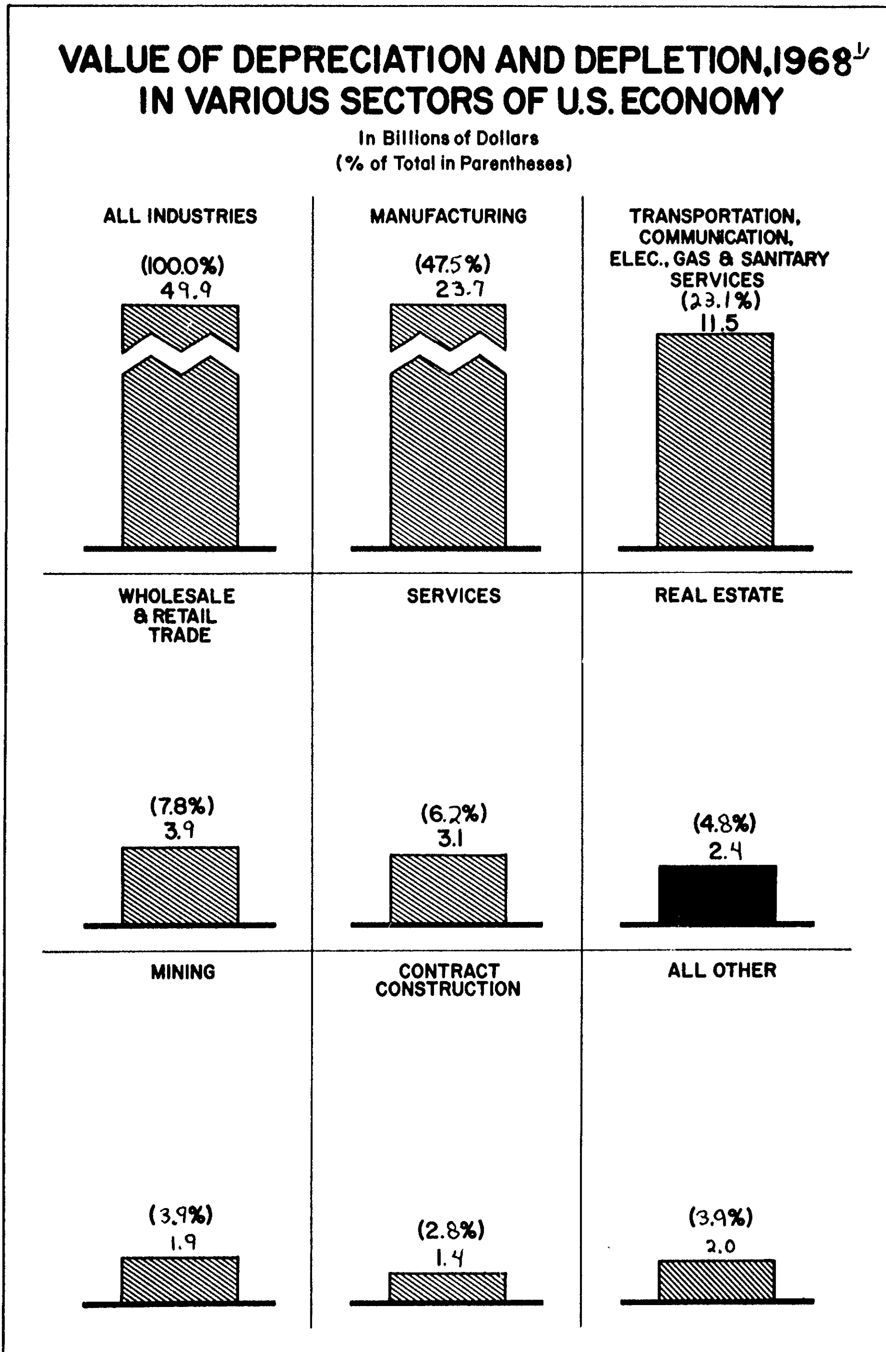

INVESTMENT: TOTAL FIXED; PRODUCERS' DURABLE EQUIPMENT; AND RESIDENTIAL AND COMMERCIAL STRUCTURES
Billions of 1969 Dollars
(Ratio to Total Fixed Investment in Parentheses)
1961 ACTUAL
TOTAL FIXED INVESTMENT
86.6
PRODUCERS' DURABLE EQUIPMENT
(37.6%)
32.6
RESIDENTIAL AND COMMERCIAL STRUCTURES
(41.7%)
36.2
1970 ACTUAL / 1971 1st Half
TOTAL FIXED INVESTMENT
126.0 / 130.9
PRODUCERS' DURABLE EQUIPMENT
(51.3%) / (47.7%)
64.7 / 62.4
RESIDENTIAL AND COMMERCIAL STRUCTURES
(30.1%) / (34.8%)
37.9 / 45.5
1980 GOAL
TOTAL FIXED INVESTMENT
240.0
PRODUCERS' DURABLE EQUIPMENT
(43.0%)
103.3
RESIDENTIAL AND COMMERCIAL STRUCTURES
(38.7%)
92.8
Basic Data: Dept. of Commerce, Office of Business Economics

Chart 32



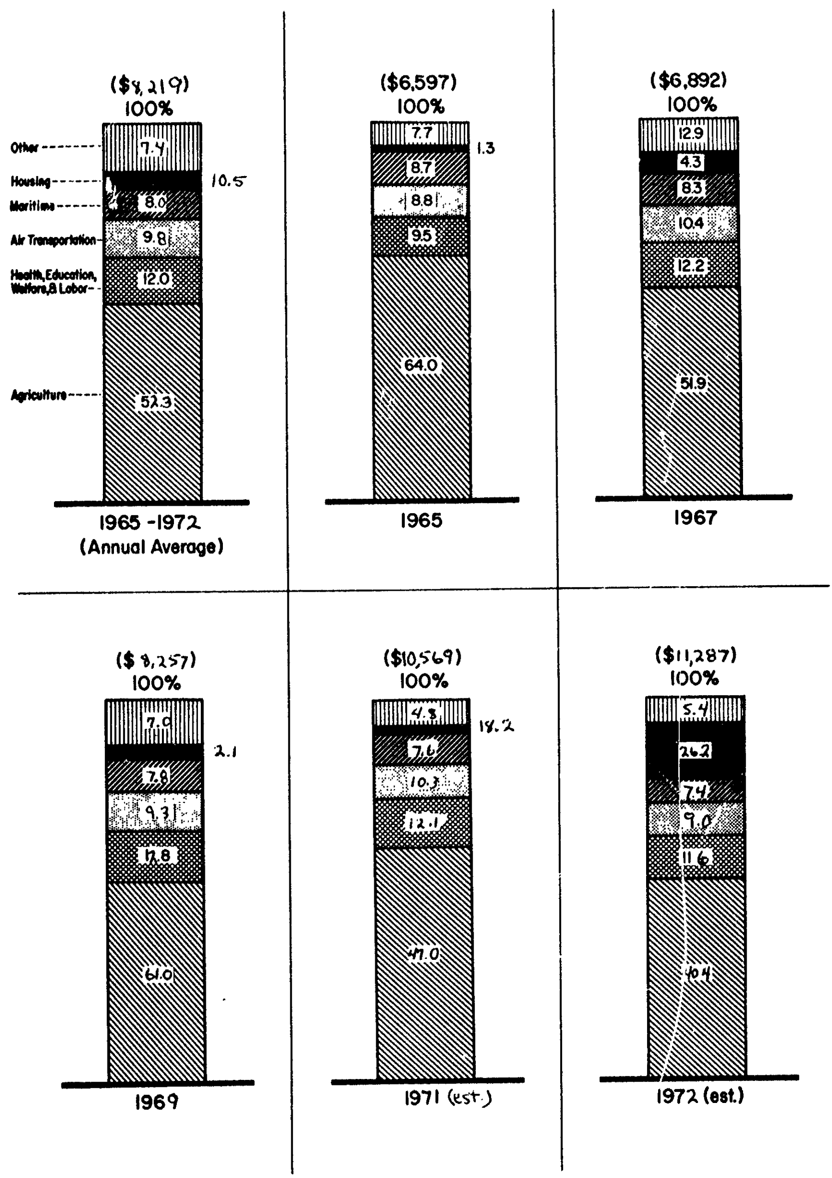
1/ As expressed in corporate income tax returns. 1968 latest available year.

Source: Treasury Dept.

Chart 33

% DISTRIBUTION OF NET FEDERAL EXPENDITURES FOR SUBSIDY PROGRAMS, FY 1965-1972

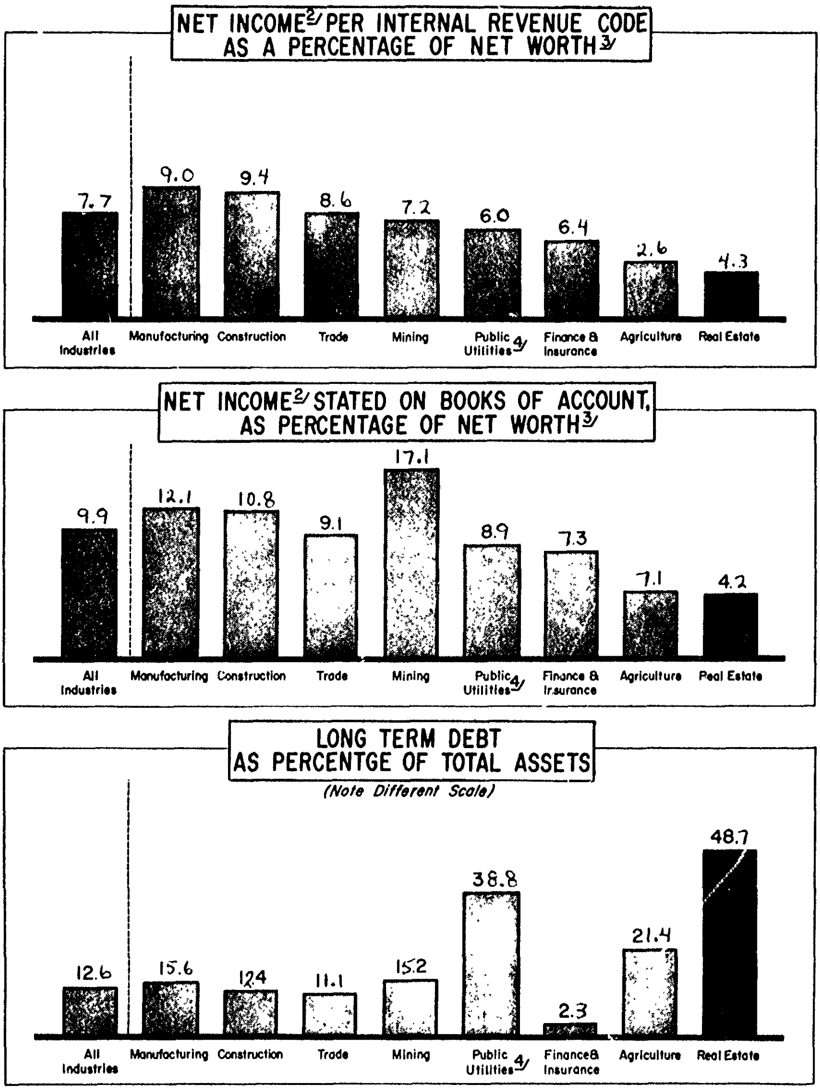
(Millions of Current Dollars in Parentheses)



Source: Dept. of Commerce. 1972 based on President's fiscal 1972 Budget.

Chart 34

RATES OF RETURN & OTHER FINANCIAL RATIOS ALL CORPORATIONS IN VARIOUS INDUSTRIES, 1967 1/



1/ Latest year available. 1966 latest year available for middle cross-section

2/ Net income after Federal income tax.

3/ Stockholder equity.

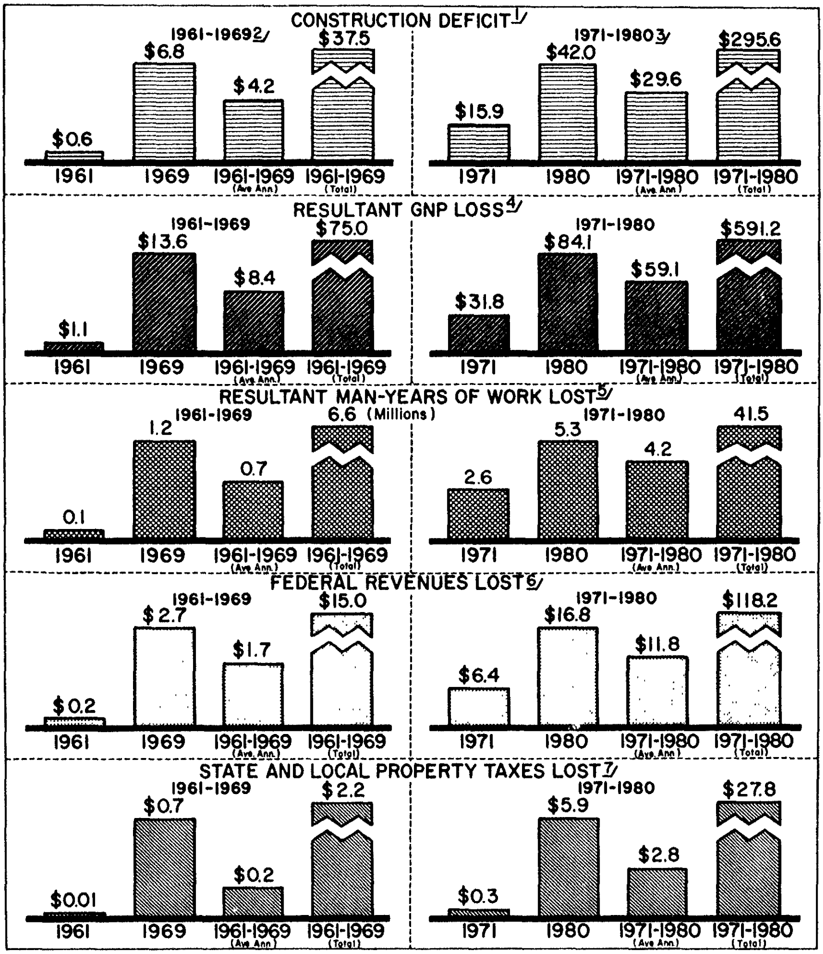
4/ Including transportation.

Source: Treasury Dept., Internal Revenue Service, Statistics of Income, 1967 Corporation Income Tax Returns

Chart 35

DEFICITS IN HOME AND COMMERCIAL CONSTRUCTION 1961-1969, AND PROJECTED 1971-1980

(All Dollar Figures in Billions of 1969 Dollars)
(Note Different Scale in Each Box)



1/ For 1961-1969 inclusive, deficits measure actual performance against estimated needed performance in terms of model for total economy. For 1971-1980 inclusive, deficits measure projection of 1960-1969 performance against projection of needed performance.

2/ Actual average annual growth 1.7%; needed, 4.9%, or same as actual for total economy.

3/ Projection of 1961-1969 performance, 1.7%; needed, 7.4%, or much greater than needed growth rate of 5.0% for total economy.

4/ Based on multiplier of 2.0.

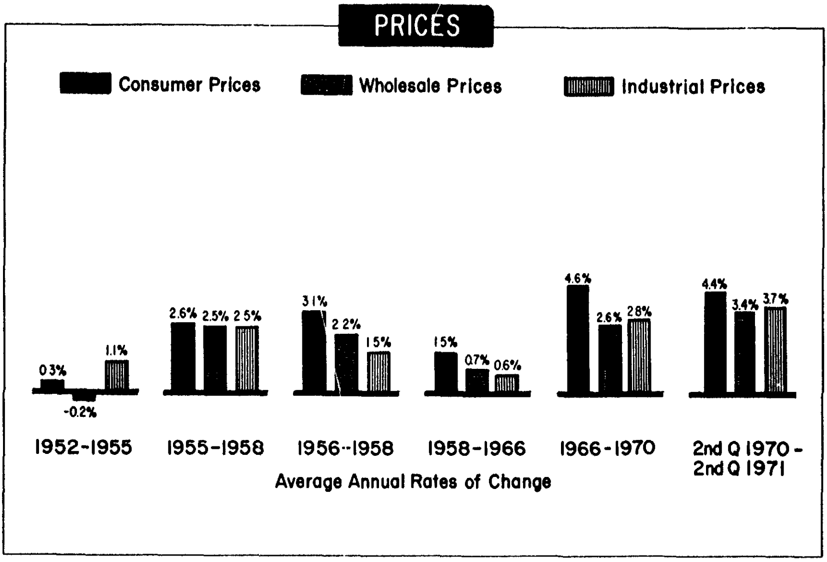
5/ Based on yearly ratio of GNP to employment. Projections involve 3.0% average annual increase in productivity.

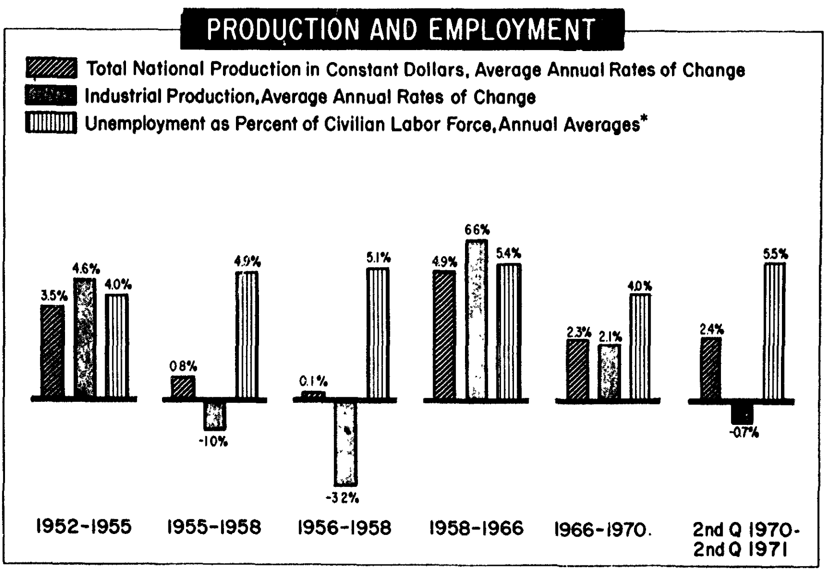
6/ Equals 20% of GNP loss.

7/ Assumes property tax loss is 2% of construction deficit, cumulated.

Chart 36

RELATIVE TRENDS IN ECONOMIC GROWTH UNEMPLOYMENT, & PRICES, 1952-2Q 1971





*These annual averages (as differentiated from the annual rates of change) are based on full-time officially reported unemployment measured against the officially reported Civilian Labor Force.

Source: Dept. of Labor, Dept. of Commerce, & Federal Reserve System

WASHINGTON, D.C., *October 21, 1971.*

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR RUSSELL: I am sending you herewith two letters, one relating to the problem of an excess interest tax, and the longer one containing suggestions for amending H.R. 10947 to deal more favorably with investment in housing and related commercial construction.

Fully aware of how busy you are now, I nonetheless hope that you may be able to give these two matters your consideration, as both seem to me very important.

With all good wishes,

Very sincerely yours,

LEON H. KEYSERLING,
Consulting Economist and Attorney at Law.

Enclosure.

WASHINGTON, D.C., *October 22, 1971.*

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR RUSSELL: This is in response to your request, when I testified at the hearings before the Senate Finance Committee on H.R. 10947, that I make some suggestion with respect to an excess interest tax.

The problem, as you know, is extremely difficult and complex, and preparation of definitive recommendations would require much more technical study than I have been able to undertake since your request to me. But the formula which I have thus far come up with would require that net interest received as income (interest received less interest paid) be taxed separately at a specified excess interest tax rate, insofar as such net interest exceeds the interest rate during a stated base year for the type of borrowing involved. The net interest below this figure would be taxed in the usual manner. Thus, if the interest rate in the base year were 6 percent and the actual interest rate charged were 8 percent, the excess interest tax rate would apply to the amount of net interest received in excess of 6 percent. To illustrate the complexity of the problem, the determination of the amount of net interest received and the excess interest tax thereon would have to be made separately, by those preparing their tax returns, for each type of borrowing.

Presumably, with respect to publicly-issued securities, instead of imposition of an excess interest tax, the legislation would need to provide definitively that the interest rate charged should not be above that in the base year (or, if the 90 percent excess interest tax referred to below were in effect, not above the rate which would yield the amount resulting from the base year rate plus 10 percent of the amount of excess interest).

As to choice of the appropriate base year, that is a matter of judgment. I am enclosing a tabulation which shows bond yields and interest rates, 1929–1970 on 11 different types of obligations, and during 1953–1970 on three additional types. As a personal preference, I would like to go back as far as 1952, when the high interest rate policy got going in earnest, or at least to 1955 or 1960. But this would not seem practical. As a practical matter, I would suggest 1966 as the base year, that being five years before 1971; in 1966, although in my view interest rates were too high, they were enough lower than 1971 to make it worthwhile to push them back to that rate. It appears that the legislation would have to provide that the interest rate in the base year should be as determined by the agencies set forth respectively in the footnote on page 265 of the tables transmitted herewith.

There is also the question as to what the excess interest tax rate should be on the excess net interest as determined. Theoretically, it should be 100 percent, but that might not be practical for a number of reasons. I, therefore, suggest a rate of 90 percent. The practical consequence of this proposal would be to push interest rates back to about 10 percent above the 1966 levels.

There is no doubt in my mind that some of your technical assistants can improve upon my suggestion, and work it out in detail. It may be that the whole matter is so complex and thorny that no proposal would have any chance of enactment; certainly, it would stir up an immense amount of objection. But it might be worthwhile to try something, which would have value as an indication that there is a determination to do something about the subject.

As an alternative to legislating the foregoing proposal, or some alternative to it, the selected specific proposal might be inserted in the Report of the Senate Finance Committee, as a guideline to those who determine interest rates. The Report might also indicate intent at a later date to back up the proposal with legislation, if a satisfactory voluntary response to it is not made manifest over the next year or two. This procedure would seem entirely appropriate, especially in view of the guidelines now in evolution on wages and prices, and the possibilities that the Executive Branch may even develop guidelines on interest rates. Why not then the Congress also, in view of the two decades of default on the part of the Executive Branch and the Federal Reserve System?

Many thanks for the opportunity you have accorded me to make suggestions to you on this matter of vital importance.

With all good wishes,

Very sincerely yours,

LEON H. KEYSERLING.

Enclosure.

TABLE C-57.—BOND YIELDS AND INTEREST RATES, 1929–70

[Percent per annum]

Year or month	U.S. Government securities: 3-month Treasury bills [1]	U.S. Government securities: 9–12 month issues [2]	U.S. Government securities: 3–5 year issues [3]	U.S. Government securities: Taxable bonds [4]	Corporate bonds (Moody's): Aaa	Corporate bonds (Moody's): Baa	High-grade municipal bonds (Standard & Poor's)	Average rate on short-term bank loans to business—selected cities	Prime commercial paper, 4–6 months	Federal Reserve Bank discount rate	FHA new home mortgage yields [5]
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1929	(6)				4.73	5.90	4.27	(7)	5.85	5.17	
1930	(6)				4.55	5.90	4.07	(7)	3.59	3.04	
1931	1.402				4.58	7.62	4.01	(7)	2.64	2.12	
1932	.879				5.01	9.30	4.65	(7)	2.73	2.82	
1933	.515		2.66		4.49	7.76	4.71	(7)	1.73	2.56	
1934	.256		2.12		4.00	6.32	4.03	(7)	1.02	1.54	
1935	.137		1.29		3.60	5.75	3.40	(7)	.75	1.50	
1936	.143		1.11		3.24	4.77	3.07	(7)	.75	1.50	
1937	.447		1.40		3.26	5.03	3.10	(7)	.94	1.33	
1938	.053		.53		3.19	5.80	2.91	(7)	.81	1.00	
1939	.023		.59		3.01	4.96	2.76	2.1	.59	1.00	
1940	.014		.50		2.84	4.75	2.50	2.1	.56	1.00	
1941	.103		.73		2.77	4.33	2.10	2.0	.53	1.00	
1942	.326		1.46	2.46	2.83	4.28	2.36	2.2	.66	[8] 1.00	
1943	.373	0.75	1.34	2.47	2.73	3.91	2.06	2.6	.69	[8] 1.00	
1944	.375	.79	1.33	2.48	2.72	3.61	1.86	2.4	.73	[8] 1.00	
1945	.375	.81	1.18	2.37	2.62	3.29	1.67	2.2	.75	[8] 1.00	
1946	.375	.82	1.16	2.19	2.53	3.05	1.64	2.1	.81	[8] 1.00	
1947	.594	.88	1.32	2.25	2.61	3.24	2.01	2.1	1.03	1.00	
1948	1.040	1.14	1.62	2.44	2.82	3.47	2.40	2.5	1.44	1.34	
1949	1.102	1.14	1.43	2.31	2.66	3.42	2.21	2.68	1.49	1.50	4.34
1950	1.218	1.26	1.50	2.32	2.62	3.24	1.98	2.69	1.45	1.59	4.17
1951	1.552	1.73	1.93	2.57	2.86	3.41	2.00	3.11	2.16	1.75	4.21
1952	1.766	1.81	2.13	2.68	2.96	3.52	2.19	3.49	2.33	1.75	4.29
1953	1.931	2.07	2.56	2.94	3.20	3.74	2.72	3.69	2.52	1.99	4.61
1954	.953	.92	1.82	2.55	2.90	3.51	2.37	3.61	1.58	1.60	4.26
1955	1.753	1.89	2.50	2.84	3.06	3.53	2.53	3.70	2.18	1.89	4.64
1956	2.658	2.83	3.12	3.08	3.36	3.88	2.93	4.20	3.31	2.77	4.79
1957	3.267	3.53	3.62	3.47	3.89	4.71	3.60	4.62	3.81	3.12	5.42
1958	1.839	2.09	2.90	3.43	3.79	4.73	3.56	4.34	2.46	2.15	5.49
1959	3.405	4.11	4.33	4.08	4.38	5.05	3.95	[9] 5.00	3.97	3.36	5.71

TABLE C–57.—BOND YIELDS AND INTEREST RATES, 1929–70—Continued

[Percent per annum]

Year or month	U.S. Government securities				Corporate bonds (Moody's)		High-grade municipal bonds (Standard & Poor's)	Average rate on short-term bank loans to business—selected cities	Prime commercial paper, 4–6 months	Federal Reserve Bank discount rate	FHA new home mortgage yields [5]
	3-month Treasury bills [1]	9–12 month issues [2]	3–5 year issues [3]	Taxable bonds [4]	Aaa	Baa					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1960	2.928	3.55	3.99	4.02	4.41	5.19	3.73	5.16	3.85	3.53	6.18
1961	2.378	2.91	3.60	3.90	4.35	5.08	3.46	4.97	2.97	3.00	5.80
1962	2.778	3.02	3.57	3.95	4.33	5.02	3.18	5.00	3.26	3.00	5.61
1963	3.157	3.28	3.72	4.00	4.26	4.86	3.23	5.01	3.55	3.23	5.47
1964	3.549	3.76	4.06	4.15	4.40	4.83	3.22	4.99	3.97	3.55	5.45
1965	3 954	4.09	4.22	4.21	4.49	4.87	3.27	5.06	4.38	4.04	5.46
1966	4.881	5.17	5.16	4.65	5.13	5.67	3.82	6.00	5.55	4.50	6.29
1967	4.321	4.84	5.07	4.85	5.51	6.23	3.98	[10] 6.00	5.10	4.19	6.55
1968	5.339	5.62	5.59	5.26	6.18	6.94	4.51	6.68	5.90	5.17	7.33
1969	6.677	7.06	6.85	6.12	7.03	7.81	5.81	8.21	7.83	5.87	8.19
1970	6.458	6.90	7.37	6.58	8.04	9.11	6.51	8.48	7.72	5.95	9.05

[1] Rate on new issues within period. Issues were tax exempt prior to Mar. 1, 1941, and full taxable thereafter. For the period 1934–37, series includes issues with maturities of more than 3 months.

[2] Certificates of indebtedness and selected note and bond issues (fully taxable).

[3] Selected note and bond issues. Issues were partially tax exempt prior to 1941, and fully taxable thereafter.

[4] First issued in 1941. Series includes bonds which are neither due nor callable before a given number of years as follows: April 1953 to date, 10 years; April 1952–March 1953, 12 years; October 1941–March 1952, 15 years.

[5] Data for 1st of the month, based on the maximum permissible interest rate (8 percent beginning Dec. 2, 1970). Through July 1961, computed on 25-year mortgages paid in 12 years and thereafter, 30-year mortgages prepaid in 15 years.

[6] Treasury bills were first issued in December 1929 and were issued irregularly in 1930.

[7] Not available on same basis as for 1939 and subsequent years.

[8] From Oct. 30, 1942, to Apr. 24, 1946, a preferential rate of 0.50 percent was in effect for advances secured by Government securities maturing in 1 year or less.

[9] Beginning 1959, series revised to exclude loans to nonbank financial institutions.

[10] Beginning February 1967, series revised to incorporate changes in coverage, in the sample of reporting banks, and in the reporting period (shifted to the middle month of the quarter).

Note: Yields and rates computed for New York City except for short-term bank loans.

Source: Cols. (1)–(4), Treasury Department; cols. (5)–(6), Moody's Investor's Service; col. (7), Standard & Poor's Corp.; cols. (8)–(10), Board of Governors of the Federal Reserve System; col. (11), Federal Housing Administration.

Year	Public utilities	Industrial corporate bonds	Dividend yields, preferred stocks
1953	3.45	3.30	4.27
1954	3.15	3.09	4.02
1955	3.22	3.19	4.01
1956	3.54	3.50	4.25
1957	4.18	4.12	4.63
1958	4.10	3.98	4.45
1959	4.70	4.51	4.69
1960	4.69	4.59	4.75
1961	4.57	4.54	4.66
1962	4.51	4.47	4.50
1963	4.41	4.42	4.30
1964	4.53	4.52	4.32
1965	4.60	4.61	4.33
1966	5.36	5.30	4.97
1967	5.81	5.74	5.34
1968	6.49	6.41	5.78
1969	7.49	7.25	6.41
1970	8.67	8.26	7.22

Source: Public utility and independent corporate bonds, Moody's preferred stocks, Standard and Poor's.

WASHINGTON, D.C., *October 21, 1971.*

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR RUSSELL: In my testimony before the Senate Finance Committee on H.R. 10947, I urged that the House Bill be amended to overcome the great discrimination against investment in housing and essentially related commercial construction, and help restore these activities to their vital role in the total employment picture, in overcoming substandard housing conditions, and in urban renewal. In substantiation of my recommendation, I set forth before the Finance Committee the following facts, which I summarize below:

During the first half of 1971, investment in housing and commercial construction represented a smaller ratio to G.N.P. than in any year from 1947 through 1965, and smaller in ratio to gross private investment than in any year from 1947 through 1964 (see my *Chart 28* p. 296).

From 1960 to 1971, the actual rate of investment in non-residential structures averaged annually only 0.6 percent, and in residential and commercial structures only 2.1 percent, compared with 3.0 percent for G.N.P. and 3.1 percent in new plant and equipment (see my *Chart 29* p. 297).

Yet, in accord with balanced projections for economic development from 1970 to 1980, the average annual rate of growth should be 6.1 percent for non-residential structures, and 9.4 percent for residential and commercial structures, compared with 5.5 percent for G.N.P. and 4.8 percent for producers' durable equipment (see my *Chart 30* p. 298).

Investment in residential and commercial structures fell from 41.7 percent of total fixed investment in 1961 to 34.8 percent in first half 1971, and needs to rise to 38.7 percent by 1980 (see my *Chart 31* p. 299).

In 1968 (later comprehensive data not available), the value of depreciation and depletion allowance granted to real estate was only 3.8 percent of the total; the value granted to manufacturing came to 47.5 percent of the total (see my *Chart 32* p. 300).

During 1965–1972, looking at all net Federal expenditures for subsidy programs, the amount made available to housing averaged annually only 10.5 percent of the total, while the amount made available to agriculture came to 52.3 percent, and to air transportation and maritime, 17.8 percent (see my *Chart 33*, p. 301).

In 1967 (later comprehensive data not available), net income per internal revenue code as a percentage of net worth, came to only 4.3 percent for real estate, compared with 7.7 percent for all industry, 9.0 percent for manufacturing, and 6.4 percent for finance and insurance (see my *Chart 34*, p. 302).

I have estimated that, during 1961–1969, the deficit in investment in housing and commercial construction totaled 37.5 billion dollars, resulting with its multiplier effect in a loss of 75 billion in G.N.P., a loss of 6.6 million man-years of employment opportuntiy, a loss of 15.0 billion dollars in Federal revenues, and a loss of 2.2 billion dollars in state and local property taxes.

If nothing much is done to provide more stimulus to such investment, I estimate that the deficit during 1971–1980 will aggregate 295.6 billion dollars, resulting in a G.N.P. loss of 591.2 billion dollars, a loss of 41.5 million man-years of employment opportunity, a loss of 118.2 billion in Federal revenues, and of 27.8 billion in state and local property taxes (see my *Chart 35*, p. 303).

Others might arrive at considerably different estimates. Be this as it may, it is absolutely clear that properly stimulated investment in housing and commercial construction would solve one third to one half of the total *job addition* problem of achievement and maintenance of maximum nationwide employment, production, and purchasing power during the decade ahead.

The so-called boom in housing construction during the first seven months of 1971 was highly misleading and very temporary. Actually, the rate of housing starts during this period was barely higher than 1950, when the population was much smaller and the need much less. The poor record during most of the intervening years has created a vast cumulative deficit, with almost no inroads upon unsatisfactory housing, and further urban deterioration. Moreover, the rate even during the first seven months of 1971 was very far below the needed average annual rate during the decade ahead (see my *Chart 36*, p. 312).

Beyond all this, the housing "boom" during the first seven months of 1971 was but one more example of the recurrent temporary saturation of housing for families above the middle income structure, with very little being built for those lower down. In consequence, there has already set in since July 1971 a foreboding decline in housing starts.

I should add that the tax burden on real estate is extraordinarily heavy, and rising rapidly. In 1970, taking into account both income taxes and all other taxes, the tax burden on real estate as a percent of the industry's gross product (volume of economic activity occurring in an industry) was 33.6 percent, compared with 26.2 percent for all U.S. industries (G.N.P.) and 23.4 percent for all manufacturing (see my *Chart 37* p. 313).

It should be borne in mind that, in addition to the examples provided above relating to tax benefits and subsidies, there have been manifold other discriminations against housing and commercial construction. This sector was not accorded benefits in the vast Treasury concessions to the investment process early in 1971. The length-of-life provisions of Treasury Regulations are unduly unfavorable to these sectors, as against plant and equipment investment. Although it is not feasible at this time to suggest, much less to enact, thorough remedial action, the following proposals are suggested for consideration by the Senate Finance Committee *in re* H.R. 10947. These suggestions are entirely in accord with those made available to the Finance Committee by Alan J. B. Aronsohn, testifying as Counsel to the National Realty Committee, Inc., an organization with which I have been working on this technical phase of the problems covered more generally in my current letter.

RECOMMENDATION 1

The Job Development Investment Credit should be extended to the construction of new buildings. The compelling reasons for this are amply developed in the foregoing parts of this letter. The appropriate language toward this end would be to amend Section 104, Definition of Section 38 Property, of H.R. 10947, as follows:

Insert a new paragraph (b) after paragraph (a) of Section 104 as follows:

(b) REAL PROPERTY.—

(1) Section 48(a)(1)(B) (relating to the definition of tangible property which qualifies as section 38 property) is amended to read as follows:

"(B) other tangible property, but only if such property—

"(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

"(ii) constitutes a research or storage facility used in connection with any of the activities referred to in clause (i), or

"*(iii) is a building and its structural components, or*" [new material]

(2) The last sentence of section 48(a)(1) is amended by striking out "4" and inserting in lieu thereof "3".

[The succeeding paragraphs of Section 104 would be redesignated (c) through (e).]

RECOMMENDATION 2

If rental real property is not excluded from the definition of investment property under Sections 57(b) and 163(d), the reference to "reimbursed amounts" should be deleted from Section 304(a) of H.R. 10947.

This is desirable because reimbursements by a tenant of expenses incurred by a landlord do not diminish the activity of the landlord in connection with the management of the property subject to a lease, and is relevant only in connection with the determination of whether or not the property is to be treated as "net leased" by reason of the "guarantee of return" test.

RECOMMENDATION 3

It is recommended that a statement in the report of the Finance Committee clarify the Congressional intent with respect to the treatment of interest incurred during construction. It is respectively submitted that such a clarification might be in substance along these lines:

> "In its study of Section 304(a) of the House Bill, it was called to the Committee's attention that the regulations proposed by the Treasury relating to excess investment interest include in proposed regulation Section 1.57–2(b)(1)(iv) a statement that 'If the taxpayer intends to hold property as an investment by leasing such property under a net lease (as defined in sec. 1.57–3), the resulting construction interest is an investment interest expense.' The Committee feels that this statement and following statements in the proposed regulations which purport to treat interest paid or accrued on indebtednesses incurred or continued in the construction of property as investment interest do not reflect the intention of Congress in the enactment of Sections 57(b)(2)(D) and 163(d)(3)(D) and, therefore, it is requesting the Treasury Department to amend its proposed regulations with respect to construction interest to make it clear that interest incurred during the construction of property shall not constitute investment interest expense."

RECOMMENDATION 4

It is suggested that the Senate Finance Committee Report request that the Treasury include real estate property in the new Class Life Depreciation System proposed by Section 110 of H.R. 10947, together with a request that the Treasury reexamine useful life for buildings now provided in Bulletin F and the 1962 Guidelines with a view towards reducing such life toward more reasonable capital cost recovery periods. Suggested language toward this end is as follows:

> "During the Committee's consideration of depreciation and useful lives, its attention was called to the useful lives prescribed for real estate under Bulletin F and the 1962 Guidelines program and the fact that real estate was omitted from the ADR System. The Committee believes that real estate should be included in the Class Life System, and it is joining the House in requesting the Treasury Department to undertake a review of the useful lives accorded various types of real property. In this connection, the Committee believes that the useful lives generally accorded to real estate under Bulletin F and the 1962 Guidelines exceed reasonable capital cost recovery periods for investments in real property, and that the amendments to the recapture rules contained in Section 1250 of the Code, as amended by the 1969 Tax Reform Act, more than suffice to protect the public revenues from any potential abuses which might result from shortening the useful lives accorded to real property."

As I have already stated, the details of the four foregoing recommendations, and the specific language relating to them, were developed by Mr. Alan J. B. Aronsohn, to whom I have referred above, and the reasons for them are much more fully developed in his testimony before the Senate Finance Committee. However, I concur in these recommendations, representing as they do a joint effort by many groups to remedy the situation which I have described in the body of this letter.

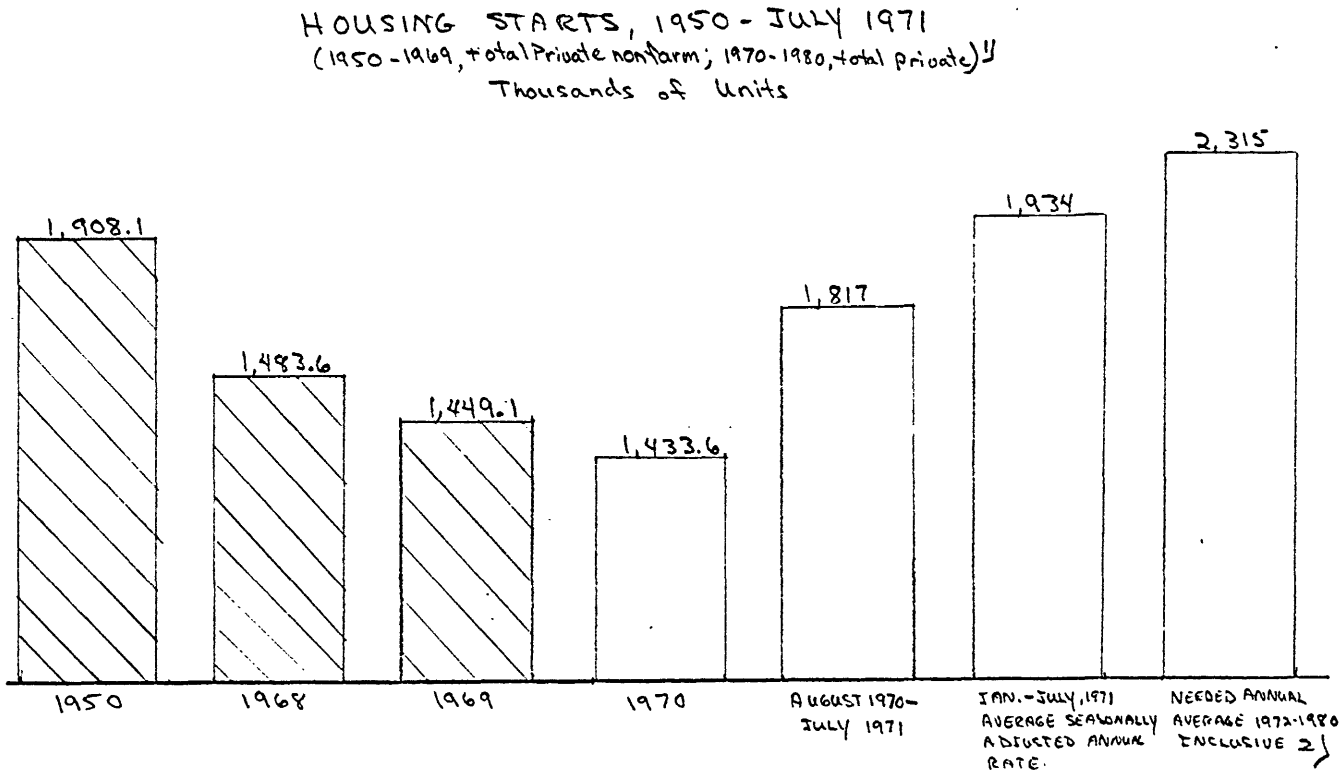
I am very reluctant to intrude upon the heavy work-load of the Finance Committee by offering this letter and the recommendations contained therein. But it is my intense conviction that the situation which I describe requires redress in the national interest, and that action by Congress in accord with the recommendations offered herein would tremendously increase the effectiveness of the currently pending legislation as a *Job Development* measure. In addition, such action would help to meet more effectively some of our most urgent domestic priority needs.

With all good wishes,

Very sincerely yours,

LEON H. KEYSERLING.

Enclosure.



1/ The available data do not permit strictly comparable data for all years, but this does not substantially affect the comparisons.

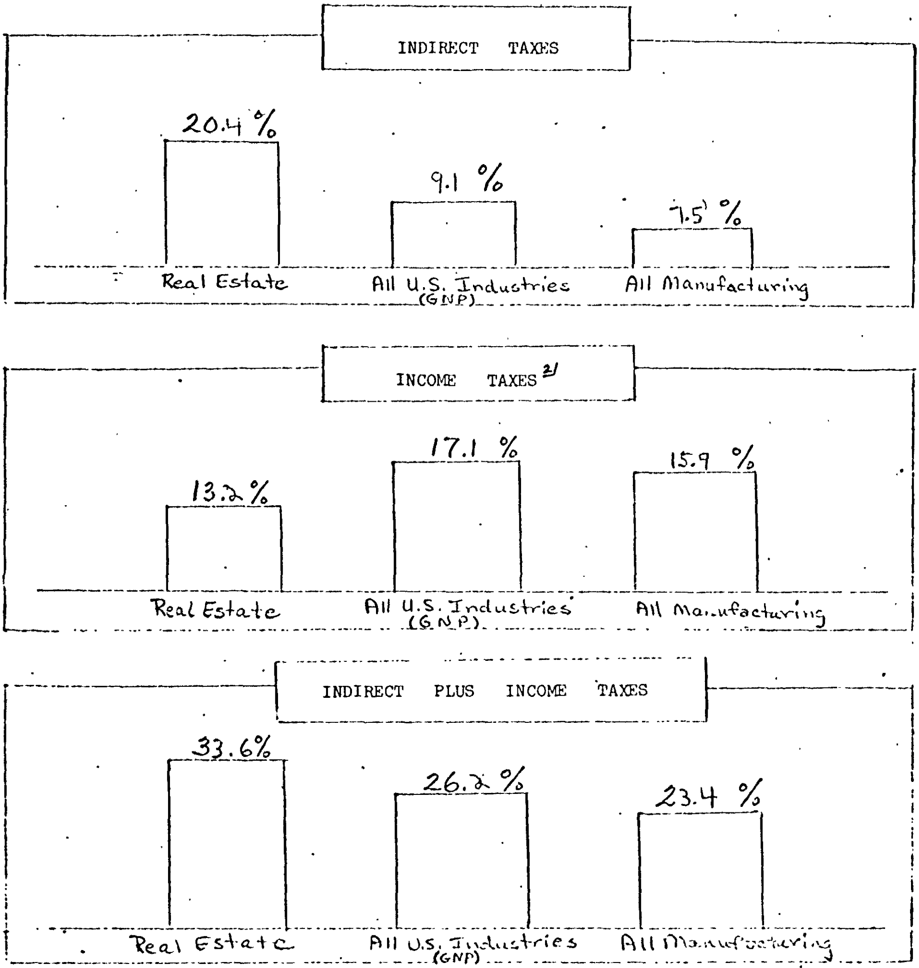
2/ Based on needed annual average of 2.2 million during 1970-1980 inclusive.

Source: Council of Economic Advisers and Economic Indicators

Chart 36

Chart 37

THE TAX BURDEN ON REAL ESTATE, 1970 1/
Taxes as a Percentage of Gross Product 1/
Real Estate and Other Industries



Notes: See attached page.

Basic Data: Department of Commerce, Office of Business Economics

The CHAIRMAN. The next witness is Mr. Norman B. Ture, economic consultant of Washington, D.C.

STATEMENT OF NORMAN B. TURE, ECONOMIC CONSULTANT, WASHINGTON, D.C.

Mr. TURE. I am Norman B. Ture, economic consultant, with offices at 1100 Connecticut Avenue, District of Columbia, and in Reston. Va. My testimony today represents my own views although I certainly would like to believe that my past and present clients would associate themselves with them.

I would like to request that my prepared statement be included in the record and I will briefly summarize it.

The CHAIRMAN. Certainly.

Mr. TURE. I appreciate the opportunity to appear before the committee and to present my views on certain features of H.R. 10947, the Revenue Act of 1971. I have focused my testimony on a number of issues which have been raised concerning the job development credit, the ADR, and repeal of the auto and excise taxes. I think much of the discussion that we have heard since the bill was received by the Committee on Ways and Means has focused on the short-run consequences of the enactment or modification. While I believe that enactment of the bill in your hands will surely have some significant effects for the short run, I would respectfully submit to the committee that the proper focus of retention is not on the short-run effects but rather on the long-term impact of the legislative proposals before you.

I think the question which should be asked with respect to each of the provisions of the proposed legislation is whether it will, over time, contribute to a freer and more efficient economy with a steadier and more rapid advance in productivity?

The reason why I feel this is because in conjunction with a stable monetary policy these are the requirements for continuing sustained increases in real income for far more stable price levels and for improving the competitive position of the United States in world markets.

In examining some of the issues which have been raised about and by the bill, I believe this committee would be well served by review of economic developments in the United States in the recent past.

In my prepared statement I have specifically spelled out in some detail several of the salient features of the mild recession of 1969–70 and of the relatively weak recovery so far this year. Rather than go into all of that detail let me simply regard what I consider to be some of its principal features. What this record shows is the weakness of the economic recovery to date is attributable almost entirely to the softness in the business sector of the U. S. economy. It is a striking fact that profits after tax in the second quarter of this year were the smallest fraction of gross corporate product. That is, the value added generated in the corporate sector of the economy in the entire post-war period.

There are some who object to this measure because they say depreciation allowances provided by provision of the tax law often are artificial and artifically depressed recorded profits. In order to avoid any sort of ambiguity on that score I think it is useful to look at corporate cash flow defined now as profits after tax plus capital consumption allowance.

In the second quarter of 1971 corporate cash flow was lower at an annual rate, lower than any post-year other than the excess profits tax years of 1951, 1954 and the recession years 1958 and 1960–61.

As a fraction of the cash of the gross product originating in the corporate sector and, in other words, corporate cash flow, profits plus depreciation and other capital consumption allowances were in the first half of the year at an extremely depressed rate.

As one might expect from looking at these data, there has been very little recovery of business investments so far this year and the official survey forecast for the remainder of this year and going into next year is for a very mild increase in total capital outlays in the American economy.

I think it is instructive to try to find the source of the weakness in the corporate sector and so far as I can see that weakness lies in the very substantial increase in business income tax liabilities which were provided by the enactment of the Tax Reform Act of 1969.

That legislation included among it very important and substantial provision of the laudible purpose of correcting abuses but the plain, simple fact is it has very substantially increased the burden on business taxpayers. It is estimated by the Treasury that in the current taxable year 1971 the results of the Tax Reform Act of 1969 increased business tax liabilities by $4.2 billion.

While the business sector of the U. S. economy was in serious difficulties as a result of the Tax Reform Act of 1969, and the recession of 1969–70, while the recovery so far has been extremely weak, in sharp contrast if we look at the household sector of the U. S. economy we find that it held up very well indeed during the mild recession of 1969–70 and the household sector has realized most of the gains from the recovery to date.

For example, from the second quarter of 1970 to the second quarter of this year, personal disposal income, that is, income after tax, has increased by 8 percent. Personal savings has gone up by 12.4 percent. Personal consumption outlays have risen by 7.7 percent. Personal consumption expenditures for durables have increased by 11.1 percent.

Against this background I think it is useful to examine some of the major criticisms which have been directed against the bill before you.

Chief among these are the following: First, that the proposed tax changes are unduly biased in favor of business. Second, the credit ADC provisions of the bill will not generate any significant increase in capital outlays in the short run and will not contribute to faster economic recovery. And, third, that larger individual tax reduction will stimulate strong increase in consumption expenditures and would be more effective in the short run in promoting economic recovery.

Let me begin with the first contention. H.R. 10974 is biased in favor of business.

I think the contrary is clearly true. The Tax Reform Act of 1969 and the present taxable bill heavily weight tax reductions in favor of nonbusiness individual taxpayers for the years 1969 through 1973. Nonbusiness taxpayers will realize tax savings aggregating $35.3 billion.

For the same years business taxpayers, corporate and unincorporated alike, will realize net tax savings of $4.8 billion, less than one-seventh of those of nonbusiness taxpayers.

Moreover, these revenue estimates do not take into account any offsetting revenue increases, which I believe will occur primarily from the business sector, which will result over time by virtue of the expansion of production potential in rsponse to the ADR and the job development credit provisions in the bill.

The second major criticism of the bill before you is that the credit and the ADR will not increase investment, it will be ineffectual in this respect. On the contrary, I am confident that the ADR, once uncertainty over its status is removed by enactment of the bill, and job development credit will encourage a significant near-term increase in capital goods, orders, and production.

I would estimate that increase might very well be of the order of $5 to $7 billion in the first fully applicable taxable year. Neither economic theory nor the historical records support the contention that business will be unresponsive to these provisions in the bill before you. The assertion that virtually no additional investment will occur assumes that business has zero price response to changes in the effective price of capital goods. That is, that the price elasticity of capital goods in the business sector is virtually zero. There are no zero price elasticities anyplace in the U.S. economy.

Reference is made to the low capacity utilization as an argument on behalf of the contention that the ADR and the job development credit will have no significant effect in the near term on investment, let me point out, as has been suggested earlier today, that the capacity utilization rate numbers are extremely ambiguous in concept. When the survey goes out to the businessman there are no directions to him as to what he should or should not include in his capacity. If a man shoved against the wall a machine which may be brought back into production under extraordinary demands, that is included in his capacity and necessarily the present capacity utilization rate. I think this is on the whole and entirely inconsequential observation, it is analogous to say that a housewife will not buy more cans of soup say when the price of those cans of soup is reduced because she already has some in her larder. If in fact that is a correct characterization of the situation, chain store and grocery store managers for years past have been managing their firms on the basis of a great misconception.

Let me go on that, however. The ADR and job development credit provision of the bill should not be characterized as windfull for business. On the contrary, extending and broadening the general economic recovery, which has been underway since the end of last year, requires vigorous growth in profits, cash flow and investment. The required increase in investment will not be forthcoming unless businesses profit anticipation are improved. Curtailment of or failure to enact the ADR and the job development credit provisions of the bill, both of those provisions, will adversely effect actual and expected business net earnings and cash flow and will adversely as well effect business anticipation of future profits. They will, as such developments would as a consequence, significantly curb the growth in business investment.

Another factor which I think the committee ought to give very careful consideration to is the very high probability in my judgment that developments under Phase 2 will dampen the profit recovery which usually accompanies a movement out of recession. The ADR and the proposed credit, I believe, are both needed to provide favorable anticipation for expansion of private capital formation. But more important than short run gains from the ADR and job development credit is a contribution which these provisions will make in the long run to accelerating the increase in productivity and real earnings upon which depend the solutions to both our domestic and international economic problems.

The reason why our balance-of-payments situation has been deteriorating over the last several years is because of the more rapid advance in productivity abroad than in the United States. This is not to say that productivity has not increased in the United States, though the rate of that increase has been slowing in recent years. It is to say that the rate of increase in productivity in a number of countries abroad, including our principal trading partners, has been materially more rapid than in the United States.

A third criticism that is opposed to the bill before you is that it provides inadequate stimulus, tax stimulus for additional consumption. In my view further tax stimulus for consumption should have an extremely low priority in tax policy at this point in time. For one thing, as I have pointed out, consumption outlays have been rising very strongly. The increase in consumption expenditures for durables is at a very nearly record rate.

Secondly, the record shows a rapid gain in disposable income and personal savings and suggests that consumption increases have not been unduly constrained by insufficient increases in after-tax incomes.

Third, and I think this is most important, contrary to a widely held impression, consumer-oriented income tax cuts have little short-term impact on consumption expenditures.

If you look at our experience under the surcharge enacted in 1968 and repealed by the provisions of the Tax Reform Act of 1969, what you will find is the following: Upon enactment of the surcharge consumption, personal consumption expenditures were not reduced nor was the rate of their growth significantly curbed. On the contrary, there was a significant reduction in personal savings. After the repeal of the surcharge, consumption outlays did not spurt ahead. What happened was that savings increased materially. There is no evidence and very little theory, indeed, to support the view that individual tax reductions have any significant effect on the rate of expansion or consumption outlays in the short run. To base tax policy at this point in time on surmise, to the contrary, I think, will be a gross error.

Moreover, further tax cuts for consumers at this time would mistakenly focus tax policy on the short run rather than on the long pull, on the principal policy objective which should be before us; that is, on more rapid and steadier increase in productivity.

Let me turn to our international trade situation and the implications of the ADR and the job development credit thereto. I am confident that the enactment of the bill with both of those provisions included, at least the present effective rate, will contribute significantly to improving our balance of trade over the long run by accelerating the rate of productivity advanced in the United States. The United States tax systems burdens the returns to capital formation very heavily, indeed. We tax returns to capital; we tax capital formation in the United States more heavily than we do cigarettes.

The Secretary of the Treasury presented to you the extremely interesting analysis the other day showing that the effect of U.S. taxation as compared with that of our principal trading partners is that the company's capital in the United States is materially higher than it is among our principal trading partners.

There are some additional data which have been referred to in the testimony so far this morning. President Nixon's Task Force on Business Taxation, on which I was privileged to serve, compiled information showing capital recovery allowances on a typical piece of industrial machinery at the end of the first, third and seventh taxable years in the United States and in a number of other countries and that table and charts thereto are included in the business task force report. But what that showed, of course, we lagged very far behind that of all of our principal competitors the law as of 1970. I have arranged to have that table and those charts updated and they are included in my prepared testimony.

What they show is that with the enactment of both the ADR and the job development credit, the U.S. taxpayer's relative portion compared to that of his competitor in these other countries would be materially improved. The gap between the U.S. businessman and his competitor abroad would be narrowed but among many of our principal trading partners we would still lag very far behind. If we eliminate either one, either the ADR or the job development credit, that gap becomes substantially wider.

The bill before you will go far to abate the tax disadvantages of U.S. compared to business abroad. It would by that token reduce incentive for U.S. business to locate those facilities abroad without the imposition of artificial constraints on international capital flows. It would for the very same reason have a significant effect on slowing the export of U.S. jobs.

Incidentally, let me call to your attention that the contention that U.S. jobs were being exported abroad is almost a universal one, it goes through every stage of our business cycle and it seems to be voiced irrespective of what the absolute facts of the case may be.

When the unemployment rate in the United States just a few years ago was 3½ percent the same contention was being offered to tax policy committees of the Congress.

One brief word, if I may, on the automobile excise and light truck excise repeal. These measures are long overdue. These excises are the very prototype of bad taxes. They have severe and adverse effects in misallocating resources among industries, misallocating labor and capital, depressing the incomes of those employed in the industries producing the taxed articles. The repeal of the excise would improve the allocation of production resources in the U.S. economy, it would increase employment, output, and earnings of the automobile industry, and it would bring car prices more closer into line with the actual factor cost of producing automobiles in the United States. It will do so both in the short and in the long run.

One of the major criticisms that has been directed against the repeal of these excises comes from the environmentalists. It seems to me they are entirely on the wrong track. If indeed their argument is correct, what we ought to do is increase the excise on automobiles. We ought to increase it to where automobile production comes to a virtual halt in this country. Then we will eliminate, certainly, the problem of air pollution generated by the use of automobiles in the Nation.

In the process, of course, we would be imposing an enormous burden on tens and hundreds of millions of Americans. The automobile industry is a much maligned industry in the United States. But let me point out to you that it has over its history provided cheap and flexible transportation service to more people than any other industry anyplace else in the world in the history of man. I think the industry certainly deserves the support of tax policy rather than a punitive approach. The industry and the oil industry in the United States are making material strides toward curbing pollution generated by the use of automobiles. Tax policy to support those efforts would be wholesome. Repeal of the automobile excise strikes me as an entirely wholesome step.

The CHAIRMAN. I just want to ask one question. Can you explain to me what is the point in taking the tax off foreign automobiles?

Mr. TURE. Well, I have been listening to the discussion so far this morning on this point with great interest. I would suggest the following. If you were to repeal the excise with respect to domestically produced automobiles and leave it on with respect to foreign produced imported automobiles, you would have in effect a selective excise on imports. This would be tantamount to having an incremental tariff on automobile imports.

I hadn't chosen to get into the subject of trade policy in general. On the whole my position is that of very liberal free trade but it seems to me that the proposition that has been suggested by Senator Fannin and yourself, sir, is one that should be taken up in the larger context of foreign trade policy.

I point out that in the near term at any rate so long as the 10 percent surcharge remains in effect, the repeal of the automobile excise still leaves a 10 percent differential against the foreign car. You may very well look ahead to the time when the surcharge is eliminated and it seems to me it is quite appropriate to take this matter up in connection with a large number of other matters of foreign trade policy.

The CHAIRMAN. Well, it seems to me that in reducing and taking the tax off of foreign automobiles we are making a $400 million investment in losing jobs for Americans. If we think in terms of people that we are doing business with in the automobile area, mainly Japan, Germany, United Kingdom and France, just a quick tabulation of that indicates that they have tariff barriers sky high on what we are sending them anyhow. How on earth could they complain if we had our barriers in line with theirs?

Mr. TURE. I have no argument with you on that point, sir, and I think that your point that you made earlier that we are not likely through any, even the most hard-nosed negotiations with our trading partners to start selling a great many American produced automobiles abroad, I think that point is well taken, but it is not necessarily the automobile we are interested in selling abroad, it is our produced products. We realize in order to be able to import we must export. The same thing is true of our trading partners.

The CHAIRMAN. They don't seem to share the same views as far as automobiles are concerned.

Mr. TURE. Yes, sir. May I add gratuitously this suggestion. The point was raised by Senator Fannin earlier this morning, that is to say, if we really wished to use tax policy as an effective instrument with respect to our international trade situation we might very well want rather than to select particular taxes on particular products, we might very well want to take a more general approach. I would suggest a wholesome, unbiased and objective evaluation of the value added taxes with border tax adjustments would very well pay.

The CHAIRMAN. Let's just understand each other. I can afford to be a statesman about liquidating that industry. We have too little of it in Louisiana, I can afford to take the broad statesmanlike view on that and say the good of the Nation requires this. I would assume if we look at the people we have been trading with, for example, the logical tradeoff would be for us to sell them more soybeans. When we do that we are trading off five dollar jobs for two dollar jobs.

Mr. TURE. We do indeed sell, a substantial portion of our exports do consist of agricultural products but not anywhere near 100 percent of them. We do export a substantial amount of manufactured items as well and, nevertheless, there is much it seems to me, Senator, in the point that you are raising and my response to that would be really to examine this issue in the broader context of trade policy generally, the whole posture of our present negotiations with our trading partners, with our competitors abroad, rather than on a highly selective basis.

People in the automobile industry are estimating that the repeal of the excise with the 10 percent surcharge in place for some indefinite period of time, presumably a short period of time, will result in a very substantial increase in output and employment in the automobile industry. Surely there would be a larger increase in that output and employment if we maintained on top of the present 10 percent surcharge the 7 percent excise on the imports.

(Mr. Ture's prepared statement with attachments follows. Hearing continues on p. 333.)

PREPARED STATEMENT OF NORMAN B. TURE, ECONOMIC CONSULTANT, WASHINGTON, D.C.

I am Norman B. Ture, an economic consultant with offices at 1100 Connecticut Avenue, Washington, D.C. and Reston, Virginia.

I appreciate the opportunity to appear before the Committee and to present my views on certain features of H.R. 10947, the Revenue Act of 1971. The bill includes a number of features which will contribute in important ways to increasing the productivity of the U.S. economy and therefore, over time, to enhancing the real sources of strength of the U.S. economy domestically and internationally. The Committee on Finance is to be commended for promptly taking up this legislation, as are the Committee on Ways and Means and the House of Representatives for their prompt and constructive response to President Nixon's legislative proposals.

This Committee will, of course, wish to review the bill carefully and to amend it when the need and opportunities for improvement become apparent. At the same time, the Committee is aware, I am sure, that the effective date provisions, particularly those pertaining to the tax reductions for individuals, impose a heavy burden on the Senate for quick action. Any tax bill as diverse in content as H.R. 10947 affords abundant opportunities for modifications. Hopefully, only the most substantively urgent will detain the Committee at this time; there should be ample opportunity for refinements next year.

While quick action is highly desirable, the tax changes proposed in the bill should not be evaluated in terms of their short-run impact on the economy. There is no economic emergency—nor was there one in recent months—which commends the bill before this Committee; neither this bill nor the other elements of the President's New Economic Policy will instantly cure our economy's ailments. The question which should be asked with respect to each provision of the proposed legislation is, in my judgment, whether it will over time contribute to a freer and more efficient economy with a steadier and more rapid advance in productivity. The focus of public policy should be on the long pull, not on quick solutions to transitory problems. That focus, to repeat, should be on freeing up our markets and on more rapidly advancing our productivity. In conjunction with a stable monetary policy, these are the requirements for continuing and sustained increases in real income, for a far more stable price level, and for improving the competitive position of the United States in world markets. The provisions of H.R. 10947, therefore, should be evaluated as at least initial steps toward more effective public economic policy to support solid and enduring progress of the U.S. economy.

I wish to focus my testimony on some of the issues which have been raised concerning the Job Development Credit, the ADR, and the repeal of the auto excise, provisions of the bill which I heartily endorse. Permit me to preface my discussion by some comments on developments in the U.S. economy during the recent past.

I. THE ECONOMIC SETTING

The U.S. economy entered a recession phase in the last quarter of 1969. It turned the corner in to a recovery phase a year later, in the last quarter of 1970. Measured in terms of changes in real GNP, output, employment, and income, the recession was extremely mild by historical standards; in the same terms, the recovery to date has been somewhat less vigorous than other recoveries in the postwar era.

It is instructive to look beyond the aggregates, however. In every major sector the economy but one, substantial strength has been evident during the past year. Thus, from the second quarter of 1970 through the second quarter of 1971,

Gross national product rose by 7.6 percent.

Personal income increased by 6.3 percent.

Disposable personal income increased by 8.0 percent.

Personal saving increased by 12.4 percent.

Personal consumption outlays increased by 7.7 percent.

Personal consumption expenditures for durables increased by 11.1 percent.

Total new construction rose 16.8 percent between July 1970 and July 1971; nonfarm residential construction increased 45.6 percent in this period.

Total civilian employment in September 1971 was about one million greater than a year earlier.

Federal expenditures rose 6.2 percent.

State and local expenditures increased 13.6 percent.

On the other hand,

Corporate profits after tax, while increasing 6.8 percent over the second quarter of 1970, were lower in the second quarter of this year than in any of the years 1965–69,

Producers' durable equipment outlays (nonfarm) increased by only 2.8 percent,

Plant and equipment outlays rose by only 1.3 percent and prior to the President's August 15 proposals were expected to increase by only 2.2 percent for 1971 over 1970.

While the price level had continued to rise, the increase was markedly slower: from July 1970 to July 1971, the Consumer Price Index increased 4.4 percent, compared with a 5.9 percent increase for 1970 over 1969.

It is clear, even from this very summary review, that only private business capital formation was lagging behind the general recovery under way over the past year. Contrary to the widespread allegation, consumers were not keeping their wallets and pocketbooks closed, nor does the evidence suggest that consumption increases were constrained by too sluggish growth in disposable income.

In the business sector, on the other hand, a quite different picture is seen. Here, business spending for new production facilities has increased very little—indeed, allowing for price increases, private nonresidential fixed investment in the first half of 1971 was significantly lower than in the first half of 1970 and markedly lower than in 1969.

The reason is not hard to find; after-tax profits fell off sharply in 1969 and 1970, in large part because of the repeal of the investment tax credit and other business-tax increasing provisions of the Tax Reform Act of 1969. The Treasury estimates, for example, that the 1969 measures taken together will increase business tax liabilities by $4.2 billion in 1971.

The effects of these actions are to be seen in the official data published by the Office of Business Economics in the Department of Commerce. Corporate after-tax profits plummeted from $43.8 billion in 1968 to $36.4 billion in 1970, a *reduction* of about 17 percent. During the same period, on the other hand, compensation of corporate employees rose from $291.8 billion to $366 billion, an *increase* of over 25 percent.

In 1970, after-tax corporate profits were only 6.7 percent of the gross value product produced by corporations, the smallest fraction of gross corporate product in the entire postwar period. Moreover, the modest profit recovery in the first half of 1971 resulted in virtually no increase in the after-tax profit share of gross corporate product. In contrast, compensation of corporate employees accounted for 67.6 percent of corporate gross product in 1970, up from 64.8 percent in 1968; this share was virtually unchanged in the first half of this year.

Some critics of the Job Development Credit and the ADR challenge these profits statistics, claiming that profits as measured in the national income accounts are depressed by "artificial" depreciation allowances. To eliminate any possibility of understanding profits because of overstatement of depreciation, one may instead look at corporate cash flow, i.e., after-tax profits plus depreciation allowances. Much the same picture emerges: corporate cash flow as a share of gross corporate product was 17.1 percent in 1970 and 17.3 percent in 1969, down from 18.4 percent in 1968. In fact, with the exception of the four years 1951–54, cash flow was a smaller share of gross corporate product in 1970 than in any other postwar year. The four lower years, it should be noted, were those in which the Korean excess profits tax was in effect. To be sure, corporate cash flow has increased in the first half of 1971, but as a share of gross corporate product it remains significantly below the postwar average. Moreover, it is lower than in any postwar year, except the excess profits tax years and the 1958, 1960–61 recession years. Compensation of employees, on the other hand, though a slightly smaller share in the first half of 1971 than in 1970, was nevertheless equal to the 1969 share and higher than any other postwar year except 1946.

The soft spot in the U.S. economy, clearly, is the corporate sector and business spending for production facilities. A significant part of the explanation for this softness, in the face of a widespread expansion of total spending in other sectors, lies in the substantial shift in Federal income tax liabilities from individuals to business effected by the Tax Reform Act of 1969. While many of the TRA measures were enacted for the laudable purpose of correcting abuses, the plain fact remains that they have substantially increased business tax burdens, reduced profitability, and impaired incentives to expand and modernize production facilities. The consequence has been a sharp drop in the growth of private capital formation since 1968.

The irony in these developments is that many of those who most vociferously demanded these increases in business and who now most shrilly oppose the Job Development Investment Credit and the ADR are the very ones who in fact bear the heaviest burdens from the 1969 tax increases. It is a simple truth, verified by all of the history of mankind, that no economy is better off with less than with more capital and that the smaller the amount of capital with which labor is employed, the less productive is that labor and the lower are its real earnings. And the response of the business sector to the 1969 business tax increases verifies another simple truth: if you increase the tax burdens on the returns to capital, you will slow the rate of capital formation. Thus, the precipitate slowing of private investment has not only cut into the profits of capital goods producers; it has also cost tens of thousands of employees their jobs and slowed the advance of labor productivity and real earnings relative to the advances that otherwise would have been realized.

II. SOME ISSUES

Numerous issues have been raised by President Nixon's August 15 tax proposals. Chief among these are the contentions that (1) the proposed tax changes are unduly biased in favor of business, i.e., the Job Development Credit on top of the ADR affords an excessive reduction in business tax liabilities relative to the proposed reductions for individuals; (2) the credit and ADR will not generate any significant increase in capital outlays in the short run and therefore will not contribute to faster economic recovery because corporations will hoard their tax savings or pay them out in dividends; and (3) larger individual tax reductions would stimulate a strong increase in consumption expenditures and would be more effective in the short run in promoting economic recovery.

A. The "pro-business bias" in H.R. 10947

The contention that the President's tax proposals and the provisions of H.R. 10947 are heavily biased in favor of business appears to rest in large part on a highly suspect and incomplete fiscal arithmetic. Critics of the bill add up the estimated income tax reductions, including the ADR without the ¾ year convention, which the bill provides for individuals and corporations over the years 1971–73 and find that the latter exceed the former by close to $5 billion. Q.E.D.; the bill is biased in favor of business.

This arithmetic is deficient for several reasons. First, it ignores the fact that the lion's share of the estimated tax savings from the repeal of the auto and truck excises is allocable to individuals. Secondly, it overlooks the shift in tax liabilities effected by the Tax Reform Act of 1969. And third, none of the estimates take into account the effects on tax liabilities of the potential expansion in personal and business income attributable to the ADR and Job Development Credit.

Let us rearrnge the Treasury and Ways and Means Committee revenue estimates and show the net changes in tax liabilities from the 1969 Act and H.R. 10947, as in the following table. We find that corporate and individual business tax liabilities were increased for calendar years 1969, 1970, and 1971 and with the provisions of H.R. 10947 will decrease in 1972 and 1973. Taking the five years together, business tax liabilities are reduced by $4.8 billion. Nonbusiness taxpayers, on the other hand, realized about $1.4 billion in tax reductions in 1970 and these tax reductions increase to very sizeable amounts, under the TRA and House bill, in 1971 through 1973. For the five years 1969–73, nonbusiness tax liabilities are reduced by a total of $35.3 billion.

TABLE 1.—ESTIMATED CHANGES IN BUSINESS AND NONBUSINESS TAX LIABILITIES, CALENDAR YEARS 1969–73

[Billions of dollars]

	1969	1970	1971	1972	1973	Total
Business taxpayers:						
Investment credit	0.9	2.5	1.6	−3.6	−3.9	−2.5
Reform [1]		1.0	1.1	1.2	1.3	4.6
ADR			−.7	−1.7	−2.5	−4.9
Excise			−.3	−.8	−.7	−1.7
DISC				−.1	−.2	−.3
Total	.9	3.5	1.7	−5.0	−6.0	−4.8
Nonbusiness taxpayers:						
Relief		−1.4	−6.6	−11.3	−11.9	−31.2
Excise			−.7	−1.8	−1.6	−4.1
Total		−1.4	−7.3	−13.1	−13.5	−35.3

[1] Does not include increase in individual business tax liabilities from TRA reform measures.

Note.—Columns and rows may not add to totals due to rounding.

Source: Statement submitted by Secretary Connally to the Committee on Ways and Means, Sept. 8, 1971, p. 12, and report of the Committee on Ways and Means on the Revenue Act of 1971, Sept. 20, 1971, p. 12.

It is difficult to believe that any objective exarination of these estimates would support the contention that H.R. 10947 unduly favors business taxpayers. The combined effect of the Tax Reforme Act of 1969 and H.R. 10947 affords more than seven times as much tax savings to nonbusiness taxpayers as it provides for business taxpayers. Indeed, a fair appraisal of these estimates in the light of recent and current development suggests, if anything, that the balance of tax reductions in the present bill should be redressed in favor of business taxpayers, if the total revenue loss is to be held to the amount in the bill.

All of these estimates are based on the assumption that the rate of expansion of economic activity will not be affected by the provisions of H.R. 10947. Given the relatively short-term projection, only through 1973, of these estimates, this is a reasonable assumption. For the longer term, however, the more rapid increases in private capital formation which will be made possible by the Job Development Credit and the ADR imply a larger increase in production potential than would otherwise occur. For the longer run, then, more rapid expansion of economic activity will result from these provisions. The larger flow of business and household incomes will generate, at any given tax rates, revenue increases which will offset some part of the revenue losses which are currently projected. A substantial part of those incremental revenues will represent increases in business tax liabilities. For the long term, then, the imbalance in the tax savings in H.R. 10947 in favor of nonbusiness taxpayers is even more pronounced than the table shows.

B. Effectiveness of the Job Development Credit and the ADR

Arguments over the arithmetic of the tax savings in the bill, however, only obscure the major thrust of the proposed legislation. There is little sense, in my judgment, in merely adding up dollars of tax reduction for nonbusiness and business taxpayers and in measuring equity or inequity as the difference between the two. If you do so, the score card tells you that H.R. 10947 doesn't come close to evening up the "inequity" against business in the 1969 Act; nonbusiness taxpayers remain far ahead of business in their tax savings from the '69 Act and the provisions of the present bill. But what counts is not this arithmetic but the benefits for all sectors of the economy afforded by the ADR and the proposed credit in alleviating somewhat the present heavy tax bias against the returns to capital and capital formation.

The ADF (once uncertainty over its status is removed by enactment of H.R. 10947) and the Job Development Credit should certainly encourage a significant increase in capital goods orders and production in the very near term. The bulk of *deliveries* of these new production facilities, however, should be expected to show up in the official statistics on capital outlays only with a lag of 12 to 18 months. But the flow of new orders and the response of capital goods producers thereto will quickly be revealed in the measured increases in employment, production, and income in the capital goods industry.

Some critics of the ADR and the Job Development Credit assert that these measures will have little or no effect on investment but will merely swell corporate cash hoarding. No evidence is provided to support this assertion other than to point to the current capacity utilization rates which are certainly quite low.

In evaluating this assertion, it is important first to bear in mind the ambiguity in the measure of production capacity. Many of the respondents to the capacity utilization surveys include in "capacity" machinery and equipment that is woefully obsolete and inefficient, that is seldom used, and that is brought into production only when production is running at extraordinary rates. Including these facilities, of course, unrealistically depresses the measure of the utilization rate.

A more fundamental flaw in the critics' argument, however, is the implicit and erroneous assumption that business is completely unresponsive to changes in the effective price of production facilities in making investment decisions. Both the proposed credit and the ADR should be viewed as reducing the net (of tax) price to business for using capital facilities in their production processes. To assert that enactment of these provisions will have no effect on investment is to say that the price elasticity of business demand for capital goods is zero. That this assertion is utterly incorrect is clearly shown by the response of machine tool orders, to take a simple example, to the suspension, reinstatement, and repeal of the investment tax credit. Indeed, the assertion is equivalent to claiming that housewives will not buy, say, more cans of soup when their price is reduced because they already have some cans of soup in their larders. If this is true, a great many grocery stores have been operating on the basis of a misconception for many years past.

The historical record affords no evidence to support the claim that the proposed credit and the ADR will not promptly stimulate investment but will merely increase corporate cash hoards or flow out promptly in additional dividends. On the contrary, the record shows that business has quickly responded to improvements in the tax treatment of capital recovery.

Extending and broadening the general economic recovery cannot be assured without vigorous growth in profits, cash flow, and investment. Further strong expansion in output, employment, and real earnings will require substantial increases in the stock of production facilities. But the required investment will not be forthcoming unless business can confidently anticipate a strong increase in profitability. Enactment of the Job Development Credit and the ADR provisions in H.R. 10947 will contribute materially to structuring favorable expectations. Any significant curtailment of, or failure to enact, these provisions, on the other hand, would certainly crimp the expansion of business net earnings and cash flow, thereby materially and adversely affecting business anticipations and curbing the growth in business investment. The consequence would be significantly smaller gains in employment, wages, and output and retardation of the return to full employment.

An important but uncertain element of the business outlook and in the prospects for renewed expansion of investment is the Phase II program for wages and prices. It is likely to be some time before the policy guides are firmly set and operating, but I think it is realistic to assume that in practice, they will more vigorously curb price rises than increases in wage rates. If this assumption is borne out by actual developments, the result will be a damper on the profit recovery which typically occurs in the normal pattern of recovery from a recession. As I noted earlier, the profit recovery so far this year has been weak. It is further burdened by the implementation of Phase II wage-price policy, as I believe it is likely to be, the increase in profits may very well be inadequate to sustain the expectations that would warrant any substantial growth in investment during the coming year.

Viewed in this context, enactment of both the ADR and the job Development Credit—at effective rates no lower than in H.R. 10947—is critical to providing the favorable anticipations required for expansion of private capital formation. Neither provision, in its present form, is itself likely to be adequate to the job; both are needed. And to repeat the pace of business investment in new plant and equipment is likely to be a critical determinant of the scope, vigor, and durability of economic recovery during the coming year.

Significant as the short-term gains in employment, output, and earnings in the capital goods industries will be, the more important aspect of the ADR and Job Development Credit will be their contribution over the longer term in increasing productivity and real earnings. Increasing productivity is the prerequisite for more rapid increases being dissipated in higher prices or increased unemployment. Accelerating the advance in productivity is also the basic source for long-term improvement in our balance of payments situation—realignment of the dollar with other currencies today will offer no effective solution for tomorrow if our production costs continue to increase relative to those of foreign producers. Moreover, productivity advances are the only unltimate source for the real financing of the expanding public programs we are urged to adopt in efforts to solve social and economic problems.

It is in this context, I submit, that this Committee and the Congress should evaluate the provisions of H.R. 10947. The Job Development Credit and ADR may not alone be enough to assure an adequate acceleration in productivity advance which is basic to making progress towards solution of our domestic and international problems. But these tax measures are at the least important first steps. Surely we would be ill advised to reject or dilute their contribution to greater productivity on the basis of rhetoric about "trickle down" or "tax breaks for business" or unfounded assertions about their ineffectuality.

C. More Stimulus for Consumption

Some critics of the ADR and Job Development Credit assert that what is needed is not more investment but more stimulus for consumption expenditures. This assertion is based on visceral preference, not analysis. The record shows that the household sector of the economy held up very well through the mild recession of 1969–70 and has realized the lion's share of the gains from the recovery date. In fact, this year's second quarter increase in *disposable* personal income was more than 86 percent of the total increase in GNP in that quarter. As I pointed out earlier, consumption outlays have increased strongly, particularly for durables. And the high personal saving rate over the past year certainly does not suggest that increases in consumption expenditures are being curbed by insufficient increases in disposable income.

To repeat, it is not the household sector and consumption which accounts for any inadequacy in the pace of economic recovery. It is, rather, the fact that business income and investment were hit hard by the Tax Reform Act of 1969 and the ensuing recession, and that recovery in the business sector has been weak.

Would additional income tax reductions for consumers quickly increase consumption expenditures? Both economic theory and the historical record argue that the short-run impact of such tax cuts on consumption is very small, indeed. The principal effect of the 10 percent income tax surcharge of 1968 was to cut the personal *saving* rate, not to curb expenditure increases. The principal effect of the expiration of the surcharge to date has been to increase the personal *saving* rate, not to spur more rapid gains in consumption outlays. As a short-term measure for accelerating economic recovery, personal income tax reduction aimed at increasiing consumption outlays offers little promise.

Moreover, tax cuts aimed at stimulating a more rapid rise in consumption expenditures would represent an ill-founded focus only on the near term. To repeat, the urgently required focus is on the long run, on a more rapid and steadier increase in productivity. The principal initiative for productivity-increasing measures lies in the business sector. To activate that initiatives the more favorable tax climate which will be afforded by the ADR and the Job Development Credit is an important and constructive feature of public policy

AAA. INTERNATIONAL ECONOMIC IMPLICATIONS

I alluded above to the contribution which the ADR and Job Development Credit will make to easing our balance of payments difficulties by accelerating the advance of productivity in the United States. Lest too much be claimed in this respect, let me state at the outset that it would be foolish to anticipate any quick and complete redress in our balance of trade for the enactment of these provisions. Indeed, there are no easy measures for promptly erasing our trade deficit and for generating a large trade surplus. To repeat again, the policy focus here must be on the longer term.

The reason is simple. Our international trade position depends fundamentally on real factors, on our real productio.ı advantages relative to those of our trading partners. The deterioration of our trade balance reflects fundamentally the more rapid gains in productive efficiency abroad than in the United States over the past two decades. The slower pace of productivity advance in the United States than in many of the other industrial nations was reported in the lead story of the Wall Street Journal on October 6, 1971, which showed that for the period 1965–70, the U.S. lagged far behind Japan, the Netherlands, Sweden, France, Germany, Italy, and the United Kingdom in the average yearly gain in output per man-hour.

Many factors, of course, enter into the determination of the rate of advance of productivity, and there is a temptation to claim too much for one or another of these factors. Whatever its relative importance, however, there is no doubt that the rate of growth of the stock of production facilities relative to the rate of growth of employment is one such factor. Similarly, there can be little doubt that retarding the growth of capital formation will slow the advance in productivity and that speeding up additions to the stock of capital will enhance productivity gains. And while many factors also enter into business decisions about the amount of additional production facilities to be purchased, tax considerations surely play an important role.

Secretary Connally presented to the Committee last week some important and revealing information concerning the impact of taxes on the cost of capital in the United States and abroad. As these data show, the U.S. tax system burdens the returns to capital and capital formation more heavily than do the tax systems of other major industrial nations. In themselves, these data do not fully account for the adverse developments in our trade balance, but they strongly urge that at least in this connection, tax changes such as the ADR and the Job Development Credit will contribute importantly to increasing U.S. productivity and in time to improving our international trade position.

A vivid picture of the tax disadvantage of U.S. business relative to businesses in other industrial nations was presented in the 1970 Report of President Nixon's Task Force on Business Taxation on which I was privileged to serve. Table II and Chart A in that report show the proportion of the cost of industrial machinery and equipment recoverable at the end of the first, the third, and the seventh year under U.S. and other nations' tax laws. It should be stressed that in the case of the U.S., the proportions shown are, with few exceptions, the maximum amounts actually allowed, whereas in the case of most of the other countries the indicated proportions are those prescribed by statute from which substantial exceptions favorable to the taxpayer are very often made.

The following tables and charts update the materials in the Task Force Report.

TABLE II.—COMPARISON OF COST RECOVERY ALLOWANCES[1] FOR INDUSTRIAL MACHINERY AND EQUIPMENT IN LEADING INDUSTRIAL COUNTRIES WITH SIMILAR ALLOWANCES IN THE UNITED STATES[2]

	Representative cost recovery periods (years)	Aggregate cost recovery allowances (percentage of cost of assets)		
		1st taxable year	1st 3 taxable years	1st 7 taxable years
Belgium	[3] 10	[4] 20.0	48.8	[5] 89.0
Canada[6]	[3] 10	[4] 23.0	56.1	90.9
France	[7] 8	15.6	60.1	[8] 92.2
Italy	[9] 6	[10] 20.0	[11] 65.0	100.0
Japan	[12] 11	[13] 34.5	56.9	81.4
Luxembourg	[3] 10	[14] 28.0	60.4	94.4
Netherlands	[9] 5	10.0	50.0	100.0
Sweden	[15] 5	[4] 40.0	75.7	110.0
Switzerland	[3] 6⅔	15.0	58.4	90.0
United Kingdom	[3] 8	[16] 80.0	[17] 88.8	[17] 96.4
Western Germany	[18] 9	[19] 16.7	49.6	[20] 88.8
United States:				
With investment credit	[3] 13	[21] 21.7	47.9	80.1
Without investment credit	[3] 13	7.7	33.9	66.1
Proposed legislation—with ADR and investment credit	[22] 10½	[21] 23.5	54.7	88.5

[1] The capital cost recoveries for each of the foreign countries have been computed on the assumption that the investment qualifies for any special allowances, investment credits, grants, or deductions generally permitted. The deductions in the United States have been determined under the double declining balance method without regard to the limited 1st-year allowances for small businesses.

[2] Capital cost recovery allowances set forth on this table are based on those published in September 1970 by the President's Task Force on Business Taxation. The amounts set forth in that report have been reviewed and, where appropriate, updated by a leading international firm of public accountants.

[3] Double declining balance method.

[4] Full-year allowance in first taxable year.

[5] Method changed to straight line in 5th taxable year. Straight-line rate applied to original cost for 5th, 6th, and 7th taxable years.

[6] The aggregate cost recovery allowances are determined by using 115 percent of original cost.

[7] 250 percent declining balance method.

[8] Method changed to straight line in 7th taxable year. Straight-line rate applied to original cost in such year.

[9] Straight-line method.

[10] Includes additional foreshortened allowance of 15 percent.

[11] Includes additional foreshortened allowance of 15 percent, 15 percent and 10 percent in 1st, 2d, and 3d taxable years, respectively.

[12] Modified double declining balance method; 18.9 percent per Japanese Government rate table, salvage value built into rate.

[13] Includes special 1st year allowance of 25 percent; allowance reduces recoverable base cost in 2d and succeeding taxable years.

[14] Includes 18-percent allowance equivalent to 9-percent investment credit at effective 50-percent income tax rate; credit does not reduce recoverable base cost.

[15] Modified declining balance method—30-percent rate plus additional 10-percent allowance in 1st taxable year (such additional allowance does not reduce recoverable cost); accumulated cost recovery may not be less than 20 percent of cost for each year asset is in service.

[16] 80-percent allowance in 1st taxable year.

[17] 25-percent each year of remaining unrecovered cost.

[18] The average cost recovery period for machinery and equipment in Western Germany is 8 to 10 years to which additional allowances are permitted for multiple shift operations: 25 percent of allowance for 2-shift operations and 50 percent of allowance for 3-shift operations. Allowances may be further increased when plant is located in certain areas such as Berlin, areas bordering on Iron Curtain countries, and undeveloped areas.

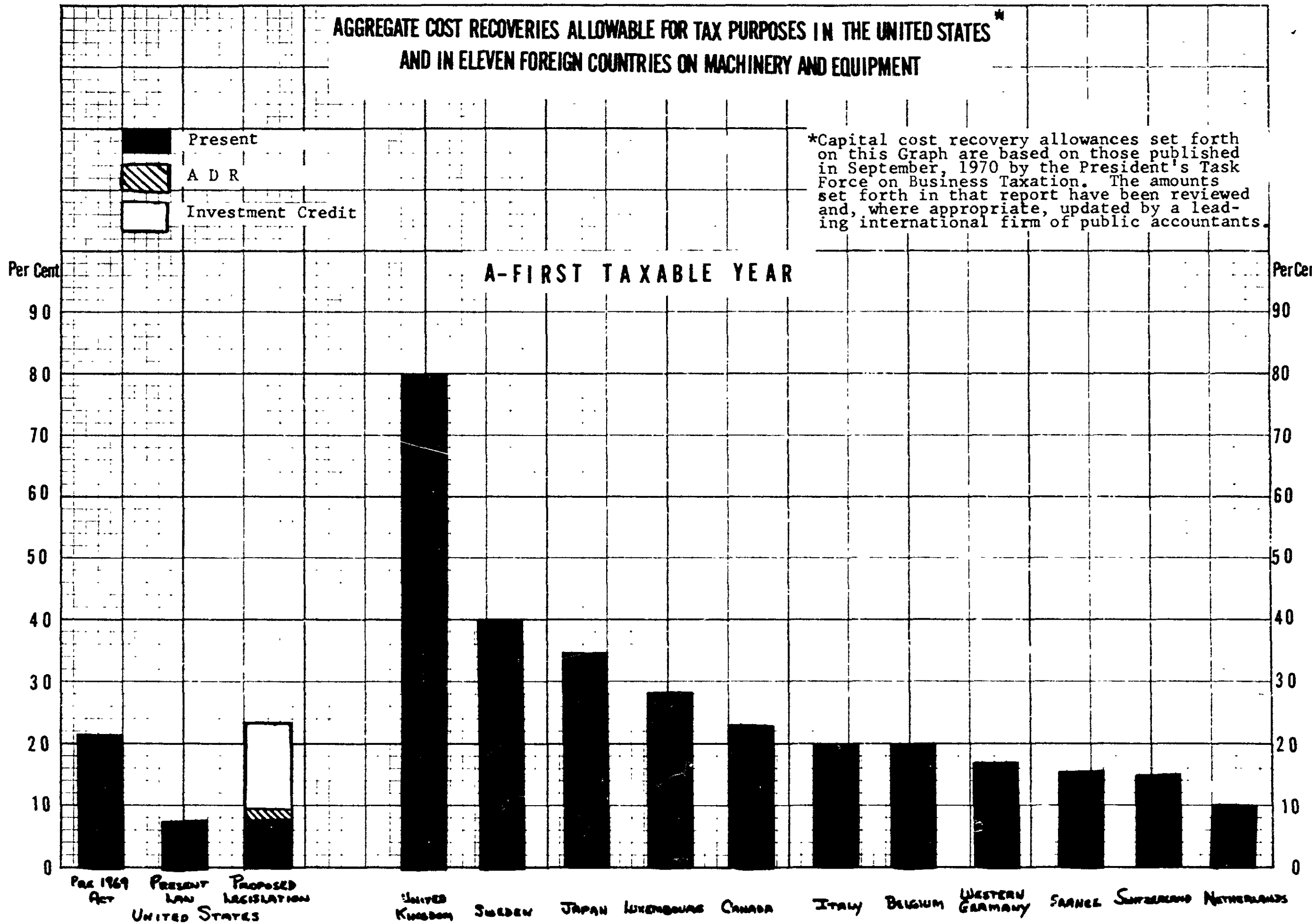
[19] Full-year allowance in 1st taxable year for assets acquired in 1st half of such year; half-year allowance for assets acquired in 2d half.

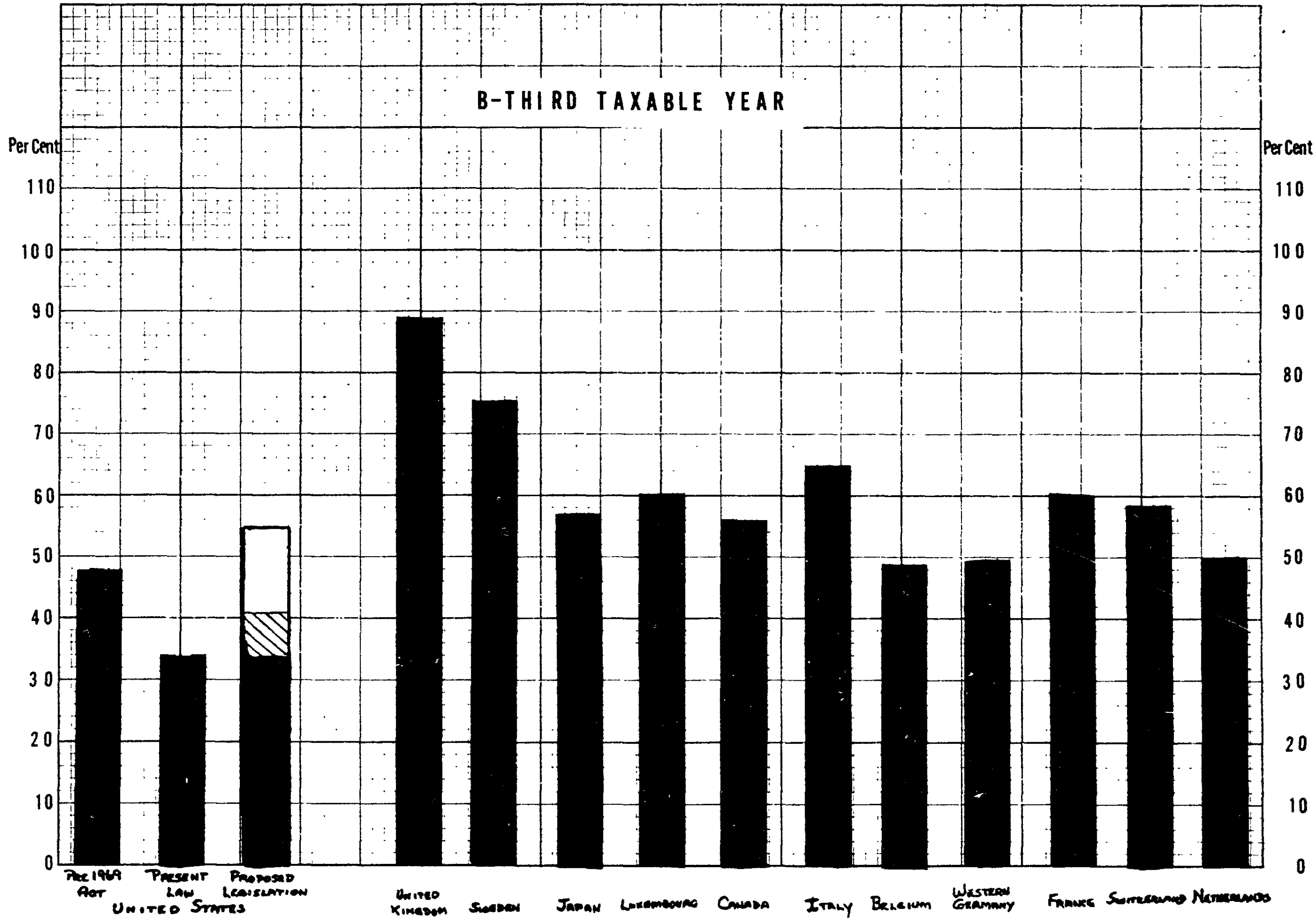
[20] Method changed to straight line in 5th taxable year. (See (17) above.)

[21] Includes 14-percent allowance equivalent to 7-percent investment credit at effective 50-percent income tax rate. Credit does not reduce recoverable base cost.

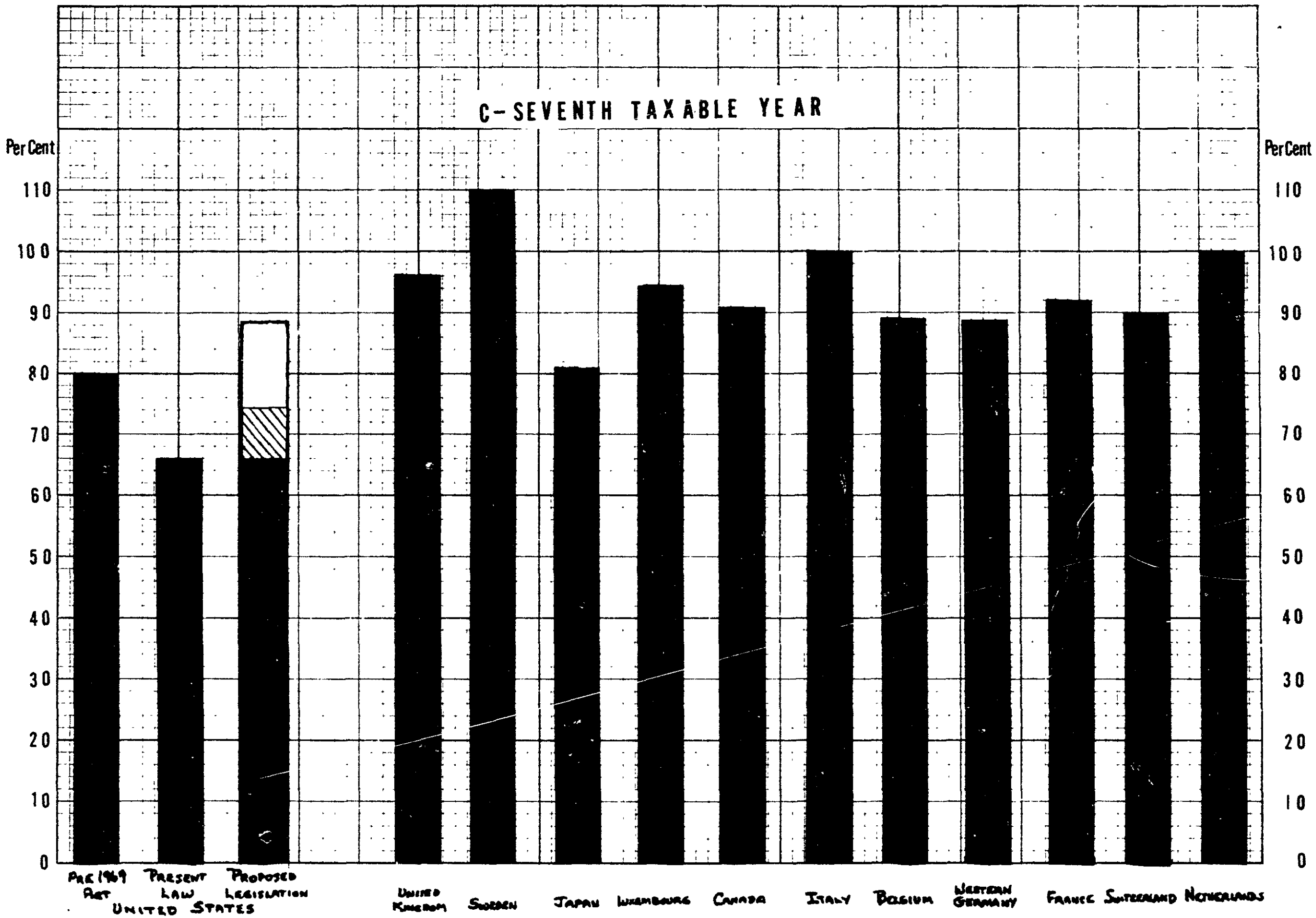
[22] 13-year recovery period reduced by 20 percent and rounded to nearest ½ year. Double declining balance method.

Note: The above table I sets forth cost recovery allowances based on an average cost recovery period of 9 years. The double declining balance method is used. A 25-percent additional allowance for 2-shift operations is taken into account beginning with the 5th year when the method is changed to straight line. The corporate depreciation rate thus computed is slightly over the maximum 20-percent-rate permitted on a declining balance method to reflect that: (A) the straight-line method produces more depreciation than does the double declining balance method for certain short-lived assets; and (B) items of machinery and equipment costing under U.S. $200 can be expensed. No other incentives have been taken into account.


AGGREGATE COST RECOVERIES ALLOWABLE FOR TAX PURPOSES IN THE UNITED STATES*
AND IN ELEVEN FOREIGN COUNTRIES ON MACHINERY AND EQUIPMENT
Present
A D R
Investment Credit
*Capital cost recovery allowances set forth on this Graph are based on those published in September, 1970 by the President's Task Force on Business Taxation. The amounts set forth in that report have been reviewed and, where appropriate, updated by a leading international firm of public accountants.
A-FIRST TAXABLE YEAR
Per Cent
90
80
70
60
50
40
30
20
10
0
Per Cent
Pre 1969 Act
Present Law
Proposed Legislation
United States
United Kingdom
Sweden
Japan
Luxembourg
Canada
Italy
Belgium
Western Germany
France
Switzerland
Netherlands



B-THIRD TAXABLE YEAR
Per Cent
110
100
90
80
70
60
50
40
30
20
10
0
Pre 1969 Act
Present Law
Proposed Legislation
United States
United Kingdom
Sweden
Japan
Luxembourg
Canada
Italy
Belgium
Western Germany
France
Switzerland
Netherlands


C-SEVENTH TAXABLE YEAR
Per Cent
110
100
90
80
70
60
50
40
30
20
10
0
Pre 1969 Act
Present Law
Proposed Legislation
United States
United Kingdom
Sweden
Japan
Luxembourg
Canada
Italy
Belgium
Western Germany
France
Switzerland
Netherlands

Comparing the second bar in the chart with the fourth and following bars, it is readily seen that under present law, U.S. cost recovery allowances for tax purposes are far less generous than those in any of the other nations shown. The enactment of the proposed Job Development Credit by itself would still leave the U.S. business taxpayer behind his counterpart in the United Kingdom, Sweden, Japan, Luxembourg, and Canada at the end of the first year, and behind his counterpart in these countries and in Italy, Belgium, Germany, France, Switzerland, and the Netherlands at the end of the third and the seventh years.

Enactment of both the credit at no less than the effective rate in H.R. 10947 and ADR would materially improve the U.S. business taxpayer's relative position. At the end of the first taxable year, he would still fall behind his competitor in the United Kingdom, Sweden, Japan, and Luxembourg, would be about in the same position as his counterpart in Canada, and ahead of those in the other countries. By the end of the third taxable year, the U.S. taxpayer's relative position would change; his competitors in the U.K., Sweden, Japan, Luxembourg, Canada, Italy, France and Switzerland would be ahead, but the gap would be narrower. At the end of the seventh year, the U.S. business taxpayer would pull ahead of the Japanese firm, would still be about on a par with his Belgium, German, and Swiss competitors, and hebind his counterpart in the other nations. But, again, his situation compared with the business taxpayer in the U.K., Sweden, Luxembourg, Canada, Italy, France, and the Netherlands would be materially better than under present law or under either the ADR or the Credit by itself.

H.R. 10947 would go far toward abating the tax disadvantage of U.S. businesses abroad. The bill would materially reduce the incentives confronting U.S. business to locate facilities abroad, without artificial constraints on the flow of capital resources. It would contribute, therefore, to arresting the supposed export of U.S. jobs. Most important, by somewhat abating the existing tax bias again capital and capital formation, it would contribute significantly to accelerating productivity gains by expanding and modernizing U.S. production facilities and to improving the long-run competitive position of American industry in international markets.

IV. ELIMINATION OF THE 7 PERCENT EXCISE ON AUTOMOBILES

The proposal to repeal the 7 percent excise on automobiles, effective August 15, 1971, would accelerate the elimination of this tax, now scheduled to be reduced in stages and finally eliminated over the next 10 years. The proposal to repeal the 10 percent excise on light trucks, effective September 23, 1971, goes beyond present law under which the tax is scheduled to be reduced to 5 percent in 1977. The existing statute, thus, clearly reflects the judgment of the Congress that the auto excise, a vestigial appendix of the World War II tax system, should be removed. The surgery is long overdue.

The present automobile excise is the very prototype of tax which virtually all tax experts, economists, consumers, labor, and businesses regard as abhorrent. It interferes with consumers' exercise of their preference by differentially increasing the price of the taxed product relative to other goods and services. It thereby reduces sales and output of the product below the levels that would otherwise prevail. It therefore reduces employment of labor and capital in the companies producing the product and lowers the real incomes of those supplying these production inputs. In short, it arbitrarily distorts the market's allocation of resources, involving losses for consumers, labor, capital—the entire economy.

The automobile excise is an especially bad tax because of the magnitude of its impact. A differential excise on a product or service to which a very small part of household budgets is allocated and to the production of which relatively few resources are allocated is bad enough in principle and in fact for the particular households and production services it affects, but it may be of little moment for the economy as a whole. The automobile excise, by contrast, involves massive interference with the efficient operation of the economy by virtue of the very magnitude of the auto industry. The tax raises the price of transportation services to tens of millions of consumers, it restricts the growth in real earnings of hundreds of thousands of workers, and it adversely impacts on the allocation of hundreds of millions of dollars of capital. Quite apart from any favorable short-run impact it may have on employment, output, and income, therefore, repeal of the excise should be hailed as a significant improvement in the Federal tax structure.

What should we expect from the proposed elimination of the excise in the short run?

In the near term, repeal of the automobile excise should result in a prompt and brisk increase in U.S. car sales and production. It should, therefore, mean an important near term increase in employment in the industry and in the industries supplying automobile manufacturers.

The repeal of the excise, taken by itself, represents a 7 percent price reduction, assuming car manufacturers pass the full amount of the tax savings along to dealers and car buyers. A price reduction of this magnitude will probably result in roughly 700,000 additional U.S. cars produced and sold in 1972. This increase in production implies additional employment of 175,000 persons. Repeal of the excise should also improve the competitive position of U.S.-produced cars in the world market and at home.

When account is taken of the surcharge on imported cars, the excise repeal results not merely in a cut in the price of U.S. cars relative to all other goods and services but also relative to the prices of the closest substitute for U.S. automobiles. At present, U.S.-produced cars carry the 7 percent excise while imported cars pay a 3½ percent duty plus the excise, or a total of 10½ percent. After the repeal, the price of U.S.-produced cars will fall by 7 percent, while the surcharge on imported cars will rise, in the near terms, to 10 percent, an increase in price differential of 6½ percent. Buyers' substitution of U.S. makes for foreign cars should significantly increase production, income, and employment in the U.S. auto industry in the near term.

U.S. car makers' profits should certainly be expected to increase as a result of the excise repeal. Moreover, the anticipation of expanded sales, production, and profits should lead U.S. car producers to amend their present investment plans to the benefit of the producers of the capital goods and facilities used in auto production and their employees. And over the longer term, investment, employment, and income in the automotive industry should be larger than other wise, while prices should be lower, more closely approximating factor costs of production.

These favorable effects on car manufacturers' and suppliers' profits and on the level of activity in the associated capital goods industries do not characterize the excess repeal as a tax break for business. A substantial part of every dollar of additional value added in the industry will go to increasing payrolls. Surely, the critics of the excise repeal cannot claim it is pro-business merely because profits will increase consequent to an increase in production.

Some enthusiasts for vigorous environmental control measures have added their voices to the criticism of the proposed repeal, viewing the automobile as a major air pollution source. But if limiting the number of automobiles in use by imposing an excise on their purchase is a good environmental control measure, why don't these critics call for a, say, 50 percent or 75 percent excise on autos? Why not use the taxing power to reduce the number of cars in use by a third, a half or three quarters?

The answer is clear: the losses in human well-being from any substantial nonmarket curtailment of the consumption of automobile transportation services would greatly exceed the gains in terms of a purer, more pleasing environment. For, despite the complaints of environmentalists and Naderites, the U.S. auto industry has served the public enormously well by making low-cost, highly flexible transportation service available to the vast majority of the population. The answer to the pollution problem is not to be found in retaining the automobile excise. Rather it lies in the continuing progress by the industry in the development of emission control systems and by the petroleum industry in the development of better fuel. These efforts should be encouraged by public policy.

V. CONCLUSION

The Job Development Credit, the ADR, and the repeal of the auto excise in H.R. 10947 should be viewed as initial steps toward providing a tax climate more nearly consonant with the requirements for advances in the productivity of our human and capital resources and for the freedom of our markets. Whatever their immediate effects in increasing employment, output and real incomes, these provisions of the bill will contribute materially over the long run to increasing the efficiency of resource allocation, to expanding our production potential, and to strengthening our international trading position. These are the considerations which should be given greatest weight in evaluation of the bill before this committee.

The CHAIRMAN. Well, thank you very much for your well-considered statement here.

We will be back here at 2:30.

(Whereupon, at 12:15 p.m., the hearing was recessed until 2:30 p.m., the same day.)

AFTERNOON SESSION

The CHAIRMAN. The hearing will come to order.

The Chair has had a request on the part of a witness who has an airplane reservation this afternoon and would like to testify as soon as possible. I would like to ask if there are other people who have a similar problem among the witnesses.

We will call Mr. John Roche, president of the American Iron and Steel Institute.

We are pleased to see you here, Mr. Roche. I hope that your problems that existed the last time you were here have been moderated somewhat since that time.

STATEMENT OF JOHN P. ROCHE, PRESIDENT, AMERICAN IRON AND STEEL INSTITUTE; ACCOMPANIED BY WILLIAM LOWE, VICE PRESIDENT, INLAND STEEL CO.

Mr. ROCHE. Thank you, Mr. Chairman.

I particularly appreciate your reference to the last time we were here and your understanding of our problems, and as a result of the hearing before this committee and other factors that have taken place, I think our situation is a little bit better than it was when we were last here.

I appreciate particularly the courtesy you have extended to me and to the gentleman who is with me, Mr. William Lowe, who is vice president of the Inland Steel Co., and chairman of the taxation committee of the institute.

In the interest of time, I know you have a time problem, I will ask that my prepared statement be made part of the record, Mr. Chairman, and I will briefly go over it in terms of some of the highlights.

The CHAIRMAN. Yes, it will be included in the record.

Mr. ROCHE. Thank you, Mr. Chairman.

The steel industry strongly favors H.R. 10947 and we believe it is important that the Nation's current economic problems be dealt with decisively and promptly. We hope that there will be favorable action on this matter by this committee and that the overall program will be adopted by the Senate.

I am skipping through this paper as I move along, Mr. Chairman.

We make reference to the removal of the 7-percent excise tax on automobiles and certain trucks, and on this point I want to say that we endorse completely the approach that was taken here by you this morning, Mr. Chairman, and by Senator Fannin in this general area of problems identified with importation and whether or not the removal should be across the board to apply to import as well as to domestically produced automobiles, and from our point of view, since the prime objective of this overall economic program of the administration and the Congress is to improve our own economy and to increase jobs in this country, we believe that this matter has to be looked at in the light in which you two gentlemen have viewed it here this morning.

I make some quotes on pages 3, 4, 5, and 6 in my paper identified with the President's task force and business taxation.

I will simply move over to page 6 and give one quote there that I think is meaningful and it is a kind of wrapup of all overall situations and the quotation reads:

"All the countries referred to," and there are many of them referred to in the report, the industrialized nations, "have deliberately focused their tax policies on affording a tax climate favorable to private investment in plant and equipment."

We think that that essentially covers our overall approach on this question of the investment tax credit. We think it is absolutely vital to the program that the administration has in mind and that the business community, at least from our point of view, has in mind that the 7-percent investment tax credit be passed by the Senate.

I want to make a few comments starting on page 7 identified with, in our own industry, where it comments that the total earnings of all companies dropped from over $1 billion in 1966 to only a little over $500 million in 1970. I further comment that the market for the steel industry of the United States is essentially a domestic market, and I come over to page 8, the paragraph in the middle of page 8, and I want to particularly stress this, Mr. Chairman, where I say the foreign-produced steel continues to enjoy a substantial price advantage in the U.S. market which cannot be overcome by domestic producers, despite the fact that efficiency in our own industries, measured by tons of product per man-hour, is better than that of any foreign steel industry, and the plain fact is that our employment costs per man-hours and our unit labor costs are so much greater than our foreign competition that we are unable to meet their prices.

Now, the comment was made here this morning, Mr. Chairman, of course, testimony by the representative from the U.S. Chamber of Commerce, and joined in by implication, at least, by some of the members of the committee, that the great factor of obsolescence in the American steel industry has to be met and that this is one of the reasons that the investment tax credit is so important.

I am not discounting at all the importance of the importance of the investment tax credit but I do want to point out that this matter of obsolescence in the steel industry has been overworked, not by the firms of the industry, but unhappily by many of those who are not too much interested in the steel industry prospering in the United States.

I can say without reservation, Mr. Chairman, that the technology of the domestic steel industry in the United States matches any in the world, including the Japanese. We have been spending billions of dollars every year for the past 10 years and we have brought our plant up to date. It is modern and up to date and it is one of these things that admittedly 15 to 20 years ago, there was a problem. We had a catchup matter to take care of but we haven't taken care of it.

On the matter of employment costs, however, as you have indicated in some of your comments this morning related to the automotive industry, and you know the same disparity applies to the domestic steel industry, there is this matter—this is a matter we cannot cope with and the 15-percent increase which became effective under the new labor agreement was negotiated in August of this year, and, of course, it just further compounds the problem.

But I do want to stress and make as clear as I can to the members of this committee and to any of the press that may be represented here, the technology is not a problem in the domestic steel industry. Our plant is up to date. We have done all of the things within our power to do. There are some that we cannot deal with, and these are outside of the borders of the United States.

Now, in summary, Mr. Chairman, we would urge that the 10-percent import surcharge be maintained until the administration has accomplished the changes in international monetary and trade policies that it is seeking, and we would also urge the elimination of the annual tax credit ceiling of 50 percent of tax liability.

If the objective is truly to stimulate investment in new machinery and equipment throughout the economy, it makes little sense to dampen possible capital expenditures by those whose taxable income is depressed for any given year.

We would further recommend that the investment credit be made applicable to expenditures for environmental improvement facilities, in addition to the 5-year capital recovery, rather than the either/or election provided for in the House bill, and we recommend that the benefits of the investment credit not be reduced by application of the 10-percent minimum tax enacted in 1969.

Finally, we suggest that the bill be amended to permit unused credit to carry forward to succeeding years to be deducted before application of the current year's credit.

H.R. 10947 provides that this practice with respect to pre-1970 tax credit carried forwarded, but not with respect to future tax credit. We urge that uniform practices be permitted in all such cases.

The steel industry, as well as industry in general, commends the inclusion in 10947 of both the job development tax credit and the ADR system for reduction of depreciable liens and we believe that it is essential that both be enacted so that capital recovery allowances in this country will be more in line with those allowed in other industrialized nations.

That is a brief statement of our overall paper, Mr. Chairman.

The CHAIRMAN. Well, thank you very much, Mr. Roche.

I would like to ask you some questions about this matter but I think in view of the fact we are going to be around here for some time this afternoon, I will withhold at this time. I think your statement is very clear and a very good statement of your position.

Senator BENNETT. I am not going to pursue questioning either, but when Mr. Roche makes the flat statement the steel industry caught up with the technology of the world, he should come out to the Geneva plant and realize that it is fighting for its life with technology that hasn't changed much since it was built in 1945.

If United States Steel would like to tell us it is going to come out there and bring that up to the very latest modern technology, I would be happy, and until it does, I will go on saying that one of the benefits of the tax credit 7-percent investment credit, is the hope that plants like this can be brought up in line with modern technology.

Mr. ROCHE. Senator, I am not going to differ with that statement. I am talking about the steel industry in general in the United States. It is a big industry. There are many companies in it.

I am sure that if Mr. Gott were sitting here, he would not claim that every one of his plants throughout the country is modern and up to date in the fashion in which he would like it, but I am saying in the overall, related to the great majority of the production that is produced by the plants in this country—and one of my associates just tells me $18 billion is a pretty good sized industry—then it seems to me that we are well on the road to having gotten over the hump that we have been sitting on our hands and not doing anything about modernizing plants.

Senator BENNETT. Well, this is a pretty good argument; don't throw it away.

Mr. ROCHE. No.

Senator BENNETT. That is all I want to say.

Mr. ROCHE. Thank you very much.

The CHAIRMAN. Thank you very much.

Senator Fannin.

Senator FANNIN. Just one comment. I do want to commend Mr. Roche on a very fine statement, and the encouraging part about your statement to me was that you do feel the 10-percent surcharge should be retained until after we have satisfactory changes in the international monetary and trade policy.

I want to emphasize that that trade policy—I don't know whether you read the comments in the paper this morning about a speech by Fred J. Borch, board chairman of the General Electric Co.?

Mr. ROCHE. No, sir; I didn't.

Senator FANNIN. Yesterday he referred to the reevaluation of the dollar.

Mr. Borch said he was amused by the hue and cry on both sides of both oceans of the imposition of what some called the trade wall of the 10-percent surcharge.

> It absolutely fascinates me as a manufacturer who has spent many years trying to scale the import tax walls of the other countries where the rates of their border tax ranges from 11 percent in Germany to 23 percent in France, and where for electrical appliances and TV imports reached 20 percent in Japan up to 36⅔ percent in England.

Have you had a similar experience?

Mr. ROCHE. Quite similar. We have said many times we couldn't give a ton of steel away in Japan. We can't get any steel in Japan and the border taxes and the entry permit system that exists in many European countries are deliberately designed to see to it that no steel gets in from the United States.

I am not talking about what goes on among the six in terms of the Common Market itself, but in terms of our moving any steel abroad. The barriers are so much higher than the surcharge, and even the surcharge in its application is not understood too well, because in many of our product lines, as it works out in its application, it is only

3, 4, 5 percent, and not 10 percent that the public generally believes is true. So that the great clamor that is put up about the unfairness of the imposition, it seems to me they protest a little too loudly.

Senator FANNIN. I agree with you wholeheartedly and, like the automobile surcharge application, it is not 10 on $3\frac{1}{2}$, but you feel both in the steel industry and the automobile industry that by the trade barriers we are facing and our available market has resulted in a boom in Japan.

Mr. ROCHE. No question about it, in our judgment. I join with Mr. Borch's statement.

Senator FANNIN. Thank you. And I feel this way about the 7-percent excise tax on cars. As far as imports are concerned, I think there isn't any reason why we shouldn't utilize some tool to help us recover a market we have lost because of their use of tools far more powerful than the excise tax.

Mr. ROCHE. This is true. That is why I join 100 percent, Senator, in what you have been saying with respect to the 7 percent, and also the same comments made by the chairman.

Senator FANNIN. Thank you.

The CHAIRMAN. Senator Hansen.

Senator HANSEN. I don't have a question, but I would like to observe for our good friends from the steel institute that, as you have so many times done yourself, if we would figure the cost of insurance and freight and discount to sales that have resulted directly from foreign-aid programs under Public Law 480, we would have had a trade deficit in a lot more than the last year or what may appear in this year, or a number of years.

Mr. ROCHE. I agree completely. As I stated in the paper, through 8 months the deficit in steel was $1.4 billion and this figure could be multiplied many times over, if not many times over, but could be increased if we went to the calculation.

Senator HANSEN. On our trade balances?

Mr. ROCHE. Absolutely.

The CHAIRMAN. Thank you very much.

Mr. ROCHE. Thank you.

(Mr. Roche's prepared statement follows:)

PREPARED STATEMENT OF JOHN P. ROCHE, PRESIDENT, AMERICAN IRON AND STEEL INSTITUTE

My name is John P. Roche. I am president of the American Iron and Steel Institute, an association of 67 domestic steel companies representing approximately 95 percent of American raw steel production. I am pleased to be here today to discuss with you the general views of the steel industry concerning the Revenue Act of 1971 as adopted last week by the House. Our industry is indeed gratified by your prompt consideration of this important measure. The steel industry strongly favors H.R. 10947, for we believe it important that this nation's current economic problems be dealt with decisively and promptly.

As enunciated by the President and reaffirmed by the House Ways and Means Committee report, the current economic needs of the nation are: to bring inflation under control, to reduce unemployment, to stimulate economic growth, to restore a reasonable balance to international payments, and to modernize our nation's productive facilities. The steel industry subscribes to these objectives. Prompt approval by the Senate of the Revenue Act of 1971 will constitute a very major step toward achievement of these important objectives.

We recognize the stated need to stimulate additional consumer expenditures and therefore the desirability of speeding up personal exemptions and increasing standard deductions as set forth in this bill.

We also hope that the elimination of the 7% excise tax on autos and certain trucks will stimulate the sale of domestic vehicles. This could mean more steel sales to Detroit. But the steel industry and steelworkers would not be the only beneficiaries. There would be more jobs for auto-workers and for those who work in the plants of all their suppliers.

While there are rather wide variations in the participation in export sales by individual steel companies, we do support any appropriate measures, such as the D.I.S.C. provisions of the bill, that will encourage increases in this nation's export sales and thereby help to alleviate the balance of payments problem.

Of particular interest to industry generally is the Job Development Investment Credit.

Although the steel industry and its employees would certainly benefit from the job development tax credit, we believe that it is of far greater importance to emphasize that the major advantages of enacting the tax credit would accrue to the economy as a whole.

We believe that functioning of the credit will create jobs, and jobs are sorely needed in our economy today.

Perhaps the best way of examining the basis for this expectation is to look at the nation's economic experience during the 1960's when the investment credit was in operation much of the time. The investment credit was, of course, proposed during the Kennedy Administration as an incentive for stimulating investment in new machinery and equipment.

As is generally recognized, the last decade was a period of prolonged economic growth for America. The growing productivity and volume of production within the economy provided more jobs, more government revenue, higher wages to employees and improved profits for industry. A substantial portion of this growth resulted from increased investment in more efficient tools of production, which in turn resulted from the more favorable climate for such investment brought about at least in part by the investment credit.

The impact of the investment credit during the 1960's was studied by the President's Task Force on Business Taxation. Their recent Report pointed out that the share of real GNP allocated to real private investment in production facilities rose "in the years 1964–1966 following the enactment of the investment credit and the depreciation revision in 1962."

This Report concluded that "our own country's experience during the recent past when we did furnish tax incentives to capital investment, and the experience of our principal competitors all suggest that such incentives do significantly encourage the development of the productive capacity of a nation."

Improving and expanding our nation's productive capacity, in turn, creates new and better jobs in several ways. People must be employed to supply all of the parts and supplies directly or indirectly going into the new machinery and equipment, and other people are then employed to build and install it. New jobs are created for still other people who operate these new tools of production once they are in place, for those who supply the raw materials which these new tools consume in the production process, and for those who transport and distribute the resulting finished products. When all of these people spend their incomes, additional new jobs are created throughout the economy. The incomes flowing from all of these new jobs, of course, generate tax revenues which far more than offset the tax cost of the investment credit.

If we are to sustain a high level of employment in this country, investment in modern and efficient facilities must be continued at a very high level during the 1970's, since perhaps as many as 20 million new jobs will need to be created and several times that number of jobs will need to be upgraded. Further, the cost of creating new jobs and of upgrading existing jobs has been constantly on the increase.

Since investments in new tools of production are only undertaken when it appears economically attractive to do so, it seems clear that the greater the incentive for such investment, the better will be our nation's chances of achieving and sustaining maximum employment during the 1970's.

A second major advantage accruing to the economy as a whole from enactment of this tax credit, would be a material improvement in this nation's international competitiveness.

An incentive such as the investment credit is required if U.S. business firms are to be placed on better footing with foreign competitors. With the prospect of this nation's first annual trade deficit in modern times, with the recent necessity to remove the dollar from the gold standard and to impose a 10% surcharge on many imports, and with foreign producers in many industries having a much greater proportion of modern equipment and much lower production costs than producers in this country, there is little doubt that the need to improve our international competitiveness is equally as great today—if not greater—than it was in 1962. Improved productivity is absolutely essential to meeting foreign competition, and improved productivity stems largely from more capital spending which, in turn, for machinery and equipment under United States rules compares unfavorably with the recovery allowed by all other industrialized nations—particularly during the first few years after a capital expenditure is made. This report also points out that "... all the countries referred to have deliberately focused their tax policies on affording . . . a tax climate favorable to private investment in plant and equipment."

In our own industry, total earnings of all companies dropped from over one billion dollars in 1966, to only a little over 500 million dollars in 1970. We sell primarily to a domestic economy whose consumption of our product has been growing relatively slowly, at an average of only 2 percent per annum over the past fifteen years.

Our domestic markets have absorbed rapidly increasing quantities of foreign steel. In the year 1968, 18 million tons of foreign products entered the United States, as compared to only 5½ million tons, five years earlier. This growth was reduced in part by the three-year voluntary limitation Japanese and European steel. In the year 1968, 18 million tons of foreign product entered the United tempting to improve and extend through 1974. But the high level of imports that remains still constitutes a formidable obstacle to our industry's well-being. For example, the deficit in steel trade the first eight months of this year was nearly $1.4 billion.

Foreign-produced steel continues to enjoy a substantial price advantage in the U.S. market which cannot be overcome by domestic producers. Despite the fact that efficiency of our industry measured by tons of product per man-hour is better than that of any foreign steel industry, the plain fact is that our employment costs per man-hour and our unit labor costs are so much greater than our foreign competition, that we are unable to meet their prices. As an example, unit labor costs in Japan are about one-quarter, and those in Western Europe are about one-half of ours. We are also adversely affected by the remission of value added taxes on exports by other countries, their barriers to imports, and their sales in our markets at less than home market prices. We believe the difference between foreign steel employment costs and ours eventually will narrow, to some extent, but for an interim period, the built-in advantage of foreign steel poses a major threat to the well-being of our industry and to the nation generally, because of steel's vital role in this nation's economy and national security.

For these reasons, we strongly urge that the 10% import surcharge to which I have already referred, be maintained until the Administration has accomplished the changes in international monetary and trade policy it is seeking.

In summary, Mr. Chairman:

Because of the high level of capital investment which will continue to be needed in our economy, we suggest certain modifications to the provisions of H.R. 10947. First, we urge the elimination of the annual tax credit ceiling of 50% of the tax liability. If the objective is truly to stimulate investment in new machinery and equipment throughout the economy, it makes little sense to dampen possible capital expenditures by those whose taxable income is depressed for any given year.

Our second recommendation is that the investment credit be made applicable to expenditures for environmental improvement facilities in addition to the five-year capital recovery, rather than the either/or election provided for in H.R. 10947. Such expenditures benefit society in general, divert available funds from more productive uses, and seldom produce revenues to offset the higher operating costs.

Third, we recommend that the benfits of the investment credit not be reduced by application of the 10% minimum tax enacted in 1969. Finally, we suggest that the bill be amended to permit unused credits carried forward to succeeding years to be deducted before application of the current year's credit. H.R. 10947 provides for this practice with respect to pre-1970 tax credits. We urge that uniform practices be permitted in all such cases.

The steel industry, as well as industry in general, commends the inclusion in H.R. 10947 of both the job development tax credit and the ADR system for reduction of depreciable lives. It is essential that both be enacted so that capital recovery allowances in this country will be more in line with those allowed in other industrialized nations.

The CHAIRMAN. As I had indicated, I will now call out of order Mr. John Waltersdorf, in view of his transportation problem.

STATEMENT OF JOHN M. WALTERSDORF, TRUSTEE, NATIONAL ASSOCIATION OF WHOLESALER DISTRIBUTORS

Mr. WALTERSDORF. Thank you, Mr. Chairman.

My name is John M. Waltersdorf and I am appearing here today as a trustee of the National Association of Wholesaler-Distributors. You should also know that I am a distributor and am president of Tristate Electric Supply Co. of Hagerstown, Md., where, I might add, we have an 11-percent unemployment rate right now. We distribute electrical supplies and equipment, and I am also immediate past president of the National Association of Electrical Distributors.

The National Association of Wholesaler-Distributors is composed of 77 national commodity line associations, which in turn are comprised of 26,000 merchant wholesale establishments. Our members purchase, break bulk, sell, deliver and extend credit. Approximately 50 percent of our sales are to retail establishments and dealers for resale and the other 50 percent are to industrial, commercial, institutional, and professional business users. In 1970 merchant wholesaler sales totaled nearly $250 billion.

The opportunity afforded to appear here today is greatly appreciated. I am testifying because the portion of the House-passed Revenue Act of 1971, H.R. 10947, dealing with the investment tax credit, is deficient in its ability to produce new jobs. It virtually ignores that sector of the economy which holds the largest potential number of new jobs—the distribution and services sector.

Over past decades the majority of jobs were located in industries known as the producing industries—manufacturing, farming, mining, and construction. But due to mechanization, automation, and new techniques, all four of these production industries have made phenomenal progress—in every field except the expansion of employment opportunities.

In mining, for example, there are 621,000 jobs in 1971—Survey of Current Business, Office of Business Economics, U.S. Department of Commerce, August 1971—compared with 672,000—Handbook of Labor Statistics, 1970, Bureau of Labor Statistics, U.S. Department of Labor—10 years ago, a decrease of 8 percent.

In manufacturing, there are 18.6 million jobs today compared with 16.3 million in 1961—a job increase of only 14.1 percent. Yet in the production sector as a whole, jobs actually decreased 1.2 from 26.7 million to 26.4 million. In marked contrast, jobs in the distribution and services sector increased 37.4 percent from 25.6 million to 35.2 million. The Government, in seeking ways to encourage business employment opportunities growth through the use of tax incentives must not overlook the vast potential for new jobs in the distribution and services sector of the economy because that is where the largst number of new job opportunities lie.

Wholesale distribution needs help to create jobs sooner than they would normally evolve. The need for new jobs is here today—but the means, that is capital, in the form of retained earnings is not. New jobs, therefore, must await formulation of required capital before expansion can take place.

While this growth potential is recognized, the Department of Commerce in its U.S. Industrial Outlook of 1971 gave recognition to the wholesalers' lack of working capital. There is a dire need for tax measures to permit the distribution and service industries, which are primarily composed of smaller business enterprises, to retain more capital in order to expand and adequately serve a growing nation and to provide the employment opportunities which are so desperately needed.

It should be remembered that in a manufacturing plant a new modern machine will reduce three jobs to two, or possibly to one. As this machine becomes more efficient, its products must transit through the channels of distribution to the final consumer. In many categories of merchandise the products must be serviced.

There is need to review just how investment credit, when limited to depreciable personal assets, affects different segments of the business community. The Internal Revenue Service in its publication, "Corporate Income Tax Returns, 1968," indicates that for the wholesale idustry, there was an investment credit of $51.2 million. This is for an industry which had sales totaling $206.6 billion and assets of $70.8 billion. The same publication indicates that transportation industry had total receipts of $51 billion, total assets of $75.2 billion and received an investment credit of $187.4 million.

Manufacturers had sales of $640.7 billion, total assets of $495 billion and received an investment credit of $1.3 billion. Also, corporations which provide electric, gas and sanitary services had total receipts of $33.2 billion, assets of $101.3 billion and received an investment credit of $281.1 million.

Thus, it is evident that a tax credit limited to investment in depreciable personal assets has little stimulating effect on wholesale distribution. Such limited applictaion will have little impact on this industry's capacity to provide new jobs. We believe this is also true of retailing and the service industries.

No group is more aware of the on-again/off-again nature of the investment credit concept than are the members of this committee.

Twice it has been suspended, and is now proposed again. Heat up the economy; slow down the economy; enact investment tax credit; suspend investment tax credit—but always limit the benefits to the production sector of the economy, and deny them to the distribution and service industry.

We recommend a tax adjustment based on the aggregate increase in investment in inventories and accounts receivable. In order to limit revenue loss, we suggest that this credit be limited to 20 percent of the taxable income or $40,000, whichever is the lesser. The credit would be available to all business, to corporations, partnerships, and proprietorships, engaged in every type of endeavor. Enactment would provide an increase in the available after-tax capital to finance and accelerate new jobs in the wholesaling industry.

The thrust of our proposal is contained in legislation now pending before this committee. I refer to S. 2165 introduced by Senator Griffin, a member of this committee. We believe the principles are sound.

Under the concept of a tax adjustment for an aggregate increase in inventory and accounts receivable, a 3-year moving average is recommended. The tax adjustment would be allowed on the increase over the previous 3-year average. For example, if a wholesaler-distributor increases his inventory and receivables in 1972, he would not receive a tax credit unless his average level of inventory and receivables for the years 1970, 1971, and 1972, is higher than his average inventory and receivables for the years 1969, 1970, and 1971. The tax adjustment would be computed on the difference between the two averages.

We believe that because the distribution and service industries are made up, to a very large extent, of smaller business enterprises, the tax adjustment proposed in S. 2165 will result in the production of hundreds of thousands of new jobs which otherwise would not develop for some years. We believe this can be accomplished with minimum revenue loss. Further, we believe that the accelerated production of these new job opportunities is worth the revenue loss; and that a maximum number of jobs can be created by timely aid that will assist the distribution and service industries to retain the capital required to expand.

Your consideration of these views will be appreciated.

On behalf of the wholesale distribution industry, may I express again our thanks for the time afforded us here today.

The CHAIRMAN. Thank you very much.

(Mr. Waltersdorf's prepared statement with attachments follow:)

PREPARED STATEMENT OF JOHN M. WALTERSDORF, TRUSTEE, NATIONAL ASSOCIATION OF WHOLESALER-DISTRIBUTORS

My name is John M. Waltersdorf and I am appearing here today as a Trustee of the National Association of Wholesaler-Distributors. You should also know that I am a distributor and am President of Tristate Electric Supply Company of Hagerstown, Maryland, a firm which distributes electrical supplies and equipment. I am also immediate past President of the National Association of Electrical Distributors.

The National Association of Wholesaler-Distributors is composed of 77 national commodity line associations, which in turn are comprised of 26,000 merchant wholesale establishments. Our members purchase, break bulk, sell, deliver and extend credit. Approximately 50% of our sales are to retail establishments and dealers for resale and the other 50% are to industrial, commercial, institutional and professional business users. In 1970 merchant wholesaler sales totaled nearly 250 billions of dollars.

The opportunity afforded to appear here today is greatly appreciated. I am testifying because the portion of the House passed Revenue Act of 1971, HR 10947, dealing with the Investment Tax Credit, is deficient in its ability to produce new jobs. It virtualy ignores that sector of the economy which holds the largest potential number of new jobs—the Distribution and Services sector.

Over past decades the majority of jobs were located in industries known as the producing industries—manufacturing, farming, mining and construction. But due to mechanization, automation, and new techniques, all four of these production industries have made phenomenal progress—in every field except the expansion of employment opportunities. In mining, for example, there are 621,000 [1] jobs in 1971 compared with 672,000 [2] ten years ago, a decrease of 8%. In manufacturing, there are 18.6 [1] million jobs today compared with 16.3 [2] million in 1961—a job increase of 14.1%. Yet in the production sector as a whole, jobs actually decreased 1.2% from 26.7 [2] million to 26.4 [1] million. In marked contrast, jobs in the distribution and services sector increased 37.4% from 25.6 [2] million to 35.2 [1] million.

The segment of distribution and services which I represent—wholesale distribution—has 3.9 million employees today compared with 3 million in 1961. This is a job expansion rate of 30%, or more than double that of manufacturing for the same period.

As our economy and our society continues to develop, an ever expanding portion of our gainfully employed citizens will be engaged in distributing and servicing the goods which are produced. The August 1971 Survey of Current Business, published by the Department of Commerce, indicates that when government workers are excluded 57% of all gainfully employed persons are employed in the distribution and services segment, and only 43% in production. Some economists have predicted that by 1985, 2 out of every 3 gainfully employed persons will be in distribution and services.

It will take only one-third of our workers to produce all our needs for goods . . . for food, clothing, shelter, transportation vechicles, recreation supplies, radios, TV's, household appliances, furniture, etc. The economy has gradually evolved from one of production to one of distribution and service. This evolvement is of course a great tribute to the genius that has characterized our production industries.

Fortunately or unfortunately, this vast improvement in technology has substantially reduced the ratio of job opportunities that are available in production. The government, in seeking ways to encourage business growth through the use of tax incentives, must not overlook the vast potential for new jobs in the distribution and service sectors of the economy because that is where the largest number of new jobs lies. Wholesale distribution needs help to create jobs sooner than they would normally evolve. The need for new jobs is here today—but the means, that is capital, in the form of retained earnings is not. New jobs, therefore, must await formulation of required capital before expansion can take place.

Wholesale distribution is almost entirely composed of smaller business enterprises. Over 90% of all wholesaler-distributor firms would be classified as small business under any definition that is commonly used. It lacks access to capital markets—public markets—as sources of capital necessary for expansion.

The U.S. Department of Commerce projection of employment for our industry is five million persons by 1980 which would require the addition of 125,000 new

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[1] *Survey of Current Business*, Office of Business Economics, U.S. Dept. of Commerce, August, 1971.
[2] *Handbook of Labor Statistics*, 1970, Bureau of Labor Statistics, U.S. Dept. of Labor.

jobs each year on the average. That same projection estimates that sales by merchant wholesalers, which as I said were nearly $250 Billion in 1970, will increase to $344 Billion in 1975 and $470 Billion by 1980. A tremendous growth rate for the decade of the 70's.

While this growth potential is recognized, the Department of Commerce in its U.S. Industrial Outlook of 1971 gave recognition to the wholesalers' lack of working capital. There is a dire need for tax measures to permit the distribution and service industries, which are primarily composed of smaller business enterprises, to retain more capital in order to expand and adequately serve a growing nation and to provide the employment opportunities which are so desperately needed. It should be remembered that in a manufacturing plant a new modern machine will reduce three jobs to two, or possibly to one. As this machine becomes more efficient, its products must transit through the channels of distribution to the final consumer. In many categories of merchandise the products must be serviced.

There is need to review just how investment credit, when limited to depreciable personal assets, affects different segments of the business community. The Internal Revenue Service in its publication "Corporate Income Tax Returns, 1968", indicates that for the wholesale industry, there was an investment credit of $51.2 Million. This is for an industry which had sales totaling $206.6 Billion and assets of $70.8 Billion. The same publication indicates that the transportation industry had total receipts of $51 Billion, total assets of $75.2 Billion and received an investment credit of $187.4 Million. Manufacturers had sales of $640.7 Billion, total assets of $495 Billion and received an investment credit of $1.3 Billion. Also, corporations which provide electric, gas and sanitary services had total receipts of $33.2 Billion, assets of $101.3 Billion and received an investment credit of $281.1 Million.

The percentage relationship of the investment credit to total receipts, net income, and total assets for selected industries is given in the following table. The table is based on Internal Revenue Service statistics.

1968 RATIO OF CORPORATION INVESTMENT CREDIT TO ITEMS LISTED

[In percent]

	Total receipts	Net income	Total assets
Manufacturing	0.20	2.77	0.26
Transportation, communications, electric, gas, and sanitary services	.56	5.51	.26
Wholesale trade	.20	1.03	.07

Thus it is evident that a tax credit limited to investment in depreciable personal assets has little stimulating effect on wholesale distribution. Such limited application would have little impact on this industry's capacity to provide new jobs. We believe this is also true of retailing and the service industries.

No group is more aware of the on-again off-again nature of the investment credit concept than are the Members of this Committee. Twice it has been suspended, and is now proposed again. Heat up the economy; slow down the economy; enact investment tax credit; suspend investment tax credit . . . but always limit the benefits to the production sector of the economy, and deny them to the distribution and service industry.

Accordingly we wish to recommend to this Committee an addition to the Bill now pending in order to extend its benefits to the distribution and service industry, as it is in these industries that the greatest number of new job opportunities await.

We recommend a tax adjustment based on the aggregate increase in investment in inventories and accounts receivable. In order to limit revenue loss, we suggest that this credit be limited to 20% of the taxable income or $40,000, whichever is the lesser. The credit would be available to all business, to corporations, partnerships and proprietorships, engaged in every type of endeavor. Enactment would provide an increase in the available after-tax capital to finance and accelerate jobs.

The thrust of our proposal is contained in legislation now pending before this Committee. I refer to S. 2165. We believe the principles are sound.

Under the concept of a tax adjustment for an aggregate increase in inventory and accounts receivable, a three year moving average is recommended. The tax adjustment would be allowed on the increase over the previous three year average. For example, if a wholesaler-distributor increases his inventory and receivables in 1972, he would not receive a tax credit unless his average level of inventory and receivables for the years 1970, 1971 and 1972 is higher than his average inventory and receivables for the years 1969, 1970, and 1971. The tax adjustment would be computed on the difference between the two averages.

In the past, it has been stated that some wholesalers might abuse the purpose of the tax adjustment by making large purchases of inventories immediately at the end of the tax year. This argument is spurious. Carrying inventory costs money. It is estimated that it costs 20¢ to 35¢ per year to carry $1.00 of merchandise in inventory. Moreover, distribution is analogous to a pipeline. Goods, from the moment of production, are in a part of that pipeline until they are placed in the hands of the ultimate user. Goods are going into or out of inventories throughout the distribution process. When the wholesaler-distributor purchases from the manufacturer, the manufacturer's inventory is decreased, and the wholesaler's inventory is increased. When the wholesaler sells to his customer, the wholesaler's inventory is decreased and his customer's inventory is increased.

Our suggestion to provide a tax adjustment meaningful to the distribution industry may be met with the response that the tax credit legislation under consideration is basically aimed at increasing productivity of our producers to enable them to better compete in the export trade. But how much of the investment tax credit will really be channeled into lowering costs of goods produced for export? Ever since enactment of the tax credit, all classes of investments in depreciable personal assets have been eligible. The electric utility which serves Washington, D.C. had no exports but derived significant benefits from the credit. The railroads which hauled products for both foreign and domestic consumption received it. The value of the tax credit granted to manufacturers had no dividing line between those investments made to produce for export or for domestic consumption. It certainly cannot be said that the tax credit was, or is now being, primarily tailored to expand exports.

In 1964, the then President of NAW, John Robertson, wrote to President Johnson suggesting an extension of the investment credit concept to inventory and accounts receivable. Replying for President Johnson in a letter dated June 10, 1964, Mr. Ralph A. Dungan, Special Assistant to the President, indicated that "at current income levels (1964) a tax credit for net increases in inventories and receivables would probably lose upwards of three-quarters of a billion dollars of revenue annually". We are not able to make an estimate of revenue loss due to enactment of our proposal but inasmuch as the tax adjustment is restricted to a deduction of 20% on taxable income, or $40,000 whichever is the lesser for any single business, the revenue loss would be limited.

We believe that because the distribution and service industries are made up, to a very large extent, of smaller business enterprises, the tax adjustment proposed in S 2165 will result in the production of hundreds of thousands of new jobs which otherwise would not develop for some years. We believe this can be accomplished with minimum revenue loss. Further, we believe that the accelerated production of these jobs is worth the revenue loss; and that a maximum number of jobs can be created by timely aid that will assist the distribution and service industries to retain the capital required to expand.

Your consideration of these views will be appreciated.

On behalf of the wholesale distribution industry, may I express again our thanks for the time afforded us here today.

U.S. INDUSTRIAL OUTLOOK 1971

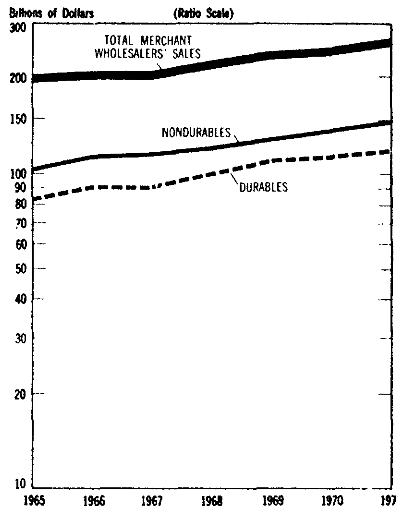
Wholesale Trade

Merchant wholesalers' sales in 1971 are expected to reach $265 billion, an increase of better than 7 percent over 1970. Wholesalers of durable goods are expected to increase sales 9 percent, and nondurable goods wholesalers' sales will increase 7 percent.

The year 1970 was disappointing for most wholesalers. Sales increases averaged only about 4 percent, and many wholesalers experienced declines. Since wholesalers function as intermediaries between producers and users of goods, they were affected by most of the major economic problems which beset the economy in 1970. Industrial wholesalers were hurt by aerospace and defense cutbacks and lagging construction. Wholesalers of consumer goods felt the impact of decreased residential construction and consumer spending.

Continuing a 1969 trend, increased operating expenses again contributed to lower profits. The profit shrinkage problem is one of the most serious concerns of the industry, since funds for capital expansion are usually internally generated from profts. As a result, there will probably be little expansion of wholesalers' plant and equipment in 1971.

Nondurables lead wholesalers' gains



SOURCE: Bureau of the Census and BDC.

Employment Costs Increase

Although total wholesale employment increased only 2 percent in 1970, wage and salary costs increased almost 6 percent. Wage increases have averaged about 4 percent per year since 1960. Even though the rate of hiring was lower in 1970, competent personnel were difficult to find. Turnover among warehousemen, equipment operators and other semiskilled labor was a problem. There is also an industry-wide shortage of experienced salesmen, and many wholesalers had to initiate training programs. Since wholesale trade hourly rates are now on a par with average manufacturing rates, wage increases should be more moderate in 1971.

Inventory Developments of Importance

Despite lower sales in 1970, wholesalers' workload and handling costs increased. Because of the prevailing tight money situation, customers resorted to ordering smaller quantities with increased frequency. Billing values and dollars per unit order were therefore down. Inventory-sales ratios reached decade-high levels for a majority of wholesale industries. Wholesalers

Table 1.—Wholesale Trade Employment Trends 1963–70

[annual average in thousands]

SIC	Industry	1963	1967	1968	1969	1970 [1]	Percent increase 1969 70	Average annual percent increase 1963-70
50	Wholesale trade	3,104	3,525	3,611	3,738	3,826	2	2
501	Motor vehicles and automotive equipment	236.1	274.5	289.1	306.3	327.5	7	3
502	Drugs, chemicals	188.4	214.6	219.3	226.9	234.7	3	2
503	Dry goods, apparel	131.8	143.6	146.3	148.6	150.3	1	1
504	Groceries	485.4	526.5	532.8	543.8	548.1	1	1
505	Farm products	91.7	94.1	96.5	93.8	n.a.	n.a.	n.a.
506	Electrical goods	234.1	276.7	289.7	304.9	333.6	9	4
507	Hardware, plumbing, heating equipment, supplies	144.2	158.6	163.8	169.9	170.7	0	2
508	Machinery, equipment, supplies	526.8	664.2	696.1	730.8	739.1	1	3
509	Miscellaneous wholesalers	1,056.0	1,166.5	1,177.5	1,213.3	1,232.6	2	2

[1] Estimated by BDC.
n a. = not available.
Source: Bureau of Labor Statistics.
Note: Employment data above are for all wholesale trades, while sales data in this chapter are for merchant wholesalers only. In the 1967 Census of Business, merchant wholesalers accounted for 69 percent of wholesale trade employment.

found that minimal profits obtain from small orders, as paperwork, processing, and transportation costs increased significantly.

Wholesalers have attempted to cut back on inventories by pruning out low-turnover goods and ordering less from suppliers. However, because of the proliferation of commodity lines and customer service requirements, this tactic has been less than successful. Pressure on gross margins finally forced wholesalers to initiate a minimum-order policy and to charge premium amounts for such minimums in an attempt to recover breakeven costs on processing and handling. Significantly, in analyzing orders to determine minimum charges, wholesalers found that in some lines 10 percent of their sales may have been marginal.

Perhaps the most important long-term inventory trend which developed over the last few years is the maintenance and storage of customer inventory by wholesalers. Major customer industries, including retailers, and commercial industrial businesses, have reduced inventory holdings and are now keeping backup stock in distributor warehouses. Wholesalers have thus far performed this service for only the largest customers. However, the practice reinforces strongly the time and place utilities which wholesalers perform.

The coming decade will continue the proliferation of consumer and industrial goods coming into the market. Even the largest retailers and industrial companies may find it prohibitively expensive to maintain full inventories in an ever-broadening product universe. Thus, wholesalers have the possibility of increasing sales and service income considerably by filling gaps in customer inventories. There is the strong possibility that customer inventory maintenance will lead to rack jobber type service by wholesalers, where wholesalers would be completely responsible for replacement needs for certain customer commodity lines, which would further strengthen distributor ties to customers. The implications of this trend to wholesalers are less product specialization because profit potential will force the addition of new lines, and considerable additions to storage faciiities and materials handling equipment.

Working Capital Shortage

Wholesalers' working capital—the difference between current income and spending—was critically short in 1970. Manufacturers cut both the time period and the discount allowable for cash payment. Wholesalers were also forced to cut back on customer cash discounts. In the tight money climate of 1970, wholesalers' customers found it cheaper to forego discounts than borrow.

Accounts receivable increased significantly over previous years. Even the largest companies fell behind in payments to distributors. Collection periods on sales, which in former years averaged 25 to 35 days, increased in many kinds of wholesale business to 60 days and more. Factor charges or bank loans to cover wholesalers' accounts receivable carried a minimum interest rate of 9 percent, but money for this purpose was in most cases scarce. Wholesalers stepped up collection efforts, and put smaller troublesome accounts on C.O.D. type payment. However, a majority of wholesalers resorted to service charges on late accounts (usually 1 to 1½ percent per month on accounts in excess of 45–60 days) as the most efficient solution to the accounts receivable problem.

Service charges were instituted strictly as a protective measure, but were adopted by a majority of the distribution industry in 1970. Since service charges did not seem to hurt sales in a not-outstanding year nor drive customers to alternate sources of supply, they will probably be permanent. Application and use of service charges in distribution markets, while not widely used yet by manufacturers, indicates wholesaler's dominance in those markets.

Transportation Crisis

Factory deliveries were again slow in 1970. Shipping delays were caused by the transportation system rather than production bottlenecks. A survey taken by the National Association of Wholesaler-Distributors in 1970 revealed that almost all distributors rely completely on common carriers for incoming shipments, and that better than 90 percent of distributors reported using motor carriers in shipments to their customers. More than 75 percent of wholesalers reported that more than one carrier handled their shipments enroute. Moreover, less than truckload shipments are held in carrier warehouses until sufficient goods are accumulated by the carrier for shipment.

It is in trans-shipment of goods from carrier to carrier that significant concealed damage losses are usually incurred. The ICC has ruled that freight bills must be paid within 7 days. Damage claims made against carriers may, however, remain open indefinitely. Almost all wholesalers reported that they had damage claims in 1969. In some cases, distributors have had to go to court for settlement of long outstanding claims.

Early in 1970, carriers arbitrarily ruled that henceforth they would be responsible for only one-third of all damage claims since there were three parties (shipper, carrier, receiver) involved. After this move by carriers, claim payments stretched out over longer periods and became even harder to collect. As a result, the National Association of Wholesaler-Distributors entered an antitrust suit in Federal District Court against the American Trucking Association, alleging conspiracy between the Association and its members in the adoption of the new damage claims policy. The ICC claimed jurisdiction in the case and has been considering it since late summer. The ICC will hold hearings on the case in 1971.

Meanwhile, the NAW has asked the ICC to establish a time limit for claim payment and that interest be paid on unsettled claims. Distributors have lost millions of dollars in concealed damage, and the pending decision will affect both the transport and distribution industries for years to come. The NAW has promised to keep the case before the courts and to seek legislative relief for damage losses.

Table 2.—Merchant Wholesalers' Inventory/Sales Ratios for Selected Years

[percent]

SIC code	Industry	1960	1965	1970 [1]
50	Merchant wholesalers, total	121	116	125
	Durable goods	162	149	163
501	Motor vehicles and automotive equipment	180	181	148
506	Electrical goods	156	142	177
5097	Furniture, home furnishings	145	152	164
507	Hardware, plumbing, heating equipment	185	174	186
5098	Lumber, construction equipment	101	103	110
508	Machinery, equipment and supplies	184	164	188
5091	Metals, metalwork	191	165	171
	Nondurable goods	91	90	94
504	Groceries	57	58	55
5095	Beer, wine, spirits	104	93	98
502	Drugs, chemicals	124	124	130
5095	Paper, paper products	108	100	111

[1] Estimated by BDC.
Sources: Bureau of the Census and BDC.

Prospects for 1971 Brighten

The easing of the money situation, increased residential and commercial construction, and consumer spending should boost wholesalers' sales for 1971. Wholesale price increases for all commodities averaged under 3 percent for 1970, while industrial commodity prices increased almost 4 percent. More moderate price increases hoped for in 1971 will decrease some of the cost pressure on wholesalers and contribute to significant real sales gains.

Many of the cost-effective measures used in 1970 by wholesalers will contribute to higher unit sales in 1971. With more money available at lower cost, the time outstanding for accounts receivable should decrease to more normal periods. Although profits are expected to rise with sales increases, the profits squeeze will remain with wholesalers. Price competition from manufacturers, employment costs, inventory proliferation and the capital expansion requirements of the industry will affect future profits.

Expansion Foreseen in Coming Decade

Merchant wholesalers are expected to increase sales to $344 billion by 1975 and $470 billion by 1980, a growth rate averaging 7 percent a year for the decade of the seventies. Durable goods wholesalers' sales will increase at a rate greater than 7 percent per year, and nondurable goods wholesalers' sales at about a 6 percent rate. Both rates are at least 1 percentage point higher than comparable growth rates achieved in the 1960's.

Future sales growth will come from increased merger activity, territorial and product line expansion. Continuing a trend started in the late 1960's, vertical integration—whereby one company handles a product from manufacturing through distribution to the ultimate consumer—will probably increase in the 1970's. Retailers will integrate with manufacturers to obtain more product control. Manufacturers will merge vertically or open their own retail outlets to expand sales. Wholesalers seem to be integrating in both directions.

Territorial expansion by wholesalers should be considerably enhanced by a Supreme Court decision which invalidated the practice by some manufacturers of setting up exclusive territories for distribution of their products. The Court ruled that a manufacturer may select its customers and sell only to selected dealers, but that once title to goods has passed from the manufacturer to distributor, the manufacturer cannot prevent the distributor from competing in other territories. Such restriction by manufacturers is now considered a violation of the Sherman Act. Probably the greatest barrier to geographic expansion by distributors—manufacturers' selective territorial policies—has thus been removed. Territorial expansion by wholesalers, possibly in the form of horizontal mergers, should therefore increase in the 1970's.

Reversing a trend which developed strongly in the 1960's, wholesalers are moving away from specialization. Even though many wholesalers continue to retain specialized line titles, they have been forced to broaden product bases. The introduction of thousands of new products along with the fragmentation of consumer markets has resulted in a proliferation of commodity lines. In order to maintain profits and serve customers in new markets, wholesalers will find it necessary to continue to broaden product distribution.

Because of this trend, wholesalers will more and more adopt a systems approach to filling customers' needs. In the markets of the 1970's, competition will require that a distributor have

Table 3.—Wholesale Trade Failure Trends for Selected Years

Industry	1960 Number	1960 Liabilities ($1,000)	1965 Number	1965 Liabilities ($1,000)	1969 Number	1969 Liabilities ($1,000)
Total wholesale trade	1,473	107,156	1,355	144,361	842	172,287
Food and farm products	321	29,318	275	27,276	199	39,442
Apparel	46	3,513	37	3,142	28	4,825
Dry goods	35	1,403	39	3,157	28	7,163
Lumber, building materials, hardware	184	14,040	183	17,542	73	7,811
Chemical and drugs	45	1,626	43	2,569	30	2,985
Motor vehicles and auto equipment	116	7,404	114	6.634	66	9,059
Electrical goods	83	7,537	78	7,392	49	13,286
Furniture and rurnishings	79	6,176	63	4,101	37	7,194
Machinery, equipment and supplies	221	12,298	221	27,231	140	12,330
Miscellaneous	343	23,841	302	45,317	192	68,192

Source: Dun & Bradstreet, Inc., business economics department.

Wholesale Trade: Trends and Projections 1963–80

[in millions of dollars except as noted]

SIC code	Industry	1963	1967	1968	1969	1970 [1]	Percent change 1969–70
50 (part)	Merchant wholesalers total	160,578	205,187	219,943	236,711	247,200	4
	Durable goods, total	68,696	90,447	100,012	109,569	111,800	2
501	Motor vehicles, automotive equipment	10,477	14,195	16,696	18,485	20,150	9
506	Electrical goods	10,248	14,112	14,969	15,753	15,600	−1
5097	Furniture, home furnishings	3,957	4,440	4,905	5,418	5,370	−1
507	Hardware, plumbing, heating equipment, supplies	7,159	8,875	9,804	10,756	10,650	−1
5098	Lumber, construction materials	9,202	8,614	10,427	11,764	10,820	−8
508	Machinery, equipment, supplies	17,162	23,836	25,466	28,075	28,630	2
5091	Metals, metalwork	6,364	9,692	10,998	11,780	12,840	9
	Nondurable goods, total	91,882	114,740	119,930	127,142	135,400	6
504	Groceries	32,436	41,287	44,131	47,786	50,800	6
5095	Beer, wine, spirits	8,369	10,427	11,088	11,909	12,750	7
502	Drugs, chemicals	6,209	8,074	8,830	9,377	9,750	4
5094	Tobacco	4,762	5,357	5,612	5,745	6,030	5
503	Dry goods, apparel	7,407	9,772	10,271	10,158	10,360	2
5096	Paper, paper products	4,837	6,236	6,707	7,294	7,460	2
505	Farm products	13,130	14,542	13,364	13,371	14,170	6

SIC Code	Industry	1971 [1]	Percent change 1970–71	1975 [1]	Percent change 1970–75*	1980 [1]	Percent change 1970–80*
50(part)	Merchant wholesalers total	265,190	7	344,000	7	470,000	7
	Durable goods, total	121,790	9	163,500	7	231,700	7
501	Motor vehicles, automotive equipment	22,170	10	32,500	10	52,300	10
506	Electrical goods	17,050	9	22,500	7	31,600	7
5097	Furniture, home furnishings	5,750	7	7,490	7	10,270	7
507	Hardware, plumbing, heating equipment, supplies	11,340	7	14,390	6	19,400	6
5098	Lumber, construction materials	11,900	10	13,800	5	17,600	5
508	Machinery, equipment, supplies	30,640	7	42,080	8	61,800	8
5091	Metals, metalwork	13,740	7	18,350	7	26,200	7
	Nondurable goods, total	143,400	6	180,500	6	238,300	6
504	Groceries	54,000	6	69,100	6	93,300	6
5095	Beer, wine, spirits	13,520	6	17,130	6	23,040	6
502	Drugs, chemicals	10,340	6	13,430	6	18,140	6
5094	Tobacco	6,330	5	7,340	4	8,930	4
503	Dry goods, apparel	10,880	5	13,220	5	16,900	5
5096	Paper, paper products	7,890	6	10,030	6	13,500	6
505	Farm products	14,460	2	15,650	2	17,300	2

[1] Estimated by BDC.
*Compound annual rate of growth.

Sources: Bureau of the Census and BDC.

the ability to sell more than products to customers. The distributor will have to provide more service to customers and become more involved in the marketing of customer products. The integration and maintenance of customer inventories with wholesalers' stocks is an indication of this trend. There will be a continued drive by customers to free capital tied up in the distribution system, thus shifting more and more inventory responsibility to distributors.

Emphasis on Strong Management

For distributors, the emphasis and direction in the 1970's will be better management rather than technology. It will take several years to utilize properly the technological developments of the 1960's. The computer is utilized by large distributors at present primarily for payroll and inventory purposes. Computer penetration of distribution markets will double or triple in the 1970's. It has been estimated that the top 5 to 7 percent of wholesalers presently own or rent computers. This percentage will increase in the 1970's to include at least the top 20 percent of wholesalers.

Not only will the number of companies using computers increase, but the purposes for which computers are used will also increase. Distributors will utilize the computer in market analysis and sales strategy to tie in with a total systems approach to fulfilling customer needs. Simulation models will be used to forecast markets and to provide alternatives for marketing and management decisions.

It will become increasingly necessary to coordinate transportation of goods with storage facilities and customer requirements. Increased shipping rates and distribution handling costs will require much better transport utilization in the 1970's. A computer order processing technique which automatically reorders low stock items from suppliers, selects carriers and delivery routes, and pinpoints delays or bottlenecks may be the most efficient solution to the transport problem. Such computer systems will be used by the profit-minded distributor of the 1970's. It has been estimated by the president of one of the largest integrated retail corporations that while at present only 20 percent of consumer goods are affected by the computer, in the seventies that figure should rise to 90 or 95 percent.

Inventory requirements (including customer stocking) and increased product lines will necessitate large increases in warehouse facilities. Efficient use of transportation requires larger shipments. The distribution warehouse of the 1970's can be expected to increase in vertical as well as horizontal space. New materials handling equipment including "stacker" cranes, automatic conveyor systems and larger fork lifts facilitate the most efficient use of warehouse space.

More Standardization a Necessity

A recent study of a food chain warehouse revealed that there were over 2,400 different sizes and shapes of shipping cartons stocked. Only 18 percent of carton sizes were used two to nine times, and 1 percent of the cartons were used 20 times or more. This condition is probably representative of most distributors' warehouse inventory situation.

Because of the concealed damage problem and increased shipping rates, common carriers, distributors, and manufacturers must move toward standardization of shipping cartons. Concealed damages will be lowered considerably if containerization—the complete sealing of a shipment at the factory—were used extensively by manufacturers. Consolidation in shipping, which requires unitization and containerization, results in lower unit rates and better deliveries. Since distributors rely heavily on commercial carriers for delivery of goods, and will continue to do so in the 1970's, unitization and standardization of shipping must be part of distribution management's systems approach to problem solving and cost cutting in the 1970's.—*Robert Jaxel, Consumer Products and Services Division.*

The CHAIRMAN. Our next witness is Mr. Edwin A. Locke, Jr., president, American Paper Institute.

STATEMENT OF EDWIN A. LOCKE, JR., PRESIDENT, AMERICAN PAPER INSTITUTE, ACCOMPANIED BY WILLIAM J. STEINMETZ, VICE PRESIDENT AND TREASURER OF THE AMERICAN CAN CO. AND CHAIRMAN, AMERICAN PAPER INSTITUTE'S FINANCIAL MANAGEMENT COMMITTEE, AND THOMAS R. LONG, ASSISTANT COMPTROLLER OF WESTVACO AND CHAIRMAN, AMERICAN PAPER INSTITUTE SUBCOMMITTEE ON TAX AFFAIRS

Mr. LOCKE. Mr. Chairman, I have with me Mr. William J. Steinmetz, vice president and trasurer of the American Can Co., and chairman of the American Paper Institute's Financial Management Committee; and on my left is Mr. Thomas R. Long, assistant comptroller of Westvaco and chairman of our tax division.

In the statement which we have submitted to the committee, Mr. Chairman, we have sketched the case history of the paper industry in the last 10 years. We have presented facts and figures to show the great similarity between the situation in 1962 and the one we face today. We have shown that in response to stagnant conditions in 1962, the U.S. Treasury significantly liberalized the depreciation rules and the Congress passed the first investment tax credit.

In the ensuing 4 years, capital investment in the paper industry more than doubled. Employment increased by 50,000 people. Productivity, cash flow, profits, income taxes, and dividends all expanded appreciably. Today, without an investment credit, with employment on dead center, with profit margins at postwar lows, and with increasing technological obsolescence in our industry, we are faced with more and greater problems than in 1962.

Capital expenditures for pollution abatement are substantial and bring no financial return. In fact, such facilities cost money to operate.

The industry's debt ratio is considerably higher than, and its liquidity ratio considerably lower than in 1962, leaving much less room for additional financing, and inflation has greatly increased costs of all kinds and has been more urgent than ever in the installation of the most modern and efficient production facilities.

With this serious and difficult situation confronting us, we have stressed in our statement the essentiality of both the asset depreciation system and the job development tax credit.

We have recommended that the tax credit be set at 10 percent in order to enhance both our domestic efficiency and our international competitiveness. As pointed out by Secretary Connally, a long-term credit of 10 percent plus the new depreciation system would only bring us into the range of the capital costs of our competitors abroad.

I have heard it said, Mr. Chairman, that the rules of the tax credit should be such as to reduce the depreciable basis of the property involved. We submit that the effect of this would be in considerable part to take away with one hand what the other hand had given, and also to cause substantial administrative complexity. We see no virtue or validity in the idea.

We have referred to our large current expenditures for pollution abatement and the fact that they are no return assets. The Tax Reform Act of 1969 rightly recognizes the need for differential tax treatment of such assets by providing 5-year rapid amortization for them but the same law denies the use of any investment tax credit for assets so amortized.

We recommend, therefore, that the law be amended to remove this prohibition and thus enable more mills to continue in operation and more jobs to be saved.

As for DISC, we recommend that the proposal put forward by the administration should be the one approved rather than the incremental approach passed by the House.

The paper industry has achieved a great expansion of its exports in the last decade and is now struggling to hold its gains. The incremental limitation will provide scant aid in this respect quite aside from the administrative complexities in competitive inequities it would cause.

In conclusion, Mr. Chairman, I should like to say a word or two about a chart we have just prepared at the American Paper Institute, and which I believe has been distributed with our statement. With your consent, I should like to place it in the record.

The paper industry is a capital intensive industry and in order to stay efficient as well as to meet the growth needs of the economy, it invests large sums each year. Recently, the industry capital expenditures for pollution abatement—and these are expenditures, I repeat, from which there will be no financial return—have increased substantially to the point where in 1971 they will total some $234 million or 19 percent of our companies' total expenditures.

In future years, as the chart shows, pollution expenditures will rise to still higher levels. This means, of course, that the industry will have that much left to invest in new production machinery and equipment.

The top line on this chart, which is in red, shows what these investments for other than pollution abatement were in 1970 and what they are estimated to be in 1971.

The very disturbing aspect of this red line is that it drops so sharply in 1971, by some 33 percent, to be exact, and by a much larger amount than the increase in the capital expenditures for pollution abatement.

We believe that the data presented on this chart show dramatically the need by the paper industry for assistance in the area of capital expenditures.

The ADR system and tax credit are vital to keeping the industry modern and efficient, and together with the DISC proposal are vital to putting the American paper industry exports on a reasonable competitive basis with those of other countries.

Mr. Chairman, thank you for this opportunity to present our views.

The CHAIRMAN. Thank you very much, sir.

Senator CURTIS. I am not sure I got the point of what you were suggesting that we repeal, which was in the Tax Reform Act of 1969.

Mr. LOCKE. The Tax Reform Act of 1969, Senator, says, that those facilities for pollution abatement on which 5-year amortization is granted are ineligible or denied any tax credit treatment. In other words, if you amortize it over 5 years, you can't apply to it the income tax credit.

Senator CURTIS. There was no credit in force at that time?

Mr. LOCKE. There was but it was terminated by that law.

Mr. STEINMETZ. The point is that there were special benefits for pollution equipment. They were created in the 1969 law, which in fact terminated the tax credit for everybody. Under the House proposed bill. There is no longer a differential or special encouragement for pollution abatement equipment. They would get the same benefits as other equipment.

Senator CURTIS. Does the House bill directly take away or deny the investment credit to equipment that is for pollution abatement?

Mr. LOCKE. The House bill gives us a choice, you can take one or the other.

Senator CURTIS. I see. Does any part of this hinge on the question of whether or not the equipment might be classified as real estate?

Mr. LOCKE. I believe I am correct in saying that it applies primarily to machinery and equipment and their foundations, that type of thing.

Mr. STEINMETZ. Special structures would qualify but not real estate per se.

Senator CURTIS. Special structures?

Mr. STEINMETZ. Yes, sir.

Senator CURTIS. Is it your understanding that special structures in the House bill qualify for the investment credit?

Mr. STEINMETZ. Yes, sir. The concept, we understand, is that the person who builds a pollution abatement facility has a choice of either the investment credit or the 5-year amortization, but that in effect puts him on a parity with other investment, other competing invesments. In effect, there is no special benefit for pollution equipment which in effect is a no-return asset and which was deemed important to encourage in the 1969 act.

Mr. LOCKE. Senator, these expenditures for pollution abatement are getting to be very substantial, as I pointed out. They are 19 percent of our total capital expenditures in 1971. Next year they will be about 25 percent.

Senator CURTIS. I have had the same question raised with respect to agricultural equipment and facilities, some of which by simple definition might be classified as buildings or real estate, but actually they are more in the nature of equipment in order for agriculture to meet the requirements of pollution abatement in reference to feed lots and barnyard lots and the like, and I am interested in this point.

Mr. LOCKE. Yes, sir.

Senator FANNIN. Mr. Locke, I wondered about the chart that shows such a drop in capital expenditures and I am certainly anxious for us to do what we can to entice industry to do more in this country and try to increase employment and for every other reason to have the investment made here. I noticed in your chart investments going down. Does that mean that more is being imported in this country?

What about the imports percentagewise, have they increased greatly?

Mr. LOCKE. No, sir; we cannot complain about imports.

Senator FANNIN. That is the problem?

Mr. LOCKE. No. There are some minor problems but we can say, at least, that we are not troubled by any Japanese imports.

Senator FANNIN. That is fine. How about the Canadian problem?

Mr. LOCKE. With Canada there are some minor problems of printing and writing papers coming in, but this is partly a matter of classification.

Senator FANNIN. It is difficult from the chart to tell what the trend had been before.

Mr. LOCKE. The trend was fairly flat before and the total capital expenditures of this industry have been between \$1.4 billion, and \$1.5 billion for the last 3 or 4 years.

Senator FANNIN. Then your pollution abatement capital expenditures have mostly been on old plants?

Mr. LOCKE. That is where the most difficult problems and the most expensive problems occur.

Senator FANNIN. I can understand.

You show 20-percent pollution abatement as a percent of the total capital expenditures. That is taking care of problems you had on some of the plants that had been in production for some time?

Mr. LOCKE. Yes, sir; and including such very few new plants as are being built, but they are comparatively few.

Senator FANNIN. Isn't there an increase in paper and allied products sales, a tremendous increase?

Mr. LOCKE. This year they will be up between 2 and 3 percent in physical terms, real dollars, from last year. That is a very small increase.

Senator FANNIN. Thank you, very much.

Senator HANSEN. Mr. Chairman, may I?

The CHAIRMAN. Yes.

Senator HANSEN. Do you support the DISC concept?

Mr. LOCKE. Yes.

Senator HANSEN. Do you favor the administration's proposals or the DISC provision as passed in the House measure.

Mr. LOCKE. We favor the administration's proposals, Senator.

Senator HANSEN. Can you indicate what impact the incremental limitations imposed on DISC in the House bill would have on your industry?

Mr. LOCKE. In my opinion, Senator, the House approach would have very little impact. The benefits are so small that they are not really significant enough to spur our companies on to do as much as they well might along this line.

Senator HANSEN. Thank you very much.

The CHAIRMAN. Thank you very much, sir.

(Mr. Locke's prepared statement with attachments follows:)

Prepared Statement of Edwin A. Locke, Jr., President, American Paper Institute

I am Edwin A. Locke, Jr., president of the American Paper Institute. The Institute represents the pulp, paper, and paperbroad producers who comprise one of the nation's ten largest industries.

I have with me Mr. William J. Steinmetz, Vice President and Treasurer of the American Can Company and chairman of the American Paper Institute's Financial Management Committee, and Mr. Thomas R. Long, Assistant Comptroller of Westvaco and Chairman of our Subcommittee on Tax Affairs.

We are grateful for this opportunity to testify. We trust that by providing your Committee with certain background information on the paper industry we can make clear to you the great significance to our industry of the Job Development Tax Credit combined with depreciation reform and of meaningful Domestic International Sales Corporation legislation.

JOB DEVELOPMENT TAX CREDIT AND DEPRECIATION REFORM

The products of the American paper industry are an essential part of modern living and are used in virtually every segment of the economy. In the last year and a half, despite problems of inflation and recession, we have been operating at, or close to 90% of capacity; in fact, during the entire post-war period we have seldom dropped below 85% on an annual basis. We employ some 700,000 people on a remarkably steady year-round basis. We have had a long-term growth rate of between 4 and 4½% a year, moderately above that of the real GNP. We are also a capital intensive industry, requiring constant investment in more efficient equipment and machinery in order to meet growing demands at reasonable cost and to maintain our competitiveness in the international marketplace.

With these characteristics as background, we think it is instructive to look at the experience of the last 10 years. Back in 1962, faced with a stagnant economy, the Congress passed the original 7% investment tax credit legislation. In the same year, the Treasury Department liberalized the depreciation rules through the issuance of Revenue Procedure 62-21. In the case of the paper industry this Procedure 62-21 shortened depreciable lives for pulp and paper making machinery to 16 years from the previous 22 years, a 27% reduction. Although these shortened lives were considerably longer than the 12 years the paper industry had then recommended, based on an extensive study of actual useful life experience and of accelerating rates of technological obsolescence, they were a distinct step forward in tax policy and proved of real help to the industry in efficiently meeting the demands for its products.

In the next four years, that is, from 1963 to 1966 inclusive, the paper industry's capital expenditures, which since 1958 had been growing rather slowly, suddenly more than doubled from $660 million to $1,430,000,000. At one and the same time we were able to increase the efficiency of existing facilities and to add considerably to new capacity. Other results were similarly impressive. Employment increased by 50,000 people. Productivity, cash flow, profits, income taxes, dividends, and return on net worth also went up.

In our view there can hardly be any question that these large investments and the good results flowing from them would not have taken place, indeed would not have been possible, to anywhere near the same extent without the aid of the liberalized depreciation rules and the investment credit.

Now in 1971 we have a situation similar in many ways to what existed in 1962. We have no investment credit. Capital expenditures in the paper industry are at present actually falling and, according to government forecast, will be down 26% in 1971 from 1970. Employment has been static since 1968 and productivity has not improved much. Profits declined 25% in 1970 from 1969, and in the first half of 1971 declined another 25%. Based on experience in the first half of this year, dividends in 1971 will show the first year-to-year decline since

1958. The industry's financial return, whether based on sales, net worth, or total investment, will be at its lowest level in the postwar period.

There are also some differences between 1971 and the early and middle 60's. An important one is that capital expenditures for pollution abatement in the paper industry are now running at 19% of total capital expenditures, and next year will approach 25%. The industry is dedicated to improving the quality of the environment, but its programs to this end require large cash expenditures. This means that a large part of the industry's cash flow, which would otherwise be available for modernization and expansion, must be applied to these socially desirable but financially non-productive purposes.

Another key difference is that today the industry's debt ratio is considerably higher and its liquidity considerably lower than in 1962, leaving much less leeway for borrowing to help finance new capital expenditures.

Still another difference is that inflation has added substantially to the costs of labor, materials, services, and money, and thus to the costs of simply replacing existing equipment. Inflation makes more urgent than ever the provision of the most modern and efficient machines.

In short, the paper industry is more in need than it was in 1962 of a realistic depreciation policy as represented by the ADR System, together with meaningful tax credits. We believe that the investment in modern facilities which such measures would help so importantly to bring about are vital to controlling costs, checking inflation and maintaining our competitive position in world trade.

We are gratified that the House has legislatively confirmed the ADR System. We support, as well, the House's action to provide a Job Development Tax Credit, but we respectfully suggest for your consideration two significant changes:

(a) To enhance our domestic efficiency and our international competitiveness by increasing the investment credit to 10% from the 7% provided in the House bill. As Secretary Connally pointed out in his testimony before this Committee last week, a 7% Job Development Credit and the new depreciation system will not put U.S. manufacturers on an equal footing with competitors abroad. As he stated, "It would take a long-term credit of at least 10%, plus the depreciation changes, to bring us into their range of capital costs."

(b) To help finance the very large pollution abatement expenditures with which the industry is now faced, repealing the language of the Tax Reform Act of 1969 that denies the investment tax credit to pollution abatement equipment certified for rapid amortization. The Congress, by providing for rapid amortization of pollution control equipment and facilities, rightly recognized the need for a differential tax treatment for them. That treatment should continue after a broadly applied tax credit is instituted. By lessening the immediate financial burden of pollution control facilities more mills will be able to continue in operation and more jobs will be saved.

Finally, we would like to emphasize the importance to the paper industry of a sound, stable and permanent tax credit. An on-again, off-again approach is not conducive to encouraging large capital expenditures which must be planned for and executed over a period of years.

DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

In June last year we wrote the Chairman of the House Ways and Means Committee, when that Committee was considering the original DISC proposal, and expressed our strong support for it. We pointed out that the paper industry's exports had been growing at a vigorous pace over the preceding 10 years. In the case of linerboard, which is the industry's largest single export product, foreign sales now represent about 15% of national production. In 1970 we experienced further increases in exports, with the total exceeding $1,100,000,000. So far in 1971 our exports are down slightly.

In our letter we also pointed out that our exporting companies are selling abroad against steadily growing competition from other countries, which on the whole provide their exporters with much greater tax advantages than are available to U.S. producers. Furthermore, we said, the production capacity of our competitors, particularly Canada and Sweden, is growing at a considerably faster rate than the capacity of the American industry.

Today we are more strongly convinced than ever that if we are to maintain our export growth, or indeed even to stay at present levels, we need tax incentives for export as embodied in the President's original DISC proposal. As Secretary Connally put it so well in his testimony before this Committee last week:

"From a balance of payment standpoint, it is as important to maintain a dollar of existing export sales against loss as it is to increase export sales by one dollar".

The incremental limitation of DISC as passed by the House of Representatives would do little to further the growth of export sales or to retain the level already achieved. The incentive to keep manufacturing, and the jobs that go with it, in the United States would be small indeed. The administrative complexities for both government and industry would be considerable. The inequities among competing exporters would be sizeable because the veteran exporter that maintained a substantial level of exports could defer taxes on only one-eighth of his profits while the newcomer could defer taxes on one-half of his profits. And to the paper industry, which has achieved a great expansion of its exports in the last decade and is now struggling to hold its gains, the incremental approach would offer scant aid.

Mr. Chairman, it is for these reasons that we respectfully urge that your Committee reject the incremental approach and adopt the DISC proposal as proposed by the Administration.

Thank you for your consideration, Mr. Chairman, in allowing us to present our views to your distinguished Committee.

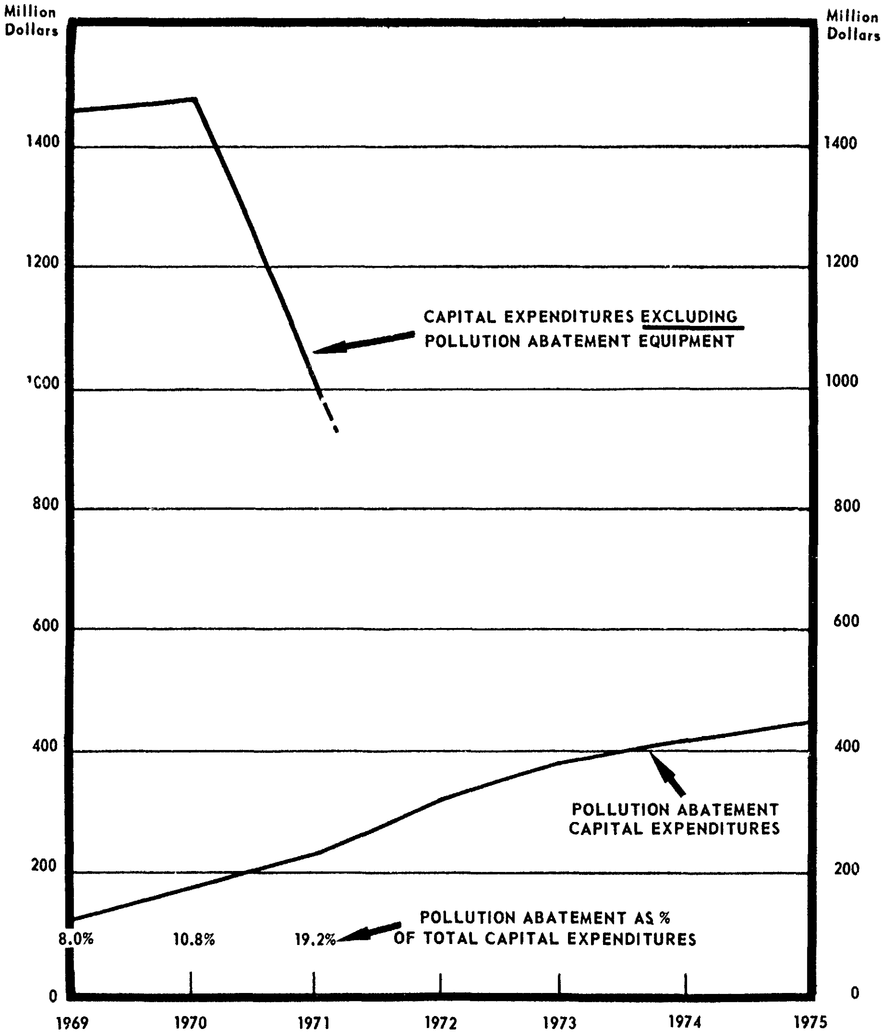
JOB DEVEOPMENT TAX CREDIT AND DEPRECIATION REFORM

1. In 1962, in an economic situation similar to today, institution of a tax credit and depreciation reform spurred a four-year increase in paper industry capital investment, productivity, cash flow, jobs, profits, income taxes, dividends, and return on net worth.
2. Today, environmental demands, the paper industry's higher debt ratio and lower liquidity, and inflated costs of labor, materials, services and money make a realistic depreciation policy and meaningful tax credits even more urgently needed.
3. The American Paper Institute recommends two changes in the House-passed Job Development Tax Credit:
    (a) Increase the credit from 7% to 10% to help make U.S. manufacturers more efficient at home and on a more equal footing with competitors abroad.
    (b) Repeal language in the Tax Reform Act of 1969 that denies the tax credit to pollution abatement equipment certified for rapid amortization. Differential tax treatment for this equipment is badly needed and should continue.
4. The Tax Credit should be stable and permanent—not on-again, off-again.

DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

The Senate should adopt the DISC proposal as put forward by the Administration, rather than the incremental approach passed by the House. The incremental limitation would do little to increase export sales, retain export levels already achieved, and keep manufacturing jobs in the United States. The incremental system would be complex to administer. The inequities between competing exporters would be sizable. And for the paper industry, which has achieved a great expansion of its exports in the last decade and is now struggling to hold its gains, scant aid could be expected from the DISC proposal in the form passed by the House.

PAPER AND ALLIED PRODUCTS CAPITAL EXPENDITURES



Source: Pollution Abatement Capital Expenditures, 1969-1972: National Council of the Paper Industry for Air and Stream Improvement. 1973-1975: Forecast by NCASI and American Paper Institute

Other Capital Expenditures: Paper and Allied Products Industry Totals reported by Office of Business Economics (U.S. Dep't of Commerce) - Securities and Exchange Commission less NCASI data.

American Paper Institute
October 13, 1971

The CHAIRMAN. Our next witness is Mr. Milo G. Coerper, German-American Chamber of Commerce, Inc.

STATEMENT OF MILO G. COERPER, GERMAN-AMERICAN CHAMBER OF COMMERCE, INC.

Mr. COERPER. Mr. Chairman, I will get through my statement as quickly as possible. I will only hit the high points.

My name is Milo G. Coerper. I am a partner of the law firm of Coudert Bros. and the Washington counsel for the German-American Chamber of Commerce. I am making this statement on your invitation on behalf of the chamber. The chamber was incorporated in the State of New York in 1947. It is registered under the Foreign Agent's Registration Act because it receives some of its financial support from abroad. It is a binational organization of 952 members, consisting of 478 United States members and 474 German members, thus representing businessmen from the two largest trading nations in the world. One of its primary concerns is the fostering of two-way trade between the United States and Germany. Its members are as interested in exports from the United States to Germany as they are in exports from Germany to the United States.

We want to make clear that we are not critical of the job development credit concept as such—only the aspect of it which discriminates against "foreign produced property." We are aware of the exemption granted to the President "in the public interest" in H.R. 10947 and the guidelines set out for the President in this regard in the accompanying House report.

Notwithstanding, we continue to believe this discriminatory provision unsound for the following reasons:

1. The U.S. machinery interests do not need this special protection—given at the expense of other domestic interests.
2. This special protection is not in the economic interest of a great number of U.S. workers and companies.
3. This special protection if granted would be in violation of U.S. international legal commitments.

U.S. machinery imports consist mainly of tailor-made and highly specialized equipment with the greatest productivity effect. An exclusion of such imports from the proposed job development credit would either deprive numerous domestic industries (textiles, printing, apparel, furniture and others), relying on such import machinery from the benefits of the investment stimulus or force them to make investment decisions of a second or third best choice.

It cannot be the administration's aim to support one U.S. industry, that is, machinery, at the expense of other industries. These other industries are facing even stronger competition from abroad and their foreign competition can buy the most modern equipment wherever available on the world market, some of them even at lower cost than before, due to the revaluation of their currencies. In addition, these other industries, as a result of the surcharge, already face the increased costs of imported machinery contracted for months ago.

The U.S. machinery industry does not need such a preference. It is not losing out to foreign competition in its domestic market, nor does it show a bad record with regard to exports. In 1969, as revealed by U.S. survey figures and trade staitstics, not more than 4.6 percent of the overall domestic demand for machinery was met by imports (approximately 1.6 percent of which came from Canada and 1 percent from Germany). This compares with a market share of imported machinery into Germany of 20 percent. As to the balance of trade, it should be kept in mind that U.S. machinery exports exceeded imports in 1970 by $5.1 billion.

It would be paradoxical if the United States—the biggest machinery producer in the world and the leading exporter with approximately $8 billion in machinery exports and having itself one of the lowest import percentages of machinery in the world—resorted to a new policy of discriminating specifically against machinery imports.

It should be mentioned, of course, that there is imported machinery competing directly with corresponding lines of production in the United States. It can hardly be said that such competing German machinery, with a burden of about 19 precent revaluation during the last 2 years, domestic wage and price increases parallel to those of U.S. industry, and considerably longer periods of delivery, will have any advantages in the U.S. market. The additional import surcharge of 10 percent on top of normal tariffs for machine tools and textile machinery, which are already higher than the corresponding EEC tariffs, provides ample additional protection. A 10-percent or 7-percent tax credit which could result in as much as a 20-percent or 14-percent tax saving granted to domestic interests but not to foreign produced property in addition to the revaluation, the normal duty and the import surcharge is totally unjustifiable.

The shiftover from foreign produced machinery to domestic machinery, stimulated by this preference, will adversely affect a number of domestic jobs and companies. This will be the case as regards U.S. dealers and sales and service personnel connected with the importation of machinery, as well as those workers and companies directly affected by the resulting break in continuity of service and supply of foreign parts for already installed foreign made machinery in U.S. plants.

As admitted in the explanatory material accompanying the President's address:

> The limitation on the credit for machinery and equipment which is predominantly produced abroad will create a preference in favor of U.S. produced machinery and equipment.

We respectfully suggest that such preference is in violation of article III, paragraphs 1, 2, and 4 of the General Agreement in Tariffs and Trade (GATT). Under the terms of those provisions, all the contracting parties recognized that internal taxes and other internal charges, laws, regulations, and requirements affecting the purchase of products should not be applied to imported products so as to afford protection to domestic production.

Congressman Sam M. Gibbons, in his dissenting views to House Report No. 92–533, concurred in the above expressed views as follows:

Finally, the "Buy American" provision of the proposed investment tax credit, which would remain in effect as long as the temporary 10-percent import surcharge remains, is clearly in violation of the intent of section 3 of the General Agreements on Tariff and Trade (GATT). The committee has authorized the President to suspend this and allow the tax credit for imported machinery, but only in certain very limited circumstances. This change does not eliminate the extremely undesirable effects of the "Buy American" provision on some American industries which use imported raw materials and on our relations with the other trading nations of the world * * *.

Of the greatest importance to both United States and German interests, as well as to all major-trading nations, is the longstanding and widely recognized policy that once an imported product is past the Customs barrier, it should receive the same treatment as domestic products. This concept, known as "national treatment," has been written into bilateral treaties even long before the existence of GATT and is written into the Treaty of Friendship, Commerce and Navigation between the United States and Germany signed on October 29, 1954 (TIAS No. 3593).

Article XVI, paragraph 1, of that treaty provides:

> Products of either party shall be accorded, within the territories of the other party, national treatment and most-favored-nation treatment in all matters affecting internal taxation, sale, distribution, storage and use.

Article XXV, paragraph 1, of that treaty provides:

> The term "national treatment" means treatment accorded within the territories of a party upon terms no less favorable than the treatment accorded therein, in like situations to nationals, companies, products, vessels, or other objects as the case may be, of such party.

By the very admission of the administration, quoted above, imports of German produced machinery and equipment are not receiving national treatment in the United States.

We do not believe that this committee would want a treaty commitment violated if there were any possibility to avoid such action. We further believe that it would not want to put the President in such a position.

In view of the above arguments, we respectfully urge this committee to remove in toto the discrimination against foreign produced property. However, if this committee desires to maintain the exemption granted to the President in H.R. 10947, then we respectfully suggest that paragraph (C) at the bottom of page 7 of H.R. 10947 be amended by adding at the end thereof the following sentence:

> The President shall find that the application of subparagraph (A) is not in the public interest if he finds that such applicataion is in violation of a U.S. treaty commitment.

Thank you, Mr. Chairman, for giving me and the German-American Chamber of Commerce this opportunity to be heard.

The CHAIRMAN. I appreciate your right to come in here. You are registered under the Foreign Agents Act to testify for your clients, against what this Nation feels it must do to protect the jobs of American workers. As you know, you and I have had some difference of opinion during this last year.

Mr. COERPER. Yes, sir.

The CHAIRMAN. You were sending me resolutions by the American Bar Association saying we had no right to protect the rights of jobs of American workers. My attitude toward your position was that you weren't speaking for the American Bar Association, you were speaking for your clients, and I still feel that way.

Mr. COERPER. I wrote you a long letter explaining my position, Senator Long, and I thought it was a full explanation.

The CHAIRMAN. Well, you are entitled to your position. I am frank to tell you that nothing impresses me less than to have some fellow go and get himself on some committee, some subcommittee, the Chamber of Commerce Committee or something else, and use it as a front.

It was typical of that committee, when we were put out of business down in New Orleans with all the imports and hear some fellow who is a freight expediter gets himself appointed chairman of the Subcommittee on Foreign Trade for the New Orleans Chamber of Commerce, and then the next thing you know, I get a resolution saying that the New Orleans Chamber of Commerce is wildly opposed to all limitations on all exports, that we are putting them out of business down there.

If you submit that to the average member of the chamber of commerce it wouldn't reflect his views for a moment, and at the time you get yourself appointed chairman of the Subcommittee of the American Bar Association and run through some sort of resolution which reflects the interest of your clients in Germany and proceed to suggest that we sacrifice a great number of American jobs in this country. If the rank and file of the American Bar knew what the effect of the resolution was I don't think they would be supporting it at all.

Mr. COERPER. I would be very happy if you would put your letter to the American Bar Association on this subject in the record. And also put my letter to you on the subject in the record. I have them before me.

I think I pointed out to you that we are a rather large law firm and represent a large number of people, not only foreign interests; that I have represented many people who wanted to change the law from a protectionist point of view, as well as from a liberal point of view, that I was on the committee of the bar association long before the question of quota legislation came before the Congress, and that I did not initiate that action but was asked to participate in it.

The CHAIRMAN. I will be glad to put your letter in the record as well as my letter.

(The letters referred to follow:)

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C., February 26, 1971.

Mr. WILLIAM REECE SMITH, Jr.,
Secretary, American Bar Association,
Exchange National Bank Building,
Tampa, Fla.

DEAR MR. SMITH: Thank you for your letter of February 15 informing me that the American Bar Association has adopted a resolution to the effect that the import quota provisions of last year's Trade Act of 1970 were inconsistent with the international legal obligations of the United States under the General Agreements on Tariffs and Trade (GATT).

I found your position most tenuous on legal grounds for the following reasons:

1. The Congress of the United States has never approved the GATT as a treaty obligation or otherwise;

2. Under Section 8 of Article 1 of the Constitution, the Congress has the power "to lay and collect taxes, duties, imports, and excises . . .," and "to regulate commerce with foreign nations . . . ;"

3. The GATT provisions themselves (Article XII) permit a country to impose quotas if it is suffering from balance of payments problems or in order to stop a decline in its international reserves; and

4. The quota provisions of H.R. 18970 were most flexible and would not have gone into effect;

(*a*) If the President deemed them not to be in the national interest;

(*b*) If the President determined there was no market disruption caused by the imports;

(*c*) If the President entered into voluntary agreements with foreign countries; and

(*d*) If the President deemed there to be insufficient domestic supply of the imported article.

Your position appears to suggest that the Congress, which has the plenary authority to regulate foreign trade, could not exercise its constitutional authority because of an executive agreement never approved by the Congress. That is a very strange position for the American Bar Association to be taking, and, if applied to other areas where the Constitution specifically delegates authority to the Congress, such as its power to declare war, it would mean that the Congress could not act if the executive branch had entered into an agreement with a foreign government, without the approval of Congress, in an area outside of the authority delegated to the President.

I do not think your position would hold up in any court of law.

Being surprised at the legal position your Association holds on this issue, I checked into the makeup of your Committee on "Tariffs, Customs and the GATT" and discovered that its Chairman, Milo G. Coerper, has been registered since June 15, 1967, as a foreign agent for the German American Chamber of Commerce which receives a considerable part of its financial support from abroad. Mr. Coerper provided our Committee with a statement on behalf of his client, the German American Chamber of Commerce, opposing the Trade Act of 1970. He may well be a fine lawyer for the well-known international law firm--Coudert Brothers—(which is also registered under the Foreign Agents Registration Act), but you can hardly say he is a disinterested party in the matter of tariffs, customs and GATT. I do not question his integrity at all, but just his objective on this issue, and the Constitutional soundness of your resolution. Would you kindly send me a list of the other members of the Committee on Tariffs, Customs, and the GATT, and their principal affiliations.

With every good wish, I am

Sincerely,

RUSSELL B. LONG, *Chairman.*

AMERICAN BAR ASSOCIATION,
Chicago, Ill., May 3, 1971.

Senator RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: Your letter of February 26, 1971, addressed to the Secretary of the American Bar Association and dealing with the Association's position on import quota legislation, has been referred to me for reply.

I trust that you have subsequently received the letter of March 15, 1971 (a copy of which I attach) which the Secretary addressed to you on this subject and that the corrected resolution which he enclosed makes unnecessary a response by me to Items (1) through (4) of your letter.

I have two comments concerning your request for a list of the members of the Association's Committee on Tariffs, Customs and the GATT and the "principal affiliations" of those members.

First: The issue the American Bar Association is seeking to bring to your attention is that import quota legislation like H.R. 18970 appears to conflict with the obligations of the United States under the GATT. I respectfully submit that the identity and affiliations of our committee members are no more relevant to that issue than are the identity and affiliations of the individuals whose research and advice contributed to your letter of February 26, 1971.

Second: Your questions suggest a misunderstanding on your part of the deliberative processes by which the resolution was adopted by the American Bar Association.

That process was as follows: Two committees of this Section (namely, our *Committee on Tariff, Customs and the GATT* and our *Committee on Commercial Treaties*) studied the question of H.R. 18970 and the obligations of the United States under the GATT. The study report of those committees and their proposed resolution was submitted to the *Council* of this Section, which recommended a revised resolution to the *Board of Governors* of the Association. The Board of Governors revised the resolution further and recommended it for adoption to the *House of Delegates* of the American Bar Association, which adopted the Board of Governors' resolution. The various forms of resolution were actively considered at every level of the process, including debate on the floor of the House of Delegates.

In response to your request for a list of the members of our first-named committee and their "affiliations," I therefore enclose such lists with respect to both of the above-named committees, the Council of this Section, and the Board of Governors of the Association. You will appreciate that lawyers join the American Bar Association as individuals, not as representatives of organizations, and consequently are usually shown on our records only by name and address. I have, however, searched other directories available to me for firm and company affiliations, with the result shown, I also enclose a list of the members of the House of Delegates, but in view of their considerable number (295) I have not attempted to determie their affiliations.

Please note that I have listed the entire membership of each deliberative body and have not attempted to delete the names of those who (as was the case of Judge Wilkey and Mr. Stevenson of our Council) abstained, because of official position or otherwise, from the deliberation.

Yours truly,

EWELL E. MURPHY, Jr.,
Chairman, Section of International and Comparative Law,
American Bar Association.

COUDERT BROTHERS,
ONE FARRAGUT SQUARE SOUTH,
Washington, D.C., May 19, 1971.

Senator RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: Recently I received a copy of Mr. Murphy's letter to you of May 3, 1971 regarding the ABA Resolution on import quota provisions, along with a copy of your letter to the Secretary of the ABA of February 26, 1971.

Coincidentally, I had the pleasure of chatting with Mr. Eberhard P. Deutsch on Saturday, May 1, 1971 at the meeting of the Council of the Section of International and Comparative Law, ABA, held here in Washington. Mr. Deutsch informed me that you were somewhat disturbed by the ABA Resolution and suggested that I drop in to see you regarding same.

I thought it more appropriate to write and let you decide whether you would like to confer with me in this matter. In the meantime, my article has appeared in the April 1971 issue of The International Lawyer on the same subject and I am taking the liberty of forwarding a reprint of that article to you herewith.

In response to your letter to Mr. Smith of February 26, 1971, I would first like to respectfully suggest that the Resolution does not challenge H.R. 18970 on Constitutional grounds, but only on the grounds of its possible conflict with existing international legal obligations. As you and I well know, the United States may commit itself to international legal obligations which in no way restrict the United States Congress. As stated in my article on page 257:

> Quite clearly, Congress may enact legislation violative of the GATT obligations which will be enforceable in the United States—even though a breach of an international obligation.

You also appreciate that, even though the Senate may not like it, the United States through the Executive may enter into international legal obligations outside of the treaty-making power of the United States Constitution and, as you point out, that is what was done in the case of GATT.

Thus, I respectfully submit that all of the points raised in your letter of February 26, 1971 do not make the ABA's position "most tenuous on legal grounds" because we admit all of the points you have made in your said letter and still feel it appropriate to suggest to both the Executive and the Congress that they keep in mind the international legal obligations assumed by the United States under the GATT.

I would like to respond to your suggestion that you question my "objectivity on this issue" in view of the fact that one of my clients is the German American Chamber of Commerce. For your information, I personally represent a number of other clients, some of whom have sought measures to restrict injurious and dumped imports into the United States under various statutory procedures available for this purpose. I am a lawyer, Senator Long, who advocates the positions of his clients, and I do not "belong" to any one client.

Certainly you, as a lawyer, appreciate that a lawyer can act as an advocate of a client's point of view and also, quite independently, participate in an objective manner in the deliberations of a professional Association on the same subject matter. This is what I very sincerely attempted to do in this case.

If you read my article, I feel you will conclude that it is most objective in that I have pointed out how difficult it is for domestic industry to get relief under presently existing legislation. In fact, a number of my so-called "liberal" friends have felt the article too "protectionist."

Finally, I might add that I did not initiate the ABA action in this area. My Committee was approached by the Committee on Commercial Treaties and asked to participate in the study which led to the ABA Resolution. Quite naturally, we did so.

If you feel it would be worth while to discuss this matter further with me, I would be very happy to meet with you.

Most sincerely,

MILO G. COERPER.

Senator FANNIN. I compliment you on the statement that certainly represents your client's position. I don't understand your figures on the people you represent. It seems to me that your representation is strictly one from the standpoint of Germany, from the standpoint of exports and not from the standpoint of what is happening in our international trade.

I believe in a two-way street. You indicated by your first statement, that you may also have interests in having the two-way street but I don't feel your statement does this.

The third item here that special protection would be in violation of the U.S. international legal commitments under GATT. I am sure that you realize that GATT has never been approved by the Congress.

Mr. COERPER.. I realize that it is not a treaty, yes, sir.

Senator FANNIN. I am sure you are aware that the European economic community will not consider a bid from a U.S. producer on heavy electrical equipment.

Mr. COERPER. Well, Senator, I addressed myself to this problem in an article which I sent to Senator Long which I think was quite an objective article on the whole question. I think I summed up by saying it was my hope that the Congress would be a little more aware of our international legal obligations, but I also said that perhaps the Executive should be more aggressive in pursuing our international legal rights. They are doing so now.

Since we have had this tremendous problem, you have a 19 percent reevaluation in the German mark and a 10 percent import surcharge. That is 29 percent more right there on any product coming into the United States from Germany.

We are not complaining here about burdens at the border. I think the United States could well consider what they want to do at the border. What we are complaining about here primarily is discrimination—once something comes inside the United States which, of course, is a violation of a treaty and not only of the GATT.

Also, I would like to point out that even under GATT, article 23, the United States could have been doing a number of things to those people who are primarily violating the GATT, which is not Germany.

In fact, there was a study made by the GATT on nontariff barriers in 1968 and the Office of Ambassador Roth at the time, made a study of such nontariff barriers and this study was submitted to the Congressional Record by Senator Muskie on March 7, 1968.

From that study it will be seen Germany appears to have the fewest number of nontariff barriers in the world, including the United States.

Senator FANNIN. I certainly would agree that most every industrialized nation has had great advantage over the United States as far as GATT is concerned. But that doesn't exclude the inequity involved in our trade relationship with Germany.

I think it is a very serious problem and the dollar volume that has been affected with the automotive shipments.

Mr. COERPER. Senator, believe me, I understand this problem. I don't think you solve it by reacting to violations of international agreements by other people, by violating them yourself without using the procedures that are available under those agreements.

If the administration were so inclined, we could take a number of tremendous actions against these people that are violating GATT. In fact, they have recently started to do this.

You realize the tough position taken on textiles and now it looks like the Japanese Government is finally going to come around and negotiate. Those people aren't going to negotiate until they are put against the wall, and they can be put against the wall under the procedures that are already set forth in these agreements.

Senator FANNIN. Look at the delays in bringing administrative action such as the anti-dumping laws and other existing statutes, started.

Recently, we have brought more actions but what has happended? We certainly haven't had the results.

Mr. COERPER. You have had the results under the anti-dumping law. I know something about that.

Senator FANNIN. Our competitors practically built up an empire of manufacturing, of commodities coming into the United States before anything was ever done.

Mr. COERPER. Well, this is something that should be taken up with the Executive. They should probably act more aggressively.

Senator FANNIN. Still in your statement you are throwing it all back on our shoulders whereas I think there is a great responsibility on our trading partners.

Mr. COERPER. Well, I think we dropped the ball on that when we were negotiating during the Kennedy round. We should have been tougher at that time.

Senator FANNIN. Yes. But now you are asking us to relax.

Mr. COERPER. I am, of course, speaking to you as a representative of the German-American Chamber of Commerce, but I am also an American lawyer. I am not an economist. I am primarily interested in the way we handle these things procedurally. I think we are going about it in the wrong way. I think if we make agreements we should keep them, but we should require those people to keep them too. When they violate them, I think we should use the remedies under the agreement to correct the violation.

Senator FANNIN. If we look at the violations that have occured year after year, I agree we haven't been as tough as we should have been, but we shouldn't have to be, this is a two-way street.

Mr. COERPER. Well, I think that you have to be in some cases.

Senator FANNIN. Evidentily that is why we are having these sessions at the present time.

Mr. COERPER. But I really do feel that with the revaluation of the German mark, which they have accomplished long before anyone forced them to, 2 years ago, 19 percent there, a 10-percent import surcharge, that is 29 percent, and I don't see why they have to be discriminated against further on the job development credit, particularly when it violates the treaty commitment we have with them.

It seems to me that as of this point they are under a big enough burden and I don't see why you want to give machinery the special privilege. I don't know why they should have any more special position than any other industry in the United States, and that is what they are getting under this particular discrimination.

Senator FANNIN. If Germany goes to a 15-percent value added tax, why shouldn't we have some reaction on our side?

Mr. COERPER. I think you should have reaction, but I think it should be applied across-the-board and you have in the import surcharge. People don't like the import surcharge but——

Senator FANNIN. You are not in disagreement with the import surcharge?

Mr. COERPER. Let me say this: Nobody likes it, but everyone has recognized that something was necessary.

The CHAIRMAN. Let me get this matter straight about the GATT. Insofar as you and others who have tried to suggest to us that we are legally bound by this as international law by this General Agreement on Tariffs and Trade, especially for the Congress, I could not disagree more.

This is, as far as we are concerned, and as far as I, personally, am concerned, a mere executive agreement. I have some doubts about the capacity of one President to bind the next President, or for that matter, even to bind himself against changing his mind about this type of thing.

But as far as a President, by a mere executive agreement binding the Congress, I almost feel like laughing.

When we pass a law and put it on the statute books with the signature of the President, or if we find it necessary to override a Presidential veto and put it on there without the President's signature, that is the law, and that is what is binding on us. The fact that some President may have signed some executive agreement that he proposes to bind himself to, doesn't bind this Congress for a moment if we don't agree.

Mr. Coerper. That is absolutely correct, Senator, and if I may I will quote from my letter to you on this subject.

In response to your letter to Mr. Smith of February 26, 1971, I would further like to respectfully suggest that the resolution does not challenge H.R. 18970 on constitutional grounds but only on the ground of its possible conflict with existing international legal obligations. As you and I well know, the United States may commit itself to international legal obligations which in no way restrict the United States Congress. As stated in my article on page 257, "Quite clearly, Congress may enact legislation violative of the GATT obligations which will be enforceable in the United States even though a breach of an international obligation." You also appreciate that even though the Senate may not like it, the United States through the Executive, may enter into international obligations outside of the treaty-making power of the United States Constitution. And, as you point out, that is what was done in the case of GATT.

That is correct. The U.S. Government can enter into an international agreement without getting the approval of the Senate, in which case it is not called a treaty, or they can enter into an international agreement and have it ratified by the Senate, in which case it is called a treaty. In either case, the U.S. Congress may then pass a law directly contrary to that international agreement or treaty, and that is binding in the United States. There is no question about that. It is binding in a U.S. court. But this means that the State Department then has an international problem, and under international law if you have a treaty, as we do with Germany, they can take it to the International Court of Justice and they arbitrate it and the United States can be forced to pay damages for violating the international agreement.

The Chairman. You and I know if you don't like what happens in the International Court of Justice, they have an appeal to the Security Council and if you want to look after your interest, like the other guy looks after his, you veto it.

If that was France sitting there and France found their economic interests were involved and we won a case before the International Court of Justice, and we said, "Here is what you must do, we now have a judgment in the International Court of Justice. If you don't like it you appeal it and go to the Security Council." France had a Member sitting there and he vetoed it and that is the end of it. Anybody would do that except us.

We might be foolish enough to take it on the chin but nobody else would. They would say, "This involves our interests, veto it." The Russians did it so many times that we lost count and we quit bringing things up to the Security Council that they objected to, knowing that they would veto it, not for fear of it but for certainty.

Mr. COERPER. I think it was an Englishman who said we have two standards—one a civilized standard and one for the others. Does that mean we should lose our standards?

The CHAIRMAN. You know that no one takes cases to the International Court of Justice any more.

Mr. COERPER. A lot of them can't go there because it doesn't have compulsory jurisdiction.

The CHAIRMAN. Most of them don't bother to go there anyhow.

Mr. COERPER. I think we ought to follow the agreements we make and follow them in a very tough manner and utilize the procedures within those agreements to get what we want rather than going around saying, you broke it, so we are going to break it. That doesn't get us anywhere.

The CHAIRMAN. The experience that I have had with these GATT matters is when our European trading partners find it is to their advantage, as they did in the Chicken War, they go ahead and break it.

Mr. COERPER. I think we reacted in the Chicken War and we stopped the Volkswagen trucks and the German brandy from coming into the United States.

The CHAIRMAN. You let me make my statement and you can make yours. When they find it to their advantage, they violate the GATT and they have done it many times. They violate it and we sit around and take about a year arguing about the fact they have violated it and, eventually, we say, we are going to have to retaliate so we take some action against their Volkswagen or some foreign produced cars over there. If that had been them, they would have acted the next day to retaliate.

When somebody acts in violation of the GATT, your only recourse is as a practical matter to retaliate. And suppose it doesn't violate the GATT but he takes some action that is contrary to your economic interest, what do you do? You retaliate. It is the same thing.

If we violate the GATT, they go and retaliate, if they feel it is in their interest to do so, and if we don't violate the GATT, they will retaliate anyway, if they feel it is in their national interest to do so.

In the last analysis it doesn't make any difference whether you are violating or not violating the GATT, and as far as what that means, I recall the day when Dean Rusk came down here and talked about that being international law and all that sort of thing. We are bound by the laws that we enact. We are bound by the treaties that we ratify. None of us on this committee or those of us in Congress are not foreclosed, we are not bound by some executive agreement from passing a law that says what we want it to say.

Mr. COERPER. I also cited a treaty to you, Senator, aside from the GATT, a treaty between the United States and Germany.

The CHAIRMAN. I will take a look at it. Thank you very much.

Mr. COERPER. Thank you, sir. I appreciate the opportunity to be here.

(Mr. Coerper's prepared statement with attachments follows:)

PREPARED STATEMENT OF MILO G. COERPER, ON BEHALF OF THE GERMAN AMERICAN CHAMBER OF COMMERCE, INC.

SUMMARY OF PRINCIPAL POINTS

The German American Chamber of Commerce, Inc., recommends the elimination of the discrimination against foreign produced property from the Job Development Credit provision of H.R. 10947 for the following reasons:

1. The U.S. machinery interests do not need this special protection—given at the expense of other domestic interests.
2. This special protection is not in the economic interest of a great number of U.S. workers and companies.
3. This special protection if granted would be in violation of U.S. international legal commitments.

Mr. Chairman and distinguished members of the Committee on Finance: My name is Milo G. Coerper. I am a partner of the law firm of Coudert Brothers and the Washington Counsel for the German American Chamber of Commerce. I am making this statement on your invitation, on behalf of the Chamber. The Chamber was incorporated in the State of New York in 1947. It is registered under the Foreign Agents' Registration Act because it receives some of its financial support from abroad. It is a bi-national organization of 952 members, consisting of 478 United States members and 474 German members, thus representing businessmen from the two largest trading nations in the world. One of its primary concerns is the fostering of two-way trade between the United States and Germany. Its members are as interested in exports from the United States to Germany as they are in exports from Germany to the United States.

We are here today to present information which should be helpful in your deliberations on the one proposal which we believe to be unsound, not only from the point of view of U.S. economic interests but also from the point of view of U.S. international legal commitments—namely, the discriminatory feature of the President's proposed Job Development Credit.

We want to make clear that we are not critical of the Job Development Credit concept as such—only the aspect of it which discriminates against "foreign produced property." We are aware of the exemption granted to the President "in the public interest" in H.R. 10947 and the guidelines set out for the President in this regard in accompanying House Report No. 92–533.

Notwithstanding, we continue to believe this discriminatory provision unsound for the following reasons:

1. The U.S. machinery interests do not need this special protection—given at the expense of other domestic interests.
2. This special protection is not in the economic interest of a great number of U.S. workers and companies.
3. This special protection if granted would be in violation of U.S. international legal commitments.

U.S. MACHINERY INTERESTS DO NOT NEED SPECIAL PROTECTION

The aim of the relevant part of the President's new economic policy—"to provide the strongest short-term incentive in our history to invest in new machinery and equipment that will create new jobs for Americans"—can only be realized on a sound and lasting basis if the new jobs are tied to products competitive in the world market. This means that the U.S. with its high level of wages will, more than any other country, have to apply the most advanced production methods and use the most modern and sophisticated equipment available.

U.S. machinery imports consist mainly of tailor-made and highly specialized equipment with the greatest productivity effect.(1) An exclusion of such imports from the proposed Job Development Credit would either deprive numerous domestic industries (textiles, printing, apparel, furniture and others), relying on such import machinery from the benefits of the investment stimulus or force them to make investment decisions of a second or third best choice.(2)

It cannot be the Administration's aim to support one U.S. industry, that is, machinery, at the expense of other industries. These other industries are facing even stronger competition from abroad and their foreign competition can buy the most modern equipment wherever available on the world market, some of them even at lower cost than before, due to the revaluation of their currencies. In addition, these other industries, as a result of the surcharge, already face the increased costs of imported machinery contracted for months ago.

The U.S. machinery industry does not need such a preference. It is not losing out to foreign competition in its domestic market, nor does it show a bad record with regard to exports.(3) In 1969, as revealed by U.S. survey figures and trade statistics, not more than 4.6% of the overall domestic demand for machinery was met by imports (approximately 1.6% of which came from Canada and 1% from Germany). This compares with a market share of imported machinery into Germany of 20%. As to the balance of trade, it should be kept in mind that U.S. machinery exports exceeded imports in 1970 by 5.1 Billion Dollars. (4)

It would be paradoxical if the United States—the biggest machinery producer in the world and the leading exporter with approximately 8 Billion Dollars in machinery exports and having itself one of the lowest import percentages of machinery in the world—resorted to a new policy of discriminating specifically against machinery imports.

It should be mentioned, of course, that there is imported machinery competing directly with corresponding lines of production in the United States. It can hardly be said that such competing German machinery, with a burden of about 19% revaluation during the last two years, domestic wage and price increases parallel to those of U.S. industry,(5) and considerably longer periods of delivery, will have any advantages in the U.S. market. The additional import surcharge of 10% on top of normal tariffs for machine tools and textile machinery, which are already higher than the corresponding EEC tariffs, provides ample additional protection. A 10% or 7% tax credit which could result in as much as a 20% or 14% tax saving(6) granted to domestic interests but not to foreign produced property in addition to the revaluation, the normal duty and the import surcharge is totally unjustifiable.

SPECIAL PROTECTION NOT IN ECONOMIC INTERESTS OF MANY U.S. WORKERS

The shift-over from foreign produced machinery to domestic machinery, stimulated by this preference, will adversely affect a number of domestic jobs and companies. This will be the case as regards U.S. dealers and sales and service personnel connected with the importation of machinery, as well as those workers and companies directly affected by the resulting break in continuity of service and supply of foreign parts for already installed foreign made machinery in U.S. plants.

VIOLATION OF INTERNATIONAL LEGAL COMMITMENTS

As admitted in the "Explanatory Material" accompanying the President's address: "The limitation on the credit for machinery and equipment which is predominantly produced abroad *will create a preference* in favor of United States produced machinery and equipment."

We respectfully suggest that such preference is in violation of Article III, Paragraphs 1, 2 and 4 of the General Agreement on Tariffs and Trade (GATT). Under the terms of those provisions, all the contracting parties recognized that internal taxes and other internal charges, laws, regulations and requirements affecting the purchase of products should not be applied to imported products so as to afford protection to domestic production.

Congressman Sam M. Gibbons, in his Dissenting Views to House Report No. 92-533, concurred in the above expressed views as follows:

"Finally, the 'Buy American' provision of the proposed investment tax credit, which would remain in effect as long as the 'temporary' 10 percent import surcharge remains, is clearly in violation of the intent of Section 3 of the General Agreements on Tariff and Trade (GATT). The Committee has authorized the President to suspend this and allow the tax credit for imported machinery, but only in certain very limited circumstances. This change does not eliminate the extremely undesirable effects of the 'Buy American' provision on some American industries which use imported raw materials and on our relations with the other trading nations of the world. . . ."

In this connection, we would also like to refer to the recent testimony of Professor Richard N. Gardner, a Member of the President's Commission on International Trade and Investment Policy, before the Committee on Foreign Affairs of the House of Representatives, placed in the *Congressional Record* of October 4, 1971 (S15700) by Senator Stevenson. Therein, Professor Gardner (as did the Williams Commission Report) recommended the reduction and eventual elimination of all non-tariff barriers by others as well as the United States. Professor Gardner referred specifically to the desirability of internationally agreed rules which would eventually eliminate discrimination in favor of domestic suppliers. He then stated: "In this connection, the decision taken on August 15 to tie the investment credit to expenditures for equipment produced in the United States is a most unfortunate step."

Of the greatest importance to both U.S. and German interests, as well as to all major-trading nations, is the long-standing and widely recognized policy that once an imported product is past the Customs barrier, it should receive the same treatment as domestic products. This concept, known as "national treatment," has been written into bi-lateral treaties even long before the existence of GATT and is written into the Treaty of Friendship, Commerce and Navigation between the United States and Germany signed on October 29, 1954 (TIAS No. 3593).

Article XVI, Paragraph 1, of that Treaty provides: 'Products of either party shall be accorded, within the territories of the other party, *national treatment* and most-favored-nation treatment in all matters affecting internal taxation, sale, distribution, storage and use."

Article XXV, Paragraph 1, of that Treaty provides. "The term 'national treatment' means treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situations, to nationals, companies, products, vessels, or other objects as the case may be, of such Party." By the very admission of the Administration, quoted above, imports of German produced machinery and equipment are not receiving "national treatment" in the United States.

We do not believe that this Committee would want a Treaty commitment violated if there were any possibility to avoid such action. We further believe that it would not want to put the President in such a position.

CONCLUSION

In view of the above arguments, we respectfully urge this Committee to remove *in toto* the discrimination against foreign produced property. However, if this Committee desires to maintain the exemption granted to the President in H.R. 10947, then we respectfully suggest that Paragraph (C) at the bottom of Page 7 of H.R. 10947 be amended by adding at the end thereof the following sentence: "The President shall find that the application of subparagraph (A) is not in the public interest if he finds that such application is in violation of a U.S. Treaty commitment."

Thank you, Mr. Chairman, for giving the German American Chamber of Commerce this opportunity to be heard.

REFERENCES

1. Annex A gives detailed figures for U.S. machinery imports in 1970 as to subgroups and supplying countries. Yet statistics cannot show the high specialization of the imports in the machinery field.

2. As an example of this we quote from a letter dated September 7, 1971 addressed to President Nixon by Mr. Deussen, Vice President of American Schlafhorst Corp., Charlotte, North Carolina: "In order to remain competitive at home and to stem the rising tide of textile imports, in particular from the Far East, the textile industry in America has over the past years heavily invested in the best production tools and textile machinery available in the World Market. In calendar year 1970, the textile industry, as a whole, invested 530 million dollars in new plant and equipment. Of this amount, $260,036,614 was spent on foreign machinery or a hefty 50% of all outlays for modernization and expansion.

"In 1971, according to an annual projection based on the first two quarters, imports of foreign textile machinery will amount to $320,000,000 of a projected total of $490,000,000 for new plant and equipment. This is 65% of the total.

"Virtually all this machinery is produced in Europe. It sells at *higher* prices than comparable domestic equipment, if available. The American textile industry is not buying European machinery on price, but strictly on the merits of its technological advancement and performance.

* * * * * * *

"While American textile machinery producers have not reinvested their earnings in research and development to the extent European firms have done, and while the American producers have failed to attract young talent to their trade, European textile machinery developers have gained considerable technological knowhow and experience in this particular field.

* * * * * * *

"With lower profits, and being denied the best available production tools in the world, the textile industry will not continue to modernize and expand as planned. Therefore, it will not develop additional jobs for Americans as intended in your program.

"European textile machines enable U.S. textile mills to produce *better quality* yarns and fabrics at *lower costs*, a fact which can be proven in every mill operating comparable equipment side-by-side.

"The textile industry in this country employs about a *million* people (944,000 to be exact). Less than *25,000* employees of the textile machinery industry, in contrast, produce textile processing equipment. Consequently, the minority instead of the majority of people would benefit from your measure."

* * * * * * *

Another example is the printing and paper processing trade with 824,000 employees and 33,000 small and medium-sized enterprises. This industry relies strongly on specialized machinery imported from Germany, such as "sheet-fed letter press printing machines". Letter press printing holds 40% of the market and is used by approximately 25,000 printing shops. The denial of the tax credit for new investments in imported machinery would discriminate against this industry and adversely affect its competitive position.

3. Annex B gives a list of the market shares of imported machinery as to subgroups for 1967, the last year for which census figures are available. A *review* of the figures in the Annual Survey of Manufacturers General Statistics for Industrial Groups and Industry for 1969 and the U.S. Foreign Trade Statistics for 1969 indicates that also in 1969 the import share of the U.S. market is approximately 4.6%. Accordingly, it can be assumed that no significant changes have taken place as to the percentages of the different types of machinery.

4. The chart in Annex C provides a comparison of machinery exports and imports of the largest suppliers of machinery to the world market, pointing out the leading role of the USA, closely followed by Germany.

As to individual categories, the United States are leading in exports of foundry equipment, locomotives, engines, compressors, pumps, ventilation air conditioning and refrigeration equipment, construction machinery, mining machinery, oil field equipment, agricultural machinery, tractors, chemical plants, hoists and cranes, office machinery, computers, washing and dry cleaning machines and power transmissions. With regard to U.S. exports to Germany, office machinery and data processing equipment ($190 Million), construction machinery ($36 Million), machine tools ($26 Million), valves, fittings and pumps ($32 Million) head the list of machinery.

5. The change of machinery prices as to U.S. and German indices in percentage is:

	1965	1966	1967	1968	1969	1970
United States: Wholesale price-index: Machinery and equipment	+1.0	+3.7	+4.8	+3.1	+4.5	+4.3
Germany: Producer price-index	+4.5	+2.8	+.5	+0	+4.8	+9.5

6. See the below calculation:

ACTUAL EFFECT OF PREFERENTIAL 10 PERCENT TAX CREDIT—UP TO 20 PERCENT SAVING

The impact of the 10 percent investment credit on purchases of foreign produced property:

	United States	Foreign
Selling price	100,000	80,000
Tax saved by depreciation 50 percent	−50,000	−40,000
Total	50,000	40,000
Less investment credit which is deductible from tax liability	−10,000	
Net cost to customer	40,000	40,000

Thus, the foreign producer is forced to sell at a 20% discount in the United States to meet the net cost to the U.S. customer for identical domestic U.S. equipment, as a result of the preferential tax credit. (In the case of a 7% tax credit, the foreign producer would be forced to sell at a 14% discount.)

ANNEX A.—U.S. IMPORTS OF NONELECTRICAL MACHINERY BY COMMODITY GROUPS AND COUNTRIES, 1970

[Values in thousands of dollars]

Commodity groups	Total	Share of groups (percent)	Of which— West Germany	France	Italy	United Kingdom	Switzerland	Canada	Japan
Metalworking machine tools	158,472	5.6	55,570	4,442	11,446	24,885	13,495	10.314	17,966
Rolling mills machinery and equipment	26.752	.9	12,164	624	1,914	1,355	518	4,680	2,311
Industrial process furnaces and ovens	3,771	.1	1,460	237	51	332	30	924	201
Foundry machinery									
Mechanical measuring devices	1,010	0	284	23	44	277	237	11	52
Woodworking machinery and machinery for working plastic materials	14,029	.5	5,323	55	1,724	675	247	3,638	433
Precision tools, measuring instruments, and industrial tools	20.040	.7	3,042	110	1,290	2,610	1,177	1,117	4,520
Welding machines and equipment	2,347	.1	1,388	3	33	413	12	375	42
Locomotives	8	0						8	
Internal combustion engines (except automobile and aircraft)	390,992	13.9	66.545	5,768	6,166	131,884	1,650	109.327	45,059
Steam engines and turbines	32.841	1.2	1.435	34	433	4,869	3,157	13.665	7,339
Other prime movers	7,291	.2	210	23	23	938	454	1,418	3,812
Air and gas compressors	53,670	1.9	9.428	1,600	5,599	5,905	2,751	14,166	6,146
Fluid power pumps	24,806	.9	5,530	588	401	6,162	341	5,371	3,035
Ventilating and air-conditioning equipment	38,666	1.4	2,104	251	36	509	114	28,702	5,925
Refrigerating machinery	61,445	2.2	2.830	7	30,686	2,329	315	2,160	9.633
Construction machinery [1]	62,048	2.2	11,196	7,517	5,922	5,100	583	19,681	4,942
Machinery for building materials and for the ceramic and glass industries	27,426	1.0	7,293	1.043	1,402	5,338	392	4,791	352

Machinery for processing rubber and plastics	66,472	2.4	19,033	1,064	4,730	3,060	495	25,982	4,883
Oilfield machinery									
Farm machinery	175,634	6.2	2,948	529	344	5,434	208	150,199	1,646
Dairy and milk products machinery	390	0	352		37			1	
Tractors	175,481	6.2	15,218	7,598	16,433	47,344	16	54,219	6,560
Food products machinery (including packaging machines)	55,478	2.0	24,033	1,432	3,444	6,686	3,192	5,482	1,695
Apparatus and machinery for the chemical and allied industries	14,041	.5	5,352	405	190	1,052	304	3,624	252
Scales and balances	2,606	.1	1,057	3	116	153	319	244	175
Cranes, hoists, conveying and materials handling equipment	97,331	3.5	10,618	5,596	1,565	12,918	2,293	32,679	15,807
Pulp and paper machinery	56,585	2.0	16,912	493	1,321	5,569	10,277	10,299	4,259
Printing machinery	54,745	1.9	29,855	868	5,485	8,727	1,460	2,412	1,701
Office machines	503,744	17.9	79,152	16,069	43,931	33,547	6,665	67,779	145,051
Textile machinery	235,052	8.3	99,6[illegible]	24,809	21,140	27,518	28,182	2,837	10,585
Sewing machines	113,336	4.0	13,955	129	12,045	16,685	4,321	3,557	56,603
Commercial laundry equipment	6,023	.2	2,295		824	730	49	0	182
Machinery for the shoe and leather industries	7,667	.3	3,403	49	1,804	617		1,516	12
Automatic merchandising machines	2,684	.1	171		125	102	0	515	723
Fire fighting equipment									
Valves and fittings	49,351	1.8	6,063	582	5,867	3,292	1,290	20,053	6,689
Power transmission equipment	26,723	.9	4,407	884	591	5,354	455	2,176	9,405
Bearings	77,836	2.8	9,457	1,004	328	6,734	1,005	10,621	45,807
Safes and vaults	1,805	.1	6	0	2	228		14	1,464
Miscellaneous machinery	167,557	6.0	48,634	5,115	11,654	19,254	6,786	35,403	17,524
Total	2,816,105	100.0	578,405	88,954	199,144	398,585	92,750	649,990	442,832
Share of countries (percent)	100.0		20.5	3.2	7.1	14.2	3.3	23.1	15.7

[1] Including mining machinery.

Source: U.S. Foreign Trade Statistics and VDMA-Compilations.

ANNEX B

SUPPLY OF NONELECTRICAL MACHINERY IN THE USA, 1967

[Dollar amounts in millions]

Product group	Shipments	Exports	Imports	Internal supply	Import share (percent)
Metalworking machine tools	$2,654.4	$293.2	$210.5	$2,571.7	8.3
Rolling mills machinery and equipment	332.9	67.9	10.6	275.6	4.0
Industrial process furnaces and ovens	1,061.5	53.7	.2	1,011.0	0
Foundry machinery	140.5	49.4			
Mechanical measuring devices	56.4	15.9	1.3	41.8	3.1
Woodworking machinery and machinery for working plastic materials	244.7	40.3	8.0	212.4	3.8
Precision tools, measuring instruments, and industrial tools	2,792.7	56.7	16.5	2,752.5	.6
Welding machines and equipment	463.9	11.6	2.5	454.8	.5
Locomotives	571.6	102.9	0	468.7	0
Internal combustion engines (except: automobile and aircraft)	1,958.8	334.7	204.6	1,828.7	11.2
Steam engines and turbines; Other prime movers	1,001.4	55.6	13.6	959.4	1.4
Air and gas compressors; Fluid power pumps	2,086.8	365.6	51.7	1,772.9	2.9
Ventilating and air-conditioning equipment	1,619.3	124.5	3.6	1,498.4	.2
Refrigerating machinery	2,403.1	164.6	21.3	2,259.8	.9
Construction machinery	2,806.7	549.1	25.5	2,283.1	1.1
Machinery for building materials and for the ceramic and glass industries [1]	119.3	91.2	15.8	43.9	36.0
Machinery for processing rubber and plastics	357.4	64.1	39.4	332.7	11.8
Mining machinery	549.2	67.6			
Oilfield machinery	660.1	170.4			
Farm machinery; Dairy and milk products machinery	2,976.1	251.3	219.3	2,944.1	7.4
Tractors	2,164.8	606.6	125.0	1,683.2	7.4
Food products machinery (including: packaging machines)	955.4	156.1	38.1	837.4	4.5
Apparatus and machinery for the chemical and allied industries	819.5	173.2	7.5	653.8	1.1
Scales and balances	115.8	12.9	2.2	105.1	2.1
Cranes, hoists, conveying and materials handling equipment	2,123.4	247.3	40.3	1,916.4	2.1
Pulp and paper machinery	545.8	81.8	45.8	509.8	9.0
Printing machinery	605.0	82.1	45.8	566.7	8.1
Office machines [2]	915.9	100.5	106.7	922.1	11.6
Textile machinery	663.0	133.7	145.6	674.9	21.6
Sewing machines	116.7	31.0	78.3	164.0	47.7
Commercial laundry equipment	199.6	31.0	3.1	171.7	1.8
Machinery for the shoe and leather industries [1]	35.3	5.9	6.3	35.7	17.6
Automatic merchandising machines	261.2	49.9	2.2	213.5	1.0
Fire fighting equipment	19.3	8.9			
Valves and fittings	2,508.7	133.1	20.8	2,396.4	.9
Power transmission equipment	1,255.9	110.9	13.7	1,158.7	1.2
Bearings	1,296.3	89.3	57.5	1,264.5	4.5
Safes and vaults	79.5	2.1			
Miscellaneous machinery	1,271.7	164.8	116.4	1,223.3	9.5
Total	40,802.6	5,151.7	1,700.0	37,350.9	4.6

[1] Definitions of census data and foreign trade data are not completely harmonized.
[2] Excluding bookkeeping machines and electronic computers.

Source: Bureau of the Census, Census of Manufactures 1967 and Foreign Trade Statistics 1967. Compilation of the VDMA.

ANNEX C

MACHINERY IMPORTS AND EXPORTS OF WESTERN INDUSTRIAL COUNTRIES, 1965–70

[In millions of dollars]

	Western industrial countries		Of which—									
			United States		West Germany		United Kingdom		Japan		Canada	
Year	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
1965	9,724	16,945	1,172	5,166	1,105	3,848	1,068	2,413	472	621	1,492	351
1966	11,225	18,581	1,537	5,599	1,161	4,472	1,148	2,718	430	600	1,728	409
1967	12,188	20,372	1,819	5,756	1,087	4,262	1,329	2,616	575	918	1,778	469
1968	13,767	22,219	2,051	6,437	1,271	5,284	1,401	2,778	779	1,143	1,738	483
1969	15,782	25,914	2,433	6,966	1,701	6,062	1,518	[illegible]	917	1,514	2,033	600
1970	19,520	30,559	2,816	7,976	2,354	7,297	1,666	3,466	1,187	1,944	2,171	684

Source: VDMA-compilation.

The CHAIRMAN. I would like to put in the record at this point excerpts from a pamphlet prepared by our staff, "General Agreements on Tariff and Trade Analyzing the International Law Aspect of the Problem."

(The excerpts referred to follow:)

THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)

* * * * * * *

GATT AND THE INTERNATIONAL TRADE ORGANIZATION

The collapse of international trade in the 1930's and the resulting political and economic effects led some world leaders to conclude that new international economic institutions were essential for international cooperation in international trade and payments matters. The ultimate goals envisaged for such institutions were the prevention of war and the establishment of a just system of economic relations.

During World War II preparations were underway for the establishment of these institutions. The Bretton Woods Conference in 1944 resulted in the emergence of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD). But it was recognized that an international organization to regulate trade was a necessary complement to the IMF and the IBRD.[1] During the war years, the U.S. State Department had prepared a draft charter of an International Trade Organization.[2]

At the first session of the United Nations, the Economic and Social Council resolved that a conference to draft a charter for an ITO should be called. Four conferences were held. The last of these conferences was held in Havana from November 21, 1947 to March 24, 1948.

The ITO never came into being. Many of its provisions were considered too extreme. They would have amounted to a virtual delegation of congressional tariff setting and trade regulating powers under the Constitution to the Executive.

To fill the gap caused by the death of the ITO, many of the clauses in the drafts of the ITO charter were taken and put into a document called the General Agreement on Tariffs and Trade (GATT).

The basic GATT agreement was completed in 1947 but it has never been submitted to the Congress for its study and approval. It is being observed by the United States through a "protocol of provisional application."

The "protocol of provisional application" stated that the eight governments who signed it would undertake "not later than November 15, 1947, to apply provisionally on and after January 1, 1948:

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[1] The Bretton Woods Conference resolved: "Complete attainment of * * * purposes and objectives [of the IMF] * * * cannot be achieved through the instrumentality of the Fund alone; * * *" and recommended that the government seek agreement "to reduce obstacles to international trade and in other ways promote mutually advantageous international commercial relations * * *."

[2] U.S. State Department Document 2411, December 1945.

(a) Parts I and III of the General Agreement on Tariffs and Trade, and
(b) Part II of that Agreement to the fullest extent *not inconsistent* with existing legislation." [3]

This protocol is still in effect, although the GATT has been amended a number of times and affected by other protocols, including some that are not in force themselves. Thus, the basic treaty is a complex set of instruments, applying with different rigor to different countries.[4]

In spite of the fact that GATT has never been specifically approved by the U.S. Congress as a treaty or otherwise, the executive branch trade spokesmen tend to view GATT as "the law." Whenever the Congress contemplates taking any action to protect a domestic interest, the Executive pointedly reminds it of the "international commitments" of the United States.[5] It is not clear however, that the executive branch demands the same respect for adhering to "international commitments" from other signatories of the Agreement as it demands of itself.

For example, Japan has import quotas on 98 commodities without any finding of serious injury; Britain imposed a "surtax" on imports and an "import deposit scheme," in violation of GATT; the Continental Europeans have entered into "special commercial arrangements" on citrus fruits and other products in violation of GATT MFN principles, and its common agricultural policy is significantly more protectionist than the previous individual country restrictions on agricultural imports, another violation of GATT principles. Outside of complaining, the United States has done nothing to demand compensation or to retaliate against these violations of GATT principles.

The GAAT was born more than 20 years ago at a time when Europe and Japan were in ruins and the United States completely dominated world trade as well as other matters. In the year in which GATT was negotiated, 1947, the United States had a $10 billion trade surplus. The attitude of many U.S. officials at that time was one of redistributing the wealth. We embarked on an ambitious Marshall plan aid program and later on a technical assistance program. U.S. officials were worried about the so-called "dollar gap" meaning that foreign countries did not have enough dollars to purchase needed imports. It is somewhat understandable that under these circumstances, GATT would contain certain provisions designed to favor European countries and Japan.

Conditions in 1970 are vastly different from those in 1947. At this point, the GATT should be redrawn to take out the inequitable provisions which effectually discriminate against certain countries, mainly the United States, and to put in new provisions to cope with new conditions in the world economy.

MOST-FAVORED-NATION TREATMENT

Nondiscrimination is intended to be the cardinal principle of GATT. It is embodied in article I. What you give to one you give to all. This principle is aimed at making anathema discriminatory bilateral trade agreements, preferences, and special commercial relationships.

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[3] The eight signatures, some with reservations, were Australia, Belgium, Canada, France, Luxembourg, The Netherlands, United Kingdom, and the United States.

[4] For example, the GATT provisions regarding subsidies apply to some countries, but not to others. Even the fundamental principle of GATT—nondiscrimination—has been compromised by numerous exceptions in recent years. The GATT provisions have not prevented the widespread use of nontariff barriers in recent years as substitutes for tariff protection.

[5] The prospect of "retaliation" against U.S. exports if the United States applied "unilateral" restrictions to foreign imports, was discussed by Secretary of State Dean Rusk before the Committee on Finance in these terms:

"Retaliation would simply be what is permitted by the rules of the game as that game is now practiced by some seventy countries accounting for about 85 percent of world trade. I refer, of course, to the General Agreement on Tariffs and Trade—the GATT.

"The GATT is essentially a code of conduct for fairplay in international trade. The United States played a major role in its negotiation in 1947. Like many of the great initiatives of the early post-World War II days, it reflected a conviction that there must surely be a better way to organize man's affairs than had been the case in the preceding decades of self-centered nationalism. In the area of international trade policy, the GATT represents an attempt to prevent a repetition of some of the economic blunders of the 1930's.

"The GATT does this by establishing *a legal framework* for the stability of trade concessions negotiated in good faith among sovereign countries. We accord others access to our market in return for the right of our exporters to sell in their markets. If we impair the access we have agreed to give others, two courses of action are available under the GATT. We ourselves can offer reductions of our import barriers on other products equivalent in trade value to the impaired concession or the foreign country can withdraw concessions affecting the equivalent trade value of American exports in the foreign market. This may sound a bit complicated—*the legal language* of the GATT is much more complicated—but the idea is clear. It is retaliation—by agreement among all parties in advance that restrictive action by one party entitles the aggrieved party, *as a matter of legal right,* to compensatory action." [Emphasis supplied.]

However, the GATT sanctions the departure from unconditional MFN treatment in the case of customs unions and free trade areas (article XXIV), certain exceptions in article XIV, and the existence of certain preferences in article I, paragraph 2. These "exceptions" effectively allow European countries to depart from MFN treatment when it suits their commercial interests.

The United States generally observes the unconditional MFN principle although in recent years the United States has compromised on its rigid adherence to this GATT principle.[6] This is particularly evident in the U.S. request for a GATT waiver on the United States-Canadian automobile pact and the Presidential announcements in favor of a system of special "generalized tariff preferences" for less developed countries.

One of the provisions of article XXIV in defining customs unions was that such formations were required to "facilitate trade between the parties" by eliminating regulations of commerce on "substantially all trade between constituent territories of the union." In fact, however, this was violated in 1952 when the six European nations set up the European Coal and Steel Community to pool resources of coal, steel, iron ore, and scrap in a single market without internal frontier barriers. The GATT considered this project as limited to one sector of the economy and therefore not covered by the provisions relating to customs unions. Nevertheless, in light of the fact that the ECSC would have been agreed to by the six with or without GATT approval, the GATT granted a waiver.

France, West Germany, Italy, Belgium, Luxembourg, and The Netherlands signed in 1958 the Treaty of Rome, establishing the European Economic Community, a common market agreement. The legal question of whether the Rome Treaty is consistent with article XXIV of the GATT has never been settled but is obviously academic. Since the common market of Europe was established in 1958, other important trade blocs have also developed. The outer countries of Europe established the European Free Trade Association in 1959. The countries of South America signed the Montevideo Treaty in 1960, creating the Latin American Free Trade Area (LAFTA), a free trade association among the South American countries. A common market among the Central American countries is in existence and now at Punte del Este agreement has been reached to integrate the Central American Common Market and the Latin American Free Trade Area into a Latin American common market. Japan is currently considering the establishment of a free trade area or common market with Australia and New Zealand (which already have a free trade area between themselves) hoping that it will later include Canada and the United States.

There are also tariff preferences, "reverse preferences" and special commerical arrangements sprouting up all over the world.

In Asia, Australia has unilaterally violated MFN by granting preferences to less developed countries. There is growing sentiment of a Pacific Free Trade Area among Japan, Australia, and New Zealand. The British Commonwealth preference system violates the MFN principle. In short, there are very few countries if any, who observe unconditional MFN treatment, without exceptions.

But, the problem is that the exceptions are growing and threaten to make the MFN principle a mockery. The EEC has special preferences for its 19 former African colonies which in turn give "reverse preferences" to EEC goods. The EEC has concluded or is in the process of negotiating discriminatory commercial arrangements with Greece, Turkey, Israel, Spain, Tunisia, and Morocco. Applications for membership with the community are being considered for Austria,

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[6] For 140 years, until 1923, the United States adhered to a "conditional" most-favored-nation principle, under which we would extend tariff and other trade benefits negotiated with one party to another, only if the latter offered reciprocal benefits. Under "conditional" MFN, no country would get a "free ride." The major considerations in the U.S. decision to change to an "unconditional" MFN principle were:

A. By 1923 international commercial relations were dominated by tariff rates and regulations, whereas previously tariffs were of relatively minor importance as compared with the right to trade at all. Bilateral negotiations with such trading partners were cumbersome and time-consuming.

B. The United States had become a major manufacturing nation and sought immunity from discrimination by other countries in order to compete abroad for markets.

C. Under the Tariff Act of 1922, the President was authorized to impose additional duties on the whole or on any part of the commerce of any country which discriminated against American commerce. Consistency, therefore, required that we not initiate discriminatory rates.

Spain, Ireland, Great Britain, and others. All this involves a massive movement away from MFN.

Tariff preferences are by nature discriminatory, and yet the whole developed world seems to have accepted this as a necessary concession to the demands of the less developed countries. In short, the principle of nondiscrimination is being observed more and more in the breach.

It concerns us to see developing in the world a situation in which more and more trading partners of the United States are being incorporated in regional trade blocs which do not adhere to the unconditional most-favored-nation clause. The United States has eschewed joining a free trade area with North Atlantic countries partly because of its concern for dividing up the world into competitive regional blocs. Yet, we have actively supported the participation of other countries in regional trade blocs, which threaten to accomplish the same unwanted result. In addition, as more countries enter into regional trade blocs the U.S. competitive position is bound to suffer from the inherently discriminatory nature of these arrangements. This fact has important ramifications in determining a future U.S. trade policy.

GATT PROVISIONS ON SUBSIDIES AND BORDER TAXES

Another important area in which GATT principles are both inadequate and discriminatory concerns subsidies and border tax adjustments.

In essence, the GATT provisions on subsidies and border taxes have been interpreted to permit the rebate of "indirect taxes" (such as value added or turnover taxes) on exports and the imposition of such taxes on imports, but to deny equivalent treatment for "direct taxes," such as income taxes.

TAX SHIFTING ASSUMPTIONS IN GATT

The entire border tax adjustment theory and practice is based on the assumption that "indirect taxes" are always and wholly shifted forward into the final price of a product and that "direct taxes" are always and wholly shifted backward to the factors of production.

The distinction between direct and indirect taxes on the basis of their presumed difference in incidence, though generally accepted two generations ago, is now widely questioned. All taxes on business are increasingly thought of as costs, with varying effects and differential impacts depending on their form, but in one way or another constituting a cost which must be recovered from customers or those who supply resources if the enterprise is to survive. Indirect taxes, at least in the short run, are partially absorbed by the manufacturer depending upon the degree of competition in his markets, and in the markets for his raw materials. Direct taxes, especially the corporate income tax, are shifted forward to the price of the product sold to consumers to the extent that market conditions allow. Well known economists and fiscal experts brought together in a symposium, organized by the Secretary-General of the Organization for Economic Cooperation and Development in September 1964, reached the following conclusions, (1) "In practice, indirect taxes are not fully shifted into product prices . . ." and, (2) "Certain direct taxes, and particularly the corporate profits tax, may be partially shifted into product prices: although the degree of shifting may vary from country to country."

Businessmen operate with target rates of return in mind and will pass-on all costs, including taxes, into the price structure of their products to the extent that price elasticity of demand in the market will permit. Thus, modern economic theory suggests that the distinction in the GATT treatment of direct and indirect taxes is an extreme and arbitrary assumption which does not stand the test of economic reality. The Business and Industry Advisory Committee of the OECD (BIAC) in a report on the problem of tax shifting stated: "In a strongly competitive situation the prices obtainable—and hence the degree of tax shifting—are substantially determined by the market itself." In short the GATT on border taxes are not "trade neutral."

Actually, the distinction between "direct" and "indirect" taxes is itself somewhat arbitrary and appears to be based more on prevailing practice than on reason. The distinction is, in fact, not made explicit in the GATT provisions, but flows from interpretations of, and amendments to, various provisions. For example, value added taxes, according to GATT classification are considered to be indirect taxes. However, value added taxes fall on both costs and profits of the producer (value added being defined as the difference between the value of a firm's purchases and sales) and to the extent that they fall on profits how can they be distinguished from a profits tax in effect? Corporate profits taxes are classified by GATT as "direct" falling entirely on the producer. Logically, if corporate taxes were reduced, prices should fall. But to the extent that tax reductions stimulate increased spending and demand, they could stimulate price increases. For example, there is no evidence that corporate tax reductions in 1964 led to price reductions.

HISTORY OF GATT DISTINCTION

The provisions in GATT relevant to border taxes and subsidies, basically articles II, III, and XVI, are drawn from the Havan Charter of the 1940's. These provisions were themselves either a compromise (for example, article XVI) or were adapted from provisions of numerous bilateral trade treaties, including especially the United States-Canada reciprocal trade agreements of the mid-thirties.[7] The lack of precise or concentrated thinking about the border tax problem is illustrated by the absence of explicit definitions of key concepts.[8]

There is no unified section of the GATT which deals exclusively with border taxes and is quite clear that the provisions of GATT which do cover border tax adjustments were not the product of carefully reasoned theory, or of experience molded in the crucible of extensive usage.

When the present GATT language was drawn up more than two decades ago, the question of border taxes did not appear to be a major one. Levels of indirect taxes were much lower. Under these circumstances, overlying simple and sweeping assumptions about tax shifting seemed acceptable, and already existing practices were incorporated in very general terms without searching examination.

IMPORT "EQUALIZATION" CHARGES

Border tax adjustments on the import side, i.e., import equalization charges, are permitted under Article II and III of the GATT, but only for "indirect taxes." Article II (Schedules of Concession) provides that its terms shall not prevent any contracting party from imposing charges "equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part". This exemption of indirect taxes gives a GATT blessing to the European practice of imposing "equalization" charges at the border. Article III (National Treatment of Internal Taxation and Regulation) provides in paragraph 2 thereof that "products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products." This article is apparently being ignored by European countries which impose discriminatory road taxes against larger American cars. Japan and other countries also discriminate against American cars through their tax system.

EXPORT REBATES

Article XVI, adopted in 1955 deals with the question of border tax adjustments for exports in the following terms:

> The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued shall not be deemed to be as subsidy.

This Article contains many vague terms which need clarification. For example, what is meant by "borne by the like product when destined for domestic consumption" or "remission of such duties or taxes in amounts not in excess of those which have accrued"? These terms seem to be an attempt to apply the "destination principle" to indirect taxes, but the meaning of indirect taxes itself is not at all clear.[9]

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[7] 49 Stat. 3960 (1936). Effective May 14, 1936.

[8] For example, the meaning of linking the import charge at the border with "charge * * * applied, directly, or indirectly, to like domestic products" is not defined.

[9] This principle states that internationally traded commodities should be subject to some specified taxes of the importing country and exempt from similar taxes of the exporting country in order to avoid double taxation. The principle contrasts with (a) the origin principle as applied to other forms of taxation on transactions, (b) income taxes levied according to source of income, or domicile or residence of the taxpayer, and (c) property taxes imposed according to the situs of the taxable object.

In 1960, the contracting parties adopted a Working Party Report which listed a number of practices construed to be subsidies.[10] Among these were the remission of direct taxes or social welfare charges on industrial or commercial enterprises and "the exemption in respect of exported goods, of charges or taxes, other than charges in connection with importation or indirect taxes *levied at one or several stages on the same goods* if sold for internal consumption. The implications of practices listed in (b), (c) and (d) of footnote 10 below were not fully appreciated by the United States. They, in effect permitted the European countries to impose border taxes on imports and rebate indirect taxes on exports in accordance with their value added or cascade turnover taxes.

In the late forties and early fifties it is not surprising that U.S. trade officials were willing to incorporate existing commercial practices on border tax adjustments into the GATT agreement. There were much larger problems in international trade than border tax adjustments, which at that time were low—in the range of 2-4 percent and limited to around one-sixth of the goods traded—and then only in the case of a few nations. The United States and a $10 billion trade surplus in 1947 which must have had an effect on our negotiators' attitudes.

But the failure to appreciate the consequences of excluding the so-called "indirect tax" rebates in 1960 from the general prohibition against export subsidies while including a specific prohibition against rebating "direct taxes", was a major blunder. The United States by that time had run into serious balance of payments difficulties. Western Europe had become a prosperous "third force." Giving away commercial advantages to prosperous Europe for the sake of their own internal tax harmonization objectives was an unwise and costly move, in which vague political objectives out-weighed clear commercial considerations.

BALANCE-OF-PAYMENTS SAFEGUARDS

Balance-of-payments considerations have exerted and will continue to exert a powerful influence on major countries' dispositions to deal with trade matters. Recent history shows that countries will adopt whatever measures they deem necessary to protect their balance of payments irrespective of GATT. The British imposed an import deposit scheme to control imports and prior to that they and the Canadians adopted import surcharges to protect their balance of payments. The French subsidized their exports even beyond what the inequitable GATT rules allow. In developed as well as the less developed countries quantitative restrictions and licensing arrangements are legion.

The GATT recognizes that member countries may have to protect their balance of payments and international reserve positions and to this end Article XII

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[10] Point 5 of the report adopted on November 19, 1960, dealing with subsidies stated: "The following detailed list of measures which are considered as forms of export subsidies by a number of contracting parties was referred to in the proposal submitted by the Government of France, and the question was raised whether it was clear that these measures could not be maintained if the provisions of the first sentence of paragraph 4 of Article XVI were to become fully operative:

"(a) Currency retention schemes or any similar practices which involve a bonus on exports or re-exports;

"(b) The provision by governments of direct subsidies to exporters;

"(c) The remission, calculated in relation to exports, of direct taxes or social welfare charges on industrial or commercial enterprises;

"(d) The exemption, in respect of exported goods, of charges or taxes, other than charges in connexion with importation or indirect taxes levied at one or several stages on the same goods if sold for internal consumption; or the payment, in respect of exported goods, of amounts exceeding those effectively levied at one or several stages on these goods in the form of indirect taxes or of charges in connexion with importation or in both forms;

"(e) In respect of deliveries by governments or governmental agencies of imported raw materials for export business on different terms than for domestic business, the charging of prices below world prices;

"(f) In respect of government export credit guarantees, the charging of premiums at rates which are manifestly inadequate to cover the long-term operating costs and losses of the credit insurance institutions;

export credits at rates below those which they have to pay in order to obtain the funds

"(g) The grant by governments (or special institutions controlled by governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed;

"(h) The government bearing all or part of the costs incurred by exporters in obtaining credit.

"The Working party agreed that this list should not be considered exhaustive or to limit in any way the generality of the provisions of paragraph 4 of Article XVI. It noted that the governments prepared to accept the declaration contained in Annex A agreed that, for the purpose of that declaration, these practices generally are to be considered as subsidies in the sense of Article XVI:4 or are covered by the Articles of Agreement of the International Monetary Fund. The representatives of governments which were not prepared to accept that declaration were not able to subscribe at this juncture to a precise interpretation of the term 'subsidies,' but had no objection to the above interpretation being accepted by the future parties to that declaration for the purposes of its application."

sanctions the use of quantitative restrictions (quotas). Export subsidies or import surcharges are not allowed under GATT rules as balance-of-payments adjustment mechanisms; import quotas are. This rigidity in the GATT flies in the face of other provisions of the GATT which are more flexible. Limiting available options to quotas also is inconsistent with the main emphasis of GATT to eliminate quotas as a trade protective device.

It is also difficult to understand why, if quotas are sanctioned by GATT as a balance of payments safeguard, the United States would be violating either the letter or the spirit of the agreement if it imposed quotas for balance of payments reasons—a position that has been stated by administration spokesmen. The United States has experienced deficits in its balance of payments in every year since 1950, with two exceptions, and its international reserve position has deteriorated substantially. This would appear to fully justify the application of Article XII quotas for the United States. Member countries in GATT should face up to the lack of flexibility in Article XII, and decide whether quotas should be the only recourse available to a country suffering from chronic balance of payments problems. In facing this issue, the member countries should consider that in recent years many countries have not hesitated to use whatever means they deemed necessary to restore equilibrium notwithstanding the GATT.

CONCLUSION

In a number of areas the GATT is deficient and discriminatory. Its exceptions to unconditional MFN treatment favor common markets and free trade areas, and threaten to break up the trading world into competitive regional blocs. Recent bilateral commercial arrangements involving the European Common Market and other countries do not even pretend to justify their existence under article XXIV. The United States could gradually become isolated as a trading nation if it continues to adhere to a policy of encouraging other nations to join regional trade blocs which violate MFN principles, while eschewing U.S. participation in such arrangements under the theory of "multilateralism."

The GATT treatment of subsidies and import charges discriminate against countries relying principally on one form of tax structure—direct or income taxes—in favor of other countries whose revenues are derived from a different system—such as value added taxes.

The GATT safeguard on balance of payments is an anachronism and is inconsistent with other principles in GATT. Furthermore, in recent years major countries such as England and France have imposed import restrictions for balance of payments reasons in complete disdain of GATT principles.

The GATT does not even pretend to be a guide in agricultural trade which is now heavily controlled and subsidized, especially in the European Community.

In short, as presently constituted, the GATT is not a guide to fair trade. Its rules are often inequitable and outdated. It was written at a time when the United States held a virtual monopoly over production and trade and when the rest of the world suffered from an acute shortage of dollars. Trade at that time was mainly between unrelated parties at arms length transactions. Today, trade is increasingly becoming a movement of goods within a multinational business complex. The drafters of GATT may not have forseen all the postwar economic and structural changes. But no one can claim that world conditions have not changed sufficiently to require a new look at the GATT. It is the view of the staff that the GATT should be redrawn to provide for principles of fair and free trade before the Congress approves its provisions.

The CHAIRMAN. The next witness will be Mr. Herbert B. Cohn, chairman, Policy Committee on Cost of Money and Taxes, Edison Electric Institute.

STATEMENT OF HERBERT B. COHN, CHAIRMAN, POLICY COMMITTEE ON COST OF MONEY AND TAXES, EDISON ELECTRIC INSTITUTE

Mr. COHN. Mr. Chairman and members of this distinguished committee, I am appearing here today on behalf of the Edison Electric Institute, which is the principal trade organization for the Nation's electric utilities. Its 196 members serve more than three-quarters of the electric customers in the United States.

I have filed a rather lengthy statement, which I understand will be incorporated in full in the record. To conserve the time of the committee, I will merely summarize briefly the two principal points made in the statement and, if I may, I would like to add a brief word on a proposal made yesterday by Senator Magnuson, which would affect the electric utility industry in a very significant way.

The two principal points made in our statement are to urge, first, that the regulated electric utility industry should be treated in the same way as all other taxpayers, as to any investment tax credit made available.

Second, to urge that the class life depreciation system authorized in the House bill, which represents a long-overdue reform in the allowance for depreciation, should not be any more restrictive than the ADR system adopted by the Treasury earlier this year.

As the committee knows, the House bill allows a 7-percent tax credit to taxpayers generally but only a 4-percent credit to regulated electric utilities.

We urge that electric utilities be treated equally with all other taxpayers for the following reasons:

First, it is the basic general principle of business taxation to provide business taxpayers similarly situated with equal treatment. It is generally thought to be unfair to make available tax advantages to one taxpayer which are not equally available to others.

Second, the objectives to be obtained by the investment credit will, we submit, be best attained by allowing the full credit to electric utilities. Reducing the cost of producing electric power will help lower the cost of manufactured goods and will help combat inflation.

The availability of the full tax credit to electric utilities will stimulate capital investment to as great or greater extent than would be the case of any other taxpayers.

The electric utilities do have large areas for discretionary investment, discretion in terms of whether to make the investment and when to make it.

Possible examples are the undergrounding of distribution lines which, in many parts of the country, are not required. I guess in our parts of the country they are regarded as highly desirable. This is an area where there is discretion on the part of the utility to make the investment or not.

Generally, the aesthetic quality of utility facilities can be improved if there is an incentive to do so. There is a financial incentive in addition to whatever other incentive there might be. The provision of the two-way need to improve, again, is an area of some degree of some discretion.

So far as the tax credit is being proposed to help the financing of new capital facilities, there is a greater need for capital in the electric utility industry than, perhaps, any other in the country, and the availability of the credit in the full amount made available to other taxpayers will help considerably to ease the pressures on the capital markets.

The third reason is that a smaller credit for electric utilities will unfairly prejudice them in their competition with taxpayers who are to receive the full credit.

The oil industry will receive the full credit, as it should, but the oil industry is an industry with which we are competing quite intensively in many parts of the country for space-heating business. If we do not get the full credit, we will be prejudiced in our competition with the oil industry.

Another example of such competition is what is called industrial self-generation. In may parts of the country a large industry will provide its own generating facilities if it believes that it is more economic. Other industries will receive the full credit. If we do not, we will suffer competitively when we try to convince other industries that we can sell power more cheaply than they can produce it with the use of their own facilities.

This is not an insignificant item. Industrial self-generation amounted to something on the order of 19 million kilowatts and there was produced in the last 12 months for which we have figures, 106 billion kilowatt-hours by industrial self-generation.

A different treatment under the tax credit will encourage industrial self-generation to build the smaller less efficient plant in order to obtain the full credit. This, we believe, could lead to misallocation of natural resources and it will also, by encouraging the building of a large number of smaller units, add to the pollution problem.

The House of Representatives in their report did recognize the increasing competition, and I think they gave some recognition to the arguments of general fairness that I have been attempting to submit.

The House concluded that the proposed difference in the amount of credit, which I am sure you gentlemen recall, was 7 percent, as against 3 percent in the past, that that difference should be lessened, but they went only part way, and we submit that fairness and equity require that the same percentage be available to all taxpayers.

The second major point made in our statement is to urge that the class life depreciation system authorized in the House bill should be no more restrictive than the ADR system regulation adopted by the Treasury earlier this year, for the following reasons:

First, the ADR system represents a long-overdue and highly desirable reform in the allowance of depreciation, an area in which the United States has lagged behind most other countries to the detriment of our competitive position in international trade.

Second, the ADR system was proposed to provide simpler and more certain basis for computing a reasonable allowance for wear, tear, and obsolescence. It was also proposed to recognize that changing technological, social, and economic conditions greatly reduce the useful lives of machinery and equipment. Both of these are important and highly desirable objectives. They are in no way lessened or changed by the adoption of the tax credit.

Third, we urge that the first year convention authorized in the ADR system be reinstated. The first year convention does not in any way increase the depreciation allowances permitted over the life of a particular piece of property. All it does is deal with the timing of the capital recovery.

Second, earlier recovery in the first year will be particularly helpful in providing immediate stimulation when it is most needed.

Third, the first year convention does provide greater simplication and certainty.

I would like to emphasize a point that has been made by some of the other witnesses and made, perhaps, most strongly and persuasively by Secretary Connally, and that is that the combination of the 7-percent credit and ADR, including the full first year convention, will still leave us behind most other industrial nations of the world in respect to capital cost recovery.

Secretary Connally included a chart in his statement which I think shows that most persuasively.

I would like to make one other point about ADR and that is, if it is to be modified at all, I would like to urge that the committee give special consideration to allowing the ADR system to be effective without any modification for at least the year 1971.

The ADR system was first proposed at the beginning of the year: when final regulations were adopted in June, they were effective as of the first of the year. American business was told in the early part of the year that it could rely on the availability of ADR for 1971 and to plan accordingly. It has done so in its business planning, in the payment of estimated taxes, and in its planning with respect to cash flow and financing.

We submit that the Congress should not as late as October or November of this year, change these rules on which American business has been relying on a retroactive basis. If there is to be any modification of the ADR system, we urge that it be effective only after the close of the taxable year.

Last, I should like to say a very brief word about the proposal made yesterday by Senator Magnuson.

As we understand that proposal, it would be to add a rider to the bill under consideration by this committee to take back 90 percent of the investment credit made available to the taxpaying segment of the electric utility industry, and to make the proceeds available to a new Federal agency to engage in research and development on electric utility technology.

We think this proposed amendment should be rejected for at least the following reason. And I say parenthetically I have not had an opportunity since the matter first came up yesterday to consult with any of my associates at the Edison Electric Institute, but I am sure that the reasons that I will submit at this time are the reasons which they will join, and they may be able to think of many others.

First, the proposal is a novel, far-reaching and highly controversial one. We submit that it should be the subject of an independent hearing to explore fully all of its aspects, including alternatives being developed within the industry.

Second, the proposal would give us the investment credit with the one hand and take it away with the other. This is not equal treatment with other taxpayers, which I have tried to suggest we think we ought to receive. In addition, it would prejudice our competitive position as against the oil industry, industrial self-generation, and any others with whom we compete who would receive the full credit without any drawback of 90 percent.

Third, it would put the Federal Government into research to the tune of $300 million a year, through a Federal Board, which would be dealing with research on the technology of electrical power, with no representation whatever from anyone in the electric utility industry.

Fourth, the proposal comes close to representing an appropriation of $300 million a year, without going through the appropriations process.

Fifth, prior to this proposal, there appeared to be a general agreement that if anything like this were to be done, the cost would be borne equally by all segments of the utility industry and by all of their customers. Indeed, this is what I understand to have been provided in Senator Magnuson's original legislative proposal.

The proposed rider would have the effect, instead, of imposing the burden only on one segment of the industry, the taxpaying electric utilities, and only on their customers.

For all of these reasons, we urge that the proposed rider not be adopted.

Gentlemen, I very much appreciate your courtesy of giving us this opportunity to present our views. Thank you.

Senator BENNETT (presiding). Any questions?

Senator FANNIN. It has been reported that some regulated companies, which have previously received a 3-percent credit, were in competition with companies entitled to the 7-percent credit. Could you provide the extent of this competition?

Mr. COHN. Yes, sir. Some of the areas of competition I have referred to. For example, competition for space heating with the oil industry, which in the past received 7-percent credit, whereas the electric utility receive only 3-percent credit.

I have referred also to industrial self-generation, in which virtually every industrial taxpayer has received the 7-percent credit, when it builds a generating facility to take care of its own needs. If we want to build a generating facility and try to sell power, in the past we have received only 3 percent.

Senator FANNIN. An electrical company that has its own communications system, I am thinking about out West in areas where there are long distances involved, I know that some of them have their own communications systems. What percentage depreciation would they receive on those communications systems?

Mr. COHN. Senator, I am not 100-percent sure of my ground. I think the answer is, under the past investment credit, they would have gotten 7 percent on what is regarded as nonutility property. I am not sure of that.

Senator FANNIN. That was one of the problems that has been brought to my attention, that they were receiving 7 percent, and still the utility that is in competition, the telephone company, would receive 3 percent or 4 percent.

Mr. COHN. Three percent; that is right.

Senator FANNIN. That was one of the questions.

Mr. COHN. That is right. My understanding is that the telephone industry has raised similar points to the one that I have raised, and I think, Senator, that you have stated precisely what their argument was.

Senator FANNIN. Thank you.

Senator BENNETT. I would like to ask one question.

For the record, can you supply us with information as to the amount of money the private electric industry is now putting into research and development?

Mr. COHN. Yes, sir; we will be glad to supply some figures.*

I would like to say, preliminarily, by way of explanation, that this is not an easy figure to give with precision because the fact of the matter is I know in my own company that we have spent many millions of dollars to build a powerplant which was really an experimental powerplant. We have not charged that to research and development.

The figures that we will submit will generally be the figures which have actually been charged to an account for research and development. These are the figures that are generally submitted when that kind of question is asked, and we will be glad to submit that.

Senator BENNETT. I think if we are going to consider the amendment to which you object, that it would be useful for us to know how much money is already going into this area in which the money would be applied if the Magnuson amendment were adopted.

Mr. COHN. Yes; we will be glad to submit that, Senator Bennett.

I should say, perhaps two other things, if I may.

Traditionally, the electric utility industry has not been in the manufacturing business. They have not manufactured their own equipment as has, for example, the telephone industry.

Traditionally, the electric utility industry has not been in the manufacturing business. They have not manufactured their own equipment as has, for example, the telephone industry.

Traditionally, the reliance on research and development to produce better and more effective equipment has been carried out by the manufacturers and has been factored into the price of their equipment. There is a very substantial change taking place and the electric utility industry is looking more and more into getting into the research and development itself. Increasing the amounts that are being spent and the raising of the kind of money that Senator Magnuson is proposing to be raised is very much under consideration, but there are other ways which are being proposed to do precisely that. The major thing I would like to say about Senator Magnuson's proposal is that we would like the opportunity to meet that proposal on its own in independent hearings and be able to indicate what it is that is being proposed as an alternative way to deal with the problem.

Senator BENNETT. Thank you.

The CHAIRMAN. You made a very fine statement, Mr. Cohn. I would like to ask you one thing. How much is it going to cost to do all of this? What is the cost? Do you have a Treasury estimate of what it would cost to do what you are asking us to do?

Mr. COHN. I am afraid I don't know that. I believe the cost involved in reinstating the first year convention does appear in Secretary Connally's statement.

The CHAIRMAN. I am told by one of the members of our staff, after I asked the question, that the figures is $2.1 billion to do that.

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*See letter, p. 391 ff.

Now, that sounds like a lot of things that I know of. It would sound great until somebody hands you the price tag for it. $2.1 billion is an awful lot of money.

Mr. COHN. With reference to the gentlemans, answer I would have some question as to whether that is an accurate figure. It is hard for me to believe it is. I don't know whether it tends to be $2 billion a year or $2 billion over some period of time.

The CHAIRMAN. I am told by the staff that the statement available to them is it would start out costing $2,100 million revenue loss for the first year and then would gradually scale down over a period of years. The initial cost is $2,100 million a year to do what you are asking. That is a very heavy blow on our revenue.

Mr. COHN. It is very difficult for me to believe that that is correct, but I appreciate the opportunity to submit what we believe to be the appropriate figures, Senators.

The CHAIRMAN. I am told that is actually the Treasury estimate. If you are up here with something that costs $20 million, I would be happy to vote for it, but when it gets to be $2,100 million that sounds like a very formidable expense for us to add to this bill.

Mr. COHN. We will take $20 million.

The CHAIRMAN. We will study it and see what we can do.

Thank you so much.

(The following letter was submitted by Mr. Cohn in response to the Chairman's request and a previous request by Senator Bennett:)

AMERICAN ELECTRIC POWER SERVICE CORPORATION,
New York, N.Y., October 18, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: In the course of my appearance before the Senate Finance Committee on Wednesday, October 13, you requested that I furnish information on the revenue losses which might be associated with proposals I made in my testimony: and Senator Bennett requested that I supply information relating to research and development expenditures of the electric utility industry. This letter is intended to supply the information requested.

1. The two principal proposals I urged in my testimony were (a) that the regulated electric utility industry should be given equal treatment to that of all other taxpayers with respect to the percentage of the investment credit made available, and (b) that the first year convention included in the ADR System regulations promulgated earlier this year be permitted to stand—at least for the year 1971.

In the course of our colloquy, I had understood your question on associated revenue losses to relate to the first of these proposals and, therefore, I had some difficulty in understanding your staff representative's comment that there might be a $2.1 billion revenue loss involved. I suspect the explanation is that he had in mind the second of my proposals.

In any event, to cover both points, Edison Electric Institute has made an analysis of each and its best estimates are as follows:

(1) The estimated revenue loss associated with equal treatment for the regulated electric utilities in terms of increasing the 4% credit made available to electric utilities in the House bill to the 7% made available to taxpayers generally would be about $250 million for the fiscal year 1971–1972.

(If the Congress were also to provide equal treatment for the other regulated utilities for whom only 4% has been provided in the House bill, this would involve some additional revenue loss, but we do not have the basic information to formulate any estimate in this respect.)

(2) The House action in nullifying the first year convention under the ADR System promulgated by the Treasury Department is estimated in the House Report to produce a revenue gain of some $2.1 billion for the year 1971. Reinstatement of the first year convention for all taxpayers for the year 1971 would, on that basis, involve a revenue loss in such amount.

However, since the first year convention in no way increases the total depreciation allowed over the life of depreciable property, this loss would be fully offset (except for the time factor) in future years.

While the initial revenue loss involved—particularly in the case of the second proposal—is very large, it does seem to us that the essential question is whether either or both proposals should be adopted to achieve fair and equitable treatment. If so, and the revenue loss were regarded as a major obstacle, it could, of course, be recovered by other modifications. Thus, for example, if it were to be concluded that fair and equitable treatment required that the percentage of the tax credit made available should be the same for all taxpayers, it would be a relatively simple matter to achieve such equal treatment without any revenue loss whatever by merely adjusting the percentage to be used.

2. The Edison Electric Institute has prepared a memorandum setting forth the information requested by Senator Bennett relating to research and development expenditures in the area of electric utility technology. A copy of such memorandum is enclosed.

It is my understanding that Senator Bennett requested such information for consideration in connection with Senator Magnuson's proposed rider to the bill before the Committee. This proposed rider would take back 80% of the new investment credit made available to the tax-paying segment of the electric utility industry and make it available to a new Federal agency to enable such agency to engage in research and development on electric utility technology.

As I indicated in my testimony, we believe that the proposed rider should be rejected for at least the following reasons:

(1) The proposal is a novel, far-reaching and highly controversial one. It should be the subject of an independent hearing which will provide an opportunity for all those affected and interested to explore fully all of the issues raised—and to present alternatives being developed by the industry, some of which are discussed in the enclosed memorandum.

(2) The effect of the proposal would be to make available the investment credit to the electric utility industry with one hand and to take it away with the other. This would further increase the disparity of treatment with other taxpayers who would be receiving the full credit and would further prejudice the competitive position of the electric utility industry as against the oil industry, industrial self-generation, the owners of on-site generation and others receiving the full credit with whom the electric utility industry is competing.

(3) The proposal would put the Federal Government into the research business—initially to the extent of $300 million a year—through a Federal board which would not even have representation by the industry most directly affected.

(4) The proposal has the effect of creating an appropriation of $300 million a year without going through the appropriations process.

(5) Prior to this proposal, there appears to have been general agreement that, if there were to be any Federal tax imposed to raise funds for electric utility research and development, any such tax should be imposed and borne equally by all segments of the electric utility industry and by all of their customers. The proposed rider would have the effect of imposing the burden only on one segment of the industry—the tax-paying electric utilities—and only their customers would bear the burden.

For all of these reasons, we urge that the proposed rider not be adopted.

If there is any further information the Committee would like to have, we would, of course, be glad to supply it.

Since the information relating to research and development expenditures was requested by Senator Bennett, I am taking the liberty of sending a copy of this letter to him.

Sincerely yours,

HERBERT B. COHN.

ELECTRIC UTILITY RESEARCH AND DEVELOPMENT

Traditionally, much of the industry's research effort has been carried out by electrical equipment manufacturers. This research, much of it competitively motivated, is ultimately paid for by electric power organizations in the purchase price of equipment.

In the early 1960's a separate research activity was established in the Edison Electric Institute, principal trade association of the industry's investor-owned segment. This action was based upon the following major considerations:

(a) A continuing and dramatic upward trend in the demand for electric energy.

(b) Indication of the need for increasingly vigorous, centrally managed research activities aimed at protection and improvement of the environment.

(c) The above two considerations in combination identified a third: the need for research in areas such as new methods of power generation which by their nature exceeded the R&D capabilities and initiatives of the equipment manufacturers.

From 1961 to 1970, expenditures for research through the EEI research program increased by a factor of ten. During that same period, according to surveys conducted by the Federal Power Commission, annual R&D expenditures by electric utility companies and EEI amounted to approximately $45 million. An estimated additional $105 million was being spent annually by leading electrical equipment manufacturers on R&D activities specifically identified with electric utility equipment. The resulting total annual R&D expenditure of approximately $150 million is estimated to be the current level.

In 1965, the Electric Research Council was organized. Composed of representatives of investor-owned and government power organizations, the Council provides the means for cooperatively stimulating and promoting electric utility research on a broad scale.

Within the past year, the number of research programs being sponsored and/or supported by the EEI research effort has increased by a third to a total of sixty. The total estimated cost of these projects is $60 million. Approximately one-fourth of the projects now involve ERC sponsorship and support. Included in the present effort are major research programs in such important areas as air pollution, thermal effects of cooling water discharge, underground transmission, liquid metal fast breeder reactor development and investigation of other new methods of generation such as thermonuclear fusion and magnetohydrodynamics (MHD). Concurrently, individual companies are pursuing an expanded program of independently sponsored research. In addition to expenditures specifically identified as R&D, substantial amounts are being spent for the installation of experimental or first-of-a-kind equipment.

Planning activities initiated during the past year will in the near future lead to unprecedented expansion of the electric utility industry research program. Two task forces of the Electric Research Council are conducting in-depth analyses of industry R&D goals and financing. An R&D goals group has identified research goals, priorities, timetables and cost estimates to the year 2000. Concurrently, a finance task force has been devising an administrative and financial plan for meeting industry R&D needs. The R&D Goals Task Force has recommended annual research expenditures averaging $1.12 billion over the next 29 years. Their report has been accepted by the Electric Research Council as a benchmark in planning an expanded industry R&D effort. It is the consensus of industry leaders that immediate steps must be taken toward the program outlined in the report.

Moving toward an expanded program the investor-owned segment of the industry has made commitments to date for more than $200 million to assist in building a liquid metal fast breeder reactor demonstration plant. Additionally, having provided funds to permit continued operation of the Fermi-I reactor during 1971, a second solicitation has been initiated to contribute funds to permit Fermi-I operation and evaluation from 1972 through 1977. Further, suggested member contributions to EEI research program have been increased by nearly 90% within the past year.

Senator CURTIS. I want to ask one question. How much added activity would be promoted in the regulated industries with the 7-percent investment credit as compared with four?

Mr. COHN. We think, Senator, it would be very significant.

As you know, the investment credit has been up several times. We have appeared in the past, and I think when the credit first came up and the question that you just put was first raised, specific figures were put into the record in terms of what you thought the 7-percent credit would do in the way of inducing the construction of facilities which would not otherwise be built as against the 4-percent credit.

Off the top of my head I would say it would do at least twice as much. It is a difficult thing to give precise figures.

Senator CURTIS. Do these regulatory bodies let you use the money for expansion or do they require you to pass it through to the customer?

Mr. COHN. This would tend to vary in different parts of the country. But even if it is passed through, the pass-through is by no means automatic, and it would still have an effect in the benefit-cost ratio which any utility will take into account in deciding whether or not to build a facility, which is in the area of its discretion. That is, if the 7-percent credit is allowed to the electric utilities then the benefit-to-cost ratio, the fixed charges, will come down significantly and this will make it possible to build facilities to justify a facility that would not otherwise be justified.

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

Mr. COHN. Thank you, sir.

(Mr. Cohn's prepared statement follows:)

PREPARED STATEMENT OF HERBERT B. COHN ON BEHALF OF EDISON ELECTRIC INSTITUTE

My name is Herbert B. Cohn. I am an Executive Vice President of American Electric Power Service Corporation and Chairman of the Edison Electric Institute's Committee on Cost of Money and Taxes. This statement is submitted on behalf of Edison Electric Institute, which is the principal trade association of the nation's investor-owned electric utility companies. Its 196 member companies serve more than three-quarters of all electric customers in the United States.

In response to the President's proposal of August 15 for a new tax credit, similar to the investment credit repealed in 1969, the House has passed a bill (H.R. 10947) providing for restoration of the investment credit. For most taxpayers the credit is 7% of the cost of qualifying property. Under the House bill a 7% credit is available to some regulated companies, but for others, including electric utilities, the credit is only 4%.

The Edison Electric Institute fully supports the restoration of the investment credit, but urges that the credit be made applicable for electric utility property in the same percentage as for the property of all other taxpayers.

We also support those provisions of H.R. 10947 which expressly authorize Treasury Department regulations relating to a class life depreciation system; but we urge that this system, which represents a long overdue reform in the allowance for depreciation, shoud not be more restrictive than the Asset Depreciation Range System regulations promulgated earlier this year by the Treasury Department.

I. THE INVESTMENT CREDIT WILL FURTHER THE OBJECTIVES OF THE PRESIDENT'S ECONOMIC PROGRAM AND IS HIGHLY DESIRABLE

The President has proposed adoption of a tax credit to encourage capital expenditures and thereby stimulate employment and economic growth and improve productivity. Improving productivity will in turn have anti-inflationary effects, as well as making American goods more competitive in world markets.

Our previous experience with the 1962 and 1967 investment credit clearly demonstrates that such a credit will materially help in achieving those objectives. As a result of the 1962 and 1967 investment credit programs, productive facilities of our country were modernized and expanded, and the unemployment rate dropped.[1]

Restoration of the investment credit will stimulate capital investment, will help to hold down the prices of goods and services, will lessen the competitive advantage of the greater tax incentives provided by other industrial nations to stimulate exports, and will help to improve our balance of trade.

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[1] The graph appearing at page 6 of the House Report on H.R. 10947 (H.R. Rep. No. 92-533) is dramatic evidence of the past effect of the investment credit in stimulating investment in new production facilities.

A temporary reduction in tax collection from restoration of the investment credit will soon be offset by the greater tax yield which will result from the economic growth produced.

II. THE INVESTMENT CREDIT SHOULD BE MADE AVAILABLE TO TAX-PAYING ELECTRIC UTILITIES IN THE SAME PERCENTAGE AS TO ALL OTHER TAXPAYERS

The investment credit for electric utility property should be at the same rate as that for all other taxpayers.

A. Fairness and equity call for the same tax treatment of electric utilities as of other taxpayers

A basic general principle of business taxation is to provide taxpayers with equal treatment. It is generally unfair to make available tax advantages to one taxpayer which are not equally available to others. This is particularly true where, as here, the objectives of a tax incentive would best be met through equal treatment and where unequal treatment would unfairly and materially discriminate against one industry engaged in competition with another which is treated more favorably.

We think that equal treatment requires the use of the same percentage investment credit under the same conditions for all taxpayers.

B. The objectives of the investment credit will be attained by allowing the full credit to electric utilities.

The objectives sought to be achieved through restoration of the investment credit will be attained, in at least as great a measure, through the availability of the full credit to electric utilities as through its availability to other businesses.

1. The full credit to electric utilities will lower the cost of manufactured goods and help to combat inflation.

Taxes are an operating expense to an electric utility and must be reflected in the rates charged for its service. Lower taxes on power companies, whether reflected as a reduction in tax expense or in fixed charges, mean a lower cost of energy to their customers.

The availability of an abundant supply of low-cost electric energy has contributed in a very material way to the development of the American economy as the most productive in the world. Electrification provides much of the impetus for rising levels of productivity. The national interest in maintaining the superiority of our electric power industry suggests that every possible encouragement should be afforded to it or, at the very least, that it should not be subjected to the burden of discriminatory taxation.

Because of high labor costs, the ability of American manufactured goods to compete in world markets depends to a significant extent on low energy costs for operating modern plants and equipment. The availability of the full investment credit to the electric utility industry will lower the costs of American generating and transmission facilities and thus hold down energy costs to domestic manufacturers.

Electric energy is an essential household service whose cost is a factor in the cost of living to the American public. Cheaper electric energy will, therefore, also help to combat inflation.

2. The investment credit will stimulate capital expenditures by electric utilities to as great or to a greater extent than in the case of most other taxpayers.

The House bill, like prior investment credit legislation, provides certain utilities with a lower percentage credit than other taxpayers. This has apparently been done on the premise that the investment credit is not as much as an incentive for regulated utilities because, it is said, they must, in any event, provide capital facilities to meet the needs of their customers.

We submit that this approach is, first, unfair in principle and, second, erroneous in its basic premise.

It may well be that the degree of the incentive provided by the investment credit may vary depending on the particular industry involved. *But the fact is that no other industry and no other taxpayer have been subjected to any such test relating the percentage of the credit to the degree of the incentive thought to be provided.* We submit that it is clearly unfair to attempt to apply any such test in the case of only one category of taxpayer—the regulated utilities.

Moreover, we submit that the basic premise that the capital spending of regulated utilities is not materially affected by tax incentives is erroneous.

It is true that electric utilities must build the essential facilities needed to meet the requirements of their customers, but it is also a fact that they have a very significant area for discretionary investment which will be dependent, in large part, on the availability of capital and an evaluation of the costs and benefits of such investment. Some of these discretionary judgments relate to timing and some relate to whether a particular capital investment will be made at all. Taken as a whole, and having in mind the capital intensive nature of the electric utility industry, the amounts of discretionary capital investment which can be inflenced by a tax credit are very large indeed.

In determining whether and when such discretionary capital expenditures are justifiable, a major consideration is the fixed charges which will be associated with the new investment. Federal income taxes have generally represented some 25% of such fixed charges. Reduction of income taxes through availability of the investment credit will reduce the fixed charges of new projects and make many, which would not otherwise be built, economically justifiable.

One objective of the investment credit is to assist in providing required capital. This is particularly applicable in the case of the electric utility industry. There is probably no other single industry in the country which has greater need to accumulate capital for investment. In the case of electric utilities, the percentage of required capital investment supplied by internally generated cash has been decreasing significantly.

Environmental quality requirements are becoming more and more stringent. This has made it necessary to invest substantial amounts of capital in non-productive pollution control facilities. Control of the environmental effects of the energy conversion process requires very large investments in precipitators and other ash disposal systems, higher stacks for better atmospheric dispersion, systems such as huge cooling towers to minimize the discharge of waste heat to the nation's waters, and complex and expensive systems for controlling radioactive emissions from nuclear generating plants.

Electric utilities are also being called upon to make substantial investments in facilities to improve environmental aesthetics. For example, transmission facilities are being redesigned and more and more distribution facilities are being put underground.

Electric utilities are now spending about $1,000,000,000 a year for capital investment and expenses associated with air and water pollution control and on the aesthetics of their systems.

Any increase in the internal generation of cash for capital investment, such as through the investment credit, will relieve the great pressures on the capital markets, will facilitate even the non-discretionary capital investment requirements and is bound to be helpful to the economy.

C. A smaller credit for electric utilities than for other taxpayers will unfairly affect the competitive position of electric utilities

An investment credit for electric utilities in a smaller percentage than that available to other taxpayers would seriously and adversely affect existing competitive relationships.

The 7% credit would be available to the oil industry. The oil industry and the electric utility industry are intense competitors in the residential and commercial space-heating market. It would be unfair—and highly prejudicial to electric utilities in this competition—to gve electric utilities anything less than the full credit given to the oil industry.

Another example of the unfairness of such treatment is the effect on the competition of electric utilities with industry self-generation. Large manufacturing companies have the option, often exercised, of producing their own electric power instead of purchasing it from electric utilities. By the end of June 1971, non-utility industries had installed some 19.3 million kilowatts of self-generating capacity. Industrial self-generation in the 12 months ending June 1971 amounted to 106.1 billion kilowatt hours.

There have been, historically, continuing efforts by electric utilities to sell power to supply the increased requirements of companies which have been generating their own energy, and to replace industrial self-generation. The full 7% investment credit will be available for new self-generation plant and equipment of the non-utility industry. The difference between a 7% credit and a 4% credit would have a significant effect on the economics of a non-utility's purchase of new generating equipment as compared with purchasing its expanded electric energy requirements from an electric utility.

A smaller investment credit for electric utilities than for nonutility industry will thus clearly and unfairly prejudice electric utilities in their efforts to combat industrial self-generation.

Electric utilities also compete with on-site generation, to serve, for example, large housing projects and large office buildings. Some owners of such projects have been generating the energy needs of the project and its tenants with on-site generation facilities fueled with gas or oil. Such generating facilities are eligible for the 7% credit. The difference between a 7% credit and a 4% credit affects the economics of on-site generation versus purchasing the energy requirements for the project from an electric utility.

The net result of a smaller percentage credit for electric utilities than for nonutility taxpayers would be to encourage the latter to generate their own energy from smaller, less efficient facilities to obtain the benefits of the full tax credit and thus to produce a misallocation of national resources and, incidentally, to multiply the problems of air and water pollution control—consequences which are certainly not in the national interest.

The House Report expressly recognized that "the regulated companies are encountering increased competition from other regulated companies and, in the case of many of their products, from unregulated companies as well"; and that "some regulated companies which previously received the 3-percent credit . . . are in substantial competition with companies eligible under prior law for the full 7-percent credit"; and concluded that "it was appropriate to lessen the difference between the credit allowable for public utilities and for taxpayers generally" and to make certain other changes "to equalize the treatment of regulated companies in substantial competition with each other". (H.R. Rep. No. 92-533, at p. 24)

But, while the House recognized the existence of such competition and the unfairness of unequal treatment of competitors, H.R. 10947 goes only part way to achieve equal treatment. We submit that fairness and equity requires that the same percentage be applicable to all taxpayers.

III. IF THERE ARE TO BE PROVISIONS IN THE LEGISLATION RELATING TO THE TREATMENT OF THE INVESTMENT CREDIT IN DETERMINING THE COST OF SERVICE FOR RATEMAKING PURPOSES, SUCH PROVISIONS SHOULD NOT BE ANY MORE RESTRICTIVE THAN THOSE IN H.R. 10947

H.R. 10947 places certain limitations on the availability of the restored investment credit for the property of regulated utilities. These limitations relate to the treatment of the credit in determining cost of service for ratemaking purposes.

The availability of the investment credit to all other taxpayers is in no way conditioned on any requirements relating to the accounting or pricing to be followed to reflect such credit. We submit that no such provisions should be associated with the availability of the credit to regulated utilities. In such event, the accounting and ratemaking of the regulated utilities would be as required by the regulatory agencies having jurisdiction.

If, nevertheless, the Congress determines that such provisions are to be included, we urge that they not be any more restrictive than those in H.R. 10947.

The provisions in H.R. 10947 provide some flexibility, rather than a rigid rule, and thus provide some deference, and permit some accommodation, to the differing accounting and ratemaking requirements of the various regulatory agencies throughout the country.

IV. IT WOULD BE CONTRARY TO THE OBJECTIVES OF THE INVESTMENT CREDIT TO REDUCE THE BASIS OF PROPERTY ELIGIBLE FOR THE CREDIT

The Revenue Act of 1962, which first provided for the investment credit, required a reduction in basis equal to the amount of the credit. This provision was repealed by the Revenue Act of 1964. The reasons for the repeal given in the House and Senate Committee Reports were first, that the reduction in basis severely restricted the incentive effect of the investment credit; second, that it had proved troublesome since it required a downward basis adjustment with respect to eligible property, whether or not investment credit was claimed for the property; and, third, that the basis adjustment had presented difficult record-keeping problems, especially in the case of early retirements.

Previous experience with a basis reduction thus established that it presented technical problems as well as sharply reducing the stimulative effect of the credit on the economy.

The House Report on H.R. 10947 states that provision is not made for a basis reduction in view of the concern of the Ways and Means Committee that the credit have as great a stimulative effect on the economy as possible, and that since a reduction in basis is generally in the amount of the credit, it would be necessary to provide a larger credit to obtain the same overall stimulative effect. (H.R. Rep. No. 92-533, at p. 30)

If basis were reduced by the amount of the credit, the net tax reduction, over the tax life of the property would, with a 48% federal income tax rate, be only slightly more than half of the benefit without any reduction in basis.

We submit that it would be illusory—and contrary to the principal objectives of the investment credit proposal—to provide for a credit equal to 7% of the cost of the property, and then in effect to cut the credit in half by requiring that the basis of the property be reduced by the amount of the credit.

V. THE CLASS LIFE DEPRECIATION SYSTEM SHOULD NOT BE MORE RESTRICTIVE THAN THE TREASURY DEPARTMENT'S ADR SYSTEM REGULATIONS

On January 11, 1971 the Administration announced a new system of depreciation called the Asset Depreciation Range System ("ADR System"). After hearings and extensive comments, the ADR System was embodied in regulations promulgated by the Treasury Department on June 22, 1971.

The ADR System represents a long overdue and highly desirable reform in the allowance of depreciation—an area in which the United States has lagged behind most other industrial countries in the world to the substantial detriment of our competitive position in international trade. The System was proposed by the Treasury Department, after consultation with the leaders of the Congressional tax-writing committees, (1) to provide a simpler and more certain basis for computing a "reasonable allowance" for wear and tear and obsolescence, and (2) in recognition of changing technological, social and economic conditions, to authorize the use of shorter lives in making such computation. These are both highly desirable and important objectives and their desirability and importance would in no way be lessened by reason of the adoption of the investment credit.

The salient features of the ADR System are: (1) permissible lives for computing depreciation rates ranging from 20% shorter to 20% longer than the guideline lives established in 1962; (2) elimination of the much-criticized reserve ratio test under the guideline depreciation rules; (3) an annual repair allowance equal to a percentage of the cost of property, with the percentage varying for different guideline classes of property; and (4) two optional forms of a "modified half-year convention" for taking depreciation on property in the year in which it is placed in service.

It is important to emphasize that, under the ADR System, the total depreciation deductions allowable over the life of the property are the same no matter what life is chosen from the permissible range of lives, and is the same as the total depreciation deductions with guideline lives or other lives previously used by the taxpayer. The only difference caused by varying the life is in the timing of the depreciation deductions.

H.R. 10947 authorizes a depreciation system, called the class life depreciation system, which is similar to the ADR System, except that both forms of the modified half-year convention as contained in the regulations are eliminated.

A. H.R. 10947 should be amended to provide for both forms of the modified half-year convention

Under one of the optional forms of the modified first-year convention in the Treasury Department regulations, all property placed in service during the first half of the taxable year is treated as being placed in service on the first day of the taxable year, and all property placed in service during the second half of the taxable year is treated as placed in service on the first day of the second half of the taxable year. Under the second optional form of the modified half-year convention, all property placed in service during the taxable year is treated as being placed in service on the first day of the second quarter of the taxable year.

Neither of these options increases the aggregate depreciation deductions allowable over the life of the property. The modified half-year convention simply permits acceleration of a portion of the total depreciation deductions for the property.

As brought out in the September 1970 Report of the President's Task Force on Business Taxation (Table II, page 8), capital cost recoveries for machinery and equipment in the United States have been significantly slower than in other industrialized nations of the world. The Task Force Report states (page 10):

"In comparisons between allowances for capital cost recovery, the early years are, of course, very important since the earlier the tax benefit, the sooner cash is freed for the purpose of the business, including further capital investment. As matters now stand, the United States appears to give significantly less emphasis than other countries to weighting capital cost recovery heavily in favor of the early years."

Even with the 40% shortening of guideline lives recommended by the Task Force, the United States cost recovery allowance in the first year would be substantially less than allowances permitted in ten out of the eleven foreign industrial nations with which comparison was made (Id., at p. 28). The Report states:

"By the end of the seventh year (and, of course, by that time only one year would remain under our proposal for a 40 percent reduction of an assumed thirteen-year recovery period) United States cost recovery allowances still would not be equivalent to those of the United Kingdom, France, Luxembourg, Sweden and Italy" (at p. 29).

The ADR System modified half-year convention is desirable, not only to achieve the important objectives of increased simplicity and certainty, but also to help narrow the gap between capital cost recoveries in the United States and those in other industrial nations in the first year of the propery's life. Such a first-year convention will do much to improve the competitive position of our industries in relation to those of other industrial nations, and to help our balance of trade. The ADR System modified half-year convention will also help in the immediate generation of capital for further plant investment at the time when it is needed to stimulate our present sluggish economy.

Accordingly, we urge that the bill be amended to permit both alternative forms of the modified half-year convention contained in the ADR System regulations.

1. The ADR System modified half-year convention should be available for at least the taxable year 1971

When the Treasury Department announced the ADR System early this year, it stated that the new provisions would apply to property placed in service on or after January 1, 1971. The Treasury Department regulations promulgated on June 22, 1971, so provide. Taxpayers were told that they could rely on the availability of the ADR System for 1971 and that they could plan accordingly.[1]

Taxpayers have, in fact, made payments of 1971 income tax and have taken other action in reliance on the Treasury Department statements that the ADR System, including the modified half-year convention, would be applicable to property placed in service on or after January 1, 1971.[2] If the Congress finally decides to repeal the modified half-year convention of the ADR System, we submit that fairness to the taxpayer would require, at the least, that any such repeal should not be effective with respect to property placed in service in 1971, and certainly not with respect to property placed in service in 1971 on or prior to the date on which the bill becomes law.

B. The provisions of H.R. 10947 relating to the class life depreciation system should not in any event be further weakened

As has been indicated, the ADR System was a long overdue reform to achieve the highly desirable objectives of providing a simpler and more certain basis for computing a reasonable allowance for depreciation and of recognizing that

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[1] See, for example, Secretary Connally's address before the annual meeting of the U.S. will have been substantial underpayments of estimated taxes with substantial effect on Chamber of Commerce on April 27, 1971.

[2] Thus, if the first year convention is effectively repealed as of January 1, 1971, there the taxpayer's cash position and financing plans because of the taxpayer's reliance on the effectiveness of the ADR regulations for the year 1971.

changing technological, social and economic conditions are materially shortening the useful lives of depreciable property. *Neither of these objectives will be furthered by the investment credit.*

It is true that the ADR System—along with the investment credit—will also be helpful in improving our competitive position in international trade. But it is clear that the restored investment credit will not bring the speed of our capital cost recoveries up to the level of those of other industrialized nations with which we compete. The modest shortening of lives permitted under the class life depreciation system, and the repair allowance, will help to redress this imbalance. But even the combination of both the ADR System, including the first year convention, and the investment credit will still leave us behind most other industrial nations of the world in this respect.[8]

Accordingly, we submit, the class life depreciation system provisions in H.R. 10947 should not be altered in a way which would further slow down capital cost recovery; any amendment of these provisions should be in the direction of accelerating capital cost recoveries.

The CHAIRMAN. Our next witness will be Mr. William J. Lehrfeld, counsel, Motor & Equipment Manufacturers Association.

STATEMENT OF WILLIAM J. LEHRFELD, COUNSEL, THE MOTOR & EQUIPMENT MANUFACTURERS ASSOCIATION

Mr. LEHRFELD. Thank you, Mr. Chairman.

My name is William J. Lehrfeld, and I am a tax attorney with the Washington firm of Arent, Fox, Kintner, Plotkin, & Kahn, and we are counsel for the Motor & Equipment Manufacturers Association, known in the industry as MEMA.

I believe I am the last witness today, so when the committee considers title IV, the last will in fact be first.

MEMA is an organization of about 500 manufacturers of automotive, truck, and off-highway vehicle parts, equipment, chemicals, accessories, and tools. They represent producers of virtually every piece of equipment that is employed in, on, or in connection with both taxable and nontaxable motor vehicles.

I might say for the benefit of the Chair that I am not a member of the excise tax committee of the bar association, a tax-exempt organization, so there is no interest there. I am here today to urge the committee to amend section 4061(6) of the Code to remove the 8-percent excise tax on truck parts.

Senator CURTIS. On what?

Mr. LEHRFELD. On truck parts. At the present time, the Revenue Act of 1971 repeals the 7-percent excise tax on automobiles and the 10-percent excise tax on family or farm pickups, but it retains the 8-percent tax on all truck parts, both those for the family pickup as well as for the heavier, over-the-road truck.

We understand the basis for the House action repealing the pickup truck tax was that many farm families used the family pickup as a means of personal transportation and in order to provide comparability between the automobile which one family can afford and the family pickup which is the substitute for the automobile, that tax should be repealed.

These light trucks should be exempted from the Federal excise tax. But in its present form all of the parts, the replacement parts for the existing family and farm pickup trucks are going to remain subject

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[8] See Table I of Secretary Connally's Statement before this Committee on October 7, 1971.

to tax. In order to keep these trucks on the road, lower income families, trying to maintain their older trucks rather than buying newer trucks, will be paying the Federal excise tax on their parts and accessories.

In 1965, the automobile parts was repealed by this Congress as part of its general tax reduction in the excise tax. One of the reasons for retaining the tax on truck parts was that the Treasury Department representative, Mr. Surrey, told this committee that the parts tax was retained to prevent the avoidance of the 10-percent tax on trucks. Treasury was fearful that trucks would be sold in a stripped-down condition, and, therefore, people would buy their parts tax free if they remove the truck parts tax and put them on the trucks that they were supposedly paying 10 percent on.

If you repeal the 10-percent tax on light trucks, there doesn't seem to be any tax avoidance motive that can be consistent in this regard.

Second, in 1965 truck parts tax receipts were added to the Highway Trust Fund. At the present time, we estimate that the truck parts tax, all truck parts tax, is about 1½ percent of all Highway Trust Fund revenues and the parts for the family pickup and the light truck represent less than 1 percent of the Highway Trust Fund, and as a consequence represent less than 1 percent of the total tax reduction thus far voted by the House.

We are talking about potential revenue loss of about $35 million.

In an administrative vein, at the present time the statute exempts so-called interchangeable parts and accessories, that is, those parts suitable for use and ordinarily used on both automobiles and trucks. Unfortunately, in the 6 years since that standard was enacted the Internal Revenue Service has issued no regulations.

In the past year and a half, since the Tax Reform Act was enacted, there are almost 40 different sets of regulations issued in connection with private foundation. Yet, when you are dealing with taxpayers, the people who are manufacturing the parts and accessories for the automobiles and truck after-market, have gone 6 years without any regulations. We have no idea what the concept of "suitable for use and ordinarily used" means in connection with its application of the present law. As a consequence you will find many revenue agents coming into a business establishment and retroactively assessing tax on the ground that the part the manufacturer is selling is not an automobile part but it is a truck part. He has to, in effect, try to trace down his entire aftermarket and determine what use is a sufficient use to convince the agents that he is, in fact, selling an automobile part.

Senator CURTIS. How much revenue is involved?

Mr. LEHRFELD. If we limit the repeal to trucks of 10,000 pounds or less, we estimate between $30 million and $40 million revenue. The entire truck part tax for all trucks is approximately $80 million a year.

Senator CURTIS. And there is no tax on automobile parts?

Mr. LEHRFELD. No; and, supposedly, there is no tax on interchangeable parts. But without regulations we have no way of knowing whether, in fact, a manufacturer is justified in not charging a tax because even if he doesn't make a profit the Federal excise tax can be imposed and a deficiency asserted. Excise tax deficiencies come out of, in effect, his capital, if he is not making sufficient money, unlike any income tax deficiency.

I believe the argument offered for the repeal of the light-duty

10,000-pound panel truck or pickup truck justifies the repeal of the tax on parts and we understand the only consideration that the Revenue Service or Treasury Department has is simply one of dollars of revenue lost. But we are dealing with an item, considering all of the revenues that are involved in the present excise tax repeal, that represents less than 1 percent of the total tax reduction thus far proposed.

Senator CURTIS. You are having trouble distinguishing between interchangeable parts on automobiles and trucks. How about between heavy trucks and light trucks?

Mr. LEHRFELD. We have recommended to the staff, and they have our language, a test that is one called "Suitable for Use." In other words, if it fits the panel truck, then it would be exempt regardless of whether it is used in an automobile, a light-duty truck, heavy-duty truck, or, for example, an off-the-highway vehicle.

If the design is such that it can be used then it would be exempt and you would not have to trace through your aftermarket to find out whether or not it is used on a light truck or heavy truck. This, of course, would increase competition between manufacturers because if an individual truckowner has the capability to choose between products on the basis of their design that will enhance the free market and, as a consequence, be a much greater assistance to the economy.

The CHAIRMAN. Thank you very much, sir.

(Mr. Lehrfeld's prepared statement follows:)

PREPARED STATEMENT OF WILLIAM J. LEHRFELD, COUNSEL, ON BEHALF OF THE MOTOR & EQUIPMENT MANUFACTURERS ASSOCIATION

I. INTRODUCTORY STATEMENT

On behalf of the Motor & Equipment Manufacturers Association (MEMA), I would like to express our sincere appreciation for the opportunity to appear before this Committee during its study of the President's revenue and tax proposals.

MEMA is composed of over 500 manufacturers of automotive and truck parts, equipment, chemicals, accessories, and tools, with plants located throughout the United States. Its membership is comprised of the producers of virtually every piece of equipment that is employed in, on, or in connection with, servicing all forms of taxable motor vehicles. Some members sell the aftermarket only, some sell original equipment only, while most sell both channels. Aftermarket sales are the sales of replacement parts to warehouse distributors, wholesalers, national accounts, service sales divisions of car and truck manufacturers, and, in the case of truck parts, sales through fleet specialists. It is these sales that are most immediately affected by the excise taxes I will discuss today.

As you know, original equipment sales of parts to motor vehicle manufacturers are exempt from excise taxes because the manufacturers can buy these items tax free on an exemption certificate if the part is to be used in the further manufacture of a subsequently taxed automotive or truck chassis or body. Further, due to a 1965 Act of Congress, automobile parts are exempt from excise taxes. Yet, an excise tax of 8% is still imposed upon all truck parts by § 4061(b) of the Internal Revenue Code. I am here today to urge this Committee on Finance to amend § 4061(b) of the Code so as to exclude from the scope of the 8% excise tax those parts suitable for use on vehicles having a gross vehicle weight of 10,000 pounds or less. As amended, that section [§ 4061(b)(2)] would provide:

> "No tax shall be imposed under this subsection upon any part or accessory which is suitable for use on or in connection with, or as a component part of, any article enumerated in subsection (a)(2) or a house trailer."

Since subsection (a)(2) has been amended by H.R. 10947 to include within its scope light-duty trucks, the above wording for § 4061(b)(2) will clearly exclude parts for such trucks from the excise tax.

Statement of the Motor & Equipment Manufacturers Association

Summary of Principal Points

1. Introductory statement calling for amendment of § 4061(b) of the Internal Revenue Code.

2. The Association (MEMA) supports the House bill, H.R. 10947, and its repeal of the 10% excise tax on light-duty trucks. We urge, as a corollary to this measure, that the excise tax on *parts* for such light-duty trucks also be repealed.

3. Prior to The Excise Tax Reduction Act of 1965, truck and automobile parts were treated as a unit for excise tax purposes. That Act removed the tax on automobile parts yet retained the same tax on truck parts.

4. One explanation for the retention of the truck parts tax was that it prevented avoidance of the 10% excise tax on new trucks. H.R. 10947 negates this justification for the tax on light-duty truck parts since it repeals the 10% tax on light-duty trucks.

5. The retention of the truck parts tax was also justified as a "user charge". Our statement shows that this justification has no validity when applied to parts for light-duty trucks.

6. The Internal Revenue Service has provided no guidelines for determining when a part—particularly a light-duty truck part—is suitable for use on an automobile (and, therefore, not taxable). Congressional action will correct this situation.

7. The Excise Tax Reduction Act of 1965 saved consumers upwards of three quarters of a billion dollars by repealing the excise tax on automobile parts. The removal of this same tax on parts for light-duty trucks will also result in substantial consumer savings.

8. There are other significant economic reasons which justify the 1971 repeal of the excise tax on parts for light-duty trucks

II. H.R. 10947, as Passed by the House

The House, on October 6, passed its version of the Revenue Act of 1971. Included in that measure, H.R. 10947, is a provision for the repeal of the 10% excise tax on new trucks having a gross vehicle weight of under 10,000 pounds (so-called "light-duty trucks"). This provision compliments another provision of H.R. 10947 which repeals the 7% excise tax on passenger automobiles.

The report of the Committee on Ways and Means accompanying H.R. 10947 explains the repeal of these excise taxes as follows:

> "As indicated under the discussion with respect to reasons for the bill, the excise tax on passenger automobiles is repealed in this bill both to provide a stimulus for the purchase of cars and because of the jobs this is expected to create. In addition Congress has previously concluded that excise taxes, such as the one on passenger automobiles, are undesirable because they interfere with the freedom of consumer choice. As indicated previously, *the tax on light-duty trucks is repealed because, to a substantial degree, these trucks are used by many families in farm areas, as well as by other individuals, as a means of personal* [*sic*] *transportation comparable to the use of passenger cars.*[1] [emphasis supplied]

We are in complete agreement with the action taken by the House and commend the Ways and Means Committee for recognizing that light-duty trucks should receive the same excise tax treatment as passenger cars.

However, the elimination of the excise tax on new light-duty trucks and the rationale given for this measure indicate that the Congress should go one step further toward equalizing the excise tax treatment of light-duty truck owners and the owners of passenger automobiles. That further step, which we urge this Committee on Finance to take, is the repeal of the 8% excise tax on *parts* for light-duty trucks. Since no similar tax exists on parts for automobiles, removal of the tax on light-duty truck parts will insure that owners of such trucks—the farmers and other individuals referred to by the House—get the same excise tax treatment as the owners of passenger automobiles.

Two things are clear from the language used in the Committee report and from the House repeal of the excise taxes on light-duty trucks as well as on auto-

[1] H.R. Rep. No. 533, 92d Cong., 1st Sess. 51 (1971).

mobiles. First, that the owners of *all* vehicles used for personal transportation purposes should receive the same tax benefits under the Revenue Act of 1971; and second, that light-duty trucks *are* used—whether by farmers, individuals engaged in recreational pursuits, or whatever—for personal transportation purposes. Since this is the case, there is no longer any justification for imposing on the owners of one type of personal transportation vehicle (light-duty trucks) an excise tax that is not borne by the owners of another class of personal transportation vehicle (automobiles). Cetrainly, the House did not intend this inequitable result from an action which is aimed at achieving parity.

The reason this inequitable situation will exist, unless the truck parts excise tax section (§ 4061(b)) is modified, is primarily historical and due to the fact that, until the Revenue Act of 1971, Congress made no distinction between trucks used for personal transportation purposes and other types of trucks.

III. EXCISE TAX REDUCTION ACT OF 1965.

A brief review of the recent history of the truck parts tax in its present form will contribute to an understanding of why that tax section should now be amended to exlude light-duty truck parts.

Prior to 1965, there had been no distinction made in the excise tax treatment of automobile parts and truck parts. In fact, parts for both types of motor vehicles were lumped together in § 4061(b) of the Code as "automobile and truck parts" and subjected to an 8% excise tax. In 1965, the Congress passed Public Law 89-44 (The Excise Tax Reduction Act of 1965) which extensively revised the entire excise tax structure. As a part of this revision, the excise tax on *automobile* parts was repealed. The excise tax on *truck* parts, however, was retained.

IV. TAX AVOIDANCE THEORY

A spokesman for the Johnson administration explained, in 1965, that the tax on truck parts was retained to prevent the avoidance of the 10% excise tax on new trucks.[2] The fear was that eliminating the tax on truck replacement parts while retaining the 10% tax on new trucks would provide individuals with an opportunity to avoid the 10% tax by selling new trucks stripped of parts, which parts could be purchased on the aftermarket free of tax and then installed. Whether such devious tax avoidance schemes would have indeed occurred is questionable but, in any event, is no longer an important issue in so far as replacement parts for light-duty trucks are concerned. The House version of the Revenue Act of 1971 negates this tax avoidance justification by *repealing the 10% excise tax on new light-duty trucks*. There is no incentive for tax avoidance for the purchases of light-duty trucks because there is no longer any tax to be avoided. Therefore, the 8% excise tax on parts for such trucks can not be justified today by the tax avoidance theory as a necessary backstop to the tax imposed on new light-duty trucks.

V. USERS CHARGE THEORY

The only other justification given in 1965 for the retention of the truck parts tax was that it constituted a user charge. This being the case, the revenues from the tax were consigned to the highway trust fund.

In describing the tax as a user charge, the Congress was attempting to make certain that the chief users of a particular governmental service—in this case, the Interstate Highway System—would pay their fair share of the cost of providing that service. There is no question that this is a valid principle of taxation. However, since the House has now recognized that light-duty trucks are like automobiles in that they are personal transportation vehicles, there is no greater justification for charging the owners of these particular vehicles for their use of the highways than there is for so charging automobile owners. In fact, automobile owners pay no user charge in the form of an excise tax on the purchase of replacement parts; light-duty truck owners should enjoy the same freedom from tax.

It is obvious that the truck parts tax, as a user charge, was intended to make the heavy duty tractors and truck trailers pay their fair share of the additional cost of heavier pavement and other design features needed to carry them. These

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[2] Statement of Assistant Secretary Surrey before Committee on Finance, U.S. Senate, June 8, 1965, reprinted in "Legislative History of H.R. 8371, 89th Congress, The Excise Tax Reduction Act of 1965, Public Law 89-44," prepared by Staff of Joint Committee on Internal Revenue Taxation, p. 361.

are the chief users of the interstate highway system. Yet, the excise tax on *all* truck parts applies, in its present form, to not only these heavy duty over-the-highway tractors and truck trailers but the light duty trucks as well. In H.R. 10947, the House has now recognized that valid and important distinctions can and should be made in the excise tax treatment of "trucks". In particular, the House has determined that trucks of a certain weight class (10,000 pounds gross vehicle weight or below) are used as personal transportation vehicles and should be treated differently for excise tax purposes than those other vehicles which come within the scope of the generic term "truck".

In the face of this recognition that not all *trucks* are proper objects for the new truck excise tax (because of significant differences in their size, weight and use), it seems hard to justify an across the board excise tax for all truck replacement *parts*. The arguments for breaking down the "truck" category into light-duty trucks and all other trucks for the purposes of the new truck excise tax have just as much force and validity when applied to the case of the excise tax on truck parts.

In its present form, the truck parts excise tax, as a user charge, makes no distinction between actual truck usage of the interstate highway system and the levying of taxes to pay for that system. The tax is imposed upon all truck parts, whether they are sold to heavy users, partial users, non-users, or any degree in between. Unless H.R. 10947 is amended to include a modification of the truck parts excise tax, the farmer who uses a light-duty pick-up truck will, in effect, be told by the Congress that the new truck he purchases will not be taxed because it is a vehicle used for personal transportation purposes. But if he has an accident on the way home from the dealer and must replace his front headlight, that replacement part will be taxed (though it would not be if it were for a car) because he is no longer driving a personal transportation vehicle, he is driving a "truck" and everybody knows that trucks, as the chief users of the interstate highway system, must help pay for that system.

The poor farmer will be confused at best. He may never have seen an interstate highway system. All he knows is that (a) his new pickup truck is not subject to an excise tax because it is a "personal transportation" vehicle; (b) the "personal transportation" vehicle his neighbor drives is an automobile; (c) when his neighbor buys a replacement part (brake shoes, for example) for his personal transportation vehicle, no excise tax is levied; but (d) when he (the farmer) buys brake shoes for his own personal transportation vehicle, he gets socked with an excise tax charge.

The farmers and other individuals, referred to in the House report, who must use their light-duty trucks as a means of family transportation should not be penalized by a tax which other segments of our society do not have to pay merely because they are able—perhaps because they are more affluent—to use an automobile as their means of personal transportation.

If the House intended for light-duty truck owners to achieve parity with automobile owners for excise tax purposes (and it seems that this was the intent), it has failed (perhaps through oversight) to accomplish its purpose. This Committee on Finance can remedy the situation and see that parity is achieved.

If the House merely intended to give the farmers and other individuals who own light-duty trucks a partial excise tax break—and not make them "equal" to automobile owners—we urge this Committee to go one step further and give this particular group of consumers the additional economic benefits that repeal of the excise tax on parts for light-duty trucks will provide.

VI. CURRENT LACK OF ADMINISTRATIVE GUIDELINES

It should be noted at this point that although Congress presently excludes from excise tax those parts which are "suitable for use" (and ordinarily used) on automobiles, it has been virtually impossible for the Internal Revenue Service, and manufacturers as well, to make clear-cut determinations as to whether or not many light-duty truck parts are "suitable for use" on automobiles. In the six years since The Excise Tax Reduction Act of 1965, the Internal Revenue Service has not published any regulations to assist manufacturers of interchangeable parts which fit both passenger cars and trucks. Guidelines are particularly important in the case of light-duty truck parts: yet, we are no closer today in knowing what those guidelines are than we were when parts "suitable for use and ordinarily used" on automobiles were exempted from excise tax in 1965.

This Congress can relieve the plight of manufacturers of light-duty truck parts—who live in fear of an after-the-fact adverse ruling by the I.R.S.—and at the same time ease the administrative burden imposed upon the Service by extending the parts exemption to include parts suitable for use on light-duty trucks.

VII. CONSUMER SAVINGS FROM THE TAX AMENDMENT

This Committee on Finance has expressed an abiding concern that the economic benefits resulting from the Revenue Act of 1971 not flow primarily to business at the expense of the consumer, but that the consumer receive his fair share. In this regard, there is no question that the primary beneficiary of the repeal of the 8% excise tax on light-duty truck parts will be the consumer.

Most product manufacturers, and manufacturers of automotive products are no exception, utilize a three to five step distribution system for marketing their diverse products. The various distribution channels at each step, in computing prices to customers, mark up their total costs *including taxes*. The 8% excise tax on truck parts, since it is based on the manufacturer's selling price, is pyramided through each step of the multichannel distribution process. A multiplier effect is created for the excise tax and the ultimate consumer often ends up paying, as part of the final price, the equivalent of three to four times the original tax.

Thus, for example, the repeal of the automobile parts tax in 1965 cost the Treasury $224 million in revenues but, when multiplied through the automotive aftermarket distribution system, saved consumers of such auto parts an estimated three quarters of a billion dollars. By the same principle, consumers of light-duty truck parts will save upwards of three times the amount of revenue that will be lost to the Treasury by repeal of this tax on light-duty truck parts.

In 1970, the truck parts tax produced $84 million in federal revenues. In that same year, over 80% of domestic truck sales were for vehicles of 10,000 pound gross vehicle weight or below. While it is not accurate to say that 80% of the excise tax revenues are attributable to owners of light-duty trucks (the tax is not only based on the cost of the part but also the amounts derived depend upon frequency of repair and replacement), it is fair to say that a substantial portion of these excise revenues are paid by owners of light-duty trucks. Assuming that such consumers accounted for $60 million of the $84 million collected, the cost to the federal coffers of repealing the portion of the tax that applies to light-duty truck parts will be $60 million while the amounts saved by the ultimate consumer will be in excess of $180 million. Elimination of the light-duty truck parts tax will convey substantial economic benefits to consumers, and the tax does not, from a revenue standpoint, have the impact on the government's finances that the tax on auto parts had in 1965 or that the repeal of the automobile tax will have today. We submit to this Committee that the benefits to the consumer are well worth the cost to the government.

VIII. FURTHER ECONOMIC JUSTIFICATION FOR AMENDING THE TRUCK PARTS TAX

The tax on automobile parts was repealed in 1965 according to the Tax Committee reports, on the grounds that, like the other selective excise taxes which were then repealed, such a tax:

1. placed discriminatory tax burdens on the consumers and producers of the taxed products;
2. tended to reduce sales and therefore reduced incomes and jobs in the industries which produced the taxed goods;
3. resulted in arbitrary and undesirable distortions in the allocation of resources thus interfering with the free play of the competitive market;
4. placed arbitrary tax burdens on firms depending for their requirements on taxed items;
5. tended to discourage the use of the most advanced and efficient machines or other products; and
6. introduced distortions in markets for final goods and services.

We are convinced that each of these reasons applies with equal force to the tax on light-duty truck parts in the context of today's economic picture and the President's tax program.

1. The excise tax is a cost of doing business unrelated to normal competition, to productivity or profitability of the manufacturer.

One of the many negative features of the parts tax is that it constitutes an inflexible "front end load" on the cost of doing business. Because it does not respond to market impulses as do other costs of doing business, it discourages capital investment in equipment designed to improve productivity and efficiency.

The President's New Economic Policy recognizes that when the objective is economic growth, taxes should have a minimum effect in reducing the rate of capital formation. Indeed, the President's program offers, and H.R. 10947 has adopted, an incentive to capital formation in the form of an investment tax credit. We merely ask that a detrimental influence to capital investment, in the form of a discriminatory excise tax, be removed.

2. The parts tax impedes the development and use of better and safer parts.

Another undesirable feature of the tax on these truck parts is that it taxes articles, which, in many respects, are necessary for the safety of the driving public. It can be, quite literally, a tax on safety. The quality of parts and their timely replacement are factors which greatly affect the safety characteristics of any motor vehicle. As individuals, and cosumers, we are all aware of the importance of such articles as shoes and drums for brakes which must be replaced periodically to insure safety for the operator of the vehicle as well as others on the highway. And yet, replacement parts for light-duty trucks, which are as vital to the safe condition of these trucks as automobile replacement parts are to automobiles (and perhaps even more important to the public safety), have to carry the disincentive to their purchase of an 8 percent excise tax. The price of safety equipment to the consumer can be a determinig factor when a consumer is considering the purchase of a safety device. If we are to encourage preventive maintenance, rather than remedial maintenance, and increase the safety of our highways, the price incentive of an excise tax cut on light-duty truck parts will be of great assistance.

The CHAIRMAN. That, then, concludes our hearing for today. The committee is scheduled to continue hearings on H.R. 10947 at 10 o'clock tomorrow morning. We will stand in recess.

(Whereupon, at 4:20 p.m., the committee adjourned, to reconvene at 10 a.m., on Thursday, October 14, 1971.)

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