TAX REDUCTION AND SIMPLIFICATION ACT OF 1977

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-FIFTH CONGRESS

FIRST SESSION

ON

H.R. 3477

AN ACT TO PROVIDE FOR A REFUND OF 1976 INDIVIDUAL INCOME TAXES AND OTHER PAYMENTS, TO REDUCE INDIVIDUAL AND BUSINESS INCOME TAXES, AND TO PROVIDE TAX SIMPLIFICATION AND REFORM

MARCH 8, 9, 10, AND 11, 1977

Pri[illegible] for the use of the Committee on Finance

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CONTENTS

ADMINISTRATION WITNESSES

Page

Blumenthal, Hon. W. Michael, Secretary of the Treasury 93
Lance, Hon. Thomas Bertram, Director, Office of Management and Budget 78
Schultze, Hon. Charles L., Chairman, President's Council of Economic Advisers 83

PUBLIC WITNESSES

Ad HOC Committee for an Effective Tax Credit, Blair Bolles, chairman, executive committee, accompanied by William Condrell, general counsel, and James Morrison, assistant general counsel 340
American Council for Capital Formation, Dr. Charls E. Walker, chairman 239
American Federation of Labor and Congress of Industrial Organizations, Andrew J. Biemiller, director, Department of Legislation, accompanied by Rudolf Oswald, director of research 289
American Gas Association, George H. Lawrence, president 242
American Paper Institute, Inc., Norma Pace, senior vice president 504
Associated General Contractors of America, D. E. Warfield, chairman, tax and fiscal affairs committee 515
Ballhaus, William F., president, Beckman Instruments, Inc 477
Barlow, Wallace D., executive director, Share the Work Coalition 522
Beckman Instruments, Inc., William F. Ballhaus, president 477
Biemiller, Andrew J., director, Department of Legislation, American Federation of Labor and Congress of Industrial Organizations, accompanied by Rudolf Oswald, director of research 289
Bixler, Roland M., chairman, National Association of Manufacturers Taxation Committee, accompanied by Edward Sprague, vice president and manager, Fiscal and Economic Policy Department 413
Bolles, Blair, chairman, executive committee of the Ad Hoc Committee for an Effective Tax Credit, accompanied by William Condrell, general counsel, and James Morrison, assistant general counsel 340
Carlson, Dr. Jack, vice president and chief economist, Chamber of Commerce of the United States, accompanied by Robert R. Statham, Director, Tax and Finance Section, Chamber of Commerce of the United States 248
Chamber of Commerce of the United States, Dr. Jack Carlson, vice president and chief economist, accompanied by Robert R. Statham, Director, Tax and Finance Section, Chamber of Commerce of the United States 248
Coalition of National Voluntary Organizations, Richard Dewey, executive director, accompanied by Jack Moskowitz and Jack Myers 333
Consolidated Rail Corp., Thomas Sweeney, vice president, accompanied by H. Lawrence Fox, Pepper, Hamilton & Scheetz 421
Cox, Dr. Albert H., president, Merrill Lynch Economics, Inc., on behalf of Merrill Lynch & Co., Inc 231
Dewey, Richard, executive director, Coalition of National Voluntary Organizations, accompanied by Jack Moskowitz and Jack Myers 333
Domenici, Hon. Pete V., a U.S. Senator from the State of New Mexico 429
Edison Electric Institute, W. Reid Thompson, president and chairman of the Potomac Electric Power Co 279
General Electric Co., Reginald Jones, chairman and chief executive officer 297
Independent Petroleum Association of America, A. V. Jones, Jr., president 246
Javits, Hon. Jacob K., a U.S. Senator from the State of New York 450
Jones, A. V. Jr., president, Independent Petroleum Association of America 246
Jones, Reginald, chairman and chief executive officer, General Electric Co 297

	Page
Kennedy, Hon. Edward M., a U.S. Senator from the State of Massachusetts	167
Lawrence, George H., president, American Gas Association	242
McClure, Hon. James A., a U.S. Senator from the State of Idaho	434
Machinery & Allied Products Institute, Charles W. Stewart, president	180
Merrill Lynch & Co., Inc., Dr. Albert H. Cox, president, Merrill Lynch Economics, Inc	231
Motley, John J., legislative affairs representative, National Federation of Independent Businesses	313
National Association of Manufacturers Taxation Committee, Roland M. Bixler, chairman, accompanied by Edward Sprague, vice president and manager, Fiscal and Economic Policy Department	413
National Federation of Independent Businesses, John J. Motley, legislative affairs representative	313
National Small Business Association, Milton D. Stewart, president, accompanied by John Lewis, executive vice president and executive director, the Small Business Council	203
Pace, Norma, senior vice president, American Paper Institute, Inc	504
Percy, Hon. Charles H., a U.S. Senator from the State of Illinois	436
Schwab, Donald H., director, National Legislative Service, Veterans of Foreign Wars	512
Schweiker, Hon. Richard, a U.S. Senator From the State of Pennsylvania	199
Share the Work Coalition, Wallace D. Barlow, executive director	522
Speer, Edgar B., chairman, United States Steel Corp., and chairman, American Iron & Steel Institute	324
Stewart, Charles W., president, Machinery & Allied Products Institute	180
Stewart, Milton D., president, National Small Business Association, accompanied by John Lewis, executive vice president and executive director, the Small Business Council	203
Sweeney, Thomas, vice president, Consolidated Rail Corp., accompanied by H. Lawrence Fox, Pepper, Hamilton & Scheetz	421
Thompson, W. Reid, president and chairman of the Potomac Electric Power Co., on behalf of Edison Electric Institute	279
United States Steel Corp., Edgar B. Speer, chairman, and chairman, American Iron & Steel Institute	324
Veterans of Foreign Wars, Donald H. Schwab, director, National Legislative Service	512
Walker, Dr. Charls E., chairman, American Council for Capital Formation	239
Warfield, D. E., chairman, tax and fiscal affairs committee, the Associated General Contractors of America	515

COMMUNICATIONS

American Association of Retired Persons	578
American Gas Association, George H. Lawrence, president	554
American Society for Training and Development, Inc., Kevin O'Sullivan, executive director	545
American Textile Manufacturers Institute, Inc., W. Ray Shockley, executive vice president	547
Barlow, Wallace D., executive director, Share the Work Coalition	549
Birchby, Kenneth L., chairman, committee on taxation, National Association of Mutual Savings Banks	581
Brannon, Gerald M	569
Council of Jewish Federations and Welfare Funds	540
Council of State Chambers of Commerce, Committee on Federal Finance, George S. Koch, chairman	546
Crown, Joseph H	580
Davidson, John C., on behalf of the Tax Council	549
Driver, William J., president, Manufacturing Chemists Association	538
Gaffney, Edward J., president, Ortho-Kinetics, Inc	572
Hickman, Frederic W., on behalf of Trans Union Corp	541
Koch, George S., chairman, Committee on Federal Finance, Council of State Chambers of Commerce	546
Lawrence, George H., president, American Gas Association	554
Manufacturing Chemists Association, William J. Driver, president	538
Moynihan, Hon. Daniel Patrick, a U.S. Senator from the State of New York	527
National Association of Letter Carriers, AFL-CIO, J. Joseph Vacca, president	544

Page
National Association of Mutual Savings Banks, Kenneth L. Birchby, chairman, committee on taxation ... 581
National Association of Retired Federal Employees ... 553
National Machine Tool Builders' Association ... 560
National Retired Teachers Association ... 578
Ortho-Kinetics, Inc., Edward J. Gaffney, president ... 572
O'Sullivan, Kevin, executive director, American Society for Training and Development, Inc ... 545
Public Employee Department AFL-CIO ... 560
Reese, Thomas J ... 569
Share the Work Coalition, Wallce D. Barlow, executive director ... 549
Shockley, W. Ray, executive vice president, American Textile Manufacturers Institute, Inc ... 547
Stockholders of America, Inc., Margaret Cox Sullivan, president ... 536
Sullivan, Margaret Cox, president, Stockholders of America, Inc ... 536
Tax Council, John C. Davidson ... 549
Vacca, J. Joseph, president, National Association of Letter Carriers, AFL-CIO ... 544
Trans Union Corp., Frederic W. Hickman ... 541

ADDITIONAL INFORMATION

Committee on Finance press release announcing these hearings ... 1
Opening statement of Senator Roth ... 77
Text of bill H.R. 3477 ... 3

APPENDIXES

Appendix A—Communications received by the committee showing an interest in these hearings ... 527
Appendix B—Questions submitted by Senator Curtis to be asked of Secretary Blumenthal ... 583

TAX REDUCTION AND SIMPLIFICATION ACT OF 1977

TUESDAY, MARCH 8, 1977

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

The committee met, pursuant to notice, at 9:30 a.m., in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Byrd, Jr., of Virginia, Nelson, Gravel, Bentsen, Haskell, Matsunaga, Curtis, Hansen, Packwood, Roth, Jr., and Danforth.

The CHAIRMAN. Let me make this statement for the record. We will have that much out of the way.

The committee begins hearings today on H.R. 3477, the Tax Reduction and Simplification Act of 1977. We find ourselves in the unusual position of beginning our hearings, we hope, before the House of Representatives has passed a bill.

It is not our purpose to prejudge what action the House will take on that bill, but in view of the importance of acting quickly on the tax reduction portions of the economic stimulus proposals, the committee is expediting consideration by holding its hearings now.

In any case, we want to have the benefit of the administration's view on what elements they feel ought to be in the economic stimulus package.

[The Committee on Finance press release announcing these hearings and the bill H.R. 3477 follow. Hearing continues on p. 77.]

FINANCE COMMITTEE TENTATIVELY SETS HEARINGS ON TAX CUT BILL

The Honorable Russell B. Long (D., La.), Chairman of the Committee on Finance, announced today that the Committee plans to begin hearings in March on H.R. 3477, the Tax Reduction and Simplification Act of 1977. The hearings have tentatively been set to begin on Tuesday, March 8, at 9:30 A.M. in Room 2221, Dirksen Senate Office Building. The Honorable W. Michael Blumenthal, Secretary of the Treasury, the Honorable Thomas Bertram Lance, Director, Office of Management and Budget, and The Honorable Charles L. Schultze, Chairman of the President's Council of Economic Advisers will be the leadoff witnesses on March 8 and will present the Administration's views on the bill.

Senator Long noted that H.R. 3477 had been ordered favorably reported by the Committee on Ways and Means of the House of Representatives. It is expected that the bill will be considered by the House during the week of February 28. Because of the importance of prompt action on this measure to stimulate the economy, the Finance Committee is tentatively setting a hearing date at this time so that the Committee can begin its consideration of the bill quickly following House passage.

Requests to testify.—The Chairman advised that witnesses desiring to testify during this hearing must submit their requests to Michael Stern; Staff Director, Committee on Finance, 2227 Dirksen Senate Office Building, Washington, D.C. 20510, not later than Thursday, March 3, 1977. 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 the date of his 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. The hearings will be held in Room 2221, Dirksen Senate Office Building and will begin at 9:30 A.M. on Tuesday, March 8 and at 10:00 A.M. each day thereafter.

Consolidated testimony.—Senator Long 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 than it might otherwise obtain. The Chairman 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.—Senator Long stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify must comply with the following rules:

(1) A copy of the statement must be filed by the close of business two days before the day the witness is scheduled to testify.

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

(3) The written statements must be typed on letter size paper (not legal size) and at least 75 copies must be submitted by the close of business the day before the witness is scheduled to testify.

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

(5) not more than ten minutes will be allowed for oral presentation.

Written testimony.—The Chairman stated that the Committee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25-double-spaced pages in length and mailed with five (5) copies by Friday, March 11, 1977, to Michael Stern, Staff Director, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510.

95TH CONGRESS
1ST SESSION

H. R. 3477

IN THE SENATE OF THE UNITED STATES

MARCH 9 (legislative day, FEBRUARY 21), 1977
Read twice and referred to the Committee on Finance

AN ACT

To provide for a refund of 1976 individual income taxes and other payments, to reduce individual and business income taxes, and to provide tax simplification and reform.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. SHORT TITLE; TABLE OF CONTENTS.**
4 (a) SHORT TITLE.—This Act may be cited as the "Tax
5 Reduction and Simplification Act of 1977".
6 (b) TABLE OF CONTENTS.—

Sec. 1. Short title; table of contents.
Sec. 2. Amendment of 1954 Code.

II

TITLE I—REFUND OF 1976 INDIVIDUAL INCOME TAXES; PAYMENTS TO RECIPIENTS OF CERTAIN BENEFITS

PART I—REFUND OF 1976 INDIVIDUAL INCOME TAXES

Sec. 101. Refund of 1976 individual income taxes.
Sec. 102. Refunds disregarded in the administration of Federal programs and federally assisted programs.
Sec. 103. Payments to the governments of American Samoa, Guam, and the Virgin Islands.
Sec. 104. Payment not to be considered income or a reduction in Federal income taxes under State law.

PART II—PAYMENTS TO RECIPIENTS OF CERTAIN BENEFITS

Sec. 111. Special payment to recipients of benefits under certain retirement and survivor benefit programs.
Sec. 112. Special payment to recipients of aid to families with dependent children under approved State plans.
Sec. 113. Provisions applicable to special payments generally.

TITLE II—REDUCTION AND SIMPLIFICATION OF INDIVIDUAL INCOME TAXES

Sec. 201. Change in tax rates and tax tables to reflect permanent increase in standard deduction.
Sec. 202. Change in definition of taxable income to reflect change in tax rates and tables.
Sec. 203. Extension of individual income tax reductions.
Sec. 204. Change in filing requirements.
Sec. 205. Withholding tax.
Sec. 206. Effective dates.

TITLE III—REDUCTION IN BUSINESS TAXES

Sec. 301. Extension of certain corporate income tax reductions.
Sec. 302. New jobs credit.

1 **SEC. 2. AMENDMENT OF 1954 CODE.**

2 Except as otherwise expressly provided, whenever in
3 this Act an amendment or repeal is expressed in terms of
4 an amendment to, or repeal of, a section or other provision,
5 the reference shall be considered to be made to a section or
6 other provision of the Internal Revenue Code of 1954.

1 # TITLE I—REFUND OF 1976 INDIVIDUAL INCOME TAXES; PAYMENTS TO RECIPIENTS OF CERTAIN BENEFITS
2
3
4

5 ## PART I—REFUND OF 1976 INDIVIDUAL INCOME TAXES
6

7 ### SEC. 101. REFUND OF 1976 INDIVIDUAL INCOME TAXES.

8 (a) GENERAL RULE.—Section 6428 (relating to refund
9 of 1974 individual income taxes) is amended to read as
10 follows:

11 "SEC. 6428. REFUND OF 1976 INDIVIDUAL INCOME TAXES.

12 "(a) GENERAL RULE.—Except as otherwise provided
13 in this section, each individual shall be treated as having
14 made a payment against the tax imposed by chapter 1 for
15 his first taxable year beginning in 1976 in an amount equal
16 to the sum of—

17 "(1) $50 multiplied by,

18 "(2) each exemption provided by subsection (b) or
19 (e) of section 151 for which the taxpayer is entitled
20 to a deduction for such taxable year.

21 "(b) PHASEOUT BETWEEN $25,000 AND $30,000.—

22 "(1) IN GENERAL.—If the adjusted gross income

1 of the taxpayer for his first taxable year beginning
2 in 1976 exceeds $25,000, the amount treated as paid
3 by reason of this section (determined without regard
4 to this subsection and subsection (c)) shall be reduced
5 (but not below zero) by an amount which bears the
6 same ratio to the amount so treated as the adjusted gross
7 income of the taxpayer for the taxable year in excess
8 of $25,000 bears to $5,000.

9 "(2) MARRIED INDIVIDUALS FILING SEPARATE
10 RETURNS.—In the case of a married individual filing a
11 separate return, paragraph (1) shall be applied by
12 substituting '$12,500' for '$25,000' and by substituting
13 '$2,500' for '$5,000'.

14 "(c) LIMITATION BASED ON AMOUNT OF TAX.—

15 "(1) IN GENERAL.—The amount treated as paid by
16 reason of this section shall not exceed the amount of the
17 taxpayer's liability for tax for his first taxable year
18 beginning in 1976.

19 "(2) REFUND MADE TO CERTAIN TAXPAYERS.—
20 Paragraph (1) shall not apply to any individual who
21 for his first taxable year beginning in 1976—

22 "(A) is entitled to a credit under section 43
23 (relating to credit for earned income), or

24 "(B) (i) has a dependent child who lived with
25 such individual,

1 "(ii) has earned income, and

2 "(iii) if married, filed a joint return.

3 For purposes of subparagraph (B) (ii), the term 'earned
4 income' has the meaning given to such term by section
5 43 (c) (2), except that self-employment income (as de-
6 fined in section 1402 (b)) shall be substituted for net
7 earnings from self-employment in clause (ii) of section
8 43 (c) (2) (A).

9 "(d) LIABILITY FOR TAX.—For purposes of this sec-
10 tion, the liability for tax for the taxable year shall be the
11 sum of—

12 "(1) the tax imposed by chapter 1 for such year,
13 reduced by the sum of the credits allowable under—

14 "(A) section 33 (relating to foreign tax
15 credit),

16 "(B) section 37 (relating to credit for the
17 elderly),

18 "(C) section 38 (relating to investment in
19 certain depreciable property),

20 "(D) section 40 (relating to expenses of work
21 incentive programs),

22 "(E) section 41 (relating to contributions to
23 candidates for public office),

24 "(F) section 42 (relating to general tax
25 credit),

1 "(G) section 44 (relating to purchase of new
2 principal residence), and
3 "(H) section 44A (relating to expenses for
4 household and dependent care services necessary
5 for gainful employment), plus
6 "(2) the tax on amounts described in section 3102
7 (c) or 3202 (c) which are required to be shown on the
8 taxpayer's return of the chapter 1 tax for the taxable
9 year.
10 "(e) DATE PAYMENT DEEMED MADE.—The payment
11 provided by this section shall be deemed made on which-
12 ever of the following dates is the later:
13 "(1) the date prescribed by law (determined with-
14 out extensions) for filing the return of tax under chap-
15 ter 1 for the taxable year, or
16 "(2) the date on which the taxpayer files his re-
17 turn of tax under chapter 1 for the taxable year.
18 "(f) MARITAL STATUS.—The determination of marital
19 status for purposes of this section shall be made under
20 section 143.
21 "(g) CERTAIN PERSONS NOT ELIGIBLE.—This section
22 shall not apply to any estate or trust, nor shall it apply to
23 any nonresident alien individual."
24 (b) NO INTEREST ON INDIVIDUAL INCOME TAX RE-

1 FUNDS FOR 1976 REFUNDED WITHIN 60 DAYS AFTER
2 RETURN IS FILED.—In applying section 6611 (e) of the
3 Internal Revenue Code of 1954 (relating to income tax re-
4 fund within 45 days after return is filed) in the case of any
5 overpayment of tax imposed by subtitle A of such Code by
6 an individual (other than an estate or trust and other than
7 a nonresident alien individual) for a taxable year beginning
8 in 1976, "60 days" shall be substituted for "45 days" each
9 place it appears in such section 6611 (e).
10 (c) APPROPRIATIONS AUTHORIZED.—There are au-
11 thorized to be appropriated, out of any funds in the Treasury
12 not otherwise appropriated, such sums as may be necessary to
13 make the refunds provided for by section 6428 of the Internal
14 Revenue Code of 1954 (as amended by subsection (a)), to
15 the extent that such refunds exceed the applicable liability
16 for tax referred to in subsection (d) of such section 6428.
17 (d) CLERICAL AMENDMENT.—The table of sections
18 for subchapter B of chapter 65 is amended by striking out
19 the item relating to section 6428 and inserting in lieu thereof
20 the following:

"Sec. 6428. Refund of 1976 individual income taxes."

21 (e) EFFECTIVE DATE.—The amendments made by this
22 section shall apply to taxable years beginning in 1976.

1 **SEC. 102. REFUNDS DISREGARDED IN THE ADMINISTRA-**
2 **TION OF FEDERAL PROGRAMS AND FED-**
3 **ERALLY ASSISTED PROGRAMS.**

4 (a) GENERAL RULE.—Any payment considered to
5 have been made by any individual by reason of section 6428
6 of the Internal Revenue Code of 1954, as amended by section
7 101 (a) of this Act, shall not be regarded as income (or, in
8 the calendar year 1977 or 1978, as a resource) of such
9 individual (or of the family of which he is a member) for
10 purposes of any Federal, State, or local program which
11 undertakes to furnish aid or assistance to individuals or
12 families, where eligibility to receive such aid or assistance (or
13 the amount of such aid or assistance) under such program
14 is based on the need therefor of the individual or family
15 involved. The requirement imposed by the preceding sentence
16 shall be treated as a condition for Federal financial participa-
17 tion in any such State or local program of aid or assistance
18 for the first calendar quarter of 1978.

19 (b) TECHNICAL AMENDMENT.—Section 102 of the
20 Tax Reduction Act of 1975 is amended by inserting after
21 "the Internal Revenue Code of 1954" the following: "(as
22 in effect on the day before the date of the enactment of the
23 Tax Reduction and Simplification Act of 1977)".

1 **SEC. 103. PAYMENTS TO THE GOVERNMENTS OF AMERI-**
2 **CAN SAMOA, GUAM, AND THE VIRGIN ISLANDS.**
3 (a) The Secretary of the Treasury is authorized to make
4 separate payments to the government of American Samoa,
5 the government of Guam, and the government of the Virgin
6 Islands. The payment to the government of a particular
7 possession shall be in an amount equal to the payments con-
8 sidered to have been made by individual residents of that
9 possession by reason of section 101 of this Act, and the loss
10 to that possession with respect to tax returns for the first
11 taxable year beginning after December 31, 1976, by reason
12 of sections 201 and 202 of this Act. Such amount shall be
13 determined by the Secretary of the Treasury upon certi-
14 fication to the Secretary by the United States Government
15 Comptrollers for Guam and the Virgin Islands.
16 (b) Subsection (c) of section 111 and subsections (a)
17 and (b) of section 113 are hereby extended to and made
18 applicable with respect to the payments considered to have
19 been made by individual residents of American Samoa,
20 Guam, and the Virgin Islands by reason of section 101 of
21 this Act; and the payment to the government of any such
22 possession provided by subsection (a) of this section shall

86-032 O - 77 - 2

1 be conditioned on compliance by such government with sub-
2 section (a) of section 113.
3 (c) There are hereby authorized to be appropriated,
4 out of any funds in the Treasury not otherwise appropri-
5 ated, such sums as may be necessary to carry out the
6 provisions of this section.

7 **SEC. 104. PAYMENT NOT TO BE CONSIDERED INCOME OR**
8 **A REDUCTION IN FEDERAL INCOME TAXES**
9 **UNDER STATE LAW.**

10 Payments considered to have been made by reason of
11 section 6428 of the Internal Revenue Code of 1954, as
12 amended by this Act, shall not be considered as gross income
13 for purposes of such Code, and shall not be considered as
14 income or a reduction in tax imposed by subtitle A of
15 such Code for purposes of any law of any State (or the
16 District of Columbia) relating to the taxation of income.

17 **PART II—PAYMENTS TO RECIPIENTS OF CERTAIN**
18 **BENEFITS**

19 **SEC. 111. SPECIAL PAYMENT TO RECIPIENTS OF BENE-**
20 **FITS UNDER CERTAIN RETIREMENT AND**
21 **SURVIVOR BENEFIT PROGRAMS.**

22 (a) PAYMENT.—Subject to subsections (b) and (c),
23 the Secretary of the Treasury shall, at the earliest practicable
24 date after the enactment of this Act, make a $50 payment
25 to each individual who, for the month of March 1977, was
26 entitled to—

1 (1) a monthly benefit payable under title II of the
2 Social Security Act;
3 (2) a monthly annuity or pension under the Rail-
4 road Retirement Act of 1935, the Railroad Retirement
5 Act of 1937, or the Railroad Retirement Act of 1974;
6 (3) a benefit under the supplemental security income
7 benefits program established by title XVI of the Social
8 Security Act (as an eligible individual or as an eligible
9 spouse), or a payment made in supplementation of such
10 benefits under a State program of the type described in
11 section 1616 of such Act or section 212 of Public Law
12 93-66 (whether such program is administered by the
13 Secretary of Health, Education, and Welfare or by the
14 State);
15 (4) a benefit under title IV of the Federal Coal
16 Mine Health and Safety Act of 1969 (30 U.S.C. 901
17 et seq.); or
18 (5) compensation, dependency and indemnity
19 compensation, or pension under laws administered by
20 the Veterans' Administration.
21 The determination of whether an individual was entitled for
22 March 1977 to a benefit described in paragraph (1) shall
23 be made without regard to sections 202(j)(1) and 223(b)
24 of the Social Security Act; and the determination of whether
25 an individual was entitled for such month to an annuity or

1 pension described in paragraph (2) shall be made without
2 the application of section 5(a)(ii) of the Railroad Retire-
3 ment Act of 1974.

4 (b) SPECIAL RULES.—In the application of subsection
5 (a)—

6 (1) payment under such subsection shall be made
7 only to individuals who are paid the benefit, annuity,
8 pension, or compensation involved for March 1977 in
9 a check issued no later than December 31, 1977;

10 (2) no payment under such subsection shall be
11 made to any individual who is not a resident of the
12 United States; and

13 (3) no individual shall be entitled to receive more
14 than one payment under such subsection.

15 For purposes of this subsection, the term "resident of the
16 United States" means an individual whose address of record
17 for purposes of paying the benefit, annuity, pension, or com-
18 pensation involved for March 1977 is located within the
19 United States (as defined in section 210(i) of the Social
20 Security Act).

21 (c) LIMITATION ON PAYMENT TO INDIVIDUALS RE-
22 CEIVING INCOME TAX REFUNDS.—Notwithstanding any
23 other provision of this section, if any individual otherwise
24 entitled to a payment under subsection (a)—

25 (1) is treated as having made a payment against

1 1976 individual income taxes under section 6428 of the
2 Internal Revenue Code of 1954, or
3 (2) is taken into account as an exemption for pur-
4 poses of any such payment treated as having been made
5 by another person,
6 the amount of the payment to which such individual would
7 otherwise be entitled under subsection (a) shall be reduced
8 (but not below zero) by the amount of any payment treated
9 as having been made under section 6428 of such Code to the
10 extent that such payment is attributable to an exemption
11 claimed by or for such individual.

12 **SEC. 112. SPECIAL PAYMENT TO RECIPIENTS OF AID TO**
13 **FAMILIES WITH DEPENDENT CHILDREN UN-**
14 **DER APPROVED STATE PLANS.**

15 (a) PAYMENT.—Every State (as defined in section
16 1101 (a) (1) of the Social Security Act) which has in effect
17 a plan for aid and services to needy families with children
18 approved under section 402 (a) of such Act shall, at the
19 earliest practicable date after the enactment of this Act,
20 make a $50 payment to each individual who, for the month
21 of March 1977, received aid to families with dependent
22 children as a child or relative under such plan.
23 (b) SPECIAL RULES.—In the application of subsection
24 (a)—
25 (1) payment under such subsection shall be made

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1 only to individuals with respect to whom aid to families
2 with dependent children for March 1977 is paid in a
3 check issued no later than December 31, 1977; and
4 (2) no such payment shall be made to any individ-
5 ual who is entitled for March 1977 to a benefit, annuity,
6 pension, or compensation under any of the programs
7 referred to in paragraph (1), (2), (3), (4), or (5)
8 of section 111 (a).
9 Compliance by any State with the requirement of sub-
10 section (a) shall be a condition of its eligibility for Federal
11 financial participation under section 403 of the Social
12 Security Act for the first calendar quarter of 1978, and
13 the State's plan approved under section 402 (a) of such Act
14 shall be deemed to so provide.
15 (c) FULL FEDERAL REIMBURSEMENT OF STATE
16 COSTS.—Notwithstanding any other provision of law (or of
17 any State plan approved under section 402 (a) of the Social
18 Security Act), the Secretary of the Treasury shall pay to
19 each State, in advance on the basis of satisfactory estimates
20 or by way of reimbursement, the full amount of all payments
21 made by such State under subsection (a), plus an additional
22 sum, as compensation for the administrative costs incurred
23 in connection with such payments, equal to the product of
24 75 cents multiplied by the number of dependent children and

1 relatives who for March 1977 received aid to families with
2 dependent children under the State plan.
3 **SEC. 113. PROVISIONS APPLICABLE TO SPECIAL PAY-**
4 **MENTS GENERALLY.**
5 (a) RECIPIENT IDENTIFICATION.—
6 (1) IN GENERAL.—Notwithstanding any provision
7 of Federal law heretofore enacted—
8 (A) the Secretary of Health, Education, and
9 Welfare, the Railroad Retirement Board, the Secre-
10 tary of Labor, the Administrator of Veterans'
11 Affairs, and the appropriate State agencies adminis-
12 tering programs in supplementation of benefits under
13 title XVI of the Social Security Act (i) shall pro-
14 vide the Secretary of the Treasury and each other
15 with such information and data, in such form and
16 after such processing, as the Secretary of the Treas-
17 ury may determine to be necessary to enable him to
18 make the payments authorized under section 111 (a)
19 (and to determine the amount of any such payment
20 under the limitation in section 111 (c)), and (ii)
21 shall provide the State agencies referred to in sub-
22 paragraph (B) of this paragraph with such informa-
23 tion and data, in such form and after such processing,
24 as the Secretary of the Treasury may determine to

1 be necessary to enable them to exercise their respon-
2 sibilities under section 112; and
3 (B) the appropriate agency of each State
4 administering or supervising the administration of
5 its State plan approved under section 402 of the
6 Social Security Act and the Secretary of Health,
7 Education, and Welfare shall furnish the Secretary
8 of the Treasury with such information and data, in
9 such form and after such processing, as the Secre-
10 tary of the Treasury may determine to be necessary
11 to enable him to make or evaluate the estimates
12 referred to in section 112(c) and to exercise his
13 other responsibilities under section 112.
14 (2) RESTRICTION ON USE AND DISCLOSURE OF
15 INFORMATION.—Information and data furnished by any
16 officer or agency to the Secretary of the Treasury or to
17 another officer or agency under paragraph (1) shall
18 be used by the Secretary or such other officer or agency
19 only for purposes directly connected with carrying out
20 the relevant provisions of this part; and the Secretary
21 and such other officer or agency shall establish such safe-
22 guards as may be necessary to restrict the use or dis-
23 closure of such information and data to those purposes.
24 (b) PAYMENTS TO BE MADE AS SOON AS PRACTI-
25 CABLE, ETC.—

1 (1) In general.—Payments under this part shall
2 be made as soon as practicable. If the Secretary of the
3 Treasury determines that, because of the lack of in-
4 formation on compatible computer tapes or for similar
5 reasons, the application of subsection (b) (3) or (c) of
6 section 111 or of subsection (b) (2) of section 112 will
7 unduly postpone the making of payments under this part
8 to any category of individuals, the Secretary shall waive
9 the application of that provision to such category of
10 individuals. In the case of any waiver under the preced-
11 ing sentence, the Secretary of the Treasury shall
12 promptly notify the Congress of the waiver, the category
13 of individuals affected by the waiver, the circumstances
14 surrounding the waiver, and the reasons why such
15 waiver is necessary to carry out the purposes of this title.
16 (2) Relief from liability.—Under regulations
17 prescribed by the Secretary, in the absence of fraud or
18 gross negligence, to the extent any erroneous payment is
19 attributable to subsection (b) (3) or (c) of section 111
20 or to subsection (b) (2) of section 112—
21 (A) the recipient of such payment shall not be
22 liable to repay such payment, and
23 (B) all fiscal, disbursing, and other officers
24 shall be relieved of liability with respect to the mak-
25 ing of such payment.

1 (c) COORDINATION WITH OTHER FEDERAL PRO-
2 GRAMS.—Any payment made to any individual by the Sec-
3 retary of the Treasury under section 111 (a) or by a State
4 under section 112 (a) shall not be regarded as income (or,
5 in the calendar year 1977 or 1978, as a resource) of such
6 individual (or of the family of which he is a member) for
7 purposes of any Federal, State, or local program which
8 undertakes to furnish aid or assistance to individuals or
9 families, where eligibility to receive such aid or assistance (or
10 the amount of such aid or assistance) under such program is
11 based on the need therefor of the individual or family in-
12 volved. The requirement imposed by the preceding sentence
13 shall be treated as a condition for Federal financial partici-
14 pation in any such State or local program of aid or assist-
15 ance for the first calendar quarter of 1978.
16 (d) APPROPRIATIONS AUTHORIZATION.—There are
17 hereby authorized to be appropriated, out of any funds in the
18 Treasury not otherwise appropriated, such sums as may be
19 necessary to carry out the provisions of sections 111 and 112.
20 (e) PAYMENTS NOT TO BE CONSIDERED INCOME.—
21 Payments made under sections 111 (a) and 112 (a) shall
22 not be considered as gross income for purposes of the Internal
23 Revenue Code of 1954.

TITLE II—REDUCTION AND SIMPLIFICATION OF INDIVIDUAL INCOME TAXES

SEC. 201. CHANGE IN TAX RATES AND TAX TABLES TO REFLECT PERMANENT INCREASE IN STANDARD DEDUCTION.

(a) CHANGE IN TAX RATES.—Section 1 (relating to tax imposed) is amended to read as follows:

"SECTION 1. TAX IMPOSED.

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

"(1) every married individual (as defined in section 143) who makes a single return jointly with his spouse under section 6013, and

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

a tax determined in accordance with the following table:

"If the taxable income is:	The tax is:
Not over $3,000	No tax.
Over $3,000 but not over $4,000	14% of the excess over $3,000.
Over $4,000 but not over $5,000	$140, plus 15% of excess over $4,000.
Over $5,000 but not over $6,000	$290, plus 16% of excess over $5,000.
Over $6,000 but not over $7,000	$450, plus 17% of excess over $6,000.
Over $7,000 but not over $11,000	$620, plus 19% of excess over $7,000.

"If the taxable income is:	The tax is:
Over $11,000 but not over $15,000	$1,380, plus 22% of excess over $11,000.
Over $15,000 but not over $19,000	$2,260, plus 25% of excess over $15,000.
Over $19,000 but not over $23,000	$3,260, plus 28% of excess over $19,000.
Over $23,000 but not over $27,000	$4,380, plus 32% of excess over $23,000.
Over $27,000 but not over $31,000	$5,660, plus 36% of excess over $27,000.
Over $31,000 but not over $35,000	$7,100, plus 39% of excess over $31,000.
Over $35,000 but not over $39,000	$8,660, plus 42% of excess over $35,000.
Over $39,000 but not over $43,000	$10,340, plus 45% of excess over $39,000.
Over $43,000 but not over $47,000	$12,140, plus 48% of excess over $43,000.
Over $47,000 but not over $55,000	$14,060, plus 50% of excess over $47,000.
Over $55,000 but not over $67,000	$18,060, plus 53% of excess over $55,000.
Over $67,000 but not over $79,000	$24,420, plus 55% of excess over $67,000.
Over $79,000 but not over $91,000	$31,020, plus 58% of excess over $79,000.
Over $91,000 but not over $103,000	$37,980, plus 60% of excess over $91,000.
Over $103,000 but not over $123,000	$45,180, plus 62% of excess over $103,000.
Over $123,000 but not over $143,000	$57,580, plus 64% of excess over $123,000.
Over $143,000 but not over $163,000	$70,380, plus 66% of excess over $143,000.
Over $163,000 but not over $183,000	$83,580, plus 68% of excess over $163,000.
Over $183,000 but not over $203,000	$97,180, plus 69% of excess over $183,000.
Over $203,000	$110,980, plus 70% of excess over $203,000.

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

"If the taxable income is:	The tax is:
Not over $2,400	No tax.
Over $2,400 but not over $3,400	14% of the excess over $2,400.
Over $3,400 but not over $4,400	$140, plus 16% of excess over $3,400.
Over $4,400 but not over $6,400	$300, plus 18% of excess over $4,400.
Over $6,400 but not over $8,400	$660, plus 19% of excess over $6,400.
Over $8,400 but not over $10,400	$1,040, plus 22% of excess over $8,400.
Over $10,400 but not over $12,400	$1,480, plus 23% of excess over $10,400.
Over $12,400 but not over $14,400	$1,940, plus 25% of excess over $12,400.
Over $14,400 but not over $16,400	$2,440, plus 27% of excess over $14,400.
Over $16,400 but not over $18,400	$2,980, plus 28% of excess over $16,400.
Over $18,400 but not over $20,400	$3,540, plus 31% of excess over $18,400.
Over $20,400 but not over $22,400	$4,160, plus 32% of excess over $20,400.
Over $22,400 but not over $24,400	$4,800, plus 35% of excess over $22,400.
Over $24,400 but not over $26,400	$5,500, plus 36% of excess over $24,400.
Over $26,400 but not over $28,400	$6,220, plus 38% of excess over $26,400.
Over $28,400 but not over $30,400	$6,980, plus 41% of excess over $28,400.
Over $30,400 but not over $34,400	$7,800, plus 42% of excess over $30,400.
Over $34,400 but not over $38,400	$9,480, plus 45% of excess over $34,400.
Over $38,400 but not over $40,400	$11,280, plus 48% of excess over $38,400.
Over $40,400 but not over $42,400	$12,240, plus 51% of excess over $40,400.
Over $42,400 but not over $46,400	$13,260, plus 52% of excess over $42,400.
Over $46,400 but not over $52,400	$15,340, plus 55% of excess over $46,400.
Over $52,400 but not over $54,400	$18,640, plus 56% of excess over $52,400.
Over $54,400 but not over $66,400	$19,760, plus 58% of excess over $54,400.
Over $66,400 but not over $72,400	$26,720, plus 59% of excess over $66,400.
Over $72,400 but not over $78,400	$30,260, plus 61% of excess over $72,400.

"If the taxable income is:	The tax is:
Over $78,400 but not over $82,400	$33,920, plus 62% of excess over $78,400.
Over $82,400 but not over $90,400	$36,400, plus 63% of excess over $82,400.
Over $90,400 but not over $102,400	$41,440, plus 64% of excess over $90,400.
Over $102,400 but not over $122,400	$49,120, plus 66% of excess over $102,400.
Over $122,400 but not over $142,400	$62,320, plus 67% of excess over $122,400.
Over $142,400 but not over $162,400	$75,720, plus 68% of excess over $142,400.
Over $162,400 but not over $182,400	$89,320, plus 69% of excess over $162,400.
Over $182,400	$103,120, plus 70% of excess over $182,400.

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

"If the taxable income is:	The tax is:
Not over $2,400	No tax.
Over $2,400 but not over $2,900	14% of the excess over $2,400.
Over $2,900 but not over $3,400	$70, plus 15% of excess over $2,900.
Over $3,400 but not over $3,900	$145, plus 16% of excess over $3,400.
Over $3,900 but not over $4,400	$225, plus 17% of excess over $3,900.
Over $4,400 but not over $6,400	$310, plus 19% of excess over $4,400.
Over $6,400 but not over $8,400	$690, plus 21% of excess over $6,400.
Over $8,400 but not over $10,400	$1,110, plus 24% of excess over $8,400.
Over $10,400 but not over $12,400	$1,590, plus 25% of excess over $10,400.
Over $12,400 but not over $14,400	$2,090, plus 27% of excess over $12,400.

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"If the taxable income is:	The tax is:
Over $14,400 but not over $16,400	$2,630, plus 29% of excess over $14,400.
Over $16,400 but not over $18,400	$3,210, plus 31% of excess over $16,400.
Over $18,400 but not over $20,400	$3,830, plus 34% of excess over $18,400.
Over $20,400 but not over $22,400	$4,510, plus 36% of excess over $20,400.
Over $22,400 but not over $24,400	$5,230, plus 38% of excess over $22,400.
Over $24,400 but not over $28,400	$5,990, plus 40% of excess over $24,400.
Over $28,400 but not over $34,400	$7,590, plus 45% of excess over $28,400.
Over $34,400 but not over $40,400	$10,290, plus 50% of excess over $34,400.
Over $40,400 but not over $46,400	$13,290, plus 55% of excess over $40,400.
Over $46,400 but not over $52,400	$16,590, plus 60% of excess over $46,400.
Over $52,400 but not over $62,400	$20,190, plus 62% of excess over $52,400.
Over $62,400 but not over $72,400	$26,390, plus 64% of excess over $62,400.
Over $72,400 but not over $82,400	$32,790, plus 66% of excess over $72,400.
Over $82,400 but not over $92,400	$39,390, plus 68% of excess over $82,400.
Over $92,400 but not over $102,400	$46,190, plus 69% of excess over $92,400.
Over $102,400	$53,090, plus 70% of excess over $102,400.

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

"If the taxable income is:	The tax is:
Not over $1,500	No tax.
Over $1,500 but not over $2,000	14% of the excess over $1,500.
Over $2,000 but not over $2,500	$70, plus 15% of excess over $2,000.

"If the taxable income is:	The tax is:
Over $2,500 but not over $3,000	$145, plus 16% of excess over $2,500.
Over $3,000 but not over $3,500	$225, plus 17% of excess over $3,000.
Over $3,500 but not over $5,500	$310, plus 19% of excess over $3,500.
Over $5,500 but not over $7,500	$690, plus 22% of excess over $5,500.
Over $7,500 but not over $9,500	$1,130, plus 25% of excess over $7,500.
Over $9,500 but not over $11,500	$1,630, plus 28% of excess over $9,500.
Over $11,500 but not over $13,500	$2,190, plus 32% of excess over $11,500.
Over $13,500 but not over $15,500	$2,830, plus 36% of excess over $13,500.
Over $15,500 but not over $17,500	$3,550, plus 39% of excess over $15,500.
Over $17,500 but not over $19,500	$4,330, plus 42% of excess over $17,500.
Over $19,500 but not over $21,500	$5,170, plus 45% of excess over $19,500.
Over $21,500 but not over $23,500	$6,070, plus 48% of excess over $21,500.
Over $23,500 but not over $27,500	$7,030, plus 50% of excess over $23,500.
Over $27,500 but not over $33,500	$9,030, plus 53% of excess over $27,500.
Over $33,500 but not over $39,500	$12,210, plus 55% of excess over $33,500.
Over $39,500 but not over $45,500	$15,510, plus 58% of excess over $39,500.
Over $45,500 but not over $51,500	$18,990, plus 60% of excess over $45,500.
Over $51,500 but not over $61,500	$22,590, plus 62% of excess over $51,500.
Over $61,500 but not over $71,500	$28,790, plus 64% of excess over $61,500.
Over $71,500 but not over $81,500	$35,190, plus 66% of excess over $71,500.
Over $81,500 but not over $91,500	$41,790, plus 68% of excess over $81,500.
Over $91,500 but not over $101,500	$48,590, plus 69% of excess over $91,500.
Over $101,500	$55,490, plus 70% of excess over $101,500.

1 "(e) ESTATES AND TRUSTS.—There is hereby imposed
2 on the taxable income of every estate and trust taxable under

1 this subsection a tax determined in accordance with the
2 following table:

"If the taxable income is:	The tax is:
Not over $500	14% of the taxable income.
Over $500 but not over $1,000	$70, plus 15% of excess over $500.
Over $1,000 but not over $1,500	$145, plus 16% of excess over $1,000.
Over $1,500 but not over $2,000	$225, plus 17% of excess over $1,500.
Over $2,000 but not over $4,000	$310, plus 19% of excess over $2,000.
Over $4,000 but not over $6,000	$690, plus 22% of excess over $4,000.
Over $6,000 but not over $8,000	$1,130, plus 25% of excess over $6,000.
Over $8,000 but not over $10,000	$1,630, plus 28% of excess over $8,000.
Over $10,000 but not over $12,000	$2,190, plus 32% of excess over $10,000.
Over $12,000 but not over $14,000	$2,830, plus 36% of excess over $12,000.
Over $14,000 but not over $16,000	$3,550, plus 39% of excess over $14,000.
Over $16,000 but not over $18,000	$4,330, plus 42% of excess over $16,000.
Over $18,000 but not over $20,000	$5,170, plus 45% of excess over $18,000.
Over $20,000 but not over $22,000	$6,070, plus 48% of excess over $20,000.
Over $22,000 but not over $26,000	$7,030, plus 50% of excess over $22,000.
Over $26,000 but not over $32,000	$9,030, plus 53% of excess over $26,000.
Over $32,000 but not over $38,000	$12,210, plus 55% of excess over $32,000.
Over $38,000 but not over $44,000	$15,510, plus 58% of excess over $38,000.
Over $44,000 but not over $50,000	$18,990, plus 60% of excess over $44,000.
Over $50,000 but not over $60,000	$22,590, plus 62% of excess over $50,000.
Over $60,000 but not over $70,000	$28,790, plus 64% of excess over $60,000.
Over $70,000 but not over $80,000	$35,190, plus 66% of excess over $70,000.
Over $80,000 but not over $90,000	$41,790, plus 68% of excess over $80,000.

84-032 O - 77 - 3

"If the taxable income is:	The tax is:
Over $90,000 but not over $100,000	$48,590, plus 69% of excess over $90,000.
Over $100,000	$55,490, plus 70% of excess over $100,000."

1 (b) CHANGE IN TAX TABLES.—Section 3 (relating to
2 tax tables for individuals having taxable income of less than
3 $20,000) is amended to read as follows:

4 "SEC. 3. TAX TABLES FOR INDIVIDUALS.

5 "(a) IMPOSITION OF TAX TABLE TAX.—
6 "(1) IN GENERAL.—In lieu of the tax imposed by
7 section 1, there is hereby imposed for each taxable year
8 on the tax table income of every individual whose tax
9 table income for such year does not exceed the ceiling
10 amount, a tax determined under tables, applicable to
11 such taxable year, which shall be prescribed by the Sec-
12 retary. In the tables so prescribed, the amounts of tax
13 shall be computed on the basis of the rates prescribed by
14 section 1.
15 "(2) CEILING AMOUNT DEFINED.—For purposes
16 of paragraph (1), the term 'ceiling amount' means, with
17 respect to any taxpayer, the amount (not less than
18 $20,000) determined by the Secretary for the tax rate
19 category in which such taxpayer falls.
20 "(3) CERTAIN TAXPAYERS WITH LARGE NUMBER
21 OF EXEMPTIONS.—The Secretary may exclude from the
22 application of this section taxpayers in any tax rate

1 category having more than the number of exemptions
2 for that category determined by the Secretary.
3 "(4) TAX TABLE INCOME DEFINED.—For purposes
4 of this section, the term 'tax table income' means
5 adjusted gross income—
6 "(A) reduced by the excess itemized deduc-
7 tions, and
8 "(B) increased (in the case of an individual to
9 whom section 63(e) applies) by the unused zero
10 bracket amount.
11 "(b) SECTION INAPPLICABLE TO CERTAIN INDIVID-
12 UALS.—This section shall not apply to—
13 "(1) an individual to whom—
14 "(A) section 911 (relating to earned income
15 from sources without the United States),
16 "(B) section 1201 (relating to alternative
17 capital gains tax),
18 "(C) section 1301 (relating to income averag-
19 ing), or
20 "(D) section 1348 (relating to maximum rate
21 on personal service income),
22 applies for the taxable year,
23 "(2) an individual making a return under section
24 443(a)(1) for a period of less than 12 months on

1 account of a change in annual accounting period, and

2 "(3) an estate or trust.

3 "(c) TAX TREATED AS IMPOSED BY SECTION 1.—For

4 purposes of this title, the tax imposed by this section shall

5 be treated as tax imposed by section 1.

6 "(d) TAXABLE INCOME.—Whenever it is necessary

7 to determine the taxable income of an individual to whom

8 this section applies, the taxable income shall be determined

9 under section 63.

10 "(e) CROSS REFERENCE.—

"For computation of tax by Secretary, see section 6014."

11 (c) CHANGES IN GENERAL TAX CREDIT.—

12 (1) Subsection (a) of section 42 (relating to allow-

13 ance of general tax credit) is amended to read as

14 follows:

15 "(a) ALLOWANCE OF CREDIT.—In the case of an indi-

16 vidual, there shall be allowed as a credit against the tax im-

17 posed by this chapter for the taxable year an amount equal

18 to the greater of—

19 "(1) 2 percent of so much of the taxpayer's tax-

20 able income for the taxable year (reduced by the zero

21 bracket amount) as does not exceed $9,000; or

22 "(2) $35 multiplied by each exemption for which

23 the taxpayer is entitled to a deduction for the taxable

24 year under section 151."

1 (2) Section 42 is amended by adding at the end
2 thereof the following new subsection:
3 "(e) INCOME TAX TABLES TO REFLECT CREDIT.—
4 The tables prescribed by the Secretary under section 3 shall
5 reflect the credit allowed by this section."
6 (3) Subsection (c) of section 42 is amended to
7 read as follows:
8 "(c) SPECIAL RULE FOR MARRIED INDIVIDUALS
9 FILING SEPARATE RETURNS.—
10 "(1) IN GENERAL.—In the case of a married in-
11 dividual who files a separate return for the taxable year,
12 the amount of the credit allowable under subsection (a)
13 for the taxable year shall be the amount determined
14 under paragraph (2) of subsection (a).
15 "(2) MARITAL STATUS.—For purposes of this sub-
16 section, the determination of marital status shall be made
17 under section 143."
18 (d) TECHNICAL AND CONFORMING AMENDMENTS.—
19 (1) Section 141 (relating to standard deduction),
20 section 142 (relating to individuals not eligible for
21 standard deduction), section 144 (relating to election
22 of standard deduction), and section 145 (cross refer-
23 ence) are hereby repealed.
24 (2) Section 21 (relating to effect of changes) is
25 amended—

1 (A) by striking out subsections (d) and (e),
2 (B) by redesignating subsection (f) as subsec-
3 tion (d), and
4 (C) by inserting after subsection (d) (as so
5 redesignated) the following new subsection:
6 "(e) CHANGES MADE BY TAX REDUCTION AND
7 SIMPLIFICATION ACT OF 1977.—In applying subsection
8 (a) to a taxable year of an individual which is not a cal-
9 endar year, the amendments made by sections 201 and
10 202 of the Tax Reduction and Simplification Act of 1977
11 shall not be treated as changes in a rate of tax."
12 (3) Section 36 (relating to credits not allowed to
13 individuals taking standard deduction) is hereby
14 repealed.
15 (4) Section 143(a) (relating to determination of
16 marital status) is amended by striking out "this part
17 and".
18 (5) (A) Paragraph (1) of section 57(a) (relating
19 to items of tax preference) is amended by striking out
20 "excess" in the heading and text and inserting in lieu
21 thereof "adjusted".
22 (B) The heading of subsection (b) of section 57,
23 and so much of paragraph (1) of such subsection as
24 precedes subparagraph (A), are each amended by

1 striking out "excess" and inserting in lieu thereof "ad-
2 justed".
3 (C) Paragraph (1) of section 57 (b) is amended—
4 (i) by striking out subparagraph (B), and
5 (ii) by redesignating subparagraphs (C)
6 through (E) as subparagraphs (B) through (D),
7 respectively.
8 (6) Paragraph (1) of section 511 (b) (relating
9 to tax on unrelated business income of charitable, etc.,
10 trusts) is amended by striking out "section 1 (d)" and
11 inserting in lieu thereof "section 1 (e)".
12 (7) Subsection (d) of section 584 (relating to
13 common trust funds) is amended—
14 (A) by inserting "and" at the end of para-
15 graph (2),
16 (B) by striking out "; and" at the end of para-
17 graph (3) and inserting in lieu thereof a period,
18 and
19 (C) by striking out paragraph (4).
20 (8) Subsection (a) of section 641 (relating to im-
21 position of tax for estates and trusts) is amended by
22 striking out "section 1 (d)" and inserting in lieu thereof
23 "section 1 (e)".
24 (9) Subsection (k) of section 642 (relating to

1 special rules for credits and deductions of estate or
2 trust) is amended to read as follows:
3 "(k) CROSS REFERENCE.—

"For special rule for determining the time of receipt of dividends by a beneficiary under section 652 or 662, see section 116(c)(2)."

4 (10) Subsection (a)(2) of section 703 (relating
5 to partnership income and deductions) is amended—
6 (A) by striking out subparagraph (A), and
7 (B) by redesignating subparagraphs (B)
8 through (G) as subparagraphs (A) through (F),
9 respectively.
10 (11) Subsection (c) of section 873 (relating to
11 deductions in the case of nonresident alien individuals)
12 is amended to read as follows:
13 "(c) CROSS REFERENCE.—

"For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1)."

14 (12) Paragraph (3) of section 931(d) (relating
15 to deductions in computing income from sources within
16 possessions of the United States) is hereby repealed.
17 (13) Subsection (a) of section 6014 (relating to
18 tax not computed by taxpayer) is amended—
19 (A) by striking out "entitled to take" through
20 "section 141(e))" in the first sentence thereof and
21 inserting in lieu thereof "who does not itemize his

1 deductions and who does not have an unused
2 zero bracket amount (determined under section
3 63 (e)),", and
4 (B) by striking out "and shall constitute an
5 election to take the standard deduction" in the sec-
6 ond sentence thereof.
7 (14) Paragraph (4) of section 6014 (b) (relating
8 to regulations) is amended to read as follows:
9 "(4) to cases where the taxpayer itemizes his de-
10 ductions or has an unused zero bracket amount."
11 (15) Subparagraph (A) of section 6212 (c) (2)
12 (relating to further deficiency letters restricted) is
13 amended to read as follows:
14 "(A) Deficiency attributable to change of
15 treatment with respect to itemized deductions and
16 zero bracket amount, see section 63 (g) (4)."
17 (16) Paragraph (2) of section 6504 (relating to
18 cross references) is amended to read as follows:

"(2) Change of treatment with respect to itemized deductions and zero bracket amount where taxpayer and his spouse make separate returns, see section 63(g)(4)."

19 (e) CLERICAL AMENDMENTS.—
20 (1) The table of sections for subpart A of part IV
21 of subchapter A of chapter 1 (relating to credits allow-
22 able against tax) is amended by striking out the item
23 relating to section 36.

1 (2) The heading and table of sections for part IV
2 of subchapter B of chapter 1 (relating to standard de-
3 duction for individuals) are amended to read as follows:

4 "PART IV—DETERMINATION OF MARITAL STATUS

"Sec. 143. Determination of marital status."

5 (3) The table of parts for subchapter B of chap-
6 ter 1 (relating to computation of taxable income) is
7 amended by striking out the item relating to part IV
8 and inserting in lieu thereof the following:

"Part IV. Determination of marital status."

9 **SEC. 202. CHANGE IN DEFINITION OF TAXABLE INCOME**
10 **TO REFLECT CHANGE IN TAX RATES AND**
11 **TABLES.**

12 (a) TAXABLE INCOME DEFINED.—Section 63 (defin-
13 ing taxable income) is amended to read as follows:

14 **"SEC. 63. TAXABLE INCOME DEFINED.**

15 "(a) CORPORATIONS.—For purposes of this subtitle, in
16 the case of a corporation, the term 'taxable income' means
17 gross income minus the deductions allowed by this chapter.
18 "(b) INDIVIDUALS.—For purposes of this subtitle, in
19 the case of an individual, the term 'taxable income' means
20 adjusted gross income—
21 "(1) reduced by the sum of—
22 "(A) the excess itemized deductions, and

1 "(B) the deductions for personal exemptions
2 provided by section 151, and
3 "(2) increased (in the case of an individual for
4 whom an unused zero bracket amount computation is
5 provided by subsection (e)) by the unused zero bracket
6 amount (if any).
7 "(c) EXCESS ITEMIZED DEDUCTIONS.—For purposes
8 of this subtitle, the term 'excess itemized deductions' means
9 the excess (if any) of—
10 "(1) the itemized deductions, over
11 "(2) the zero bracket amount.
12 "(d) ZERO BRACKET AMOUNT.—For purposes of this
13 subtitle, the term 'zero bracket amount' means—
14 "(1) $3,000 in the case of—
15 "(A) a joint return under section 6013, or
16 "(B) a surviving spouse (as defined in section
17 2(a)),
18 "(2) $2,400 in the case of an individual who is
19 not married and who is not a surviving spouse (as so
20 defined),
21 "(3) $1,500 in the case of a married individual
22 filing a separate return, or
23 "(4) zero in any other case.
24 "(e) UNUSED ZERO BRACKET AMOUNT.—

1 "(1) INDIVIDUALS FOR WHOM COMPUTATION
2 MUST BE MADE.—A computation for the taxable year
3 shall be made under this subsection for the following
4 individuals:
5 "(A) a married individual filing a separate
6 return where either spouse itemizes deductions,
7 "(B) a nonresident alien individual,
8 "(C) a citizen of the United States entitled to
9 the benefits of section 931 (relating to income
10 from sources within possessions of the United
11 States), and
12 "(D) an individual with respect to whom a
13 deduction under section 151(e) is allowable to an-
14 other taxpayer for a taxable year beginning in the
15 calendar year in which the individual's taxable year
16 begins.
17 "(2) COMPUTATION.—For purposes of this sub-
18 title, an individual's unused zero bracket amount for the
19 taxable year is an amount equal to the excess (if any)
20 of—
21 "(A) the zero bracket amount, over
22 "(B) the itemized deductions.
23 In the case of an individual referred to in paragraph
24 (1)(D), if such individual's earned income (as defined
25 in section 911(b)) exceeds the itemized deductions,

such earned income shall be substituted for the itemized deductions in subparagraph (B).

"(f) ITEMIZED DEDUCTIONS.—For purposes of this subtitle, the term 'itemized deductions' means the deductions allowable by this chapter other than—

"(1) the deductions allowable in arriving at adjusted gross income, and

"(2) the deductions for personal exemptions provided by section 151.

"(g) ELECTION TO ITEMIZE.—

"(1) IN GENERAL.—Unless an individual makes an election under this subsection for the taxable year, no itemized deduction shall be allowed for the taxable year. For purposes of this subtitle, the determination of whether a deduction is allowable under this chapter shall be made without regard to the preceding sentence.

"(2) WHO MAY ELECT.—Except as provided in paragraph (3), an individual may make an election under this subsection for the taxable year only—

"(A) if such individual's itemized deductions exceed the zero bracket amount, or

"(B) in the case of a married individual filing a separate return, if such individual's spouse qualifies under subparagraph (A) and makes an election under this subsection.

1 "(3) TIME AND MANNER OF ELECTION.—Any
2 election under this subsection shall be made on the tax-
3 payer's return, and the Secretary shall prescribe the
4 manner of signifying such election on the return.
5 "(4) CHANGE OF TREATMENT.—Under regulations
6 prescribed by the Secretary, a change of treatment with
7 respect to the zero bracket amount and itemized deduc-
8 tions for any taxable year may be made after the filing
9 of the return for such year. If the spouse of the taxpayer
10 filed a separate return for any taxable year correspond-
11 ing to the taxable year of the taxpayer, the change shall
12 not be allowed unless, in accordance with such
13 regulations—
14 "(A) the spouse makes a change of treatment
15 with respect to the zero bracket amount and itemized
16 deductions, for the taxable year covered in such
17 separate return, consistent with the change of treat-
18 ment sought by the taxpayer, and
19 "(B) the taxpayer and his spouse consent in
20 writing to the assessment, within such period as
21 may be agreed on with the Secretary, of any defi-
22 ciency, to the extent attributable to such change of
23 treatment, even though at the time of the filing of
24 such consent the assessment of such deficiency would

1 otherwise be prevented by the operation of any law
2 or rule of law.
3 This paragraph shall not apply if the tax liability of the
4 taxpayer's spouse, for the taxable year corresponding to
5 the taxable year of the taxpayer, has been compromised
6 under section 7122.
7 "(h) MARITAL STATUS.—For purposes of this section,
8 marital status shall be determined under section 143."
9 (b) TECHNICAL AND CONFORMING AMENDMENTS.—
10 (1) Section 161 (relating to allowance of deduc-
11 tions) is amended by striking out "section 63(a)" and
12 inserting in lieu thereof "section 63".
13 (2) Subsection (d) of section 172 (relating to
14 modifications in determining net operating loss) is
15 amended by adding at the end thereof the following
16 new paragraph:
17 "(8) ZERO BRACKET AMOUNT.—In the case of a
18 taxpayer other than a corporation, the zero bracket
19 amount shall be treated as a deduction allowed by this
20 chapter. For purposes of subsection (c), the preceding
21 sentence shall not apply to an individual who itemizes
22 deductions or who is an individual described in section
23 63(e)(1)."
24 (3) Section 211 (relating to allowance of deduc-

1 tions) is amended by striking out "section 63 (a)" and
2 inserting in lieu thereof "section 63".
3 (4) Subparagraph (C) of section 402 (e) (1) (re-
4 lating to imposition of separate tax on lump sum distri-
5 butions) is amended by striking out "amount equal to
6 one-tenth of the excess of" and inserting in lieu thereof
7 "amount equal to $2,400 plus one-tenth of the excess
8 of".
9 (5) Clause (iii) of section 441 (f) (2) (B) (re-
10 lating to change in accounting period) is amended to
11 read as follows:
12 "(iii) if such change results in a short
13 period to which subsection (b) of section 443
14 applies, the taxable income for such short period
15 shall be placed on an annual basis for purposes
16 of such subsection by multiplying the gross in-
17 come for such short period (minus the deduc-
18 tions allowed by this chapter for the short
19 period, but only the adjusted amount of the
20 deductions for personal exemptions as described
21 in section 443 (c)) by 365, by dividing the
22 result by the number of days in the short period,
23 and by adding the zero bracket amount, and the
24 tax shall be the same part of the tax computed

1 on the annual basis as the number of days in the
2 short period is of 365 days."
3 (6) Paragraph (1) of section 443(b) (relating
4 to computation of tax on change of annual accounting
5 period) is amended to read as follows:
6 "(1) GENERAL RULE.—If a return is made under
7 paragraph (1) of subsection (a), the taxable income for
8 the short period shall be placed on an annual basis by
9 multiplying the gross income for such short period
10 (minus the deductions allowed by this chapter for the
11 short period, but only the adjusted amount of the deduc-
12 tions for personal exemptions) by 12, dividing the result
13 by the number of months in the short period, and adding
14 the zero bracket amount. The tax shall be the same part
15 of the tax computed on the annual basis as the number
16 of months in the short period is of 12 months."
17 (7) Paragraph (1) of section 613A(d) (relating
18 to limitation on percentage depletion based on taxable
19 income) is amended by inserting "(reduced in the case
20 of an individual by the zero bracket amount)" after "the
21 taxpayer's taxable income".
22 (8) Paragraph (2) of section 667(b) (relating to
23 tax on amount deemed distributed by trust in preceding
24 years) is amended to read as follows:

86-032 O - 77 - 4

1 "(2) TREATMENT OF LOSS YEARS.—For purposes
2 of paragraph (1), the taxable income of the beneficiary
3 for any taxable year shall be deemed to be not less
4 than—
5 "(A) in the case of a beneficiary who is an
6 individual, the zero bracket amount for such year, or
7 "(B) in the case of a beneficiary who is a cor-
8 poration, zero."
9 (9) Subsection (b) of section 861 (relating to
10 income from sources within the United States) is
11 amended by adding at the end thereof the following new
12 sentence: "In the case of an individual who does not
13 itemize deductions, an amount equal to the zero bracket
14 amount shall be considered a deduction which cannot
15 definitely be allocated to some item or class of gross
16 income."
17 (10) Subsection (b) of section 862 (relating to
18 income from sources without the United States) is
19 amended by adding at the end thereof the following new
20 sentence: "In the case of an individual who does not
21 itemize deductions, an amount equal to the zero bracket
22 amount shall be considered a deduction which cannot
23 definitely be allocated to some item or class of gross
24 income."
25 (11) Subsection (a) of section 904 (relating to

1 limitation on foreign tax credit) is amended by adding
2 at the end thereof the following new sentence: "For
3 purposes of the preceding sentence, in the case of an
4 individual the entire taxable income shall be reduced
5 by an amount equal to the zero bracket amount."
6 (12) Subparagraph (B) of section 911(d)(1)
7 (relating to computation of tax where there is earned
8 income from sources without the United States) is
9 amended to read as follows:
10 "(B) the tax imposed by section 1 or section
11 1201 (whichever is applicable) on the sum of—
12 "(i) the amount of net excluded earned
13 income, and
14 "(ii) the zero bracket amount."
15 (13) Subparagraph (A) of section 1211(b)(1)
16 (relating to limitation on capital losses) is amended to
17 read as follows:
18 "(A) the taxable income for the taxable year
19 reduced (but not below zero) by the zero bracket
20 amount,".
21 (14) Section 1302(b) (defining average base
22 period income) is amended by adding at the end thereof
23 the following new paragraph:
24 "(3) TRANSITIONAL RULE FOR DETERMINING
25 BASE PERIOD INCOME.—The base period income (deter-

1 mined under paragraph (2)) for any taxable year
2 beginning before January 1, 1977, shall be increased
3 by the amount of the taxpayer's zero bracket amount
4 for the computation year."

5 **SEC. 203. EXTENSION OF INDIVIDUAL INCOME TAX RE-**
6 **DUCTIONS.**

7 (a) GENERAL TAX CREDIT.—Section 3(b) of the
8 Revenue Adjustment Act of 1975, as amended by section
9 401(a) of the Tax Reform Act of 1976, is amended by
10 striking out "December 31, 1977" and inserting in lieu
11 thereof "December 31, 1978".

12 (b) EARNED INCOME CREDIT.—Section 209(b) of the
13 Tax Reduction Act of 1975, as amended by section 401(c)
14 of the Tax Reform Act of 1976, is amended by striking out
15 "January 1, 1978" and inserting in lieu thereof "January 1,
16 1979". There are authorized to be appropriated, out of any
17 funds in the Treasury not otherwise appropriated, such sums
18 as may be necessary to pay that portion of the refunds
19 under section 6401(b) of the Internal Revenue Code of
20 1954 which is attributable to the amendment made by the
21 preceding sentence.

22 (c) TECHNICAL AMENDMENTS.—Subsection (e) of
23 section 401 of the Tax Reform Act of 1976 is amended by
24 striking out the first sentence and inserting in lieu thereof
25 the following new sentences: "The amendments made by

1 subsection (a) shall apply to taxable years ending after
2 December 31, 1975, and shall cease to apply to taxable
3 years ending after December 31, 1978. The amendments
4 made by subsection (c) shall apply to taxable years ending
5 after December 31, 1975, and shall cease to apply to tax-
6 able years beginning after December 31, 1978."

7 (d) AFDC AND OTHER RECIPIENTS' ELIGIBILITY
8 FOR THE EARNED INCOME CREDIT.—Paragraph (1) of
9 section 43 (c) (defining eligible individual for purposes of
10 the earned income credit) is amended by adding at the end
11 thereof the following new sentence:

12 "The determination of whether an individual maintains
13 a household for the taxable year for purposes of this
14 section shall be made by not taking into account any aid
15 or assistance for any child of such individual under a
16 Federal, State, or local governmental program, and by
17 not taking into account that portion of any aid or assist-
18 ance to the family under such a program which is based
19 on the needs of any child of such individual."

20 **SEC. 204. CHANGE IN FILING REQUIREMENTS.**

21 Paragraph (1) of section 6012 (a) (relating to persons
22 required to make returns of income) is amended to read as
23 follows:

24 "(1) (A) Every individual having for the taxable
25 year a gross income of $750 or more, except that a

1 return shall not be required of an individual (other than
2 an individual described in subparagraph (C))—
3 "(i) who is not married (determined by apply-
4 ing section 143), is not a surviving spouse (as de-
5 fined in section 2(a)), and for the taxable year
6 has a gross income of less than $3,150,
7 "(ii) who is a surviving spouse (as so defined)
8 and for the taxable year has a gross income of less
9 than $3,750, or
10 "(iii) who is entitled to make a joint return
11 under section 6013 and whose gross income, when
12 combined with the gross income of his spouse, is, for
13 the taxable year, less than $4,500, but only if such
14 individual and his spouse, at the close of the taxable
15 year, had the same household as their home.
16 Clause (iii) shall not apply if for the taxable year such
17 spouse makes a separate return or any other taxpayer is
18 entitled to an exemption for such spouse under section
19 151(e).
20 "(B) The amount specified in clause (i) or (ii) of
21 subparagraph (A) shall be increased by $750 in the
22 case of an individual entitled to an additional personal
23 exemption under section 151(c)(1), and the amount
24 specified in clause (iii) of subparagraph (A) shall be
25 increased by $750 for each additional personal exemp-

1 tion to which the individual or his spouse is entitled
2 under section 151 (c).
3 "(C) The exception under subparagraph (A) shall
4 not apply to—
5 "(i) a nonresident alien individual;
6 "(ii) a citizen of the United States entitled to
7 the benefits of section 931;
8 "(iii) an individual making a return under sec-
9 tion 443 (a) (1) for a period of less than 12 months
10 on account of a change in his annual accounting
11 period;
12 "(iv) an individual who has an unused zero
13 bracket amount determined under section 63 (e); or
14 "(v) an estate or trust."
15 **SEC. 205. WITHHOLDING TAX.**
16 Subsection (a) of section 3402 (relating to income tax
17 collected at source) is amended to read as follows:
18 "(a) REQUIREMENT OF WITHHOLDING.—Except as
19 otherwise provided in this section, every employer making
20 payment of wages shall deduct and withhold upon such
21 wages a tax determined in accordance with tables prescribed
22 by the Secretary. With respect to wages paid after April 30,
23 1977, and before January 1, 1979, the tables so prescribed
24 shall be the same as the tables prescribed under this subsec-
25 tion which were in effect on January 1, 1976; except that

1 such tables shall be modified to the extent necessary so that,
2 had they been in effect for all of 1977, they would reflect the
3 full year effect of the amendments made by sections 201
4 and 202 of the Tax Reduction and Simplification Act
5 of 1977. With respect to wages paid after December 31,
6 1978, the tables so prescribed shall be the same as the tables
7 prescribed under this subsection which were in effect on Jan-
8 uary 1, 1975, except that such tables shall be modified to
9 the extent necessary to reflect the amendments made by sec-
10 tions 201 and 202 of the Tax Reduction and Simplification
11 Act of 1977. For purposes of applying such tables, the term
12 'the amount of wages' means the amount by which the wages
13 exceed the number of withholding exemptions claimed, mul-
14 tiplied by the amount of one such exemption as shown in
15 the table prescribed under subsection (b) (1)."
16 (b) TECHNICAL AND CONFORMING AMENDMENTS.—
17 (1) Paragraph (1) of section 3402 (f) (relating
18 to withholding exemptions) is amended—
19 (A) by striking out "a standard deduction" in
20 subparagraph (G) and inserting in lieu thereof "a
21 zero bracket", and
22 (B) by striking out "standard deduction" in
23 the sentence following subparagraph (G) and in-
24 serting in lieu thereof "zero bracket".

1 (2) Subparagraph (B) of section 3402(m)(1)
2 (relating to withholding allowances based on itemized
3 deductions) is amended to read as follows:
4 "(B) an amount equal to $3,000 ($2,400 in
5 the case of an individual who is not married (within
6 the meaning of section 143) and who is not a sur-
7 viving spouse (as defined in section 2(a)))."
8 (3) Section 3402(m)(2) (relating to definitions)
9 is amended—
10 (A) by striking out "sections 141 and" in
11 subparagraph (A) and inserting in lieu thereof
12 "section",
13 (B) by striking out "(or the amount of the
14 standard deduction)" in subparagraph (A) and
15 inserting in lieu thereof "(or the zero bracket
16 amount (within the meaning of section 63(d)))",
17 and
18 (C) by striking out "(or the standard deduc-
19 tion)" in subparagraph (C) and inserting in lieu
20 thereof "(or the zero bracket amount)".
21 **SEC. 206. EFFECTIVE DATES.**
22 (a) GENERAL RULE.—The amendments made by sec-
23 tions 201, 202, 203(d), and 204 shall apply to taxable
24 years beginning after December 31, 1976.

1 (b) WITHHOLDING AMENDMENTS.—The amendments
2 made by section 205 shall apply to wages paid after April 30
3 1977.

4 TITLE III—REDUCTION IN
5 BUSINESS TAXES

6 **SEC. 301. EXTENSION OF CERTAIN CORPORATE INCOME**
7 **TAX REDUCTIONS.**

8 The following provisions are each amended by striking
9 out "December 31, 1977" and inserting in lieu thereof "De-
10 cember 31, 1978" and by striking out "January 1, 1978"
11 and inserting in lieu thereof "January 1, 1979":
12 (1) section 11(b) (relating to normal tax);
13 (2) section 11(d) (relating to surtax exemption);
14 (3) section 821(a)(1) (relating to mutual insur-
15 ance companies); and
16 (4) section 821(c)(1)(A) relating to alternative
17 tax for certain small companies).

18 **SEC. 302. NEW JOBS CREDIT.**

19 (a) IN GENERAL.—Subpart A of part IV of subchapter
20 A of chapter 1 (relating to credits allowable) is amended
21 by inserting after section 44A the following new section:

22 **"SEC. 44B. CREDIT FOR EMPLOYMENT OF CERTAIN NEW**
23 **EMPLOYEES.**

24 "(a) GENERAL RULE.—There shall be allowed as a
25 credit against the tax imposed by this chapter the amount
26 determined under subpart D of this part.

1 "(b) REGULATIONS.—The Secretary shall prescribe
2 such regulations as may be necessary to carry out the pur-
3 poses of this section and subpart D."
4 (b) RULES FOR COMPUTING CREDIT.—Part IV of
5 subchapter A of chapter 1 (relating to credits against tax) is
6 amended by adding at the end thereof the following new
7 subpart:

8 **"Subpart D—Rules for Computing Credit for Employment**
9 **of Certain New Employees**

"Sec. 51. Amount of credit.
"Sec. 52. Special rules.
"Sec. 53. Limitation based on amount of tax.

10 **"SEC. 51. AMOUNT OF CREDIT.**
11 "(a) DETERMINATION OF AMOUNT.—The amount of
12 the credit allowable by section 44B shall be—
13 "(1) for a taxable year beginning in 1977, an
14 amount equal to 40 percent of the excess of the aggre-
15 gate unemployment insurance wages paid during 1977
16 over 103 percent of the aggregate unemployment insur-
17 ance wages paid during 1976, and
18 "(2) for a taxable year beginning in 1978, an
19 amount equal to 40 percent of the excess of the aggre-
20 gate unemployment insurance wages paid during 1978
21 over 103 percent of the aggregate unemployment insur-
22 ance wages paid during 1977.
23 "(b) TOTAL WAGES MUST INCREASE.—The amount

1 of the credit allowable by section 44B for any taxable year
2 shall not exceed the amount which would be determined for
3 such year under subsection (a) if the aggregate amounts
4 taken into account as unemployment insurance wages were
5 determined without any dollar limitation.

6 "(c) $40,000 PER YEAR LIMITATION ON CREDIT.—
7 Except as provided in subsection (d), the amount of the
8 credit determined under this subpart for any employer (and
9 the amount of the credit allowable by section 44B to any
10 taxpayer) with respect to any calendar year shall not exceed
11 $40,000.

12 "(d) ADDITIONAL 10 PERCENT CREDIT FOR VOCA-
13 TIONAL REHABILITATION REFERRALS.—

14 "(1) IN GENERAL.—The amount of the credit
15 allowable by section 44B for any taxable year (deter-
16 mined without regard to this subsection) shall be
17 increased by the amount determined for such taxable
18 year—

19 "(A) by substituting '10 percent' for '40 per-
20 cent' in the appropriate paragraph of subsection (a),
21 and

22 "(B) by applying such paragraph and sub-
23 section (b) separately with respect to the unem-
24 ployment insurance wages paid to vocational reha-
25 bilitation referrals.

26 "(2) AGGREGATE WAGES MUST INCREASE.—The

1 increase in wages taken into account under paragraph
2 (1) (B) of this subsection shall not exceed the increase
3 in wages taken into account for purposes of that portion
4 of the credit which is determined under subsections (a)
5 and (b) without regard to this subsection.
6 "(3) $40,000 LIMIT NOT APPLICABLE.—Nothing
7 in subsection (c) shall prevent the allowance of an
8 increase in credit resulting from the application of this
9 subsection.
10 "(e) UNEMPLOYMENT INSURANCE WAGES DE-
11 FINED.—For purposes of this subpart—
12 "(1) FUTA WAGES.—Except as otherwise pro-
13 vided in this subpart, the term 'unemployment insurance
14 wages' has the meaning given to the term 'wages' by
15 section 3306 (b), except that, in the case of amounts
16 paid during 1978, '$4,200' shall be substituted for
17 '$6,000' each place it appears in section 3306 (b).
18 "(2) AGRICULTURAL LABOR.—If the services per-
19 formed by any employee for an employer during more
20 than one-half of any pay period (within the meaning
21 of section 3306 (d)) taken into account with respect to
22 any calendar year constitute agricultural labor (within
23 the meaning of section 3306 (k)), the term 'unemploy-
24 ment insurance wages' means, with respect to the re-
25 muneration paid by the employer to such employee for
26 such year, an amount equal to so much of such remunera-

1 tion as constitutes 'wages' within the meaning of section
2 3121 (a), except that the contribution and benefit base
3 for each calendar year shall be deemed to be $4,200.
4 "(3) RAILWAY LABOR.—If more than one-half of
5 the remuneration paid by an employer to an employee
6 during the calendar year is remuneration for service
7 described in section 3306 (c) (9), the term 'unemploy-
8 ment insurance wages' means, with respect to such em-
9 ployee for such year, an amount equal to $\frac{7}{8}$ of so much
10 of the remuneration paid to such employee during such
11 year as is subject to contributions under section 8 (a)
12 of the Railroad Unemployment Insurance Act (45
13 U.S.C. 358 (a)).
14 "(4) VOCATIONAL REHABILITATION REFERRAL.—
15 "(A) IN GENERAL.—The term 'vocational
16 rehabilitation referral' means a handicapped individ-
17 ual who has been referred to the employer upon
18 completion of (or while receiving) rehabilitative
19 services pursuant to an individualized written re-
20 habilitation plan under a State plan for vocational
21 rehabilitation services approved under the Voca-
22 tional Rehabilitation Act.
23 "(B) HANDICAPPED INDIVIDUAL.—For pur-
24 poses of subparagraph (A), the term 'handicapped
25 individual' means any individual who has a physical

1 or mental disability which for such individual con-
2 stitutes or results in a substantial handicap to
3 employment.
4 "(f) RULES FOR APPLICATION OF SECTION.—For
5 purposes of this subpart—
6 "(1) REMUNERATION MUST BE FOR TRADE OR
7 BUSINESS EMPLOYMENT WITHIN UNITED STATES.—
8 Remuneration paid by an employer to an employee
9 during any calendar year shall be taken into account
10 only if more than one-half of the remuneration so paid
11 is for services performed in the United States in a trade
12 or business of the employer.
13 "(2) SPECIAL RULE FOR CERTAIN DETERMINA-
14 TIONS.—Any determination as to whether paragraph
15 (1) of this subsection, or paragraph (2) or (3) of sub-
16 section (e), applies with respect to any employee for
17 any calendar year shall be made without regard to any
18 dollar limitation and without regard to subsections (a)
19 and (b) of section 52.
20 "SEC. 52. SPECIAL RULES.
21 "(a) CONTROLLED GROUP OF CORPORATIONS.—For
22 purposes of this subpart, all employees of all corporations
23 which are members of the same controlled group of corpora-
24 tions shall be treated as employed by a single employer. In
25 any such case, the credit (if any) allowable by section 44B

1 to each such member shall be its proportionate contribution
2 to the increase in unemployment insurance wages giving
3 rise to such credit. For purposes of this subsection, the term
4 'controlled group of corporations' has the meaning given to
5 such term by section 1563 (a), except that—
6 "(1) 'more than 50 percent' shall be substituted
7 for 'at least 80 percent' each place it appears in section
8 1563 (a) (1), and
9 "(2) the determination shall be made without re-
10 gard to subsections (a) (4) and (e) (3) (C) of section
11 1563.
12 "(b) EMPLOYEES OF PARTNERSHIPS, PROPRIETOR-
13 SHIPS, ETC., WHICH ARE UNDER COMMON CONTROL.—
14 For purposes of this subpart, under regulations prescribed
15 by the Secretary—
16 "(1) all employees of trades or businesses (whether
17 or not incorporated) which are under common control
18 shall be treated as employed by a single employer, and
19 "(2) the credit (if any) allowable by section 44B
20 with respect to each trade or business shall be its pro-
21 portionate contribution to the increase in unemploy-
22 ment insurance wages giving rise to such credit.
23 The regulations prescribed under this subsection shall be
24 based on principles similar to the principles which apply in
25 the case of subsection (a).

1 "(c) ADJUSTMENTS FOR CERTAIN ACQUISITIONS,
2 ETC.—Under regulations prescribed by the Secretary—
3 "(1) ACQUISITIONS.—If, after December 31, 1975,
4 an employer acquires the major portion of a trade or
5 business of another person (hereinafter in this para-
6 graph referred to as the 'predecessor') or the major
7 portion of a separate unit of a trade or business of a
8 predecessor, then, for purposes of applying this subpart
9 for any calendar year ending after such acquisition, the
10 amount of unemployment insurance wages deemed paid
11 by the employer during periods before such acquisition
12 shall be increased by so much of such wages paid by
13 the predecessor with respect to the acquired trade or
14 business as is attributable to the portion of such trade
15 or business acquired by the employer.
16 "(2) DISPOSITIONS.—If, after December 31,
17 1975—
18 "(A) an employer disposes of the major por-
19 tion of any trade or business of the employer or the
20 major portion of a separate unit of a trade or busi-
21 ness of the employer in a transaction to which para-
22 graph (1) applies, and
23 "(B) the employer furnishes the acquiring
24 person such information as is necessary for the
25 application of paragraph (1),

86-032 O - 77 - 5

1 then, for purposes of applying this subpart for any
2 calendar year ending after such disposition, the amount
3 of unemployment insurance wages deemed paid by the
4 employer during periods before such disposition shall be
5 decreased by so much of such wages as is attributable
6 to such trade or business or separate unit.

7 "(d) TAX-EXEMPT ORGANIZATIONS.—No credit shall
8 be allowed under section 44B to any organization (other
9 than a cooperative described in section 521) which is exempt
10 from income tax under this chapter.

11 "(e) CERTAIN DISMISSALS.—If any employer dis-
12 misses any employee for the purpose of securing (or increas-
13 ing) a credit under section 44B for any taxable year, the
14 amount of the credit allowable under section 44B for such
15 year (determined without regard to this subsection) shall
16 be decreased by an amount equal to two times any increase
17 in such credit which would (but for this subsection) have
18 resulted in whole or in part by reason of such dismissal.

19 "(f) CHANGE IN STATUS FROM SELF-EMPLOYED TO
20 EMPLOYEE.—If—

21 "(1) during 1976 or 1977 an individual has net
22 earnings from self-employment (as defined in section
23 1402(a)) which are attributable to a trade or business,
24 and

1 "(2) for the succeeding calendar year such individ-
2 ual is an employee of such trade or business,
3 then, for purposes of determining the credit allowable for a
4 taxable year beginning in such succeeding calendar year,
5 the employer's aggregate unemployment insurance wages
6 for 1976 or 1977, as the case may be, shall be increased by
7 an amount equal to so much of the net earnings referred to in
8 paragraph (1) as does not exceed $4,200.
9 "(g) SUBCHAPTER S CORPORATIONS.—In the case of
10 an electing small business corporation (as defined in section
11 1371)—
12 "(1) the amount of the credit determined under
13 this subpart for any taxable year shall be apportioned
14 pro rata among the persons who are shareholders of such
15 corporation on the last day of such taxable year, and
16 "(2) any person to whom an amount is appor-
17 tioned under paragraph (1) shall be allowed, subject
18 to section 53, a credit under section 44B for such
19 amount.
20 "(h) ESTATES AND TRUSTS.—In the case of an estate
21 or trust—
22 "(1) the amount of the credit determined under
23 this subpart for any taxable year shall be apportioned
24 between the estate or trust and the beneficiaries on the

1 basis of the income of the estate or trust allocable to
2 each,
3 "(2) any beneficiary to whom any amount has
4 been apportioned under paragraph (1) shall be allowed,
5 subject to section 53, a credit under section 44B for
6 such amount, and
7 "(3) the $40,000 amount specified in section 51 (c)
8 applicable to such estate or trust shall be reduced to an
9 amount which bears the same ratio to $40,000 as the
10 portion of the credit allocable to the estate or trust under
11 paragraph (1) bears to the entire amount of such credit.
12 "(i) LIMITATIONS WITH RESPECT TO CERTAIN PER-
13 SONS.—Under regulations prescribed by the Secretary, in
14 the case of—
15 "(1) an organization to which section 593 (relat-
16 ing to reserves for losses on loans) applies,
17 "(2) a regulated investment company or a real
18 estate investment trust subject to taxation under sub-
19 chapter M (section 851 and following), and
20 "(3) a cooperative organization described in sec-
21 tion 1381 (a),
22 rules similar to the rules provided in section 46 (e) shall
23 apply in determining the amount of the credit under this
24 subpart.
25 "(j) $40,000 LIMITATION IN THE CASE OF MARRIED

1 INDIVIDUALS FILING SEPARATE RETURNS.—In the case
2 of a husband or wife who files a separate return, the limita-
3 tion under section 51 (c) shall be $20,000 in lieu of $40,000.
4 This subsection shall not apply if the spouse of the taxpayer
5 has no interest in a trade or business for the taxable year
6 of such spouse which ends within or with the taxpayer's
7 taxable year.

8 "(k) CERTAIN SHORT TAXABLE YEARS.—If the em-
9 ployer has more than one taxable year beginning in 1977
10 or 1978, the credit under this subpart shall be determined
11 for the employer's last taxable year beginning in 1977 or
12 1978, as the case may be.

13 **"SEC. 53. LIMITATION BASED ON AMOUNT OF TAX.**

14 "(a) GENERAL RULE.—Notwithstanding section 51,
15 the amount of the credit allowed by section 44B for the
16 taxable year shall not exceed the amount of the tax imposed
17 by this chapter for the taxable year, reduced by the sum of
18 the credits allowable under—

19 "(1) section 33 (relating to foreign tax credit),

20 "(2) section 37 (relating to credit for the elderly),

21 "(3) section 38 (relating to investment in certain
22 depreciable property),

23 "(4) section 40 (relating to expenses of work
24 incentive programs),

1 "(5) section 41 (relating to contributions to can-
2 didates for public office),
3 "(6) section 42 (relating to general tax credit),
4 and
5 "(7) section 44A (relating to expenses for house-
6 hold and dependent care services necessary for gainful
7 employment).
8 For purposes of this subsection, any tax imposed for the
9 taxable year by section 56 (relating to minimum tax for
10 tax preferences), section 72(m)(5)(B) (relating to 10
11 percent tax on premature distributions to owner-employees),
12 section 408(f) (relating to additional tax on income from
13 certain retirement accounts), section 402(e) (relating to
14 tax on lump-sum distributions), section 531 (relating to
15 accumulated earnings tax), section 541 (relating to personal
16 holding company tax), or section 1378 (relating to tax on
17 certain capital gains of subchapter S corporations), and
18 any additional tax imposed for the taxable year by section
19 1351(d)(1) (relating to recoveries of foreign expropriation
20 losses), shall not be considered tax imposed by this chapter
21 for such year.
22 "(b) SPECIAL RULE FOR PASS-THRU OF CREDIT.—
23 In the case of a partner in a partnership, a beneficiary of an
24 estate or trust, and a shareholder in a subchapter S corpora-
25 tion, the limitation provided by subsection (a) for the tax-

1 able year shall not exceed a limitation separately computed
2 with respect to such person's interest in such entity by taking
3 an amount which bears the same relationship to such limi-
4 tation as—
5 "(1) that portion of the person's adjusted gross
6 income which is attributable to the person's interest in
7 such entity, bears to
8 "(2) the person's adjusted gross income for such
9 year.
10 "(c) CARRYBACK AND CARRYOVER OF UNUSED
11 CREDIT.—
12 "(1) ALLOWANCE OF CREDIT.—If the amount of
13 the credit determined under section 51 for any taxable
14 year exceeds the limitation provided by subsection (a)
15 for such taxable year (hereinafter in this subsection
16 referred to as the 'unused credit year'), such excess
17 shall be—
18 "(A) a new employee credit carryback to each
19 of the 3 taxable years preceding the unused credit
20 year, and
21 "(B) a new employee credit carryover to each
22 of the 7 taxable years following the unused credit
23 year,
24 and shall be added to the amount allowable as a credit
25 by section 44B for such years. If any portion of such

1 excess is a carryback to a taxable year beginning before
2 January 1, 1977, section 44B shall be deemed to have
3 been in effect for such taxable year for purposes of
4 allowing such carryback as a credit under such section.
5 The entire amount of the unused credit for an unused
6 credit year shall be carried to the earliest of the 10 tax-
7 able years to which (by reason of subparagraphs (A)
8 and (B)) such credit may be carried, and then to each
9 of the other 9 taxable years to the extent that, because
10 of the limitation contained in paragraph (2), such un-
11 used credit may not be added for a prior taxable year to
12 which such unused credit may be carried.
13 "(2) LIMITATION.—The amount of the unused
14 credit which may be added under paragraph (1) for any
15 preceding or succeeding taxable year shall not exceed
16 the amount by which the limitation provided by sub-
17 section (a) for such taxable year exceeds the sum of—
18 "(A) the credit allowable under section 44B
19 for such taxable year, and
20 "(B) the amounts which, by reason of this sub-
21 section, are added to the amount allowable for such
22 taxable year and which are attributable to taxable
23 years preceding the unused credit year."
24 (c) TECHNICAL AND CONFORMING AMENDMENTS.—
25 (1) CLERICAL AMENDMENTS.—

1 (A) The table of sections for subpart A of part
2 IV of subchapter A of chapter 1 is amended by
3 inserting after the item relating to section 44A the
4 following new item:

"Sec. 44B. Credit for employment of certain new employees."

5 (B) The table of subparts for part IV of sub-
6 chapter A of chapter 1 is amended by adding at the
7 end thereof the following new item:

"Subpart D. Rules for computing credit for employment of certain new employees."

8 (2) MINIMUM TAX.—
9 (A) Section 56(c) (defining regular tax de-
10 duction) is amended by striking out "and" at the
11 end of paragraph (7), by striking out the period at
12 the end of paragraph (8) and inserting in lieu
13 thereof ", and", and by adding at the end thereof
14 the following new paragraph:
15 "(9) section 44B (relating to credit for employ-
16 ment of certain new employees)."
17 (B) Subparagraph (A) of section 56(c)(1)
18 (relating to tax carryover for timber) is amended—
19 (i) by striking out "and" at the end of
20 clause (ii),
21 (ii) by striking out "exceed" at the end of

1 clause (iii) and inserting in lieu thereof "and",
2 and
3 (iii) by inserting after clause (iii) the
4 following new clause:
5 "(iv) section 44B (relating to credit for
6 employment of certain new employees),
7 exceed".
8 (3) CORPORATE REORGANIZATIONS.—
9 (A) Subsection (c) of section 381 (relating
10 to items of the distributor or transferor corporation)
11 is amended by adding at the end thereof the follow-
12 ing new paragraph:
13 "(26) CREDIT UNDER SECTION 44B FOR EMPLOY-
14 MENT OF CERTAIN NEW EMPLOYEES.—The acquiring
15 corporation shall take into account (to the extent proper
16 to carry out the purposes of this section and section
17 44B, and under such regulations as may be prescribed
18 by the Secretary) the items required to be taken into
19 account for purposes of section 44B in respect of the
20 distributor or transferor corporation."
21 (B) Section 383 (relating to special limitations
22 on unused investment credits, work incentive pro-
23 gram credits, foreign taxes, and capital losses), as in
24 effect for taxable years beginning after June 30,
25 1978, is amended—

1 (i) by inserting "to any unused new em-
2 ployee credit of the corporation under section
3 53(c)," after "section 50A(b),"; and
4 (ii) by striking out "**WORK INCENTIVE**
5 **PROGRAM CREDITS,**" in the section heading
6 and inserting in lieu thereof "**WORK INCEN-**
7 **TIVE PROGRAM CREDITS, NEW EMPLOYEE**
8 **CREDITS,**".
9 (C) Section 383 (as in effect on the day before
10 the date of the enactment of the Tax Reform Act
11 of 1976) is amended—
12 (i) by inserting "to any unused new em-
13 ployee credit of the corporation which could
14 otherwise be carried forward under section
15 53(c)," after "section 50A(b),"; and
16 (ii) by striking out "**WORK INCENTIVE**
17 **PROGRAM CREDITS,**" in the section heading
18 and inserting in lieu thereof "**WORK INCEN-**
19 **TIVE PROGRAM CREDITS, NEW EMPLOYEE**
20 **CREDITS,**".
21 (D) The table of sections for part V of sub-
22 chapter C of chapter 1 is amended by striking out
23 "work incentive program credits," in the item re-
24 lating to section 383 and inserting in lieu thereof

1 "work incentive program credits, new employee
2 credits,".
3 (4) STATUTES OF LIMITATION AND INTEREST
4 RELATING TO NEW EMPLOYEE CREDIT CARRYBACK.—
5 (A) ASSESSMENT AND COLLECTION.—Sec-
6 tion 6501 (relating to limitation on assessment and
7 collection) is amended by adding at the end thereof
8 the following new subsection:
9 "(p) NEW EMPLOYEE CREDIT CARRYBACKS.—In the
10 case of a deficiency attributable to the application to the
11 taxpayer of a new employee credit carryback (including
12 deficiencies which may be assessed pursuant to the provi-
13 sions of section 6213(b)(3)), such deficiency may be
14 assessed at any time before the expiration of the period
15 within which a deficiency for the taxable year of the unused
16 new employee credit which results in such carryback may
17 be assessed, or, with respect to any portion of a new
18 employee credit carryback from a taxable year attributable
19 to a net operating loss carryback, an investment credit
20 carryback, a work incentive program credit carryback, or a
21 capital loss carryback from a subsequent taxable year, at any
22 time before the expiration of the period within which a
23 deficiency for such subsequent taxable year may be assessed."
24 (B) CREDIT OR REFUND.—Section 6511(d)
25 (relating to limitations on credit or refund) is

1 amended by adding at the end thereof the follow-
2 ing new paragraph:
3 "(9) SPECIAL PERIOD OF LIMITATION WITH
4 RESPECT TO NEW EMPLOYEE CREDIT CARRYBACKS.—
5 "(A) PERIOD OF LIMITATIONS.—If the claim
6 for credit or refund relates to an overpayment
7 attributable to a new employee credit carryback, in
8 lieu of the 3-year period of limitation prescribed
9 in subsection (a), the period shall be that period
10 which ends with the expiration of the 15th day of
11 the 40th month (or 39th month, in the case of a
12 corporation) following the end of the taxable year
13 of the unused new employee credit which results
14 in such carryback (or, with respect to any portion
15 of a new employee credit carryback from a taxable
16 year attributable to a net operating loss carry-
17 back, an investment credit carryback, a work in-
18 centive program credit carryback, or a capital loss
19 carryback from a subsequent taxable year, the pe-
20 riod shall be that period which ends with the
21 expiration of the 15th day of the 40th month, or
22 39th month, in the case of a corporation, following
23 the end of such taxable year) or the period prescribed
24 in subsection (c) in respect of such taxable year,
25 whichever expires later. In the case of such a claim,

1 the amount of the credit or refund may exceed the
2 portion of the tax paid within the period provided in
3 subsection (b) (2) or (c), whichever is applicable
4 to the extent of the amount of the overpayment
5 attributable to such carryback.

6 "(B) APPLICABLE RULES.—If the allowance
7 of a credit or refund of an overpayment of tax attrib-
8 utable to a new employee credit carryback is other-
9 wise prevented by the operation of any law or
10 rule of law other than section 7122, relating to com-
11 promises, such credit or refund may be allowed or
12 made, if claim therefor is filed within the period
13 provided in subparagraph (A) of this paragraph.
14 In the case of any such claim for credit or refund,
15 the determination by any court, including the Tax
16 Court, in any proceeding in which the decision of
17 the court has become final shall not be conclusive
18 with respect to the new employee credit, and
19 the effect of such credit, to the extent that such
20 credit is affected by a carryback which was not in
21 issue in such proceeding."

22 (C) INTEREST ON UNDERPAYMENTS.—Sec-
23 tion 6601(d) (relating to income tax reduced by
24 carryback or adjustment for certain unused deduc-

1 tions) is amended by adding at the end thereof the
2 following new paragraph:
3 (5) NEW EMPLOYEE CREDIT CARRYBACK.—If the
4 credit allowed by section 44B for any taxable year is
5 increased by reason of a new employee credit carryback,
6 such increase shall not affect the computation of interest
7 under this section for the period ending with the last day
8 of the taxable year in which the new employee credit
9 carryback arises, or, with respect to any portion of a
10 new employee credit carryback from a taxable year
11 attributable to a net operating loss carryback, an invest-
12 ment credit carryback, a work incentive program credit
13 carryback, or a capital loss carryback from a subsequent
14 taxable year, such increase shall not affect the computa-
15 tion of interest under this section for the period ending
16 with the last day of such subsequent taxable year."
17 (D) INTEREST ON OVERPAYMENTS.—Section
18 6611 (f) (relating to refund of income tax caused
19 by carryback or adjustment for certain unused
20 deductions) is amended by adding at the end thereof
21 the following new paragraph:
22 "(5) NEW EMPLOYEE CREDIT CARRYBACK.—For
23 purposes of subsection (a), if any overpayment of tax
24 imposed by subtitle A results from a new employee
25 credit carryback, such overpayment shall be deemed not

1 to have been made before the close of the taxable year
2 in which such new employee credit carryback arises, or,
3 with respect to any portion of a new employee credit
4 carryback from a taxable year attributable to a net oper-
5 ating loss carryback, an investment credit carryback, a
6 work incentive program credit carryback, or a capital
7 loss carryback from subsequent taxable year, such over-
8 payment shall be deemed not to have been made before
9 the close of such subsequent taxable year."
10 (5) TENTATIVE CARRYBACK ADJUSTMENTS.—
11 (A) APPLICATION FOR ADJUSTMENT.—Sec-
12 tion 6411 (relating to quick refunds in respect of
13 tentative carryback adjustments) is amended—
14 (i) by striking out "or unused work in-
15 centive program credit" each place it appears
16 in such section and inserting in lieu thereof
17 "unused work incentive program credit, or un-
18 used new employee credit",
19 (ii) by inserting after "section 50A (b),"
20 in the first sentence of subsection (a) "by a
21 new employee credit carryback provided in sec-
22 tion 53 (c),",
23 (iii) by striking out "or a work incentive
24 program carryback from" in the second sen-
25 tence of subsection (a) and inserting in lieu

1 thereof ", a work incentive program carryback,
2 or a new employee credit carryback from", and
3 (iv) by striking out "investment credit
4 carryback)" in the second sentence of subsec-
5 tion (a) and inserting in lieu thereof "invest-
6 ment credit carryback, or, in the case of a new
7 employee credit carryback, to an investment
8 credit carryback or a work incentive program
9 carryback)".
10 (B) TENTATIVE CARRYBACK ADJUSTMENT
11 ASSESSMENT PERIOD.—Section 6501 (m) (relating
12 to tentative carryback adjustment assessment
13 period) is amended—
14 (i) by striking out "or a work incentive
15 program carryback" and inserting in lieu
16 thereof "a work incentive program carryback,
17 or a new employee credit carryback", and
18 (ii) by striking out "(j), or (o)" each
19 place it appears and inserting in lieu thereof
20 "(j), (o), or (p)".
21 (6) DESIGNATION OF INCOME TAX PAYMENT.—
22 Section 6096 (b) (relating to designation of income tax
23 payments to Presidential Election Campaign Fund) is
24 amended by striking out "and 44A" and inserting in
25 lieu thereof "44A, and 44B".

86-032 O - 77 - 6

1 (d) EFFECTIVE DATE.—The amendments made by this
2 section shall apply to taxable years beginning after Decem-
3 ber 31, 1976, and to credit carrybacks from such years.

Passed the House of Representatives March 8, 1977.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

The CHAIRMAN. This morning we are hearing the administration witnesses: The Secretary of the Treasury, Mr. Michael Blumenthal, the Director of the Office of Management and Budget, Mr. Bert Lance, and the Chairman of the President's Council of Economic Advisers, Mr. Charles Shultze.

I will ask that these gentlemen be allowed to complete their statements before we begin interrogating them on those statements.

I see that Mr. Lance has now arrived. We are actually a moment or two ahead of time. I think we might as well go ahead and start, at least, with opening statements.

I will insert in the record at this point an opening statement of Senator Roth.

[The opening statement of Senator Roth follows:]

OPENING STATEMENT OF SENATOR WILLIAM V. ROTH, JR.

Mr. Chairman, and distinguished guests. If there is one clear message from this past November's election—both the Presidential election and my own re-election—it is that the American people want action to get this country moving again, and they do not want more politicals as usual.

The American people do not want bigger deficits, bigger government, or more government spending. They want a more efficient, more responsive Federal government, and they want the government to have a greater concern for the average working American taxpayer.

In all candor, the Administration's economic stimulus package, and even the Senate Republicans alternative package, represent nothing more than more politics as usual.

The Rube Goldberg package of $50 tax rebates and increased deficit spending on make-work public service jobs is a quick fix solution which provides a little for everyone and which will do very little to get our country moving again.

The higher energy prices, the increasing costs of government, and the crushing tax burden have slowed our country down, and the major challenge facing us today is to enact policies to create a buoyant economy for the 1970's and beyond.

A $50 rebate check and more government jobs will not inspire anyone's confidence in the future, and it will not inspire business to increase production and create permanent new jobs.

I believe it is essential that we take steps to restore the consumer's and businessman's confidence in the economy and the future, and we must reject easy government solutions and rely instead on the private sector which has served this country so well.

I believe we should reject the ineffective tax rebate gimmick and more government spending, and enact a permanent across-the-board reduction in both individual and business tax rates.

What I am proposing is the same solution President John F. Kennedy proposed, and Congress enacted, in the early 1960's to get the country moving again.

Jack Kennedy realized then, as we should realize now, that the heavy tax burden on our workers and businesses was primarily responsible for slow economic growth, reduced consumer purchasing power, and higher rates of unemployment. Now, as then, we need to take action to build confidence in the economy.

Although some fear that permanent tax cuts will result in massive revenues losses and erode the Federal revenue base, the Kennedy tax rate reductions proved that tax cut create more permanent tax-paying jobs, produce a greater increase in GNP, and expand the economy enough to produce more, not less, Federal revenues.

Permanent tax rate reductions will also provide tax relief to middle-income taxpayers, the most ignored men and women in America. The Administration's tax package, and the package approved by the House Ways and Means Committee provide virtually no relief to working middle-income taxpayers, and none at all to those who itemize their deductions. Working middle-class taxpayers, as well as lower-income families, deserve and need permanent tax relief.

A permanent tax cut will increase the incentives to produce, invest, and save. It will immediately increase every taxpayers' take-home pay, and it will increase business production and create permanent new jobs in the private sector.

The American people have been paying through the nose for bigger and bigger government, and neither the Administration nor the Congress seem to understand the squeeze the heavy tax burden is putting on the American people.

The Administration has said that permanent tax relief proposals will be submitted later on. But I believe that now is the time for the Federal Government to pay its debt to the American people—not with a $50 rebate check, but with substantial and permanent income tax reductions.

This is what President Kennedy did in the early 1960's, and it is what I intend to fight for both in the Senate Finance Committee and on the Senate floor.

The CHAIRMAN. Mr. Lance, I would be pleased to hear from you, if you care to deliver your opening statement.

STATEMENT OF THOMAS BERTRAM LANCE, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

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

I have prepared a statement for you. I don't know if you have had a chance to read it or not.

I think most of the information contained in it is well known to the members of the committee. In the interest of saving your time, unless you particularly want me to read it, I will make a few broad comments on it. I would be glad to read it, whichever way you prefer it.

The CHAIRMAN. Would you summarize the statement.

Mr. LANCE. All right, sir. Of course, I am delighted to have this opportunity this morning for my first appearance before this committee.

This committee and the work connected thereto is extremely important to the budget process and to the conduct of effective economic policy.

I welcome this opportunity to discuss with you President Carter's budget revisions and the stimulus package. Mr. Schultze will discuss the general economic situation, and the need for stimulus. Secretary Blumenthal will discuss the specifics of the tax proposals, the international economy, and credit markets. I will just confine myself to providing a broad background, and to provide some information on how the stimulation package and the tax proposals relate to the budget as a whole.

The stimulus package was designed to give the economy a strong steady boost, and to begin quickly. In that connection, I think it would be a grave mistake to delay the passage of the sorely needed stimulus measures by attempting to make them carry the burden of rectifying tax structure deficiencies that are less pressing than the national economic problem.

As you gentlemen know, we are slowly emerging from the worst recession in the last 40 years. For the past 2 years, the national unemployment rate has been higher than at any other time since the great depression of the 1930's. The stimulus package would help speed the movement toward a healthy economy.

A few refinements have been made in the stimulus package recommendations since they were originally presented.

First, we would like to see the additional countercyclical revenue sharing begin in April. This will require slightly higher funding than we had originally proposed.

Second, we have proposed changes in the standard deduction to a flat $2,200 for single persons, and $3,000 for joint returns.

The tax proposals reduce 1977 receipts by $10.6 billion, and 1978 receipts by $7.9 billion. In addition to the economic stimulus package, we are proposing extension of the temporary tax reductions that would otherwise expire. Without this extension, 1978 receipts will be increased by $7.8 billion.

We believe that the President's stimulus package will give us a better rate of economic growth than would otherwise occur, so that by the end of the year, real output of goods and services will be increasing by an annual rate of about 6 percent. This, of course, will help bring down the unemployment rate.

President Carter will be working with Congress on major tax reform. That is an important reason why most of the stimulus package that we have presented to you is temporary.

As I noted earlier, we need to act on getting the economy moving, but we need time to work out the details of tax reform.

We have also tried to take a similar approach in reviewing much of the budget. That is, in cases where we believe that serious problems would result from the recommendations of the previous administration, our recommendation tends to remove those features. At the same time, we are trying to reserve the flexibility for the future when we will have more time to develop program alternatives.

While we have had to build on President Ford's budget, the changes we have made are significant, as I think you can see from our brief document on budget revisions.

The revisions to the budget have added $6.2 billion to 1977 outlays, and $19.4 billion to 1978 outlays.

It is important to note that the unified budget, deficit budget drops by over $10 billion between 1977 and 1978. We, of course, will need to speed up the rate of decrease in order to meet our goal of a balanced budget by 1981. At the same time, we need to get the economy moving. That is essential to achieving a balanced budget.

In the defense area, to cover a few changes in our budgetary request, our budget revisions reduce the budget authority requested for 1978 by nearly $3 billion. In most cases, we are slowing down the rate of planned activity, or we are putting off the start of new activity, so that we can make sure that the defense programs are essential to national security. We have also recommended some initial efficiency moves that will save money, but will not impair the effectiveness of our national defense.

Some changes are being proposed in areas of special interest to the committee. In health care, we face a very serious problem of inflation. Therefore, the budget proposes a nationwide program to hold down the rate of inflation in hospital costs. Also, we are proposing a new comprehensive child health care program.

The previous administration recommended an increase in social security taxes. We do not agree with that proposal. We are beginning an intensive study to see what steps should be taken to maintain a sound social security system.

The previous administration also proposed cutting back the food stamp program, and to convert the child nutrition program into block grants for States, with sharply reduced funding. We will be looking into those areas with a view to finding improvements. However, we do not support the proposals advanced by the previous administration.

The revised budget proposed by this administration provides for outlays for grants-in-aid to State and local governments of $72.4 billion in 1977, and $81.7 billion in 1978, $2 billion and $10 billion, respectively, higher than was proposed in the January budget. The recommended amount for 1978 is 38 percent higher than the $59 billion spent in 1976.

The document we sent to Congress on February 22 is intended to meet the needs of congressional committees as they prepare their recommendations to the budget committees in the House and the Senate.

We have tried to live within the congressional schedules that we have to live with, and I might add that we have tried to make the revisions to the budget as quickly as possible. It has been very difficult to deal with these revisions in such a short period of time.

One further comment, Mr. Chairman. I feel that there has been a great deal of discussion about the inflationary implications of the budget revisions and the stimulus package as proposed by President Carter.

I simply would like to say that in my opinion, and in the opinion of my colleagues, we feel strongly that the inflationary implications under the present circumstances of the economy today are much different from when administrations made this sort of proposal in the past.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, sir.

[The prepared statement of Mr. Lance follows:]

STATEMENT OF BERT LANCE, DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

Mr. Chairman and Members of the Committee: I am very pleased to be here this morning for my first appearance before this committee. The work of this committee is extremely important to the budget process and to the conduct of effective economic policy. We therefore welcome the opportunity to discuss with you President Carter's budget revisions and stimulus package.

Our individual areas of specialization of responsibility suggest that Chairman Schultze discuss the general economic situation and the need for stimulus, that Secretary Blumenthal discuss the specifics of the tax proposals, the international economy, and credit markets, and that I confine myself to providing some background on the budget and on how the stimulus package and the tax proposals relate to the budget as a whole.

Our stimulus package is designed to give the economy a strong, steady boost, and to begin quickly. It was designed in such a way that it would not tie our hands or limit our future options with respect to tax reform. It was not designed to solve all the complex problems of equity and tax incentives that comprehensive tax reform must address. I think it would be a grave mistake to delay the passage of these sorely-needed stimulus measures by attempting to make them carry the burden of rectifying tax structure deficiencies that are less pressing than the national economic problem.

We are slowly emerging from the worst recession of the last 40 years. For the past two years the national unemployment rate has been higher than at any other time since the Great Depression of the 1930's. The stimulus package would help speed the movement toward a healthy economy.

Having said this much about the need for timely action on stimulus, let me turn to brief summaries of the stimulus package and of overall fiscal context set by our revised budget. The major items in the stimulus package are $50 per person in tax rebates and payments, business tax incentives, accelerated public works, expanded public service employment and job training programs, and expanded countercyclical revenue sharing.

A few refinements have been made in the stimulus package recommendations since they were originally presented. First, we would like to see the additional countercyclical revenue sharing begin in April, and this will require slightly higher funding than we had originally proposed. Secondly, we have proposed changing the standard deduction to a flat $2,200 for single persons and $3,000 for joint returns. Our initial proposal was for a $2,400 flat deduction for single people and $2,800 for married couples.

The tax proposals reduce 1977 receipts by $10.6 billion and 1978 receipts by $7.9 billion. In addition to the economic stimulus package, we are proposing extension of the temporary tax reductions that would otherwise expire. Without this extension, 1978 receipts would be increased by $7.8 billion.

We believe that the President's stimulus package will give us a better rate of economic growth than would otherwise occur, so that by the end of the year real output of goods and services will be increasing at an annual rate of about 6%. This, of course, will help to bring down the unemployment rate. Both real economic growth and the decline in unemployment are somewhat greater than forecast in the January budget, while the inflation forecast is virtually identical.

The forecast does not reflect the effects of the severe cold weather recently experienced in part of our country, or of continued drought in the West. When the effects of the weather can be more accurately estimated, the economic outlook will be reassessed. It now appears, however, that the overall adverse effects of the severe cold weather will be relatively moderate and temporary, and that real economic activity by the end of the fourth quarter of this calendar year will have recovered nearly all the ground lost due to the cold weather. Moreover, generalized fiscal stimulus is likely to be of little help in re-opening a plant that was shut down because supplies and raw materials were ice-bound hundreds of miles away, or needed natural gas supplies are not available, or irrigation water supplies or hydroelectric power are not available. To the extent something can be done about weather-created economic dislocations, we need specific targeted measures, not generalized stimulus, to deal with the problems.

President Carter will be working with the Congress on major tax reform. That is an important reason why most of the stimulus package is temporary. As I noted earlier, we need to act now on getting the economy moving, but we need time to work out the details of tax reform.

We have tried to take a similar approach in reviewing much of the budget. That is, in cases where we believe that serious problems would result from the recommendations of the previous administration, our recommendations remove those features. At the same time, we are trying to reserve the flexibility for the future when we will have more time to develop program alternatives.

While we had to build on President Ford's budget, the changes we have made are significant, as I think you can see from our brief document on budget revisions.

The revisions to the budget have added $6.2 billion to 1977 outlays and $19.4 billion to 1978 outlays. I would like, if I may Mr. Chairman, to place in the record at this point a table that shows the major categories of increases.

BUDGET OUTLAY REVISIONS

[Fiscal years; in billions of dollars]

	1977	1978
Fiscal stimulus	5.1	8.0
Restorations:		
For fiscal stimilus programs	.2	2.8
For other programs	1.4	5.0
Initiatives and program changes (net)	.2	2.6
Reestimates	–.7	1.0
Total revisions	6.2	19.4

It is important to note that the unified budget deficit drops by over $10 billion between 1977 and 1978. We will need to speed up the rate of decrease in order to meet our goal of a balanced budget by 1981. At the same time we need to get the economy moving. That is essential to achieving a balanced budget.

Last year there was considerable concern about shortfalls of Federal outlays from the levels originally estimated. There was an $8 billion underrun in fiscal year 1976 and a $3½ billion underrun in the transition quarter. President Carter indicated in his budget revisions document that experience to date suggests that fiscal year 1977 outlay estimates may be too high in some instances. As the President promised, we are making a detailed review of expenditure underruns and will inform the Congress as to the results of that review. A persistent underrun of outlays would tend of course to offset some of the stimulus package.

In the Defense area our budget revisions reduce the budget authority requested for 1978 by nearly $3 billion. In most cases, we are slowing down the rate of planned activity or we are putting off the start of new activity, so that we can make sure that the defense programs we support are essential to national security. We have also recommended some initial efficiency moves that will save money but not impair the effectiveness of our national defense.

Some changes are being proposed in areas of special interest to this Committee. For example, in health care we face a very serious problem of inflation. Therefore, the budget proposes a nationwide program to hold down the rate of inflation in hospital costs. We are also proposing a new comprehensive child health care program.

The previous administration recommended an increase in social security taxes. We do not agree with that proposal, but we are beginning an intensive study to see what steps need to be taken to maintain a sound social security system.

The previous administration also proposed cutting back the food stamp program and converting the child nutrition program into block grants for States, with sharply reduced funding. We will be looking into these areas with a view to finding improvements. However, we do not support the proposals advanced by the previous administration.

The revised budget proposed by this Administration provides for outlays for grants-in-aid to the State and local governments of $72.4 billion in 1977 and $81.7 billion in 1978, $2 billion and $10 billion, respectively, higher than was proposed in the January budget. The recommended amount for 1978 is 38 percent higher than the $59 billion spent in 1976. Much of the increase in grant-in-aid outlays is for temporary fiscal stimulus, which explains a large part of their dramatic expansion in 1977 and 1978.

The document we sent to Congress on February 22 is intended to meet the needs of congressional committees as they prepare their recommendations to the Budget Committees in the House and in the Senate. Their recommendations are due on March 15 and we thought that they would like to have President Carter's views on the budget so that they could consider them as they develop their own ideas. The document is supported by a large amount of detail that we have not tried to print. Additional material has been sent to the Congress, including specific appropriation language for virtually all of the proposed changes.

There is a great deal that we would like to do in the future that we have not been able to do in this budget revision. We are going to start zero base budget reviews. We are going to reorganize the Government. We are going to reform the tax structure. Thus, our revisions represent only a beginning of our substantive efforts to improve the Federal Government. We think and we hope we have corrected the major shortcomings in the budget as proposed in January, and that we have set forth the appropriate fiscal policy.

Mr. Chairman, I would be pleased to answer your questions.

The CHAIRMAN. Now we will hear the statement of Charles Schultze, chairman of the Council of Economic Advisers.

STATEMENT OF CHARLES L. SCHULTZE, CHAIRMAN OF THE PRESIDENT'S COUNCIL OF ECONOMIC ADVISERS

Mr. SCHULTZE. In talking about the President's proposal for economic stimulus and, in particular, how the tax reduction and reform components fit into an overall economic strategy, what I would probably do is ask that my statement be submitted for the record, and I will read just selected parts of it to allow more time for questioning.

If you would like to follow along, I am going to start at the top of page 3 of my statement.

The CHAIRMAN. If you would tell us, from time to time, where you skip, that would help.

Mr. SCHULTZE. In designing the economic program that the President has presented in the 1978 budget revisions which have just been presented, the administration followed a number of principles. Let me outline those principles.

First, the economic policy has to be sufficiently expansive to put millions of Americans into productive jobs. It should take effect quickly, but with over 7 million people unemployed, the need is now.

Second, that economic recovery must be durable enough to convince business firms that the future holds expanding markets because that is a prerequisite to increased spending by industry on new plants and machinery.

Third, at the same time, the economic stimulus policies have to be designed cautiously. We can't afford to bump up against the limits of capacity. And our policies must not put such pressure on capital markets. That rapidly rising interest rates on investments shut off the very expansion which we are trying to accomplish.

Fourth, economic and budgetary policies have to be so designed that they will reduce the budget deficit steadily, and finally, eliminate that deficit as the economy approaches high levels of employment and output. This is an essential ingredient to the goal of ending the inflation.

For that reason, we think that the fiscal stimulus in the 1977 and 1978 budget should be programed now so as to phase out as we move into 1979 and beyond.

It is always easier to provide more stimulus later, should that prove necessary, than to run the risk of overcommitment now.

These are tough standards, but they are the only responsible ones in the present environment.

While no package of proposals is ever perfect, we believe that the President's fiscal program meets these varied criteria.

It is a 2-year program that will inject $15.5 billion of stimulus in 1977, and slightly over $15.5 billion in 1978. The stimulus in the first year will have to come from the tax rebate and other payments which will mean an immediate lift of new consumer spending in the economy.

On the other hand, the composition of this stimulus changes from emphasis on the tax rebate this year to emphasis on direct employment-creating programs next year.

As the economy improves, in turn, in 1978 and beyond, most of these stimulus programs are designed to be broadly phased out, and finally, the budget deficit is scheduled to decline in 1978, and the groundwork is laid for a continued decline in 1979 and thereafter.

What goals for output and employment are we looking at with this economic stimulus? Without some such stimulus, the real gross national product, in our judgment, would have grown between the fourth quarter of 1976 and the fourth quarter of 1977 by only about 4.5 to 4.75 percent, too little to make a significant dent in unemployment that drags so heavily on the economy.

With the economic stimulus program, on the other hand, the growth rate should rise to maybe 4.75 to 6 percent. Growth should continue in 1978.

We expect the overall rate of unemployment to drop into the 6.75- to 7-percent range by the end of 1977, and to be down close to 6 percent by the end of 1978.

To set in motion a self-sustaining rise in output and employment in the economy, the initial increases in consumer and public spending made possible by the stimulus must be followed by a rise in spending on plant and equipment by business firms.

To date, investment spending by business in this recovery has been weak. In the fourth quarter of 1976, business investment in real terms was running 12 percent below the peak achieved in early 1974.

While there are many factors which explain the lagging performance, one of them is the continuing high level of unutilized capacity.

The growth in business sales, and markets which the economic stimulus will produce should reduce that unutilized capacity and provide support for a larger expansion of investment spending.

Let me turn to the top of page 8. I would like to turn now to two aspects of the tax proposals in the stimulus package that are particularly important for meeting our overall economic goals.

The first of these is the rebate that is the centerpiece of our first-year stimulus proposals. The need for the stimulus to economic activity that shall be provided by the rebate has not been lessened by the improved performance of the economy over the past several months.

Even at the time the stimulus package was formulated, our view was that the economy would emerge from the pause largely on its own, and it has. But economic growth in 1977 will not be sufficient to make a significant dent in the unemployment rate without the additional fiscal stimulus.

The rebate will make a welcome addition to consumer purchasing power this year.

Because of the cold weather, consumer fuel bills will be from $2 billion to $4 billion larger than last year. The moderating effect of this drain of purchasing power on consumer spending for goods and services other than fuel is going to be small but not insignificant.

Furthermore, in the fourth quarter of last year, consumers, as a whole, used 94.4 percent of their after-tax income for current spending, and saved only 5.5 percent. This is a relatively low saving rate by the standards of recent years.

Not since 1969 has the personal saving rate been that low for any full year. Part of this year's increase in disposable income, therefore,

will probably be absorbed by a rise in the saving rate to more normal levels.

For this reason, the strengthening of consumer markets that will stem from the rebate will be desirable.

A tax rebate is the best option for simulating economic activity at the present time for several reasons. First, its effects are relatively certain.

The 1975 experience indicates that the rebate will boost consumer spending strongly. Because their confidence has improved since 1975, consumers may buy all the services that they have available. Consumers may actually spend a larger fraction of the rebate on goods and services this year than they did 2 years ago. They did spend a large fraction.

Second, the rebate will work quickly. Judging by the 1975 experience, if those rebate checks are sent out during the second quarter, a large part of their effect on consumer spending will occur during the spring and summer months.

On the other hand, job programs, while they play an important role in our overall fiscal strategy, cannot be brought onstream quickly.

Large public works programs would also be hard to start up quickly, and they would be equally hard to shut down later, when fiscal stimulus may no longer be needed.

At the end of 1976, the total national output was 3 percent above the prerecession peak. Business investment, on the other hand, was 12 percent its prerecession peak.

It is just the proposal, unless we have some specific employment ideas, that is, particular plans to grant extra tax credit with certain additional provisions and restrictions; the primary restriction in the proposal.

I think at this stage, Mr. Chairman, it would be best if I would cease, and let Secretary Blumenthal go ahead, and leave time for questions.

The CHAIRMAN. Do you have a statement? It might perhaps be best to include your statement. How much more time will you take? We were going to hear all three and then have all three answer questions.

Mr. SCHULTZE. All right, sir. I will go on, kind of skipping.

Let's ask whether the economic stimulus program and the 1977 and 1978 budgets are about the right size. The administration asks are they about the right size. It is, obviously, an important question for the committee.

Last month, worries were expressed in some quarters that the economic stimulus program was too small in view of the setback which the economy suffered from the cold weather and natural gas shortage. We have looked at this question pretty carefully.

Now, while some people have worried about the stimulus program being too small, others have worried about it being too large. The national economy growth rates in the 5- to 6-percent range over the next 2 years will not, in my judgment, put significant upward pressures on costs or prices.

As estimated by the outgoing National Council of Economic Advisers, the Nation's gross national product would have been about $135 billion larger.

This year, the amount of lost output will be less, but there will still be a gap of over $100 billion between actual and potential output. By 1978, the gap will diminish further, to the neighborhood of $75 billion, valued at today's prices. We will not be pressing anywhere against the economy's limits. Labor markets are not tight.

I would also like to comment on the 2 percentage point increase in the investment tax credit that the administration has proposed. Here, again, we are convinced that an inducement to business to purchase new plants and equipme[illegible] necessary.

Put simply, there is [illegible] the administration and the Congress can meet our join[illegible] long-run economic and budgetary goals without a strong and sustained recovery in business capital outlays.

There is no way that the Federal budget can be balanced by 1981 unless the private economy recovers very strongly. There simply will not be enough Federal revenues to cover ongoing programs and finance high priority initiatives unless economic growth produces a rising tax base.

Recent studies by the Congressional Budget Office study confirm this. Similarly, there is no way that unemployment can be steadily reduced without a strong private economy.

We cannot rely for employment increases on ever-expanding governmental hiring programs. Ultimately, five out of six new jobs have to come in the private sector.

In turn, it is going to be impossible to get strong sustained advances in the private economy without a sharp pickup in business investment in plant and equipment.

Investment is the most laggard sector in the economy. At the end of 1976, total national output, gross national product, was above the 1973 prerecession peak; business investment, on the other hand, was 12 percent below its prerecession peak.

The House Ways and Means Committee has voted to replace our proposal for business tax relief with an employment related tax credit. We are opposed to this plan for a number of reasons.

First, while a 2 percentage point increase in the investment tax credit won't do the job alone, obviously, it will contribute to an expansion in business investment, particularly as we go into 1978 when sales and markets ought to be expanding from the impact of the other parts of the economic program.

Second, rejection of the investment incentive included in the administration's package will send out a very discouraging signal to businessmen, that out of a $15.5 billion per year stimulus program, the Congress and the administration would not devote even a small amount to investment incentives.

We also have some specific concerns about the Ways and Means proposal. That plan would grant a tax credit equal to 40 percent of the first $4,200 paid to each new employee hired this year and next.

The primary restriction in the proposal is a maximum credit of $40,000 per company, which makes this proposal principally useful to small businesses.

This proposal has several very important drawbacks. It will not stimulate substantial additional employment. It is of little significance to large firms. And small firms will not generally hire additional work-

ers even with the credit unless they can sell the added goods or services the new workers produce.

We will put in a structural measure to increase the skills and improve the employment of the disadvantaged, if necessary, of the labor market from which employers can draw to meet the supply requirements of an extended recovery.

But the credit does not contribute to expanding sales or markets. It does provide additional cash for those small firms which already have strongly expanding markets, or are located in rapidly growing communities.

But it does nothing for those firms which need assistance most, those whose markets are declining or growing very slowly.

We have looked carefully at this question. Generally speaking, our conclusions are optimistic. Undoubtedly, production lost as a result of the cold will mean a somewhat slower rate of growth in gross national product in the first 3 months of 1977 than otherwise would have taken place.

Real output will rise appreciably this quarter, but its level will be below earlier expectation, but those losses are not permanent.

The rate of growth in the second quarter will probably be somewhat higher than otherwise expected as production losses associated with the cold snap are made up.

On balance, we expect the production loss to be fully recovered before the end of the year.

The U.S. economy today is performing well below its potential. If our labor and our capital stock had been fully employed last year, as conservatively estimated by the outgoing Council of Economic Advisers, the Nation's GNP, valued at today's prices, would have been about $135 billion larger.

Labor markets are not tight. Over 7 million Americans are out of work. Some of them are the structurally unemployed who have a difficult time finding a job even in periods of prosperity.

But others are experienced wage and salary workers who are out of work because the recovery has not been strong enough to provide them jobs.

Even if the recovery outperforms our expectations over the next 2 years, labor markets won't be tight. And as employment rises during the recovery, we will also be putting into place structural measures to increase the skills and improve the employability of disadvantaged workers, thereby expanding the effective labor market from which employers can draw to meet the supply requirements of an extended recovery.

In 1973, part of the upsurge of inflation resulted from bottlenecks and scarcities of raw materials. Today, the overall capacity utilization among firms producing industrial materials is about 80 percent. Twenty percent of the plants are idle.

If the recovery proceeds according to our expectations, capacity utilization in these key industries will be about 85 to 87 percent at the end of 1978, still well below the 93 percent reached in 1973.

Moreover, there is ample productive capacity worldwide. When the economy was experiencing accelerating inflation in 1973 and 1974, the entire industrial world was roaring along the same upward track.

Today recoveries in other nations are faltering or progressing more slowly than our own. Thus, there is ample room for consumers and businesses to obtain goods from abroad as well as from domestic sources.

Measures of gross national product relative to its potential, a measure of labor market tightness, and a measure of raw material availability all strongly indicate that the economic recovery program as set forth in the 1977 and 1978 budgets will not be inflationary.

But this administration is concerned not only with avoiding any new inflation, but also in promoting policies that will reduce the inflation we now have.

Given the upward march of costs and prices that we have inherited, and the outlook for food prices over the next year, this will not be an easy task nor one that can bring instantaneous results. But we have to begin.

At the present time, we are putting together the elements of a many-faceted anti-inflation program. It will have to consist of a number of elements.

Our chief reliance will have to be on fiscal and monetary policies that avoid excess demand and provide for a continuing and steady return to a balanced budget.

A continuing attention will be needed on the part of the Government to the potential price-and-cost-raising effects of its own actions in the field of international trade, agricultural policy, and regulatory measures, and the like.

An early warning system will be developed to review the demand-supply situation in critical areas and provide the framework for recommending corrective steps wherever possible.

A set of arrangements will have to be devised where the Government can discuss with business and labor leaders, on a voluntary basis, the potential impact on inflation and unemployment of major wage and price actions.

We all know that bringing down the rate of inflation will be a very difficult task. Obviously, it will not be easy.

But this administration does not believe that the goals of high employment and price stability are incompatible. Indeed, we recognize that sustained prosperity will not be achieved unless we can bring inflation under better control. This task cannot be accomplished by Government alone.

The Federal Government can play a role, but it cannot do the job without the active cooperation of the American people.

[The prepared statement of Mr. Schultze follows:]

PREPARED TESTIMONY OF CHARLES L. SCHULTZE, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. Chairman and members of the committee, I am very pleased to join you today to discuss the President's proposals for economic stimulus and, in particular, how the tax reduction and reform components fit into an overall economic strategy.

Let me say at the outset that this Administration is committed to promoting more vigorous economic expansion and to reducing unemployment. Let me also assure you that the Administration is equally committed to a course of policy that will bring an end to the inflation that is still troubling our economy.

In my testimony today, I would like to outline the economic strategy that underlies the President's stimulus program, and the goals he has set for the economy. The course of fiscal policy recommended by the President is, I believe, the right one to achieve our national economic goals—both in the near term and over the longer run.

STRATEGY AND GOALS

The development of an overall economic policy requires balancing competing objectives and needs. Certainly that has been true in the formulation of these budget proposals. We have recognized from the outset that the American economy is fundamentally sound and strong, but that it is also doubly troubled—by an erratic recovery and by persistent inflation. Fiscal policy must give appropriate weight to both of those problems. In designing its economic program and its 1978 budget revisions the Administration adhered to the following principles:

1. Policy must be sufficiently expansive to put millions of Americans into productive jobs, and it must take effect quickly, for the need is immediate.
2. The recovery must be durable enough to convince business firms that the future holds expanding markets—a prerequisite to increased spending by industry on new plants and machinery.
3. At the same time, stimulative policies must be designed cautiously. We cannot afford to bump up against the limits of capacity. And our policies must not put such pressure on capital markets that skyrocketing interest rates shut off the very expansion we are trying to accomplish.
4. Economic and budgetary policy must be so designed as to reduce budget deficits steadily, and finally eliminate them, as the economy approaches high levels of employment and output. This is an essential ingredient to the goal of ending inflation.

For that reason we think that the fiscal stimulus in the 1977 and 1978 budget should be programmed now so as to phase out as we move into 1979 and beyond. It is always easier to provide more stimulus later, should that prove necessary, than to run the risk of overcommitment now.

Those are tough standards, but they are the only responsible ones in the present environment. While no package of proposals is ever perfect, we believe the President's fiscal program meets these varied criteria.

It is a two-year program that will inject $15.5 billion of stimulus in fiscal 1977, and other $15.7 billion in 1978.

The first-year stimulus will come from the tax rebate and other payments that will mean an immediate lift of new consumer spending in the economy.

The composition of the stimulus changes from emphasis on the tax rebate in fiscal 1977 to emphasis on direct employment-creating programs in 1978.

As the economy improves, most of the stimulus programs are designed to be phased out.

The budget deficit is scheduled to decline in 1978 and the groundwork is laid for a continued decline in 1979 and thereafter.

GOALS FOR OUTPUT AND EMPLOYMENT

Without stimulus, the real gross national product would have grown between the fourth quarter of 1976 and the fourth quarter of 1977 by only 4½ to 4¾ percent—too little to make a significant dent in the unemployment that drags so heavily on the economy. With the economic stimulus program, that growth rate should be 5¾ to 6 percent, and growth should continue into 1978. Real GNP in the final quarter of 1978 should be 5 to 5½ percent above the year earlier. Increases in GNP of that magnitude should have a sizable impact on unemployment. We expect the overall rate of unemployment to drop into the 6¾ to 7 percent range by the end of 1977, and to be down close to 6 percent by the end of 1978.

To set in motion a self-sustaining rise in output and employment, the initial increases in consumer and public spending must be followed by a rise in spending on plant and equipment by business firms. To date, investment spending by business in this recovery has been weak. In the fourth quarter of 1976, business investment in real terms was running 12 percent below the peak achieved in early 1974. While there are many factors which explain this lagging performance, one of them is the continuing high level of unutilized capacity. The growth

in business sales and markets which the economic stimulus will produce should reduce the unutilized capacity and provide support for a larger expansion of investment spending.

There are a few early signs that the acceleration in investment spending we are hoping for will materialize. In the fourth quarter of last year, capital appropriations of manufacturing firms rose sharply. A recent private survey of business plans to spend on new plant and equipment this year reported an overall increase of 15 percent over 1976—up from the 13 percent rise business firms were planning last November. And new orders for non-defense capital goods placed in December and January were 28 percent above orders in the same months of the previous year. Even after inflation is factored out, the rise is still over 20 percent.

I would like to turn now to two aspects of the tax proposals in the stimulus package that are particularly important for meeting our overall economic goals.

The first is the rebate that is the centerpiece of our first-year stimulus proposals.

The need for the stimulus to economic activity that will be provided by the rebate has not been lessened by the improved performance of the economy over the past several months. Even at the time the stimulus package was formulated, our view was that the economy would emerge from the pause largely on its own, and it has. But economic growth in 1977 will not be sufficient to make a significant dent in the unemployment rate without additional fiscal stimulus.

The rebate will make a welcome addition to consumer purchasing power this year. Because of the cold weather, consumer fuel bills will be from $2 to $4 billion larger than last year. The moderating effect of this drain of purchasing power on consumer spending for goods and services other than fuel will be small but not insignificant. Furthermore, in the fourth quarter of last year, consumers as a whole used 94.4 percent of their after-tax income for current outlays, and saved only 5.6 percent. This is a relatively low saing rate by the standards of recent years. Not since 1969 has the personal saving rate been that low for any full year. Part of this year's increase in disposable income, therefore, will probably be absorbed by a rise in the saving rate to more normal levels. For this reason, too, the strengthening of consumer markets that will stem from the rebate will be desirable.

A tax rebate is the best option open for stimulating economic activity at the present time for several reasons. First, its effects are relatively certain. The 1975 experience indicates that the rebate will boost consumer spending strongly. Because their confidence has improved since 1975, consumers may actually spend a larger fraction of the rebate on goods and services this year than they did two years ago.

Second, the rebate will work quickly, judging by the 1975 experience, if the rebate checks are sent out during the second quarter, a large part of their effects on consumer spending will occur during the spring and summer months.

On the other hand, jobs programs—while they play an important role in our overall fiscal strategy—cannot be brought on stream quickly. Larger public works programs would also be hard to start up quickly, and they would be equally hard to shut down later—when fiscal stimulus may no longer be needed.

I would also like to comment on the 2 percentage point increase in the investment tax credit that the Administration has proposed. Here again, we are convinced that an inducement to business to purchase new plants and equipment is very necessary.

Put simply, there is no way that the Administration and the Congress can meet our long-term economic and budgetary goals without a strong and sustained recovery in business capital outlays. There is no way that the federal budget can be balanced by 1981 unless the private economy recovers very strongly. There will not be enough Federal revenues to cover ongoing programs and finance high priority initiatives unless economic growth produces a rising tax base. Recent studies by the Congressional Budget Office study confirm this. Similarly, there is no way that unemployment can be steadily reduced without a strong private economy. We cannot rely for employment increases on ever-expanding governmental hiring programs. Ultimately 5 out of 6 new jobs have to come in the private sector.

In turn, it will be impossible to get strong sustained advances in the private economy without a sharp pickup in business investment in plant and equipment. Investment is the most laggard sector in the economy. At the end of 1976 total national output (GNP) was 3 percent above the 1973 pre-recession peak; business investment, on the other hand, was 12 percent below its pre-recession peak.

The House Ways and Means Committee has voted to replace our proposal for business tax relief with an employment related tax credit. We are opposed to this plan for a number of reasons.

First, while a 2 percentage point increase in the investment tax credit will not do the job alone, it will contribute to an expansion in business investment, particularly as we go into 1978 when sales and markets ought to be expanding from the impact of the other parts of the economic stimulus program.

Second, rejection of the investment incentive included in the Administration package will send out a very discouraging signal to businessmen—that out of a $15½ billion per year stimulus program, the Congress and Administration would not devote even a small amount to investment incentives.

We also have some specific concerns about the Ways and Means proposal. That plan would grant a tax credit equal to 40 percent of the first $4,200 paid to each new employe hired this year and next. The primary restriction in the proposal is a maximum credit of $40,000 per company, which makes this proposal principally useful to small businesses.

This proposal has several very important drawbacks. It will not stimulate substantial additional employment. It is of little significance to large firms. And small firms will not generally hire additional workers even with the credit, when they can sell the added goods or services the new workers produce. But the credit does not contribute to expanding sales or markets. It does provide additional cash for those small firms which already have strongly expanding markets or are located in rapidly growing communities. But it does nothing for those firms which need assistance most—those whose markets are declining or growing very slowly.

ARE THE ECONOMIC STIMULUS PROGRAM AND THE 1977 AND 1978 BUDGETS ABOUT THE RIGHT SIZE?

Last month, worries were expressed in some quarters that the economic stimulus program was too small, in view of the setback which the economy suffered from the cold weather and natural gas shortages.

We have looked carefully at this question. Generally speaking, our conclusions are optimistic. Undoubtedly, production lost as a result of the cold will mean a somewhat slower rate of GNP growth in the first three months of 1977 than otherwise would have taken place. Real output will rise appreciably this quarter, but its level will be below earlier expectations. Those losses are not permanent, however. The rate of growth in the second quarter will probably be somewhat higher than otherwise expected as production losses associated with the cold snap are made up. On balance, we expect the production loss to be fully recovered before the end of this year.

THE PROBLEM OF INFLATION

While some people have worried about the fiscal program being too small, others have worried about it being too large. The budget deficits of 1977 and 1978, it has been argued, many be inflationary.

Growth rates of real GNP in the 5 to 6 percent range over the next two years will not, in my judgment, put significant upward pressure on costs or prices.

The U.S. economy today is performing well below its potential. If our labor and capital stock had been fully employed last year, as conservatively estimated by the outgoing Council of Economic Advisers, the nation's GNP—valued at today's prices—would have been about $135 billion larger. This year the amount of lost output will be less, but there will still be a gap of over $100 billion between actual and potential output. By 1978 the gap will diminish further, to the neighborhood of $75 billion, valued at today's prices. We will not be pressing against the economy's limits.

Labor markets are not tight. Over 7 million Americans are out of work. Some of them are the structurally unemployed who have a difficult time finding jobs even in periods of prosperity. But others are experienced wage and salary workers who are out of work because the recovery has not been strong enough to provide them jobs. Even if the recovery outperforms our expectations over the next two years, labor markets will still not be tight. And as employment rises during the recovery, we will also be putting into place structural measures to increase the skills and improve the employability of disadvantaged workers, thereby expanding the effective labor market from which employers can draw to meet the supply requirements of an extended recovery.

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In 1973, part of the upsurge of inflation resulted from bottlenecks and scarcities of raw materials. Today the overall capacity utilization among firms producing industrial materials is about 80 percent. If the recovery proceeds according to our expectations, capacity utilization in these key industries will be about 85 to 87 percent at the end of 1978, still well below the 93 percent reached in 1973.

Moreover, there is ample productive capacity worldwide. When the economy was experiencing accelerating inflation in 1973 and 1974, the entire industrial world was roaring along the same upward track. Today recoveries in other nations are faltering or progressing more slowly than our own. Thus there is ample room for consumers and businesses to obtain goods from abroad—as well as from domestic sources.

Measures of GNP relative to its potential, of labor market tightness, and of raw material availability all strongly indicate that the economic recovery program as set forth in the 1977 and 1978 budgets will not be inflationary.

This Administration is concerned, not only with avoiding any new inflation, but also in promoting policies that will reduce the inflation we now have. Given the upward march of costs and prices that we inherited, and the outlook for food prices over the next year, this will not be an easy task nor one that can bring instantaneous results. But we must begin.

At the present time we are putting together the elements of a many-faceted anti-inflation program. It will have to consist of a number of elements.

Our chief reliance will have to be on fiscal and monetary policies that avoid excess demand and provide for an early return to a balanced budget.

A continuing attention will be needed on the part of the Government to the potential price- and cost-raising effects of its own actions—in the field of international trade, agricultural policy, and regulatory measures.

An early warning system will be developed to review the demand-supply situation in critical areas and provide the framework for recommending corrective steps wherever possible.

A set of arrangements will be devised whereby the Government can discuss with business and labor leaders, on a voluntary basis, the potential impact on inflation and unemployment of major wage and price actions.

We all know that bringing down the rate of inflation will be a very difficult task. But this Administration does not believe that the goals of high employment and price stability are incompatible. Indeed, we recognize that sustained prosperity will not be achieved unless we can bring inflation under better control. This task cannot be accomplished by government alone.

The Federal government can play a role, but it cannot do the job without the active cooperation of the American people.

A related worry is that heavy Federal borrowing in 1977 and 1978 will cause sharp increases in interest rates and crowd private borrowers out of credit markets. For the same reason we believe his package is not inflationary, we also believe it need not put undue stress on credit markets. Secretary Blumenthal has already addressed this issue in some detail, but I would like to make a few points.

First, Federal borrowing that accompanies the 1977 and 1978 deficits has as its counterpart a weakness of demand for funds by the private sector. Even though we will move shortly into the third year of recovery, it is recovery from the deepest recession in 40 years, and there is still a long way to go to regain full prosperity. For example, when the fourth quarter of 1976 is compared to the same stage of previous recoveries we find that:

Real GNP was only 3 percent above the prior peak, versus an 8 percent climb recorded in the average of the previous postwar recoveries.

Business fixed investment in real terms was still 12 percent below the prior peak, compared with 5 percent above, typically, at this stage of the earlier postwar recoveries.

Relative to the size of the economy, demands for funds in the private sector are low.

As recovery proceeds, the economy will generate more personal savings and retained corporate profits just because incomes are rising. Moreover, business liquidity has recovered strongly in this recovery. By most measures, business has not been in such good financial shape since the late 1960's, so that the demands for funds to rebuild liquid asset holdings are probably largely behind us.

There is no simple correlation between Federal deficits and high interest rates. Actually, interest rates have been lowest in recession and early recovery periods

when the Federal deficit is largest. That is because deficits are high when, as now, unemployment is high.

The key to avoiding pressure on interest rates from deficit spending is to end the continuation of large deficits during periods of high levels of economic activity. This we are determined to do.

As the expansion picks up stream, the Government's need for credit will begin to diminish for a number of reasons. One is that the stimulus package we have proposed will begin to phase out as business expansion picks up. Also, the expanding incomes will mean larger tax revenues for the Government, and lower unemployment will reduce the level of spending on unemployment insurance and other regular budget programs that are tied to the business cycle.

Some rise in short-term interest rates may well occur as the recovery proceeds. But a budget policy aimed at steadily shrinking the deficit as private demands for funds rise, and a monetary policy of prudently accommodating a reasonable recovery pattern can—in combination—avoid a sharp run-up in interest rates and provide ample credit for the private sector in a non-inflationary way.

The CHAIRMAN. Now we will hear from the Secretary of the Treasury. Mr. Blumenthal, we are happy to have you.

We started about 2 minutes ahead of time, and seek to make full use of everybody's time.

STATEMENT OF W. MICHAEL BLUMENTHAL, SECRETARY OF THE TREASURY

Mr. BLUMENTHAL. I appreciate that, Mr. Chairman.

The CHAIRMAN. We were underway at the time you arrived.

Mr. BLUMENTHAL. I apologize for being 5 minutes late. I am pleased to present the President's economic stimulus program, a very important program, designed to create the kind of economic conditions that will allow us to reduce the rate of unemployment and the rate of inflation simultaneously, as well as to move toward the goal of a balanced budget that we hope to achieve by 1981.

I have a detailed statement, Mr. Chairman, which, with your permission, I would like to submit for inclusion, in totality, in the record.

The CHAIRMAN. Without objection.

Mr. BLUMENTHAL. Then I would like to deal in some detail with the tax aspects of the stimulus package.

Mr. Lance and Mr. Schultze have talked about the general economic framework and the expectations for the economy. I share their view that we need this program in order to move forward, and that it is not an inflationary program under the present circumstances of the economy's low capacity utilization rate and the high rates of unemployment.

In particular, I think the tax elements of that program are carefully chosen, both as they regard the rebate, and as they regard the proposals for tax reform and simplification, together with some reduction for individuals and businesses. I would like to deal with them in some detail.

With regard to the specifics of the $50 rebate, the House Ways and Means Committee has made revisions in our original proposal.

The CHAIRMAN. If I might just interrupt you for a moment, I would like to make this clear. All the members of the committee who are present and those who are not present at the moment should be aware of the statements made by the Secretary of the Treasury, by Mr.

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Schultze, on behalf of the Presidents' Council of Economic Advisers. and Mr. Lance, Director of the Office of Management and Budget. These statements are submitted for the record; every Senator ought to read each statement at least one time—hopefully, at least twice, because they are stated as succinctly, I believe, as possible as to the case for the bill that we are considering here. In fact, the witnesses' abbreviation of these statements is based on the assumption that we have read them already, and we are going to further review them after this testimony.

So the fact that you might skip something in your presentation should not cause anyone to conclude that we are not considering every word that you are saying in your statement.

Mr. BLUMENTHAL. That is entirely correct, Mr. Chairman. I am doing so in the interest of time, to allow the maximum time for the discussion of these proposals rather than reading every word of it.

On the rebate, the administration proposed a $50 per person refund for 1976 on tax liability for a married couple with earned income and maintaining a household for a dependent child, the rebate would be refundable; that is, the $50 per capita payment would be made even though the family had little or no tax liability in 1976.

The House modified the administration's $50 per person refund by passing it out for those with an adjusted gross income between $25,000 and $30,000.

The administration supports that phaseout, but I would also point out that this reduces the overall stimulus by about a billion dollars.

In addition to the tax refunds, the administration proposed that the $50 payment be made to all beneficiaries under social security, SSI and railroad retir ment.

The House adopted this proposal, and added payments for recipients of AFDC, black lung benefits, and veterans' benefits and compensation.

The House also precludes double payments under the tax refund, or under one or more transfer programs other than AFDC.

The administration supports extension of the $50 payment to recipients of AFDC, but because of administrative difficulties, we question the desirability of extending the payments to beneficiaries of black lung and veterans' programs.

In the case of black lung beneficiaries and the beneficiaries of the veterans' pension program, it is believed that most of them also receive social security payments, or payments from other sources; so that these persons would be covered from those sources. There is a special problem with VA beneficiaries, in that in most cases, we do not know what their social security numbers are.

This means that cross checking to prevent double payments in these cases cannot be accomplished under the Ways and Means Committee b

the committee desires to continue the rebates for those covered by the black lung program and the veterans' program, we will be glad to work with you in developing the most desirable way of dealing with the administrative problems in the screening.

It is clear, though, Mr. Chairman, that it would be complicated. It probably would delay payments, in some instances. But in some instances, it would eliminate what is fondly known as "double dipping."

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The administration, of course, supports the elimination of duplicate payments for social security, SSI and railroad retirement benefits as provided in the House bill, but it will delay until July or August payments to these beneficiaries, because social security numbers first have to be matched against their income tax records in order to eliminate duplicate payments.

Let me now turn to the tax simplification and reform proposals that are before you, Mr. Chairman. This is considered by us to be a very important part of the overall package because it not only reduces taxes on a permanent basis, although to a modest degree for lower income people, but it is also the beginning of the desirable objective which President Carter has emphasized on numerous occasions, and which I know you share, Mr. Chairman, and that is to simplify the tax system as much as possible for as many taxpayers as possible.

One source of complexity under the present law is the standard deduction provision where presently, for single people, the standard deduction is 16 percent of the adjusted income, but not less than $1,700, or not more than $2,400.

In the case of married couples, it is not less than $2,100, or not more than $2,800; and everyone claiming that standard deduction, even though using the tax table, must make this calculation, which is quite complicated for many people.

Now, under the administration's proposal, we would substitute for this complicated set of provisions a flat dollar amount of $2,200 for single people, and $3,000 for married couples.

That flat dollar standard deduction is not only easier to compute than the variable deduction, but it also makes it possible to incorporate the standard deduction into the tax tables and the rate structure.

This means that there will be no separate computation of the standard deduction, as there is today, but the taxes would simply be reflected in the tax tables.

Even taxpayers who itemize their deductions will be able to use the same tax tables, or rate structures, with the standard deductions built in.

Itemizers will simply subtract from their income the excess of their itemized deductions over the flat standard deduction, and then turn to the tax table.

This overall change in the standard deduction represents an annual budget cost of about $4 billion, but since these changes wouldn't take effect until mid-year, the revenue impact in fiscal year 1977 would only be $1.5 billion.

In fiscal year 1978, the revenue loss then would be the annual $4 billion plus some refunds, for a total of about $5.7 billion, and in future years, the cost would continue at a level of about $4 billion a year.

Much of this permanent tax cut, Mr. Chairman, is concentrated at the low-income levels. Specifically, 55 percent of the reduction goes to those with incomes of less than $10,000.

For example, a family of four with earnings of $10,000 would have its tax reduced by $171, from $651 to $480—about $171.

Parenthetically, we except the percentage of filers using the standard deduction to increase from the present 69 percent to about 75 percent of all filers.

These tax changes will also insure that persons at or below the poverty level will pay no income tax.

Mr. Chairman, originally, the administration proposed a flat standard deduction of $2,400 for single individuals, and $2,800 for married individuals.

But then we recognized that this would increase the marriage penalty. In other words, the gap between persons filing separately, or filing jointly, would be increased from $1,300, under the present law, to $2,000. So under that proposal, if two single individuals get married, their combined standard deduction decreases from $4,800—$2,400 times 2—to $2,800, or a decline of $2,000.

Because of this increase in the marriage penalty, which we do not consider desirable, we modified our position to favor a flat standard deduction of $2,200 for single individuals, and $3,000 for joint returns.

That way, the marriage penalty remains the same, and does not increase materially over the present situation.

The $2,200 standard deduction for single individuals would result in 2 million single individuals paying more tax under the proposed law than they are presently paying. The tax increase, however, would average only $52 per return, a marginal increase.

However, those single taxpayers whose liabilities would increase under the proposal also received large tax reductions in 1976.

In no cases would these taxpayers have higher taxes than in 1975.

Now, the House Ways and Means Committee has changed that somewhat, and it provides for a flat standard deduction of $2,400 as compared to our $2,200 for single individuals, and $3,000 for married couples.

That modification has the effect that no single individual has a tax increase. But it does increase the marriage penalty from $1,300 to $1,800, and it also increases the tax cut by about $800 million.

So while it has one beneficial effect, it has a couple of other effects that we consider not beneficial. For that reason, we continue to support our proposal for $2,200 and $3,000 rather than $2,400 and $3,000.

This, we believe is consistent with President Carter's desire to reduce the disincentives to marriage which are contained in the tax laws and in the transfer programs.

Let me now turn to the important matter of business tax reductions.

I hope that the goal of decreasing the disincentives to marriage meet with your approval, Mr. Chairman.

Turning, now, to the business tax reductions, the most important element in the Ways and Means bill is the substitution of a new job tax credit for the administration's optional credit, the option between either an additional investment tax credit, or a credit based on payroll taxes.

The Ways and Means Committee bill works in such a way that the employer would receive a credit equal to 40 percent of the difference between 1977 and 103 percent of 1976 wages, up to $4,200 per employee.

There is, however, a special ceiling limitation which provides that credit can't exceed 40 percent of the difference between total 1977 wages, and 103 percent of the total 1976 wages.

We do not believe that this particular proposal will lead to increased jobs, increased employment. At the same time, we are very

concerned that elimination of the investment tax credit option would have a negative impact on business investment. This is exactly the sort of thing that we think we need to encourage in order to supply more permanent private jobs in the economy, which is really the basis for any kind of growth in the future. Apart from that, from the psychological viewpoint, taking out of the entire administration's proposal the one element that emphasizes additional investment by business to create jobs would, in our view, send the wrong message to industry and to employers.

Now turning to the employment credit in the Ways and Means Committee bill, we think that in its present form, it is particularly troublesome, Mr. Chairman because the committee adopted a credit that is intended to cover only the increment in jobs.

Now, about half of the employers in a given year will not be increasing their jobs, for one reason or another. That means that they will be excluded from any kind of tax benefit if there is no investment credit option.

Many of these employers, even though they face business conditions under which they are struggling to get along and need the extra income and can spend it on valuable and important things which, in a secondary sense, will be employment creating, will get nothing. These employers who are not increasing employment by at least 3 percent to account for about 30 percent of the labor market.

Our analysis indicates that by dropping out those employers who will not be increasing their employment, we are dropping out, in effect, what represents 30 percent of the labor market.

Now, furthermore, this bill proposes to further target the subsidy by limiting the amount of the tax credit to $40,000 per employer except in cases of disabled and handicapped workers.

This $40,000 cap, then, would limit the number of eligible employees to 24; that is, a maximum of only 24 additional employees would be covered.

We then estimate that this $40,000 cap, effectively, would exclude another 36 percent of the labor market from any possible gains in employment in response to the tax credit. Those are workers in industries which require a large-scale operation. This 36 percent, that would be excluded because they are in industries which have large-scale operations, might well show the greatest growth in employment in recovery from the recession. Automobiles, steel, machine tools, electric equipment, manufacturing, and other heavy manufacturing are examples.

So if you take the threshold and the cap, you have, in fact, excluded 66 percent of the labor market from any kind of benefits under the business tax proposal. We consider this to be undesirable.

In addition, the Ways and Means Committee employment credit has three other effects which we consider to be undesirable. First, the credit might well encourage the substitution of part-time for full-time workers.

An employer could do better, under the circumstances, if he fires a full-time employee, and hires two new part-time employees.

The total wage limitation bill is, presumably, aimed at denying the credit to employers who substitute part-time for existing full-time

workers; but given some reasonable growth in money wages currently in the order of 6 to 7 percent per year, the total wage bill limitation will be largely ineffective against the replacement of current full-time workers with part-time workers.

Many of these part-time workers would be second and third earners in families, while those workers displaced are more likely to be family breadwinners.

The second distorting effect of the credit relates to overtime employment. A firm that decides to reduce overtime, and to hire additional workers may be excluded from the credit because of the overall wage bill limitation.

This results from the fact that overtime work is paid at higher rates than straight time work so as a result, replacing overtime work with new employees could reduce the total wage bill, thereby bringing the overall wage limitation into play.

Thus, the credit is a disincentive to a desirable means of spreading available work, the addition of new jobs after some workers have worked a full week.

Yet a third distortion, Mr. Chairman, is that it would easily be possible for noncorporate employers in the tax bracket exceeding 50 percent to make money from this program simply by hiring new workers, and telling them to stay at home. Certainly, that is not a desirable result.

For example, for an employer subject to the 70 percent marginal tax rate, the tax saving from paying the new employee wages up to the Federal Unemployment Tax Act base of $4,200, actually exceeds the gross amount of wages paid.

The tax deduction for wages paid reduces the after-tax cost of labor to 30 cents on the dollar. Then on top of that, under the proposal, he gets a credit which provides additional tax savings of 50 cents if a handicapped person is hired—for a net wage cost of minus 10 or 20 cents.

So that, in fact, you have a situation where you can hire people, and tell them to stay at home and do nothing; and pocket the difference. Thus, by paying $1 of wages qualified for the credit, after-tax income of the employers can increase by 10 or 20 cents even if the new employee is totally unproductive.

Mr. Chairman, it should also be understood that any tax reduction attributable to incremental credit would be confined to industries and regions that would otherwise have experienced employment growth, and they are, primarily, the small and medium-sized businesses.

This means that trade and construction workers benefit as compared to those in manufacturing, and there would be an acceleration of the movement of jobs to those regions that have been growing more rapidly, especially in the South and West as compared to those places where employment has been slower, or where employment has been declining.

A further characteristic of this credit is that the types of jobs that would receive the most subsidy would be those requiring limited skills and at relatively low pay.

This is one result of limiting the provision to small businesses. Also, because this program will provide a large subsidy for each additional

employee, but only for the year in which he is hired, many of these additional jobs would turn out to be temporary.

Mr. Chairman, I think these elements and some others indicate the reason why we have real reservations about the job-tax credit.

On the other hand, we believe that the option that we provide of either an investment tax credit, or a credit on payroll taxes does achieve the objective at the same cost. Our objective is to provide an opportunity for all employers, large or small, in manufacturing, retailing, or whatever, and in every part of the country to mak a choice between two alternatives, a choice based on what suits them best, to benefit equally from this modest but, nevertheless, significant tax reduction.

You may have noticed in the Wall Street Journal yesterday, Mr. Chairman, a reference to the encouraging trend toward increasing plans by business to invest. That is precisely the kind of thing that we want to encourage.

As was described by the reporter, I noted that one reason for the encouraging trend was the proposal by the administration for an increase from 10 to 12 percent in the investment tax credit. The report indicated that the survey seemed to show that what it meant to businessmen was that this program of investment tax credits was a permanent one, that would continue, and that they could count on it. This gave them the kind of confidence they need to go ahead and implement their investment plans that they have had on the shelf for some time.

It is exactly the sort of thing that we are trying to encourage.

The other alternative for companies or businesses that do not invest a great deal, but tend to be labor intensive, provides a modest reduction in taxes, as part of the overall stimulus program, which would be of some benefit to them.

Most of these businesses would be ruled out under the proposal that the House Ways and Means Committee has adopted.

Finally, Mr. Chairman, let me say, if I may have just one final word, on the investment tax credit. Mr. Schultze, with great foresight, brought along the article to which I referred. Let me quote the particular paragraph because I think it is significant. It is an article in the Wall Street Journal dated March 7, 1977, entitled, "Stronger Business Growth Seen in Studies by Buying Agents and Conference Board."

It quotes Elliot Grossman, the Conference Board's economist who did the study. Now I quote:

> When it appeared all but certain that the investment tax credit would be raised from 10 to 12 percent, manufacturers felt sufficiently confident to push ahead with the capital spending plans, aware that most of the last quarter appropriations wouldn't actually be spent until well in 1977 or 1978.

It is that kind of confidence-creating factor that we think is very important, and the reason why we feel so strongly that it should be retained in the legislation.

Mr. Chairman, to conclude, let me say a word about the impact of all of this on the Federal budget deficit and on the credit market.

We are absolutely determined and convinced that this particular program, which is modest, will not result in increased inflation.

We are as concerned about keeping that problem under control as we are in bringing down the rate of unemployment. We will be watching these statistics very carefully.

We are equally determined to bring the Federal budget into balance. I am sure that Mr. Lance has talked about this package. We think the deficit in 1977 will be $68 billion. We expect it in the next fiscal year to be $58 billion.

And we have previously indicated that we expect—with the first budget over which this administration will be able to have total control, starting from the beginning, employing zero-based budgeting, and looking very carefully at every element—that we will be able to accomplish an important reduction in fiscal year 1979 so that we will indeed achieve balance by no later than fiscal year 1981. So there will be the $68 billion deficit in 1977, and $58 billion in 1978.

That means that together with the deficits of off-budget Federal entities, and other factors involved in budget financing that is required, which amounts to $11 billion in 1977 and $8.5 billion in 1978, the Treasury will have to raise $73 billion of net cash in fiscal year 1977, and $66 billion in fiscal year 1978.

Those are large amounts. Mr. Chairman, I will await anxiously the day when we will not have to go out for that much new money into the market.

If any question has been raised as to whether this will crowd out private borrowers from the market, we have very carefully looked at that question, and we do not believe that it will.

Let me, first of all, point out that in the calendar year of 1976, the Treasury also borrowed a large amount of new cash from the public—almost $70 billion; to be exact, $69 billion.

Notwithstanding the very large borrowing, interest rates declined throughout the second half of 1976, and other borrowers, businesses, State, and local governments were able to float record bond financing.

I mention this point only to demonstrate that the deficit alone is not, by any means, an indication that there is going to be a shortage, or that there has to be crowding out. You have to look at the totality of the demand, and supply equations to determine the impact on the market, the total amount of money, and the supply of funds. This is what we have been doing in order to determine what this kind of program will mean for the credit market.

We do see, over the next 2 years, as our recovery takes place, that private credit demand will be rising further from the present level.

That is as it should be with a growing economy.

Housing recovery will require additional mortgage financing. Business requirements for funds will increase in 1977 and 1978 as plant equipment rises, and inventories accumulate.

Consumer credit, under those circumstances, no doubt, also will be augmented somewhat. Sales of automobiles, and other durables, too. So there is going to be increasing demand in the private sector.

Our estimate of the total demand for funds, taking into account the budgetary, the Federal budget deficit, and the private demand, is that in the calendar year 1977, the total amount will be about $325 billion or, roughly, 10 percent more than the previous year.

We have then looked at the availability of funds to meet this enlarged financing, and we have come to the conclusion that they will be ample.

The rise in personal incomes and in corporate profits generated by economic expansion under the stimulus should permit a growing volume of individual and business savings to flow into the market.

Savings institutions, therefore, should have substantially larger flowing funds from the public for investment in the credit market.

Our preliminary estimates are that these financial intermediaries are likely to be able to provide more than $150 billion to the financial markets in 1977, which is up 12 percent from the previous year, and about 40 percent more than in 1975.

In addition, businesses, governments, foreign investors, and households should be placing more funds in securities and loans as the economy grows.

Now, within the context of noninflationary expansion, it would be appropriate for the commercial banks to acquire larger amounts of credit market instruments.

The bank system, commercial and Federal Reserve banks, supplied only $38 billion of funds to borrowers in the recession year of 1975, it is low, and $57 billion in the first recovery year of 1976.

In 1977 and 1978, the banking system should have the resources to be able to supply $80 to $90 billion of funds each year. This is less than the amount they supplied in 1973 when they supplied $93 billion.

For this reason, Mr. Chairman, we do not believe that crowding out will result, and a significant increase in interest rates is likely to be a problem.

This, Mr. Chairman, is a summary with particular emphasis on the tax elements of our proposal, and we present it to you for your careful consideration. Thank you.

The CHAIRMAN. Thank you very much, Mr. Secretary, and Mr. Schultze and Mr. Lance for the fine statements that you have made to us.

[The prepared statement of Secretary Blumenthal follows:]

STATEMENT OF HON. W. MICHAEL BLUMENTHAL, SECRETARY OF THE TREASURY

Mr. Chairman and members of this distinguished committee, it is an honor to make my first appearance before this Committee to support the President's economic stimulus program. I look forward to working closely with members of this Committee on this program, as well as on the tax reform program that we will be submitting to Congress in the fall.

The economic stimulus program proposed by President Carter provides for about $15 billion in tax reductions and increased outlays in 1977 and closer to $16 billion in 1978. The program consists of four major elements:

1. Rebates of 1976 taxes and cash payments to social security, SSI, and railroad retirement recipients;
2. Permanent reduction in individual taxes;
3. Reduction in business taxes to stimulate employment and encourage investment: and
4. Direct expenditure programs designed to increase employment by providing more public service jobs, more public works and increased countercyclical revenue sharing.

The first three elements of this program, as modified by the Ways and Means Committee, are contained in the Tax Reduction and Simplification Act of 1977 (H.R. 3477) which is now before your Committee. I shall get to the specifics of

H.R. 3477 a little later. First, I want to outline the broad economic problems this Administration inherited, and the strategy of our stimulus program for dealing with them.

THE PROBLEM WE FACE

As the Carter Administration took office, we were slowly emerging from the worst recession of the last 40 years.

The recovery from this recession began reasonably well. By the end of the first quarter of 1976, the real gross national product had risen some 7 percent, from the recession trough, and unemployment in the spring of 1976 was down to 7½ percent from the peak rate of 9 percent a year earlier. This improvement was the result largely of the tax cut enacted by Congress in 1975, which encouraged consumer spending and business willingness to replenish inventories.

But because the 1975 stimulus program did not have a follow-through component, the pace of recovery slackened in the spring of 1976. By the end of last year, growth in real output was down to a pace of only 2½ percent, and between May and December 1976, the number of unemployed workers rose from 6.9 million to 7.5 million.

More recently, some signs of renewed strength seemed to be emerging, but the severe weather conditions we have been experiencing—blizzards in the East and drought in the Plains and West—tend to obscure the fundamental trends in the economy. As best as one can read the signals, it would seem that the recovery has resumed, but at too slow a pace to make sufficient inroads in the large amount of slack in utilization of plant capacity or labor resources. Without additional stimulus, we fear that the economy would grow in calendar year 1977 at only a 4½ to 4¾ percent, leaving the unemployment rate significantly above 7 percent.

Moreover, the current recovery does not appear to be self-sustaining, raising the possibility of a "stalling-out" such as occurred early last year. Relative to earlier recoveries, this one has lacked a strong rebound in private business investment. We need this investment, not only to maintain the momentum of the recovery, but also to create the capital base that can support a full employment economy. Investment will not be adequate until businessmen see a reasonable reasonable prospect of a sustained growth in consumer demand. In turn, the course of demand very much on the trend in consumer incomes; we cannot reasonably expect consumers to maintain rising rates of spending unless their incomes continue to rise and their fears of inflation are assuaged.

STRATEGY OF THE PROGRAM

Our program is designed to address these problems directly: it would inject additional purchasing power into the private economy as quickly as possible; it has built into it the elements to sustain the recovery into 1978 and beyond; its order of magnitude is scaled to avoid the kinds of pressures on resources that might ignite the inflationary tendencies. The structure of the program is such as to encourage consumers and businessmen to plan ahead within the framework of a predictable set of government policies, and to count on the recovery neither faltering nor becoming excessively rapid.

This is a 2-year program. In both fiscal years 1977 and 1978, the total amount of stimulus would be about the same. But in 1977, 87 percent of the stimulus would flow from tax reductions and only 13 percent from increased Federal spending. The emphasis is on measures that can be put in place quickly and that have a rapid impact.

In fiscal year 1978, the emphasis changes: 49 percent of that year's stimulus flows from direct spending. In this way we marry quick action putting the economy back on an appropriate track to the long term need to provide consumers and businesses with a predictable and steadily improving economic future.

Next fall the Administration will submit to Congress its tax reform program for a simpler, fairer, and more efficient tax structure. The program presented at that time will lay even more emphasis on capital formation.

EFFECTS OF THE STIMULUS PROGRAM ON THE OVERALL ECONOMY

In no small part as a result of the stimulus package, we believe the unemployment rate will fall below 7 percent by the fourth quarter of 1977. This decline in the unemployment rate—along with the normal growth in the labor force—means an increase of over 3 million jobs during 1977. Up to 1 million of the increase in

jobs may be attributable—directly and indirectly—to the stimulus program. We hope the unemployment rate will decline toward 6 percent by the end of 1978. With this program, the real gross national product should increase during calendar year 1977 by about 6 percent, as contrasted to only 4½ or 4¾ percent in the absence of the program. This would mean an increase in the nation's output of approximately $18 billion by the end of 1977 and up to $35 billion by the end of 1978.

While this program will provide the needed economic stimulus, we do not expect it to cause any significant increase in the rate of inflation. The present high unemployment rate and the substantial slack in use of industrial capacity indicate that a significant increase in the rate of economic growth should be feasible without rekindling inflationary pressures. Some effects of adverse weather will, of course, pass through the price structure, but should be in large part reversed over the year as supply and transportation difficulties diminish with improved weather conditions.

We will, however, be monitoring inflationary danger signals very carefully. As you know, President Carter is fully determined to ensure that inflation and unemployment be reduced at the same time. That is why we are also engaged in developing and implementing programs to attack inflationary pressures and potential with specific measures across a wide front of governmental and private activities. We will be pursuing these vigorously as the stimulus package is put into effect. The overall impact of stimulus and anti-inflation programs should have an important positive result.

SPECIFIC CONSIDERATIONS WITH HOUSE WAYS AND MEANS COMMITTEE BILL

Let me turn now to specific considerations with the Ways and Means Committee bill. The House is expected to approve its version of the tax portion of the stimulus program today. This bill provides about the same amount of tax reduction in 1977 and $1 billion more in 1978 than proposed by the President. We support many but not all of changes contained in the House bill. The principal item to which we object in the House bill is the incremental jobs credit. It is extremely cumbersome, has little employment impact, and is unfair to many businesses.

TAX REBATE

The debate portion of the stimulus package provides the means for obtaining an initial, substantial increase in purchasing power. Nevertheless, it has been questioned by many. Some feel that the Administration should be advocating permanent tax changes rather than one time rebates. Others have stated that the additional income which households receive from the rebate will not quickly find its way to the spending stream. Still others have maintained that direct job creating programs should replace the tax rebate.

These criticisms fail to recognize that the rebate program is part of a broader stimulus package. First, there is no faster way to get the money into the spending stream than providing additional disposable income directly to households. The total time lags involved in making the income available are much shorter than those in developing new, or expanding existing, spending programs. There undoubtedly will be some delay before the rebate is spent. But the rebate is not spread evenly throughout the year as a permanent tax cut would be. Instead it is concentrated in just a few months. Even with some spending delays, the rebate is likely to be spent much more quickly than a permanent tax cut of the same magnitude.

Evidence available suggests that although part of the 1975 rebate was saved in the first quarter, it got out into the spending stream in the following months. There is every reason to believe that new rebate will also be spent and probably more rapidly. The economy is now characterized by improving performance and rising consumer confidence. There are, therefore, fewer reasons for this money to be saved to protect against future uncertainty than was true in 1975.

Second, we are also recommending some permanent tax cuts as the first step in tax simplification and reform. We have already begun work on a program for overhauling the tax system. We expect to present these proposals to Congress in the fall, but we do not wish to delay the stimulus program until we have developed a full set of tax reform proposals. In fact, the rebate may be viewed not only as providing some immediate increase in spending, but doing so in a way which will not adversely affect our ability to make fundamental tax changes in the future.

Third, an important part of the stimulus program does involve direct job creation through public works, public service, and retraining programs. These are in bills before other committees. Such programs, however, take time to get fully underway. We do not wish to encounter this delay providing stimulus to the economy.

Let me turn now to the specifics of the Ways and Means Committee revisions of the $50 rebate. The Administration proposed a $50 per person refund of 1976 tax liabilities. For married couples with earned income and maintaining a household for a dependent child, the rebate would be refundable; that is, the $50 per capita payments would be made even though the family had little or no tax liability for 1976.

The House modified the Administration's $50 per person refund by phasing it out for those with adjusted gross income between $25,000 and $30,000. The Administration supports the phase out, but I would also point out that this reduces the overall stimulus by about $1 billion.

In addition to the tax refunds, the Administration proposed that a $50 payment be made to all beneficiaries under social security, supplemental security income, and railroad retirement. The House adopted this proposal and added payments for recipients of AFDC, black lung benefits, and veterans' pensions and compensation. The House bill also precludes double payments under the tax refund or under more than one of the transfer programs (other than AFDC).

The Administration supports extension of the $50 payment to recipients of AFDC, but because of administrative difficulties we question the desirability of extending the payments to beneficiaries of black lung and the veterans' programs. In the case of black lung beneficiaries and beneficiaries of the veterans' pension program, it is believed that most of them also receive social security payments or payments from other sources. A special problem with VA beneficiaries is that in most cases we do not know what their social security numbers are. This means that cross-checking to prevent double payments in these cases cannot be accomplished under the Ways and Means Committee bill. If the committee desires to continue the rebates for those covered by the black lung program and the veterans' programs, we will be glad to work with you in developing the most desirable way of dealing with the administrative problems in the screening.

The Administration supports the elimination of duplicate payments for social security, SSI, and railroad retirement beneficiaries as provided in the House bill. But this will delay to July or August payments to these beneficiaries for their social security numbers must be matched against their income tax records.

TAX SIMPLIFICATION AND REFORM

Another part of this package is designed not only to provide a stimulus for the economy but also to simplify the tax laws. This is the first step in our long range tax reform and simplification program.

One source of complexity under present law is the standard deduction provision. Presently the standard deduction for single people is 16 percent of adjusted gross income, but not less than $1,700 or more than $2,400. In the case of married couples the standard deduction is not less than $2,100 or more than $2,800. Everyone claiming the standard deduction, even though using the tax table, must make this calculation.

The Administration proposes to substitute, for this complicated set of provisions, a flat dollar amount of $2,200 for single people and $3,000 for married couples. The flat dollar standard deduction not only is easier to compute than the variable deduction but also makes it possible to incorporate the standard deduction into the tax tables and rate structure. This means that there would be no separate computation of the standard deduction, as there is today. Instead, it would be simply reflected in the tax tables.

Even taxpayers who itemize their deductions will be able to use the same tax tables, or rate structures, with the standard deduction built in. Itemizers will simply subtract from their income the excess of their itemized deductions over the flat standard deduction, and then turn to the tax tables.

In addition, the new tax tables will include built-in computations of personal exemptions and the general tax credit. Under present law, taxpayers must make all of these calculations themselves. For example, the general tax credit involves

a choice between a per capita credit of $35 and an alternative credit of up to $180 based on the first $9,000 of taxable income. The new tax tables will require none of these calculations.

This overall change in the standard deduction represents an annual budget cost of about $4 billion. However, since these changes won't take effect until mid-year, the revenue impact in fiscal year 1977 will only be $1.5 billion. In fiscal year 1978, the revenue loss is expected to be about $5.7 billion, because of refunds reflecting the catch-up effect that year.

Much of the permanent tax cut is concentrated in the lower income levels. Specifically, 55 percent of the reduction goes to those with income below $10,000. For example, a family of four with earnings of $10,000 will have its taxes reduced by $171 (from $651 to $480). Parenthetically, we expect the percentage of filers using the standard deduction to rise from approximately 69 percent to 75 percent. These tax changes will also insure that persons at or below the poverty level will pay no income tax.

The Administration originally proposed that the present standard deduction be replaced with a flat deduction of $2,400 for single individuals and $2,800 for married couples. These dollar limits are equal to the maximum standard deduction now permitted. However, we subsequently recognized that this change would increase the "marriage penalty" for those who now take the minimum standard deduction from $1,300 under present law to $2,000.

Under the proposal if two single individuals get married their combined standard deduction decreases from $4,800 ($2,400 x 2) to $2,800, or a decline of $2,000. Because of this increase in the marriage penalty, the Administration modified its position to favor a flat standard deduction of $2,200 for single individuals ($200 less than the current maximum standard deduction) and $3,000 for joint returns.

This would increase the marriage penalty for those presently using the minimum standard deduction to $1,400 and would reduce it for many taxpayers claiming the percentage or maximum standard deduction. The $2,200 standard deduction for single individuals would result in 2 million single individuals paying more tax under the proposed law than they presently pay. The tax increase would average $52 per return. However, those single taxpayers whose liabilities would increase under this proposal also received large tax reductions in 1976. In no cases, would these taxpayers have higher taxes than in 1975.

The Ways and Means Committee bill provides a flat standard deduction of $2,400 for single individuals and $3,000 for married couples filing jointly. While this insures that no taxpayer has a tax increase, it increases the marriage penalty from $1,300 to $1,800, and it increases the permanent tax cut by $800 million.

The Administration continues to support a change in the standard deduction to $2,200 for single individuals and $3,000 for married couples. This is consistent with President Carter's aim to reduce the disincentives to marriage contained in the tax law and transfer programs.

BUSINESS TAX REDUCTIONS

To provide further stimulus for economic expansion, the Administration proposed that each business be able to choose between a 2 percentage point increase in the investment tax credit or a refundable income tax credit equal to 4 percent of the employer's share of social security payroll tax. The self-employed would choose between the additional investment tax credit or 2 percent of the self-employed payroll tax (currently 7.9 percent) plus, of course, 4 percent of any other payroll taxes they have. These credits would apply to equipment eligible after December 31, 1976, or to social security taxes incurred after that date.

The Administration continues to support the optional payroll/investment credit. It will insure that all businesses receive some benefit. Business taxes in calendar year 1977 would be reduced by $2.3 billion. Of this total, $0.8 billion would reflect use of the payroll tax credit and $1.5 billion would represent use of the higher investment credit.

The Ways and Means Committee bill substituted a new jobs tax credit for the Administration's optional credit. Under the bill, the employer would receive a credit equal to 40 percent of the difference between 1977 wages up to

$4,200 per employee and 103 percent of 1976 wages up to $4,200 per employee. However, a special ceiling limitation provides that the credit cannot exceed 40 pecrent of the difference between total 1977 wages and 103 percent of total 1976 wages.

The Administration is especially concerned because the Committee bill leaves out the optional investment credit. If we are to obtain a high level of employment through the private sector of the economy, we must induce the private sector to provide more capital investment. This is necessary both to increase productivity and raise the stanadard of living and also to provide the capital tools needed for an increase in jobs. For these reasons we need to provide a signal to business—as well as tangible evidence—that we recognize this need for expanded investment. The 2 percent optional increase in the investment credit is in itself important in achieving more investment, but the psychological impact on investment decisions is probably still more important.

In addition, the type of employment credit in the Ways and Means Committee bill is in a form which is especially troublesome. The committee adopted a credit that is intended to cover only the increment in jobs. About half of the employers in a given year will be below the threshold in the normal course of events, and will be excluded from the benefit of the credit. This, of course, means that they are excluded from responding to the incentive to hire. On the other hand, those who are increasing their employment will earn a benefit whether or not they are responding to the credit. In fact, the threshold serves not to identify incremental decisions but, rather, to omit some employers and to favor others.

We have tried to quantify the effects of the threshold contained in the Committee bill. Using detailed industry data, we estimate that in 1977 30 percent of the labor market would be excluded by the threshold.

The bill proposes to further "target" the subsidy by limiting the amount of the tax credit to $40,000 per employer except in the case of disabled and handicapped workers. This "cap" would limit the number of eligible additional employees to 24. We estimate that the $40,000 cap effectively would exclude at least 36 percent of the labor market from any possible gains in employment in response to the credit. This labor market is in industries which require a large scale operation and would show the most growth in recovery from recession. Examples are automobiles, steel, machine tools, electrical equipment, manufacturing, and other heavy manufacturing. The threshold and cap together mean that about 66 percent of the labor market is precluded from any benefits under this credit.

The employment credit in the Committee bill also has three other effects which are undesirable. First, the credit would encourage the substitution of part-time for full-time workers. The total wage bill limitation presumably is aimed at denying the credit to employers who substitute part-time for existing full-time workers. However, given some growth in money wages—currently on the order of 6 to 7 percent per year—the total wage bill limitation will be largely ineffective against the replacement of current full-time workers with part-time workers. Many of these part-time workers will be second and third earners in families, while those displaced are more likely to be family breadwinners.

The second distorting effect of the credit relates to overtime employment. A firm that decides to reduce overtime and hire additional workers may be excluded from the credit because of the wage bill limitation. This results from the fact that overtime work is paid at higher rates than straight time work. As a result, replacing overtime work with new employees could reduce the total wage bill, thereby bringing the overall wage limitation into play. Thus, the credit is a disincentive to a desirable means of spreading available work; the addition of new jobs after some workers have worked a full week.

A third distortion is that it would easily be possible for noncorporate employers in tax brackets exceeding 50 percent to make money from this program simply by hiring new workers and telling them to stay at home. For example, for an employer subject to the 70 percent marginal tax rate bracket, the tax saving from paying the new employee wages up to the Federal Unemployment Tax Act base of $4,200 actually exceeds the gross amount of wages paid. The tax deduction

for wages paid reduces the after-tax cost of labor to 30 cents on the dollar. Then the credit provides an additional tax savings of 40 cents—or 50 cents where handicapped persons are hired—for a net wage cost of minus 10 cents or 20 cents. Thus, by paying $1 of wages qualified for the credit, after-tax income of the employers can increase by 10 or 20 cents even if the new employee is totally unproductive.

It should also be understood that any tax reduction attributable to the incremental credit would be confined to the industries and regions that would otherwise have experienced employment growth, and primarily to small and medium-sized businesses. This means that trade and construction workers would benefit as compared to those in manufacturing, and there would be an acceleration of the movement of jobs to those regions that have been growing more rapidly, especially in the South and West, as compared to those places where employment growth has been slower or employment has been declining. Another characteristic of this credit is that the types of jobs that would receive the most subsidy would be those requiring limited skills and at relatively low pay. This is one result of limiting the provisions to small businesses. Also, because this program will provide a large subsidy for each additional employee, but for only the year in which he is hired, many of these additional jobs may also be temporary.

The House bill also included an additional 10 percent credit where the increase in the first $4,200 of wages paid is due to the hiring of handicapped workers. This credit would not be subject to the $40,000 cap. We believe that it would cause a number of administrative problems. It must be recognized that it is difficult to target narrow expenditure programs through the tax system. We oppose the enactment of this special credit.

EXTENSION OF 1977 INDIVIDUAL AND CORPORATE TAX REDUCTION

The House bill also extends through 1978 three important tax cuts that would otherwise expire at the end of 1977. The Administration supports these extensions. The three tax cuts are as follows: (1) The general tax credit equal to the greater of $35 for each taxpayer and dependent or 2 percent of the first $9,000 of taxable income. (2) The earned income credit which is equal to 10 percent of the first $4,000 of earned income with a phase-out as income rises between $4,000 and $8,000. It is available only to people with dependent children. (3) The increase in the corporate surtax exemption from $25,000 to $50,000 and the reduction in the tax rate on the first $25,000 of corporate income from 22 percent to 20 percent. These changes reduce fiscal year 1978 revenues by $7.8 billion of which $6.8 billion is attributable to the general tax credit and $1.0 billion to the corporate reduction. In fiscal year 1979, the reduction is $6.2 billion of which $3.9 billion is attributable to the general credit, $1.0 billion to the earned income credit, and $1.3 billion to the corporate reduction.

FEDERAL BUDGET DEFICITS AND CREDIT MARKETS

If the Carter stimulus package is enacted, the fiscal year 1977 deficit will be in the order of $68 billion, with the next fiscal year deficit dropping to $58 billion. Together with the deficits of the off-budget Federal entities ($11 billion in 1977 and $8.5 billion in 1978) and other factors involved in budget financing, the Treasury will have to raise upwards of $73 billion of net cash in fiscal year 1977 and about $66 billion in fiscal year 1978.

Questions have been raised as to whether this prospective Treasury financing will "crowd out" private borrowers from the credit markets First, let me point out that in the calendar year 1976 the Treasury also borrowed a large amount of new cash from the public—$69 billion. Notwithstanding this amount of financing, interest rates declined throughout the second half of 1976, and other borrowers—including businesses and State and local governments—were able to float record amounts of bond financing. At the same time the Treasury was able to meet its needs largely in the coupon area and, thus, to extend the maturity of the national debt. 1976 thus demonstrated that a large Federal borrowing program does not necessarily result in strained credit markets and rising interest rates.

86-032—77——8

Over the next 2 years, we do expect private credit demands to be rising further, reflecting the rise in economic activity the Carter budget will induce. Continuing, the housing recovery will require substantial additions to mortgage financing. Business requirement for funds will also increase in 1977 and 1978, as plant and equipment expenditures rise and inventories are accumulated. Consumer credit demands, too, will be augmented somewhat as sales of automobiles and other durable goods rise.

We have been carefully reviewing the resultant outlook for the credit and capital markets. Our most current estimate—based on revised numbers for 1976 from the Federal Reserve—is that the total volume of funds raised in U.S. markets by Federal and State and local governments, corporate and other business, consumers and foreign borrowers could reach about $325 billion in the calendar year 1977, up some 10 percent from last year.

The funds available to meet these enlarged financing demands will, however, also increase. The rise in personal incomes and corporate profits generated by the economic expansion the stimulus will provide should permit a growing volume of individual and business savings. Therefore, savings institutions should have substantially larger inflows of funds from the public for investment in credit markets. Our preliminary estimates are that these financial intermediaries are likely to be able to provide more than $150 billion to financial markets in 1977, up some 12 percent from last year, and about 40 percent more than in 1975. Also, businesses, governments, foreign investors and households should be able to place more funds in securities and loans as the economy grows.

In the context of a noninflationary expansion, it would be appropriate for the commercial banks to acquire larger amounts of credit market instruments. The banking system—commercial and Federal Reserve banks—supplied only $38 billion of funds to borrowers in the recession year 1975, and $57 billion in the first recovery year 1976. In 1977 and 1978, the banking system should have the resources to be able to supply $80 to $90 billion of funds each year. These are less than the $93 billion provided in 1973.

My judgment is, therefore, that of "crowding out" will not occur and that any rise in short term interest rates will be relatively modest.

CONCLUSION

Let me conclude my testimony this morning with a plea that the Committee not add non-germane amendments to this bill. The President places high priority on this legislation, and consideration of non-germane amendments will only delay its enactment. The Administration is committed to presenting a program for full scale tax revision and simplification this fall. The legislative consideration of those proposals will provide the appropriate opportunity to consider amendments that range beyond the simple objective of economic stimulus.

TABLE 1.—ESTIMATED EFFECTS OF THE ADMINISTRATION'S FLAT STANDARD DEDUCTION PROPOSAL, DISTRIBUTED BY ADJUSTED GROSS INCOME CLASS

[Calendar year 1976 levels of income]

Adjusted gross income class (thousands)	Tax change resulting from the $2,200/$3,000 standard deduction[1]		
	Amount (millions)	Percentage distribution	Cumulative percentage distribution
Less than $5	—$487	11.9	11.9
$5 to $10	—1,764	43.1	55.0
$10 to $15	—1,359	33.2	88.2
$15 to $20	—321	7.9	96.0
$20 to $30	—132	3.2	99.3
$30 to $50	—25	.6	99.9
$50 to $100	—5	.1	100.0
$100 or more	(2)	(2)	100.0
Total	—4,093	100.0	

[1] Includes the effect of extending the $35 general tax credit to exemption for age and blindness.
[2] Less than $500,000 or 0.05 percent.

Note: Details may not add to totals due to rounding.

TABLE 2.—TAX REBATE PROGRAM

[Ways and Means Committee version endorsed by the administration]

Adjusted gross income class, 1976 (thousands)	Amount of rebate		
	Amount	Percentage	Cumulative percentage
Up to $5	$981	11.4	11.4
$5 to $10	2,004	23.4	34.8
$10 to $15	2,230	26.0	60.8
$15 to $20	1,907	22.2	83.0
$20 to $30	1,454	17.0	100.0
$30 and over	0	0	100.0
Total	8,577	100.0	

Note: This is the tax portion of the rebate as passed by the Ways and Means Committee at the end of February 1977. The rebate is $50 per capita, limited to the amount of tax unless the return has earned income and meets the dependent test for the earned income credit. It is phased out over a range of adjusted gross incomes from $25,000 to $30,000. The total of $8,577,000,000 includes $7,268,000,000 refunds of tax, and $1,309,000,000 payments in excess of tax liability.

TABLE 3.—FLAT STANDARD DEDUCTION (ADMINISTRATION PROPOSAL AS PRESENTED TO WAYS AND MEANS COMMITTEE) TAX CHANGES FOR REPRESENTATIVE TAXPAYERS

Filing status: adjusted gross income	1975 law tax	1976 law tax	Proposed 1977 Law [1]		
			Tax	Tax change from 1975 law	Tax change from 1976 law
Single:					
$3,000	62.50	42.50	0	−62.50	−42.50
$5,000	403.50	363.50	278.50	−125.00	−85.00
$7,000	796.50	714.50	619.50	−177.00	−95.00
$10,000	1,476.00	1,331.00	1,221.00	−255.00	−110.00
$15,000	2,586.50	2,409.50	2,464.50	−122.00	+55.00
$20,000	4,123.00	3,939.00	4,007.00	−116.00	+68.00
$50,000	18,330.00	18,120.00	18,240.00	−90.00	+120.00
$100,000	50,955.50	50,736.50	50,874.50	−81.00	+138.00
Joint return					
$5,000	170.00	130.00	0	−170.00	−130.00
$7,000	492.00	448.00	300.00	−192.00	−148.00
$10,000	1,054.00	948.00	795.00	−159.00	−153.00
$15,000	2,002.00	1,882.00	1,750.00	−252.00	−132.00
$20,000	3,175.00	3,005.00	2,955.00	−220.00	−50.00
$50,000	14,950.00	14,730.00	14,630.00	−320.00	−100.00
$100,000	42,660.00	42,420.00	42,300.00	−360.00	−120.00
Family of 4:					
$7,000	[2] 86.00	[2] 35.00	[2] −100.00	−186.00	−135.00
$10,000	709.00	651.00	480.00	−229.00	−171.00
$15,000	1,612.00	1,552.00	1,420.00	−192.00	−132.00
$20,000	2,740.00	2,630.00	2,580.00	−160.00	−50.00
$50,000	14,140.00	13,980.00	13,880.00	−260.00	−100.00
$100,000	41,700.00	41,520.00	41,400.00	−300.00	−120.00

[1] The proposal would change the standard deduction to a flat $2,200, or, for joint returns, $3,000.
[2] Assumes use of the earned income credit.

Note.—Tax calculations are based on the tax rate schedules and assume the standard deduction, both for present law and under the proposal. The maximum tax on earned income is not illustrated.

TABLE 4.—TAX-FREE LEVELS AND PROJECTED POVERTY LEVELS

	Tax-free levels		Projected poverty levels [1]	
	1976 law	Proposed for 1977 and thereafter	1977	1979
Single person	$2,700	$3,200	$3,107	$3,439
Couple without dependents	4,100	5,000	4,018	4,448
Family of 4	6,100	7,000	6,110	6,763

[1] Applicable to nonfarm families. Projections assume consumer price indexes of 179.11 in 1977 and 198.26 in 1979.

TABLE 5.—ESTIMATED BUDGET COSTS OF THE PRESIDENT'S REVISED ECONOMIC STIMULUS PROGRAM

[Including provisions of H.R. 3477, "The Tax Reduction and Simplification Act of 1977," as reported by the House Ways and Means Committee, which are endorsed by the administration]

	Fiscal year (in billions)— 1977	1978
Rebate and payments to beneficiaries of certain programs:		
$50 per capita rebate phased out between $25,000 and $30,000 of adjusted gross income:		
Reduction of tax	7.3	
Refunds in excess of liability	1.3	
Total rebate	8.6	
$50 payments to:		
Social security, SSI, and railroad retirement beneficiaries ineligible for the full $50 tax rebate	1.2	
AFDC recipients	.6	
Total, payments to beneficiaries of certain programs	1.8	
Total, rebate and payments	10.3	
Simplification and reform program: Replace the current law standard deduction with a flat deduction of $2,200 for single returns and $3,000 for joint returns [1]	1.5	5.7
Business tax reduction program: Optional increase in the investment tax credit from 10 percent to 12 percent or an income tax credit equal to 4 percent of employers' social security tax payments	.9	2.4
Other expenditures program:		
Increased countercyclical revenue sharing	[2] .7	[2] .7
Public service employment	.7	3.4
Public works	.2	2.0
Expanded training and youth programs	.3	1.6
Total, other expenditures programs	1.9	7.7
Total economic stimulus program	14.6	15.8

[1] Includes extension of the $35 general tax credit to exemptions for age and blindness and the limitation of the general tax credit for married persons filing separately to the $35 per capita credit.

[2] Extension of the current program would increase outlays by an additional $2,000,000,000 in fiscal year 1977 and $8,000,000,000 in fiscal year 1978.

Note: Details may not add to totals because of rounding.

TABLE 6.—ESTIMATED NUMBER OF RETURNS OF TAXPAYERS MADE NONTAXABLE AND INCREASE IN THE NUMBER USING THE STANDARD DEDUCTION UNDER THE CARTER SIMPLIFICATION PROGRAM [1] BY ADJUSTED GROSS INCOME CLASS

[Calendar year 1976 levels of income, thousands of returns]

Adjusted gross income class (thousands)	Returns made nontaxable	Increase in returns using standard deduction
Less than $5	2,203	248
$5 to $10	1,012	1,576
$10 to $15	48	2,294
$15 to $20	1	717
$20 to $30	(2)	348
$30 to $50	(2)	41
$50 to $100	(2)	5
$100 or more	(2)	1
Total	3,264	5,229

[1] Consists of replacing the current law standard deduction with a flat $2,200 deduction for single returns, $3,000 for joint returns, and extending the $35 general tax credit to exemptions for age and blindness.

[2] Less than 500 returns.

Note: Details may not add to totals because of rounding.

The CHAIRMAN. Let me tell you the order in which I propose to proceed today. I will suggest that we call on the Senators in the order that they appeared in the room. If you are here when your turn comes, you will be recognized. We will try to confine ourselves to 10 minutes on the first round with a bell set to remind you that the time has expired.

I will suggest that in view of the fact that all of the witnesses are very busy men—and the Director of the Office of Management and Budget has a problem squeezing in as many things as he can with the time available to him—I believe we should be able to conclude our questions of Mr. Lance during the first round of questioning.

If you have some questions you want to direct to Mr. Lance on the first round of questions, I urge you to direct your questions to him at that time so that we can excuse him after the morning's session.

I believe we want to keep the Secretary and Mr. Schultze here for the second round of interrogation.

If a Senator wants to go back and study these statements, or if a Senator didn't have a chance to read or hear it all, he can leave the room, and come back to take his turn, if he desires, and he will be recognized when the time comes.

If he is not here when his name is called, his name will go to the end of the list. On that basis, since I was the first man here, I would like to ask the Secretary the first question.

Mr. Secretary, we have been reading lately about the administration's 2-percent increase in the investment tax credit and payroll tax credit. It was an effort to send a signal to buisness that the administration intends to encourage greater capital expansion.

Aside from the 2-percent additional investment credit, what other steps does that administration plan to take to encourage business?

Mr. BLUMENTHAL. Mr. Chairman, we hope that the entire stimulus package is the first important signal to business, one that the Carter administration is serious about getting the economy moving to fuller levels of activity, to high levels of activity.

And second, that we are doing so in a cautious and careful and predictable way, which is, I think, what the business community is interested in, and is entitled to know.

In addition to the particular business components of the tax package of the stimulus, there is in this program nothing additional that is of particular or direct help to business although all of these things are, obviously, of indirect help to business, not to speak of the rebate which, certainly, should mean that the cash registers of many businesses are going to be ringing a little louder for awhile than they have been ringing.

However, as you know, the administration is hard at work on a variety of leigslative proposals which we expect will be coming to the Congress in the course of this year.

One of these that I know is of particular interest has to do with some proposals that President Carter plans to make for permanent tax reform, fundamental tax reform.

We are hard at work on this with Mr. Woodworth in the lead in the Treasury. We will be gathering in the other parts of the administration, and consulting with people, consumers, taxpayers, businesses, and others throughout the country and, of course, we will be working very closely with the Members of Congress on this.

And as part of that program which we hope to submit later on in the year to the Congress, we would like to include suggestions not only to simplify the system, not only to insure that everyone pays his or her fair share, but also, measures that redirect the tax structure so as to encourage the creation of sufficient private jobs to keep people employed. All those who are willing and able to work should be employed, and employed to the largest extent possible in private industry, in private jobs, not in Government jobs, nor in make-do jobs, but in productive, useful jobs in our private enterprise economy.

To do this, clearly, the statistics indicate that it requires more investment in productivity because it is investment in productivity that creates noninflationary new jobs, noninflationary spending, rather than price increases by business to seek to develop the necessary capital. If they develop capital by increasing their prices, that is inflationary.

If they get additional profit by being able to increase their productivity, it is not inflationary. So that the tax program, clearly, will be designed to move us further in that direction.

The CHAIRMAN. Mr. Secretary, you recommended two items that would be of great interest to business. Now, out of the $15 billion bill, as you pointed out in your statement, those two items are really not very much, and I notice that even that was too much, from the point of view of the House committee and I assume from the point of view of the House.

I hope that tells you something when you start sending additional suggestions up here. It is easy to pass something to provide lower taxes for low income brackets. Also we all applaud simplification. I can't applaud too strongly what you have recommended in the area of tax simplification.

The tendency up here, for a lot of Members of Congress on both sides, is to say. Well, now, yes, it is fine to give these reductions in rates and overall tax cuts in the middle- and lower-income brackets, but if you have in mind reducing that 70 percent tax rate for those in the upper tax brackets, and you don't take away their deductions, we are not sure we want to go along with that.

We think we ought to put more taxes on the people paying 70 percent rather than less.

I like the idea of tax uniformity, and you do, too. We want to move in that direction. It looks to me as though you are not going to achieve much in that regard where business is concerned.

Unless your administration is prepared to fight furiously for it. I think you can expect the same kind of thing that happened in the House.

This time you come up with a bill that does very little for business. I assume that you are going to be recommending a bill that goes in the direction of tax equality, tax uniformity, tax justice.

But you better anticipate it is going to be popular on behalf of a lot of people in Congress to strike out and leave more successful individ-

uals with a tax increase. I hope that when you bring your additional tax change proposals to use that you will seek to provide more tax equity, more tax uniformity, more tax justice, and that you will be prepared to fight vigorously for your proposals.

If you lose in the House, try in the Senate. I applaud you for doing that. I resent the type of thing the House committee is trying to do; taking your proposal, changing it around to fit their ideas, and trying to force the Secretary of the Treasury to go testify on the Senate side—to something that is contrary to what he honestly thinks—when the bill gets there.

So, if you still think you are right when the House turns you down, I hope you continue to come over to the Senate, and tell the Senate what you honestly think, rather than yield to the powers of the House committee, or the House itself, and yield on your proposals. Tell us your firm convictions on the matter when the second turn comes; tell the Senate what you think about the matter.

Mr. BLUMENTHAL. Yes, sir.

The CHAIRMAN. Some taxes can be counterproductive. My favorite story about that has to do with the excess profits tax back in World War II.

Three lobbyists were in the lounge of the Mayflower Hotel. They had had a few rounds of drinks. Someone decided it was time to pay the check. One said: "Let me have the check. I am in the 90 percent excess profits tax bracket. It won't cost me but 10 cents on the dollar. I will be glad to pay the check."

The other fellow said: "I have an expense account. It won't cost me anything."

The third man said: "Hell, no, Let me pay the check. I've got a cost plus expense contract. I will make a 10-percent profit on the check.

Now, there are all kinds of inefficiencies that have worked their way into our tax system because of that excess profits tax. There are all kinds of charitable foundations that were set up, all sorts of charitable gifts made, where a taxpayer actually bought something with the money. There were also instances where taxpayers just moved property to a foundation. Some property never makes its way to charity.

There were lots of pension programs for executives which were started back at that time; all sorts of private airplanes, and God knows what else. The money came from other taxpayers. This is what that sort of program induces as taxpayers try to avoid what they would have paid in excess profits taxes.

Now, 70 percent is not as counterproductive as 90 percent. But I hope very much that your administration, in trying to work out a good program, will recommend adjustments of rates to take that into account so that the final program is not something that, on the whole, is going to discourage people from making investments that provide jobs and opportunities for everybody in America.

Mr. BLUMENTHAL. Mr. Chairman, the employment credit, which we are not afraid to say we do not like, we oppose because it does have all of these problems—actually, it has the same kind of base problem that the excess profits tax had.

So the problem with that tax, really, is the same as with the employment tax because you have to go to a base in order to calculate whether

they get something or not. That was the beginning, I think, of all of the troubles in this business.

The CHAIRMAN. Senator Nelson.

[No response.]

The CHAIRMAN. Senator Hansen.

[No response.]

The CHAIRMAN. Senator Curtis.

Senator CURTIS. Mr. Chairman, I would like to ask Mr. Schultze: How many adults are there in the country 18 years of age and over?

Mr. SCHULTZE. Just a moment, Mr. Chairman. I don't carry the number in my head. Eighteen and over?

Senator CURTIS. Yes.

Mr. SCHULTZE. I have 16 and over. I don't have 18 and over.

Senator CURTIS. How about 16 and over.

Mr. SCHULTZE. OK, sir.

Mr. BLUMENTHAL. He wants the total?

Mr. SCHULTZE. The total. I will get it. Let's see, 155—no, 157 million.

Senator CURTIS. That is over which age?

Mr. SCHULTZE. Over age 16. We just checked. That should be right. Over 16.

Senator CURTIS. Would you have a guess as to how many would be over 18?

Mr. SCHULTZE. About 145 million in 1974.

Senator CURTIS. Say 150. How many individuals pay income tax? Not those who file a report, but pay an income tax.

Mr. SCHULTZE. 83 million returns. Now, that is not necessarily——

Senator CURTIS. 83 million.

Mr. SCHULTZE. 83 million taxable returns.

Senator CURTIS. If there are 150 million people over 18 and only 83 million of them file a tax return, it means that 67 million of them do not even file a tax return.

Mr. SCHULTZE. 44 million more file joint returns, Senator.

Senator CURTIS. I see. You don't know how many file either a separate, or a joint return. Well, that can be supplied.

Now, what is the total price of the Carter package as submitted?

Mr. SCHULTZE. Over a 2-year period?

Senator CURTIS. Yes.

Mr. SCHULTZE. $31.2 billion. That is 2 years.

Senator CURTIS. How much of that goes to taxpayers?

Mr. SCHULTZE. Directly?

Senator CURTIS. No. Yes.

Mr. SCHULTZE. Eleven plus. Just a second.

Mr. BLUMENTHAL. Can I add something to this?

Senator CURTIS. Yes.

Mr. BLUMENTHAL. This indicates, Senator, that 170 million people are covered by taxable returns, which means if you take 220 million in the population, that is, everybody, about 50 million are not covered; 45, 50 million are not covered.

Senator CURTIS. That is all ages?

Mr. BLUMENTHAL. All ages. Everybody.

Senator CURTIS. This is covered by tax?

Mr. BLUMENTHAL. Taxable returns. The return which was taxed in 1976.

Senator CURTIS. I think we crossed the line a few years ago. The Carter administration didn't do that. The Congress did.

Mr. BLUMENTHAL. I don't believe we have reached that point yet, Senator.

Senator CURTIS. I think we did in tax payments.

Mr. SCHULTZE. Strictly in terms of going to the taxpayers, it is approximately . . . Senator, we can get this for you . . . $20 billion, additional go to social security beneficiaries; and there are some refunds in the tax system to payers who don't have any tax liability.

Senator CURTIS. Now, how will that be arrived at, by subtracting the number of social security recipients and these other people who get a rebate?

Mr. SCHULTZE. Plus subtracting those parts of the program which go to public service employment, public works, leaving only the tax part.

Senator CURTIS. Then a third of it goes to nontaxpayers.

Mr. SCHULTZE. Not necessarily. A third of it will go in the form of, some form of income outside the tax route, for example.

Senator CURTIS. I want that, and you can supply it for the record. That is considered . . . well, I will put it this way: Payments to individuals, how much of it goes to individuals who pay some taxes? How much of it goes to individuals who pay no taxes? If you can get it, supply it for the record. Who, for instance, is eligible for rebate?

Mr. BLUMENTHAL. There is a variety of groups, Senator. First, everyone who has had a tax liability. Second, all those on social security, SSI, and railroad retirement. Third, those eligible for the earned income credit even though they did not have a tax liability under the Ways and Means bill, AFDC, veterans, and black lung recipients would also be eligible.

Senator CURTIS. Earned income credit of a family, the head of the household.

Mr. BLUMENTHAL. Yes.

Senator CURTIS. So everybody in the lower brackets will get a rebate except the single unemployed.

Mr. BLUMENTHAL. The single taxpayers who had not tax liability, and are not covered by any of these other programs. That is right. The single person who had no tax liability who was not covered by any of the other programs, and who was not covered under the parent's return. Those are the only ones that would not be covered.

Senator CURTIS. How about the old couples that aren't on social security, or SSI, and are not eligible for earning income credit?

Mr. BLUMENTHAL. If they have any earned income at all?

Senator CURTIS. If they had no children.

Mr. BLUMENTHAL. If they have any earned income, they could be covered. No. I was going to say that if it is an old couple, chances are that they are on social security, at least.

Senator CURTIS. Well, some of them aren't.

Mr. BLUMENTHAL. If they are not on social security, if they are not on some SSI, and none of these other things pertain, I suppose that the couple would not receive anything.

Senator CURTIS. Now, take the case of an individual who is on social security, and he has a very sizable income in addition thereto; he still gets a rebate.

Mr. BLUMENTHAL. He will get it under the social security. Yes. He will get a rebate. He won't get two, but he will get one.

Senator CURTIS. Now, including all social security beneficiaries, that is one point where the rebate is not limited to people of low income.

Mr. BLUMENTHAL. That is right.

Senator CURTIS. Some of it, by chance, will be, but there are many people on social security that certainly aren't of the lower, limited income.

Now, I want to ask, Mr. Secretary, a question of you. I was interested very much in what you said about expenditure and investment that is free from inflation.

How much of an investment does it take in the private sector to put one man to work, one individual to work?

Mr. BLUMENTHAL. Sir, the point that I was trying to make is that business investing to increase productivity and to lower costs, and getting, in this way, additional capital resources is not inflationary as compared to seeking to raise prices.

Senator CURTIS. Yes; I agree with you thoroughly. My time is up. I would like to have an answer to the question of how much capital it takes to create jobs.

Mr. BLUMENTHAL. I think that depends entirely on the business and the circumstances.

Senator CURTIS. What are the ranges?

Mr. BLUMENTHAL. I would have to get whatever averages I have, to go to the statistics, and get you some averages.

Senator CURTIS. If you will, please.

Mr. BLUMENTHAL. I will.

[The following was subsequently supplied for the record:]

As Secretary Blumenthal suggested, the amount of capital per worker varies greatly by industry and other circumstances. Using 1973 estimates of the fixed non-residential business capital stock and non-agricultural employment, an average of $13,000 of capital exists for every worker in the United States. Changes in capital stock and employment statistics indicate that the marginal amount of capital per each additional new worker is about $14,500.

Senator BYRD. Senator Packwood.

Senator PACKWOOD. Let me be sure that you depict the other comments to be contrary. You sound to be.

Mr. SCHULTZE. I don't know.

Senator PACKWOOD. I notice in the standard revision table here that you have moved from 24 to 22 to 30. Is that the present position, which is, of course, spread away from the Congress, and the only difference between singles and married couples?

Is it the intention of the administration to move backward from what Congress has been going to tax, make taxable income equal for those who are married and those who are single; tax deductible income is equal?

Mr. SCHULTZE. Well, that is right. The administration's position of $2,200 versus $2,400 goes in the direction of reducing the marriage penalty.

Senator PACKWOOD. You are making the spread between 22 and 30, as I look under the deduction.

Mr. SCHULTZE. Yes, it is $200 less in the administration's proposal that is in the package than what came out of the Ways and Means Committee.

Senator PACKWOOD. Under current law, $400.

Mr. BLUMENTHAL. Under the present law, $1,300, $1,700, and $2,100 are the amounts. You multiply $1,700 by 2 to get $3,400 as compared to $2,100. There is a $1,300 difference; and under the $2,200 and $3,000, it is a difference of $1,400. There is a $100 difference between the two.

Senator PACKWOOD. The current maximum standard deduction is $2,400 for singles. Right?

Mr. BLUMENTHAL. Right.

Senator PACKWOOD. $2,800, married, under the current, present law.

Mr. BLUMENTHAL. The present law is $1,700 and $2,100. Right.

Senator PACKWOOD. That is the minimum.

Mr. BLUMENTHAL. Minimum. Yes. The maximum is $2,400 and $2,800.

Senator PACKWOOD. What is the maximum going to be under the present proposal?

Mr. BLUMENTHAL. There will only be one. There won't be a maximum or a minimum but only one standard deduction.

Senator PACKWOOD. What is it?

Mr. BLUMENTHAL. $2,200 and $3,000.

Senator PACKWOOD. Right. So there would be a widening of the gap between the present maximum on singles and marrieds, and the standard that you are going to have now, as I read it, it should be $2,200 and $3,000, and that is going to be the standard deduction, depending upon whether you are single or married. Is that right?

Mr. SCHULTZE. It keeps the gap to a minimum.

Mr. BLUMENTHAL. It keeps it the same result, it seems. Let's try it. All right. The proposal is at $2,200; our proposal.

Senator PACKWOOD. Right.

Mr. SCHULTZE. $2,200. Double it. That is $4,400. That is two single people.

Senator PACKWOOD. I understand that.

Mr. SCHULTZE. $4,400. If they marry, it comes down to $3,000.

Mr. BLUMENTHAL. Why don't we get Mr. Woodworth to come on up. Would you?

Senator PACKWOOD. I am glad to see him back in a familiar position again.

The CHAIRMAN. One always tries to move to more exclusive company, but he sees he couldn't escape.

Mr. WOODWORTH. I think that what you are referring to is a comparison between a single person, and a married couple with one income earner.

Senator PACKWOOD. I couldn't hear.

Mr. WOODWORTH. I think you are making your comparison between a single person and a married couple, where there is one earner.

Senator PACKWOOD. That is correct.

Mr. WOODWORTH. In the family.

Senator PACKWOOD. That is right.

Mr. WOODWORTH. Of course, you have two different kinds of comparisons. That is what makes it difficult here.

Senator PACKWOOD. The question I was asking was that over the years, Congress has tried to narrow that difference between the single taxpayer and the married taxpayer, the family with one earner, and we have succeeded in the past to have tax reform in narrowing this slightly, sufficiently to move away from that.

Mr. WOODWORTH. Congress has moved two ways in that regard. On occasion, Congress has moved in the direction you are saying, but not always.

I think I can find you cases where the Congress has acted both ways in that regard, sometimes in the same bill.

It depends on whether you are referring to the minimum standard deduction, in which case they have tended to move in the direction that you are saying. In fact, it used to be the same for the single and married, and then there was concern expressed about that by families where there were two earners and by individuals who were preparing to marry, and they found their taxes going up appreciably.

So the Congress then began, as you know, to make subsequent modifications in the standard deduction. You began then to create a differential between the single and married.

I think it was about 10 years ago when it was the same. But at least twice since that time, two or three times since that time, you have begun to widen the difference; and in that sense of the word, this tends to continue that same procedure you previously followed.

But if you are referring to the rate structure, it is cerainly true that the 1969 procedure went the other way.

Senator PACKWOOD. I am going to take the last one. Heads of households. Statistically, usually, divorced or widowed women with dependent children, they will be left with the standard deduction, $2,200. Would they be left with $2,200?

Mr. WOODWORTH. I believe it is $2,200.

Senator PACKWOOD. $2,200.

Mr. WOODWORTH. Yes.

Senator PACKWOOD. You are normally talking about workingwomen with children, which you are putting at $2,200 as opposed to $3,000, where they would be if they were married. Is that right?

Mr. WOODWORTH. That is true. The Congress has—maybe not correctly—but has kept the head of the household, as far as standard deductions are concerned, in the same category as the single person, and there has been no change made in that regard.

It actually wasn't particularly reviewed.

Senator PACKWOOD. All right. The second question. Unrelated. All of the testimony of the three of you dealt here very well. I am just curious as to how you can be so positive that what you are saying is going to work.

Mr. BLUMENTHAL. You can take that one, Mr. Schultze. [Laughter.]

Mr. SCHULTZE. What do I do with it? [Laughter.]

In the first place, obviously, nobody is 100 percent sure of anything in the world. Nevertheless, in terms of looking at all of the alternative options, we do not propose a very large permanent tax cut.

We concentrate our economic proposals solely on direct Government job-creating jobs and programs. If you look at all of the different alternatives, I think that I can say that we are very convinced that this is the best. If you ask us if this is a perfect proposal, no.

Senator PACKWOOD. In terms of the rebate versus the reduction, especially, possibly, if there has been a reduction, but just the rebate of it, is there any reason that one would believe that one over the other would create any more permanent jobs?

Mr. SCHULTZE. If that is the only criterion, no, sir.

I don't want to let that answer stand in the record without saying why that is, given qualification, on the grounds that we chose one rather than the other.

Senator PACKWOOD. Yes.

Mr. SCHULTZE. An essential point is, particularly for an administration coming into office, initially, we did not want to mortgage permanently a very large block of revenues, and with that mortgage, forever close several possibilities, (a) having the resources available to go with, in terms of a tax reduction, to go with a major tax reform simplification program.

Second, balancing the budget by 1981 at the latest.

Third, being able to propose some high priority initiatives and, therefore, when you put all the criterion together, even though they are equal, roughly, on the first, they are not equal on all the others.

Senator PACKWOOD. Thank you.

The CHAIRMAN. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Lance, I believe this is the first time that the committee has had the privilege of having you with us, and I want to say welcome.

Mr. LANCE. Thank you.

Senator BYRD. I believe you have perhaps the most difficult job in Washington and, indeed, perhaps the most important job.

I don't know whether I should address this to you or to Mr. Blumenthal, but how much does the Carter program add to the 1977 deficit?

Mr. LANCE. To the fiscal year 1977 deficit?

Senator BYRD. This current fiscal year.

Mr. LANCE. In outlays?

Senator BYRD. How much does it add to the deficit?

Mr. LANCE. For 1977, the stimulus package totals $14.6 billion. That includes the increased expenditures in the stimulus package and the rebates and the other revenue decreases in the stimulus proposal.

Senator BYRD. So it adds to the deficit?

Mr. BLUMENTHAL. How much does it increase the deficit. About $8 or $9 billion, I believe.

Mr. LANCE. I have to check on the deficit increase. It is not that much. The Ford 1977 budget deficit was $57.2 billion. We show a $10.8 billion increase in the deficit, making it $68 billion for 1977.

Senator BYRD. The Carter program adds $10 billion to the deficit.

Mr. LANCE. $10.8 billion.

Senator BYRD. $10.8 billion.

Mr. LANCE. That is right. For 1977.

Senator BYRD. Now, how much does the Carter program add to the deficit for fiscal year 1978?

Mr. LANCE. The same amount, $10.8 billion.

Senator BYRD. So for the 2-year period, the Carter program will add to the deficit some $21.6 billion.

Mr. LANCE. Yes, sir.

Mr. SCHULTZE. Can I just add one proviso to that. That calculation is assuming that with the budget proposals of the outgoing administration, we would achieve an economy which would have given the lowest kind of revenues; that is, the revenues you are going to get, particularly in 1978 will, obviously, depend not only on the tax proposals, but on the state of the economy.

It is our judgment that with those particular fiscal proposals in the Ford budget, you wouldn't have gotten that kind of economy, and you wouldn't have gotten that kind of revenue. That is our judgment, that actually, we don't believe you would have that low a deficit with that particular budget.

Mr. LANCE. We believe that the 1978 deficit would have been higher under the Ford proposal because their revenue forecast was too optimistic.

Senator BYRD. Is it correct or incorrect that the deficit for fiscal year 1977 will be the highest deficit in the history of the Nation?

Mr. LANCE. To my knowledge, that is a correct statement.

Mr. BLUMENTHAL. If the deficit is $68 billion, as we estimate, then it will be $1.5 billion higher than the 1976, actually, which was $66.5 billion.

It is, roughly, the same since we can't be that sure—within $1 million—what it actually is going to be.

Senator BYRD. Is it correct or incorrect that the 2-year deficit for fiscal year 1977 and fiscal year 1978 will be the highest 2-year deficit in the history of the Nation?

Mr. LANCE. No, sir, I don't think that is correct.

The deficit in 1978 is expected to be less than the actual 1976 deficit. So the sum of 1977 and 1978 would not be the highest. There is a $10 billion reduction in the deficit from 1977 to 1978.

Senator BYRD. Is it correct that the Federal funds deficit, as distinguished from the unified budget, that tne Federal funds deficit for the current fiscal year of 1977 will be the highest in the Nation's history?

Mr. LANCE. That amounts to $75.9 billion in 1977, and that is the highest.

Senator BYRD. Is it correct that the 2-year deficit, Federal funds deficit for fiscal year 1977 and fiscal year 1978 will be the highest 2-year deficit in the Nation's history?

Mr. LANCE. I don't think that is an accurate statement. I think if you take $68.9 billion for 1976, and $75.9 billion for 1977, and only $68 billion in 1978, then 1978 is nearly $1 billion less than 1976. That is country arithmetic. That is the best kind I know of. So it is not a correct statement.

Senator BYRD. The Federal funds deficit for fiscal year 1977 will be $75.9 billion, as I understand it, from your figures, and the Federal funds deficit for 1978. fiscal year 1978 will be $68 billion.

Mr. LANCE. $68 billion. That is correct.

Senator BYRD. In regard to the debt, as I understand the figures, that were projected, the national debt, at the end of fiscal 1977 will be $727 billion.

Mr. LANCE. That figure, if you remember, is from Secretary Blumenthal's testimony.

Senator BYRD. Mr. Secretary, the projected debt for the end of fiscal year 1978 will be $802 billion.

Mr. BLUMENTHAL. Yes; $802 billion. That is right. That is correct, Senator.

Mr. SCHULTZE. Page 83.

Senator BYRD. Now, the national debt at the end of the fiscal year of 1970 was $383 billion. To put it another way, and if I am not figuring this accurately, I wish you would let me know, but as I study these figures, the figures show that the total national debt which will have been incurred at the end of fiscal year 1978 of $802 billion, that 52 percent of that, 52 percent of that debt was incurred between the end of the fiscal year 1970 and the end of the fiscal year 1978.

Mr. LANCE. That sounds like it would be the correct percentage points.

Senator BYRD. Is that not an astonishing figure, that 52 percent of the national debt would have been incurred in that 8-year period?

Mr. LANCE. Yes, your honor; that is an astonishing figure. I think what that means is that it is imperative to do something. We plan and hope to have a balanced budget in 1981.

With that sort of increase in the debt, there have been horrendous deficits as you have pointed out. Our proposals are well aimed from the standpoint that in actuality we have to do something about the problem.

Senator BYRD. I have forgotten exactly where I read it, but I read along the line that you feel the key to economic progress is confidence——

Mr. LANCE. Yes.

Senator BYRD [continuing]. Confidence on the part of the public, and confidence on the part of the business community, the people, generally. Do you think this program is one that is calculated to insure confidence on the part of the business community, or the general public.

Mr. LANCE. Senator, I think it is, and I would like to give you a couple of reasons why I think it does do that.

First of all, there was consensus reached early on in the Carter administration that we very definitely need some sort of stimulus program.

We tried to keep it as modest as possible under the circumstances. We did not want to increase the deficit any more than absolutely necessary simply because, as the Secretary of the Treasury has already made reference to, of the crowding-out problems, the countercyclical problems in relation to the huge deficit and all those problems undo confidence in the minds of the people in this country.

We are also doing some other things that, with the help of the Congress, will enable us to root a sense of confidence. One of these is to employ the zero-based budget for the 1979 budget. Also of extreme importance is the reorganization, which the Senate granted the authority to do last week by resounding vote. We think this is awfully important in the process.

The President also has dealt with the question of eliminating the reports that impose work on the people of this country.

We have talked to a lot of business leaders. Without exception, all say that the biggest problem they face is the amount of time they have to spend in dealing with Government intervention, in their own busi-

ness operation. They can't do any sort of planning; they can't have any sort of confidence in the future because of that sort of problem.

So we are moving up in all fronts of the economy to do something with the problem of confidence. We think the stimulus package is part of that.

Senator BYRD. The fact is that what you are advocating, the legislation before this committee, increases the deficit for each of the 2 years, the current fiscal year and fiscal year 1978, which Congress is now working on.

My time has expired. Thank you.

The CHAIRMAN. Senator Danforth.

Senator DANFORTH. I don't know who to direct my questions to with this group of principals, but we talked about the stimulus program. Is it fair to say that the principal goal of any kind of stimulus package should be to create jobs, is that the first aim?

Mr. SCHULTZE. All right. The primary goal, but there are a lot of goals that are almost as primary, but; all right, let's say jobs.

Senator DANFORTH. Well, what are the others that would go along with jobs?

Mr. SCHULTZE. First, it has to be something which is sustainable.

Second, it has to be something which goes over long enough a period to provide the confidence and the recovery that will get the private economy to come along and start picking those jobs up.

Third, it has to create jobs not at the expense of inflation. I would add immediately those other criterion that go with it.

Senator DANFORTH. Would those be the three primary additions that you can think of, jobs with those three provisions?

Mr. SCHULTZE. I am sure you are going to get me on one I forgot, but all right; yes, sir.

Senator DANFORTH. Let me just ask you this. There was some degree of speculation that one of the points of the rebate was to provide a transfer payment to a lot of people that pay their high fuel bills. Does that enter into it, and to what extent?

Mr. SCHULTZE. First, it was obviously not the objective of the rebate to do that. The size of the total rebate, approximately $11 billion, was clearly not intended with that in mind.

It turns out that one of the hangover effects, if you will, in the cold weather was the fact that people were forced to pay higher amounts for their fuel bill.

As you know, this will surely help, but obviously, we designed the stimulus before the cold weather came along. We didn't design it with that in mind.

Mr. DANFORTH. But in measuring, say, two or three different alternatives for the stimulus package, is it fair to measure those alternatives against the criterion of jobs with the proviso that the jobs should be sustainable, that the stimulus package should be one that creates confidence in the private economy, and that the jobs should be created without inducing inflation?

Mr. BLUMENTHAL. I would like to add another one, Senator. I think it is essential. I think one has to see a stimulus program not in a vacuum, but as part of the continuing, long-term economic program for a government.

So that one of the additional requirements also has to be that it fits in with the subsequent longer term components of the administration's economic program.

Now, what you have to see is how the stimulus program fits into what you do with other things, particularly in the longer run; what you do about welfare, about cities, about lots of things that tend to influence what kind of stimulus program you select.

Senator DANFORTH. Now, when economists devise a program to create a stimulus package, they create various models, or draw upon various models which predict the effect of the various components, parts of the program. Isn't that correct?

Mr. SCHULTZE. You draw upon them, but don't rely solely upon them. That is correct.

Senator DANFORTH. What are your projections for jobs that would be created by your program for a particular period of time? I would like you to go out 4 or 5 years, and indicate the number of jobs that would be created by this particular package.

Mr. SCHULTZE. Well, sir, let me start by going out for 2 years; and obviously, what I am going to say, with whatever amount of thought you feel is appropriate to put upon an economist's forecast on the basis of both looking at models and second, on applying to that some commonsense judgment, it is our estimate that, compared to what would otherwise have been the case, that this stimulus package should raise the growth rate of our national output by somewhere between three-quarters to 1 percent by the end of 1977, and something of the same amount extending out into 1978; that it would increase employment, compared to what otherwise would have happened, by something over 750,000 jobs.

Senator DANFORTH. I am sorry. Just so for my very thick skull, could you just keep it on jobs created?

Mr. SCHULTZE. Jobs?

Senator DANFORTH. By the end of 1978; by the end of 1979, and so on, for 5 years.

Mr. SCHULTZE. No, sir, not for 5 years.

Senator DANFORTH. For as long as you can. Do your best.

Mr. SCHULTZE. Let me say that what we have done is make some explicit calculations for the next 2 years. And let me first give those, that it would, by the end of 1977, increase employment approximately something over 750,000 jobs.

Senator DANFORTH. 750,000.

Mr. SCHULTZE. 750,000. That is correct. Lower the unemployment rate, which is now running at 1.5 percent to something in the range of 6.7 to 6.9 percent by the end of this calendar year.

By the end of 1978, the additional jobs created should have risen to something in the neighborhood of 900,000 jobs. The overall unemployment rate should have been lowered to something in the neighborhood of 6 percent, down toward 6 percent compared to the situation with no program.

Now, again, I remind you of the caveats, and whatever else you want to put on that forecast. They are not all that important.

Senator DANFORTH. I know, I understand that; but you are doing your best. Do you go longer than that?

86-032—77——9

Mr. SCHULTZE. Not in terms of these different projections because obviously, as you begin to get into 1978, 1979, 1980, and 1981, you are confronted with all of the other social and economic policies of this administration that, as they come along, will influence the economy.

Senator DANFORTH. What would be your best judgment of the effect of this package on jobs by the end of 1979?

Mr. SCHULTZE. Well, let me say it in another way, that by 1978, the aim of the stimulus package, together with the other measures which will be forthcoming, including the major tax reform package, would be such as to set in motion a sustained economic growth in which the private economy was picking this up so that we would not need any longer, explicit, year after year governmental injection of new stimulus.

Hence, the whole point of the stimulus package is not so much that it can go up to 1981, this stimulus package itself is not going to create 1, 2, 3 million jobs, but, rather, this stimulus package is designed to get the private economy to generate that kind of jobs, and lower unemployment in 1979 and 1980.

Senator DANFORTH. Is it a fair statement that the stimulus package is designed to get us over a 2-year hump, and that at the end of the 2-year hump, you are hopeful that the private economy, or other measures that will have been produced by then will have carried that further?

Mr. SCHULTZE. In a sense, that is correct. We do believe that the fundamental strength in the economy, that the combination of actual measures, and the confidence-building can do precisely what you have indicated.

Senator DANFORTH. Thank you.

The CHAIRMAN. Senator Haskell.

[No response.]

The CHAIRMAN. Senator Bentsen.

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

I have heard these comments about there being an increase in confidence in the country. Extending the comments, I think they are true because of the quality and the caliber of the men who are seated at this table who have been chosen by President Carter. I think you have come up with a well-rounded package in the way of tax proposals.

I have heard comments about what the House did, but you should have seen what the House did to the program of some of your predecessors. I think you came out pretty well.

I am concerned that the House removed the provision which increases the investment tax credit. Business is utilizing 78 to 80 percent of productive capacity today. Some of the unused capacity is more inefficient capacity that is laid aside. Thus, we can well have shortages in some basic industries before too long.

We ought to try to encourage jobs in this country. So I support the employment tax credit as an option. I don't happen to agree with the proposed 4-percent credit on social security tax.

Many of us are seeking an incentive for people to be hired in the private enterprise system.

Look at public works jobs; that is $30,000 for an employee; other public service jobs that may cost $8,000 to $10,000 per employee, and I support those proposals that I thought were for working, and getting paid for the work rather than getting paid for not working, but many times, these are dead-end jobs.

We are looking for a way to fight inflation, and fight recession and unemployment and some of us think that the employment tax credit may help do that.

I think a number of arguments have been made by Secretary Blumenthal about the proposal on the House side which are legitimate and that we can remedy.

Mr. Schultze says that this jobs tax credit does not help an area that is going downhill. I don't think the investment tax credit helps that area much either because it is difficult for people to buy machinery if they are not selling their product.

I think there are ways that you can select a percentage base to help businesses retain employees.

I think these incentives will help.

What I would like to see is to find ways where we bring them into the mainstream of private enterprise, and what we hope will be permanent jobs, not dead-end jobs, that are good paying jobs.

They have done some of this in Germany, supposedly, with some positive effect. I hope that you do not reject this out of hand. The idea is not a new one, but it has more support than I have seen it have in a long time. Let's find ways to see if we can make it work as an alternative to the investment tax credit. Give business a chance to have the investment tax credit with an addition of 2 percent if this is what they want, and that is what fits them best.

But I really don't believe that 4 percent on social security tax, on the employer's side, which amounts to a maximum, I believe, of about $38, is really going to be an incentive to both hold employees, or to add employees.

Now, who wants to sound off on that?

Mr. BLUMENTHAL. I will just say a couple of things, Senator. I think the goal of increasing employment is certainly one that we would fully support.

The question is how, with the limited amount of resources available, we can best do that, and do it on a continuing basis so that it is not a one-shot thing, or a gimmick, but something that really is continuous.

If you take the cap off the employment tax credit, even if then you change some of the other elements to which you have referred——

Senator BENTSEN. I am afraid it would cost too much.

Mr. BLUMENTHAL. We have great costs. The reason that that came on there is precisely because the House found that was the only way that they could live within the overall cost of this program.

So that is one very important problem that would have to be overcome. And the second one is the old problem of the base. How can you do it without getting so complicated as to confuse, rather than clarify, and have people businessmen throw up their hands.

How can you target it. That is the real question. We haven't been able to solve it, and if this committee, or the Senate, can, we would be very interested in knowing: how can you target this in such a way

that it not only stays within the cost limits, but also, that it does award those employers who really hire more employees in response to this.

Senator BENTSEN. That argument applies to the investment tax credit also. How much is the windfall? That is an argument that applies just as much to the investment tax credit which I support.

Mr. BLUMENTHAL. No. sir, I don't believe that you have heard I know you haven't heard us today, and we have taken this act, this triumvirate before various committees.

I don't believe we have, on any occasion, claimed that the investment tax credit, in the first instance, creates, by itself, additional jobs.

What we have said is that it brings about a somewhat greater incentive for business to invest over time and that that has two effects.

One, it provides a general level of confidence, which creates jobs, over time, in the longer run, but we can't tell you how much that is for next year.

And second, that it increases the speed, and the total amount of funds that leak into investments. In other words, we have really talked about the general impact on the economy over the longer run, and we have no claimed that that proposal brings about a number of jobs next year.

We can't do that, really, because we don't know.

Senator BENTSEN. I wasn't making that point. I was making the point that, as I understood it, you said that the business firms are going to expand anyway.

If so, then they would get the credit for the employment tax credit. The same point can be raised with the investment tax credit.

Mr. SCHULTZE. Some people have proposed an investment tax credit in which you get the credit o ly if you increase your investment over the last year; but that is a big difference from our proposal. You don't get that very random and arbitrary impact which comes from doing it incrementally, No. 1.

No. 2, Senator, you and I have talked about this before, and I think perhaps over the long run, some particular kind of incentives to business firms to hire particular kinds of labor under carefully structured arrangements, or, particularly, in permanent, long-term jobs where the credit isn't available unless it is long-term jobs, all that might be worth exploring, but very probably, not as part of the tax system.

Senator BENTSEN. Thank you very much, Mr. Chairman. My time has expired.

The CHAIRMAN. Senator Roth.

Senator ROTH. Thank you, Mr. Chairman. I, too, would like to agree with what Senator Bentsen said. I think that President Carter has brought together a very excellent team in the economic area, and I congratulate you.

But I must confess I have very serious problems with the economic package you have developed. You say, for example, Mr. Schultze says in his statement that we need an economic stimulus, but as he says, the $50 rebate is the centerpiece of your first year stimulus proposal.

Gentlemen, in all candor, that bothers me very deeply. I have talked to many people. I have talked to the blue-collar worker. He doesn't seem to think it is going to do very much for him.

I talked to the small businessman, the large businessman. I don't hear any of them talking about building plants because of this so-called stimulus package.

The so-called merchandisers say that they may see some increased sales temporarily, but they are not going to change their purchasing pattern. So I don't see any confidence being built into the economy through this stimulus package either for the consumer, or the businessman.

I don't see the small guy going out to buy a car. In my State we have the Chevette plant closing down shifts because they aren't being sold.

I don't see the businessman expanding production. So gentlemen, how can you see a real economic stimulus coming about by this one-shot rebate?

Mr. SCHULTZE. Senator, there are several things on that. If all we had proposed was the one-shot rebate——

Senator ROTH. I am talking about the whole tax package now.

Mr. SCHULTZE. I understand that. What we did was that we put together a program in which there are certain direct job-creating elements: The public service employment, the public works programs, revenue sharing, which, in order to manage them correctly, must necessarily phase in gradually.

And so what you really, have is two, two $15 billion to $16 billion stimulus packages in which the first part of it has the rebate in order to move quickly, and as that purchasing power fades away, because it is only a one-shot rebate, you move in with the second year's program.

So it really isn't a one-shot affair. It is, rather, a 2-year proposal with two different components and emphases in the first year versus the second. That is my first point.

My second point, I realize that the effects of the rebate are indirect; that is, by putting additional funds in people's pockets, they will buy more, and those additional purchases will, in turn, lead to additional production of the goods to be purchased, and inventories to be used during the first round, and then be refilled.

We think it would be effective in the first year, especially to get purchasing power quickly, but it is not the only step.

Senator ROTH. My concern is that I don't think a temporary $50 rebate is going to do much in the way of stimulating consumer purchasing power.

I don't see the middle-class family going out and putting a down payment on a house, or a car, or a refrigerator, or a TV.

The thing that bothers me the most is that it seems to me that, if I might say, my dear friends have forgotten the message of the Kennedy years. And a couple of people have forgotten the lesson of the Kennedy years.

Kennedy showed us that there is one very simple way to get the economy moving permanently, and to create long-term jobs. That is through a permanent across-the-board tax cut.

One of the things that bothers me about the rebate proposal here is that you are doing nothing for working Am[illegible]ca. It is all loaded down at the lower end. There should be something there at the other end.

I agree that lower income people need relief, but, the people who are making $20,000, $30,000, $35,000 are forgotten about. That is where the

productivity has to come from. That is where the puch has to come from.

I would just like, if I might, Mr. Chairman, and I am talking more than I am asking questions, point out to the committee that President Kennedy, back in the sixties, argued that the chief problems confronting our economy in the 1960's was the unrealized potential growth, underinvestment, unused capacity, persistent unemployment.

And he dealt with these problems with a permanent tax cut across the board for individual and for business.

I thought it was very interesting that he said in his message to Congress, "I do not say that a measure for tax reform or reduction is the only way to achieve these goals.

"No doubt, a massive increase in Federal spending could also create jobs and growth, but in today's setting, private consumers, employers, and investors should be given a full opportunity first."

Congress has heard testimony from the Congressional Budget Office, the Joint Economic Committee, and other economic experts that this rebate is not going to have the necessary impact.

The question I have for you, gentlemen, why don't we, right now, put in place a permanent income tax cut? That is the way you are going to get the guy making $20,000, or $25,000 to buy a house, or to buy a car, not by a $50 rebate.

Why should we wait until next fall or later for a permanent tax cut? Why don't we do it now, begin the job now, and put buoyancy in the economy?

Mr. SCHULTZE. Two things should be mentioned with respect to this, and my colleagues may want to add to that, that in the first place, with respect to the average workingman, if my calculations are right, $10,000 earners with a family of four will, in the first year of this program, in terms of a combination of the rebate plus the standard provision, get, I think they run $371; $371 is not going to make anyone rich, but $371 is a very substantial proportion.

Senator ROTH. What if he has a mortgage on his house? He won't get any tax relief from the standard deduction.

Mr. SCHULTZE. It continues on the payment. On the other hand, well, people who switch over from exemptions to the standard deductions precisely because it is more favorable.

My second point with respect to the Kennedy years is that in the permanent tax cut, I think there is one very large difference, in an analysis, under the economic conditions and the structure at that time.

It turned out that we had a tax structure that, under conditions of full employment, would generate about $20 to $30 billion more revenues than expenditures.

Let me say that at that time, if you calculated looking at the facts of that structure, that tax structure, you would generate $20 to $30 billion more revenues than expenditures under high employment conditions.

That is not true now. That is no longer true.

Senator ROTH. Mr. Chairman, the Treasury, at that time, estimated that those tax cuts would result in a huge revenue loss. But history shows us that the tax cuts actually increased revenues, or the expanded gross national product increased revenues for the Federal Government. I think we are faced with the same situation here today.

The New Republic, which is a very liberal magazine recently had an editorial stating that for the first time in our Nation's history, the middle class faces downward mobility and that there is no reason to deny tax relief to individuals who make $20,000 or even $30,000.

I think you are all missing the same boat.

In this case, I think, really, gentlemen, the best thing you can do today is go back to the drawing board, and act on something simple an across-the-board tax.

Certainly, those at the lower income bracket need to be helped, but as it has been said, the individual on the upper end should be considered, too, because more capital is going to come from him, and we must give some confidence to business by enacting a general tax decrease.

This is, it seems to me, simple. It is an alternative that a person can understand, not just the experts who can understand the administration tax proposal. It is a more acceptable alternative.

The CHAIRMAN. Could I ask for a statement, or a response to one point raised by Senator Roth?

He said that when the Kennedy package was sent down, it was estimated to be a revenue loser, but that after it was in effect, it was a revenue raiser. Is that correct, or not?

Mr. SCHULTZE. I think you have to carefully distinguish two things, Senator.

One, it is clear that in the years subsequent to 1964, as the economy rose, revenues grew, and over long enough a period of time, revenue growth was more. But that doesn't say that all of that revenue growth came from the tax cut, so that one could say, simply by looking at what happened to revenues over time, and say yes, revenues rose; and automatically, they rose. More than that, the tax cut doesn't mean that the tax cut produced that revenue gain.

Senator ROTH. Mr. Chairman, I trust you are not taking up my time.

The CHAIRMAN. Your time has expired, but I will give you one more question. Go ahead.

Senator ROTH. Thank you, Mr. Chairman. I do want to insert in the record a comparison of the estimated revenue loss versus the actual revenue gain under the Kennedy tax cut.

It shows, in fact, revenue gains of $54 billion instead of the estimated $89 billion revenue loss.

[The material referred to above follows:]

KENNEDY TAX CUTS, ESTIMATED REVENUE LOSS VERSUS ACTUAL REVENUE GAIN

[In billions of dollars]

	1963	1964	1965	1966	1967	1968	Total
Treasury, estimated revenue loss	−2.4	−5.2	−13.3	−20	−23.7	−24.4	−89
Actual revenue gain	+7.0	+6.0	+4.0	+14	+19.0	+4.0	+54
Differences	+9.4	+11.2	+17.3	+34	+42.7	+28.4	+143

Source: Library of Congress.

Senator ROTH. I would also point out, Mr. Chairman, that the members of the Kennedy administration and other economists have noted that the tax cut paid for itself in additional revenue within the first year of enactment. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Matsunaga.

Senator MATSUNAGA. Thank you, Mr. Chairman, and thank you, gentlemen, for spending the time with us.

As you know, the administration and the Congress both face the enormous task of creating 7 million new jobs in order to reduce unemployment to 5 percent by 1980.

We need to put forth unusual effort and unusual means; yet, I find in the administration's proposal, as others have found, that you are proposing an investment tax credit increase and a reduction in social security tax, and income tax cuts, and tax rebates, which is the usual way of boosting employment, and which rely upon increased demand for goods and services.

I would think that you would be trying something different, something which would be more direct, such as the job tax credit. I am disturbed that from the outset, you seem to be opposed to it from the representations made before the Ways and Means Committee, and the representations made to me by those who consider the job tax credit to be one of the most direct ones, and if not, the most effective in the sense that it would cost the least of all the proposals. In addition, Mr. Secretary, you yourself have said that one of the prime objectives of a tax stimulus package is to create jobs, or create new employment in the private sector.

And here, we have a proposal which would do exactly that without inflation; a proposal which would cost, per job, on the average of $3,100 as compared to $8,500 for public service jobs, plus the inflation, and between $10,000 to $12,000 for public works jobs; and $9,000 to $11,000 for the Jobs Corps, and the former President Ford's WIN program jobs.

Now, I just can't understand the opposition from the administration from the very outset.

I think the investment tax credit, which you propose, would likely end up with less jobs by the investments in new machinery, new equipment, which would not only replace workers, but which will increase unemployment. So I can't understand why you are opposing so much the proposed job tax credit within the private sector, among small businesses which today, as you know, are responsible for 55 percent of all employment in the United States.

Mr. BLUMENTHAL. Senator, the main reason why we feel that the job tax credit would not bring about the desired result, which we all seek, is, basically, spelled out in the statements that I have made.

We feel that it would give a benefit to employers who plan to increase the employment anyway.

It would leave out two-thirds of the work force which, for one reason or another, would not be covered, and also, we feel that the best way to get full employment in the economy is to make sure that the economy is operating as efficiently as possible.

If you invest in plant and equipment, even though machinery replaces some workers, there are other workers who are producing the machine. There are other employees who have to service the machine.

There are computer technicians who have to program the machine, and all of this adds resources to the economy. It is this increasing pro-

ductivity which makes our economy efficient, and provides work for everyone.

If it were merely a matter of finding ways to keep people busy without taking into account productivity, then I suppose we could ask the Congress to pass a law that would outlaw a lot of machines, and substitute people for them, but if we did that, we would soon find ourselves outmaneuvered and outcompeted in the international market, and the standard of living for the economy would drop, and that is really not what we would like.

Senator MATSUNAGA. I would agree with you, looking at it from the long-term angle, but we are faced here with a continuing high unemployment rate which demands immediate attention.

Our prime objective is to increase jobs, to put people back to work without causing inflation, and I don't see why your proposal could not work hand-in-hand with the proposal not quite as included in the House bill, but along the lines proposed in the bill which I and several others in the Senate have introduced.

Mr. SCHULTZE. Let me just add one point to that. A businessman is not going out to hire someone with a subsidy and lose money on his action.

If it costs me $10,000 to hire a new worker, and I can't sell the output of that worker and you give me $2,000, instead of losing $10,000, I only lose $8,000, maybe I am not about to go out and do it.

So No. 1, it will be true that there are some—in fact, many firms under the employment credit proposal who will be adding workers.

They would have added them anyway, and will take advantage of the subsidy, but you are going to add to the wage bill even if it is somewhat less unless you can sell outward.

Therefore, it is necessary to work in terms of increasing the demand for goods and services in order that the businessman will hire people who produce those additional goods and services.

And in a subsidy of this kind, in general, there will be exceptions, of course. You won't get someone to get, or hire someone at a loss even though you cut the loss.

Senator MATSUNAGA. What is the basis of the statement that small businesses are going to hire additional workers anyway?

Mr. SCHULTZE. The basis of the statement is that that combination of the additional purchasing power being put in the pockets of consumers by this bill will buy more.

The additional incentives to investment, to business firms who will buy more machinery, which puts more money in the workers' pockets who are producing the machinery, and who will, in turn, create the additional demand for goods and services to which business will respond, and simply, if you ignore that, and simply say, "I am going to pay you one-fifth or one-fourth of the additional workers' wages," I am still not going to do it unless I have the demand for goods and services coming along.

Senator MATSUNAGA. I don't know if you are familiar, Mr. Chairman—if I might proceed for just another one-half minute—with the testimony of the representative of the National Small Business Association before the House Ways and Means Committee. Representatives of small business are convinced that small businessmen will not hire

additional employees unless they are presented an incentive such as the one which is proposed in the job credits program.

Mr. SCHULTZE. Senator Matsunaga, the only thing I can add to that is that if that is true, and if, in response to business activity, small business won't hire more people, their behavior has radically changed in the last year.

It might be true. Historically, faced with their ability to sell, they may have. It may be that in the last 3 years, they have completely changed, but I haven't seen much evidence of that.

Senator MATSUNAGA. You may be right within the next 2, 3, or 4 years when investment tax credit begins to operate, but I am concerned about the immediate, one which will bring about the greatest employment the fastest, and I am convinced thoroughly that the job tax credit is the way.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gravel.

Senator GRAVEL. Thank you, Mr. Chairman. Gentlemen, going over the budget summary and some readings on economics that I indulged in recently, I am informed that the industrial capacity utilization is 87 percent. Would you agree or dispute this?

Mr. BLUMENTHAL. Eighty-seven?

Senator GRAVEL. Eighty-seven percent.

Mr. BLUMENTHAL. My figures indicate it is more like 80.

Senator GRAVEL. The figures I have for industrial capacity utilization indicate we are utilizing 87 percent of operating capacity.

Mr. BLUMENTHAL. More than that. In 90's.

Mr. SCHULTZE. Low 90's.

Senator GRAVEL. What would be the low 90's? Ninety-two?

Mr. SCHULTZE. Ninety-three.

Senator GRAVEL. Ninety-three. I am concerned that the projections you have in your book on page 8 show you are estimating increased revenues from the economy of about 10 percent per year. And the figures I have in the chart supplied for me by the staff of the committee shows that right now manufacturing is operating at 82 percent of capacity.

So if capacity is somewhere between 87 and 93 percent, then the point you made, in your paper, Mr. Schultze, is well taken. Bumping up against capacity is going to cause very severe inflation: The stimulus you propose as a means of creating revenues will also create inflation.

Mr. SCHULTZE. There are several things on that. No. 1, the 10 percent increase in revenues does not reflect a 10-percent increase in output growth.

It is a combination of an increase in real output, and a continuation by the 6-percent price increases that we are getting.

Second, capacity is increasing. Now, it is not increasing as fast as we would like it. We would like to get investment higher.

Senator GRAVEL. Maybe I misunderstand you. If you have an increase of 5 percent in manufacturing capacity, what does that translate to in terms of revenue to the Treasury?

Mr. SCHULTZE. If capacity increases.

Senator GRAVEL. It means more jobs. It means more corporate income. I am trying to find out how we are going to balance the budget by 1981 without going over capacity.

Mr. SCHULTZE. But again, Senator, we do not believe that with the appropriate policies, including the investment credit, including later tax reforms, that we will be going over capacity.

Senator GRAVEL. I would take the same point that Secretary Blumenthal does, that to prevent going over capacity we must increase our productivity. I found that increased productivity increases unemployment.

Mr. SCHULTZE. Unemployment?

Senator GRAVEL. Unemployment.

Mr. SCHULTZE. As a matter of fact, the period we had some of the largest increase in productivity, if you look at the history of the United States——

Senator GRAVEL. Yes.

Mr. SCHULTZE. The biggest period of employment gain was after World War II, 1968, 1969, precisely the time we did better than we have ever done in the history of the United States.

Senator GRAVEL. I would just say for the record that to my knowledge what is going on in our economy and the world economy, is that as we put machines to work producing more, that means less employment for people.

As you invest in automated capacity, you are going to have less employment.

Mr. SCHULTZE. Well, the entire history of rising living standards in the industrial world for 200 years has been that as you increase production, the increased productivity means that an individual can produce more. It doesn't mean less individuals are hired, necessarily.

It simply means that individuals who are hired can produce more. There are two different reasons.

Senator GRAVEL. We have hired less people as we have automated and that means less jobs. However the point I have to make is that within the limits of this 93 percent capacity, you have projected, increase in revenues of over 20 percent.

As a lay person, all I can say is that a 10-percent increase in capacity in the Nation may mean a 10-percent increase in revenues to the Treasury.

If that is your projection, then the economy will be operating at 110 percent in 1980, which will be an impossibility.

Mr. SCHULTZE. There are two numbers, one on the growth of capacity, and the growth of output, the growth of output in the next 2 years in our projections.

Senator GRAVEL. We are dealing only with revenues to the Treasury. Forget the output. We are talking about revenues to the Treasury.

You are showing an average 10-percent per year increase, in revenues to the Treasury. I am trying to relate that to the productive capacity of the Nation which you are trying to simulate.

Mr. SCHULTZE. Which I am trying to do, sir.

Senator GRAVEL. You have a ceiling of 80 percent operating capacity, perhaps 82 percent; and yet project 20 to 30 percent in revenues for the next 2 years.

Mr. SCHULTZE. Those two numbers cannot be put together that way. The revenue estimates are, I assume, a growth of 6 percent, national output, national output in the next year.

Senator GRAVEL. I would suggest, if I am partially right, that $10 million borrowing through deficit financing is inflationary, and giving a $50 float to people pushes us right over the top. With or without incentives you will have compounded inflation and this could blow out the fire of economic recovery.

Mr. SCHULTZE. We have made an attempt to look at the growth and output, the growth in capacity, the growth in national income which comes from this program.

It is our best judgment that that capacity utilization figure will grow.

We are worried, in the long run, about making sure we have enough improvement in capacity. Nevertheless, as we look at our program, next year, 2 years after that, look at the growth of capacity which is likely to occur, growth and output that is likely to occur, 80 or 82 percent will grow, that is true, but it will not push us up in the range where we will set off inflationary pressure with explicitly output capacity income.

Let me remind you that we are worried, we are concerned about making sure that capacity grows, and grows rapidly enough.

That is one of the reasons why we are interested in keeping the 2-percent investment credit in because one thing, it is a modest crack toward helping capacity a little bit.

Senator GRAVEL. We ought not just throw money into the economy through a shock method when our goal as the Congress and your goal as the administration is the same one, growth.

But growth is merely a tool to try to disperse the money, the wealth in our society. That is done through employment, so the goal is not growth even though in all of your statements you really have growth first, jobs second, inflation as another item. The point is employment.

Now, do you have a demographic profile of the unemployment situation today? Do you have that?

Mr. SCHULTZE. Yes, sir.

Senator GRAVEL. Could you give me an idea of the figures? Are they not related to the demographic profile? All black, 37 percent; teenage, 61 percent; all high school dropout rate, 38 percent; those disadvantaged; the teenage girls who are unemployed; I would like to know what the figure is for all of those, the severely high unemployment groups. How does that relate, at the present time, to the total number of unemployed. If we surgically went after those groups with public works, we might have a cost of $1.5 billion rather than the $10 billion plus you propose.

Mr. SCHULTZE. You must remember that part of this economic program is precisely a public service employment program going.

Senator GRAVEL. I voted for that, incidentally. In fact, we added another $9 billion for public works in the water area.

Mr. SCHULTZE. That won't get at these people in the construction area; this is a highly skilled area.

Senator GRAVEL. I don't think investment is going to help these people either. The only thing that is going to get at these people is to go after them, surgically with $1.5 billion.

I don't think there is anything in your package which is going to stimulate the economy sufficiently to reach down and help these people.

Mr. SCHULTZE. Again, Senator, we do have the public service employment program.

Second, we do have a 50-percent increase in comprehensive employment, a training program heavily directed at youth.

Third, and in the long run, there is no way you are going to deal with this problem except in a healthy economy because we don't want all of these people ultimately having to be put permanently on a Federal public service employment program. So we need to go after everything at once: Public service, employment training, strengthening the general economy to provide some private jobs.

Senator GRAVEL. In the 8 years I have been here that is what the Government has been trying to do. I suspect even when we are in a healthy economy, you will have to go after unemployment through a surgical process.

The CHAIRMAN. Let me suggest that those bright lights be turned off. I think at this point, the television people have had all the pictures they need or want. I suggest that the television lights be turned off.

Now, I want to ask, at this point—I think I will just take a minute—I want to make it clear, first, that when I referred to the House committee requiring the Secretary to make some kind of commitment, I do not say that happened on this occasion; or that Mr. Ullman has sought a commitment. I presume he has asked, Mr. Secretary, that you support the House bill, in the House and Senate.

Mr. BLUMENTHAL. No, sir, he has not.

The CHAIRMAN. I have had the impression on another occasion, perhaps with subtlety and finesse, there have been House chairmen—I am not saying that Mr. Ullman did it, but I think others have probably perhaps with greater finesse and good taste, but nevertheless, did seek to let the Secretary of Treasury know that his bill was not emerging from the committee until he had some kind of understanding for support of the bill.

I don't like that. It is especially offensive when the Secretary finds the managers of the Senate bill at odds with what the House did. The bill and the Senate amendments ought to stand on their own merit.

Now, I believe you said, with regard to veterans, in the section involving payments, that you don't have all the social security numbers of veterans. Is that correct?

Mr. BLUMENTHAL. Yes. That is correct.

The CHAIRMAN. Also, you say that with regard to black lung, you have a problem; that you are not sure you have the social security numbers for black lung beneficiaries.

Mr. BLUMENTHAL. That is right.

The CHAIRMAN. Now, it seems to me that before we——

Mr. BLUMENTHAL. I stand corrected. We do have it for black lung, but we do not have it for veterans.

The CHAIRMAN. It seems to me we should act, and try to help set the stage for what may come along later with even more pressing needs, and for welfare reform.

We need to get rid of duplicate social security numbers. We need to get it down to where the social security number can be used to identify an individual if he is willing to be identified.

Now, that involves some of the controversy we had over the right of privacy, but it seems to me that a person doesn't claim any right of privacy when he tries to borrow money down at the bank.

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When he is seeking to obtain money from the Government, he has no right to come in, asserting his right of privacy.

We have Mr. Lance here, the former banker.

Did you feel a person had a right to borrow money from your bank if he declined to supply you with information you requested?

Mr. LANCE. I would appreciate it if he would.

The CHAIRMAN. Well, my point is that we can't have successful welfare reform, and you can't have successful tax improvements if you have this kind of thing.

I discussed, prior to the time you came into the room, the fact that with regard to the welfare program at Health, Education, and Welfare, there was some lady on the rolls under 18 different names with 18 different social security numbers.

Now, that makes a whole country stand up in alarm, and ask how we are running this Government when someone gets on the welfare rolls under 18 different names. Even two names is too many for a person to be drawing a monthly check from the Government.

I believe that we ought to try to see to it that nobody has more than one social security number.

Now, some of the numbers were issued inadvertently, but we ought to try to see to it that everybody has a social security number, and that no one has two. And we ought to try to work with the Secretary of HEW in connection with that, and see that that does not happen, and while doing that, we ought to be thinking in terms of what other information there is that we ought to have so we can identify somebody.

We ought to have, for example, their birth certificate somewhere. If it can't be found, and some people can't find them, in the files somewhere, in either HEW files or IRS files, there ought to be a number somewhere that relates to a person's date of birth, the place of birth, all the information which is required on a great number of other things on which information is sought; and there ought to be some other information; for example, if you have a veteran's number from your service, that number ought to be there.

I think it would be desirable that your present address should be there; at least, your most recent address. That would be desirable. It might even be desirable that previous addresses should be there, and that the social security number of a person to whom you are related should be there such as your wife; that should be made available also, as well as the social security numbers of your children.

When a person seeks to use his social security number to obtain something from the Government, if he is making a fraudulent application, you have the right to use computer technology; just ring all kinds of bells all over the place where the individual is providing fraudulent information, information that is contrary to the information that the Government has that you could readily find in your computers.

All I am thinking about is in terms of using information to promote truth and honesty, and to do what is right. I will take the burden of finding out who contends they ought to be able to steal from the Government, and be protected by the Privacy Act.

It is time, it seems to me, that we better start making those social security numbers be what they are supposed to be, something that can be used for identification.

Once, again, prior to the time you came here, I mentioned the fact that in the State of Maryland, those people decided that they ought to ask welfare beneficiaries to have a picture of themselves on a card to identify them, which would entitle them to benefits.

Eleven percent of the people did not come in to have their picture taken, to honor their eligibility for welfare. That would indicate that almost all those people, 95 percent of them, were people not properly on those rolls, or maybe they were on those rolls under more than one name.

I hope we don't have the problem of people contending that we are violating somebody's privacy by asking him to identify himself when he is seeking Government benefits.

I am carrying two pictures. I carry my driver's license for identification. I carry a picture, as a U.S. Senator, that I need to get around Washington, to get into the Capitol Building, and when I call on the President to get inside the White House gates.

I think that type of thing is going to be necessary, both in the administration of your Department, and also, in the adequate administration of Health, Education, and Welfare in connection with the President's welfare reform program. I think we will be in need of that.

In either event, I hope you will give this your thought. You probably have more knowledge of computer technology than others have. I hope that you will give it your full consideration so that those who claim some benefit from the Government can identify themselves, and also, so that we can protect ourselves from those who victimize this Government.

Mr. BLUMENTHAL. Senator, I certainly agree with you that it is a very important objective, to make sure that that kind of cheating is stopped, or reduced to an absolute minimum, and the steps that you mention would all make a very important contribution in that direction.

I suppose we all recognize that there are problems attached to them, but I think we ought to work them out. I certainly support that effort, and will talk to my colleagues about it.

The CHAIRMAN. You have had a problem in your testimony with the $50 rebate. You don't want to den[y] anybody. You don't want people double dipping, as you just said here. I don't know how you are going to prevent that unless you have the social security numbers because there are so many duplicate names and things. We debated this in the Senate some time ago.

Well, for example, we have more than a million people in the country who have the name "Smith." An effort was made to try and recall just how many people there are with identical names.

We were trying to make a father do his duty toward his family. We managed to get service on some man up in Massachusetts, to haul him down here, to sue him for the support of his children.

Well, they hauled him down here. They found that he was not the same color, the same race, or the same person at all. He was not the person they were looking for. So no wonder he came down screaming in protest.

I think we have to try to make him support his children; but if we have a social security number, we won't have as large a problem.

I would hope that you would coordinate with the Secretary of Health, Education, and Welfare in these programs. You are going to be needing those numbers, too. Thank you very much.

Senator Curtis.

Senator CURTIS. Senator Dole has seven questions here, so I would like to submit them to be answered for the record.

[The material referred to above follows:]

QUESTIONS SUBMITTED BY SENATOR BOB DOLE IN THE HEARINGS ON H.R. 3477 TO BE ASKED OF SECRETARY BLUMENTHAL AND OTHER ADMINISTRATION WITNESSES

Question 1. Many economic commentators and others are beginning to have their doubts about the government's ability to fine tune and re-fine tune the economy, and believe that we should look to permanent structural changes which will strengthen our economy. Do you think that one-shot rebates and temporary cuts as opposed to permanent tax reductions will only increase these concerns?

Answer. Not at all. Every tax and expenditure policy, whether permanent or temporary in nature, tunes or affects the economy. A well formulated policy looks down the road a bit and allows leeway for future events. The package that we have presented to you combines a one-time rebate with a permanent increase in the minimum standard deduction, expenditures for public employment, and incentives for business expansion. This particular combination of programs allows for current stimulus of the economy without tying us down to numerous permanent tax changes before we have fully developed the tax reform proposals which we will be submitting to the Congress this fall.

Question 2. There has been some criticism directed to the increase in the standard deduction in that it is perceived as creating inequities between those who do itemize and those who don't. Some have suggested that simple rate reductions would be more equitable. Do you have any comments?

Answer. Of 66.6 million taxable returns which will be filed in 1976, 44.6 million would have saved tax had the President's proposal been in effect. The taxpayers which do not benefit are generally those with higher incomes. Moreover, the purpose of the flat standard deduction is to simplify tax returns by causing taxpayers to switch to the standard deduction; it is thus necessary to make the standard deduction relatively more attractive.

Even without specific policies directed at itemizers, their deductions will tend to increase with inflation. The same is not true of the minimum and maximum standard deductions. In any case, the permanent change in the standard deduction is only one of many programs contained in this package. It is the fairness of the tax system as a whole that must be examined, not just certain parts. We believe that a flat standard deduction not only will simplify the tax structure but will increase its equity as well.

Question 3. The expressed purpose of the business tax section of President Carter's economic stimulus program is to create jobs. Do you view the 4 percent Social Security tax credit as a large enough incentive for the small employer to actually create a job?

Answer. It is not really proper to look at any piece of the stimulus package and question the adequacy of that piece alone. The social security tax credit was just one element of the package. The social security tax credit, unlike the Ways and Means FUTA credit, was designed to help all employers. When combined with the other aspects of the package, including the public service jobs program, the total effect is to provide a significant employment incentive. With this program, we expect to achieve a reduction of the unemployment rate to about 6 percent by the end of 1978.

Question 4. One of the other business tax alternatives that has been discussed is a reduction in corporate tax rates. Would this approach spread out the stimulative effects to more businesses than increasing the investment tax credit?

Answer. In several important aspects, the investment tax credit combined with the social security tax credit option is more attractive than a mere reduction in corporate tax rates. Corporate rate reductions can impact only on the corporate sector so the largest fraction of the business sector numerically—unincorporated business—is not helped by rate reductions. Second, in order to take advantage of a corporate rate reduction, a company needs to have corporate tax liability in the first place. In this regard, the Administration's proposal which

makes the social security tax credit refundable is preferable since it helps out firms which are the most in need of help—new or growing firms or those without tax liability.

Question 5. It is argued that extending the investment tax credits through 1980 would allow businesses to plan ahead—would the same argument apply to the reduction in corporate tax rates?

Answer. Any business tax program should be designed so that it facilitates long-range business planning. Extending the investment tax credit at the higher level through 1980 does provide business with a stimulus that it can take advantage of in its planning process. The social security credit/investment credit option is especially good in this regard in that all firms, whether capital intensive or labor intensive, and whether in profit or loss situations, will benefit from the stimulus program.

Question 6. There has been testimony to the effect that under President Carter's 4 percent Social Security tax credit proposal a large employer with 10,000 employees and a taxable wage base of $120 million would receive a credit of $280,000 which is equivalent to a pretax profit of $540,000 even if he laid off 1,000 employees. Is this true?

Answer. Such an employer could receive such a credit just as he could currently receive the investment tax credit, the foreign tax credit, deferral of foreign earnings, plus other governmental credits or expenditures regardless of the number of workers he laid off. Furthermore, an employer who has been forced to lay off 1,000 workers may be most in need of help. The point to be made is that the entire stimulus package has been designed to spread the benefits across all business firms whatever their particular circumstances. It should also be noted that a job saved in a declining industry is just as valuable as a job created in an expanding industry.

Question 7. What would be the immediate and long-term effects of the increase in the investment tax credit in terms of reduction of the unemployment rate? Would the investment tax credit be broad enough to affect enough business to have any substantial effect on employment?

Answer. As I mentioned during my March 8 appearance before the Finance Committee, one should not attempt to speak with precision about the effect of the investment tax credit on the unemployment rate. The investment credit, couped with the social security tax credit option and the other aspects of the stimulus program, will have a broad effect on all elements of the business sector. The program taken as a whole will have a substantial effect on employment levels throughout the economy.

Senator CURTIS. I would like to ask a few questions, probably, on the 1-year cost of the change in the standard deduction.

Mr. BLUMENTHAL. $4 billion a year, Senator.

Senator CURTIS. How many taxpayers will it take completely off the tax rolls? My figure is 3.5 million.

Mr. BLUMENTHAL. That is about right, Senator. Beg your pardon. Three million taxpayers.

Senator CURTIS. Within the last 10 days, I have talked to a businessman who learned of an opportunity to buy the stock in a small company that was failing. It had great possibility.

He borrowed $500,000 to buy that stock. If he paid 8 percent, that would be $40,000 a year interest.

Under existing law, how much of that could he deduct against other income? $40,000 interest payment.

Mr. BLUMENTHAL. I believe he could deduct all of it to the extent that he had that much income.

Senator CURTIS. As an investment? When borrowing to make an investment, he is limited to $10,000?

Mr. BLUMENTHAL. I gather, under existing law, he could only deduct up to the amount of his investment income plus $10,000.

Senator CURTIS. I would like it supplied for the record, what it would cost; to go back to the old law that we used to have, that he deducted the whole amount, if it could be supplied for the record.

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Now, this happened 4 or 5 years ago. He is making a success, giving jobs to several hundred people. But suppose he would have lost his $500,000 investment; as a capital loss at the present time, how much of that loss could he deduct as against other income?

Mr. BLUMENTHAL. Mr. Woodworth.

Mr. WOODWORTH. He could deduct half of that loss against other ordinary income, but limited in amount to $3,000 or $4,000 a year. He can deduct in full against capital gain if he cares to.

Senator CURTIS. I am asking on the basis of capital gains, what he can deduct.

Mr. WOODWORTH. Half of it, but limited per year to, I believe, $4,000, beginning next year.

Senator CURTIS. Prior to the 1969 act, he could deduct it all, couldn't he?

Mr. WOODWORTH. Yes; but only at the rate of $1,000 a year.

Senator CURTIS. I would like to have, for the record, the cost of restoring the 15 percent to the 100 percent because I think those things are so vital if we are going to get people to put in their money into productive enterprises, and I don't think it is going to cost much money.

What was the highest capital gains tax applied prior to the 1969 act?

Mr. WOODWORTH. I think it was 27.5 percent.

Senator CURTIS. Capital gains?

Mr. WOODWORTH. Yes, sir.

Senator CURTIS. I thought it was 25.

Mr. WOODWORTH. The general rate was 25, but there was a period of time before the 1969 act when it was 27.5 percent.

Senator CURTIS. How long do you have to get back to the 25 percent?

Mr. WOODWORTH. Well, during most of the period before 1969, but you asked what was the highest.

Senator CURTIS. Can you tell me the highest capital gains rate at the present time?

Mr. WOODWORTH. The general capital gains rate is 35 percent, but it is possible, if you take the minimum tax into account, for that to get up to, I think it is 42.5 percent, and if you take the indirect effect of the maximum tax into account, it gets up to just almost 50 percent. That is in the maximum case.

Senator CURTIS. Around 42.5, isn't it?

Mr. WOODWORTH. I didn't know which level you wanted to take it. That takes the minimum tax into account. And that regular capital gains plus the minimum tax is 42.5, but there is an indirect effect of the maximum tax which, in effect, brings it up to almost 50 percent. That occurs because of the fact that in computing the rate, the income is subject to the 50-percent rate instead of the 70. You then have to reduce the income eligible for that rate by the amount of preference income that you have, and half of the capital gains is included in preference income.

Senator CURTIS. What would it cost, and you can supply it for the record, to return the 25-percent capital gains tax?

Now, in reference to tax preferences, without going into it, or taking the time to enumerate what all is considered tax preferences, that does

mean, or can mean a 30-percent increase in taxes for some individuals, can it not?

Mr. WOODWORTH. Well, how big an increase in taxes it means depends on what the basis that you are computing it from is. It can be any percentage. It could be 30 percent. It could be 100 percent. It could be an infinite number if they didn't pay tax apart from the minimum tax.

Senator CURTIS. The figures that have been supplied in that for 1969, 1,800 companies raised no equity capital to provide new jobs, new products, or new services.

That 649 of those were small companies, less than $5 million net, by 1974, and these 1,800 companies raised a billion and one in new capital by 1974, in 5 years after we changed the law, and it took a lot of benefit away.

When you invested money, only nine companies raised $60 million in equity capital, a 98½ percent reduction.

By 1975, only 150 companies raised new equity capital to create new jobs, new products, and new services.

It seems to me that we have an area here where a small net effect upon the revenues of the Government would really spur the economy.

I do not think a person needs to be learning a venture to come to the conclusion that if someone invests, and they never get to recoup their losses against other income, even in the long run fully, or if they win, they are going to have to, or might have to pay a tax nearly as high as the regular income, or if they have to borrow money, they are not going to offset that in interest payment against other income.

I don't think a person has to have a lot of computers and a lot of learning, at the minimum, to realize that that is a great hamper to our economy.

I happen to remember that the 1969 act is the worst act, tax act in the history of the Republic at the time it was written. I have questioned it since then a couple of times, a few times because of subsequent happenings, but its result has been deficits and inflation.

I don't contend that it was the whole cause, but it is definitely a part of the picture.

And I would appreciate not only having these estimates as to what these changes would amount to, but I would hope that these proposals might have some serious consideration.

Thank you very much.

[The questions submitted by Senator Curtis and answers by Mr. Woodworth were subsequently supplied for the record:]

Question. As a result of the 1969 Act, long-term capital losses can be offset against ordinary income at a 50-percent rate, that is, it takes $2 of losses to offset $1 of ordinary income. What would it cost to restore the 100 percent rate?

Answer. About $100 million per year, based on present law. The importance of this provision will increase when the overall limit for capital loss offsets is increased from $1,000 to $3,000, which will happen in 1978.

Question. The Tax Reform Act of 1976 limited investment interest deductions, in most cases, to the amount of investment income plus $10,000. What would be the cost of restoring prior law in this area?

Answer. The TRA provision will raise about $100 million in FY 1977, its first full year of effect. This amount will be lost if prior law is restored.

Question. There is now a $50,000 limit on capital gains subject to the alternative tax of 25 percent. (It was introduced in the 1969 Act.) What would it cost to repeal this limit and make all capital gains subject to a 25 percent rate?

Answer. Just over $200 million per year, at FY 1977 levels.

Senator BYRD. I have several more questions. First, let me say that my view of the Washington establishment is very similar to that so eloquently expressed by Candidate Carter during the election year 1976.

For example, I feel that the Congress has been reckless in its spending, in the way it has handled the tax funds of the hard-working American wage earner.

Total spending has more than doubled—more than doubled, from fiscal 1971 to fiscal 1978, not including, not even including the $19 billion increase that the new administration recommends for 1978. But that gets me to this question:

It seems to me that the Congress has appropriated so much money that the executive branch isn't able to spend it all. I would like to ask Mr. Lance about the $8 billion which the newspapers report the Government has not been able to spend, and yet, at the same time, the new administration is coming to Congress, and asking for an increase in spending over and above the huge Ford increases.

Would Mr. Lance comment on that?

Mr. LANCE. Certainly, Senator, The shortfall, of course, concerns us all. We are trying to identify the reasons for its continuation.

Senator BYRD. That doesn't concern me. I would just as soon the money not be spent.

Mr. LANCE. You like it from that standpoint. I am sure you have some company in that instance, but we have been trying to make a determination as to the reason for the shortfall. The shortfall itself is one problem. The carryover to the subsequent year is another problem that has to be dealt with.

We have not yet arrived at a conclusion as to what is really represented by this thing that has taken place.

Some of that may be systemic, relating to the congressional budgeting of expenditures. There may be overestimation on the part of the agencies and departments. As best I can determine, and I am sure that is something you have determined also, the Cabinet officers have not been concerned about the expenditure levels in the past. They have simply gone ahead, and not paid much attention to them.

We must try to implement a successful way to determine how the spending process is moving along.

There is some discussion at this point as to whether the Treasury figures represent what the final results will be or not.

The people at OMB do not seem to be surprised by the Treasury's projection in the neighborhood of $8 billion but they think it might be only $4 to $5 billion for the year. When you look at the total budget of the United States, that is about a 1-percent shift.

That is probably not too great from this standpoint, but it is something that we are trying to make a determination about.

Senator BYRD. Would someone give me the total spending of the Federal Government for the fiscal year 1975, and then for the fiscal year 1976?

Mr. BLUMENTHAL. For 1975, the outlays under the unified budget were $326 billion, and for 1976, they were $366.5 billion.

Senator BYRD. And then for 1977.

Mr. BLUMENTHAL. They are estimated to be $417.4 billion.

Senator BYRD. OK, $417 billion. So that represents an increase in spending for fiscal year 1977 of $51 billion over and above 1976. Is that correct?

Mr. BLUMENTHAL. Right.

Mr. LANCE. That is correct.

Senator BYRD. You have advocated an increase of $6 billion in spending. Is that correct?

Mr. BLUMENTHAL. For 1978 over 1977.

Senator BYRD. For 1977 over 1976?

Mr. BLUMENTHAL. Taking that into account, I think the net is $6 billion. Right; the net is $6 billion.

Senator BYRD. What I am getting at, without your $6 billion, that was already an increase of $45 billion.

Mr. BLUMENTHAL. That is right.

Senator BYRD. And yet, your administration is not satisfied with a $45 billion increase in spending. It wants a $51 billion increase.

Mr. BLUMENTHAL. That is right.

Senator BYRD. Let's get to 1978. What is your figure for 1978? $459, is it?

Mr. BLUMENTHAL. It is $459.4.

Senator BYRD. Let's say, for easy calculation, there is $417 billion this year.

Mr. LANCE. That is an increase of $42 billion.

Senator BYRD. Beg pardon?

Mr. LANCE. That is 42.

Senator BYRD. That is 43 increase in spending.

Mr. LANCE. In round numbers.

Senator BYRD. Out of that 42, your administration advocated a $19 billion increase.

Mr. LANCE. That is correct.

Senator BYRD. What the administration is saying is that an increase of $23 billion in spending is not adequate? We need to almost double that, you say, and add $19 billion additional to it.

Mr. LANCE. Well, I don't know that we are really saying that specifically, Senator, in that regard. I think what we are saying is with regard to the 1978 figures is that we have to explore whether or not the expenditure levels in the January budget were really realistic from the standpoint of what the needs actually were.

Senator BYRD. Well, in any case, you feel that $19 billion of additional spending is not adequate so you have advocated another $23 billion increase.

You advocate another over and above the 20.

Mr. LANCE. At the time we explored the budget, there wasn't much we could do about the $23 billion. That was already in place there.

I don't think it is appropriate to really say that that figure wasn't satisfactory to us. We just didn't have the time, given the real need of trying to meet congressional schedules, to deal with that sort of problem. As you know, you know most of the increase that you are talking about is coming from the stimulus package, and from the $8 billion of President Ford's cuts.

Senator BYRD. It comes from, am I not correct, the fact that the new administration is advocating an increase in spending of at least $19 billion.

Mr. LANCE. Yes, sir. From that standpoint, no matter where it comes from, we are advocating an increase in spending of $19 billion.

Senator BYRD. As we established earlier in the year, the deficit for the current year will be the largest deficit in the history of the Nation.

Mr. LANCE. Yes, sir, by a billion dollars.

Senator BYRD. And then in regard to the rebate, that will reduce revenues by $11.4 billion.

Mr. LANCE. Yes, sir.

Mr. SCHULTZE. That is correct.

Senator BYRD. And Mr. Secretary, I assume that that, of course, that amount will need to be borrowed.

Mr. BLUMENTHAL. That is right.

Senator BYRD. Of course, interest will be paid on it.

Mr. BLUMENTHAL. That is correct.

Senator BYRD. I was in Norfolk the other evening, a city of approximately 300,000 people. I was in a taxicab, and the cab driver recognized me and asked: "Are you guys in Washington going to give us $50?" I said: "Yes, I think so." I am not certain whether I will be able to support it, but I think Congress will approve it. I asked: What is your view?

"Well, the way I look at it is," he said, "the Federal Government doesn't have a surplus. It has a large debt." And, he said to me: "It doesn't make good sense to go out and borrow a lot of money to give back to everybody $50 throughout our Nation."

I just wanted to pass along the view of one taxi driver in the fine city of Norfolk.

I know, Mr. Blumenthal, that you and Mr. Lance, too, must leave shortly, but Senator Danforth, do you have questions?

Senator DANFORTH. Thank you, Mr. Chairman.

I don't want to prolong your discomfort any longer than necessary, but I would appreciate addressing to you a few more questions.

Mr. Schultze, you have heard orally the suggestion to plot on a graph the job effect of the rebate plan by quarters, how it would come out, whether these maximum effects occur, about what date; and then when it would decline to be insignificant.

Mr. SCHULTZE. I think it would be fairly heavy, fairly even, maybe, in the second and third, maybe a little bit less in the fourth quarters, and then tail off in 1978 very quickly while the other parts of the program were picking up.

Senator DANFORTH. In 1978, at what point would you——

Senator BYRD. Let me interrupt for just one moment. Mr. Secretary, I assume that you will be back at 2 o'clock.

Mr. BLUMENTHAL. I hadn't been aware that the committee will continue at 2. Are you continuing at 2?

Senator BYRD. The committee is to recess in a few moments, when Senator Danforth finishes.

We had planned to recess until 2 o'clock.

Mr. BLUMENTHAL. Then I have to return. I have the Canadian Finance Minister waiting, Mr. Chairman.

Senator BYRD. Would 2:30 be a better time for you?

Mr. BLUMENTHAL. I could be back at 2:30.

Senator BYRD. Would 3 o'clock be better?

Mr. BLUMENTHAL. 2:30 is fine. I will be back at 2:30.

Senator DANFORTH. Would you rather wait?

Mr. SCHULTZE. It is up to you.

Senator DANFORTH. In fiscal year 1978, it would tail off, then, at what point?

Mr. SCHULTZE. I think in the calendar years. I can't give you an exact time, but by the middle of the year, it would be very small.

Senator DANFORTH. Then it is my understanding that your entire package is about to get us over a hump, to last about 2 years. Then you depend on the normal expansion of the economy plus perhaps some other programs that would be devised to pick up the slack at that point.

Mr. SCHULTZE. That is correct. Yes, sir.

Senator DANFORTH. What other proposals do you have in mind, or is it way too early to tell?

Mr. SCHULTZE. I think, No. 1, we have in mind what the Secretary mentioned earlier. There was a thorough going over, comprehensive review of the tax code, and for the purpose of what we are talking about now, the emphasis within that, on looking at the taxation of business income as it impacts on investment. That is investment; this one area.

At the same time, the Secretary of Labor will be thoroughly reviewing, or training, and other programs because we have problems in that area, as you know.

I would single out those two without suggesting that is all of it. I think we really have a longer run budgetary and economic approach in the program.

A number of elements, even though you can't call them stimulus, they won't be put in for economic stimulus, but have to be looked at on their impact on the economy.

Senator DANFORTH. Well, from what you said, it is my understanding that this tax revision proposal will be submitted to Congress at some future date. And that part of that tax revision proposal will include tax reductions of one form or another.

Mr. SCHULTZE. I can't, at this stage, say very much at all about its content, but it is clear that any such package would have both revenue raising and revenue reduction consequences.

I don't want, at this stage, to say what the balance would be, or how it would come out.

Senator DANFORTH. Can you tell us perhaps more fully about the comprehensive tax revision proposal?

Mr. SCHULTZE. Again, this is something you want to address to the Secretary this afternoon. Basically, we are certainly going to review, from that standpoint, what would finally be forthcoming.

I don't know, but in my judgment, it would be quite thorough.

Senator DANFORTH. When can you tell us when it would be submitted to Congress?

Mr. SCHULTZE. I can't. The Secretary may be able. I think it should be sometime in the fall of this year, perhaps September.

Mr. LANCE. The end of September.

Senator DANFORTH. The end of September?

Mr. LANCE. Yes.

Senator DANFORTH. The last tax revision proposal to be submitted to Congress took 3 years to get it enacted.

If you are thinking of your effect on the economy as something that would be in the form of tax revision, you are risking a very long period of time before anything is done.

Mr. SCHULTZE. In line with our general attitude toward improving the affairs of the Federal Government, we trust that will also be true with our relationship with the Congress.

Senator DANFORTH. No, I think it will take some time. I certainly don't want to give just a flip answer, but I see no reason for optimism on immediate action.

May I ask you your perception of your proposed reduction in the standard reduction. Do you view it as a form of indexing of taxes to 1974 levels; as compensation for the effect of inflation, skewing that compensation toward lowering taxpayers.

Mr. SCHULTZE. In all frankness, it really wasn't designed for this purpose, but obviously, for those taxpayers who were affected, it is somewhat of the same effect, but we didn't really design it with that intention in mind.

It does have that effect for some taxpayers.

Senator DANFORTH. Is this not the kind of conceptual index which you view as something you will carry out in the future?

Mr. SCHULTZE. I hesitate to snap out an answer for that, but my judgment would be that if one really wants to go about indexing, you would probably do it that way just for the sheer indexing part of it.

Senator DANFORTH. Is it fair to say that you are less interested in protecting the pride of authorship?

Mr. SCHULTZE. Excuse me. I didn't hear the beginning of the question.

Senator DANFORTH. Is it fair to say that you are less interested in the normal pride of authorship, in defending this particular stimulus package, than you are in developing programs which would put people to work in jobs which are sustainable, which would build confidence in the private economy, and which would not be conducive to inflation?

Mr. SCHULTZE. I am not sure, apparently, that I know how to answer that except my wife would say that I haven't been beating her.

We consider very carefully a lot of different options, including that when we were putting this altogether, there were a lot of people involved, including a fairly large permanent tax cut; we looked at that very carefully, so in the sense, that what Congress has before it was a

very carefully thought through set of recommendations in which the options had been looked at, and we still are convinced, that that was the basic approach. We are still convinced that that is right.

Whether there is any pride of authorship or not, I don't know, but we are still convinced, having looked at the other options, that is right.

Senator DANFORTH. If you could be convinced on the basis of econometric models, statistical projections, and so on, that there are better approaches that will lead to more longer lasting job at a lower rate of inflation, would you be sufficiently flexible to be able to move in other directions? Or, is this a kind of an all or nothing presentation as far as you are concerned?

Mr. SCHULTZE. Well, I would hope that we would be flexible if someone could convince us. We would not be convinced solely in terms of econometric models and statistical projections of a big, long-term, low-rate budgetary situation. Where you want to be in 1980 is a very important part of it.

Senator DANFORTH. Mr. Lance, could you tell me this—supposing that Congress, instead of going the rebate route, adopted a permanent tax cut, would the President be inclined to support it?

Mr. LANCE. I couldn't respond to that because I don't think that it would be proper to speculate what the approach might be in that.

Senator DANFORTH. What, in your view, does this package do for the problem of structural unemployment, Mr. Schultze?

Mr. SCHULTZE. The package makes a beginning, but I have to confess, only a beginning at it.

Let me preface my answer by saying that the problem of structural unemployment is a very serious one and a very difficult one, and one in which the administration, with only 1 month in office, doesn't pretend to have the answer to. This is something to which we are going to have to put a lot of attention. It is very important.

However, I think if you look at, particularly, the public service jobs components, and perhaps even more so the 50-percent increase in the funding for the Comprehensive Employment and Training Act programs with an emphasis on youth, with its emphasis, even though the numbers are very small, on very particularly hard hit groups like migrants and Indians, we are, even in the stimulus package, paying some real attention to the problem; that, as I say, in all honesty, that is a problem we have to look at and work on at a longer term.

Senator DANFORTH. The rebate portion of it does not address the problem of structural unemployment at all, does it?

Mr. SCHULTZE. Directly, no, and even indirectly, only very indirectly, but in an important way.

I don't think you can solve the problem of structural unemployment in a weak economy; that whatever you do by way of training and employability and incentive programs, while they are going to be very necessary, no matter how good they are, they won't work except in a pretty healthy economy.

So clearly, the rebate doesn't go to the structural problem, but overall, the tax package, whether you agree with the particulars or not, at least, is addressed to this general proposition of getting a strong econ-

omy going, which is an express but not a sufficient condition for dealing with structural unemployment.

Senator DANFORTH. The employment tax credit is in that direction, right?

Mr. SCHULTZE. No, sir, I don't think it is. It is designed to give the credit for hiring anybody.

Second, it will give credit for, in effect, the small business who hires somebody, and I have no particular reason to believe that structural unemployment is going to be solved by small business. I don't believe it is going to be solved by big business either. If I thought of a structural problem, I don't know why I would have pitched it in that direction.

Senator DANFORTH. The particular proposal could be altered to take into consideration those factors. For example, you could define the people who came to it to be hardcore unemployed people who are unemployed for 26 weeks or more. Right?

Mr. SCHULTZE. But then to give that job to the Internal Revenue Service really poses some major governmental managerial problems, and I am not sure I have a kind of bias, I must say, against having Internal Revenue Service become the manpower training organization for this Government.

I think that then there are serious problems when you start to pinpoint from that system.

Senator DANFORTH. It is theoretically possible, though, isn't it? I mean, there might be some procedural problems, but it would be theoretically possible.

Mr. SCHULTZE. It would be theoretically possible, but I have to underline about four times the word "theoretically" rather than the word "possible".

Senator DANFORTH. If you were to remove the $40,000 limit that would also improve the proposal, wouldn't it?

Mr. SCHULTZE. Well, it still has the fundamental problem that would go with the proposal.

It would also substantially increase the cost. I don't quite know what the number would be, but if you put it in, since it involves $2.5 billion, $40,000 cutoff, and only applies to one-third of the work force, I don't know what the number would be.

If we remove an additional $2 billion, you know, to look at that, just the narrow point about less discrimination as against different firms, if we would remove it, but it would still retain the fundamental problems that way.

Senator DANFORTH. Let me ask you if this would be a fair characterization of your stimulus package.

It begins with a very quick, fixed rebate proposal which is of short duration, lasting perhaps a couple of quarters. And the reason for that is to buy time.

That is followed by a public works, public employment, public jobs type of an approach which is designed to last for approximately a year. And after that, the general effect of this stimulus package pretty well declines, or is reduced to very little. Subsequently, you would be relying on the health of the private sector, plus some other programs which may or may not include tax reductions as part of a tax revision proposal.

Is that a fair statement?

Mr. SCHULTZE. You add two things, underpinning by the continuing $6 billion of business, a standard deduction, a tax cut. That underpins it, and goes all the way through; it underpins it, but apart from that it is correct to say that it is ar attempt to get the economy moving to a point where we don't have to have continuous injections of deficit stimulus. That is correct.

Senator DANFORTH. Other than a tax revision proposal with some tax cuts attached to it, what are the other options you see down the road? What are the possibilities? More public service jobs would be one, right?

Mr. SCHULTZE. Well, not necessarily. I think there are two kind of problems.

I think if we can get the private economy, particularly, to go over, and a particular business investment picks up, that with the right air of confidence, hopefully, with tax revisions, et cetera, you can, with the normal tools that we have talked about, get the unemployment rate down in the neighborhood of 5 to 5½ percent.

To get it down below that, you have to be dealing not with general tax cuts or general expenditures, or programs or general monetary stimulus, but with a very pinpointed measure to deal with structural unemployment.

Those are not measures that, one, we have some in effect now, but they need to be improved, and I think we have to devise new forms, improve the old one.

As far as unemployment is concerned, it is going to take time to work on that. We are going to have experimentation. It is a difficult job.

We are going to have to keep working on it so that we can get the rate of unemployment down, use general tools, simultaneously working on structural unemployment problems. Those would be the two big elements.

Senator DANFORTH. Were you planning to be back this afternoon?

Mr. SCHULTZE. I don't know with this invitation.

Senator DANFORTH. I didn't know this either.

Senator BYRD. The invitation applies to Mr. Schultze if he wants to return. I don't think it is necessary for Mr. Lance.

Mr. SCHULTZE. I can be back, sir.

Senator BYRD. Do you have additional questions for this afternoon?

Senator DANFORTH. I don't know if I will. I will certainly be here.

Mr. SCHULTZE. That sounds like a command performance.

Senator BYRD. I would like to ask just one question of Mr. Lance before we recess.

Mr. Lance, do you really believe now that this economic stimulus package is going to give confidence to the business community?

Mr. LANCE. Yes, sir. I would state that it would be imperative to get the economy moving again.

Senator BYRD. Built on more deficits, more spending?

Mr. LANCE. Yes, sir. But I think you have to look at it in relationship to the total picture of what we are talking about over a 2-year period with some flexibility so that in the second year, we can take away from that need.

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I think it is important for us to get some sense of moving the economy once again. I think that when you look at it in that light, when you look at it from that standpoint, what it actually does with regard to the future, can be done. It does those things that are necessary. I think it can add confidence.

Senator DANFORTH. Looking at my schedule, it is doubtful that I will be back at 2:30.

Senator BYRD. Thank you, Mr. Lance and Mr. Schultze.

Let me check with our members of the committee, and let's leave it this way: that we will probably recess until 2:30. If it is not necessary to come back, we will be in touch with you.

Mr. SCHULTZE. You will call me. Thank you.

Senator BYRD. If it is not necessary to come back.

Mr. SCHULTZE. Thank you. If it is not.

[Thereupon, at 12:55 p.m., the committee recessed, to reconvene at 2:30 p.m. of the same day.]

AFTERNOON SESSION

Senator BYRD (presiding). Thank you, Mr. Secretary and Mr. Schultze. We will proceed expeditiously and I will try to keep my questions brief. I hope that we can conclude in about 30 minutes. That time limit will depend a little bit on the brevity of the answers. I will try to keep my questions brief.

Mr. Secretary, I think you and I would both be in agreement that the key to economic progress is confidence, confidence on the part of the general public, on the part of the investors and on the part of the business community.

The Carter economic package is based on more and more spending and more and more deficits. My question is this: Do you really believe, Mr. Blumenthal, that this economic package is likely to inspire confidence?

Secretary BLUMENTHAL. Yes; I do, Senator. I would not be able to fully agree that the Carter economic program is based on more and more spending and more and more deficits.

Senator BYRD. That is what the figures show.

Secretary BLUMENTHAL. I believe that the deficit in 1978 is expected to be less than the deficit in 1977. The deficit in 1979 is expected to be less than that, and the budget is expected to be in balance by 1981.

Senator BYRD. That is long range with nothing to substantiate it. Let us stick to 1977 and 1978, the years for which you have submitted figures.

I think both you and Mr. Lance testified this morning that it is based on more and more spending and more and more deficits. That is what results from it; is that not correct?

Secretary BLUMENTHAL. Even in those 2 years, Senator, the 1978 budget deficit is expected to be at least $10 billion less than in 1977, which is the year in which this administration came into office and had very little impact on the budget, because it was essentially complete by the time we came here.

We had to submit it very quickly.

Senator BYRD. That is true, but the new administration has advocated a new increase—an additional increase—in spending and in the deficit.

Secretary BLUMENTHAL. On that one, I would have to say that one has to ask the question, increase over what? It is an increase over a budget that was presented by the outgoing administration with assumptions that we found to be unrealistic in our judgment—it is only a judgment—to be unrealistic.

We have had budget deficits for so many years and you have been in the forefront of those who have pointed that out and criticized it. We are trying to turn that around. The President is committed to turn it around over the next 3 to 4 years, and we feel that we are developing a program that will accomplish this, but we cannot do it in 1 or 2 years.

Senator BYRD. It has already been established in these hearings by both you and Mr. Lance, Director of the Office of Management and Budget, that the Federal Government this fiscal year will have the largest deficit in the Nation's history. This will be followed by another huge deficit, not as large, but almost as great, for the next fiscal year.

Do you, Mr. Secretary, believe that such huge deficits are likely to inspire confidence?

Secretary BLUMENTHAL. I believe that the sum total of economic policy based on decreasing deficits, moving toward balance in 1981, will inspire confidence, and that one has to see the budget figures for this year and next in that context.

Senator BYRD. The Treasury Department figures show that the national debt at the end of the next fiscal year will exceed $800 billion. A study of Treasury Department figures also show more than 50 percent of that total debt will have been incurred since 1971.

Is this not cause for alarm?

Secretary BLUMENTHAL. I think that it is of concern. It should be of concern to all that the amount of the debt and the increasing cost of servicing it has been rising. It is therefore terribly important that our goal of bringing about balance in the budget as soon as possible be achieved.

I would be alarmed if we were not successful in moving in that direction and achieving it very quickly.

Senator BYRD. Up to this point you are moving in the opposite direction, moving toward greater deficits. With the Nation facing the largest deficit in history for the current fiscal year and a huge and nearly as large deficit for the next fiscal year, why will this not be inflationary?

Secretary BLUMENTHAL. Senator, we believe that the excess capacity that is in the economy both in terms of the number of unemployed, over 7 million people, as well as the excess in plant capacity is of a size that will accommodate, without further inflation, the kind of growth that we feel that we need to achieve in order to get the revenues that allow us to balance the budget.

Senator BYRD. Looking ahead 12 to 18 months, do you foresee greater inflation or not?

Secretary BLUMENTHAL. I think that there are offsetting forces in the economy. I do not anticipate any significant increase in the rate of inflation and the President has strongly indicated, as have I and Mr. Schultze individually as well as Mr. Lance, that we are putting into

place very specific anti-inflation programs that we expect will be a factor in bringing down the rate of inflation over time.

Senator BYRD. There is nothing anti-inflationary in the proposal that the committee is considering at the present time.

Mr. SCHULTZE. Yes; I believe there is one major one. That is the fact that one of the surest ways to make sure in the future we run into inflationary problems is to have a stagnant economy in which business investment is low, capacity is not expanded and, as the economy attempts to grow in later years, you run up immediately against all sorts of bottlenecks, scarcities, shortages, and the like.

To try to lick inflation by making sure that the economy tries to limp along, by not putting in an initial stimulus to get it going again, does threaten inflation further down the road, precisely because we will not have been building the capacity that we will need.

Senator BYRD. Has not the economy already been stimulated by the earlier deficits?

Mr. SCHULTZE. It was in the year 1975, that is correct, but you must remember, as I am sure you do, Senator, that that was the worst recession in 40 years.

Senator BYRD. Are not most economic indicators on an upward surge now?

Mr. SCHULTZE. They are, sir.

Several points on that. Even without this economic stimulus, the economy would grow some. At no time do we ever say that the economy would go into another recession. The question is, how much. It would not have been sufficient to undertake to pull down the rate of employment, to get the economy moving again in a situation where it was popular for business firms to go ahead and invest.

Secretary BLUMENTHAL. I think that it is important, Senator, to note that the leading economic indicators have not been turning up in recent months. On the contrary, although it may have been a temporary situation, they have been negative rather than positive for a number of months.

Senator BYRD. Wholesale prices have been increasing substantially. In January, the consumer price rose by 0.8 of 1 percent or an annual rate of 9.6 percent.

Does this indicate that there is an inflationary trend or inflationary groundwork?

Sescretary BLUMENTHAL. If that were to be repeated month after month, I would be concerned. I think that the January and February numbers are obviously heavily impacted by the adverse weather conditions in this country and one probably therefore has to take a somewhat longer period to really be able to judge these trends.

Senator BYRD. My information is that that figure does not take into consideration the impact of the severe winter weather.

Secretary BLUMENTHAL. I think if they are for the month of January, that would fall into the period where the weather was very bad.

Senator BYRD. Do you think that that increase at an annual rate of 9.6 percent—I might say that that comes on the heels of an annual rate of 9.3 percent, was it not, in the last half of 1976?

Mr. SCHULTZE. No, sir. The rate of increase in consumer prices during 1976 was 4.8 percent.

Senator BYRD. What was it for the last 6 months of 1976?

Mr. SCHULTZE. Are you talking about consumer prices?

Senator BYRD. Wholesale prices.

Mr. SCHULTZE. Wholesale prices did rise. First they rose very slightly in the first half of the year, then somewhat more in the second half of the year. Then they fell back again for about 4 months running. They did run high, in part because the industrial materials prices were going up, that is correct.

Senator BYRD. This so-called economic stimulus package is being urged upon the Congress even though during the last half of 1976 and the first month of 1977 the wholesale prices were rising at a rate greater than 9 percent.

Secretary BLUMENTHAL. The numbers that I have here—these are the changes in wholesale prices, seasonally adjusted, show an increase of 9.2 percent in 1975, 4.6 percent in 1976. In the last 6 months of 1976, they show 0.3 percent in July, -0.2 percent in August, 0.7 in September, 0.5, 0.6 and 0.6 in October, November and December and 0.5 in January. That would be in January at an annual rate of 6 percent. In November and December, roughly at that 6 to 7 percent which is too high, but not at 9 percent, according to these data, Senator.

Senator BYRD. What do you consider to be the inflationary rate at the present time?

Mr. SCHULTZE. The rate at which inflation is occurring at the present time is too high. It is between 5 and 6 percent. That is a rate that is the underlying inflation rate; because food prices were quite stable last year that dipped below that. Because of the cold weather, it will go up—5 to 6 percent is the rate at which it has been running.

Senator BYRD. Mr. Secretary, this morning I think that you said the Government will need to borrow $66 to $68 billion in new money during each of the 2 years, namely 1977 and 1978.

Secretary BLUMENTHAL. That is right, Senator. Including the off-budget items, the Treasury will have to raise about $73 billion of net cash, new cash, in fiscal year 1977 and $66 billion in fiscal year 1978.

Senator BYRD. In addition to the above figures, how much of the current debt will need to be financed during those 2 years?

Secretary BLUMENTHAL. I am afraid that I do not have that figure. I would have to supply that for the record.

Senator BYRD. Would you do that?

Secretary BLUMENTHAL. Yes, sir.

Senator BYRD. What do you estimate to be the needs of the private sector for each of those 2 years?

Secretary BLUMENTHAL. There are some summary data in my prepared statement, Senator. They indicate that the total volume of funds raised in U.S. markets for Federal, State and local governments, plus private consumers and foreign borrowers in calendar—I am now going to calendar years—calendar 1977 would be $325 billion for the year. That includes everything.

In 1978, I do not have a figure for 1978 but I would suspect that it is about 10 percent more, but I can give you a more precise figure for the record.

Senator CURTIS. Do I understand the $325 billion is the total borrowing requirement for calendar 1977?

Secretary BLUMENTHAL. That is right.

Senator CURTIS. What do you anticipate the GNP to be?

Secretary BLUMENTHAL. The GNP?

Mr. SCHULZE. It is $1,800 billion. I will give you our figures: $1,884 billion for calendar year 1977. If you want it for the fiscal year, it will be about $1,790 billion.

Senator CURTIS. About a sixth of the GNP will have to be borrowed?

Secretary BLUMENTHAL. That includes all borrowing, including foreign borrowing.

Senator BYRD. That is all borrowing, by both the private sector and the Government?

Secretary BLUMENTHAL. Yes, sir. Everybody goes into the capital markets to borrow.

Senator CURTIS. I want to know what the Government is borrowing.

Secretary BLUMENTHAL. Senator, I do not have the figure of how much rollover, how much refinancing is going to be required, nor of the breakdown of the State and local governments. I only have the figure for calendar 1977 revenue borrowing, I will supply that for the record.

There is a constant refinancing going on.

[The material referred to was subsequently supplied for the record:]

We are presently estimating that State and local new money financing in calendar year 1977 will be approximately $17½ billion, compared to aproximately $18 billion in calendar year 1976.

Senator CURTIS. What rate of interest do we have to pay on this Government borrowing in calendar 1977?

Secretary BLUMENTHAL. The average rate?

Senator CURTIS. Yes.

Secretary BLUMENTHAL. For calendar 1977—I will have to find that. We have it here for only 1976. I do not have the figure of what we estimate it to be in 1977.

Would you like it for 1976?

Senator CURTIS. Yes.

Secretary BLUMENTHAL. On U.S. Government securities, on the average for 1976 it was 4.989 percent for 3-month Treasury bills; 6.94 for 3- to 5-year bonds; and roughly between 6.5 and 7 percent for U.S. Government securities, taxable bonds, and about 5 percent for 3-month bills.

Mr. SCHULTZE. The rates are slightly lower than that now.

Senator CURTIS. About $1.8 billion to finance the Carter package?

Secretary BLUMENTHAL. It is about $3 billion.

Senator CURTIS. $3 billion?

Secretary BLUMENTHAL. $3 billion.

Senator CURTIS. I thought the package was $31 billion. $3 billion would be one-tenth.

Secretary BLUMENTHAL. On the total, I was referring to the total amount of net, new borrowing.

Senator CURTIS. I want to know what the interest would be for the Carter package.

Secretary BLUMENTHAL. On $31 billion. Yes, $1.5 billion. We take $31 billion at an average interest rate of 4.6 percent. That is what Mr. Lance refers to as country arithmetic.

Senator CURTIS. In a period of 60 years, it will cost $ billion to carry this package unless we move into a surplus position.

Secretary BLUMENTHAL. That is correct, or unless interest rates go down or up. If the interest rate remains the same and we owe the money for 50 years, it is going to be expensive.

Senator BYRD. Do you anticipate that interest rates are likely to go down?

Secretary BLUMENTHAL. I do not anticipate any significant decrease in interest rates over the foreseeable future, Senator. However, I see no reason why, once we get the economy back on the proper track and learn better how to manage our economy in such a way that we can maintain a high level of employment and, at the same time, a decreasing rate of inflation, why in that context, with a good interplay of monetary and fiscal policy, we could not have lower interest rates than we have at the present time.

They are not historically, by any means, low. I have not despaired at the prospect of seeing lower interest rates than we do today.

Senator BYRD. Would you take issue with the observation that interest rates are likely to be higher this time next year rather than lower?

Secretary BLUMENTHAL. I would not want to express myself either positively or negatively on that, Senator. I really do not know.

I do not believe that the stimulus package in and of itself will bring about an increase in interest rates. That is not what our calculations show.

I think that a generally buoyant and growing economy may perhaps, to some marginal degree, result in somewhat higher interest rates over the next 6 to 12 months. I do not think that they would be significantly higher.

Senator BYRD. In calculating the amount of interest charges on the national debt for the fiscal year 1978 budget, as I understand it, the Treasury assumes an interest rate of 4.6 percent.

Is that not unrealistically low?

Secretary BLUMENTHAL. That is based on present expectations, our best estimate of what the actual cost will be.

Mr. SCHULZE. My understanding, Senator—and I would be willing to correct this for the record—since time immemorial it has been a custom of the Federal budget to use the interest rates prevailing the week before you put the budget together, because the Federal Government does not want to be in the position of showing in its budget a flat forecast of interest rates. That is my understanding. I am willing to confirm it for the record.

Senator BYRD. I would assume that that would be accurate.

Senator Moynihan?

Senator MOYNIHAN. May I take the opportunity to welcome two old friends to this committee.

Senator BYRD. Senator Curtis?

Senator CURTIS. In your projection of a balanced budget, what factor do you have in it for new programs authorized by Congress?

Mr. SCHULTZE. Senator, the way that position was put together was the following: First, one projects the revenues under existing tax laws, counting the stimulus; second, one projects expenditures under current programs.

In a prosperous economy in 1981, there would be an excess of revenues over expenditures under current programs which in turn

86-032—77——11

could be used in one of three ways: tax reduction, additional programs by the Congress, or debt reduction.

Therefore, the premise of a balanced budget is a very strong objective of the administration, and it comes from that calculation.

As time goes on, the administration and the Congress together will be working as to exactly which mix of those possibilities goes into effect.

Senator CURTIS. I think you underestimate the creative genius of Congress for devising additional social programs. I dare say that it will exceed $400 billion, the bills that have been introduced, or will be introduced, in the next 60 days.

It seems to me that Presidents come and go—I have served under eight Presidents. This notion has not been for the last few months, but has been for some time. When their fixers get through, their tinkerers that manage the economy, at the end of a road will have a balanced budget—it is just beyond the horizon. It never happens.

It is a problem that cannot be postponed.

Senator MOYNIHAN. Mr. Chairman?

Senator BYRD. Senator Moynihan?

Senator MOYNIHAN. I would like to take the occasion to ask Secretary Blumenthal and Chairman Schultze not so much a question, but to draw to their attention an issue, I think, that acquires more saliency as time goes by: the question of investment.

As the Secretary said that of the four components in the President's proposal, one is the reduction in business taxes to stimulate employment and encourage investment, but there is a long article, an essay you may probably say, in this morning's Wall Street Journal by an old colleague of all of ours, Dean Rostow, of the University of Texas, on the cycles and the proposition that we are in a fifth Kondratieff cycle, that absent the opening of frontiers and new resources that have been the basic way to change, basic ways it has changed in the past, that large amounts of new investments are going to be required, much larger than has been our historical experience in the last generation, which has been at a very low level compared to other industrial countries.

I know that this is a subject that concerns you, but is there anything that you may want to say to it as we propose tax reductions for purposes of increasing consumption?

Secretary BLUMENTHAL. No doubt Mr. Schultze has something to say on this subject. May I say that I indicated this morning a strong concern on our part to make a very modest beginning. That is not what Mr. Rostow had in mind when he was talking about the Kondratieff cycle. I will say he has visited me and he has explained in great detail his views on this.

I did suggest this morning that we needed to move in a direction of stimulating greater investment by private industry to create private jobs. Therefore, the action by the House of eliminating, of all of the different pieces in this rather modest stimulus package that we have proposed, precisely the one that related to the stimulation of business investment, was, in our view, unfortunate. Not so much because of the amount, although that is of benefit to many companies who have investment programs, but because of the signal that it gives to the

investment community that this Government is not concerned about this problem.

Second, we feel very strongly in conjunction with the presentation of a program of fundamental tax reform that we will be presenting to the Congress later this year, that this particular concern of how to stimulate investment for additional plant and equipment, to increase producivity and lower cost, and for research and development for more investment, that has to be a very important objective of such a program of tax reform.

So it is a matter of considerable concern and one of which I have spoken last week in New York. The President is concerned about it, and we will be pursuing it.

Whether or not the particular analysis of Professor Rostow's is totally correct or not is a different matter. Certainly investment is a key element that we need to pursue.

Senator MOYNIHAN. Thank you.

Mr. SCHULTZE. I do not have very much to add to that. I think there are some very special problems with respect to investment.

We have come through the worst recession in 40 years, double-digit inflation, the burgeoning of a whole new series of governmental regulations, no matter how good, put in a lot of uncertainties, the question with respect to where the future price of energy is going, all of these things do impose very special difficulties.

We are making, we hope, the first steps with this economic package to instill some kind of confidence and sustain expansion, so I do realize there are some very special factors on investment.

I just say I have some hesitancy, however, in subscribing to the fact that there is some fundamental 20-year cycle and that we have some major technological and/or other related revolutions we must overcome.

Let me put it this way: I am not willing to accept that.

Senator MOYNIHAN. Am I correct, Mr. Chairman, in thinking that you made the absorbing observation awhile ago that one of the effects of the OPEC price increase was, in a sense, to involve a very sharp writing off of the value of American plant and equipment—that was designed at energy prices that no longer existed? That plant and equipment that was built in the expectation of cheap energy, there is a loss in the investment value when the price of energy changes.

Mr. SCHULTZE. I did not make the observation but at least, stated with some qualifications, it is true. The interesting fact is you are not sure, however, which way that cuts for investment. It hurts current profits, but it sets up a lot of stimulus for investments in energy-saving devices. Just as the destruction in the German plant and equipment after World War II raised the devil with profits, it was a big incentive for investment.

The comparison is absurd, but we have to be a little careful about the impact of that on investment.

Senator MOYNIHAN. We have heard you. The administration says the OPEC prices is the equivalent of the German destruction.

Thank you, Mr. Chairman.

Senator BYRD. Senator Matsunaga?

Senator MATSUNAGA. Thank you, Mr. Chairman.

I never realized, coming over to the Senate, that I would be assigned to my choice of committees. I asked for three committees and we were entitled to be assigned to two major committees and one minor. I never realized that all committees would be meeting at the same time. This is our real problem here, so I am sure that those of you, especially Larry, understand the situation we find ourselves in.

I must, as a member of the committee, apologize for the absence of the other members. I am sure that as you come to the Hill from time to time you realize the situation is such that we need three or four bodies all at the same time.

I would like to pursue further the question that I raised this morning relative to the job credit proposal.

I would like for either of you gentlemen to state why it is that you feel that the proposal would not work, that you feel that it should not be tried at all. Why is it?

Secretary BLUMENTHAL. I believe, Senator, that any scheme which has to employ, or be based on, an arbitrary base period, and any base period by definition is arbitrary, results in inequities, and unexpected results different from those that you intend.

Therefore, it is extremely difficult to make a scheme based on a base period work adequately.

To give you one example, I lived as a businessman through the last bout of this country—I hope we never see it again except in a period of grave national emergency—of wage and price controls. Those controls had to be based upon a certain base period. Whatever the base period was, suppose it was Otcober 1 of a certain year, and your firm happened to that year to have put out your price lists on one day and your competitor on the next day. You were frozen in a relationship that caused you the most tremendous competitive difficulties and actually could result in substantial losses.

Here, too; by picking an arbitrary base period, you are discriminating between an employer who happens to have invested some money in a new shop, for example, for which he is planning to hire more people, which he would do in any case, because he has put his money into that shop. If he made his investment 6 months later or 3 months later than his competitor did, so he is going to get some benefit but his competitor is not, even though they both spent the same amount of money on the same kind of shop to compete with each other. Because of the base period, one gets it and the other does not.

So I have some problem about that kind of inequity.

Second, I am concerned that this particular proposal, in fact, leaves out of consideration the bulk of the labor force for the reasons that are cited in my testimony.

It leaves out all of those that are not increasing. For example, it leaves out those who are increasing productivity, who have put in labor-saving devices, which is good for the American economy. Although it sounds perverse, it is good for the American economy; that is how we compete in the world. And all of these people who have spent a lot of money on technology, which is what makes this country great, on research and development, who are able to put in better machines and more efficient methods and therefore produce more—they do not get anything.

The people who are inefficient, who have not had the foresight or the courage to do that sort of thing, get something, and I do not think that that is good for the American economy.

I also do not believe that picking up one element in the American economy, namely the small employer, and leaving aside all those larger companies or employers who account for an important proportion of total employment within this economy creates the right kind of incentives.

Furthermore, I obviously have some doubts about a proposal, that can, under certain circumstances have the unexpected and unintended effect that you can hire somebody additionally and wind up with more money from Uncle Sam than if you did not hire him, even if that person never does a day's work. I am sure that that was not intended with this proposal, but it does have this impact.

Furthermore, I have some concerns that it tends to favor those employers who are in naturally growing businesses but discriminates against those who are struggling or are in declining businesses and need some help. That applies to small and large employers alike.

It is my conviction that the system not only will be highly discriminatory, but also will not result in people hiring more, although it may result in the perverse effect that two part-time workers are hired rather than keeping on a head of a family who really needs the job more. I do not believe that will result in more employment. I believe that it arbitrarily distributes tax money to employers without any reference to what they are doing to creating new jobs and that it discriminates among different types of employers in a way that I consider to be economically undesirable for the future of this economy. For these reasons, I say that I prefer a business tax proposal that provides an option such that any employer has an opportunity to benefit from it and, and to the extent that the benefit results in an increase in profits and in cash flow, the program will certainly lead to some increase in employment, but in an across-the-board way.

Senator MATSUNAGA. Assuming for the sake of argument that what you say is true, would you have any objections to the committee's instituting both the ITC and the job credit program in this incentive bill that we propose to report out?

Secretary BLUMENTHAL. I certainly would have to say that that alternative is better than the proposal presently contained in the House bill. I would also have to say that because of all of the objections and concerns that I have over the job tax credit that I would still be concerned about its inclusion. It would leave out an important group of employers who would not be covered under either, namely those employers who are relatively large employers, who would be expected to employ more than 24 additional people, but who do not invest, because, say, they are not in a factory but in a retail business.

These types of employers would not be able to benefit from the investment tax credit and would not really benefit from this particular proposal and would be left out.

Senator MATSUNAGA. The reason I suggested both programs, I do not know if you are familiar with the testimony presented on February 22 by Mr. Milton Stewart on behalf of the National Small Business Association before the Senate Select Committee on Small Business.

This is what he had to say and I would like your comment on this, and I quote:

> One of the benefits that we see stemming from this new tax incentive is the provision,

referring to the job tax credit,

> of a balance between tax incentive for capital goods expenditure and full employment.
>
> In the past ten years, corporations alone have received $26 billion in tax credits from the investment tax credit. Just about two-thirds of it went to 1,500 companies. In at least one year, more than half of it went to a few more than 300 companies.
>
> We are in favor of productivity improvement as a national goal. We are in favor of the incentive for technological improvement, but the way that the ITC has worked, in our judgment, it has never been adequately described. We believe that it has actively financed the export of various significant numbers of jobs. Major multinational corporations have used their credit to automate their domestic plants and then made major investments in labor-intensive facilities in cheap labor markets—that is, in foreign countries. We appreciate fully that this is not the whole story——

And this is what I would like your comment on especially——

> What is more, we believe that a graduated investment tax credit will be more and more important to some parts of the small business community in the years ahead. Small business, too, must upgrade its equipment.

I will stop there and ask you for your comments.

Secretary BLUMENTHAL. There is one comment that I would like to make early on in reference to the testimony that you just read, Senator, is that the tax credit goes to unincorporated businesses as well as corporations. There is no distinction there.

Senator MATSUNAGA. That is true; I do not know where he got his figures from. But what he is saying is that most of it went to corporations in 1 year, to only 300 major corporations who got one-half of all of the credit.

Secretary BLUMENTHAL. I think that the proposal that is contained in the administration bill attempted to address itself to that problem by providing the alternative of the employment tax credit to those companies or employers, particularly very small ones such as those who would be represented by this gentleman, who do not have major investment programs or any kind of investment programs. They would get some benefit and, of course, the amount that they would be getting is of more importance to them than it would be to a very large company.

I would have some concern for changing the investment tax credit in such a way that it is graduated—if I understand that, you give a larger credit to a small employer and a smaller credit as the employer becomes larger.

Senator MATSUNAGA. Like a graduated income tax in reverse.

Secretary BLUMENTHAL. That is a principle that I do not believe, except in a very minimal way, was ever adopted in the corporate tax system. With the exception of some graduation at the beginning, we tax businesses alike. We do not have graduated rates as we have in the individual income tax.

That would have all kinds of serious implications, so I would have some concerns about that. I do not think I would favor that approach.

Mr. WOODWORTH. The problem, of course, is that you have many individuals who have large incomes who have their investments in small companies, where you also have other cases where you have large companies with very many shareholders with very small incomes, so you

cannot always be sure, when you are giving that relief to the so-called smaller corporation whether it goes to the person ultimately with the lesser income.

So the size of the company is not correlated positively with the income of the shareholders.

In addition, we have had several features of the tax law which, as the Secretary has said, do tend to help corporations or businesses on the first amount of investment. With the investment credit itself, for example, you can offset the total tax liability up to $25,000. Above that, you can offset only 50 percent of tax liability.

There are depreciation schedules that also are more genenerous for the first amount.

Mr. SCHULTZE. If I could summarize, it seems to me that you have three options. You could have the investment tax credit alone and that would have some very good advantages for investment, but it would leave out those firms that are highly labor intensive that are not invested.

Second, you would have an option of an investment tax credit and the House Ways and Means Committee employment tax credit. What that would do is provide, again, some incentives for investment and some tax relief for a selected group of small business firms which happen to have the good fortune of being located in growing communities or growing industries but not give anything to others.

Third, although this option may be a little bit biased, you have the third option of what the administration proposed; the investment tax credit on the one hand and an option available to all businesses who are not investing significantly enough to take advantage of it.

That third option, it seems to us, does give advantage, particularly to small business, but it does it in a much more evenhanded manner than the Ways and Means Committee.

Senator MATSUNAGA. What if we bring in the element of the rate of unemployment, as we have in other measures. Where the rate of unemployment is in excess of 6 percent that it would apply, but not in other areas. Would that take care of the objection that you said, Mr. Schultze, that you would have in other areas?

Mr. SCHULTZE. This would mean in an area with more than 6 percent unemployment, if you happened to be in such an area and also happened to be expanding, you would get it. If you happened to be in a 6.5-percent unemployment area and were an industry—for example, let us say the shoe industry that was not expanding, even though you were in a 6-percent unemployment area, you could not get it.

Senator MATSUNAGA. The entire objective of the incentive program is to cut down the rate of unemployment. That is what we are doing insofar as this emergency program is concerned.

Mr. SCHULTZE. We agree with that.

Senator MATSUNAGA. If that is the case, we would approach it on the basis of aid where aid is most needed, just as in the public works programs, for example, where we say if the unemployment rate is in excess of 6.5 percent—we have two types: one based on the actual population of unemployed, and one based on the rate of unemployment in different areas. We could have the same thing here. I am sure that our staff could work up something that could bring about some sense of justice and take care of that problem, which both you and Secretary Blumenthal mentioned, about giving a fellow who goes into a new busi-

ness credit even though he was intending to employ someone anyway.

The base which you speak of, if I may continue, Mr. Secretary, in my bill—I am sure you have not seen my bill, but if you have seen it by any chance, the base is simple. The small businessman is not faced with intricate returns. All he does is show in his tax return that he had in his hire so many employees the year before and this year, under this program, he has 1 additional, 2 additional, up to 10 additional employees. That is the upper limit.

The limit of $40,000 in the House bill is raised in mine to $80,000. The House has set a limit of 40 percent of up to $40,000. Mine would make it up to 50 percent on the maximum of $80,000.

That would be so simple, unlike the employment programs that we have now. I am told that 85 percent of the small businessmen have not used this tax advantage because it is so complicated. This could change if we give them a simple form where all they have to do is show that they have this year so many more employees than they had last year. That indicates that they have new hires; that is all they would need to show.

Of course, we would have the Internal Revenue Service monitoring so that they would dare not cheat on it.

Secretary BLUMENTHAL. You would still have the tremendous problem of part-time employment.

Senator MATSUNAGA. I think that we would limit it to full-time employment.

Secretary BLUMENTHAL. During the entire year?

Senator MATSUNAGA. New hires for the year.

Mr. SCHULTZE. Take, for example, a construction firm. When he lays off 50 people, the next week 30, the next week 20, the next week 104. The first thing you have to do is have an averaging procedure when you average out per week how many you hire, then IRS has to check your weekly hiring pattern. Second, presumably a hamburger stand employing 8 people full time could easily substitute 16 people part time.

As you begin to think through the circumstances of individual business firms, you do raise—I would not say insuperable, but fairly significant problems.

Senator MATSUNAGA. We could set a minimum time period, that this credit will not apply unless the employee has been employed for 6 months or more during the past year, in the reporting year; and according to the National Small Business Association, they took a survey among the new membership and they found that 85 percent of them when on the fringe of hiring or not hire, generally do not hire two additional people that they could hire, because of the additional training that it would require. It would cost too much to hire a new person.

As you no doubt are aware, the highest rate of unemployment is in the construction industry. Next are those in the retail establishments, the small business establishments where they have laid off people, but they still hire 55 percent of the entire work force. I feel that this is the area where we can provide the fastest relief.

I strongly feel that way, and I would like for you to be able to agree with me.

Mr. Chairman, I have no further question.

Senator BYRD. I have two quick questions, then we will adjourn this hearing.

As one who originally opposed the investment tax credit, I quickly reached the conclusion that I was wrong, and I have been supporting it for the past 10 or 11 years. But where do we stop, in amount of the tax credit.

It seems to me that 10 percent has been a pretty reasonable figure; now you are recommending going to 12. Do you feel that that is really necessary, to go higher than 10 percent, or is it mainly a signal that you want to send out to the business community?

Secretary BLUMENTHAL. Senator, I do believe that it is both. It is clearly an indication that we do attach great importance to accelerated and expanded business investment and also the additional 2 percent does make some difference when it comes to the volume and the timing of these decisions.

I do not believe that that could go on indefinitely, that we could increase it to 15 and 20 and so on.

Senator BYRD. You feel that we should not?

Secretary BLUMENTHAL. I do not believe we should continue. I believe the additional 2 percentage points will be an important factor, both psychologically as well as materially.

I also feel that, as part of the more fundamental tax reform proposals that we will be making, we will want to look at that whole structure of taxes, as it impacts the business community to see what other techniques might be best suited to promote the right kind of business investment.

Senator BYRD. You do not envision this as a permanent change from the 10 percent to 12 percent?

Secretary BLUMENTHAL. This whole program, as I understand it, runs through 1980. It is up for reconsideration by the Congress in 1980. In any case, using the word "permanent," it is permanent until its expiration in 1980.

Senator BYRD. In looking for an alternative such as the Senator from Hawaii has and the Senator from Delaware did this morning, let me ask you for information on this. Suppose each tax rate bracket was reduced by 5 percent, starting at 14 percent and reducing that 5 percent, making it 13.3 and the higher rate of 70 would come to 66.5, and each rate in between thusly reduced.

What would be the cost to the Treasury to do that across the board, a 5-percent reduction in each bracket across the board?

Secretary BLUMENTHAL. We would have to provide that figure for the record.

Senator BYRD. Do you have a ballpark figure?

Secretary BLUMENTHAL. $7 to $9 billion.

Senator BYRD. That would be less than the total package that you are speaking of? In other words, it would be less than the $50 rebate?

Secretary BLUMENTHAL. Yes; that would be in the first year and, if it were permanent, it would repeat itself each year.

Senator BYRD. Give that figure again?

Secretary BLUMENTHAL. We are not totally sure, Senator. Mr. Woodworth thinks it is $7 billion; Mr. Schultze thinks it is $9 billion. I will pick $8 billion.

Senator BYRD. That is interesting; to reduce everyone's tax across-the-board by 5 percent would still cost less than the $50 rebate.

Secretary BLUMENTHAL. It is a permanent thing. The $50 rebate is a one-shot. So in 2 years, you would catch up rather quickly, as you

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continue. Also, the $31 billion involves a whole host of things. It does involve some reduction of taxes for lower income earners. It does involve some jobs and public service and public works programs.

It does a number of things along with the rebate. But if you just take that one element, if you worked all that out and say you would reduce it by 5 percent, then $7 to $9 billion of annual permanent reduction in revenues——

Senator BYRD. Less than the one-shot $50 rebate.

Secretary BLUMENTHAL. Less than the one-shot $50 rebate.

Senator BYRD. My last question is that it has been indicated that the increase in the minimum standard deduction will remove 3.5 million taxpayers from the rolls. Would the Treasury provide the committee with an analysis of the number of the taxpayers removed from the rolls by the 1969 Tax Reform Act and subsequent acts?

Secretary BLUMENTHAL. We will provide that, sir.

[The material referred to was subsequently supplied for the record :]

Question. The 1969 Act, and later tax reductions, have relieved many taxpayers of their entire tax burden. How many?

Answer. There will be about 21 million tax returns filed for 1976 which show no tax due, and of these, about 15 million would pay some tax if tax changes from 1969 on had not been enacted.

(This result is from the Treasury Tax Model and does not include "returns" which would pay tax under the old tax law but which are not even filed under 1976 law.)

However, it is unreasonable to pretend that the tax-free levels could have remained unchanged since 1969 in spite of over 50 percent inflation (1969 to 1976). From 1969 to 1976, the U.S. population grew 6.14 percent. If the number of tax returns paying some tax had grown by the same percentage there would be 67.6 million. Actually there will be 66.6 million. (This comparison probably understates the effect of the tax changes, because it ignores the changes in family size and the proportion of single returns that have occurred since 1969. These trends would have caused the number of taxable returns to grow more rapidly than population, but their effects have been more than offset by the changes in the law.

Senator BYRD. I thank you, and I have certain tables dealing with the national debt, the debt interest and surplus deficits and so forth. With the permission of the committee, I will insert them in the record.

[The material referred to above follows :]

STATEMENT ON INTEREST COSTS

During the past several months, a great deal of public attention has been focused upon the Administrations stimulus proposal. Unfortunately, very little of the national discussion has been about the hidden cost of such an economic program.

In discussing the economic-stimulus proposal its interest burder upon the American taxpayer has been overlooked. In fiscal year 1977, the estimated gross interest will be $42.3 Billion. In fiscal year 1978, the gross interest will be $46.8 Billion.

This is a continuation of the trend of increasingly higher interest payments on the national debt. As this chart, which I would like to put in today's record, shows our interest payments in 1959 were $7.8 Billion. In 1967, just ten years ago, they were $14.2 Billion. Today, they have more than doubled to the $42.3 Billion which is estimated for fiscal year 1977. And this amount will go up to $46.8 Billion for fiscal year 1978.

Real costs of these interest payments can be shown only when they are compared with other uses to which the money could be cut. The fiscal year 1977 interest payments are approximately 40 percent of our expenditures for national defense. They are almost twice what will be spent for educational training, employment, and social service programs. They are slightly more than our payments in the health field and are 4½ times greater than expenditures for revenue sharing.

I am greatly disturbed by these interest costs. Twenty-five cents of every working person's tax dollar goes to pay the interest on the national debt. Our interest expenditures represent money that could otherwise be returned to the taxpayers or used for necessary Government programs. Instead this money is being diverted to service our Federal debt.

It is obvious that we will not be able to control inflation and move toward economic growth until we get the cost of government including interest under control.

DEFICITS IN FEDERAL FUNDS AND INTEREST ON THE NATIONAL DEBT, 1959-78, INCLUSIVE

[In billions of dollars]

Year	Receipts	Outlays	Surplus (+) or deficit	Debt interest
1959	65.8	77.0	−11.2	7.8
1960	75.7	74.9	+.8	9.5
1961	75.2	79.3	−4.1	9.3
1962	79.7	86.6	−6.9	9.5
1963	83.6	90.1	−6.5	10.3
1964	87.2	95.8	−8.6	11.0
1965	90.9	94.8	−3.9	11.8
1966	101.4	106.5	−5.1	12.6
1967	111.8	126.8	−15.0	14.2
1968	114.7	143.1	−28.4	15.6
1969	143.3	148.8	−5.5	17.7
1970	143.2	156.3	−13.1	20.0
1971	133.7	163.7	−30.0	21.6
1972	148.8	178.0	−29.2	22.5
1973	161.4	186.4	−25.0	24.2
1974	181.2	198.7	−17.5	29.3
1975	187.5	238.5	−51.0	32.7
1976	201.1	270.0	−68.9	37.1
Transition quarter	54.1	65.1	−11.0	10.4
1977 [1]	236.6	309.5	−75.9	42.3
1978 [1]	269.8	337.8	−68.0	46.8

[1] Estimated figures.

Source: Office of Management and Budget and U.S. Department of the Treasury.

The national debt in the 20th century

Year	Billions	Year	Billions	Year	Billions
1900	$1	1927	$19	1954	$271
1901	1	1928	18	1955	274
1902	1	1929	17	1956	273
1903	1	1930	16	1957	272
1904	1	1931	17	1958	280
1905	1	1932	20	1959	288
1906	1	1933	23	1960	291
1907	1	1934	27	1961	293
1908	1	1935	29	1962	303
1909	1	1936	34	1963	311
1910	1	1937	36	1964	317
1911	1	1938	37	1965	323
1912	1	1939	40	1966	329
1913	1	1940	43	1967	341
1914	1	1941	49	1968	370
1915	1	1942	72	1969	367
1916	1	1943	137	1970	383
1917	3	1944	201	1971	409
1918	12	1945	259	1972	437
1920	24	1946	269	1973	468
1919	25	1947	256	1974	486
1921	24	1948	251	1975	544
1922	23	1949	252	1976	631
1923	22	1950	256	1977 [1]	727
1924	21	1951	254	1978 [1]	802
1925	21	1952	258		
1926	20	1953	265		

[1] Estimated figures.

NOTE.—Rounded to the nearest billion dollars.

Source: U.S. Treasury Department.

Senator BYRD. I thank the Secretary and Assistant Secretary and Dr. Schultze for being here this afternoon.

Secretary BLUMENTHAL. Thank you very much.

Senator BYRD. I may have some questions to submit to you for the record.

Secretary BLUMENTHAL. Yes, sir.

Senator MATSUNAGA. If I may, Mr. Chairman, I want to congratulate Secretary Blumenthal in his choice of his assistant, Dr. Lawrence Woodworth, who has been a stalwart supporter of sound tax legislation.

I am sure that by consulting with him, Mr. Secretary, you will agree to seeking a more direct route of the job credit plan; then, perhaps we can arrive at some compromise where we can move forward in several directions.

Secretary BLUMENTHAL. I would be glad to make that deal with you, Senator. You work on him, and he can work on me.

Senator MATSUNAGA. If it does not work on him, I may have to withdraw my commendation. [General laughter.]

Senator BYRD. Thank you, gentlemen.

[Thereupon, at 3:45 p.m., the hearings in the above-entitled matter recessed to reconvene Wednesday, March 9, 1977.]

TAX REDUCTION AND SIMPLIFICATION ACT OF 1977

WEDNESDAY, MARCH 9, 1977

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

The committee met, pursuant to notice, at 9:50 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Byrd, Jr., of Virginia, Gravel, Hathaway, Haskell, Matsunaga, Curtis, Hansen, Dole, Packwood, and Danforth.

Senator HANSEN [presiding]. The committee will come to order.

It is always a pleasure for this committee, or any committee in the Senate, to welcome to the witness table the very distinguished senior Senator from Massachusetts, my good friend, Senator Kennedy.

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

If I could, I would like to have my statement in its entirety printed in the record and then I would like to review those parts which I think are most salient.

Senator HANSEN. Without objection, your request is approved.

STATEMENT OF HON. EDWARD M. KENNEDY, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Senator KENNEDY. I have a brief opening comment, and then I will get into the details of a proposal that I hope will be given serious consideration by this committee.

It is always a privilege for me to appear before this committee once again to express my views on measures that can make our Federal income tax system a more equitable, more easily understood, and more efficient vehicle to achieve our Nation's social and economic goals.

It was only a year ago that I presented testimony before this committee as it began the work that culminated in the passage of the Tax Reform Act of 1976. Of course, my views differed from those of some members of the committee on particular aspects of that legislation. But I joined with all members of the Senate in their appreciation of the long months of dedicated work by the chairman and members of the committee to produce a bill that is worthy of the name tax reform.

I therefore welcome the opportunity to make what I hope will be useful contributions to the committee's deliberations on the proposed Tax Reduction and Simplification Act of 1977.

H.R. 3477, as passed by the House yesterday, has two major objectives. First, to provide part of the fiscal stimulus to the economy to achieve adequate growth and reduce unemployment from its present

unacceptable level of over 7 percent. Second, to move toward an income tax system that is more simple and more equitable.

These goals are easily stated and can be expected to win almost universal endorsement. The crucial question, however, is whether the proposed legislation moves us toward these goals in the most effective way.

In testimony before this committee yesterday, the administration indicated reservations about some aspects of the House bill—notably the proposed "new jobs tax credit." I share those reservations, but I do not believe the administration's proposals meet the essential requirements of a properly structured temporary tax incentive: effectiveness, simplicity, ease of implementation, ease of administration, and equity.

I, therefore, propose today for the committee's consideration an approach which more nearly satisfies those tests and which I urge the committee to consider in lieu of the House-passed "new jobs tax credit" or the investment credit-social security tax credit alternative proposed by the administration.

A better method, Mr. Chairman, of providing a temporary stimulus to job-creating capital investment is to make the basic 10-percent investment credit refundable, where a taxpayer's investment credit exceeds its tax liability. This action will provide a stimulus for the business sector of an estimated $1.1 billion in fiscal 1977 and $3.4 billion in fiscal 1978.

The advantages of this proposal for a temporary capital and jobs stimulus over those adopted by the House or suggested by the Treasury can best be seen by comparing the three approaches under the standards of effectiveness, simplicity, ease of implementation, ease of administration, and equity.

First of all, on effectiveness. My basic objection to the House-passed new jobs tax credit and the administration's proposal to increase the investment tax credit from 10 percent to 12 percent is that these proposals automatically exclude many businesses and employers who need the financial aid the most.

Moreover, the businesses that are excluded are often the ones that offer the greatest promise of increased employment.

Neither the proposed new jobs tax credit nor the increased investment credit provides any current assistance to a business that has no tax liability at all. The recession has had an especially heavy impact on my own State and throughout the Northeast, and many other parts of the country. Many have incurred tax losses over the past 3 or 4 years that will be carried forward to eliminate tax liability in 1977, 1978, and 1979. Now is the time that the stimulus is needed.

A similar problem is faced by those businesses that do incur some tax liability, but not enough to absorb the full investment credit, and by businesses that are precluded from the full use of the credit by the present general limitation on the credit of 50 percent of tax liability.

Congress addressed these problems in 1976, as you remember, in the area of railroads and airlines by temporarily increasing the limit to 100 percent.

The proposal for a fully refundable investment credit is a logical extension of that principle, but applied across the board of all businesses in an even-handed and nondiscriminatory way.

True, the excess job credit or investment credit could be carried forward, possibly to be used after 1979. As I mentioned the stimulus and help for capital investment is needed by these businesses now. It is no comfort to tell these business people that they will get tax help several years in the future, if only they will make a capital investment now.

What they need is tax help now, as they struggle to climb out of a recession they did not create and cannot cure alone.

A refundable investment credit is an effective way to provide over the next 2 years the funds that will enable these businesses to make the capital investments they need to achieve greater profitability and full productivity and maximum employment.

A second group that would get no help from the new jobs tax credit or an increased investment credit is newly created businesses. We know that venture capital is in short supply in many parts of the country. A refundable investment credit can help to solve this problem.

One major challenge that all new businesses face is to find the funds to acquire the machinery and equipment necessary to start the business. It is no help to a new business to learn that Federal funds will be available 5 to 7 years down the road, if it manages to incur an income tax liability by that time.

A new business needs funds at the time it buys equipment to open its doors. A refundable investment tax credit meets this need. Neither of the proposals before the committee provides help in such cases.

A third group excluded from the proposals advanced by the House and by the administration are the nonprofit organizations. The nonprofit sector, as a group, provides a substantial amount of available employment in many States. Hospitals, colleges, and universities, and other nonprofit organizations face enormous capital needs.

I find no persuasive reasons for excluding this vital sector of the economy from the investment credit, which is the largest single program used by the Federal Government to stimulate the economy.

In my own State, many of the colleges and scores of other institutions employ thousands of people and each year make thousands of dollars of significant capital investments in machinery and equipment. The same is true, I am sure, of Loyola and Tulane, of Emory, of Yale and, I am sure, of many colleges and universities, as well as other nonprofit institutions in your own State, Mr. Chairman.

Many of the other nonprofit institutions in States represented by members of this committee would also be included.

Making the investment credit refundable can give the nonprofit sector of the economy a badly needed shot in the arm. The temporary nature of the credit can give Congress the opportunity to study the desirability of including the nonprofit sector in the investment credit on a permanent basis.

It is sometimes asserted that we should not give the benefit of the investment credit to institutions that pay no taxes. But this argument misconceives the nature of the credit.

As I hope we all recognize at this late date, the investment credit is a massive, $11 billion a year Federal assistance program to encourage capital investment. We have chosen to carry out this Federal assistance program through the income tax system. It could also have been carried out by direct Federal payments. No one asserts that nonprofit organi-

zations, just because they pay no taxes, should be precluded from receiving direct Federal funds through research grants, capital construction funds, capitation grants like our medical schools receive, and many other Federal programs.

They should not be denied access to some types of assistance just because Congress has decided to make the assistance available through tax credits rather than through direct grants.

In fact, the Tax Reform Act of 1976 contains a precedent for this proposal because it granted one-half of the investment credit to shipping companies that construct ships out of tax-exempt capital construction funds.

In short, Mr. Chairman, neither the proposed new jobs tax credit nor an increased investment credit will be effective for businesses that need a financial boost the most: Those that were hardest hit by the recession, new businesses, and nonprofit organizations.

In addition, the investment credit has already proven its worth as an effective device for stimulating investment and creating jobs. In this bill, we are looking for a 2-year shot in the arm for investment and employment. This is not the time to be experimenting with new and untried programs.

The investment credit works. The goal now should be to allow it to work for businesses that are excluded from its benefits. Making the present 10 percent credit refundable does just that, without embarking on still another unproved, untried tax expenditure program. We need real results quickly, not the conjectural hopes projected by a computer model run.

As Secretary Blumenthal pointed out in his testimony yesterday, the proposed new jobs tax credit in the House bill is unlikely to be effective in creating a significant number of new jobs. I believe the administration is correct in focusing on the existing investment credit as a better vehicle for encouraging expanded business activity.

The fault in the administration's proposal to increase the credit by 2 percentage points is that it fails to help businesses that deserve the help the most.

Moreover, I find unpersuasive the administration's case for its social security payroll tax credit. It is difficult to believe that a tax benefit of one penny per hour of wages can be an effective jobs creation program. While I favor the concept of providing assistance to labor-intensive firms, I believe that Congress needs more time than is now available to develop an effective program.

Let me also describe very briefly, Mr. Chairman, how the House version and the administration proposal fail the other tests for an appropriate capital or jobs incentive.

On the issue of simplicity and ease of implementation, it is essential that a temporary measure to stimulate business investment be quickly and easily understood. A new 2-year tax credit is no good if it takes 2 years for a business to understand how it works.

The House-passed jobs tax credit requires six new pages in the Internal Revenue Code. Many more pages of regulations will be required to implement it. It is filled with potential chances for manipulation, as Secretary Blumenthal has explained. The proposed credit may well provide a great deal of employment for lawyers and accountants over the next 2 years. But by the time they have worked

out all the possibilities for manipulation and the Treasury has issued regulations to prevent them, 2 years will have passed.

The existing investment credit is already in place. It is well understood by business and the Internal Revenue Service. The rules for eligibility have been worked out.

Adopting the proposal to make the credit refundable will not trigger another round of complex statutes and regulations, followed by more complicated transactions, following again by still more complex regulations in the never-ending chase between Congress, tax lawyers, and the IRS.

To be effective, an investment stimulus must be understandable by business and must have the confidence of business. I agree with the Treasury that our best economic stimulus is provided by a strengthened investment credit, strengthened to help those businesses and institutions that will be most encouraged to increase investments and create new jobs. We should take advantage of our 15-year experience with the investment credit, rather than spending time and effort to develop a new program as proposed by the House.

Finally, Mr. Chairman, on the issue of the ease of administration, a refundable investment credit will also be much easier for the IRS to administer than either the new jobs tax credit in the House bill or the administration's social security payroll tax credit. The Government regulations that are required to implement a totally new program would be vastly reduced by simply modifying the existing investment credit.

Moreover, IRS personnel are already trained to audit and oversee the investment tax credit. The refundable investment credit is clearly superior to the House or administration proposals in this respect.

In addition, it would improve the equity of a major tax program already on the books. The House proposals for a new jobs tax credit and the administration's social security payroll tax credit simply introduce new sets of inequities into our tax system.

With respect to the House bill, it is actually possible for a wealthy individual to make a tax profit merely by hiring a new employee—even if the employee never works a day. This bizarre result occurs when the combination of the deduction for wages plus the tax credit can exceed 100 percent of the wages paid to the employee.

In addition, the new jobs credit, the social security tax credit, and the 2-percent increase in the investment credit, contain inherent "windfall" elements, rewarding businesses for doing what they would have done in any event. No economic stimulus program can completely eliminate the windfall element. But if any businesses are entitled to a "windfall," it is those which have been driven to their economic knees by the severe recession of the past 3 years. This is the group and refundable investment credit is designed to help, and I urge the committee to adopt it.

Finally, on the credit against payroll taxes, we could see a situation in which any corporation could actually reduce employment and still get a credit against payroll taxes.

As an incentive, it does not have the bang for the buck that the returnable investment credit has. You may get a situation where corporations are taking advantage of the credit without any increase in employment under the administration program.

86-032—77——12

It seems to me that they are moving on the right road in terms of the investment credit. I think all of us understand the enormous success of the investment credit. One of the points that I am trying to make in this presentation is that the credit should now be broadened to serve particularly those companies, corporations, businesses, and industries that can take the greatest advantage of it.

Senator HANSEN. Thank you very much, Senator Kennedy.

In conformity with the policy that has been practiced by the chairman of the committee, we will recognize Senators in the order of their arrival here to pose any questions, if they have questions. Following that procedure, I will first call upon Senator Danforth.

Senator DANFORTH. Senator Kennedy, would you mind addressing yourself to an unrelated part of this whole stimulus package, namely the question of refunds versus permanent tax cuts?

Senator KENNEDY. I support the refund concept, Senator. I know that there have been and will be submitted here economic studies about the impact in terms of stimulating the economy. I have listened to those arguments in quite considerable detail as a member of the Joint Economic Committee, and I feel that the tax rebate had an impact in 1975.

I have serious reservations about a general tax reduction over a longer period of time. I think it obviously has an important stimulus effect in terms of the economy, but it has the corresponding effect of draining revenues from various social programs that I think are vital.

Senator DANFORTH. Suppose that it could be demonstrated by econometric models and other analysis that a permanent tax cut leads to substantially more jobs than a rebate? Would that affect your judgment on this?

Senator KENNEDY. I think that, as I mentioned, there is some conflicting testimony. Some economists have made a very persuasive case about the impact of the refund. I do not think that there is any question that a general tax reduction has a stimulating effect in terms of the economy. But it is also a question of balance in terms of what a general tax reduction would mean in lost revenues over a period of time.

We are talking, in the administration's proposal, of a package and a blend that includes stimulation through the various public works programs that can reach the very large segments of our economy who have skilled trades and are unemployed in the building trades. We can show a direct, concrete result of the stimulation through spending for public works. We are talking about expansion of public service employment that reaches women and some of the handicapped, building upon a program that has had, I think, a strong record to commend itself.

We are talking about the stimulation, through the rebate, the tax credit, and the payments to those who are on social security and might not otherwise be included.

It is basically a balanced program.

I would agree with one implication of the Senator's question, which is whether this general package is significant enough to provide an economic stimulation. People in my part of the country have already spent their rebate in energy costs. They spent it last December and January. The rebate, in that respect, has already been expended and probably will not have the kind of needed stimulation that I think it might have had when it was proposed several months ago.

I would support a greater stimulus. I have some concerns about what lost tax revenues are going to mean over a prolonged period of time. It is basically a balance, Senator.

Senator DANFORTH. That is really the issue, is it not, the question of lost tax revenues over an extended period of time?

Senator KENNEDY. That is right.

Senator DANFORTH. Supposing the issue is whether x number of dollars should be used to stimulate the economy by a rebate or through a permanent tax reduction, and supposing further that it could be demonstrated statistically that more jobs could be created by going to the permanent tax reduction route.

Then, is not the only issue whether or not we want to keep taxes relatively high in order to finance more Government programs in the future?

Senator KENNEDY. I would find it much more appealing, Senator, to support a reduction if I knew where those reductions were coming from.

Senator DANFORTH. I will tell you exactly. A tax reduction, permanent tax reduction, aimed at the first $18,000 of adjusted gross income. In other words, a permanent tax reduction skewed at low income and middle income taxpayers.

Senator KENNEDY. I have suggested here, and at other times, where I thought it should come from. I have been a strong supporter of the refundable work credit, of shifting deductions to credits, which would help the lower income groups.

I have suggested those at other times and elaborated on those issues. As I say, it is a balancing question.

Basically, because of the energy crisis, I favor an expansion of the stimulus program that has been suggested by the administration. I would be more favorable to any reduction targeted to those that are the neediest groups, basically the working poor and the lower and middle income groups.

I would consider any particular proposal as it was suggested.

Senator HANSEN. If the Senator from Missouri would yield on that point, I would like to observe that between the years 1963 and 1968, on the initiative of President Kennedy, a permanent tax cut was proposed—indeed, three separate bills were passed that implemented that tax cut.

Senator KENNEDY. I believe they made up the revenue loss in the same year that the tax cut was made.

Senator HANSEN. I beg your pardon?

Senator KENNEDY. They made up the difference in the loss of tax revenues.

Senator HANSEN. Yes.

In the years 1963 to 1968, on the basis of the tax cut itself, my understanding is that Treasury had estimated a tax loss of some $89 billion. Actually, that did not occur at all. A net revenue gain was experienced totaling $54 billion. That accounts for a difference of some $143 billion.

I observe that, because as the Senator at the witness table has earlier observed, he was concerned about what impact, what opportunity the Government might have to participate in programs that could be helpful with the added revenue.

My question is, have we any reason to suspect that the figures would come out differently than they did during that 6-year period of time?

Senator KENNEDY. If you project the amount of the 1960's tax reduction in current dollars, you would find that a comparable stimulus today would have to be much larger—perhaps $55 to $65 billion. I think that is something to give us pause, quite frankly, Senator. With a larger stimulus, I would be more in favor of targeting funds toward housing and other areas of the economy rather than a broad based stimulus.

If you project the figures that we used in the early 1960's to now, you would find that you are talking about a much larger figure, with all of the implications it has in terms of the deficit and other factors in the economy.

As I said earlier, I basically would support an expansion of the stimulus package. I was not proposing an increase here today. I came here to urge action in an area where there is a division, between this committee and the House committee, on what can be done for the business community to achieve expanded employment and the creation of new capital.

Senator HANSEN. If I may make a further observation, seemingly every time a permanent tax cut has been made available to the American taxpayers, invariably there has been an investment made in the private sector. It has resulted in greater employment, has resulted in more people becoming taxpayers, more people working, and the net effect, so I am told, is to see tax revenues expand rather than contract.

This experience leads me to believe that, given the opportunity of free choice which the tax cut affords individuals, the response has been for people to make those investments, take those actions, which result in greater employment. It seems important to me that we give due consideration to the experience that we have had in the past.

Senator KENNEDY. I agree with the Senator, particularly in the area of the investment credit. It has been, I think, one of the most important achievements in terms of the creation of new capital. It can have a much greater impact in the creation of new capital than the continuation of the asset depreciation range and other less efficient tax incentives.

We talked a little bit about that last year on the floor in the tax debate.

I want to stay away from that issue now. What I am trying to do is build on the sound achievement of the investment credit, which has been to stimulate new capital, and to broaden its concept to new companies, to industries which have been the hardest pressed during the recession, and to the nonprofit area.

If we act in a way that is simple and understandable like the refundable investment credit, particularly since we are only talking about a 2-year period, I think if we provide a greater impetus to the business community. If we just add the 2 percent to the credit, companies that have been troubled over the recent period of time won't get any help.

The time that they need help is now. We can have an impact now on new businesses and those that have been adversely affected by the recession. Let's use a tried and tested concept. Both the strength of this proposal, and the problems with both the House and the administration proposal, lead me to suggest this idea. It is building on a con-

cept with which the chairman is very familiar, the concept of refundability.

Senator HANSEN. Thank you.

The CHAIRMAN [presiding]. Senator Matsunaga?

Senator MATSUNAGA. Thank you, Mr. Chairman.

Senator Kennedy, you state on page 3 of your prepared statement that your basic objection to the House-passed jobs tax credit and the administration's proposal to increase the investment tax credit from 10 percent to 12 percent is that these proposals exclude many businesses and employers in Massachusetts and other States that need the financial aid the most.

I can see the investment tax credit in this respect, and perhaps the objective of this tax incentive proposal would not be met, but where a jobs tax credit is concerned, do you not feel that it would meet much more than the investment tax credit, the basic objective of a tax incentive program, that is to create jobs?

According to the testimony presented before the Ways and Means Committee over in the House by a representative of the National Small Business Association, it was estimated that anywhere from 750,000 to 1.5 million new jobs would be created within the next couple of years under this job tax credit program.

Senator KENNEDY. I would say that the most commendable feature of the House proposal is that it is targeted in on smaller businesses. But if we are talking about really having an impact and expanding employment, the proposal actually only reaches 24 jobs in a particular company.

How significant that is going to be in terms of employment is something which I think has to be considered.

Second is the fact that an elaborate scheme of regulations and rules is going to have to be established to deal with part-time workers and with overtime workers. It is going to be a maze. Yet, all of this has to be done immediately in the administration of it.

I am not convinced, if you are talking about just a 2-year program, that this is the approach that should be taken. I think this committee should consider over a longer period of time what we are going to do for smaller businesses and I think that there is a wide variety of different questions to answer and proposals to consider.

A distinguished member of this committee, Senator Nelson, has introduced tax reform legislation for small business. I support many parts of that proposal. There are a variety of things that have to be done. But on this proposal here, I have more reservations than support.

I know you are going to have testimony in a few minutes supporting it. The witnesses are good friends of mine. I think generally that we are trying to work together in the area of tax equity.

I am sure they can speak very eloquently.

Senator MATSUNAGA. I wish I could pursue this matter further, but my time is up.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. I have no questions.

The CHAIRMAN. Yours is a very provocative statement. I will be in touch with you to discuss it further.

What usually happens when we interrogate witnesses in the beginning of a session, the chairman is left in the afternoon as the only one to hear testimony. I will be back in touch with you.

Senator KENNEDY. I thank the Chair for the opportunity. You have always been kind, and I thank you very much.

[The prepared statement of Senator Kennedy follows:]

TESTIMONY OF SENATOR EDWARD M. KENNEDY

Mr. Chairman, it is a privilege for me to appear before this Committee once again to express my views on measures that can make our federal income tax system a more equitable, more easily understood, and more efficient vehicle to achieve our nation's social and economic goals.

It was only a year ago that I presented testimony before this Committee as it began the work that culminated in passage of the Tax Reform Act of 1976. Of course, my views differed from those of some members of the Committee on particular aspects of that legislation. But I joined with all members of the Senate in their appreciation of the long months of dedicated work by the Chairman and members of the Committee to produce a bill that is worthy of the name "tax reform."

I therefore welcome the opportunity to make what I hope will be useful contributions to the Committee's deliberations on the proposed "Tax Reduction and Simplification Act of 1977."

H.R. 3477, as passed by the House yesterday, has two major objectives:

First, to provide part of the fiscal stimulus the economy needs to achieve adequate growth and to reduce unemployment from its present unacceptable level of over 7 percent.

Second, to move toward an income tax system that is more simple and more equitable.

These goals are easily stated and can be expected to win almost universal endorsement. The crucial question, however, is whether the proposed legislation moves us toward those goals in the most effective way. In testimony before this Committee yesterday, the Administration indicated reservations about some aspects of the House bill—notably the proposed "new jobs tax credit." I share those reservations, but I do not believe that the Administration's proposals meet the essential requirements of a properly structured temporary tax incentive:

Effectiveness; simplicity; ease of implementation; ease of administration; and equity.

I therefore propose today for the Committee's consideration an approach which more nearly satisfies those tests and which I urge the Committee to consider in lieu of the House-passed "new jobs tax credit" or the investment credit-Social Security tax credit alternative proposed by the Administration.

First, however, let me indicate briefly the provisions of H.R. 3477 that should be adopted by the Senate:

1. *Standard Deduction and Tax Simplification.*—The substitution of a flat standard deduction for all taxpayers in lieu of the existing low income allowance and the percentage standard deduction represents a major step toward a more easily understood tax system. A simpler tax system will result in better compliance by taxpayers and better administration by the Internal Revenue Service. Placing the new $3,000 standard deduction in the rate schedule (in effect a zero rate bracket) in turn eliminates many difficult and time-consuming computations by taxpayers and the IRS alike. Tax tables can be utilized by some 95% of taxpayers, and computations of itemized deductions can be simpified without depriving taxpayers of the benefits of those deductions. I endorse the changes in the standard deduction proposed in H.R. 3477, and urge the Senate to approve this important measure. This is a permanent change that can make our tax system permanently better.

One issue over the standard deduction involves the so-called "marriage penalty." My preference is for the House solution, because it avoids the tax increase on single persons contained in the Administration version. But I recognize the increased marriage penalty contained in the House bill. This problem, however, is only part of the larger problem of the proper relative tax treatment of single persons, one-wage-earner families, and two-wage-earner families. I urge the Administration to give this overall problem a high priority in its tax reform proposals to be submitted later this year.

2. *Tax Cuts for Individuals.*—I also strongly endorse the provisions in the House bill that provide temporary tax reductions to individuals. These include:

The $50 per person tax rebate for 1977 and the $50 per person payments to beneficiaries of other specified programs like Social Security.

The extension through 1978 of the general tax credit, equal to $35 per person or 2% of the first $9,000 of taxable income, whichever is greater.

These tax reductions are urgently needed to build the purchasing power of low and middle income families thereby giving the economy the additional stimulus required to restore more vigorous growth and reduce the unemployment rolls. The reductions, together with the increased standard deduction, are also a skillful blend of immediate and longer term tax benefits that are well de ned to provide the continuing lift the economy needs over the next two years.

3. *Earned Income Credit.*—In addition, I welcome the extension through 1978 of the refundable earned income credit for low income workers, equal to 10% of the first $4,000 of earned income. In my view, this credit is one of the most imaginative tax proposals ever to emerge from this Committee, and the Chairman deserves great credit for developing it. It provides both an incentive and a reward to American families working to lift themselves out of poverty. It is structured to guarantee that the more a family earns, the more after-tax money it will have to spend on the necessities of life.

I would, however, renew a proposal I put forward last year to broaden the coverage of the credit. It is now available only to families that include minor children, students, or disabled dependents. I urge the Committee to extend the credit to all families, even if they have no dependents. These families, too, need the incentive and the encouragement that the refundable tax credit provides to work themselves out of poverty. The revenue effect in the first full year, however, would be substantial—approximately $600 million.

4. *Tax Cut for Small Business.*—I also approve the extension through 1978 of the corporate tax reductions for small business. This action will retain the 20 percent rate on the first $25,000 of taxable income and the 22 percent rate on the next $25,000 of taxable income. Continuation of the surtax exemption at $50,000 through 1978 is needed to help small businesses continue their recovery from the recent recession.

However, Mr. Chairman, when we come to the appropriate actions to take to spur capital investment and job creation by businesses and the private sector, I find myself in disagreement with the proposal in the House bill. Moreover, while I agree with some aspects of the Treasury's suggested alternative, I believe that simpler, more effective and more equitable action can be taken to produce the economic results we all desire.

A better method of providing a temporary stimulus to job-creating capital investment is to make the basic 10 percent investment tax credit refundable, where a taxpayer's investment credit exceeds his tax liability. This action will provide a stimulus for the business sector of an estimated $1.1 billion in fiscal 1977 and $3.4 billion in fiscal 1978.

The advantages of this proposal for a temporary capital and job stimulus over those adopted by the House or suggested by the Treasury can best be seen by comparing the three approaches under the standards of effectiveness, simplicity, ease of implementation, ease of administration and equity.

Effectiveness

My basic objection to the House-passed "now jobs tax credit" and the Admintion's proposal to increase the investment tax credit from 10 percent to 12 percent is that these proposals automatically exclude many businesses and employers in Massachusetts and other States that need the financial aid the most. Moreover, the businesses that are excluded are often the ones that offer the greatest promise of increased employment.

Neither the proposed new jobs tax credit nor the increased investment credit provides any current assistance to a business that has no tax liability. The recession had an especially heavy impact on Massachusetts businesses, as well as on businesses throughout the northeast. Many have incurred tax losses over the past three or four years that will be carried forward to eliminate tax liability in 1977, 1978, and 1979. Yet, these are the very years when the stimulus is needed.

A similar problem is faced by those businesses that do incur some tax liability, but not enough to absorb the full investment credit, and by businesses that are precluded from full use of the credit by the present general limitation on the credit of 50% tax liability. Congress addressed these problems in 1976 for railroads and airlines by temporarily increasing the limit to 100%. The proposal for a fully refundable investment credit is a logical extension of that

principle, but applied across-the-board to all businesses in an evenhanded and nondiscriminatory way.

True, the excess jobs credit or investment credit could be carried forward, possibly to be used after 1979. But the stimulus and help for capital investment is needed by these businesses now. It is no comfort to tell these business people that they will get tax help several years in the future, if only they will make a capital investment now. What they need is tax help now, as they struggle to climb out of a reecssion they did not create and cannot cure alone.

A refundable investment credit is an effective way to provide, over the next two years, the funds that will enable these businesses to make the capital investments they need to achieve greater profitability, full productivity, and maximum employment.

A second group that would get no help from the "new jobs tax credit" or an increased investment credit is newly created businesses. We know that venture capital is in short supply in many parts of the country. A refundable investment credit can help to solve this problem.

One major challenge that all new businesses face is to find the funds to acquire the machinery and equipment necessary to start the business. It is no help to a new business to learn that federal funds will be available five to seven years down the road, if it manages to incur an income tax liability by that time. A new business needs funds at the time it buys equipment to open its doors. A refundable investment tax credit meets this need. Neither of the proposals before the Committee provides help in such cases.

A third group excluded from the proposals advanced by the House and by the Administration are non-profit organizations. The non-profit sector, as a group, provides a substantial amount of available employment in many states, hospitals, colleges and universities and other non-profit organizations face enormous capital needs. I find no persuasive reason for excluding this vital sector of the economy from the investment credit, which is the largest single program used by the Federal Government to stimulate the economy.

In my own state, Boston College, Boston University, Harvard, MIT, Massachusetts General Hospital, and scores of other similar institutions employ thousands of people and each year make thousands of dollars of significant capital investments in machinery and equipment. The same is true, I am sure, of Loyola and Tulane, of Emory, of Yale, and of the many other non-profit institutions in states represented by members of this Committee and all the other members of the Senate.

Making the investment credit refundable can give the non-profit sector of the economy a badly needed shot in the arm. And the temporary nature of the credit can give Congress the opportunity to study the desirability of including the non-profit sector in the investment credit on a permanent basis.

It is sometimes asserted that we should not give the benefit of the investment credit to institutions that pay no taxes. But this argument misconceives the nature of the credit.

As I hope we all recognize at this late date, the investment tax credit is a massive $1 billion a year federal assistance program to encourage capital investment. We have chosen to carry out this federal assistance program through the income tax system. It could also have been carried out by direct federal payments. No one asserts that non-profit organizations—just because they pay no taxes—should be precluded from receiving federal funds—through research grants, capital construction funds, capitation grants, and many other federal programs. They should not be denied access to some types of assistance, just because Congress has decided to make the assistance available through tax credits rather than direct grants. In fact, the Tax Reform Act of 1976 contains a precedent for this proposal, because it granted one-half of the investment credit to shipping companies that construct ships out of tax-exempt capital construction funds.

In short, neither the proposed new jobs tax credit nor an increased investment credit will be effective for businesses that need a financial boost the most: those that were hardest hit by the recession, new businesses, and non-profit organizations.

In addition, the investment credit has already proved its worth as an effective device for stimulating investment and creating jobs. In this portion of the bill, we are seeking a temporary two-year shot in the arm for investment and employment. This is not the time to be experimenting with new and untried programs. The investment credit works. The goal now should be to allow it to

work for businesses that are excluded from its benefits. Making the present 10% credit refundable does just that, without embarking on still another unproved and untried tax expenditure program. We need real results quickly, not the conjectural hopes projected by a computer model run.

As Secretary Blumenthal pointed out in his testimony yesterday, the proposed "new jobs tax credit" in the House bill is unlikely to be effective in creating a significant number of new jobs. I believe the Administration is correct in focusing on the existing investment credit as a better vehicle for encouraging expanded business activity. But the fault in the Administration's proposal to increase the credit by two percentage points is that it fails to help businesses that deserve the help the most.

Moreover, I find unpersuasive the Administration's case for its Social Security payroll tax credit. It is difficult to believe that a tax benefit of one penny per hour of wages can be an "effective" jobs creation program. While I favor the concept of providing assistance to labor intensive firms. I believe that Congress needs more time than is now available to develop an effective program.

Let me also describe briefly how the House version and the Administration proposal fail the other tests for an appropriate capital or jobs incentive.

Simplicity and Ease of Implementation

It is essential that a temporary measure to stimulate business investment be quickly and easily understood. A new two-year tax credit is no good if it takes two years for business to understand how it works. The House-passed new jobs tax credit requires six new pages in the Internal Revenue Code. Many more pages of regulations will be required to implement it. It is filled with potential chances for manipulation, as Secretary Blumenthal has explained. The proposed credit may well provide a great deal of employment for lawyers and accountants over the next two years. But by the time they have worked out all the possibilities for manipulation and the Treasury has issued regulations to prevent them, two years will have passed.

By contrast, the existing investment credit is already in place. It is well understood by business and the Internal Revenue Service. The rules for eligibility have been worked out. Adopting the proposal to make the credit refundable will not trigger another round of complex statutes and regulations, followed by more complicated transactions, followed again by still more complex regulations in the never-ending chase between Congress, tax lawyers, and the IRS.

To be effective, an investment stimulus must be understandable by business and must have the confidence of business. I agree with the Treasury that our best economic stimulus is provided by a strengthened investment credit—but strengthened to help those businesses and institutions that will be most encouraged to increase investment and create new jobs. We should take advantage of our fifteen year experience with the investment credit, rather than spending time and effort to develop a new program as proposed by the House.

Ease of Administration

A refundable investment credit will also be much easier for the IRS to administer than either the new jobs tax credit in the House bill or the Administration's Social Security payroll tax credit. The government regulations that are required to implement a totally new program would be vastly reduced by simply modifying the existing investment credit. Moreover, IRS personnel are already trained to audit and oversee the investment credit. The refundable investment credit is clearly superior to the House or Administration proposals in this respect.

Equity

Finally, a refundable investment credit would significant improve the equity of a major tax program already on the books. The House proposals for a new jobs tax credit and the Administration's Social Security payroll tax credit simply introduce new sets of inequities into our tax system.

With respect to the House bill, it is actually possible for a wealthy individual to make a tax profit merely by hiring a new employee—even if the "employee" never works a day. This bizarre result occurs when the combination of the deduction for wages plus the tax credit can exceed 100 percent of the wages paid to the employee.

In addition, the new jobs credit, the Social Security tax credit, and the 2 percent increase in the investment credit contain inherent "windfall" elements, rewarding businesses for doing what they would have done in any event. No economic stimulus program can completely eliminate this windfall element. But if any businesses are entitled to a "windfall," it is those which have been driven to their economic knees by the severe recession of the past three years. This is the group the refundable investment credit is designed to help, and I urge the Committee to adopt it.

The CHAIRMAN. Next, we will hear from Mr. Charles Stewart, president of the Machinery & Allied Products Institute.

STATEMENT OF CHARLES W. STEWART, PRESIDENT, MACHINERY AND ALLIED PRODUCTS INSTITUTE

Mr. STEWART. Thank you, Mr. Chairman. It is always a pleasure to appear before this distinguished committee. I assume that our full statement, including the attachments thereto, will be admitted into the record. I would like to leave with the staff, so as not to burden the record further, a study that we have just completed on the financial crisis in the social security system which is relevant to these hearings in terms of a proposal related to social security.

Also, over a period of 2 years, we have been concentrating in our economic research on studies dealing with capital formation and real profits. I have a compendium of those studies,[1] and would like to leave it for staff consideration, and for anybody else who is interested.

I am Charles Stewart, president of the Machinery & Allied Products Institute, which is the capital goods organization of the United States. I am accompanied by MAPI staff counsel, Frank Holman, who works in the tax area.

I would like to start out by making clear that anything we say with regard to the stimulative package intended for the short run is not mutually exclusive in terms of long-range tax revision. We believe the committee should turn to the long-range program promptly, assuming a short-term stimulus package is considered by the Congress in the context that the administration recommended it.

I am not troubled by the committee questions regarding the need for a long-term revision. We should have it: we should have it as promptly as possible. It should be given high priority.

The question before the committee really is whether there is a need for a short term, in some respects one shot, stimulus to the economy. When that was originally proposed by the administration, it had a number of considerations in mind.

First, it wanted to stimulate enough but not too much, which is a trick that is hard to accomplish, particularly when once the package starts rolling through the Congress it seems to accumulate additional provisions.

The administration was also concerned about taking too much action in terms of refueling inflation. I do not believe that any of us should overlook that consideration. Thus, I have respect for the economic balancing act which Messrs. Blumenthal, Schultze, and others went through in an effort to design what they consider to be a quick—with a termination date—short-term stimulus. It should not be considered as a substitute for the abso[illegible]ly critical need for tax revision.

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[1] See p. 194.

I will run through a very quick summary of our statement and then, if I may, I will point a little more definitely to the investment tax credit increase, to the jobs credit and a word or two about the social security credit.

We agonized over the subject of the need for a quick tax stimulus with termination dates and came to the conclusion that when all things are taken into consideration, there is merit in it.

Obviously, it is a controversial issue. Some believe that no such short-term stimulus is necessary. We come down on the side that it is.

We favor, for this purpose and in this context, the tax rebate proposal. We oppose the cap that was placed on it by the House Ways and Means Committee, because what we are talking about is a short term, subject to termination concept. The more dollars that flow into the economy as a result, the better the approach will work.

So we oppose the cap.

I want to add that there are too many people writing and thinking in the area of tax policy who assume that a person who makes $30,000 a year before taxes—or even in terms of adjusted gross income—is a well-to-do individual. If he has a family and he lives in the State of Maryland; for example, with its severe tax system on top of Federal taxes, I think that we have to consider obsolete some of the concepts about what levels of so-called salary income or adjusted gross income make a man rich.

So we oppose the cap for this reason and because we should attempt to get the maximum result from the rebate or refund. We believe that it should be across the board, as far as the rebate is concerned.

We disagree with Dr. Burns, who has characterized it as gift. It is nothing more than a small return of overtaxation. It is no gift.

The President recommended that business be given an option between a 2-percent increase in the investment tax credit from 10 to 12 percent and a social-security tax credit of 4 percent of the employer portion of social security taxes.

We favor, and enthusiastically endorse, the increase in the investment tax credit. As a matter of fact, I can recall when President Kennedy, before his inauguration, appointed a task force to study the investmement tax credit, we met with Mr. Surrey and others at that time. Over the years, our organization has not only been supportive, but engaged in original research with regard to the investment tax credit.

Our position has long been that it ought to be at least at the level of 12 percent and a higher credit should be made available for pollution control type equipment.

As to the social security credit, we think that probably it could be excluded from the legislation, in the sense that it is not tied to any economic objective other than to release some tax funds. Also, it raises some questions that trouble me about opening up the question of how do you finance social security in the future. It may be an unfortunate precedent in that regard.

This is the reason that I have submitted our new publication on social security for study. It is frightening, really, when you get through reading it.

We oppose the House committee's proposed job credit on the grounds that it would be difficult to administer, it would be of very question-

able value in creating jobs, and would result in inequities or windfalls in certain situations. I will deal with that in some detail in a moment, if time permits.

We feel that this bill is being converted into something more than a short-term tax stimulative package. The original administration recommendation, for example, with regard to the standard deduction is permanent, and now we have provisions inserted by the Ways and Means Committee that are permanent. I am not proposing to argue those questions on their merits.

I simply do not believe that a short-term stimulative package should be mixed with this type of tax revision.

Furthermore, it is an encouragement for this to become a Christmas tree bill, and the chairman and others have observed that happen before.

The CHAIRMAN. The time of the witness has expired. That was a very good statement.

Are there questions from Senators?

Senator HANSEN. I have no questions, Mr. Chairman.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. I have no questions.

The CHAIRMAN. Senator Matsunaga?

Senator MATSUNAGA. Thank you, Mr. Chairman.

Mr. Stewart, I believe you are familiar with the objections raised against the job tax credit which the House came out with and which is embodied in a bill that I have introduced. One of the objections raised by Senator Kennedy this morning and by Secretary Blumenthal and Mr. Schultze yesterday, is that it would be difficult to administer, that we would be encouraging part-time employment, and that we would not be able to distinguish between part-time and full-time employment, and so on.

I would like to hear your comments about this objection.

Mr. STEWART. Sir, my objection, really, is not based primarily on administrative difficulties—which I believe will be there, as you have listed the allegations. My principal reaction to the proposal is that it will not create sufficient jobs.

There is, in the proposal, as included in the House version, a ceiling of $40,000 per company in any single year.

Senator MATSUNAGA, That is in the House bill.

Mr. STEWART. Yes.

It seems to me, first of all, that provision is not going to create a lot of jobs because of the ceiling and also because of the fact that jobs are not created out of the air. There has to be a job, either presently vacated or created by a company, so to speak, before a company will hire a person to fit that job.

It has been estimated in varying economic studies, that it takes a corporation anywhere from $25,000 to $30,000 to create a job, and that is a complicated concept that I will not go into in detail.

The point that I am making, is that in addition to administrative difficulties, in addition to the fact that you would have some windfalls, there is a real question whether this proposal will work, and I do not think it will.

I would say further that if you want to insure that it will work, you will have to, as the term now goes, engage in an expenditure of tax funds of a much greater amount than would be involved in a proposal with a cap of $40,000 per company per year.

Senator MATSUNAGA. The bill which I introduced provides an $80,000 cap. Would that be sufficient, in your view?

Mr. STEWART. Perhaps for some small businesses, yes. I still think, in terms of the number of jobs across the economy—and we really are interested here in aggregates—the result will be minimal. We are not interested just in a narrow impact. That is why the rebate is ridiculed.

People talk about, what is $50? It is not $50. It is $50 times a number of other things and will create a rather massive inflow in total into the economy.

So what I am saying in response to your question is that even with an $80,000 cap, the number of jobs created would be quite limited and would not meet the objective that is contemplated.

I do not want to leave that question, or this table, with an impression that I do not believe that small business problems should not be addressed more effectively than they have been. I would support reasonable small business legislation, in the tax area or anywhere else.

I just come down with a strong conclusion that this proposal will not do the job, and I respect your motivation.

Senator MATSUNAGA. Do I understand your views, since you testified before the House Ways and Means Committee, have changed, and you are now opposed to the jobs credit plan?

Mr. STEWART. There has been no change. We anticipated what was then called an employer tax credit and said we did not believe it would work, and it is clear in the record that we so stated.

I must confess I finessed it a little bit on the House side by saying you are not going to do too much damage in terms of loss of revenues by enacting it because it is not going to work. Our position has not changed in any major respect between the two Houses.

Senator MATSUNAGA. Thank you.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. No questions.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. I will be very brief.

I want to commend you on your efforts to provide this committee with your study on the financial crisis in the Social Security System. This next year, we will pay out about $5 billion more than we take in. The next 5 or 6 years, even if the Congress does not raise benefits, the deficit of the social security fund is going to run between $5 and $8 billion. We do not have enough reserve to pay the benefits for 6 months, and self-employed people, this year, are going to have to pay over $1,300 a year in social security taxes alone, so that we have taxes. The way to face it is not to go to the general fund.

While there was no legal or technical connection between the credit and the social security tax, one of the motivating forces for that is that people were paying too much tax and that is the easy way out. To go to the employer with the social security tax is running away from the problem. It will not solve what we should do about social security financing.

I would like to commend you for observing that point.

Mr. STEWART. This has just been published. I used the word "frightening"; it really is, in terms of our social security crisis. This is one of the most [illegible] reasons that we shy away from the kind of left-handed [illegible] the administration's proposal regarding the social securit[illegible] credit.

On [illegible] other hand, I want to be sure that the record is clear that we strongly support what is in the administration bill, the other part of the two-part action; namely, the 2-percent increase in the investment tax credit. That is spelled out in our statement.

There is a very interesting economic aspect about the present posture of the economy in terms of capital investment that makes this increase in the ITC very timely.

I believe that it is the first time in the history of our economic cycles that at this juncture in the recovery period, capital investment is not carrying a heavier load in terms of bringing the economy along.

Therefore, any deletion of the original proposal for the investment tax credit, as distinguished from the social security credit, in my opinion, would have very significant negative consequences. You have government testimony before this committee and before the House committee that the deletion of the investment tax credit by the House committee has sent a signal to business which is very negative and will have very significant practical and psychological effects on business and business decisionmaking.

Senator CURTIS. I will not prolong the discussion, but Congress has just about done everything they could think of to destroy capital investment in the last 4 or 5 years.

Mr. STEWART. Thank you, sir.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much, we appreciate your statement.

Mr. STEWART. Thank you, sir.

[The prepared statement of Mr. Stewart follows:]

STATEMENT OF THE MACHINERY AND ALLIED PRODUCTS INSTITUTE BY CHARLES W. STEWART, PRESIDENT

BRIEF SUMMARY

1. The primary purpose of President Carter's economic recovery proposal is to stimulate the economy in the short run. MAPI agrees with this overall objective provided, after hopefully prompt passage of the stimulation bill, the Congress will turn as promptly as possible to thoughtful and effective development of a long-term sound tax policy affecting the individual and corporate tax structures.

2. The President's tax message to the Congress did include a limited number of long-term recommendations. Moreover, the Ways and Means Committee in reporting out a bill added to President Carter's recommendations for certain long-term actions.

3. In addition to the fact that the Institute urges prompt development of a long-term tax revision program, we share the concern of the Administration—and we trust the Congress—regarding the need to avoid refueling inflation and letting government expenditures get out of control.

4. For reasons spelled out in our principal statement, we support the President's tax rebate proposal because, in our view, it is a useful element in a short-term stimulative package. The Institute opposes the House Ways and Means Committee action to place a cap on the rebate or refund in 1977 so that this element

of the tax program would not be across the board affecting all individual taxpayers but would be phased out between $25,000 and $30,000 of adjusted gross income.

Bearing in mind the primary objective of the economic stimulative package as recommended by the President and as addressed by the Ways and Means Committee, the cutoff at $30,000 in adjusted gross income and phase-out between $25,000 and $30,000 reveals a good deal of misunderstanding about the economic status of individuals and families with incomes in substantially higher amounts than $25,000–$30,000. As pointed out by an economic study conducted under the auspices of the Joint Congressional Economic Committee and published on December 27, 1976, individuals and families in these higher brackets have been subjected to a scissors effect of inflation pushing them into higher tax brackets and an erosion of their real income due to inflation. The tax rebate or refund is not a "gift" as suggested by Dr. Arthur Burns, Chairman of the Federal Reserve Board. It represents in its overall effect on the entire economy an appropriate stimulative measure and in a sense, as far as the individual is concerned, it is a limited correction of what approaches, under certain circumstances, a confiscatory tax system.

5. The President recommended that business be given an option between a 2 percent increase in the investment tax credit from 10 to 12 percent and a social security tax credit of 4 percent of the employer portion of social security taxes. The House Ways and Means Committee rejected both parts of the option. We strongly urge the Committee on Finance to reinstate the 2 percent investment tax credit increase from 10 to 12 percent with or without the option of a social security tax credit. Our position is not strongly negative but, in our view, the social security credit could be dropped without any significant effect on the stimulative objectives of the legislation. On the other hand, we do recognize that the Administration's rationalization of the social security credit as an option is, to some degree, well taken.

6. We oppose the House Committee proposed jobs credit on the grounds that it would be very difficult to administer, would be of very questionable value in creating jobs, and would result in inequities or windfalls in certain situations.

7. We recommend strongly that the so-called tax simplification provisions regarding the standard deduction as recommended by President Carter, and two additional proposals contained in the House Committee bill, be deferred for final action because they are more appropriate as proposed elements of a tax revision bill. In this connection, we are concerned that the pending legislation is suffering from a creep away from its original limited objective—short-term economic stimulus—and may become a "Christmas tree."

8. MAPI's statement does not include any detailed treatment of nontax proposals of the President's economic recovery package because, as we understand the jurisdiction and procedures, these recommendations are being considered and acted upon elsewhere in the Congress. We do recognize the need for developing some new proposals addressed especially to structural unemployment. Moreover, we feel that it is a truism that long-term job opportunities are better created in the private sector than in the public sector.

Introduction

I appear today in behalf of the Machinery and Allied Products Institute (MAPI) which is the national research organization and spokesman for the capital goods and allied equipment manufacturers of the United States. For many years the Institute has carried on research, publication, and representation in the fields of national economic policy and federal tax policy, and we are therefore deeply interested in the economic strength and health of the United States and our international economic position as well.

I should add that our work in the tax policy and tax administration areas reflects a priority interest in matters involving capital formation and capital investment. The personal tax structure and the federal corporate tax structures as a whole are central to these considerations. In this connection, I will leave with the Committee staff a compendium of MAPI studies dealing with capital formation, real profits, and inflation accounting, but I do not wish to impose upon the Committee record because of the length of these materials. Attached is a listing entitled "Recent MAPI Studies With Capital Formation, 'Real Profits,' and 'Inflation Accounting'."

These hearings are addressed primarily to the tax portions of President Carter's package and the tax provisions of H.R. 3477, the Tax Reduction and Simplifica-

tion Act of 1977, as reported by the House Committee on Ways and Means. Since there are significant differences between the recommendations of the President and the House Committee-approved bill, we will endeavor to deal with these differences and the issues which they raise as we move through the statement.

It should be noted that the President's message to the Congress on January 31 contained a mixture of short-term stimulative proposals and two long-term tax policy recommendations. The House Committee bill also has a mixture of these two categories of proposals.

The critical need for a permanent tax revision to achieve sound economic growth

As already indicated, we concede that, with certain limited exceptions, the focus of these hearings is on a temporary program for economic stimulation. We would be remiss, however, if we did not emphasize the proposition—as we have documented over the years through MAPI research—that in the areas of the corporate and personal income tax structure, we must move on a permanent basis. We feel an obligation to address ourselves to the concept of the President's tax proposals. Under no circumstances, however, can this country tolerate repetition of short-term programs displacing thoughtful and effective development of a long-term sound tax policy affecting the individual and corporate tax structures.

The many considerations which now enter into a discussion of the President's program and early congressional action

I am sure that when President Carter and his associates began work on the economic recovery package they intended to concentrate almost exclusively—if not exclusively—on temporary stimulative measures and that their primary objective was short term. As already pointed out, the package now extends beyond that limited area and may be expanded further by congressional action. In addition, certain other considerations—as is frequently the case in the legislative process and in the rethinking of the Executive Branch—have entered into the picture. It is instructive, we believe, to at least refer to some of these considerations.

First, to spell out what we understand to be the prime motivation of the Administration in submitting these recommendations, it was not only concentrating on short-term stimulative proposals designed to get the economy moving at a more accelerated rate with improved economic growth and stepped up employment and reduced unemployment, it was proceeding on the assumption that these measures could be short term because the economy was improving to some extent but on too slow a basis. To put it another way, the economic pause "was not refreshing"; it was beginning to concern government policy makers. After the stimulative package has taken effect progressively over a two-year period, and to some extent at the end of one year, the short-term stimulative proposals would be withdrawn. The philosophy, therefore, to paraphrase Charles Schultze, Chairman of the President's Council of Economic Advisers, was to provide enough stimulation but not too much and to use express termination dates. Obviously there was a serious undercurrent of concern about avoiding a high level of inflation, aggravating unduly an already very serious national debt, and making the individual parts of the program cost effective.

At this point it is appropriate to compare the revenue cost of the tax provisions as recommended by the President with those of the House bill. Under H.R. 3477, the tax loss in fiscal years 1977 and 1978 is estimated, respectively, at $12.7 and $17.0 billion. The tax portion of the President's package was estimated to cost $13.8 billion in fiscal 1977 and $8.2 billion in fiscal 1978. Although the other provisions of the President's stimulative package and action thus far by the Congress on those provisions are not the subject of these hearings, it certainly is responsible to recognize that when the tax changes are added to the various actions being taken by the House in the context of total stimulative programs, the loss in revenues escalates substantially.

Other considerations have crept into the picture, including the early reaction by the Congress, in addition to the long-term proposals contained in the tax portion of the package. There is a tendency by some members of the Congress, probably including some members of this Committee, to want to focus on jobs in as direct a manner as possible as distinguished from stimulative tax measures which would less directly affect jobs but hopefully put the economy in motion so that the employment and unemployment picture would improve as a result, capital expenditure incentives being one of the most important trigger techniques. This tendency is reflected in the House Committee elimination of the increase in the

investment tax credit. Also, the element of concentrating congressional action in response to the recommendations on relatively low bracket taxpayers has been introduced, for example in the capping and scaling down of the tax rebate by the Ways and Means Committee. In our view this combination of considerations is very hard to put together in an ultimate enactment without compromising all or most of them and without ending up with a potpourri that departs substantially from the original motivation.

Is a current limited and quickly enacted stimulative package necessary at this time

With respect to the base one question, should there be a stimulus program, Dr. Arthur Burns, Chairman of the Federal Reserve Board, stated on Thursday, February 3, before the House Banking and Currency Committee that "no, it is unnecessary." We must agree that before the country was struck by a crisis in weather and energy shortage, particularly in the natural gas area, the economic indicators were becoming more encouraging. However, the Administration concluded after a waiting and monitoring period to determine whether, in its judgment, a restrained stimulus should be employed. The conclusion was affirmative.

You will find some economists who share Dr. Burns' view. On the other hand, in view of the set of conditions upon which the Administration was acting in designing its package and the subsequent impact on the economy of the weather-fuel shortage crisis, a stimulative program of the type presented by the President certainly deserves serious consideration.

In a nutshell, we are prepared to accept the case for a temporary, limited properly structured stimulative package, provided it does not result in a significant postponement of the responsibility of government to face up to substantial long-term tax revision.

MAPI's fundamental concern regarding inflation and Government expenditure

No service will be done to the economy, particularly in the longer run, if the proposed package is blown up to create an unacceptable high deficit which may be in the range of $80 billion rather than $69 billion, as estimated by the Administration in presenting its original recommendations. As a matter of fact, $70 billion may prove pretty hard to live with even if it is not exceeded. Our recommendations and comments therefore, place high priority on avoiding too great an escalation in the deficit and its inflationary consequences, inflation being the most insidious type of "robber." A corollary to this proposition is that if the proposed economic package is adopted—and especially if that package is enlarged in any significant way—some controls on federal spending should be promptly placed in effect.

There is another aspect which has become a part of the total picture in which the original dialogue on economic stimulation was framed, namely the almost unprecedented severe weather leading to serious human consequences and, in addition, compulsive furloughs of workers and shutdown of plants. In addition to the effects of the weather and the energy shortages that have already been mentioned, we have had a greatly aggravated problem in terms of the cost of energy to private individuals as well as to commercial establishments of many types. This adds to the magnitude of the problem the President was addressing.

I think most economists would agree that the economy is in the process of surmounting this temporary—even though devastating—weather and aggravated energy problem and that the recovery will not be aborted beyond the short term. We accept this conclusion even though the problems referred to extended into February, and some of the side effects are still with us.

Comments on specific recommendations of the President

Let us comment on the tax rebate proposal, first addressing the issue in general and then dealing with the House Committee changes. There is no question that a tax rebate recommendation is consistent with the basic motivation of the Administration when it began work on the package, and the same motivation is present in the House Committee bill which uses the term "tax refund" rather than rebate. Under either approach, the impact in fiscal year 1977 would be substantial. The rebate or refund is intended to play a role in supplying a quick stimulus to the economy and to terminate after it is paid on a one-shot basis.

As already indicated, it is our view that such a proposal in the context in which it is offered is justifiable. We believe that the total rebate will have a stimulative effect on the economy if it is approved by the Congress in substan-

86-032—77——13

tially the form recommended by the President, whose recommendation we prefer over House Committee action.[1] Consistent with this statement, we believe that most of the money will be spent and in those cases where it is not spent and it flows into savings, this could very well be a benefit to the economy, although indirect.[2] It has been suggested that because of the very substantial increases in the cost of utilities, the rebate would be significantly offset. However, if the rebate were increased to strengthen its impact and to compensate for the unanticipated weather-fuel problems, hopefully any such increase will be offset by some change in other portions of the total package so as to avoid a net increase in any significant amount of the total cost.

Under the House Committee bill, a cap would be placed on the rebate or refund in 1977. As the Committee Report states, a refund of 1976 individual income taxes equal to $50 for each taxpayer and dependent would be phased out between $25,000 and $30,000 of adjusted gross income. Payments of $50 would also be made to beneficiaries of several income maintenance programs including social security, supplemental security income (SSI), railroad retirement, aid to families with dependent children (AFDC), Veterans Administration pensions and disability payments, and black lung benefits.

It was originally indicated that the rebate will be paid in April, May, and June, if enacted. This estimate, I assume, is based on allowance for congressional consideration and the mechanics of cranking up the payment of the rebates. Also the switch by the Ways and Means Committee to a "tax refund" concept may be relevant here.

Since the Administration is seeking quick stimulative action, we ask why all of the rebate, assuming it is approved by Congress, needs to be deferred in payment until April–June. For example, if Congress could act swiftly—as it did on the President's recommendations regarding natural gas—even though there may be mechanical problems in the payment of the total rebate, some beneficiaries could be paid almost immediately, for example those persons on the social security rolls. Again assuming passage of the rebate proposal, it appears that there may be other ways to move forward payments so as to achieve the speed desired. These are matters, of course, on which we are not expert, but we draw attention to the point since the Administration is thinking in terms of quick stimulation.

The House Committee refund provisions.—As indicated above, the House Committee bill placed a cap on the refund of 1976 individual income taxes and related payments to individuals equal, in most cases, to $50 per person. Mechanically, the cap phases out the income tax refund proportionately as adjusted gross income rises from $25,000 to $30,000.

When the Institute presented testimony during hearings by the House Ways and Means Committee, we anticipated the possibility of the House enacting a cap on the rebate or refund proposal. With due respect to persons making this suggestion, it seems to introduce a political element. In addition, it is based on the belief that persons with adjusted gross income between $25,000 and $30,000 per year and those individuals at a higher level, say $30,000 to $40,000 per year—referring to adjusted gross income—would not spend the money so that the intended objective of stimulating the economy would not be achieved. On the merits, many persons or families with adjusted gross income in excess of $25,000–$30,000 are deserving of the refund, if the refund is to be paid at all, because of economic conditions which have adversely affected their financial resources and the heavy take of federal income tax, social security, state and local taxes. Moreover, the basic objective is to get the total amount of the money into the economic stream and, hopefully, with a multiplier effect. It makes no difference whether that money is spent by a person of a substantially higher income level than $25,000–$30,000.

To emphasize, in setting the cap at $30,000 and phasing down to $25,000, even if the objective of those who have been vocal on this point is meritorious in theory, the practical facts of life are that, in our view, many if not most of the taxpayers

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[1] See the publication of the Congressional Budget Office dated January 11, 1977 entitled *The Disappointing Recovery*, Table 2 on page 23. This study estimates that a $16 billion personal tax rebate would have a GNP impact of plus $15 billion.

[2] There have been references to previous experience with the rebate technique including the tax rebate of 1975. Although the evidence and analysis thereof is by no means extensive—and we have not had an opportunity to complete a review of the material which is available regarding the prior experience—it is our feeling that the rebate will work to a satisfactory extent. As pointed out, again referring to Mr. Schultze, this is a part of a two-year program as distinguished from a rebate by itself.

in higher brackets would spend the rebate and might be induced to buy big ticket items, particularly in the durable goods area. Moreover, there is a good deal of misunderstanding, in our opinion, about the economic status of individuals and families with incomes in substantially higher amounts than $25,000–$30,000. Devastating inflation has had a scissors and vicious effect on individuals who are in tax brackets above $25,000–$30,000 as well as those below. Many individuals and families have been forced into higher brackets in our tax structure by inflation. In addition, inflation has eroded the real income of these persons independent of the forced tax bracket impact.[3]

Finally, some individuals have pulled themselves up by their bootstraps so as to achieve an adjusted gross income of $25,000–$30,000 and are being punished for doing so. This is a much broader issue than its relationship to the rebate, but that relationship is very real.

In sum, it is our opinion that the President's recommendation on this subject, if enacted, should not be disturbed in any substantial way and clearly the specific cutback to which we have referred should be rejected for the reasons stated.

Before concluding our discussion of the refund, we feel obliged to refer to comments made in response to a question of Dr. Arthur Burns during hearings on Thursday, February 3, before the House Banking and Currency Committee. Dr. Burns referred to the tax rebate or refund as a "gift," making this comment against a background statement that he is old-fashioned about such matters. I, too, am old-fashioned about such matters, but individuals as well as corporations have been punished for many years under our tax system, federal, state and local, by high rates and by the impact of inflation.

For corporations this is spelled out in an attachment to this statement entitled Inflation and Profits by George Terborgh, our Economic Consultant. You will note that it has been reprinted four times and most recently revised in October 1976. This study addresses itself primarily to the corporate area, but the principle involved is equally applicable to all personal income taxpayers. As we have pointed out previously, not only have such taxpayers been clobbered by inflation in a general way, inflation has forced them into higher tax brackets and, at the same time, eroded their real earnings. In this sense the federal government is not making a "gift" when it engages in a very modest tax rebate or refund insofar as the individual is concerned. It is making a token correction of what approaches under certain circumstances a confiscatory tax system. When we refer to the correction as token, we are not inferring that the aggregate rebate or refund for all taxpayers will be token in nature. As we view it, it will be substantial and will have a favorable effect.

Tax reduction and simplification

The message of the President contains a recommendation for a permanent increase in the standard deduction to a flat $2,800 for couples and $2,400 for single persons. As described by the President, this would be a "larger flat standard deduction." The recommendation is offered both on tax policy grounds and with the objective of simplification in mind. The Administration asserts—and we do not disagree—that all or most of the benefits of this reform will go to low and middle-income taxpayers. The House Committee bill moves in the same direction but adopts a standard deduction of $2,400 for single returns and $3,000 for joint returns, thus slightly increasing the newly proposed standard deduction by $200 for joint returns.

We would prefer not to comment in detail on this particular proposal since it is isolated from other tax revision proposals that undoubtedly will be considered when the Congress addresses tax revision later this year or early in 1978. Piecemeal action of this sort, although argued articulately, seems to be premature and, as already pointed out, is a clear departure from the focus of the original thinking of the Administration in terms of the current stimulative short-term package. It is long-term reform and as such should be considered along with the total tax revision recommendations that will come later.

A conclusion of the Administration as to its recommendation, stated in President Carter's message, is that this change would mean that 3.7 million low income taxpayers and their families would no longer have to pay taxes. How far

[3] See "Indexing the Individual Income Tax for Inflation: Will This Help To Stabilize the Economy?" prepared for the Subcommittee on Fiscal Policy of the Joint Congressional Economic Committee, December 27, 1976. We cite this study primarily because of its demonstration of the serious scissors effect of inflation on individual taxpayers rather than the remedy suggested which in itself deserves separate study.

can the United States go in removing categories of taxpayers from the tax rolls? There must be a limit, and we believe that this fundamental tax policy question should be faced up to in the context of long-term tax revision rather than short-term economic stimulation.

The House Committee bill also includes two entirely new proposals rationalized primarily on the objective to "considerably simplify income tax returns and the tax computation for almost all individual taxpayers." In summary, the House Ways and Means Committee approved provisions which were intended to create for 95 percent of all taxpayers a new simplified method of computing tax through the use of new tax tables. The proposal would build into these tables what is now the standard deduction, the personal exemptions, and the general tax credit. In addition, the House Committee approved elimination of what is now the standard deduction and substitution therefor of a floor under itemized deductions with, as already indicated, the amount of the standard deduction being built into the tax tables and tax rate schedules. We have not had an opportunity to study in depth the House Committee Report and the bill as sent to the floor, but these would appear to be mechanical provisions based on the commendable objective of simplification. They, too; however, are not germane to the announced purpose of the proposed legislation as the Administration envisions it, namely, to provide a proper amount of economic stimulation. Unless the Congress wishes to continue to piecemeal substantive revisions of the tax system, they do not belong in the current economic and short-term stimulation bill. Further, we are concerned that this pending legislation is suffering from a creep away from its original limited objective—short-term economic stimulus—and may become a "Christmas tree."

Tax relief for business firms

The President recommended that businesses be allowed to take either credit against income taxes equal to 4 percent of the social security payroll taxes paid by the employer or an additional credit of 2 percentage points for new investment in machinery or equipment. Each firm would have an option to elect one or the other of these benefits, but it would not be permitted to move back and forth to take advantage of one benefit or the other. As the President's statement puts it, "Its choice would be binding for a fixed number of years."

The House Ways and Means Committee rejected completely this optional provision designed to stimulate capital investment and substituted for it what the Committee terms "a new jobs tax credit." In doing so, the Committee in its Report argues: "However, because the investment tax credit has recently been increased to 10 percent through 1980 and liberalized in other respects, the committee concluded that it would be more appropriate at this time to relate the business tax cut to new employment."

Proposed permanent increase in the investment tax credit.—Before commenting on the action by the Ways and Means Committee, particularly as it affects the investment tax credit, we wish to address ourselves to the recommendations of the President. For many years the Institute has urged that federal tax policy include a permanent 12 percent investment tax credit[4] and an accompanying provision for a 15 percent or higher investment tax credit where expenditures are made for anti-pollution equipment. The latter portion of this recommendation is designed to recover capital cost at a more rapid rate where antipollution installations are involved, such installations almost always being noneconomic in the strict sense of the word. They also represent a diversion of available capital funds from economic capital investments which increase productivity, help support economic capital investments which increase productivity, help support eco-

[4] Present government policy in the area of capital recovery allowances encompasses not only the investment tax credit but the accelerated depreciation system embodied in the so-called Asset Depreciation Range system. Unfortunately our depreciation approach does not recognize to any substantial extent the impact of inflation. According to government figures, because of inflation in 1976 there was a shortfall of approximately $15.5 billion between depreciation unadjusted and depreciation computed on the straight-line basis with a correction for inflation (see Economic Indicators, January 1977).

The United States cannot compete internationally nor can it build and maintain modern plant and equipment with such an inadequate capital recovery allowance, even though we have the investment tax credit on top of the ADR system.

It is both interesting and relevant to point out that in March 1976, the SEC required, by amending its pertinent regulation, the "supplemental disclosure" by certain large reporting companies of the estimated cost of replacing inventories and productive capacity and an approximation of what the company's cost of sales would have been if that figure had been calculated by estimating the current replacement cost of goods and services sold at the times when the sales were made. The purpose of this new requirement is, of course, to recognize the impact of inflation.

nomic growth, and create jobs. (We acknowledge there is a limited offset to the point just made in the sense that producers of anti-pollution equipment are obviously benefited by the environmental programs which require capital equipment to implement.) The diversion from ordinary capital investments has been estimated to be approximately $8 billion per year. The validity of this portion of our tax credit recommendation is supported by the need for accelerated capital recovery and the diversion of capital funds from noneconomic projects—however valuable they are in the socioeconomic sense. In addition, it would be very helpful to the United States from a national policy standpoint to accelerate antipollution efforts and get most of the problem behind us as a country.

We have strongly urged the importance of permanency of the investment tax credit which, under present law, runs through 1980 at a level of 10 percent. We have also emphasized the need for creating and preserving in our tax system as much certainty as possible, particularly as it affects capital formation and capital investment. Business confidence must be sustained and long-term planning must be facilitated with benefits to the economy as a whole, to productivity improvement, economic growth, and the enlargement of job opportunities.

Since the investment tax credit was first enacted, history has demonstrated that the credit at a high level is sound on a long-term permanent basis. An upward and long-term move in the investment tax credit provisions is sound tax policy. The business community, therefore, welcomed the President's recommendation with the caveat that the level of the credit should not be reduced at some later date for alleged contracyclical purposes.

Secretary of Treasury Blumenthal and Chairman of the Council of Economic Advisers Schultze in hearings before the Budget Committee just conducted have pointed to the danger of sending out a negative signal to business by the action of the House Ways and Means Committee in eliminating the investment tax credit portion of the President's tax package. This signal is especially negative in character since the action of the Ways and Means Committee represented a reversal of a Presidential recommendation and supporting argument.

The coincidence of discussion within the Administration of so-called "prenotification" with respect to wage and price increases aggravates the element of business confidence and discourages corporate decisions making in the field of capital investment and related decisions such as expansion, modernization, increases in employment, increases in training, etc. All of this should be considered in the light of another factor: Putting aside the ravages of the winter and their effect on layoffs and production levels, at this point in a recovery in a business cycle normally capital investment is carrying a heavier load in the recovery process than it now is or is forecasted for the short-term future.[5] Thus, we urge that the Senate Finance Committee at the minimum restore to the bill which it reports a significant increase in the investment tax credit and preferably on a long-term basis.[6]

The President's recommendation regarding the investment tax credit was accompanied by a suggested option for the taxpayer to use a social security tax credit with the proviso that once the election is made, it cannot be changed from year to year. We defer discussion of this recommendation until after addressing the "jobs tax credit." The jobs tax credit was adopted by the Ways and Means Committee in lieu of an increase in the investment tax credit.

House Committee proposed jobs credit.—The rationalization by the Committee at page 11 of its Report for the new jobs credit is as follows:

The committee's new jobs credit contains several features which should make it a more effective device to encourage the hiring of new employees. First the credit is based on *increases* in wages over a base period, so that to benefit from

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[5] In testimony by Charles L. Schultze, Chairman, Council of Economic Advisers, before the House Budget Committee on Friday, March 4, 1977, he underlines this point. He makes the statement that when the fourth quarter of 1976 is compared to the same stage of previous recoveries, we find that "Business fixed investment in real terms was still 12 percent below the prior peak, compared with 5 percent above, typically, at this stage of the earlier postwar recoveries."

[6] In reference to business confidence, particularly as to capital investment decisions, The Conference Board has just released data on capital appropriations by the largest 1,000 U.S. manufacturers in the fourth quarter of 1976 showing a 33 percent gain over the third quarter. Two points should be made in this connection. First, this data relates to appropriations which may or may not result in actual expenditures. Second, it is interesting and highly relevant to the danger involved in the House Committee rejecting the investment tax credit recommendation of the President to note Conference Board Economist Elliot Grossman's statement when these figures were released that business confidence was strengthened "When it appeared all but certain that the investment credit would be raised from 10 to 12 percent. . . ."

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the credit, employers will have to do more than simply maintain current employment levels. Second, the new jobs credit is two years in duration, so that to benefit from it, employers must begin hiring shortly. This should have a beneficial short-run impact on the labor market. Third, the credit contains a number of limitations designed to prevent abuses.

In our opinion, the employment tax credit, or "jobs tax credit" which the Ways and Means Committee prefers to call it, would be very difficult to administer, would be of very questionable value in creating jobs, and would create inequities or windfalls in certain situations. First, it should be observed that it is very expensive from the standpoint of equipment and training, where the latter is necessary, to create a job. A job is not created out of the air and will not be created by any such tax approach unless there is an independently established need for a job. In brief, the new jobs credit as described or any jobs credit, unless it involves a tax inducement of such proportion that the tax system could not afford it, simply will not work. Note that the credit may not exceed $40,000 in any one year for any one employer. This should be compared with the generally acknowledged fact that it costs business about $30,000 to create a single job.

We referred to the probability that a jobs tax credit would be very difficult to administer and would lead to certain windfall benefits in some cases. For example, let us assume that a company weathered the recent recession without a reduction in work force and, therefore, without significant growth since the recession, could not justify any increase in work force. That company would not benefit from the jobs credit. On the other hand, a company which engaged in heavy lay-offs during the base period which is a part of the proposed provision and then had substantial rehires in 1977–78, would be entitled to the credit. There are many other special situations which would present administrative difficulties and create inequities.

Finally, a word as to small business. Some of the members of the Ways and Means Committee may have conceived of this provision as being one especially helpful to small business in increasing employment. Regardless of the size of the business, the basic objections which we have asserted as to the jobs credit apply, in our judgment. On the other hand, if there is some benefit to be obtained by small companies from such a provision in the context of the total objectives of the stimulative program with which we are dealing, the numbers of people affected would be minimal, in our opinion. The effect across the economy would also be so limited as to make the suggestion unwarranted.

We do not wish to leave this subject without making it clear that MAPI, its constituency and, we believe, all business are deeply interested in helping to move the economy forward, improving productivity, economic growth, and jobs creation. We simply do not believe that this is the course to take and, further, that the President's recommendations in the business area, in particular the proposal for an increase in the investment tax credit—even though its effect on jobs may be considered by some to be indirect—will give the government a much greater "bang for its buck" in terms of tax revenues and results.

The Administration's proposal for a social security credit.—When the Ways and Means Committee reached final decisions as embodied in the proposed Tax Reduction and Simplification Act of 1977, in additional to rejecting the investment tax credit increase it also rejected the second part of the tax option which the President recommended, namely, the 4 percent income tax credit with respect to the employer portion of social security taxes. As already indicated, this proposal of the Administration is the option to the investment tax credit increase and is a new concept.[7] As pointed out by Secretary of Treasury Blumenthal, it does provide a benefit for certain industries or companies which are not capital intensive, for example the labor intensive industries, and therefore it introduces an element of equi[illegible] into the picture. On the other hand, the benefit is not conditioned by being t[illegible]rectly to any specific objective. It remains simply a tax benefit provided, at [illegible]st in part, for the reason just stated. On the other hand, the investment tax credit is not available to any organization until it has ordered and placed in use productive equipment which qualifies for the credit.

Except for a technical problem to which we will refer in a moment, our feeling about this proposal is fairly neutral. It has some built-in equity as already acknowledged, but suffers from the disadvantage of not being conditioned by a specific economic objective except that it would be a part of a total program designed to stimulate the economy for the short run. Certainly for the long run we do not

[7] There is always the possibility of substituting for the proposed social security tax credit a reduction in the corporate income tax rate.

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believe that it is a viable part of our federal tax system. Finally, there may be a negative fallout from the standpoint of the social security system as a whole and how it is funded. This is because the use of the 4 percent income tax credit with respect to the employer portion of social security taxes paid may be interpreted as providing a precedent for the funding of social security through the general revenues. While some such funding has crept into our system, the utilization of general revenues to date is limited.[8] We face a serious long-term problem with regard to the social security system—a tax in a real sense of the word. There is almost a consensus among tax scholars and other interested observers that neither the rate nor the base for social security taxes should be allowed to go higher. The temptation to move in the direction of funding social security to a greater extent than the present use of general revenues disturbs us greatly and should be a consideration in evaluating this recommendation.

In this connection, the Institute has just completed a study entitled "Social Security—The 'Financial Crisis' In Perspective" (March 1977), copies of which we offer to the Committee and its staff, not as a part of the record but for background purposes.

The inflexible option as between the investment tax credit and the social security payroll tax credit raises some practical questions. Why is the inflexible option provision necessary? This, we feel, deserves much greater study if ~~the social~~ security tax credit is enacted, even for a limited number of years.

New proposals addressing structural unemployment.—Members of Congress and all persons interested in the health of the U.S. economy and the human values which are involved in maintaining a high level of employment and limiting unemployment recognize that there is a serious structural unemployment problem in the United States and that measures should be developed to address the structural unemployment. We concede the malady is present and in both a social and economic sense, it is serious. Further, there may be a limit on the ability of private enterprises to deal with structural unemployment problems without some government support and programs. These proposals, however, have many ramifications that deserve study, and we are inclined to feel that for purposes of achieving a quick, short-term stimulus to move the economy, they need further study and, even if perfected, many would not be ready for implementation within the timetable of the Administration's current program as distinguished from long-term policy making.

Brief comments on other provisions of the President's economic recovery package

We will not undertake to comment at any length on the nontax recommendations[9] by President Carter regarding economic stimulation and action being taken elsewhere in the Congress on at least some of those recommendations for increases in countercyclical revenue sharing, public service employment, public works, and expanded youth and other job programs, since this Committee is concentrating in the tax area. Action on these programs ties back to federal tax policy in general and the degree to which tax policy must mesh with expenditure programs as a part of our total budgetary situation. We feel that it is a truism that long-term job opportunities are better created in the private sector than in the public sector. Further, we are concerned about the distinct tilt toward beefing up the public sector at the expense of the private sector.

An unleashing of private enterprise from certain federal intervention, a reduction for long-term purposes of extreme tax policies or policies which are anti-investment will produce the kind of economic growth and increased productivity which enables private business to expand and to support new product development, more effective training programs, greater job creation and related efforts. We recognize that there are controversial aspects of these issues. At the very least, however, the dialogue should be extended and, in the spirit in which we have approved certain suggestions contained in the President's message even though we may have some reservations, it would be a useful exercise for government and industry together as well as professional independent experts to attempt to first identify and then deal with government policies which are deterrents to expansion of the private system and support of private system programs.

We greatly appreciate the opportunity to appear before this distinguished Committee and offer our services if we can be of further help.

[8] See House Document No. 94–75 which is one of the Reports of the Quadrennial Advisory Council on Social Security, March 10, 1975.

[9] In respect to the job proposals contained in the President's message, we would like to make one comment. It would appear that extended utilization of the Comprehensive Employment and Training Act would provide an appropriate platform for addressing at least some of the structural unemployment problems which are clear and serious.

Recent Studies Dealing With Capital Formation, "Real Profits," and "Inflation Accounting"

"Unwinding the Present Inflation," by George Terborgh, March 1977.
"Inflation and Profits," by George Terborgh, MAPI Memorandum G–70 of January 1974, Revised and Republished in July and December 1974, and April and October 1976.
"The Sad Story of Corporate Profits," by George Terborgh, March 1976.
"A Mystery In Federal Profit Reporting," by George Terborgh, May 1976.
"Inflation and the Taxation of Business Income," by George Terborgh, January 1976.
"The Case for the Single-Index Correction of Operating Profit," by George Terborgh, October 1976.
"SEC Amends Its Regulations To Require Supplemental Disclosure of Certain Replacement Cost Data," MAPI Bulletin 5418, March 26, 1976.
"Fixed Investment and Productivity Growth in Major Industrial Countries, 1960–73," MAPL Capital Goods Review No. 102, February 1976.
"Corporate Financing of Economic Growth: Some Questions About the Mix of Internal and External Financing," MAPI Capital Goods Review No. 101, October 1975.
"Corporate Saving and the Capital Shortage" by George Terborgh, MAPI Capital Goods Review No. 100, September 1975.
"Another Part of the Story . . . Capital Formation and Exports," MAPI Capital Goods Review No. 98, June 1975.
"Business Capital Formation—Putting It In Perspective (1925–1970)," MAPI Capital Goods Review No. 94, December 1973.
"Inflows and Outflows Arising From U.S. Direct Investment Abroad, 1960–75," MAPI Memorandum, March 26, 1976.
"Capital Formation and Legislative Proposals for Tax Revision," March 30, 1976.
"The Favorable Impact of Direct Investment Abroad on the U.S. Balance of Payments: Spending More To Get More," MAPI Capital Goods Review No. 103, June 1976.
"Recent Changes In Capital Equipment Activity—A Puzzling Divergence In Two Widely Used Measures," MAPI Capital Goods Review No. 104, October 1976.

Inflation and Profits

(By George Terborgh, MAPI Economic Consultant)

The effect of rising price levels on the accounting of profits is not a new subject. During the sharp postwar inflation of 1946–48 it generated a lively discussion in accounting and management circles. This was revived, on a lesser scale, by the price run-ups of 1950–51 and 1956–57. But under the relatively stable price level of 1958–64 interest waned. It was widely believed that inflation was a thing of the past, that the after-effects of earlier inflation would gradually wear off, and that no corrective action was needed. This proved to be an illusion. By 1965 inflation was under way once more, and it has continued at a distressing pace ever since. It is now high time to take another look at the problem.

The Principle

The overstatement of profits during and after a period of inflation arises from the practice of charging only the historical cost of physical asset consumption (fixed assets and inventory). When the purchasing power of the dollar is shrinking, the charging of historical costs—reflecting earlier, and hence lower, price levels—is insufficient for the restoration of real assets used up in production. A proper reckoning requires the restatement of previously incurred costs in the dollars of realization, that is to say, in the revenue dollars against which they are charged. Only when costs and revenue are measured in the same dollars can the difference between them (profit) be correctly determined.

It follows that when the real cost of physical asset consumption is undercharged the shortfall is accounted as profit. It follows also that this much of the reported profit is fictitious, representing simply the understatement of costs.

The Project

The foregoing statement of principle refers to the conversion of historical costs into their equivalents in current dollars. This implies the use of an index of the general purchasing power of the dollar. Unfortunately from our stand-

point, the official conversions are based on a multiplicity of specific price indexes purporting to reflect the current replacement costs of the individual items or classes of items processed. We refer to the Department of Commerce conversions, which are applied to both fixed-asset consumption (in the depreciation adjustment) and inventory consumption (in the inventory valuation adjustment) by means of such replacement-cost indexes. While we prefer the use of a single comprehensive index of prices, the overall results obtained from a multiplicity of specific indexes are not far different. In any case, we are constrained by the nature of the available data to use the latter, which represents a conversion of historical costs into current-cost equivalents, rather than into current-dollar equivalents.[1]

In the project in hand, we propose to compare current-cost with historical-cost depreciation and current-cost with historical-cost inventory consumption. We can then see what difference the conversion makes in the profit figures. The study is limited to the corporate system because profit as such is not available for the unincorporated sector, and more specifically to nonfinancial corporations, the category principally concerned with physical asset consumption. It is limited also to the inflation of 1965–76.

I. FIXED ASSETS

The Department computes annually current-cost depreciation on the fixed assets of nonfinancial corporations, using two writeoff methods (straight-line and double-declining-balance) and a variety of service-life assumptions. It has expressed a preference on service-life assumptions (85 percent of Bulletin F lives), and we shall use that assumption in conjunction with the double-declining-balance writeoff.[2]

A word on the choice of writeoff. Notwithstanding the Department's use of the straight-line method in the recent GNP revisions, we entertain no doubt that that writeoff is in most applications a grievously retarded measure of capital consumption, and that the double-declining-balance method is in general more realistic. This is not the place to argue the issue, which we have done at length elsewhere.[3] Suffice it to say that this writeoff conforms quite well to both theoretical and empirical evidence on the typical course of capital consumption, especially for capital equipment (as distinguished from structures), which accounts for around five-sixths of corporate depreciation.

The following table compares the Department's computation of current-cost double-declining-balance depreciation with its estimate of the depreciation allowed for income tax purposes.

TABLE 1.—COMPARISON OF THE CURRENT-COST DOUBLE-DECLINING-BALANCE DEPRECIATION OF NONFINANCIAL CORPORATIONS WITH THE DEPRECIATION ALLOWED THEM FOR INCOME TAX PURPOSES

[In billions of dollars]

	Current cost DDB (1)	Income tax depreciation (2)	Excess of (1) over (2) (3)
1965	34.9	36.4	−1.5
1966	38.7	39.5	−.8
1967	42.9	42.9	0
1968	47.1	46.7	.4
1969	52.2	51.3	.9
1970	57.8	54.6	3.2
1971	62.8	58.7	4.1
1972	67.0	65.3	1.7
1973	73.7	70.5	3.2
1974	86.9	77.8	9.1
1975	103.1	85.0	18.1
1976, 1st half	[1] 112.6	90.4	22.2

[1] Our estimate. All 1976 figures are at seasonally adjusted annual rates.

Note that the excess of current-cost DDB over tax depreciation has grown from a negative amount in 1965 to $22 billion in 1976.

[1] For a discussion of this issue, see "Realistic Depreciation Policy," MAPI 1954, ch. 12.
[2] The double-declining-balance method is applied with a straight-line switch.
[3] "Realistic Depreciation Policy," chs. 3, 4, and 5.

II. INVENTORY

As indicated earlier, the conversion of inventory consumption charges from historical cost to their current-cost equivalent is computed by the Department of Commerce as the "Inventory Valuation Adjustment" (IVA). The calculation allows for inventory consumption presently charged for income tax purposes by LIFO and similar current-costing procedures, and converts only the balance under historical-costing systems. The results follow.

TABLE 2.—*Inventory valuation adjustment for nonfinancial corporations*

	Billions
1965	$1.9
1966	2.1
1967	1.7
1968	3.4
1969	5.5
1970	5.1
1971	5.0
1972	6.6
1973	18.6
1974	39.8
1975	11.4
1976–1st half	13.1

Here again we have a gradual rise in the excess of current-cost over historical-cost charges, culminating in this case in a sudden surge to nearly $40 billion in 1974, with a current (first half of 1976) level of $13 billion.

III. ADJUSTMENT OF PROFITS

We are now ready to put the pieces together and adjust profits as reported for income tax purposes.

TABLE 3.—ADJUSTMENT OF REPORTED PROFITS OF NONFINANCIAL CORPORATIONS

[In billions of dollars]

	Profits before tax as reported (1)	Income tax liability (2)	Profits after tax as reported (1)−(2) (3)	Under-statement of costs [1] (4)	Profits before tax as adjusted (1)−(4) (5)	Profits after taxes adjusted [2] (3)−(4) (6)
1965	64.4	27.2	37.2	0.4	64.0	36.8
1966	69.5	29.5	40.0	1.3	68.2	38.7
1967	65.4	27.7	37.7	1.7	63.7	36.0
1968	71.9	33.6	38.3	3.8	68.1	34.5
1969	68.4	33.3	35.1	6.4	62.0	28.7
1970	55.1	27.3	27.8	8.3	46.8	19.5
1971	63.3	29.9	33.4	9.1	54.2	24.3
1972	75.9	33.5	42.4	8.3	67.6	34.1
1973	92.7	39.6	53.1	21.8	70.9	31.3
1974	102.3	42.6	59.7	48.9	53.4	10.8
1975	95.5	39.7	55.8	29.5	66.0	26.3
1976, 1st half	122.5	52.6	69.9	35.3	87.2	34.6

[1] The sum of the excesses of current costs over historical costs shown in tables 1 and 2.

[2] Since this is a retcrspective recomputation of profits, it takes as given the corporate income taxes actually paid. If tax liabilities had been figured on the adjusted pretax profits, the after-tax effect of the adjustment would, of course, have been reduced by the tax saving resulting therefrom. But since they were actually figures on the reported profits throughout, there were no such tax savings. Adjusted after-tax profits are simply adjusted pretax profits minus actual taxes on reported profits.

Here is a startling picture. Adjusted after-tax profits started out in 1965 not far below the reported figure. They wound up in 1974 less than a fifth as large as reported. In 1976 (first half), they were still less than half as large.[4]

[4] It should be acknowledged that there is a slight duplication in combining the depreciation and inventory adjustments. Practice differs widely with regard to the treatment of depreciation, some companies charging it into cost of sales, others treating it as an expense. Overall figures on the relative prevalence of the two procedures are not available. To the extent that depreciation is included in the cost of sales, there is of course some duplication of the separate adjustment for depreciation. It is not, however, very important. Even if *all* depreciation were so charged, it would make up only 5 or 6 percent of the total inventory-consumption charges, and the maximum duplication would therefore be this percent of IVA, a relatively insignificant amount.

Restatement of retained earnings

An even more startling picture emerges when we subtract dividend payments from after-tax profits to derive adjusted retained earnings.

TABLE 4.—ADJUSTED RETAINED EARNINGS OF NONFINANCIAL CORPORATIONS

[In billions of dollars]

	Adjusted after-tax profits (1)	Dividend payments (2)	Adjusted retained earnings (3)
1965	36.8	17.2	19.6
1966	38.7	18.1	20.6
1967	36.0	18.9	17.1
1968	34.5	20.7	13.8
1969	28.7	20.7	8.0
1970	19.5	19.9	−.4
1971	24.3	20.0	4.3
1972	34.1	21.7	12.4
1973	31.3	23.9	7.4
1974	10.8	[1] 26.5	−15.7
1975	26.3	29.0	−2.7
1976, 1st half	34.6	30.1	4.5

[1] Adjusted to eliminate certain abnormalities.

Over the past 6½ years adjusted retained earnings have been almost negligible (averaging less than $2 billion a year). Nonfinancial corporations have been distributing nearly all of their adjusted earnings, their reported savings representing little more than the amount required to cover the understatement of costs.

Adjusted profits and retained earnings in constant dollars

To make the horror story even worse, the dollar has been shrin[illegible]g over the interval and it is necessary to adjust for this by stating the results in constant dollars. We use for this purpose the GNP deflator (1972=100).

TABLE 5.—ADJUSTED PROFITS AND RETAINED EARNINGS OF NONFINANCIAL CORPORATIONS IN 1972 DOLLARS

[In billion of dollars]

	Adjusted after-tax profits (1)	Adjusted retained earning (2)
1965	49.5	26.4
1966	50.4	26.8
1967	45.6	21.6
1968	41.8	16.7
1969	33.1	9.2
1970	21.3	−.4
1971	25.3	4.5
1972	34.1	12.4
1973	29.6	7.0
1974	9.3	−13.5
1975	20.7	−2.1
1976, 1st half	26.2	3.4

In constant dollars, the adjusted earnings of 1976 are slightly over one-half of 1965. As for retained earnings, the comparison is dismal. Here the 1976 figure is only one-eighth of 1965.

IV. EFFECTIVE INCOME TAX RATES ON ADJUSTED PROFITS

Since the income tax liability (federal and state) is computed on overstated historical-cost profits it is obvious that the effective rate on profits adjusted for the overstatement is higher than the rate reported. The following table shows the difference.

TABLE 6.—EFFECTIVE TAX RATES ON THE PRETAX PROFITS OF NONFINANCIAL CORPORATIONS AS REPORTED AND AS ADJUSTED[1]

[In percent]

	On profits as reported (1)	On profits as adjusted (2)
1965	42.2	42.5
1966	42.4	43.3
1967	42.4	43.5
1968	46.7	49.3
1969	48.7	53.7
1970	49.5	58.3
1971	47.2	55.2
1972	44.1	49.6
1973	42.7	55.9
1974	41.6	79.8
1975	41.6	60.2
1976, 1st half	42.9	60.3

[1] Col. 2 of table 3 as percentage of cols. 1 and 5, respectively.

It is obvious at a glance that effective tax rates on real profits have moved away from those on reported profits. In 1974 the rate reached nearly 80 percent. For 1976 it is 60 percent.

V. WHAT DOES IT MEAN

It is clear that American business has not yet learned how to protect itself against inflation. Overall, it has been unable to maintain normal margins even in the overstated profits of conventional accounting. In terms of real profits, the shrinkage has been drastic.

It is extremely difficult to protect even nominal profit margins in the face of inflation, owing to the tendency of unit costs to move up faster than realized prices. Under prevailing practice prices are often fixed for substantial periods ahead. Catalogs may be issued only annually or semiannually; seasonal merchandise may be priced months in advance of delivery; long-cycle production may be quoted before work is started; etc. But even where prices are more quickly adjustable there is a general tendency to lag behind the march of costs.

If it is difficult to protect nominal profit margins it is still more so to protect real margins. Since the latter are more adversely affected by inflation their maintenance requires even bolder and more aggressive action, not to mention their restoration after they have been allowed to decline.

The core of this action is of course pricing policy. Management must learn how to price its products in an inflationary economy. This means first of all anticipatory pricing—pricing in anticipation of cost increases prior to sale. It means secondly a proper accounting of costs themselves, especially the cost of physical asset consumption.

It must be acknowledged of course that such a pricing policy may be impracticable for an individual company in a market where the competition is pricing on understated costs. The real remedy lies in the reform of policy across the board. If all competitors are targeting their prices on fully stated costs, there is a better chance that they can make them stick.

Let us add in closing that the present situation is bad not only for business, but for the nation as a whole. Despite the suspicion and disfavor that attach to profits in the eyes of many politicians and of a considerable part of the public, it is vital that they be large enough not only to motivate the expansion of productive investment, but to finance a substantial part of it. It is frightening from the public-policy standpoint that the reinvestment of corporate earnings, realistically measured, has become negligible. If this continues it will cost the country dearly.

Let us add further that the Alice-in-Wonderland accounting of costs and profits that now passes for orthodoxy is a problem not only for business management, but for the accounting profession, the regulatory agencies of the government, and, not least, for the tax authorities. It is high time for concerted action by all concerned.

It is gratifying in this connection that both the accounting profession and governments appear at last to be grappling with the problem. The Securities

and Exchange Commission has required large companies to file supplemental statements on the current-cost inventory and fixed-asset consumption. There is much activity on the subject among accounting bodies here and abroad, and in several countries by government commissions.

These are first steps, to be sure, but we may hope that others will follow. We may hope also, and even more fervently, that the tax authorities will not be far behind. For the evils of undercosting are compounded by the present practice of taxing capital consumption as income. No reform of costing procedures can be more than partially successful so long as this practice continues.[5]

The CHAIRMAN. Next, then, we have Senator Richard Schweiker.

STATEMENT OF HON. RICHARD SCHWEIKER, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator SCHWEIKER. Thank you, Mr. Chairman. I would like to thank you and other members of this committee for providing me with this opportunity to testify in support of S. 680, the New Jobs Tax Credit Act.

Mr. Chairman, in February, there were more than 7 million workers unemployed in this country. The unemployment rate stood at the tragically high level of 7.5 percent. These figures are appalling enough in themselves. But upon closer examination it becomes clear that certain groups suffer disproportionately from the ravages of high unemployment.

More than one-third of those unemployed in February were between the ages of 16 and 21. This means that 2,479,000 young people were being denied the chance to work during a critical developmental stage—their early years in the job market.

In addition, a substantial portion of unemployment is long term. Individuals numbering 2,182,000 had been out of work for 15 weeks or more in February. If you add the number of older workers unemployed for 15 weeks or more to the unemployed between the ages of 16 and 21, you arrive at a devastating figure of roughly 4 million. Approximately 60 percent of the jobless in this country are either young or have been unemployed for more than 15 weeks.

As we continue our discussions of the most effective strategies to reduce unemployment and to stimulate a sluggish economy, I believe we must attend very closely to the needs of those hardest hit by adverse economic conditions—youths and the long-term unemployed. Members of these groups will not benefit as substantially as other unemployed workers from implementation of traditional fiscal and monetary policies. These individuals are plagued by disadvantages such as inexperience and a lack of readily marketable skills which will not disappear with increases in aggregate demand.

In the past, we have attempted to neutralize these disadvantages through job training and costly and relatively ineffective public service employment programs designed to facilitate transitions to regular employment in the private sector. I believe the Federal Government should continue and expand its efforts in job training, but I believe we must add new weapons to the arsenal we presently use to combat unemployment among youths and the long-term jobless.

The New Jobs Tax Credit Act is a new weapon, embodying a new approach both to the problems of youth and long-term unemployment.

[5] See *Inflation and the Taxation of Business Income*, MAPI, January 1976.

This bill would provide employers with a tax credit of 20 percent up to $2,000 of wages paid to youths 21 years of age or under or to persons unemployed for 15 weeks or more. The credit would be available during taxable years 1977 and 1978.

In addition, in order to qualify for the credit, each youth or long-term unemployed individual hired would have to represent an increase in the employer's work force over a previously established base level. For taxable year 1977, the base level of employment would be the average number of employees on the employer's payroll during calendar year 1976, and for taxable year 1978, the average number of employees on the payroll during calendar year 1977.

This provision should effectively inhibit any substitution of youths and the long-term unemployed for regular workers.

An employer would be able to receive the credit for 12 months for each eligible new employee. And if an employer had insufficient tax liability to subtract the full credit, he would receive the excess credit as a tax refund.

Mr. Chairman, I believe our ultimate objective should be to put people to work in the private sector where they can contribute most significantly to the economic well-being of this Nation. Our economic strength depends on the goods and services produced by the private sector and youths and the long-term unemployed should have the opportunity to contribute to the growth of that strength. I believe S. 680 will give them that opportunity.

By providing employers with a substantial tax credit for hiring youths and the long-term unemployed, we would allow employers to realize considerable savings in wage costs. These savings would neutralize the disadvantages brought to the work place by youths and the long-term unemployed and would enable employers to provide these workers with the training and experience they so desperately need.

Unfortunately, the novelty of a broadly implemented employment tax credit makes it difficult to estimate the number of jobs that might be created. However, I believe a tax credit equal to 20 percent, up to $2,000, of wages paid to youths or to the long-term unemployed would be sufficient to affect positively the hiring decisions of many employers especially in conjunction with other stimulative measures.

It should be noted that the income tax credit would reduce the effective rate of the minimum wage to $1.84 an hour for employers, while providing the newly hired youth or long-term unemployed individual with at least the $2.30 an hour minimum wage in covered industries. And, as I am sure you are aware, many experts have suggested that the high level of the minimum wage may be the most significant barrier to employment of youths and the disadvantaged.

Obviously, the cost of this proposal would depend on the number of youths and long-term unemployed individuals hired. However, a study by the Congressional Research Service indicates that the cost of a tax credit job would compare very favorably with the cost of jobs under other Federal programs.

According to CRS, if 1 million youths and long-term unemployed individuals were hired and retained for 1 year at an average wage of $4 an hour, the gross cost to the Government would be $1.67 billion. Once account is taken of increased personal income tax and social

security tax receipts, however, the net cost to the Government is estimated at $160 million, or $160 per job.

Even if increased social security tax receipts are not included, the net cost per job is only $1,050. And I should mention the CRS did not consider savings in unemployment compensation, welfare payments, or food stamps in arriving at these estimates.

Mr. Chairman, as you know, considerable interest has developed in the concept of an employment tax credit. Three distinguished members of this committee, Senators Bentsen, Dole, and Matsunaga, have introduced legislation to provide various forms of an employment tax credit. Moreover, the House Committee on Ways and Means included an employment tax credit in the recently reported Tax Reduction and Simplification Act of 1977.

However, I believe that the particular strength of S. 680 is that it is targeted at those individuals who for too long have suffered at the hands of unemployment— youths and the long-term unemployed while requiring growth in the employer's work force.

We can no longer afford to tolerate massive joblessness among this Nation's youth or unemployment of excessive duration. The human and economic costs are just too great.

I believe the innovative approach of the New Jobs Tax Credit Act deserves careful consideration as the committee continues its review of the proposals before it. I hope that the members of the committee will study this bill, offer their suggestions, and ultimately include it as part of a package which will remedy the economic ills which afflict this Nation.

I, for one, feel this course would be far preferable to expanding the public service jobs programs above current levels as the President has proposed. Simply to increase the number of public service jobs is an unimaginative proposal which at best creates temporary government jobs at high costs with little assurance of regular employment. And, at best, we can afford to reach only a fraction of those in need.

The New Jobs Tax Credit Act could potentially fulfill the needs of many more people and an individual hired as a result of this bill would stand a far better chance of keeping the regular job that a public service employee can only hope to obtain.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Hansen?

Senator HANSEN. I agree with what you say, Senator Schweiker, that high minimum wage makes it more difficult for young people, minority groups and people with few job skills. Your proposal would be to still have the minimum wage apply but give a tax credit to employers who are willing to employ these kinds of people.

Is that the main thrust of your proposal?

Senator SCHWEIKER. That is right.

The effect would be to reduce the effective rate of the minimum wage for young people and the long-term unemployed. But the harmful side-effect of having a person with a couple of children having to live on a reduced minimum wage would not be there. It is a subsidy to business, but decreases the effective rate of the minimum wage to those categories.

Senator HANSEN. If you were a typical parent, would you rather, if you had to make one of these two choices, have a youngster of yours unemployed with a minimum wage at $2.30 or have him employed at $2 an hour?

Senator SCHWEIKER. I think that having a job as opposed to having no job is certainly preferable. In essence, my bill does address itself to the issue you are raising. It does it indirectly, rather than directly, but as you know, the history of minimum wage legislation in Congress—and this is one way of doing two things simultaneously; giving the employer a credit who would work with young people and the long-termed unemployed where some extra training might be required initially and giving him an incentive to do it.

It would have the advantage of reducing the effective rate of the minimum wage.

You could well argue whether we should have a youth differential.

Senator HANSEN. I might observe, when I was Governor of Wyoming, I recommended raising the minimum wage by 33⅓ percent—it was 75 cents an hour. On my recommendation, it went to $1 an hour. I have come full circle since that time.

I do not think that that is a sound philosophy to pursue. If it is good, we should put it to $3.50 an hour and increase the tax credit for those people who are willing to employ young people, recognizing that they are not going to be able to earn a sufficient amount to make an economic return to their employers.

I find myself in this kind of a dilemma as I try to justify—and I am unable to do that—raising the minimum wage.

I have no further questions; thank you very much, Senator Schweiker.

Senator SCHWEIKER. Thank you.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. Senator, part of the administration proposals include expanded training in the youth programs. How does your position differ from theirs?

Senator SCHWEIKER. Their initial—are you talking about the jobs tax credit? They initially had a jobs tax credit that could be an option along with an increase in the investment tax credit. I believe it was 4 percent on the amount of social security taxes paid.

Senator DANFORTH. For kids.

It is my understanding that part of their proposal involves public service jobs for young people.

Senator SCHWEIKER. Let me say that I really question the effectiveness of public service jobs. I supported that concept initially as a temporary stopgap measure, and I voted for it on that basis. Now we are trying to make a permanent institution out of it.

I think there are two or three disadvantages to it, and I think that there is a Congressional Budget Office study that shows that there is a great indoor/outdoor revolving door situation where people go off one municipal payroll and go back on with the Federal Government picking up the tab. Or where State and local governments substitute Federal funds for State and local effort. That defeats the whole purpose of the program, to get new hires and new people to work. No. 2, it builds up city organizations in a way I do not think is constructive in solving the job problem.

While it was a temporary expedient, I think that temporary part has become too permanent.

In retrospect, also, it builds people up for a big letdown; at some point these programs will be stopped. When that happens, we are back with the same kettle of fish even though a lot of money has been spent.

Here is a subsidy—true, it is a subsidy, but to get people working in the private sector and hopefully, after employers have invested enough money in training and skills they are going to want to keep them. I think the incentive is to keep them.

That is the philosophy of the approach.

The administration did have a 4-percent credit initially proposed on the social security tax concept, a rebate. It amounted to 1 cent an hour; giving employers a reduction of 1 cent an hour in wage costs in an effort to stimulate hiring is also a waste.

Senator DANFORTH. Thank you.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. I have no questions.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. I have no questions.

The CHAIRMAN. Thank you very much, Senator.

Senator SCHWEIKER. Thank you, Mr. Chairman.

The CHAIRMAN. Next, we will call Mr. Milton Stewart, president of the National Small Business Association.

Mr. STEWART. Mr. Chairman, I am accompanied by Mr. John Lewis, executive vice president and executive director of the Small Business Council.

STATEMENT OF MILTON D. STEWART, PRESIDENT, NATIONAL SMALL BUSINESS ASSOCIATION, ACCOMPANIED BY JOHN LEWIS, EXECUTIVE VICE PRESIDENT AND EXECUTIVE DIRECTOR OF THE SMALL BUSINESS COUNCIL

Mr. STEWART. Let me begin by expressing my pleasure at appearing before this committee. It is always a privilege. I always feel the weight of my responsibilities when I come here very heavily, never so much as when the rest of the business community does not agree with us. But the weight is a little lighter this morning in light of the action of the House of Representatives yesterday. I sat in the gallery and saw an impressive majority of 341 to 74—bipartisan, from every part of the country, representing liberals, conservatives, and everything else, vote for an important departure in national tax policy—the job tax credit.

What I am here to urge this committee to do is lead the Senate in joining the House in enacting either the Ullman new jobs tax credit or an improved version of it.

My statement—which I ask be put into the record—actually consists of three statements, so that you can see the development of our thought over just this past month.

We have included here things we said to the Ways and Means Committee; things we said to the Senate Small Business Committee; estimates that Senator Matsunaga and others have used of jobs we hoped, or thought, would be created, not always consistently because we changed our minds as we have gone along. This is new ground that all of us are trying to cover.

86-032—77——14

Perhaps a good beginning point is just to describe for a moment the American economy's labor force that we think is at issue here, and which we think has been misstated and misunderstood.

You have read, perhaps, that one of the criticisms made of the proposal is that two-thirds of the Nation's employment base is excluded from it. Let me call to your attention appendix 2 of our table; it is a good place to begin.

Roughly three out of every four jobs in this country are in business enterprises which employ 500 or fewer people—three of every four.

Four classes of business enterprise each produce about 25 percent of the covered social security employment in this country. Those are good jobs. These are 1973 figures from social security by way of the Census Department—of the 61 million total, 15 million jobs are held in businesses with more than 500 employees, approximately the same number with between 100 and 500 employees, approximately the same number between 20 and 100 employees, approximately the same number between 1 and 20 employees.

That is the American economy that you know in your States and I know in my home town and places that I do business. Three out of every four entrepreneurs, employing social security-covered people, are in small enterprises.

Now, if you will turn to appendix 3, this is corporation income tax returns. Not all business, corporations only. If you will look at the last column, investment tax credit in 3 selected years, 5 years apart, the bottom line only, what you will see is 1,421 companies in 1963 received 50.6 of the investment credit, in 1968, 62.2; in 1973, 65.7.

Three out of every four jobs are in small business. Two out of every three dollars in investment credit benefit go to fewer than 1,500 companies. And if IRS reported breakdowns within that 1,421 as they should, the concentration of benefits is even more shocking.

Now our first concern with the economic stimulus package is what will work and what will create jobs. We believe—and we have included some data about that—that the standard economic doctrine—Brookings has been mentioned here already—the "Gospel According to St. Brookings," has not produced the full employment which this country needs.

It is in response to that that we urge the Congress to take some new departures. We began to talk about a job tax credit 2 years ago. Increasingly, it has found receptivity and support in the House and the Senate. Various proposals have been sponsored by Senator Bentsen, Senator Matsunaga, and Senator Schweiker. Others in the Chamber have introduced or expressed interest in one or another version of a job tax credit. Senator Haskell held a hearing on this a week or two ago.

In the House, as I told you, an overwhelming, almost 5 to 1 majority voted for this measure on a rollcall vote yesterday. I believe the Members were responding to the sense of the American people that the tax structure, as it exists, where business is concerned does not focus benefits or burdens where it should.

There is no question in my mind that there will be administrative difficulty at the outset. There is no question in my mind that there are some unfairnesses. They are unavoidable.

I believe fully that your brilliant staff and that of the Joint Internal Revenue Tax Committee will close all the loopholes and shut off all the

windfalls they can find. When they are through, we will need 2 or 3 years of learning experience.

While this is proposed in the Ways and Means proposal as almost a 3-year experience, 3 fiscal years, we believe that it will take 5 years and three stages for the country really to learn how to live with a job tax credit. We do not deny that.

If you do not start, you do not get any place. The time to start is right now.

The version adopted in the House, or the version offered by Senator Matsunaga, will do very well as a first-stage version. The kind of thing that Senator Schweiker was talking about, specific incentive for high-level employment areas, the disadvantaged, the disabled, what have you—that will do for stage 2.

Stage 3 is prefigured by Senator Bentsen's bill which proposes an economically-wide, permanent job tax credit.

I have offered, in this version of our views, the estimate—and I have reduced it intentionally to be sure that I am on the conservative side—that a $2,500 per job tax credit will produce approximately 600,000 jobs. I have done that, frankly, on an entirely arbitrary basis, modified only by our own experience, not insubstantial, in talking to small business people. I have probably talked to several hundred in the last 2 months. Let me tell you how I get to that number.

I estimate that 5 percent of the 2,800,000 employers of 1 to 19 persons—1 out of every 20 in that group—will hire an average of 1 new person in response to the credit. That will create 140,000 new jobs.

I have estimated that 10 percent of the almost 400,000 employers of 20 to 99 persons will hire and claim credit for an average of 4 new employees. That will provide almost 160,000 jobs.

We have estimated that 20 percent of the 75,000 employers of 100 to 499 employees will hire an average of 10 new employees as a result of the credit; that would create another 150,000 new jobs in that size class.

We are estimating that only 50 percent of the 12,000 employers of 500 or more persons would hire and claim the credit for the 24 employees authorized by the House bill.

When you put them all together, they add up to almost 600,000 employees. I believe that that is a sizable chunk of that presently indigestible and regrettable mass of unemployment that we do not seem to be able to reduce with present policies.

How long does it take to get the 600,000 employees? It depends very much on the size of the credit, the vigor and the skill and the determination of the Treasury Department and the rest of the executive branch in administering it.

On this, it is perfectly clear we will need diligent oversight by members of committees of Congress to see to it that the Treasury and the rest of the executive branch give this program the sympathetic attention that it needs. Without a major information program at the start, there may be too long a lead time.

We have estimated that a minimum of 5 years will be required before this tax really belongs as a permanent element in the tax code.

Once again, in our view, there is no better time to begin than right now. The President has made a proposal for short-term stimulus that has in it great incentives for those people who can, for example, benefit

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from public employment or local public works; some incentives for the private sector; some trickle-through for small business, but not really very much.

I have said here that we consider small business the sleeping giant of job creation in this country. We think it's time that Congress woke it up and allowed it to do its job.

I thank you very much, Mr. Chairman and gentlemen. I will answer any questions that I can.

Senator MATSUNAGA [presiding]. Thank you very much, Mr. Stewart. I think you have made a very convincing argument for the job tax credit proposal.

I was a little confused earlier. I frequently have been told that we orientals all look alike, but you caucasians not only all look alike, you have the same name—like Stewart.

[General laughter.]

Senator MATSUNAGA. I am glad that your views are different. Unfortunately, businessmen come before the congressional committees and come forth with their different views. Maybe it is fortunate. Different views make not only for interest, but the best solution in the end.

The objections are coming from small businessmen now, as was observed a few minutes ago. Let me ask you, Mr. Stewart, is it not true that when the investment tax credit was first proposed in 1962, businessmen at that time said it would not work?

Mr. STEWART. Yes, sir. There were many who did, Senator.

Senator MATSUNAGA. In 1966, when the investment tax credit was suspended, other businessmen—indeed, those who were opposed—came back and said, we want it put back.

Mr. STEWART. You are exactly correct, Senator.

Senator MATSUNAGA. So we did put it back in 1967.

I am happy, as a representative of small businessmen, that you have proposed this bold, new incentive program, and I have a feeling that if we adopt this it will work.

I am convinced, after reading your statement before the Ways and Means Committee and from the statement you presented this morning that, like the investment tax credit, once businessmen become accustomed to the job tax credit program, that they will be for it.

Mr. STEWART. Senator, let me tell you how right you are. I should have said it at the outset.

The views that I am expressing here are endorsed by 88 trade associations and the Small Business Legislative Council with over 1 million members; every small business group in the country has endorsed the proposal. The Treasury's own small business advisory committee under Secretary Simon went on record in favor of it in December, so that I am sure as time goes on, more and more businessmen will be for it, if we give it a fair try.

Senator MATSUNAGA. While you have recognized the pitfalls and several of the pitfalls have been pointed out, you have, I think, ably pointed out that in time the bugs will be picked off and the program will work.

I thank you for your most convincing statement.

Mr. STEWART. Thank you, Senator.

Senator MATSUNAGA. I yield to the Chairman.

The CHAIRMAN [presiding]. Thank you.

Senator Hansen?

Senator HANSEN. I have no questions.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. A bill has been introduced which is a part of the alternative to the various stimulus packages which are floating around. It would provide a change in the surtax. Presently, the first $25,000 of corporate taxable income is taxed at 20 percent, the second $25,000 at 22 percent and everything over that, as you know, at 48 percent.

This proposal would extend the surtax so that the first $100,000 of corporate income is taxed at 18 percent.

The effect of that would be to reduce the tax on the first $100,000 of corporate income from $34,500 to $18,000, for a tax savings of $16,500.

I would like your view on whether or not that would have a beneficial effect on the economy.

Mr. STEWART. Let me try to answer that this way, Senator. You will never have before you a more devoted enthusiast of graduating the corporate, or any other business tax that we have. To the extent that this suggestion moves in that direction, we are for it.

As a substitute for the job tax credit, no, sir, not at this time.

Senator DANFORTH. I am not asking that. I am asking, on its own merits.

Mr. STEWART. On its own merits, we would be for it, especially as a part of the overall revision of the corporate tax. It should even graduate it further.

Senator DANFORTH. My experience in talking to small businessmen is that they feel that they really have been forgotten, that it is hardly worth it any more, that they are being knocked around by taxes, by regulation, by inflation, that they are being hemmed in on every side, and that this proposal would say to the small business community, you are the future of this country, you are where the action is going to be, and if we will just let up a little bit on you and give you really substantially more money, then you can go out and put another room on your shop or hire another employee or buy another piece of equipment, not on a one-shot basis or some gimmickery. The problem with all of these proposals is that I go home to the State of Missouri and tell people about these various tax proposals and rebates and ordinary people laugh at all of this stuff. But when you talk about rate reductions aimed not at IBM and Ford Motor Co. and General Motors, but aimed at the first $100,000 of corporate taxable income and personal tax reductions aimed not at the rich or powerful or fat cats but aimed at the first $18,000 of adjusted gross income, that we are going to put our eggs in the basket of the small businessman, of the middle income, and low income taxpayers and get them to put America to work, then they listen.

When we say that we are going to create more jobs that way, that is the kind of positive response. I would like your response.

Mr. STEWART. I have to respond positively.

Lightening the tax load on small business any way you do it will help and will work. The problem is, which way to do it right now?

Given the action of the House and the attitude of the administration, the budget restrictions and all of the other things that all of us have to live with, I am not so sure that we can do this right now, But I am all for it in principle.

Senator DANFORTH. Thank you very much.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. On appendix 4 of your testimony, you make reference to a study done by the MIT Development Foundation, What is that?

Mr. STEWART. This was a study, Senator, of the relative number of jobs——

Senator PACKWOOD. What is the MIT Development Foundation?

Mr. STEWART. A foundation maintained by the university to make investments in new and small companies and this study was done by Richard Morse.

Senator PACKWOOD. Is this connected to MIT, funded by MIT, belong to MIT?

Mr. STEWART. I believe that it is funded privately. I believe that it makes an effort to invest capital in growing small companies, high technology companies for the benefit of the university and other stockholders.

Senator PACKWOOD. It is like the Stanford Research Institute? It has no connection?

Mr. STEWART. I think that is right.

Senator PACKWOOD. I am curious as to what this study is trying to prove in the selection of the companies. Under "mature" companies it lists General Electric, DuPont; do I assume that the studies presume those are not innovative companies?

Mr. STEWART. We are giving it to you as it was given to us.

Senator PACKWOOD. Do you know anything about the study other than you got it?

Mr. STEWART. Only as much as you do now that you have read this table. I know a little bit more, because I read the text.

This was introduced in response to the argument that jobs are created by big business, which we think has been overstated in the discussion about the investment tax credit as against the job tax credit.

Senator PACKWOOD. I am curious. It looks as if the study was done to prove a point that was already established, rather than using the study trying to find an independent conclusion that would come from the facts.

Mr. STEWART. It is not our study. You may well be right.

Senator PACKWOOD. I have no further questions.

The CHAIRMAN. Let me explore one thing with you.

Both with regard to the investment tax credit and this tax credit that we are thinking about for employment, we are talking about a credit that people are entitled to have against taxes that they owe.

Now it is not at all unusual in drawing up laws for corporations or businesses to get a carry-forward or a carry-back for credits or deductions. But it is just in recent years that we have frankly faced the fact that in some respects we want to subsidize something for a purpose, as we do with the tax credit for investment, and when you really get down to it, the purpose is to subsidize the purchase of new equipment or make it attractive to hire somebody. The sad thing about it when we tie it entirely to the tax system, trying to give a taxpayer back some of the taxes he has already paid, very often we do not give it to the people who need it the most.

I know what it is to be a small businessman or to be a partnership in a small business. I know what it is to have some good fortune. I know what it is to lose every nickel you put into it. So do many of your members.

I find myself wondering if we should not begin to treat one of these tax credits as a refundable tax credit—you know what I am talking about. You would get the credit, if you make a profit or if you did not, period. If you are one of those businesses where people put everything that they have into it; all that dedication and zeal; stay up and work 20 hours a day and still their business does not succeed; it is not quite fair that the other guy, because he has had some good fortune and his business succeeds, should be the only one who gets the subsidy through the tax credit.

Now, that poor fellow who works himself to death and loses his money, in addition to losing his money, does not get the tax subsidy that everybody else gets.

Does that seem quite fair to you?

Mr. STEWART. No, sir, it does not, but it seems to me that our tax code is shot through with things like that, and I could not agree with you more. I would love to see a way easily to get to the kind of state you are talking about.

The CHAIRMAN. This committee recommended last year that the investment tax credit, for example, should be a refundable tax credit. It is only because we got into a very heated fight out there on the Senate floor that we dropped that proposal.

There is one further advantage to making this a refundable tax credit, both this and the investment tax credit. That is, if you do that, you could then proceed to say that a businessman knows that he gets it and at the time he buys the equipment, or at the time he hires the person, he is entitled to get it right then and there. He does not have to wait until the end of the year.

Perhaps we could even work out a method whereby the taxpayer could draw a check to himself down at the bank and use the money in his business, which would give most of these small businesses that are desperately short of cash, as well as some of the big businesses which are also short of cash, with an even better incentive. They could then use the money, putting people to work rather than waiting until the end of the year.

Much of this argument for the $50 refund is that you need to get some money in the hands of people immediately; if you can get the money in the hands of business immediately, by making it refundable, so you know you are going to get it, you get more stimulus.

Maybe a better mechanism can be found, but in any event, if we can find a way to provide some help to small business and all business as we are advocating in the bill here, and get that help to them now and not fool around and make them wait until this time next year to get it, I think we would have substantially improved this bill.

Mr. STEWART. Mr. Chairman, I could not agree with you more.

But let me just try to rack up our priorities by way of response, if I may.

There is no doubt about it, cash flow is a hellish problem for small companies throughout the country. If you can find a way to make it refundable, great. But as one who spent 3 years in the Bureau of the

Budget in the old days, let me remind you, you will run into moral sentiment about this as high as the Capitol about letting people write checks against taxes they have not paid yet. I think that you are right. That is point one.

Point two, I do not see, if you are concerned—and I know you are, as is Senator Danforth—about the plight of small business, how you can go on much longer, much further, without becoming concerned about the relative amounts of money left in businesses by the sum total of business taxes and businesses of different size.

The central problem we have is that the tax code itself is not graduated enough from our standpoint, assuming that it has to be as high as it is to do all of the things the Government wants to do. That is as true of capital gains taxes as it is of corporate income taxes. And the investment tax credit particularly needs sharp graduation: without it refundability has no meaning or value. That is the sort of thing we hope you are going to address this coming year with the new administration, the House Ways and Means Task Force on Capital Tax Formation, and the rest of it.

Right now, we think the best and most important thing we can do is get us started on a job tax credit.

The CHAIRMAN. Let me tell you the part that I am thinking about, the refundable aspect of it and the idea of getting it now.

Let us assume that a business has $40,000 coming to it with the cut-off in this bill and then bought himself $100,000 worth of machinery. If he has a good year, he will get $10,000 next year: if he had a bad year, he will not get the $10,000. He may never get it.

If we fix it so that he definitely get both the $40,000 and the $10,000, all right, the average small business is right up to it every day of the week. A man who did a lot who moved my community around and the poor guy indicated for his checks down there, trying to run back and forth to meet the check before it gets down to the bank.

If these people could draw the money now, there is a lot they could do to move the economy and their communities.

Mr. STEWART. I could not agree with you more. It meets the President's goal. He says he wants to stimulate fast, quick fixes, make it refundable. The faster the better. I could not agree with you more.

The CHAIRMAN. Thank you so much, sir.

Senator Curtis?

Senator CURTIS. I think that it would be helpful if you would state for the record just what the procedures would be and how this would work if the House bill on employment credit were passed from the standpoint of a businessman, let us say, who had 10 or 20 employees. How will it work, what will it do for them?

Mr. STEWART. I will try, Senator.

As I understand it, assuming that your wage bill this year exceeds your last year's wage bill by at least 3 percent——

Senator CURTIS. In dollars?

Mr. STEWART. Yes.

You then begin to become eligible for the credit. You then hire new people. To the extent that you hire new people, you have a credit against your tax due of $1,680 for each employee to a maximum of 24.

Senator CURTIS. $1,680 for each employee?

Mr. STEWART. That is right. Forty percent of the Federal unemployment tax base of $4,200. That is for each employee, to a maximum of $40,000 per enterprise—enterprise is defined to include control groups, if you have several companies under one ownership.

Senator CURTIS. What would it be for someone hired at the minimum wage?

Mr. STEWART. I beg your pardon?

Senator CURTIS. What is a year's salary?

Mr. STEWART. $4,800.

Senator CURTIS. Whether it was a law firm in a country town that had three stenographers and put on four, he would get $1,680?

Mr. STEWART. That is right, sir.

Senator CURTIS. If it were a filling station that had five employees and went to six?

Mr. STEWART. Assuming the wage bill went over 3 percent in the first instance; yes, sir, in both instances.

Senator CURTIS. They would qualify on the 3-percent dollar increase, not on the increase of the number of people?

Mr. STEWART. You do not get any effective tax credit unless you hired new people as measured by the dollars and the wages.

That is one of the problems. When we try as we prefer to have it measured by number of employees, the Treasury goes up in smoke and all the tax experts say it is too complicated. That is why the House went the way they did, and Treasury, I think, felt somewhat better.

Senator CURTIS. My questions are not intended to be argumentative.

Mr. STEWART. I understand, sir.

Senator CURTIS. Suppose a small grocery has five employees. The greatest thing pressing down on him is not the need for six employees, but it is all the regulation and harassment and rate of tax, and the many taxes—State and local, licenses and everything else, plus the Federal inspectors and State inspectors and so on, and he does not need another employee.

Mr. STEWART. If he does not need another employee, Senator, this will not make him hire one, no question about it. It will not do a thing for him unless he is in a marginal position where he needs a little help.

I have said before, most small businessmen, I think we would all agree, run as tight as they can against their cash flow with employees. They wait as long as they can before they hire that next man—they prefer to run one man short.

What this will do is move them a little closer to that hiring decision. I think that is enough.

Senator CURTIS. It is not intended for him to hire somebody he does not need?

Mr. STEWART. Never. He will not do that.

Senator CURTIS. If he actually needs an employee, would he hire him anyway without this?

Mr. STEWART. You can argue that one metaphysically, about the investment credit, the tax credit—will he buy equipment without the credit or not. Certainly people will, to some extent. They will be paid for employees they would hire anyway.

We are talking about economic stimulus. It does not trouble us. The question is, would it make other people hire people that they otherwise would not, and I, myself, think it would.

Senator CURTIS. Thank you.
The CHAIRMAN. Thank you very much.
Senator Haskell?
Senator HASKELL. Thank you, Mr. Chairman.
Mr. Stewart, as you know from that hearing in Small Business, I agree with your idea of the job credit. My personal view is that the problem is not so much the general earnings in the big corporate sector, but it is unemployment.

For that reason, I am going to do this. One of the big objections that the administration has to the Ways and Means is the double dip, which I think should be eliminated. What I intend to do is offer an amendment that would raise the credit from a 40-percent level to a 50-percent level. We are going to come out with about the same amount of revenue as the Ways and Means Committee and we would have eliminated the double dip, which seems to me is the administration's big objection. What is your reaction?

Mr. STEWART. Senator, it makes sense to me. I have to tell you that we are in favor of Senator Matsunaga's bill. We are also in favor of what you described now. We will take any reasonable beginning point that you give us which is going to do the job.

I believe, based upon the most recent checks that I have done, that a minimum of $2,500 per job is what it will take. I report that to you as coming from small business people with whom I have talked.

Senator HASKELL. I suggest that it would, and I would concur with the chairman on refundability as an emergency approach. I would have a very difficult time going along with the chairman on refundability of the investment tax credit. We are talking about $7 to $8 billion, and furthermore, we do not have an emergency situation.

But I could certainly go along with refundability on the employment credit when you realize we have had over 7 percent unemployed for a period of 25 months. That is a lot of folks out of jobs.

I think this idea, combined with the public service job program, will go a long way to putting people back to work. I am delighted to see your organization in favor of it.

Mr. STEWART. Thank you.
Senator MATSUNAGA. If the Senator will yield?
The bill we are introducing provides for a 50-percent credit. I am happy to see the gentleman join me.
Senator HASKELL. I will cosponsor.
The CHAIRMAN. Senator Byrd?
Senator BYRD. What would your recommendation cost?
Mr. STEWART. The House Ways and Means estimate is $700 million for the balance of this fiscal year. I think it goes to $2.6 in the full fiscal year following that. I think it is a total of $4.8 billion in 3 fiscal years. I am sorry, I do not happen to have it handy.
Senator BYRD. It goes beyond the fiscal 1978, does it not?
Mr. STEWART. Yes, fiscal 1979 is the last year.
Senator BYRD. One other question.
Do you see the jobs tax credit——
Mr. STEWART. Excuse me, Senator, I think I may have misspoken; let me check this right now:
$700 million in fiscal 1977; $2.4 billion in fiscal 1978; $1.7 billion in fiscal 1979. That is the Ways and Means estimate.

Senator BYRD. Thank you, sir.

One other question. Do you see the jobs tax credit as complementing the $50 rebate?

Mr. STEWART. I had not really related it in my own mind at all.

Senator BYRD. If you had to choose between the jobs tax credit and the $50 rebate, what would you choose?

Mr. STEWART. I am here only for small business. I do not think I ought to choose. Small business will get enough I think out of the increased purchasing power of the $50 rebate so that I do not think I should take a position of choosing between them.

We will take anything Congress offers that stimulates the small business sector of the economy. But the job tax credit offers the prospect of adding an important new national tool to help fine tune the economy.

Senator BYRD. Thank you, sir.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Thank you for your statement, Mr. Stewart.

[The prepared statement and attachment of Mr. Stewart follow:]

STATEMENT OF MILTON D. STEWART ON BEHALF OF NATIONAL SMALL BUSINESS ADMINISTRATION

SUMMARY

The National Small Business Association is primarily concerned here with only one prospective element in the economic stimulation package presently before the Congress. That is a Small Business Job Tax Credit of a kind we have been urging for several years. In 1975 and 1976, in several of our appearances before several Congressional Committees, including this one, we called for such a measure.

We have been encouraged by House Ways and Means approval of H.R. 3477 and press accounts of rising Congressional interest in, and support for, various forms of employment tax credit legislation.

We have not been rigid in our views. We have found several alternative forms and amounts of credit appealing as we have continued to study the matter: the 10 jobs and $80,000 per firm maximum credit proposed by Senator Matsunaga and Representative Derrick; a 24 job and $60,000 maximum credit not yet formally proposed; a 10 job staggered credit for $1,000 to $5,000 per job with a $30,000 per employer maximum.

If the Senate wishes to stay with the general structure of the House Ways and Means Committee, we believe a minimum credit of $2500 per new job is necessary for effectiveness. On that basis we estimate that almost 600,000 jobs will be created—how quickly within the next two years will depend on how effectively and sympathetically the new credit is administered.

We recommend that the Congress target only generally—to small business and to all the unemployed—for a first stage; that it plan to target more specifically still to the hard-to-hire and high unemployment areas in a second stage; that it leave the effort to make a variable employment tax credit a permanent, economy-wide measure for a third stage.

Depending on what must be almost totally theoretical estimates of cost, as well as the final budget decision, the tax can figure in the total stimulus package in either of two ways. It can be made a "Third Option" for each business, an added choice as against the proposed 4 percent credit against social security, or the 2 percent increase in the investment credit. We are not very enthusiastic about either of those two but others may be and with good reason.

If there must, however, be a budget-imposed choice, we would much prefer the job tax credit. It will more surely contribute—if successful—to both the short and long-term employment programs.

A Small Business Job Tax Credit is supported by the members of Small Business Legislative Council, and other trade associations with more than 1,000,000 members. It is also supported by the eight member groups in the

Council of Small and Independent Business Associations. It was also endorsed in principle in December 1976 by the Treasury Small Business Advisory Committee on Economic Policy.

STATEMENT

Mr. Chairman and members of the committee; my name is Milton D. Stewart. I am a small businessman and a lawyer. I serve as Chairman of the Board of a construction and real estate development company called Terra California. I have been engaged in the venture capital business for 15 years, and I am a former President of the National Association of Small Business Investment Companies. I am appearing today as President of the National Small Business Association which represents 50,000 firms doing business in more than five hundred industry categories.

This is our third appearance on this subject before a Congressional committee within a month. We are here to urge you to adopt a "New Jobs Tax Credit" proposal providing more incentive for hiring than H.R. 3477. To save time we have taken the liberty of attaching a slightly edited version of a statement given on February 22 before the Senate Small Business Committee (Supplement A) and a statement given before the House Ways and Means Committee (Supplement B) on February 8. We have renumbered and added to the appendices used before.

We may well wish also to submit some further discussion of arguments made by critics of the employment tax credit—our principal concern here—before the record is closed. We would appreciate having the Committee's permission to do so.

Since the approval of a "New Jobs Tax Credit" by the House Ways and Means Committee as part of the Tax Modification and Simplification Act of 1947 (H.R. 3477) several public officials, tax specialists and economists have made repeated and critical comments about it that deserve some attention here.

Each argument we have seen is subject to one of these "refutations":

It may be made with equal validity to the extent that it has any, against the Investment Tax Credit;

It is based on a forecast of business behavior in a completely untried area;

It asks for a degree of initially guaranteed fairness and effectiveness which no new tax measure can ever provide;

It points out possible loopholes or tax shelter bases which certainly can and should be closed by this Committee.

We have stressed rather than concealed the fact that a job tax credit must be viewed as an experiment. That means a frank admission that we are not certain ourselves as to what size credit will produce what response. And we only wish that everyone else, including the critics of this proposal, would concede that they know no better than we what the response to actual jobs will be. It may well be far better than all of us anticipate.

When we first began discussing this proposal two years ago, we were thinking of a smaller number of jobs than the House Bill—two instead of 24—and we thought of a lower credit per enterprise, but higher per job. When we surveyed our own members, we found that seventy-five percent of the small businessmen who responded were in favor of the idea and fifty percent said that they would hire either one or two people. When Representative Derrick (and now Senator Matsunaga) proposed making the credit maximum $80,000 and putting the cap at 10 jobs per enterprise, we endorsed them as clearly likely to evoke a strong hiring response from small business.

In recent weeks as the tenor of the House Ways and Means Committee's thinking has become clear we have continued to check responses with small business people—and frankly we have urged every member of the House and Senate to whom we have talked to do the same thing.

Obviously the $1,680 credit with a $40,000 limit for a maximum of 24 jobs will draw a different response from what we started out with. The result may be better in some ways, worse in others when one trades off costs to the revenue, complexity of administration and jobs actually produced. But we believe it makes no sense to say that "the very terms of the credit exclude at least sixty-six percent of the labor market from participating, either because the employers normal experience places them over the threshold or over the 'cap'."

That conclusion is apparently based on an interesting arithmetic exercise with Standard Industrial Classification employment figures by people in the Treasury.

But let us say honestly that it is only an arithmetic exercise. By way of contrast let us offer one of our own.

Appendix 2 shows the private enterprise labor force covered by Social Security. It is broken down by number of employees, number of legal business entities, and number of establishments.

Roughly one-fourth of these jobs (15,645,000) are held by people working for some 12,000 employers of 500 or more employees; another fourth (14,912,000) are held in companies which employ 100 to 499 employees; another fourth (15,787,000) are held in companies which employ 20 to 99 employees and another fourth (14,872,000) by those employing between 1 and 19 employees.

Three-fourths of the covered employment in the U.S. then is provided by business entities which employ fewer than 500 employees—small businesses by anyone's definition.

Based on nothing more than our own judgment and conversations with many, many small business people we offer the Committee the following forecast as to the likely effect of a credit. Our forecast assumes a credit in the amount of at least $2,500 per new employee, but one which is otherwise provided on the basis set out in the bill approved by the House Ways and Means Committee.

We estimate that five percent of the 2,800,000 employers of 1 to 19 persons will hire an average of one new person in response to the credit. That will create 140,000 new jobs. We estimate that ten percent of the 397,000 employers of 20 to 99 persons will hire and claim credit for an average of four new employees. That will provide 159,000 new jobs. We estimate that twenty percent of the 75,000 employers of 100 to 499 employees will hire an average of 10 new employees as a result of the credit. This will create 150,000 new jobs in this size class. And we estimate that fifty percent of the 12,000 employers of 500 and more persons will hire and claim the credit for the full 24 employees authorized by the House bill.

This would create a total of 593,000 new jobs. The cost of the revenue would be $996 million if the credit given is $1680 as provided in the House Bill. If, as we recommend, the credit is raised to $2500 it would be $1,482,000,000.

This arithmetic exercise is reasonably analogous to the Treasury Department's cited above. It is, we believe, a conservative estimate. Obviously, the greater the credit, the more likely a favorable result. Whether that result will come in the first 12, 15, 18 or 24 months may well depend on how much of an information program is mounted by the Executive branch in aid of the New Job Tax Credit.

Those critics who fear that a job tax credit will be misused, become a tax shelter, result in chiseling, the replacement of full time employees by part time employees—if they are serious let them come up with specific additional proposals for closing whatever loopholes or windfalls they see. We have every confidence in the ability of this Committee and its staff and that of the Joint Committee on Internal Revenue Taxation, and the Treasury itself to achieve compliance levels parallel to those of the rest of the IRC.

The argument about fairness of the tax is one that has some merit—but surely not enough to warrant abandoning a promising national tax innovation. There is just no way to pick a base for any new tax that will be completely fair to everyone: the design can only minimize unfairness and increase the fairness as time goes by. Who claims that a twelve percent flat investment tax credit is fair to everyone? How do you come to grips with the fact that it is not fair to businesses which buy little or no equipment, or which purchased equipment last year when the credit was only ten percent? We put up with elements of tax unfairness temporarily because of overriding, more important needs. We try to keep them at a minimum, and to keep eliminating them as we find them.

Those who are concerned about "unfairness" to large enterprises because of the $40,000 per enterprise limit need only look at the distribution of Investment Tax Credits by size in Table 2 for a little perspective. Some 1,421 companies (of 1,100,000 corporate taxpayers) with assets of more than $250 million received almost two-thirds of the Investment Tax Credit which went to corporations in 1973. The other one million one hundred thousand corporations had to share the balance of one-third of the credit. And, on inspection, over a ten year period it appears that more of the credit is going to fewer and larger companies.

Would it not be wise to consider whether to make that credit fairer to smaller companies—perhaps by graduating it according to the size of expenditure—before proposing to add an additional two percent? When we first made our job tax credit proposal we suggested it only as a "third option" to provide jobs,

stimulus program balance and some minimal tax incentive as a partial offset to the continuing and concentrated credit being given to the largest companies through the ITC. But we must sympathize with the House sentiment which made it a substitute.

According to the Senate Budget Committee (Tax expenditures, March 17, 1976, p. 57) corporations in fiscal 1977 will receive $7.5 billion in Investment Tax Credits. Rougly two-thirds (64 percent) of the ITC in 1972 went to 1400 companies with more than $250 million in assets (p. 58). A two percent increase in the present credit means a twenty percent increase in the $4.8 billion estimated to go to the 1400 largest companies in the country this year. That would add $940 million for those 1400 companies alone—assuming of course that the distribution of credits claimed follows the pattern it has in the last five years.

Treasury does not report the data within that group as it should. But it is our guess that two-thirds of that $940 million would go to fewer than 500 companies; we know that in a recent year more than one-half of the credit to corporations went to some 300 companies.

Our principal concern in making this proposal is with jobs and unemployment. We believe that small business is a sleeping giant where job creation is concerned. We believe that for more than $13 billion to go into economic stimulus without an important, identifiable, direct small business program component is undesirable for two or three completely obvious reasons. The public service hiring and counter-cyclical grant expenditures will add jobs in the government sector; the Investment Tax Credit will continue to concentrate assets and employment in the big business sector. At a minimum we should be providing some balance by creating incentives for employment in the independent sector.

Just how powerful, for example, small technology companies can be in creating jobs is illustrated by the chart in Appendix 4 from an MIT Development Foundation study.

We find somewhat baffling the argument that the two percent increase in the Investment Tax Credit must be substituted for a job tax credit in order to win "business confidence" in the government's future economic policy. This "business confidence" game ought not, in our view he limited to the 1400 companies which have the greatest stake in the Investment Tax Credit, or even a subgroup of that group. It ought to comprise a concern with the confidence of all the nation's ten million entrepreneurs, and particularly with those who hire people. We have more than a little trouble with the idea that a Federal business tax policy should be designed to give policy signals only to a handful of major company managers. We believe the confidence of the whole business community is what the government requires. The first of the elements in engendering that confidence from the small business sector of the business community will begin to be provided by a New Job Tax Credit of the kind approved by the House Ways and Means Committee. We urge you to improve it as best you can and to recommend its enactment to the Senate as rapidly as possible.

SUPPLEMENT A

We are gratified to appear here to urge this Committee and the Senate as a whole to follow the lead of the House Ways and Means Committee in enacting a pioneer job tax credit measure. It is less than two years since we began urging such a measure upon this Committee and others in the Congress. We will consider its enactment a major breakthrough in national tax policy, an overdue acknowledgement of the needs of two groups whose "clout" with respect to taxation has been very limited: the unemployed and small business.

As we have made plain we believe this should be viewed as the beginning of a five-year national experiment in three stages.

The first should give us some experience with the use of a tax incentive—particularly in the small business sector of the economy—to create jobs directly.

The second should permit specific spot targeting to the hard-to-hire and areas of surplus labor.

The third should apply the incentive to the whole economy then vary automatically with the level of unemployment.

This Committee knows well our deep commitment to graduated business taxes. For all the reasons that progressive personal income taxes have served us well for sixty years, we believe that a more progressive business tax structure related to the size of enterprise will do better than the limited one with which we now live. From that standpoint, the limitation to $40,000 per enterprise imposed by the

House Ways and Means Committee is attractive: it will keep the incentive from being too concentrated at one end of the size scale.

We should further like to see the Senate add a second device for stimulating still further the hiring of the unemployed at the smallest, least inflationary and concentrative end of the enterprise scale. One way to do this would be to provide a credit, for example, of $5,000 for each of the first three jobs created by a business, a credit of $3,000 for the next three and a credit of $1,000 for each of the next six jobs created. That would reduce the total credit to $30,000 per enterprise, but would put the bulk of the compensatory stimulus in the smallest enterprises. It might in turn provide enough of a cushion within the budget ceiling to provide some room for a first move toward graduating the investment tax credit—perhaps by providing for a twenty percent ITC against the first $15,000 or $20,000 of expenditure for a small business, leaving the rest of it at 10 percent.

Three appendices to this statement illustrate some of our reasons for believing strongly that the time for a job tax credit has come. The first appendix is an excerpt from the Conference Board Magazine called "The New Army of the Unemployed." Like every other reasonable official and unofficial expert analysis of unemployment, it makes it clear that without new policies our economy will not produce enough jobs for our people.

Second, we have appended a profile of the private sector labor force of our country arranged by size. This demonstrates that if one wishes to fish for jobs where the jobs are—and that makes sense to us—one must seek them in the small business sector. That is where three-fourths of them are now, and have been for at least the past 10 years. Only one in four private business jobs is held in enterprises with more than 500 employees; about one in four is held in enterprises with fewer than 20 employees; about one in four in enterprises with 20 to 100 employees; and about one in four in enterprises with between 100 and 500 employees.

Appendix 3 compares the employment created by small, new, growing enterprises—particularly those on the technological frontier—with large, older ones.

We have also attached a copy of the statement which we submitted on the same subject to the House Ways and Means Committee for the convenience of this Committee.

In the letter of the Chairman-designate inviting us to appear several specific questions are asked which we should like to answer as directly as possible:

1. We definitely believe that the employment tax device should have as its objective a significant increase in employment as well as the distribution of a tax benefit.

2. We believe maximum employment could be stimulated by a credit of not less than forty percent nor more than fifty percent of the first year's wage cost.

3. We believe the adequacy of the dollar amount as an incentive for creating jobs varies with the size of the prospective employer, as reflected in our suggestion above.

4. We believe the dollar amount should be approached as a percent of wages and that the level of incentive can be varied by limiting the credit to $5,000, $3,000 and $1,000, depending on how many jobs are credited.

5. The job tax credit structure we propose is, we believe, a reasonable compromise of the needs of small and medium-sized businesses and maximizing job creation. Large companies need the credit less; benefit far more from the investment tax credit, accelerated depreciation and other tax created advantages.

6. We believe that eligibility for the credit should require some period of unemployment; our initial preference is for one quarter during which no Social Security has been paid to the employee's account.

7. New entrants to the labor force would not be prejudiced by this requirement since no funds would have been paid to their account during the previous quarter.

8. We consider limiting the number of employees subject to the benefit appropriate and necessary—either directly with a limit on the actual number of people—or indirectly by limits on the extent of the credit per job and by the total benefit available to an employer, or both.

9. We believe that certification of the unemployed eligible should be made by the employer when he files W-2's at year-end. This part of his tax return will be subject to the same sanction and penalty and any other for evasion and fraud.

10. We believe that the employer should be able to claim the credit to the extent that his wage total exceeds that of the last year (we see no objection to the added three percent required in the House Ways and Means measure.)

11. The mechanics for establishing such a base would be summing the wages paid for W-2 employees last year, and then summing wages paid for the current year.

There will be, we are sure, some administrative and management problems involved in launching this new program. We will support reasonable safeguards which do not complicate the program unduly.

For example, we suggest that in time a recapture provision be added—perhaps one-half of the credited, if the employee for whom the credit was taken is not on the payroll in the second year.

One of the benefits we see stemming from this new tax incentive is the provision of a balance between tax incentive for capital goods expenditure and for employment. In the past ten years corporations alone have received $26 billion in tax credits from ITC. Just about two-thirds of it went to 1,500 companies; in at least one year, more than half of it went to a few more than 300 companies. We are in favor of productivity improvement as a national goal; we are in favor of incentive for technological improvement. But the way the ITC has worked in our judgment has never been adequately described. We believe it has actively financed the export of very significant numbers of jobs. Major multi-national corporations have used the credit to automate their domestic plants and then made major investments in labor intensive facilities in cheap labor markets. We appreciate fully that this is not the whole story, nor has it been entirely negative in its consequences for the U.S. What is more, we believe a graduated investment tax credit will be more and more important to some parts of the small business community in the years ahead. Small business too must upgrade its equipment.

But those portions of the massive small business population which rest on labor must be given offsetting incentives if we are to come any where near producing the number of jobs we need for our exploding labor force at home. It was just recently estimated that the next major market for micro-processors and mini computers will be the $17 billion market to furnish them to small business. We need both to provide meaningful incentive for both capital growth and expanding employment in the small business sector.

We have tried to review every argument made against the job credit tax publically. There are administrative problems and hazards; but to talk about this as an "administrative monstrosity"—compared, for example, with the way the accelerated depreciation is handled by the IRC and in the IRS—is nonsense. We believe compliance with this tax credit will be as high as compliance generally; enforcement will be no more difficult once IRS has had experience with it.

It is often argued that a tax of this sort must be substastially a "windfall" because the people who make the employer eligible for it would be hired away. There may be some validity for this argument, just as there is when it is made against the investment tax credit. The credit there is often given needlessly—the equipment would have been purchased anyway. All of these expert economists who oppose this tax should be invited to forecast precisely how many businesses will take advantage of it and how many jobs it will create. That will save argument later. We have been frank in emphasizing that this is an experiment and should be treated like one. On the one hand, it has been argued that the tax is unfair because it will go to companies which are expanding and hiring rather than companies which need help—General Motors rather than American Motors. That can no longer be said because of the per enterprise limit put on the credit What is more, exactly the same argument can be made against the investment tax credit—it does not necessarily go to those who "need" it the most. In point of fact, it goes to those who need it the least.

It is argued that providing a tax credit for hiring people is to provide an incentive to inefficiency and to deter productivity through technological change. There may be some truth to this, although not enough to warrant hesitating over it. This tax will be most effective in those lines of business where people are more desirable than machines and only so long as they are. Automation and mechanization are hardly a universal success in business and industry. There are plenty of examples of mistaken substitution of equipment for jobs which had to be reversed for sound business reasons. What is more, capital intensiveness is almost perfectly correlated with energy intensiveness and resource use intensiveness. Our problems here will put a new importance on small labor-intensive businesses.

All of the administrative problems, managerial definition problems and categorization problems are worth serious note; they are not worth giving up the opportunity to lick them as part of the experiment. As we have watched the

parade of arguments against the tax—many of them contradictory—it has seemed to us that a kind of "Alliance of Policy Inertia" is spreading an argumentative miasma out of fear, not that the experiment will go awry, but that it will work. There are enough organization and management specialists and procedural experts in IRS, the rest of the Treasury and the rest of the Executive Branch to work out a simple mechanism like a modified W-2 form which will make this tax no more onerous than any other.

The fact that the House bill carried a separate credit for employment of the handicapped, for example, means that we will get some experience with the use of one specialized category of employee during the first stage of the experiment.

No, we cannot guarantee that the tax credit will succeed in achieving its goals. If it is gives a fair treatment over a long enough period of time and administered with a sympathetic effort at simplicity we believe it will work as well as any other tax credit.

SUPPLEMENT B

My name is Milton D. Stewart. I am a small businessman and a lawyer. I serve as Chairman of the Board of a construction and real estate development company called Terra California. I have been engaged in the venture capital business for 15 years, and I am a former President of the National Association of Small Business Investment Companies.

I am appearing today as President of the National Small Business Association which represents 50,000 firms doing business in more than five hundred industry categories.

1. JOBS ARE TOO IMPORTANT TO BE LEFT TO ECONOMISTS ALONE: HEED THE JOB-MAKERS TOO

Just as war is too important to be left to generals alone, jobs in the American economy are too important to be left to economists alone. Our concern here is first and foremost with jobs and job-makers—particularly about 2 million of the latter among the nine or ten million in small business.

For the next ten to fifteen years, expanding the job supply must be one of our four central national domestic policy goals. The other three (and they are neither more nor less important than jobs) are: avoiding excessive inflation, improving national productivity and technology, and our special concern—maintaining diversity in our economy.

We have had a statutory, largely ceremonial, commitment to full employment for more than thirty years since the passage of the Full Employment Act in 1946. During the past ten years, we have been increasingly sensitized to the perils of inflation. We have recently made higher productivity an institutional target with a Commission of its own.

We have yet to make effective a national concern with economic diversity. One major measure of that diversity is the ability to begin and to expand a small business. Another measure—important to us here—is the share of the labor force in big business, in government and in the independent, largely small business, sector.

Measured by that last standard, we have not been doing well enough for a long time now—relative growth of the small business sector has been stunted by Federal policies which have, intentionally or unwittingly, put excessive reliance on employment by big business or government. We need a better balance.

In urging this Committee to adopt a Small Business Job Tax Credit, we believe we are putting the priority for job creation where it is needed most, and where it is likely to meet all four central policy goals—an abundant supply of jobs without inflation, with growing productivity, and without concentrating the labor force further in big business or government.

Many students of population data see the need for jobs in the next fifteen years outstripping the ability of our economy (given unchanged national tax and other policies) to provide them. It is generally agreed that we have recurring short-term problems and long-term ones intersecting—short-term cyclical ones and long-term structural ones.

Here is the short-term view as seen by President:

"The economy I found when I took office had 7.5 million Americans out of work, 1.4 million full-time workers forced to take part-time jobs, and still another 1 million workers who had dropped out of the labor force because jobs are so hard to find. The outgoing Council of Economic Advisers conservatively estimated that our economy operated in 1976 at approximately $132 billion below its high-employ-

ment potential; every household in our country lost approximately $1,800 per year as a result. The nation lost approximately $35 billion in federal tax revenues and approximately $10 billion in state and local revenues because of inadequate performance. Last year, expenses caused by the recession—such as unemployment compensation—were $22 billion higher than in 1973, the last pre-recession year. Economic growth has declined for three consecutive quarters. Most economists have projected that, without further stimulus, the economy would grow by an inadequate 4½–5% in 1977. The severe weather this winter will probably reduce growth even further, if no action is taken.

"A vigorous U.S. economy is vital to our domestic welfare as well as to world stability and order."—Message to Congress, January 31, 1977

Making the job need far greater still during the next eight to fifteen years will be some interacting facts about the American people and their society. At the senior end of our population, we are living longer and demanding to be allowed to work longer. There is a rising disenchantment with mandatory retirement for those who do not want it, and increasing disgust with its implicit use to make room forcibly for younger people. That includes the policy pressure against work by social security recipients imposed by the partial loss of benefits.

At the younger end of the population, because of the last birth-rate bulge, we are trying to absorb a bumper crop of teenagers and young adults. Women and minority groups by the millions are pressing harder for equal and better job treatment. The quest for stable or higher living standards in the face of inflation is making the two-job married couple the national standard. Illegal immigrants add no small numbers to the demand for jobs. Concentration in the economy and growth of world economic interdependence makes it easy (and too often attractive) for multinationals to export significant numbers of jobs.

Technology and automation improve productivity and reduce demand for at least some kinds of jobs. On the other hand, shortages of energy now, and other resources later, may raise the importance of labor as a substitute for them.

Most numbers we have seen make it appear that these pressures will fuel rising job demand into the mid-1980s. Thereafter, we may well have more and more jobs chasing fewer and fewer people. But for the next decade, steady and swift job expansion is one of the paramount tests of national policy.

It is, moreover, my own view that those who argue that our unemployment statistics do not fully reflect the problem are essentially right. When you add discouraged non-workers who have given up, under-utilized and dissatisfied workers, there is a far greater labor force reserve available for new jobs than the number indicate. Involuntary non-producers are a wasted resource, a drain on the economy, a pressure for higher public deficits, and, we are coming to see, inflation. Those are only economic terms. In human and social terms, a society that does not provide all willing workers with a choice among satisfying, challenging and stable jobs is not fully civilized.

Two obvious points about the relationship between "economic stimulation" and "jobs" are worth mentioning. First, they are correlated in both directions, not just caused in one. Economists often talk as though consumer purchasing power, capital investment, or public expenditures stimulate the economy—and jobs then drop out of the end of some Rube Goldberg machine. But in real life the machine works the other way too—jobs created may stimulate the economy by adding to purchasing power, savings and investment and taxes paid. Second, it seems unfortunately to be the case that we may have significant amounts of economic stimulation as measured by sales increases, increases in business and stock prices with too little effect on the number of jobs that result.

Perhaps the only competence we can claim here is proximity to small business decision-makers and to small business job-makers. Although we surely make mistakes even in that limited role, we do keep trying. Our judgements about the criticality and the likely effectiveness of the Small Business Job Tax Credit are based on continuing dialogue with such men and women.

Eighteen months ago, for example, 75 percent of small business respondents to a survey we made expressed support for such a tax credit. Almost half of them said that they would themselves use in their own businesses a credit of 50 percent of the first year's wage cost to hire one or two people.

Our recommendations about a Small Business Job Tax Credit are not based on theory. They are based on repeated discussions with many small business people. One of the proposals we believe makes sense—although not the one we would now start with—has been endorsed by all eight small business groups who comprise the Council of Small and Independent Business Associations. (It

was included as a section of H.R. 13687 in the last session by Representative Joe Evins and a number of others, and as H.R. 297 by Representative Silvio Conte in this Congress.) It was unanimously endorsed by the twenty-five members of the Treasury Small Business Advisory Committee on Economic Policy and this concept was endorsed, in principle, by the Small Business Legislative Council whose membership represents more than 250,000 small businesses.

Just last week, to take a current reading and to test my own reactions to the alternative approaches being floated by various members of Congress, I called eight small businessmen whom I know and respect.

One runs a construction and development company on the West Coast which does about 12 million dollars in business a year. A second manufactures products for big business in two Northeastern States and employs about 450 people in two plants. A third runs a hardware and software service business in the Southeast and employs 300 people.

A fourth runs a consumer goods manufacturing business in upstate New York. A fifth runs a tiny chain of four retail stores in the Midwest. A sixth runs a soft consumer goods factory in the Southwest. A seventh runs a venture capital company in the Midwest which is in about fifteen small businesses. The last is in wholesaling and distribution in the Mountain States.

While I got a variety of responses from these job-makers, they confirmed again that a 5 percent Small Business Job Tax Credit would probably lead to a significant number of new hires, but a smaller credit would not. Four of the eight said flatly that with the tax credit, they would put on between 2 and 20 people during 1977. One said it could not influence him because he is completely tax-sheltered and "he's going to stay that way until Congress gets us to where we're not paying nearly 50 percent and big companies are paying an average of half that." Another said it would help him only if he could carry the credit forward several years, since he has losses to set off against taxes for at least two years. With that carry forward he probably would do some new hiring.

Yet another said that the only thing that would make him hire more people was more sales; even with tax credit, he could not or would not risk his 50 percent of the cost of new people until his sales went up. I specifically asked him whether the proposed increase in the investment credit to 12 percent would help his sales and he thought it probably would—frankly that surprised me. Yet another just said his labor force is stable and he has no business need to think of adding to it with or without a new credit.

We cannot and do not claim that every small business will take advantage of the proposed credit. Or that this credit alone will solve our national employment problem. We do say it will be used enough to help a lot just where help is needed the most.

If you know small business, you know that the good small entrepeneur usually runs his labor force "tight against cash flow"—one to ten men or women short, depending on the size of the business. He is always stalling his new hires until his sales get up to where he can cover the cost of training, wages and something more. A tax credit for half that first year's wages should make him decide to hire now rather than later. And we believe that after making his own share of the investment in the new jobs, he will work his head off to keep his new hires as permanent employees.

There are some two million employers with between four employees and five hundred employees. That is, we think, the part of the economy where the Small Business Job Tax Credit would mean the most. Our best guess, and it can only be that, is that it would in time—say 18 to 24 months—add as many as 750,000 to 1,500,000 jobs. Or we may be totally wrong about the order of magnitude—it may be only 250,000 to 500,000.

But the beauty of this proposal is that there is no cost to the Treasury except as jobs are actually created—no job created, no credit earned against tax, no reduction in what Internal Revenue collects from the business.

2. A THREE-STAGE EMPLOYMENT TAX CREDIT EXPERIMENT

We probably do not yet know all of the versions of the employment tax credit which various Members of Congress have sponsored or advocated. But during the past week or two, we have been reviewing those of which we do know. We believe that there is a sensible staging strategy into which the different proposals can be fitted in a way that makes sense.

The Congress should treat this as the frankly innovative important tax experiment it is.

Stage 1.—It is best to begin with a version of the tax credit which is as simple as possible administratively and gives the proposal the best chance of success. There should be just one standard for eligibility for the credit, just one percentage of wage cost to be applied—one high enough to be sure of a good result, and a relatively low limit on the number of jobs that may be credited for each employer.

We believe that the bill recently introduced by Rep. Butler Derrick (H.R. 2691) is an excellent model for a Stage 1 bill for this Committee. It would set the credit at 50 percent for all truly new hires, for no more than ten jobs per employer. And there would be a flat limit on the amount of the credit at $80,000 per enterprise. (We would provide for a two or three year credit carry forward for those small companies which will show a loss this year, but which anticipate being profitable in the future.)

The bill provides for two reports from the Secretary of the Treasury, one not later than April 1, 1978, and another not later than April 1, 1980.

We would add two further requirements. First, that the small business advisory committees to both the Secretary and the IRS Commissioner—or a new citizen group they choose—be utilized in drafting regulations and appraising the program on a continuing basis. Second, that specific authorization and an adequate budget be given for the conduct of a joint information program by the Treasury Department, the Small Business Administration, the Labor Department, and the Commerce Department. Much administrative grief can be avoided, much time-loss avoided, and the most effective use made of the program with a careful information effort.

Stage 2.—There has already been much talk about the desirability of "targeting" a job tax credit to the neediest groups of people and the geographical areas of highest unemployment. We have, for example, sponsored and supported the measure introduced in this Congress by Representative Conte (H.R. 297).

Section 205 of that bill provides for the same 50 percent credit and the same eligibility of "additional new employees". General new employees eligibility is limited to two jobs. Beyond that, provision is made for hiring up to an additional 10 percent of the number of employees or 23 persons, whichever is less, of "disadvantaged" employees. "Disadvantaged" would be defined by the Secretary or his designee, an dwould have to include those "persons who have exhausted their unemployment compensation benefits, minorities, and the mentally or physically handicapped".

A maximum credit of $20,000 is provided for the first two new jobs; $60,000 would be the maximum credit for the "disadvantaged" hires. Or to the extent "not covered" by the 50 percent credit toward those 25 jobs, a credit up to the same $80,000 limit would be available at from 30 percent to 50 percent geared to the level of unemployment in the area (6 percent or less unemployment to 15 percent or more).

We still view this as sound public policy and would be as delighted with it as with the Derrick version. But we fear that it may delay the swift action Congress needs now, or stiffen resistance to the proposal in the Executive branch. Moreover, we think the likelihood of designing and handling "target differentials" well can be done much better after we have had at least one year of experience with this innovative tax.

It should be borne in mind that small employers are still learning—and many complain about the paperwork required—to live with the equal opportunity program. Minorities will receive the same protection under this program as they do under all hiring.

Stage 3.—We would limit Stages 1 and 2 together to no more than four years. By then serious consideration can be given to making the temporary job tax credit a permanent, automatically "variable base employment credit". Such a credit was tested econometrically under the sponsorship of Senator Bentsen's Subcommittee on Economic Growth of the Joint Economic Committee by Gary C. Fethke and Samuel H. Williamson, Associate Professors of Business Administration and Economics at the University of Iowa.

Senator Bentsen comments:

"Using a standard model of the American economy to test their idea, Professors Fethke and Williamson have reached a conclusion of no little importance to those of us in the Congress—when properly administered, a variable base employment credit could reduce unemployment, increase GNP, and reduce inflationary pressures.

"Unlike more traditional expansionary measures which try to boost employment indirectly by increasing the nation's demands for goods and services (for example, through an income tax cut) and which could stimulate inflation, Professors Fethke and Williamson argue that a VBEC would reduce labor costs and thus induce firms to hire more workers, produce more goods and reduce inflation."

This pioneering work is of great importance—any time econometricians 'data and job-makers' common sense come to similar conclusions, all of us should pay close attention: We have several reasons for considering Senator Bentsen's bill based on this work—as well as the proposals of Mr. Conable and others (H.R. 2403)—to be premature.

Because they have no specific company limits, it is likely that the bulk of their benefit would go to large enterprises which we believe had relatively little immediate need for them. We believe there is god public policy reason for giving the leading role, with respect to this tax, to small business. The level of benefits in these proposals is simply too low to be a real incentive to small business, yet it is probably higher than we believe is warranted for large business.

It is also far more prudent to acquire experience from, and measure administrative burden and cost through, a smaller business, than to march directly into permanent tax legislation for the whole economy.

When the first two stages have been tried, an economy-wide application can be designed far more realistically.

3. A BUDGETARY DECISION: THE JOB TAX CREDIT AS A "THIRD OPTION" OR AS A SUBSTITUTE

Our purpose here is not to become involved in the often fruitless debate about which element in an economic stimulation package is most useful, important or justifiable. The employment problem is many-sided; so is the general economic problem. Varied measures with varied purposes are needed. Two, business tax reductions have been included in the Administration's proposals: the 4 percent against social security payments and the 2 percent increase in the investment capital credit.

We have little confidence in either of them as a job-maker compared with a job credit tax. If they are, in Congress' judgment, desirable for other reasons, that will be welcome news to some small businessmen.

In the light of the Administration's recommended treatment of its two proposals as "options", we should be perfectly satisfied to see the kind of Small Business Job Tax Credit we support made a "Third Option."

That may well be desirable from both a fairness and a budgetary standpoint. In that events, we would anticipate—and your guess may be better than ours—that most large companies would choose either the social security tax credit or the investment tax increase. Most small ones would choose the job tax credit. If budget restrictions do not permit the option treatment, we believe the job tax credit to be much preferable to the other two.

You may recall from our prior testimony that we are strong supporters of graduating business taxes of all kinds. A time may come—in the third stage of the experiment we propose—when it may make sense to graduate the percentage of tax credit by size of enterprise or number of jobs. We are not concerned with the problem here because the total limit per enterprise in Stage I will prevent excessive benefits to large enterprises.

We are less sanguine about the fairness of the two "flatheaded" alternative options. We would like them better if they were graduated. For example, a 1 percent credit against social security payments for companies with a billion dollars or more in sales, a 2 percent credit for companies with between a hundred million and a billion dollars, a 3 percent credit for those with between ten million and a hundred million dollars, a 4 percent credit for those with between one and ten million dollars, and a 5 percent credit for those with less than a million dollars in sales.

In the same way, we have urged before that if the investment credit for large companies is to be 10 percent or 12 percent as proposed, the credit for companies that are "small" by any SBA definition should properly be at least 20 percent.

We would like also to urge this Committee to make a specific and important contribution to the clarity of public debate and discussion about business tax policy. It will help all of us greatly to keep our bearings if when we talk about what the private sector has or needs or is to be given in the way of proposed tax treatment, we distinguish between its small and large companies.

And when tables or data are presented as to what is proposed or what has happened, they should break the data down by what large and small companies get by way of benefit or must bear by way of burden. That should also extend to the non-tax consequences of tax policy like employment.

In the past, Congress and the public have had this sort of information only long after a tax package has been in effect. The situation has improved in recent years. We urge this Committee to make it part of its regular practice to report the extent to which small business does or does not get half of a proposed business tax benefit or is likely to bear more than half of a proposed tax burden.

To recover past ground lost, it should do better than that. But just to stay even with its present share of the economy, the benefit given big business in a stimulative package should not exceed 50 percent of the total business benefit.

SMALL BUSINESS LEGISLATIVE COUNCIL,
Washington, D.C., January 17, 1977.

The following 88 organizations have advised the Small Business Legislative Council they agree in principle that: In elimination of current high unemployment, the small business sector should be the employer of first resort, with the incentive being provided by a job creation tax credit.

These prestigious organizations speak for at least one million small business firms in their industries. An addendum of additional organizations endorsing the Small Business Job Creation Tax Credit will also be provided the Committee.

American Association of Minority Enterprise Small Business Investment Companies, Washington, D.C.
American Association of Nurserymen, Washington, D.C.
American Gear Manufacturers Association, Washington, D.C.
American Pipe Fittings Association, Stamford, Conn.
American Pulpwood Association, Washington, D.C.
American Road Builders Association, Washington, D.C.
Appalachian Hardwood Manufacturers, Inc., High Point, N.C.
Associated Master Barbers and Beauticians of America, Charlotte, N.C.
Associated Retail Bakers of America, Annapolis, Md.
Automotive Engine Rebuilders Association, Glenview, Ill.
Automotive Parts and Accessories Association, Washington, D.C.
Automotive Warehouse Distributors Association, Inc., Kansas City, Mo.
Boat Manufacturers Association, Chicago, Ill.
Building Service Contractors Association, McLean, Va.
Casket Manufacturers Association of America, Evanston, Ill.
Christian Booksellers Association, Colorado Springs, Colo.
Colorado Organic Growers and Marketers Association, Denver, Colo.
Computer and Communications Industry Association, Rosslyn, Va.
Connecticut Small Business Federation, Inc., Hartford, Conn.
Cutting Tool Manufacturers Association, Birmingham, Mich.
Delaware Retail Association, Wilmington, Del.
Electrical Generating Systems Marketing Association, Chicago, Ill.
Engraved Stationery Manufacturers Association, Chicago, Ill.
Farmers Elevator Association of Minnesota, Minneapolis, Minn.
Food Merchandisers of America, Inc., Washington, D.C.
Greater Washington Business Center, Inc., Washington, D.C.
Idaho Feed and Grain Association, Caldwell, Idaho.
Independent Bakers Association, Washington, D.C.
Independent Media Producers Association, Washington, D.C.
Independent Retail Businessmen's Association, Inc., Burlington, Vt.
Independent Sewing Machine Dealers of America, Inc., Hilliard, Ohio.
International Repro Graphic Blueprint Association, Franklin Park, Ill.
Machinery Dealers National Association, Silver Spring, Md.
Manufacturers Agents National Association, Irvine, Calif.
Menswear Retailers of America, Washington, D.C.
Metal Treating Institute, Phoenix, Ariz.
Metropolitan Contractors Association, Washington, D.C.
Minnesota Motorcycle Dealers Association, Minneapolis, Minn.
Motorcycle Trades Association, Inc., Alexandria, Va.
National Appliance Service Association, Kansas City, Mo.
National Association of Black Manufacturers, Washington, D.C.
National Association of Floor Covering Distributors, Chicago, Ill.
National Association of Furniture Manufacturers, Washington, D.C.
National Association of Glove Manufacturers, Inc., Gloversville, N.Y.

National Association of Independent Lumbermen, Washington, D.C.
National Association of Men's and Boys' Apparel Clubs, New York, N.Y.
National Association of Plastics Distributors, Devon, Pa.
National Association of Retail Druggists, Washington, D.C.
National Bicycle Dealers Association Inc., Wickliffe, Ohio.
National Building Material Distributors Association, Chicago, Ill.
National Candy Wholesalers Association, Washington, D.C.
National Coffee Service Association, Chicago, Ill.
National Concrete Masonry Association, McLean, Va.
National Electrical Contractors Association, Inc., Bethesda, Md.
National Electronic Service Dealers Association, Indianapolis, Ind.
National Family Business Council, West Bloomfield, Mich.
National Glass Dealers Association, Washington, D.C.
National Home Improvement Council, New York, N.Y.
National Independent Dairies Association, Washington, D.C.
National Independent Meat Packers Association, Washington, D.C.
National Insulation Contractors Association, Washington, D.C.
National Kampground Owners Association, Martinsville, Ill.
National Liquor Stores Association, Washington, D.C.
National Lumber and Building Material Dealers Association, Washington, D.C.
National Office Products Association, Alexandria, Va.
National Office Machine Dealers Association, Inc., Hackensack, N.J.
National Paper Trade Association, Inc., New York, N.Y.
National Patent Council, Inc., Arlington, Va.
National Peach Council, Martinsburg, W. Va.
National Precast Concrete Association, Indianapolis, Ind.
National Ready Mixed Concrete Association, Silver Spring, Md.
National School Supply and Equipment Association, Arlington, Va.
National Sand and Gravel Association, Silver Spring, Md.
National Screw Machine Products Association, Cleveland, Ohio.
National Selected Morticians, Evanston, Ill.
National Small Business Association, Washington, D.C.
National Utility Contractors Association, Washington, D.C.
National Water Well Association, Worthington, Ohio.
National Woodwork Manufacturers Association, Chicago, Ill.
New York State Council of Retail Merchants, Albany, N.Y.
Northeastern Lumber Manufacturers Association, Glens Falls, N.Y.
Oregon Feed, Seed and Suppliers Association, Portland, Oreg.
Rocky Mountain Food Dealers Association, Denver, Colo.
Small Business Service Contractors Association, Washington, D.C.
Society of American Florists and Ornamental Horticulturists, Alexandria, Va.
South Dakota Retailers Association, Pierre, S. Dak.
Truck Body and Equipment Association, Inc., Washington, D.C.
Truck Equipment and Body Distributors Association, Cincinnati, Ohio.

APPENDIX 2

EMPLOYERS REPORTING TO SOCIAL SECURITY ADMINISTRATION, 1973[1]

Number of employees	Number of legal business entities		Number of reporting units (establishments)	Number of employees
1 to 3	1,646,000		1,722,000	3,029,000
4 to 7	749,000		801,000	4,153,000
8 to 19	579,000		644,000	7,690,000
20 to 49	248,000		298,000	9,087,000
50 to 99	75,000		99,000	6,760,000
100 to 249	38,000		57,000	8,658,000
250 to 499	11,000		[illegible]	6,254,000
500 to 999	5,119			
1,000 to 1,499	1,609			
1,500 to 2,499	1,208	9,645	12,[illegible]	15,645,000
2,500 to 4,999	889			
5,000 and over	820			
Total	3,353,946		3,652,913	61,275,560

[1] 1st quarter data; from U.S. Department of Commerce, Bureau of the Census; most numbers rounded.

APPENDIX 3

TABLE BASED ON CORPORATION INCOME TAX RETURNS, 1973, 1968, 1963

[In percent]

Size of total assets [1]	Number of returns with net income			Total receipts			Net income			Total income tax			Investment credit		
	1963	1968	1973	1963	1968	1973	1963	1968	1973	1963	1968	1973	1963	1968	1973
$1 under $100,000 (547,737)	50.5	56.5	47.3	6.1	5.04	3.3	3.09	2.86	2.6	1.34	1.08	.9	1.26	0.98	1.01
$100,000 under $5,000,000 (577,826)	47.2	41.7	49.9	37.0	34.1	29.3	21.4	21.8	21.9	14	18.3	17.5	18.7	15.1	14.6
$5,000,000 under $25,000,000 (21,930)	1.7	1.3	2.0	10.3	9.5	9.4	[illegible].4	8.6	9.1	9.7	9.2	9.3	7.9	6.5	6.4
$25,000,000 under $250,000,000 (8,172)	.5	.4	.2	17.7	15.6	13.5	19.4	5.9	14.3	20.3	17.5	14.3	21.6	15.2	12.8
$250,000,000 or more (1,421)	.1	.1	.1	28.8	35.8	44.5	46.7	.9	52.2	50.9	54	58.1	50.6	62.2	65.7
Total returns minus zero assets:															
1963		795,436			1,002,918,374			60,958,152			26,173,480			1,102,396	
1968		1,497,405			1,488,199,153			94,045,273			39,230,855			2,360,434	
1973		1,157,086			2,213,198,820			135,440,498			51,543,450			3,685,462	

[1] Figures in parenthesis represent actual numbers of returns for 1973.

Appendix 4

COMPARATIVE JOB CREATION BY YOUNG TECHNOLOGY, INNOVATIVE, AND MATURE COMPANIES

(M.I.T. Development Foundation Study)

Successful small companies become the substantial innovative companies which have a major impact on new job creation and pay increasing revenues to the Federal Government in the form of income taxes. Recently the M.I.T. Development Foundation completed a study on sales and employment trends among selected young high technology companies, innovative companies and mature companies. The companies encompassed in the study were as follows:

Young Technology Companies: Data General, National Semiconductor, Compugraphic, Digital Equipment, Marion Labs.

Innovative Companies: Polaroid, 3M, IBM, Xerox, Texas Instruments.

Mature Companies: Bethlehem Steel, du Pont, General Electric, General Foods, International Paper, Proctor & Gamble.

The study reflected the following salient facts:

[Dollar amounts in millions; employment in numbers of employees]

	Young technology companies	Innovative companies	Mature companies
1974 sales	$857.3	$21,517	$36,795
1969 sales	145.7	11,647	21,410
5-yr sales growth	711.6	9,870	15,385
Compound annual rate of increase (percent)	(42.5)	(13.2)	(11.4)
1974 employment	41,966	555,882	812,351
1969 employment	7,597	449,284	786,793
5-yr employment increase	34,369	106,598	25,558
Compound annual rate of increase (percent)	(40.7)	(4.3)	(0.6)
1974 income tax provision	$57.4	$2,296	$1,506
1969 income tax	13.2	1,528	1,034
5-yr increase	44.2	768	472
Compound annual rate of increase	(34.1)	(8.5)	(7.8)

The following conclusions can be drawn from this study:

The Young Technology companies, with ending sales only 2 percent as much as those of the mature companies, nevertheless hired 34,369 people, or 34 percent more than the 25,558 hired by the mature companies over the 5-year period.

The innovative companies, with ending sales only 58 percent as much as those of the mature companies, nevertheless hired 106,598 people, or over 4 times more than the number hired by the mature companies during the 5-year period.

While the mature companies increased sales and net income over the period at close to the same rate as the innovative companies, the mature companies accomplished this largely through utilizing available capital to automate production rather than through expanding their labor forces. Employment in the mature companies increased by only 3.2 percent over the five years compared with 23.7 percent for the innovative companies.

Finally, the innovative companies, with ending sales only 58 percent those of the mature companies, and with ending employment 68 percent of that of the mature companies, not only hired over 4 times as many new employees as the mature companies over the 5 years studied but throughout the whole 5-year period provided substantially more revenue dollars to the federal government in income taxes. In the final year alone the innovative companies provided nearly $2.3 billion or over 52 percent more in tax revenues than the $1.5 billion provided by the mature companies.

Emerging innovative companies create products, service, jobs and revenues for the Federal Government faster than do our large mature companies. Such companies should and must be helped to flourish.

Appendix 5

[From Across the Board—The Conference Board magazine, February 1977]

Consumers (in Trouble)—The New Army of the Unemployed

(By Fabian Linden)

Seven-and-a-half million Americans, or 8 percent of the labor force, are out of work. Early last year, when the economy was making a vigorous rebound from the severest recession in three decades, unemployment declined more rapidly than many had anticipated, but with the subsequent slowing of the recovery, the number of persons looking for jobs turned up again. We can certainly expect an improvement in the job situation once the economy begins to grow more rapidly, but even optimistic observers of the long-term business scene expect the incidence of unemployment to remain stubbornly around 6 percent. In the Fifties and Sixties, except in moments of adversity, it fluctuated around 4 percent.

The present high level of unemployment and the less-than-comforting outlook have structural as well as cyclical causes. First, we evidently still have not made a robust recovery from the 1974–1975 recession. For almost a year now the economy has been growing at the disappointing real annual rate of about 4 percent—which is well below the level of activity needed to make any significant dent in the number of those looking for work. But beyond the ebb and flow of our economic fortunes is the simple fact that the labor force—the total number of persons old enough and wanting to work—has been rising at an unprecedentedly rapid rate since roughly the mid-Sixties, as the great birth-boom generation began to come of age. Actually, the number of persons now employed is at a near-record high, and except for some month-to-month fluctuations, has been growing since early 1975. But business has just not been expanding fast enough to keep up with the flow of young persons who are entering the labor force. That flow has become a flood in the last few years. For instance, during the Fifties and early Sixties new entrants to the work force averaged out at under a million a year, but beginning in the late Sixties the figure swelled to about 1.7 million, and has been higher than that most recently.

The labor force has also been growing rapidly because of the large and well-advertised rise in the number of working women. Shortly after the war, only about 25 percent of all women were holding down jobs; now the rate is around 45 percent, and is still climbing. Altogether, some three-fifths of the expansion of the work force over the past two decades is accounted for by females.

With changes in the composition of the labor force, there have also of course been big shifts in the composition of the unemployed population. In fact, the characteristics of the jobless have changed a lot more than those of the labor force, since the incidence of unemployment runs substantially above average in those groups that have been pouring into the work market.

Who, then, are the unemployed? There are two important issues here—the incidence of unemployment among various segments of the population, and the relative importance of each segment in the total jobless population. Both these dimensions are pertinent in assessing the problem.

As indicated, the unemployment rate runs substantially above average among blacks, the young, and women. Joblessness among blacks is almost twice that of whites. For women the unemployment ratio exceeds 9 percent, for men it is less than 7 percent—for young white males the ratio exceeds 14 percent, for young black males a disquieting 25 percent.

There are also large differences by occupation. Those employed in white collar jobs generally fare a lot better than blue collar workers. Among professionals, technicians and administrators, the incidence of unemployment is now running about 3.5 percent, or less than half the national average. For clerical and sales personnel, the rate is around 6 percent, but among factory workers it exceeds 10 percent.

There are also substantial differences by marital status. About 4 percent of married males are without jobs, but 14 percent of all single men are unemployed; for women the comparable figures are 8 percent and 12 percent, respectively.

Young people, in fact, account for a very substantial proportion of the jobless population. Of all persons looking for work, close to half are men and women under 25. In 1958, the previous period in which unemployment was exceptionally high, young persons accounted for only about 30 percent of all job seekers. Similarly, there has been a substantial rise in the number of unemployed women. In

the late Fifties women accounted for less than one-third of the jobless; today, the figure exceeds 45 percent.

The exceptionally high level of unemployment in the recent recession can, in some part at least, be attributed to the shifts in the composition of the labor force. For example, as compared with 1958, there are now about three million or more persons looking for work. Of that number, some two million are women. Similarly, young persons—those under 25, male and female—account for some three-quarters of the total increase in the number of jobless. In fact, if we were to apply current age-gender jobless ratios to the labor force as it was constituted in 1958, our present unemployment rate would be about a percentage point and a half lower.

The importance of young people and women in the work force shows up strikingly in the statistics on the "reasons" for unemployment. Slightly over half of all persons now looking for a job were sacked—"job losers." However, 26 percent are "re-entrants," persons who have withdrawn from the labor force at some point and now want to get back in. This is a rather heterogeneous group, but it consists heavily of women who had left the labor market to build families. About 12 percent of all those looking for work are new "entrants"—young people in search of their first jobs; an additional 12 percent left their previous positions voluntarily, to search for something more appropriate to their needs.

These ratios, of course, vary appreciably by age and sex. Among unemployed males over 25, close to 72 percent are job losers. For women the comparable figure is 44 percent. But some 36 percent of all females searching for work are re-entrants—the comparable number for men is substantially half that. Only about 10 percent of unemployed men quit their last jobs; for women the figure is about 16 percent.

Although unemployment is more prevalent now than at any time since the end of the war, by some measures at least, it is not quite as socially painful as in the past. As compared with the late Fifties, a smaller proportion of the jobless are men with families to support—more are young and single persons. Also, as compared with 1958, a relatively larger number of the jobless are married women. Thus, according to the Department of Labor figures, in half of all families headed by a jobless male, at least one other member of the household is earning a paycheck—usually the wife, and in the majority of instances she is employed full time.

However, while there is some comfort in these figures, it is rather slim. The average working wife earns only about a quarter of the family's total income; in only one out of every eight instances does she contribute half or more. In any event, whatever the precise numbers, there are now many more married women in the labor force, and this, to some extent at least, has reduced the financial sting of unemployment.

Actually, the standard measures of unemployment, those most frequently cited, substantially understate the scope of the problem. Each month the Department of Labor reports the unemployment rate—the proportion of the labor force without jobs. That measure represents a snapshot at a particular juncture in time. However, those who are unemployed at a particular moment of the year are, for the most part, not the same people who are jobless at another time. Membership in the unemployment fraternity changes quite considerably over a short interval. Hence, while the number of unemployed remain at about 7.5 million throughout most of last year, the actual number of individuals who experienced at least one unemployment episode is estimated at roughly 20 million.

In general, between 2.5 and 3.5 times as many persons experience a stint of unemployment in the course of the year than the average number jobless at any given moment. In prosperous times the figure runs closer to 3.5 because the average duration of unemployment is shorter; in periods of economic difficulty the multiplier is nearer to 2.5 because the average period of joblessness is longer.

Within this context—the number of individuals that have been unemployed at least once during the year—it becomes quite evident why a high level of joblessness results in a significant curtailment in consumer spending, a curtailment a lot larger than the monthly jobless rates would suggest.

Also, a single unemployment experience in the course of the year often makes for a sizable dent in the family's finances. The average wage earner who loses his job is out of work for some three to four months, which means that annual earnings are reduced anywhere between a quarter and a third. Some of the loss is offset by unemployment benefits, supplemented sometimes by severance pay and special union programs. But even so, the damage is frequently quite sizable, and it often takes the family a long time to make up the loss, both financially and psychologically.

Over the years there have also been important shifts in the social-economic structure of unemployment. What was once predominantly a poor man's burden has spread into the middle and better-than-middle income brackets. For example, back in 1958, close to half of all married men without jobs were heads of families with incomes of less than $7,000 the year before. Now, only about 30 percent of such males are in that family earning bracket. Conversely, in the late Fifties, some 7 percent of all unemployed married men were from the $15,000-and-over bracket, but now the figure is around 25 percent. (All figures are based on constant dollars.) Unemployment is no longer primarily the plague of the have-nots.

In substantial measure, the economic "democratization" of unemployment can be tracked to the fact that there are now appreciably more homes in the affluent earning brackets than in the past, and thus, not unexpectedly, those brackets also account for a larger proportion of the jobless. But whatever the reasons, those out of work today, as compared with not so long ago, have substantially more back-up resources. Also, because more wives are drawing paychecks, a larger number of those looking for work are from faimilies where at least one other member is employed.

But while unemployment for many today is a less devastating experience than it has been in the past, its effect on the economy has become more disruptive—and precisely because a larger proportion of those without jobs are now in the middle and upper-earning brackets. When unemployment hits those with relatively modest incomes, social insurance and other benefits add up to a substantial portion of the family's customary earnings. There is, of course, some cutback in living standards, but those with modest earnings, by definition, live modestly even when fully employed. To be sure, a small reduction in the resources of a poor family can make for considerably more deprivation than a much larger loss of earnings among those who are better off, but unemployment in the middle and upper brackets has a greater impact on the economy. Those who can afford to live well in periods of prosperity are forced to reduce their life-styles rather appreciably when the going gets difficult. Precisely because we have become a more affluent society, joblessness now has a greater adverse effect on the economy than in the past.

It will probably be some time before we are able to reduce unemployment to even reasonably acceptable levels. A more rapid rate of economic growth will ease the problem, but there will still be the demographic river to cross—the stream of you people reaching working age. For the next two or three years at least the labor force will continue to expand at a rapid pace, and there will be no significant tapering off until the end of the decade—which means that more likely than not unemployment will continue as a major problem for some time—probably for the rest of the decade.

[News release]

INFOPLAN INTERNATIONAL, INC.,
New York.

WASHINGTON, D.C., March 9.—Almost 600,000 new jobs would be created in the United States if a properly constructed small business job tax credit law is enacted, according to the president of the National Small Business Association.

Milton D. Stewart in a statement to the Senate Finance Committee today, said that the New Jobs Tax Credit bill approved by the House of Representatives yesterday was a step in the right direction and urged the Senate to "follow swiftly and energetically the lead of the House in passing a landmark tax credit bill focused on small business and the unemployed."

The House bill, sponsored by the chairman of the Ways and Means Committee, Rep. Al Ullman (D-Oregon), provides a tax credit to companies of $1,680 for each new job created, up to a maximum of 24 in any one business. The overall limit on the credit for any one business is $40,000. Rep. Butler Derrick (D-S.C.) was then bill's original sponsor.

Stewart expressed the hope that the Senate, which will consider a similar New Jobs Tax Credit bill sponsored by Sen. Spark M. Matsunaga (D-Hawaii), would strengthen the House bill by increasing the tax credit to at least $2,500 per employee and by extending the limit to more than $40,000. He said, "we have not been rigid in our views. We have found several alternative forms and amounts of credit appealing as we have continued to study the matter: the 10 jobs and $80,000 per firm maximum credit proposed by Sen. Matsunaga and Rep.

Derrick; a 24 job and $60,000 maximum credit not yet formally proposed; and a 10-job staggered credit of $1,000 to $5,000 per job, with a $30,000 per employer maximum."

Big business according to Stewart, aggressively supports a two per cent increase in the existing investment tax credit rather than the concept of a New Jobs Tax Credit on the basis that that investment tax credit would win "business confidence" in the government's future economic policy.

"But," Stewart said, "this 'business confidence' game ought not, in our view, be limited to the 1,400 companies which have the greatest stake in the investment tax credit, or even a sub-group of that group. It ought to comprise a concern with the confidence of all the nation's 10 million entrepeneurs, and particularly with those who hire people.

"We have more than a little trouble," Stewart continued, "with the idea that a federal business tax policy should be designed to give policy signals only to a handful of major company managers. We believe the confidence of the whole business community is what the government requires. The first of the elements in engendering that confidence from the small business sector of the business community will begin to be provided by a New Jobs Tax Credit of the kind approved by the House Ways and Means Committee."

This New Jobs Tax Credit concept, according to Stewart, is the first step "toward providing some balance in incentive credit for small, as against large, companies." He cited federal figures estimating that the current Investment Tax Credit will this year put $4.8 billion into 1,400 large companies, each of which has over $250,000,000 in assets.

"This handful of companies receives two of every three tax dollars which go to over a million corporations," Mr. Stewart stated. "The proposal to increase that credit from 10 to 12 percent would put almost another billion dollars in tax credits into those companies. We must prefer the House's decision to put $700 million in tax credits into job creation, and if the credit is properly administered we believe that three-fourths of it can go to small business."

In making his estimate of almost 600,000 new jobs that would be created by a well-constructed New Jobs Tax Credit act, Stewart noted that small business provides three-fourths of the jobs covered by Social Security in the United States. Small businesses are considered to be those firms with fewer than 500 employees.

"How soon significant numbers of jobs are created and how close we can come to this estimate will depend in considerable measure on how effectively the new credit is administered," Stewart said. "We will need a major federal information program directed at small business. This is an experiment and one of great importance for the future. Close Congressional oversight will be needed to see to it that full support is given the program during its critical first two years. We anticipate that it will take five full years before the value of the credit can be fully assessed."

Stewart said that the other support for a job tax credit was broad, including "members of the Small Business Legislative Council, and other trade associations with more than one million members." He also said that it is supported by "the eight member group in the Council of Small and Independent Business Associations. It was also endorsed in principle in December 1976 by the Treasury Small Business Advisory Committee on Economic Policy."

The CHAIRMAN. Next we will hear from Dr. Albert H. Cox, president, Merrill Lynch Economics, Inc., on behalf of Merrill Lynch & Co.

STATEMENT OF DR. ALBERT H. COX, PRESIDENT, MERRILL LYNCH ECONOMICS, INC., ON BEHALF OF MERRILL LYNCH & CO., INC.

Mr. Cox. Thank you very much, Mr. Chairman. My name is Albert H. Cox and I am president of Merrill Lynch Economics, an economic consulting company, and I serve as an economist at the Merrill Lynch Co. I am here today because we are deeply concerned that the size of the proposed economic stimulus might produce results which would be precisely the opposite of those intended. That is, these actions, in our judgment, might ignite another inflationary spiral which would end the economic recovery and worsen unemployment.

By most measurements, the economy's performance since the recession ended has been somewhat better than we had projected a couple of years ago. Growth has been higher and inflation has receded a little faster than we had thought it would.

Between March 1975—which was the recession's bottom—and December 1976, the gains in most of the economy's major benchmarks, including real gross national product, industrial production, total employment, and housing starts were in line with the preceding four economic recoveries in percentage gain terms.

In fact, total employment rose 5 percent in that 21-month span faster than in three of the four preceding recoveries and faster than in 1958–59, which followed a recession comparable in severity to the 1974–75 experience.

Only two major indicators have performed poorly in a relative sense. By far the worst performance has been recorded by business investment. As measured in the GNP accounts, fixed private nonresidential investment, in real terms, rose only 3.1 percent from the first quarter of 1975 to the fourth quarter of 1976. This compares to gains ranging from 10 to 17 percent in the four previous comparable recovery periods, including that of 1958–59.

A low level of business confidence in the economy's future seems to be a major explanatory factor here. Corporate profits, after taxes, in real terms have risen nearly 50 percent during the same timespan.

The other disappointing performer, as you know, has been the total unemployment rate. Through January, before the hard winter hit the economy, the total unemployment rate had declined from a peak of 9 percent to 7.3 percent, or by 1.7 percentage points. This decline was equal to the average decline in the four previous comparable recovery periods, and far greater than that during the recovery from the 1970 recession—0.5 point—but far less than during the recovery of 1947–58, 2.7 points.

Measured against progress made after the 1957–58 recession, it could be argued that the total unemployment rate should be below 6.5 percent by now. But the labor force this time has grown more than twice as fast as in that earlier period, ~~and the~~ growth of adult women in the labor force has been more than four times as fast.

Furthermore, the size and duration of unemployment benefits is far greater today. This has naturally tended to lengthen the time a person looks for a suitable job, raising the unemployment rate.

Thus we believe that the economy's performance, by most measures, has been much better than generally perceived. The large gains in total employment have been impressive. The decline in unemployment has been disappointing but not that surprising in view of the upsurge in the labor force. Meanwhile, the dismal performance of business investment has received relatively little attention, and yet it could have ominous implications for the economy's longer term well-being.

A consensus regarding the need for additional Government stimulus crystalized during the much-publicized "economic pause" in the late summer and fall of last year. But revisions of our economic statistics make it increasingly clear that the pause was mostly an illusion, mainly reflecting business inventory gyrations. Excessively rapid inventory accumulation was largely responsible for a burst of growth

early last year and a subsequent leveling of inventory activity, and its dampening impact on growth of total GNP, was to be expected.

Meanwhile, real final demand—the growth in real gross national product excluding inventories—accelerated, quarter by quarter, throughout 1976, from a first quarter rate of 3.7 to 5.5 percent in the final quarter of last year. Thus, going into the cold snap of late January and early February, the economy had a good head of steam, which is likely to reemerge this month and into the spring. Looking back, then, the original impetus for this whole program of additional economic stimulus may now prove hard to discover in the light of the statistical revisions.

In assessing the inflationary potential of this $31 billion program, it is popular to refer to the broadest measures of the economy's unutilized resources. These include the total unemployment rate, and the manufacturing and materials capacity utilization rates calculated by the Commerce Department, and the Federal Reserve, all of which were 80 percent or a little above in the fourth quarter of last year. Thus, it is argued, there is obviously ample room for stimulus without causing higher inflation.

We are very skeptical of this kind of analysis for a number of reasons. First, the use of such aggregate measures overstates the labor and capital equipment that is readily available, and tends to divert attention from the problem of inflationary bottlenecks. Second, fear of inflation, so pervasive today, reduces the predictive value of these static measures. Third, there is some evidence that inflation has already begun to accelerate again.

Total unemployment, on a seasonally adjusted basis, stood at 7 million workers in January. But a sizable percentage of the total, more than one-third, had been out of work for less than 5 weeks, and two-thirds of the total had been unemployed for less than 15 weeks. Normal labor turnover, which is very much a part of the unemployment numbers, has been trending higher over the years. But this important segment of the statistics does not represent labor that in any sense has been idled by a poorly functioning economy.

The so-called hardship unemployment rate—those unemployed 15 weeks or more—was 2.4 percent, seasonally adjusted, in January and that for adults out of work 5 weeks or more, according to our estimates, was only 4.1 percent.

These and other breakdowns of the unemployment statistics are far less reassuring, in terms of the availability of productive labor, than total unemployment and the total unemployment rate. In our view, much more attention should be paid to these facts in our economic policy deliberations.

Similar reservations apply to the aggregate statistics for plant and equipment utilization. The Federal Reserve's new monthly series on capacity utilization of materials industries shows a utilization rate of 80 percent for last December, seemingly a noninflationary level. Yet the figure for one of the major components of the total, paper materials, was at nearly 90 percent, no so reassuring in this sector. Potential bottlenecks are hidden in the aggregates.

The high level of inflationary expectations should also be taken into account. There is a deep-rooted fear in the business and financial communities that the highly inflationary conditions of 1973–74 may

return. If there is a growing feeling that Washington may rekindle inflationary pressures, there could be, for example, anticipatory price increases that could come far in advance of what traditional capacity/demand/price relationships would suggest. At some point there could be sudden, anticipatory accumulations of business inventories, which could make capacity utilization rates in some instances jump 10 to 20 points in a matter of a few months.

Finally, there is already some evidence that points toward accelerating inflation. Wholesale industrial prices rose at an annual rate of 8 percent across the second half of last year, and double-digit inflation was recorded in such diverse categories as lumber and wood products, fuels and related products and power, and rubber and plastic products. A much narrower gage, raw industrial commodity prices, has jumped sharply in January and February, at an annual rate of over 40 percent, and there has been sharp upward pressure in such diverse areas as copper and steel scrap, burlap and cotton, and rubber and tallow.

The CHAIRMAN. Your time has expired. I would urge every Senator to read the remainder of your statement, which I have read. It is a very interesting statement.

Are there any questions?

Senator Hansen.

Senator HANSEN. I do not think I have any questions, Mr. Chairman. I appreciate your statement very much.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. Assuming there is going to be some kind of stimulus that is going to come out of Congress, do you have a feeling as to which approach is most inflationary; on the one hand rebates, the sudden infusion of large numbers of dollars into the economy pumping up demand together with next year an increased number of public service jobs or, on the other hand, permanent tax reductions going to both individuals and cor[illegible]ations?

Mr. Cox. I think the [illegible]ate approach is more inflationary. The tax reduction approach would be helpful to general business confidence, therefore business investment which I think we need over the longer run, in terms of our need for greater productivity to hold down inflation. A permament reduction would be the less inflationary of the two alternatives.

At the moment, our assessment is that we do not need any stimulus. We are taking a big risk here in this program.

Senator DANFORTH. Thank you.

Senator MATSUNAGA [presiding]. Your concern is with inflation and increase in investments.

Are you recommending here the administration's proposal of an increase from 10 to 18 percent in the investment tax credit, to begin with?

Mr. Cox. To begin with, I think that that would be marginally helpful, but it is not at the top of the list as far as our concerns. Our concern is inflation, and we believe when inflation starts to heat up again and the business community perceives this, that anything that would be done on the investment tax credit side would be miniscule in terms of its effect, compared to the devastating effect of the future of business investment in high inflation.

Senator MATSUNAGA. You have heard, I suppose, and you are familiar with the job tax credit?

Mr. COX. Yes.

Senator MATSUNAGA. Intending to increase employment in small business.

Do you consider this to be in any way more inflationary or less inflationary than other proposals, such as the rebate and the investment tax credit?

Mr. COX. Compared with the investment tax credit, I would say that it would be more inflationary. The investment tax credit, I think, would give more directly in a small way.

I do not think either one of them are very important, to tell you the truth, for the outlook for plant and equipment that has been lagging badly in his recovery, which we need desperately in future years before productivity growth.

Other things equal, I would prefer the investment tax credit. Compared to the overall inflation problem, as I said, I do not think either one of them is too important, in my judgment.

Senator MATSUNAGA. Thank you.

Senator Curtis?

Senator CURTIS. In your opinion, is confidence a real determining factor in the well being of our economy? Sometimes advocates of particular measures would pooh-pooh the idea, that confidence is just a blind optimism and that it is really not important.

What is your comment on that?

Mr. COX. I think that it is very important, especially, after—I think the whole confidence and psychological aspect of our economy is very important today, as never before, probably in several decades, at least, because of the traumatic experience that we have been through in the economy the last couple of years and now business people and financial people are terribly edgy, and they are not going to make commitments unless they do have the confidence which at the moment they lack.

So I think that the psychological aspect of the economic outlook, including the confidence aspect, has to be taken into account in our economic policy deliberations. I do not think that we are doing that sufficiently.

We are relying too much on static economic history, most of which was over a timespan when confidence and psychological problems and fears were not as great as they are now in the economy.

I think that it is very important.

Senator CURTIS. Would you add that confidence and the belief that the Government in Washington had its budget under control would be a factor in our economy?

Mr. COX. Absolutely. I think the single most important aspect of this whole stream of this program is the fact that Congress is planning on a budget deficit for fiscal 1977 of about $70 billion, which is bigger than the one in the fiscal year ended last summer.

Yet the economy is stronger since that time, unemployment is lower, capacity utilization rates are higher, and this is extremely disturbing to the business community. It seems to suggest that economic policy is going in the wrong direction.

Senator CURTIS. Mr. Chairman, I ask unanimous consent to ask one more question.

86-032—77——16

The CHAIRMAN [presiding]. Yes, Senator Curtis.

Senator CURTIS. In your opinion, does inflation produce unemployment?

Mr. COX. Absolutely, no question about it.

Senator CURTIS. I have always felt, although I am not an expert, that in times of high inflation many households have to use all of their money for the bare necessities of life and it does not take very much of the work force of the country to produce the bare necessities of life.

If we could put all of our people to work when our money is valuable and there is enough left over of wages and other income for individuals and householders to buy beyond the bare necessities of life, including luxuries.

Mr. COX I think that is absolutely right. The biggest tax reduction that we have had during this whole period has been the drop in inflation from 11 percent where it was running a couple of years ago down to 7 percent, then down to 5 percent.

By our calculations, that drop added about $60 billion to purchasing power. That is bigger than any tax cut that we could ever contemplate. Inflation is the biggest tax of them all.

Senator CURTIS. The budget shows that we give in grants and revenue sharing to States, cities and localities, about $70 billion a year. That is the approximate size of the budget.

If you look back 5 or 6 years, it is my opinion that we have not given the States and localities anything. We have added to their cost of operation, through inflation, far more than $70 billion a year.

In other words, by that money and deficits here in Washington, it might now and then have a temporary spurt, but it makes the situation worse, in my opinion.

Mr. COX. I agree with you 100 percent.

Senator CURTIS. Thank you very much. Not many people agree with me; I appreciate it.

The CHAIRMAN. Thank you very much.

[The prepared statement of Mr. Cox follows:]

STATEMENT BY ALBERT H. COX, JR., CHIEF ECONOMIST, MERRILL LYNCH & CO., INC.

My name is Albert H. Cox, Jr. and I am chief economist of Merrill Lynch & Co., and president of Merrill Lynch Economics, Inc., an economic consulting company. We are deeply concerned that the size of the proposed economic stimulus might produce results which would be precisely the opposite of those intended. That is, these actions, in our judgment, might ignite another inflationary spiral which would end the economic recovery and worsen unemployment.

By most measures, the economy's performance since the recession ended has been somewhat better than we had projected. Growth has been higher and inflation has receded a little faster than we had though it would. Between March 1975 (the recession's trough) and December 1976, the gains in most of the economy's major benchmarks, including real GNP, industrial production, total employment, and housing starts, were in line with the preceding four economic recoveries. In fact total employment rose 5.0 percent in that 21-month span, faster than in three of the four preceding recoveries, and faster than in 1958–59, which followed a recession comparable in severity to the 1974–75 experience.

Only two major indicators have performed poorly in a relative sense. By far the worst performance has been recorded by business investment. As measured in the GNP accounts, fixed private nonresidential investment, in real terms, rose only 3.1 percent from the first quarter of 1975 to the fourth quarter of 1976. This compares to gains ranging from 10 to 17 percent in the four previous comparable recovery periods, including that of 1958–59. A low level of business confidence in the economy's future seems to be a major explanatory factor here. Cor-

porate profits (after taxes), in real terms, have risen nearly 50 percent during the same time span.

The other disappointing performer, as you know, has been the total unemployment rate. Through January, before the harsh winter hit the economy, the total unemployment rate had declined from a peak of 9.0 percent to 7.3 percent, or by 1.7 percentage points. This decline was equal to the average decline in the four previous comparable recovery periods, and far greater than that during the recovery from the 1970 recession (0.5 points) but far less than during the recovery of 1957–58 (2.7 points).

Measured against progress made after the 1957–58 recession, it could be argued that the total unemployment rate should be below 6½ percent by now. But the labor force this time has grown more than twice as fast as in that earlier period, and the growth of adult women in the labor force has been more than four times as fast. Furthermore, the size and duration of unemployment benefits is far greater today. This has naturally tended to lengthen the time a person looks for a suitable job, raising the unemployment rate.

Thus we believe that the economy's performance, by most measures, has been much better than generally perceived. The large gains in total employment have been impressive. The decline in unemployment has been disappointing but not that surprising in view of the upsurge in the labor force. Meanwhile, the dismal performance of business investment has received relatively little attention, and yet it could have ominous implications for the economy's longer term well-being.

A consensus regarding the need for additional government stimulus crystalized during the much-publicized "economic pause" in the late summer and fall of last year. But revisions of our economic statistics make it increasingly clear that the pause was mostly an illusion, mainly reflecting business inventory gyrations. Excessively rapid inventory accumulation was largely responsible for a burst of growth early last year and a subsequent leveling of inventory activity, and its dampening impact on growth of total GNP, was to be expected. Meanwhile, real final demand (the growth in real gross national product excluding inventories) accelerated, quarter by quarter, throughout 1976, from a first quarter rate of 3.7 to 5.5 percent in the final quarter of last year. Thus, going into the cold snap of late January and early February, the economy had a good head of steam, which is likely to reemerge this month and into the spring. Looking back, then, the original impetus for this whole program of additional economic stimulus may now prove hard to discover in the light of the statistical revisions.

In assessing the inflationary potential of this $31 billion program, it is popular to refer to the broadest measures of the economy's unutilized resources. These include the total unemployment rate, and the manufacturing and materials capacity utilization rates calculated by the Commerce Department and the Federal Reserve, all of which were 80 percent or a little above in the fourth quarter of last year. Thus, it is argued, there is obviously ample room for stimulus without causing higher inflation.

We are very skeptical of this kind of analysis for a number of reasons. First, the use of such aggregate measures overstates the labor and capital equipment that is readily available, and tends to divert attention from the problem of inflationary bottlenecks. Second, fear of inflation, so pervasive today, reduces the predictive value of these static measures. Third, there is some evidence that inflation has already begun to accelerate again.

Total unemployment, on a seasonally adjusted basis, stood at 7.0 million workers in January. But a sizeable percentage of the total, more than one-third, had been out of work for less than five weeks, and two-thirds of the total had been unemployed for less than 15 weeks. Normal labor turnover, which is very much a part of the unemployment numbers, has been trending higher over the years. But this important segment of the statistics does not represent labor that in any sense has been idled by a poorly functioning economy.

The so-called "hardship unemployment rate" (those unemployed 15 weeks or more) was 2.4 percent (seasonally adjusted) in January and that for adults out of work five weeks or more, according to our estimates, was only 4.1 percent. These and other breakdowns of the unemployment statistics are far less reassuring, in terms of the availability of productive labor, than total unemployment and the total unemployment rate. In our view, much more attention should be paid to these facts in our economic policy deliberations.

Similar reservations apply to the aggregate statistics for plant and equipment utilization. The Federal Reserve's new monthly series on capacity utilization of

materials industries shows a utilization rate of 80 percent for last December, seemingly a noninflationary level. Yet the figure for one of the major components of the total, paper materials, was at nearly 90 percent, not so reassuring in this sector. Potential bottlenecks are hidden in the aggregates.

The high level of inflationary expectations should also be taken into account There is a deep-rooted fear in the business and financial communities that the highly inflationary conditions of 1973–74 may return. If there is a growing feeling that Washington may rekindle inflationary pressures, there could be, for example, anticipatory price increases that could come far in advance of what traditional capacity/demand/price relationships would suggest. At some point there could be sudden, anticipatory accumulations of business inventories, which could make capacity utilization rates in some industries jump 10 to 20 points in a matter of a few months.

Finally, there is already some evidence that points toward accelerating inflation. Wholesale industrial prices rose at an annual rate of 8.0 percent across the second half of last year, and double-digit inflation was recorded in such diverse categories as lumber and wood products, fuels and related products and power, and rubber and plastic products. A much narrower guage, raw material commodity prices, has jumped sharply in January and February, at an annual rate of over 40 percent, and there has been sharp upward pressure in such diverse areas as copper and steel scrap, burlap and cotton, and rubber and tallow.

In January, consumer prices showed by far their biggest jump in over a year and a half. The 10 percent rate of inflation reported was partly due to the bad weather, in the case of food and fuels. But double-digit inflation rates were also recorded in other areas, including tobacco products, used cars, women's and girls' apparel, and medical services.

In summary, we believe that the economy's progress has been impressive so far in this expansion. The tempo of activity quickened noticeably in the closing months of last year, before the cold snap, and it promises to pick up steam again, beginning this month. Meanwhile, the inflation picture is beginning to look worrisome again, at least to us. In our judgment, attempts to push growth faster, while they may be successful, are simply not worth the risk of an upsurge in inflation that could end the entire expansion, pushing unemployment sharply higher again.

As this program to further stimulate the economy has come into focus, our own forecasts of inflation for 1977 and 1978 have been raised. Like many economics groups today, we have constructed more than one set of forecasts. Our Scenario I (stable growth) forecasts now include the following projections for inflation rates (using the broad GNP price deflator): 6.5 percent by the fourth quarter of this year; 6.9 percent by the fourth quarter of 1978. One of our key assumptions in making these projections is that Congress will not add substantially to the stimulus proposed by the President. Currently, we subjectively give this forecast a 55 to 60 percent chance.

Our alternative, Scenario II forecasts describe an economy heading into stagnation, and perhaps secular stagnation of the British variety. Our inflation forecasts under this scenario are as follows: 9.3 percent by the fourth quar[illegible] of this year; and 10 percent by the fourth quarter of 1978 (economic controls are assumed to be operative in the latter period). Here, our list of key assumptions includes economic stimulus and total federal spending of substantially greater magnitude than indicated thus far by the Carter Administration. We give this forecast a 40 to 45 percent chance at this time.

Our latest forecasts are spelled out in considerable detail in recent reports which have been prepared for our economic consulting clients and for use within Merrill Lynch. Mr. Chairman, I would like to submit this material for the record and ask the unanimous consent of the Committee to do so.*

The CHAIRMAN. Next we will call Dr. Charls Walker, chairman, American Council for Capital Formation. I think that we might be able to hear the next witness, Mr. George Lawrence, but we will not be able to hear the other witnesses before lunch, so they can make their plans accordingly.

All right, Dr. Walker. We are happy to have you, sir.

*The material was made a part of the official files of the committee.

STATEMENT OF DR. CHARLS E. WALKER, CHAIRMAN, AMERICAN COUNCIL FOR CAPITAL FORMATION

Mr. WALKER. Thank you very much, Mr. Chairman.

I am very happy to be back here. I am accompanied by Dr. Richard Rahn, executive director of the American Council for Capital Formation, a group that is strongly dedicated to promoting productive investment by removing what we believe to be a bias in the Federal tax system in favor of consumption and against saving and investment.

We cannot support H.R. 3477. We oppose the rebate but support an equitable and permanent reduction in individual income tax rates, provided that it is matched by restraint in the growth of Federal spending.

What the U.S. economy needs today is not a one-shot fast-dissipating attempt at pump-priming, but tax actions to lower the aftertax cost of real capital, bolster business confidence, and thereby encourage capital spending. These tax actions should be permanent and dependable, not shortrun and fleeting.

Mr. Chairman, I suggest that this committee and the Congress can strike a double "blow for freedom" by amending H.R. 3477 to include strongly stimulative capital formation measures. The current recovery will be bolstered and our longrun goals will also be more effectively served.

Rather than discussing the details of H.R. 3477, I would like to concentrate instead on certain economic, political, and public relations aspects of amending the tax code to promote capital spending.

Why does this prove so difficult?

There are several reasons, all, I think, more apparent than real. They include the contention, first, that there is no capital shortage; second, that if there is such a shortage, the public does not recognize the fact and therefore the legislative will to do something about it is weak; third, that the type of tax cuts that proponents of capital formation advocate are labeled by labor leaders, reporters, editorial writers and, as a result, the general public as mere handouts to corporations and fat cats; and fourth, that the Government cannot afford the loss of revenue resulting from such reductions.

Let us look at each of these allegations.

Is there a capital shortage? Last week, Treasury Secretary Blumenthal put it aptly when he said, "We do have a capital shortage, in the sense that growth of physical plant and equipment is lagging behind the rate of expansion required to reach a full employment economy."

The Secretary concluded that, in effect, the balance of growth between human capital, the labor force, and physical capital, plant, and equipment, is out of balance.

In reaching this conclusion he joined a very respectable and diverse group of experts, including Professors Paul McCracken and David Meiselman, Federal Reserve Board Governor Henry Wallich, Alan Greenspan, the Wall Street Journal, the Congressional Budget Office, the Washington Post, and, I might add, the American Council for Capital Formation.

Yes, there is a capital shortage. It is real. It is here. It will not go away on its own or as a result of $10 billion in one-shot tax rebates.

What about the views of the man on the street? Let me summarize this part of my testimony in just a couple of sentences.

Reliable polls show that 64 percent of the people believe that there is at least a serious problem involved in raising the dollars needed for business investment. Moreover, 95 percent of the legislators in Washington, 93 percent of the people in the executive branch and regulatory agencies, and even 75 percent of the unions, public interest groups and media people believe that we face a capital shortage or a capital problem.

Those results are surprising, but they come from the Cambridge Report and the Opinion Research Corp.

Given these public and leadership views, why does not Congress rush out today and enact a whole panoply of measures to promote capital formation? I think last August, The Washington Post in an editorial advocating tax incentives for additional investment, singled out the most important reason.

Such cuts, by definition, reduce taxes on businesses which do the real investing in new plant and equipment and on individuals who are in a position to save a substantial portion of their income—high-income individuals. In other words, the people believed to benefit are those very corporate leaders and so-called "fat cats" whom Herblock inevitably portrays or corpulent, balding, middle-aged men wearing dollar signs.

If you infer from this that the pictorial part of the Post's editorial page offsets what is often good economic advice in the left-hand column, you are 100 percent right.

To summarize: The fact is that the American people have been badly misinformed about the true nature of the U.S. tax system. The individual income tax system—leave out payroll taxes—is indeed fair. It is not regressive as many think it is; it is smoothly progressive.

And, as the Treasury recently reported, the vast majority of high-income Americans do pay Federal income taxes, and they pay heavily.

As I have said over and over, corporations do not pay taxes, people do. Therefore, there is no such thing as a tax cut for a business per se. It is passed forward to consumers or backwards to workers and investors.

If you conclude that I am saying that in getting productive tax reform the press, with some exceptions, is more part of the problem than the solution, you are again correct.

Proposals to cut business taxes in order to promote capital formation are frequently attacked on the basis of revenue loss. Every time a business tax cut is proposed, the revenue estimators plug into the computers and come up with estimates of the revenue that will be "lost" as a result.

I intend no criticisms of these able technicians, but they are almost always wrong. It is not their fault. The state of the art is such that most revenue estimates related to changes in business taxes are simply not worth the powder to blow them up.

The basic reason is that the estimators have to assume that other things remain equal. When business taxes are cut, decisions and actions that might have gone one way before the cut may turn out to be quite different.

Take for example the 2-point increase in the investment tax credit proposed by the administration. It is estimated to cost $1.5 billion, but

a good case will be made that the cost will be negative—that Uncle Sam will ultimately gain, not lose, revenues.

This is because the after-tax returns for investing in new productive equipment will rise. Businessmen will step up their capital spending; employment will immediately benefit in the industries producing the equipment and in the longer run in the economy as a whole, because we will make up the shortfall of physical capital relative to human capital that Secretary Blumenthal referred to. Workers will have more tools to work with.

Overall business activity will expand and profits will rise, for which the Government obtains a significant marginal increase in business tax payments. Payrolls will also rise, so taxable income of workers will go up and still another increase goes to Federal revenues, and so on.

The record since World War II strongly supports that argument I just presented. There is every reason that it should.

To be sure, the immediate impact of some capital formation measures, such as complete integration of the corporate and individual tax, could result in a sharp drop in revenue, but the answer here is not to avoid the action but simply to phase it in smoothly over a period of several years. This approach can be especially effective, for if businessmen feel certain that cuts will be forthcoming, they in turn will adjust their long-range planning to the anticipated conditions down the road.

An important intangible aspect of the revenue loss argument should be noted. In business decisions, especially those which involve commitments of large amounts of resources for long periods of time, the state of business confidence relative to political, economic, and social factors is crucial. A lack of confidence will lead to caution; consequently, clear signals from Congress and the administration that the problems of business, especially with respect to taxation and capital formation, are understood, and that appropriate corrective actions will be forthcoming, will themselves lead to a faster pace of activity as fear and uncertainty are reduced.

The foregoing comment leads to our concluding point in our recommendations on the bill. Unfortunately, business confidence, which rose rapidly from the election to Inauguration Day, has sagged markedly. One reason is the fear that the Federal Government is soft on inflation, an image that the President's chief economic policymakers are striving hard to eliminate. I hope they are successful.

Still another reason is H.R. 3477 itself. Most businessmen believe that the rebate approach is unwise under current conditions. More important, the bill includes an employment credit which has been strongly criticized as both ineffective and a new tax shelter. There is nothing in the bill that woud directly foster capital formation. If the bill passes in its present form, capital spending might well grow more slowly than is now expected because of the adverse effect on business confidence.

If you want the biggest bang for the buck from this legislation—by "bang," I mean the creation of rewarding and lasting jobs, strong economic growth, and progress toward control of inflation—then significant capital formation measures should be included. At least the business tax cuts originally recommended by the administration should be restored.

Mr. Chairman, I should like to suggest that a third alternative be added, namely a 2-point cut in the corporate rate. This alternative should apply to corporate taxpayers from top to bottom—the big corporation and the little corporation, by reducing the normal rate from 22 to 20 and 20 to 18.

What would this cost? I am sure your revenue estimators could quickly give you figures in the traditional sense, but I submit that it would ultimately cost nothing—in fact, constitute a very big net gain for the country, for in one action the committee and the Congress would be sending a signal to the business community. The word would be yes, we understand the problem. The first step, however, is simply a down payment on really significant measures to promote capital formation in this country.

Thank you very much.

The CHAIRMAN. Let me make a suggestion to my colleagues. If we come back this afternoon, I may be the only one here to hear these witnesses. I would suggest, if it is all right with the others, that we withhold our questions at this point and let the other witnesses make their statements in chief.

At that point, we can then interrogate them. They will have the benefit of as large an audience as I could provide for them. If that is all right with the Senators here that we do that, then we could hear Mr. Lawrence, and each witness would have a chance to be heard by a larger number of Senators.

I ask you to stand by, Dr. Walker. We will hear the other witnesses, then I would like to ask you questions after we hear the others.

Next, we will call Mr. George H. Lawrence, president, American Gas Association.

STATEMENT OF GEORGE H. LAWRENCE, PRESIDENT, AMERICAN GAS ASSOCIATION

Mr. LAWRENCE. Thank you, Mr. Chairman. I will try to be brief.

I am appearing on behalf of the American Gas Association, representing 300 natural gas distribution and transmission companies. We strongly support President Carter's proposal to increase the investment tax credit to 12 percent.

My comments are directed primarily to the investment credit proposal rather than the Jobs Tax Credit proposals. As a matter of fact, the investment credit proposal is the only one that has any real incentive that we think will benefit the natural gas industry.

Our recommendations are four on behalf of the A.G.A. The investment tax credit should be increased from 10 percent to 12 percent. This should be an option to the House-passed jobs tax credit in H.R. 3477 or to the President's proposal of a 4-percent payroll tax credit.

The second recommendation is that the investment credit should be made permanent and not continued as the on-again off-again incentive of the past. If we are going to have some long-range energy planning through the 1990's and 2000's, this capital formation incentive would be very essential to the planning of the natural gas industry. This is particularly important for our supplemental gas sources, such as those engaged in the production of synthetic gas from

coal and liquid hydrocarbons as well as those engaged in the liquefaction, transportation and gasification of LNG.

A third point is the need for greater flexibility in the limitation imposed on how much of that investment credit would be available to us.

The last Congress alleviated some of the limitation's burden on the electric industry and the gas distribution industry by allowing the benefit of the investment credit to the extent of 90 percent of their current tax liability. I believe this phases down over a 5-year period.

That more flexible limitation is not available to our pipeline companies, nor to the portion of our companies' operations engaged in new supply projects. It is only available to our conventional distribution gas operations. This is not where our big capital formation incentives are needed.

We would very much welcome that increase in flexibility.

The fourth and final point is a very important one. This capital formation incentive should be just that. As you know, many State regulatory commissions have a provision whereby these tax benefits are merely flowed through in the form of lower rates to customers. It should be made clear in the legislation that this tax incentive is not available unless the company is able to retain it as a capital formation benefit.

Mr. Chairman, we think conventional production from the lower 48 States will continue to be the bedrock of our producing capability for many years to come, through the 1990's. And we see that production rate stabilizing at the present level of 20 trillion cubic feet a year on to the year 2000 if we get the exploration incentives that this Senate passed last year.

We also need the supplemental gas supply projects. We need the Alaska gas pipeline. That is a very capital-intensive project, as you know. We need to accelerate coal gasification. It is the least capital intensive, most economic, most environmentally efficient way to use our vast coal supplies.

We need to increase our LNG capabilities.

In a nutshell, Mr. Chairman, that is it. We would like to see the investment credit increased to 12 percent. We would like to see it made permanent. We would like a more flexible investment credit limitation so our companies could take advantage of the credit. And we would like to see that we would be able to retain it rather than see it flowed through by State regulatory commissions.

Thank you very much.

The CHAIRMAN. Thank you very much.

[The prepared statement of Mr. Lawrence follows:]

STATEMENT OF GEORGE H. LAWRENCE, PRESIDENT, AMERICAN GAS ASSOCIATION

I am George H. Lawrence, President of the American Gas Association, and am appearing before you today on behalf of the A.G.A. The A.G.A. is composed of 300 member companies providing natural gas transmission and distribution services to 160 million consumers in the 50 states. The member companies of the A.G.A. provide approximately 85 percent of the nation's natural gas utility sales. Natural gas alone supplies approximately 40 percent of the primary energy consumed by homes, commercial establishments and industry.

The A.G.A. strongly supports President Carter's proposal to increase the investment tax credit to 12 percent. My comments today are directed primarily to the investment credit proposal rather than to the House-passed jobs tax credit or to

the President's proposed 4 percent payroll tax credit. While these other credits may be worthwhile as options, only the investment credit increase would have a certain, direct and significant effect on the natural gas industry. A.G.A. urges, therefore, that any economic stimulus package adopted by the Committee include an investment credit increase.

A summary of my recommendations is as follows:

(1) The investment tax credit, increased from 10 percent to 12 percent, should be available as an option to the House-passed Jobs tax credit or to the President's proposed 4 percent payroll tax credit if that is adopted by the Committee;

(2) The investment tax credit should be made permanent and not temporary;

(3) Pipeline companies and other companies engaged in development of supplemental gas sources should have the same use of the increased investment credit limitation which is provided electric and gas distribution companies;

(4) It must be made apparent to the regulatory authorities that Congress is making the investment tax credit available only if the utility is able to retain it for further capital expansion. Congress should make it plain that if the regulatory authorities require it to be directly or indirectly flowed through to the customers, it is not available;

(5) If an option is granted to take the increased investment credit or the 4 percent credit based upon payroll taxes paid for Social Security, the option should be available annually. Requiring a binding election through 1980 is unduly restrictive. Similarly, if an option is given to take the House-passed jobs tax credit, an annual election should be provided.

This winter's energy emergency has highlighted the importance of natural gas to America's factories and households. A.G.A. member companies provide gas service to 45 million customers (which translates into an estimated 160 million consumers) in all regions of the country. Gas is both clean and highly efficient, and it enjoys a considerable cost advantage over other forms of energy. The industry has already invested more than 50 billion dollars in facilities—including one million miles of pipeline—to bring natural gas from the wellhead to points of utilization.

While traditional production will continue to be the mainstay of the industry, it is essential that we develop supplemental forms of gaseous energy to cope with the inevitable decline of domestic supply.

The natural gas industry is and will be a capital intensive industry. We know that we must engage in a massive capital program during the next ten years anticipating requirements for capital expenditures of $66 billion (in terms of 1975 constant dollars) by the mid-1980's. If we allow for an inflation rate of 6 percent, our outlays will surpass $90 billion—a figure which makes our current $50 billion investment look modest by comparison.

As one example of these capital requirements, we will need financial assistance and incentives for the development of the much-needed substitute natural gas sources. Several large-scale, first-generation technology, coal gasification plants are in the advanced planning stages. Each one is estimated to cost approximately one billion dollars and will require four to five years to construct. This figure is equal to the total net worth of many of the larger gas companies. To the extent that tax benefits in legislation can be made available for such projects, the projects will be on-line and providing badly needed gas much sooner. These are not the only projects being developed by our industry. In addition to coal gasification and conventional construction, billions of dollars are required for the importation of liquefied natural gas and the movement of Arctic gas to the lower 48 states.

Legislative and regulatory assistance is necessary to assure the financing of these major projects.

President Carter's proposal that the investment tax credit be increased to 12 percent conforms to previous recommendations of the A.G.A. to Congress. It should be promptly enacted into law. We also commend the President for recognizing in his proposal the importance of making the increase in the investment tax credit permanent. Unfortunately, in the past the investment tax credit has been an "on-again, off-again" incentive, thereby making it extremely difficult for the gas industry, as well as other industries, to formulate their capital outlay plans on a rational, orderly basis with the knowledge that the credit will continue to be available. For example, under current law, property acquired or placed in service after December 31, 1980, would be subject to only a 7 percent investment tax credit (4 percent in the case of public utilities).

For the increased credit to achieve maximum effect, it must be made a permanent part of our tax laws in the same manner as the depreciation deduction. Only with the stability of a permanent credit can the gas industry and the financial community plan and carry out the capital expenditure programs that are so vitally needed to deal with the serious natural gas supply problem confronting our country.

Merely increasing the investment credit from 10 percent to 12 percent, however, will not provide a meaningful benefit and stimulus to major and very important segments of the natural gas industry. Without a concomitant increase in the limitation on the use of the increased investment tax credit, these segments of the industry will achieve only minimal benefits.

Certain public utilities are now allowed the benefit of the investment credit to the extent of 90 percent of their tax liability in 1977; this allowance then decreases 10 percentage points a year to the generally applicable 50 percent limitation in 1981.

This increased limitation, however, which is highly beneficial to the entire electric industry, benefits only a limited segment of the gas industry—those taxpayers in the local distribution segment of the industry. Under current law for purposes of the increased investment credit limitation, the term "public utilities" does not include utilities engaged in the transportation of gas by pipeline or those engaged in the development of supplemental sources of gas supplies, such as those engaged in the production of synthetic gas from coal and liquid hydrocarbons as well as those engaged in the liquefaction, transportation and gasification of natural gas. Thus, these companies are excluded from the benefits of the increased limitation.

These excluded segments of the gas industry are the very segments which must raise the greatest amounts of capital in the foreseeable future. Since the critical problem of the gas industry is to finance these new, capital-intensive gas supply facilities, they must not be excluded from the benefits of the higher investment credit limitation. Distribution, pipeline, and gas supply facilities all are essential to continued gas service. One cannot do without the others.

As the A.G.A. has suggested in the past, the distinctions in our tax laws based on the type of gas utility should be eliminated and increased benefits should be made available on the same basis to all gas utilities. The Congress has already recognized the wisdom of this policy in part by increasing the investment credit to 10 percent through 1980 for both gas distribution and transmission companies. Now is the time to eliminate the distinction altogether both for the investment credit rate after 1980 and for purposes of the investment credit limitation.

Finally, if the 12 percent investment tax credit is to achieve its purpose for natural gas utilities, these utilities must be allowed to retain, as non-regulated industries can retain, the entire amount of the investment credit and not be required to flow through directly or indirectly any part of the benefits of the credit to their customers in the form of lower rates. Congress has already taken a partial step in this direction by providing that the benefits of the investment credit ESOP (which are intended to benefit the employees of a corporation) would be unavailable if the credit is flowed through to ratepayers. This policy of discouraging regulatory agencies from flowing through the tax benefits of the investment credit to the ratepayer by causing a loss of that credit should now be extended, as the A.G.A. has frequently requested, to the entire investment credit. The credit is designed to stimulate business investment and to assist the natural gas industry in meeting the capital expenditure requirements it faces. The benefits of the credit should be retained within the companies for further capital expansion which is the primary purpose for which the credit was created. These objectives are frustrated if regulatory commissions are allowed to pass on the increased cash flow from the investment credit to customers through a reduction of utility rates. Also, flow-through of the credit to customers in the form of reduced rates would encourage waste and frustrate current government efforts to conserve our valuable energy resources.

Accordingly, Congress should specifically provide that the investment credit (both the present 10 percentage points and the additional 2 percentage points) will not be available to a utility if its regulatory agency requires it to flow-through in any manner or form the tax benefits of the investment credit to the ratepayers. Furthermore, there should be no options or elections provided to the utilities to flow-through these benefits. The existence of any option places the utility in an extremely difficult position. Pressure on utilities by regulatory agencies to make elections which would lower consumer rates can be subtle, but

very intense. In many cases, the practical result of the existence of an option or election would be forced flow-through of the benefits of the credit to ratepayers, thereby frustrating and nullifying the purpose and objective of the credit.

The additional 2 percent investment credit would generally be more beneficial to capital intensive companies, such as those in the natural gas industry. Nonetheless, the A.G.A. wishes to point out that there are borderline situations in all industries where there may be yearly variations whether the additional 2 percent investment credit, the 4 percent credit on the amount of social security taxes, or the House-passed jobs tax credit is more beneficial. As I have indicated, A.G.A. believes strongly that an investment credit increase to at least 12 percent is necessary at this time. If, however, the Committee decides to provide for one or more other types of credit, such as the 4 percent payroll credit or the House-passed jobs tax credit, it would seem most appropriate to allow an annual election of the most beneficial credit in a particular year instead of a binding election effective for a period of years. The A.G.A. does not see the necessity for such a restrictive binding election. An annual election would provide the necessary flexibility to ensure the maximum benefits to all companies in all segments of all industry, whether capital intensive or labor intensive.

We want to thank the Committee for this opportunity to testify, and will be most pleased to answer any questions you may have.

The CHAIRMAN. Under the rules, we are operating by unanimous consent, and we will call Dr. Jack Carlson, vice president and chief economist of the Chamber of Commerce of the United States.

Is Dr. Carlson here?

VOICE. He is testifying on the other side in a House committee. We have called him. He is on his way.

The CHAIRMAN. Is Mr. Reid Thompson here?

VOICE. No, he is not, Senator.

The CHAIRMAN. He undoubtedly heard me say that we were going to come back at 1:30. I think we might want to ask some questions then.

Senator HANSEN. Mr. Chairman, Mr. A. V. Jones is here.

The CHAIRMAN. I am very sorry, that is an oversight.

Mr. A. V. Jones, we would be happy to hear you right now, sir.

STATEMENT OF A. V. JONES, JR., PRESIDENT, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Mr. JONES. I am A. V. Jones, president of the Independent Petroleum Association of America. We have a membership of small businessmen who have a vital stake in what is going on in these hearings right now. We feel that it should be apparent that long term necessity to provide full employment, prevent unmanageable economic recession, and contain inflation, will require an increasing capability to provide secure energy supplies for this country.

Experience has proven that tax policy for energy resource development is a vital element in stimulating the energy supply required to assure economic growth.

On the back pages of my testimony is a chart that I would like to call your attention to that plots energy employment and economic growth from 1955 to 1976.

This chart demonstrates that with the use of energy, the growth of our economy and employment levels are so closely related they are almost mirror images of one another. It illustrates that with each additional 4 million jobs there is an increase in energy consumption of 1 billion barrels of oil or its equivalent in other energy forms, an increase in gross national product of approximately $100 billion.

The second chart that is with it there indicates that this country is going to need to provide 19 million additional jobs by 1985. This is based on a projection of labor force by the U.S. Department of Labor and assumes at that time an unemployment of 4 percent.

To employ this many additional persons, it would require that we increase our energy supply by approximately 48 percent from where it is now. Concerted efforts must be made by government, industry, and individuals to conserve all forms of energy.

We applaud energy conservation. However, because of long-lead times involved in the installing of more efficient energy consuming equipment, converting our homes, our factories and our energy use habits, these historical relationships will be expected to continue with little change through the year 1985.

Where are we today? In January of this year, for the first time, petroleum consumption exceeded 20 million barrels per day; imports of petroleum exceeded domestic production. We were approaching 50 percent dependence on foreign sources, where as as little as 9 years ago we had the ability to produce the amount of oil and natural gas that we consumed each day.

Our January balance of trade reflected the worst deficit in the history of the United States, with imported oil accounting for the major share.

In the year 1976, the total cost of imported oil and natural gas was $37 billion. By comparison, the total wellhead value of all domestic oil and gas which provided 2½ times the energy as our imported oil, was only about $36 billion.

There appears to be no disagreement about the need for stimulating our economy. What seemed to us to be overlooked by both the administration and Congress is the overwhelming evidence that to meet the Nation's economic goals, we must have a vigorous, healthy and expanded petroleum industry, one that is being encouraged instead of discouraged and, in my statement, I have a list of the discouraging things that has happened to our industry in the last couple of years, starting out with the so-called Tax Reduction Act of 1975, which took about 85 percent of the domestic oil and gas depletion allowance away from us while leaving it for 100 other extractive industries, on down to price roll backs of more than $2, leaving us at an actual dollar price for new crude oil in this country less than we started when the omnibus energy bill last year supposedly was going to get us out from under price controls.

Of course, last year's Tax Reform Act did impose what we feel were punitive tax legislation on the independent segment of the oil and gas business.

The prime impact on domestic oil and gas producers is to remove roughly $5 billion annually that otherwise would have been available for additional drilling and exploration. This listing should dispel any doubts as to why our domestic oil and gas production is declining and why we grow more and more dependent on insecure foreign oil.

The 10,000 independent producers and explorers who drill most of the wells should be making a maximum effort to develop new supplies, but they are not because of the counter-productive effects of much adverse Government policy. During 1975 and 1976, active rigs were basically at a standstill, roughly with 1,650 rigs running.

Twenty years ago, we had 2,600 rigs running in this country. We should be utilizing 3,000 rigs if we are to bring on the new production adequate to reverse our intolerable dependence on foreign supplies.

This will require positive action on the part of the Congress and the administration.

If we are going to activate all of these rigs, then the Nation's independent producers must be fully mobilized. Drilling by independents will be seriously inhibited by the penalty tax on intangible drilling expenditures enacted last year.

Unfortunately, this tax penalizes most severely those who are the most aggressively exploring for oil and developing our natural resources, Independents who committed substantial capital resources to drilling last year are only now discovering the devastating effect this tax had when it brought their IDC's under the 15-percent minimum tax.

For many of them, their increased tax liability for 1976 can only be met by reducing their drilling budget in 1977. This tax treatment is counterproductive, where we can least afford it, because it is imposing a direct tax on drilling expenditures rather than income.

Clearly, the need to maximize oil and gas development and production in the short term is being frustrated by this tax on drilling expenditures. Accordingly, we urge the committee to reconsider this provision and eliminate it as a major impediment to drilling.

We further encourage and urge you to consider an energy development investment credit to be in force until our present overdependence on insecure foreign energy supplies is corrected. This can only be achieved by major efforts to stimulate the search for and development of all domestic energy resources, oil, natural gas, coal, the various synthetics, nuclear and solar energy.

At a minimum, a new credit for energy should make capital commitment to energy research, exploration and development at least as attractive as alternative investment in lower risk industries.

In conclusion, Mr. Chairman, I wish to emphasize that our industry is confused as to what the Government wants it to do. We are not going to do all that we are capable of doing unless we are convinced that the Congress and the administration is ready to give us the incentive to go out and find the oil and gas and do something to offset the repeated disincentives that we have had during the past two years.

Thank you very much.

The CHAIRMAN. Thank you so much, Mr. Jones.

We will hear next from Dr. Jack Carlson.

STATEMENT OF DR. JACK CARLSON, VICE-PRESIDENT AND CHIEF ECONOMIST, CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY ROBERT R. STATHAM, DIRECTOR, TAX AND FINANCE SECTION, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. CARLSON. Thank you very much, Mr. Chairman. I am pleased to be here on behalf of the chamber of commerce. Accompanying me is Robert R. Statham.

Mr. Chairman, if you do not mind, I will be brief. I would like to draw the attention of the committee to the fact that the stimulus package that we are talking about is not $15 billion for each of 2 years given the budget revisions coming out 10 days ago. It is some $17 billion for fiscal year 1977 and a $27 billion stimulus for fiscal year 1978.

It is a much larger package than we were talking about previously. Modest stimulus to the economy of the size initially offered by the President can be justified.

Such a stimulus should be primarily in the form of permanent tax cuts for both individuals and business and should not cause a faster growth of Government spending. Efforts to assist the structurally unemployed—those who experience difficulty finding employment even during good times—should be concentrated in the private sector where four of five career jobs are located.

Accordingly, the national chamber recommends: direct stimulus through tax relief for job-creating investment in plant and equipment; increased permanent tax reductions; solving structural unemployment through incentives to private employers; and scaling down Federal spending proposals.

There is too little stimulus for job-creating investment in plant and equipment in the President's proposal and none in the House Ways and Means proposals. Too much emphasis has been placed on public works and little or none on "private works" where nine-tenths of investment normally occurs.

Nonresidential investment in this recovery has been well below the rate of investment during earlier economic recoveries since World War II. Moreover, the ability to attract funds for necessary investment has declined during the last decade. Profits as a percentage of national income have declined from 12.3 percent to 10.7 percent. Also corporate profits taxes and corporate social security contributions are taking a larger proportion of corporate profits—59 percent in 1968 and 74 percent forecast for 1978.

Unless investment increases it will be impossible to have the necessary plant and equipment for workers when the economy approaches capacity operations. In the absence of a substantial increase in private investment, unemployment will remain high, more attempts to socialize job creation will be made and the danger of a return to double-digit inflation will be increased.

Stimulating consumer buying through individual tax cuts will not be enough to stimulate business investment on a timely basis. Business investment in equipment and structures is lagging behind growth of sales. It is also lagging behind capacity utilization and availability of loanable funds.

Stimulating investment now will achieve two objectives: faster job creation in the near term and providing tools for the larger work force in the longer term. Presumably this fact has not been made clear to the House or it would not have ignored "private works" by concentrating exclusively on "public works."

Clearly the House Ways and Means and to a lesser extent the administration proposal are anti-investment. There is no direct stimulus in the House Ways and Means proposal and only a small stimulus the administration proposal. The administration would increase the

investment tax credit from 10 to 12 percent only for equipment. No stimulus is provided for structures in either proposal. Only a massive public works program is proposed. In sharp contrast, stimuli in 1975 and 1964 provided encouragement for both equipment and structures and at least twice the proportion.

We strongly recommend adoption of President Carter's proposed increase in the investment tax credit. Also we recommend that the corporate surtax exemption be increased to $100,000 with a 20-percent normal tax on the full amount subject to the surtax exemption.

While the President's proposed $11.4 billion rebate based on $50 per person will temporarily stimulate the economy, the effect will pass quickly and the timing may create problems. An $11.4 billion rebate effective May 1, 1977, will cause real disposable income and GNP to increase abruptly for a few months and then return to previous levels. The roller coaster effect is also reflected in employment.

When the tax cut is made permanent, real disposable income, GNP, and employment increase to higher plateau levels and remain there.

The roller coaster effect of a tax rebate could be particularly injurious to the economy at this juncture because an inventory cycle might be triggered. Retail sales increased all through last year but business inventories in relation to sales, declined throughout the year.

When retail sales were particularly high during the Christmas season, inventories declined more rapidly. But inventories could not be replenished in January and February because bad weather and the Government-caused natural gas shortage slowed production and deliveries.

Now, businessmen are attempting to build inventories based on the recent sales trend. This trend will be distorted when the Federal Government passes out $50 checks in May. Retail sales will temporarily rise. The resulting further decline in business inventories may induce an even greater than otherwise volume of inventory replenishing orders from business firms, as happened in 1975.

If this replenishment proves to be excessive, a sharp downturn in business orders will occur by next fall or winter, causing an employment cutback. This pattern may have occurred following the tax rebate in 1975.

Inventories were built up for a larger sales volume temporarily brought about by the rebate. It took business firms a full year to reduce inventories to a desirable level and caused unemployment to increase. Both the normal roller coaster effect of temporary tax cuts and the abnormal conditions now, make a rebate a risky way to stimulate the economy.

Moreover, the unusually cold weather and Government-caused shortage of natural gas has resulted in a temporary decline in both actual and potential output, by about $5 billion. Abrupt stimulus will tend to cause higher prices than would occur with a smaller but continuous stimulus. If, instead of a lump-sum increase of $50 in May, income increased $4.67 per month, then purchasing power would be spread throughout the year, greater supplies would be forthcoming and substitutes could more easily be found. The inflationary impact would be less.

As Federal Reserve Board Chairman Arthur Burns has observed, the risk of a slower growing economy will occur late in 1977 or 1978.

Therefore, temporary stimulus now will be worn out by the time it is needed. A permanent individual tax cut would provide the stimulus through 1977 and 1978 and thus counter the likelihood of a slowdown later in the year or next year.

The administration has proposed an optional, small wage subsidy based on a tax credit equivalent to 4 percent of social security contributions. The House passed a tax credit up to $1,680 for new hires up to a limit of $40,000 per firm. Other legislators propose a wage subsidy limited to assisting unemployables—structural unemployment. All three proposals serve different purposes and assist companies differently.

An across-the-board wage subsidy as proposed by the administration can provide additional cash flow to all industries. Retail and other labor-intensive industries would benefit most.

The House bill would assist significantly only new hires up to a maximum of 24, but would encourage jobs only in small firms and those growing rapidly. Synthetic materials would benefit while agricultural materials might not, faster growing export industries would benefit more and slower growth domestic industries would benefit less; service industries would benefit while primary industries would benefit less; the construction industry would benefit twice—from increased public works and the tax subsidy—while other industries would not; faster growing sunbelt-located companies would benefit more than snowbelt companies.

If eligibility for a wage subsidy were narrowed to the structurally unemployed, it could be considered a substitute for spending programs for the same purpose. But it would have the big advantage of creating productive jobs in the private sector and not dead end jobs in the public sector. There would be some likelihood that private sector subsidized jobs could work into permanent, career, unsubsidized jobs. Four-fifths of career jobs are now located in the private sector.

Proposals for a large increase in Federal spending raise fears that the Federal Government will become the engine of inflationary pressures. An increase in Federal spending should be limited to special purposes that will stimulate the economy— such as helping to overcome structural unemployment problems.

Public works are particularly ill-suited for quickly stimulating the economy. Public works projects require the elapse of a long time period before the jobs are created. Based upon estimates provided in the fiscal year 1978 budget the administration's public works program would create more jobs in 1979 through 1982 than during 1977 and 1978.

Moreover, the potential for expanding construction is much greater through private works—structures—than public works. Yet public works are proposed to receive at least a twofold increase and no stimulus is proposed for private works—factories and buildings. The investment tax credit applies only to equipment. This is clearly a serious oversight.

If the Government acts as the employer of last resort for the structurally unemployed, it should do it in the least costly way and where the most potential for new jobs exists. Four-fifths of all new jobs are created in the private sector and jobs can be created easily with a 25-percent subsidy of costs. Yet the thrust of the major stimulus pro-

86-032—77——17

posals is to create jobs where less than one-fifth of the new jobs will be created and with 100-percent subsidies. A tax wage subsidy of modest size would be a preferable route to take on a pilot test basis before expanding it.

For overcoming cyclical unemployment, tax cuts for individuals and business, and spending increases only for essential Government services should be used—but these must not replace job creation in the private sector. Public service jobs for employable persons is a disservice to them. These jobs last only for 1 year at the longest and thus are dead end. It is far better to provide permanent, career jobs in the private sector.

Public sector jobs cost $8,200 per year on the average or nearly twice the minimum wage, and thus create inequities for those who are working without subsidy, and for less.

Also, public sector jobs do not always result in a net increase in employment. Often cities use public service job funds to pay for existing employees or employees they intended to hire anyway.

In conclusion, we recommend that the Senate:

Increase the size and include all taxpayers in a permanent tax cut for individuals;

Provide incentive for investment by increasing the investment tax credit for equipment and by increasing the corporate surtax exemption to $100,000 for both equipment and structures;

Provide incentives for hiring workers in the private sector, such as the Carter tax credit, the House Ways and Means small business tax credit, and particularly tax credits for hiring the structurally unemployed on a test basis.

The CHAIRMAN. Thank you very much.

Now I suggest that we call back Mr. Walker and we will ask him the questions I had in mind.

Senator Hansen, do you care to ask any questions?

Senator HANSEN. Mr. Chairman, just let me say "Amen" to what Dr. Walker said. I think he is right on target. I was particularly impressed with his testimony and the testimony of some other witnesses. I think that inflation is a real problem. It seems to me that we take all of the easiest choices around here; we do not want to offend anybody.

We will probably vote to raise the minimum wage in the country because that clearly will make employment opportunities fewer and less for people. We propose to give credits of one kind or another to business to encourage them to do what we have just discouraged them further from doing when we raise the minimum wage.

The credits are going to have to be paid for by Government. We will not raise taxes to pay for that part of the bill and because of our reluctance to raise taxes, we are going to add to the inflationary pressures. All of which means, in my judgment, that we are going to make it tougher for people to find jobs. We are going to make the short of investment capital that is required harder to come by.

We are going to be actually working against a majority of Americans, and the easy way out is to let inflation pick up the difference in the cost of these various programs. It is encouraging and refreshing to me to hear the witnesses that we heard this morning, as Senator Curtis said, who happen to agree with me.

Thank you.

The CHAIRMAN. Thank you very much.
Senator Danforth?

Senator DANFORTH. I would like to ask the same question to Dr. Walker and to Dr. Carlson, Mr. Chairman.

I am interested in your comments about how the tax laws are now written so as to encourage immediate consumption and discourage savings and investment.

Sometimes politically it is a little bit difficult to take the position, as you pointed out in your statement, about which Herblock is going to draw a cartoon. So there has been one approach that aims the inducement at more savings and investments—not at corporate capital investment immediately, but at the small investor to encourage him to save more, to encourage him to invest more.

That would be an increase in exclusions for dividends received for what it is now, which is $100 for an individual, $200 for a joint return; up to $600 for an individual, $1,200 for a joint return.

To enact an exclusion for interest received of $100 and to provide a limited deduction for amounts invested by the smaller investors in securities, all of these would be aimed particularly at smaller investors, at small savers, to try to encourage people to save more and invest more with the view that that would have a positive effect on saving, investment, capital formation down the road.

What I would like to ask you, would you view such a proposal favorably or unfavorably?

Mr. WALKER. As a matter of pure economics and theory of public finance, I would question those sorts of approaches.

But, given our political system, given the misinformation about our tax system, given the political inability to do the things directly that I think that we should do, then I am pragmatic enough to say that we will have to go at this in various ways that are politically acceptable.

So long as we have the political forces that we do, I would look at any of these various things sympathetically. I think some of them are superior to the others.

Senator DANFORTH. You did not exactly give me the most quotable quote with your initial set of negative reactions to it.

Given the realities of the situation, would some sort of tax incentive for small investors to save money in savings and loans, to put money in investments of one kind or another, to buy equities, would that kind of tax incentive to the small investor create jobs? Would it create capital formation? Would it be helpful?

It might not be the best of all possible worlds, but would it move the ball forward from your standpoint?

Mr. WALKER. Yes, sir, I am convinced that it would.

The CHAIRMAN. Senator Dole?

Senator DOLE. I only have one question.

I want to note first, Mr. Chairman, just so the record will be correct, that we are in the process in the Committee on Agriculture of having hearings every day from 9 o'clock until who knows when. When you send out your attendance chart, I hope you correlate those with other committees.

The CHAIRMAN. What I wish you would do, is to just call over here and have someone give you credit for the fact that you are at the Agriculture Committee. We will be glad to do that.

Senator DOLE. We have an interest in this committee, of course, but we also have an interest in Louisiana rice producers, and I try to spend time in both committees.

The CHAIRMAN. That is very important, sir.

If you look after Louisiana rice on the Agriculture Committee, I will look after Kansas taxes on this committee.

Senator DOLE. We will do our best. There is a lot of interest in food stamps this year on our committee because more people in agricultural areas are getting them.

With reference to the employment tax credit, did you touch on that at all?

Mr. WALKER. I noted the criticism in the business community, which I share, of the action of H.R. 3477 which we strongly criticize as being ineffective and being a new tax haven, or shelter.

Senator DOLE. How does it create a tax shelter? We may need one of those.

Mr. WALKER. I am not the expert in this area. There is an excellent article in Tax Advocates and Analysts, which is a public service interest group which I do not always agree with. But this time they are absolutely correct. Basically, it works this way.

If you are a self-employed entrepreneur above a 50-percent range, in the 70-percent bracket, the arithmetic is such that you could hire someone, let him stay home and do no work, take the credit and still make money out of it. This is because you are paying 70 cents on the dollar in your own taxes and you get back a 40-percent credit.

Senator DOLE. That would be earned or unearned income?

Mr. WALKER. It would have to be in the unearned income range. You would have to be above 60 percent, I guess. It depends. When you get the 103 percent in there, it complicates it.

This article explains it well.

Senator DOLE. If you do not have to work for it, you can receive it as a Member of Congress. If you have to work for it, it is illegal under the Ethics bill.

I want to make sure that I am in the right category.

Thank you.

The CHAIRMAN. I wanted to ask you about this aspect of the problem.

If we were to repeal the investment tax credit, based on the revenue estimates it would appear that we would pick up $9 billion. Is that the present estimate?

Mr. WALKER. I will get it in just a minute.

So-called tax expenditures—at least $9 billion; I think it is $12 billion in the next fiscal year.

The CHAIRMAN. On two previous occasions we did repeal the investment tax credit. We estimated that we would pick up $5 billion. Instead of gaining $5 billion, we lost $5 billion in corporate income tax collections alone.

Then we put the investment tax credit back into effect; and we estimated that since that was a tax cut, it would lose money for the Government. Instead, it made money for the Government.

Then we repealed it and estimated it would have $7 billion.

This time, instead of saving $7 billion, we lost $7 billion.

So, while people try to explain it away, the fact is that every time we remove the investment tax credit, it has worked out just exactly opposite to our estimates.

Of course, I know they try to explain that away by saying people hear you are going to repeal it so they rush out and place their orders to come under the wire. Then they hear you are going to enact it and they hold back their orders waiting for it.

The fact is, it has worked out just exactly the opposite for the estimators. That gets me to this: How can we work out some way where we get the feedback of something like the investment tax credit reflected?

You mentioned these standard operating procedures in the Treasury. To me, that can only mean that those computers cannot think for people. All they can do is give you back an answer that has been programed in there to begin with.

Why is it that we cannot work out some way to have revenue estimates show us what the feedback is and what the overall effect of something is where you can expect it to have a stimulating effect and it does have a stimulating effect?

Mr. WALKER. I would make two comments on that, Mr. Chairman, and my field of economics is not specialized in this particular area, but I do have a feeling that we have not tried hard enough.

Having said that, we are getting out of economics into the realm of psychology, because it depends on what people will do under changed circumstances.

I happen to believe—and the whole discipline of economics is based on—the fact that people prefer more to less. As a consequence, if you give them a reward for doing something, they will tend to do more of it. That is the theory of the job credit and the investment tax credit.

At the very least, as a start, knowing we cannot work this out in terms of econometric models, I would hope that the press, that economists, politicians and others, would quit referring to a 2-point increase in the investment tax credit as costing $1.5 billion or so. At least we can conclude on the basis of past experience that in the long run, it will not cost that at all. It will probably not cost anything. We will probably gain revenues.

The CHAIRMAN. All this mischief starts in the Treasury. You used to work down there. You used to come up to the Finance Committee on these bills. You gave us the same kind of estimates that I am complaining about now.

It was under your administration. You were in charge of it yourself. Why can that thing not be straightened out, so somebody can say, look, on the face of it, it looks like you are going to lose $1.8 billion. Our experience with that type thing is that it brings on more orders; it puts more people to work; and to tell you the truth, really, the objective evidence of what happened when you put it back on and took it back off, gives us four or five cases to look at and the objective evidence is that it is not costing you anything.

The increased economic activity resulting from the investment tax credit and the impact that it has on other things that are taxable, such as wages, winds up yielding a net gain.

I am not asking you to take a leap on what the objective records seem to show, but why cannot the Treasury, and the people who agree with you, make the computer come up with the right answer, other than an answer that seems to be 180 degrees off target?

Mr. WALKER. I went to Treasury in 1969—this is not an excuse, it is a reason—with a long list of things to do. I did not get them all done. I wish I had put that one in higher priority.

That is No. 1.

No. 2, one thing I am very disappointed in—even though I was very anxious to see Congress take a stronger approach to controlling spending through the budget process—I was very disappointed to see the incorporation in the legislative language of the tax expenditure concept without a thorough examination of just what it might mean, of what it might mean along the lines we are talking about now.

It seems to me that the members of the Budget Committee and this committee and the other committees could direct the attention of the joint staff, the Congressional Budget Office staff, and the staff of the individual committees in taking a look at this.

We are caught in a Catch-22. You cannot reduce business taxes because it gets outside of the budget parameters of how far you can go. Commonsense tells you though that those budget figures on impact are really not what the situation is.

You have quite a staff here now, and I would like to see the members say to them, why do you not take a hard look at it, too? I would like you to say that to Mr. Blumenthal and I will say that to Mr. Blumenthal, but you will have more influence than I will.

It needs to be done. I am not trying to be facetious.

The CHAIRMAN. Thank you very much.

Mr. WALKER. By the way, that figure, according to so-called tax expenditures for corporations in fiscal 1978, investment credit is plugged in at $9.7 billion; for individuals who also get the credit, $2.2 billion, for a total of $11.9 billion.

The CHAIRMAN. You and I know that if you repealed it, you would not make any money. You would probably show, by the time you got through repealing it, rather than a revenue increase of $11.9 billion, it would show a revenue loss of something close to that amount.

Mr. WALKER. It would throw hundreds of thousands of people out of work. You would immediately quit collecting taxes from the individual income taxes. That is not plugged in here anywhere.

The CHAIRMAN. That ought to be there. Thank you so much.

Senator DOLE. Mr. Chairman.

The CHAIRMAN. Mr. Dole.

Senator DOLE. Not a question, but I agree with you on the investment tax credit. I think it should be increased. I wish you would take a more sympathetic look at the employment tax credit. It has not been tried. Maybe that could be effective in some areas.

Mr. WALKER. Perhaps as an alternative with the investment credit, it might be effective. I suggested also as an alternative a cut in the corporate rate, including the normal tax level, too. That is better for small business.

As an alternative, the start of an experiment on a modest basis, I could not object to that, although there are problems that Mr. Woodworth and Secretary Blumenthal pointed that are very real indeed.

The CHAIRMAN. Thank you.

Now, let us call Mr. George H. Lawrence, president of the American Gas Association.

Senator Hansen?

Senator HANSEN. Mr. Chairman, I have no questions. Let me repeat what I said earlier.

I think Mr. Lawrence has made a very important contribution here today. We are faced with an extremely serious situation. When you stop to reflect on the fact, that we have increased our dependency on foreign sources of supply to upward of 50 percent, so one out of two barrels of oil or gas equivalent that we used has to be purchased abroad, the urgency of given serious consideration to the recommendation contained in Mr. Lawrence's testimony, I think ought to be brought up.

Thank you very much indeed.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. I have no questions.

The CHAIRMAN. Senator Dole?

Senator DOLE. I have no questions.

The CHAIRMAN. Thank you very much for your statement. You have made a good case and I hope we can do something about it.

Next, let us call Mr. A. V. Jones, president, Independent Petroleum Association of America.

Senator Hansen?

Senator HANSEN. Mr. Chairman, I have known Mr. Jones a long while. We have an interest, of course, because of the fact that Wyoming is an important natural gas and oil producer.

I suspect few Members of Congress understand really what has been done to this industry. I would hope that this committee would avail itself of the opportunity presented by Mr. Jones' appearance and others to understand this situation as clearly as he does, to call attention to all Members of Congress as to what we have done to this industry.

We changed the tax laws—and he details seven different actions here—and made certain laws retroactive to January 1, 1976. I have heard more than one independent say, well you have caught me once. You are sure not going to catch me again.

When we talk about the number of rotary rigs operating in this country, the number we should have, the number that we need and the contribution that those rigs could make to a move in the direction of greater energy self-sufficiency in this country in a way of stimulating a lot of job opportunities, and then consider the whole unrealistic approach that we have taken in rolling back domestic prices and putting caps on the way certain costs can be treated, in intangible drilling costs, in reducing the amount of depletion allowance that is applicable, we see that all this action has been very much against the best public interests.

I am fully aware that this is a popular group of people to beat upon these days because everybody knows that anybody in the energy business is a bad guy, and the oil business is the worst of all.

If you talk about gouging the profits or adding further to the disincentives that the industry has, you are going to have a lot of people cheering you on, yet the long-term effect of it and the relationship between jobs in this country and the availability of energy has been proven repeatedly.

I think that we need to undo much of the damage that a lot of demagogs have done to this industry. It is important to your State of Louisiana, tc mine, to the State of Kansas, and I am certain our friend

from Missouri has a very lively interest in it, so I appreciate Mr. Jones' appearance.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. I have no questions.

The CHAIRMAN. Senator Dole?

Senator DOLE. I share the views expressed by Senator Hansen. I have some particular knowledge of the independents' role in exploration and discovery. We still rely heavily on the independents and we have made it more and more difficult for anyone to have much incentive to expand in this industry.

I noted in your statement reference to creation of an energy development investment credit.

Mr. JONES. That has been kicked around. Ways and Means looked at it some, where all the money expended for acquiring leases, the geological, geophysical expenses, the drilling and equipping of the wells would be treated much like the investment tax credit that has been discussed here today, Senator Dole, and that this would be injected as a stimulus to the business to get on about exploring for domestic oil and gas, a stimulation to the business in the form of an investment tax credit, hopefully refundable as we discussed also where if you lost money drilling the wells you still may have something out there that would return you some of your capital.

Senator DOLE. Do you have any estimated costs?

Mr. JONES. It depends. I think this is the sum total of the crux of it—how much money are we going to entice into the exploration business in the next 1, 2, 3, or 4 years. I think our chart shows that we are going to have to almost double our drilling rate. It is going to take a tremendous amount of money to do it. The Government would have a lot of control over how much money we do entice into the business, including whether we should do it through an investment tax credit.

Senator DOLE. It would offset in part, at least, some of the disincentives.

Mr. JONES. We have been bombarded with disincentives. We come in to talk to people in the Government and in Congress, they say come up with something in the way of an incentive, and this is partially an answer to this suggestion.

Senator DOLE. Thank you.

The CHAIRMAN. I would hope that all of my colleagues will read, and I will see to it that as many of them as I can persuade to do so will read, the seven steps that Congress has taken to discourage the production of oil and gas in America.

Mr. JONES. Mr. Curtis suggested awhile ago, why do we not go back to 1969 and pick up the first reduction in percentage depletion that many people said would be the last. They said, "Give us 5 percent and then we will let the depletion alone, let the oil industry alone." That has not seemed to be how it worked out.

The CHAIRMAN. That is right. In 1969, they said, if the industry will go along with this, that is all you will have to worry about. And then they came up with seven more blows.

Each one of these steps represents a very severe blow to the oil and gas producers as a whole, does it not?

Mr. JONES. Yes, sir. A blow to us, and a good thing for the Arabs. Anything we lack, when they roll our price back, they replace it with more expensive, imported oil.

All we do is kick our people and cheer on the foreign imports.

The CHAIRMAN. Let me ask you this. You say that you really ought to have twice as many rigs operating. To be specific, you say, rather than 1,600 rigs operating, you should have 3,000 rigs operating?

Mr. JONES. Yes.

The CHAIRMAN. How long do you think it would take to get the additional rigs?

Mr. JONES. As a practical matter, the International Association of Drilling Contractors say there are 2,250 rigs in the country right now. This is the shame and disgrace of this whole thing.

We have about 400 to 500 rigs sitting there manned and ready to go, at a time when we have high unemployment, people wanting to work on those rigs, but not the economic incentive to put them to work. Those rigs can go to work immediately.

We can go ahead and in steps bring on the other 500 or 600 rigs necessary, I feel certain, by the year 1982, 1983. There is a lot of industrial capacity in this country that would start making rigs if it were profitable to make rigs, if there was a market for them. I think, as a practical matter, we can add 100 to 150 rigs per year without too much strain.

The CHAIRMAN. How many jobs would that be, if we could put that many people to work, if we could put 450 rigs to work?

Mr. JONES. A one-rig unit would take 20 to 25 people to run it. You are talking about not a large number of direct jobs, but how many people would have been working in this country last year when they did not have natural gas because those rigs are stacked.

All this investment credit and job credit is not going to avail us of anything if we do not have the power to run those factories. This is the point we would like to make.

You are talking about 100,000 people more or less that would get involved directly in running 3,000 rigs. You are talking about millions of people that this energy provides jobs for, ultimately.

The CHAIRMAN. So there are a lot of jobs involved in an area where you have a market for the product. A lot of things you try to produce more of, if you want to produce more automobiles for instance, you may not have a market for them. If you try to produce more shoes, or more clothing or something, you may not have a market for them. But in energy there is a ready market. They are crying for it.

Rather than give your industry some help, all these tax reformers can think of—I call them that; they call themselves that, but these self-appointed tax reformers, clobber the industry. Again, they clobbered it seven times and are trying to think of an eighth.

Mr. JONES. The man in this industry does not know whether he is wanted or not wanted. That is why we say that the administration's package does not address itself to doing something to stimulate the energy business.

It is less than a tax reform, less than a tax stimulant for this economy. No matter what you do, if we do not have the energy to run our businesses throughout the country we are going to be in bad shape. We are going to be in just as bad a shape—I hope I make this point very clear—if we import that energy from a foreign source. We have done nothing but export jobs to other places.

The CHAIRMAN. The Governor of Louisiana has become so frustrated and irritated by all of this resentment of the oil-producing States,

along with the producers, he announced he is going to do what he can, once this heating season is over, to reduce production every way that Louisiana can reduce production, on the theory that nobody is really serious about the matter.

One day they tell us we must do this and must do something else, and accuse us of withholding gas. The same day, the Secretary of the Interior signs an order to hold back the production of gas in Alaska and they proceed to give us an opinion out there that there will be no more drilling in the Atlantic Ocean.

My State administration is saying, we no longer believe you people are sincere. We no longer believe you are in earnest about any of this.

I think you know how the program to produce western coal is coming along; it is moving at a snail's pace, half the time in reverse.

Mr. JONES. This is the frustrating thing to all the energy producers—the answer to the question seems to be the farthest thing from where the Government says it wants to be.

We say, until they answer these first priorities for stimulating domestic energy supply, that this economy is not going anywhere. There are not going to be jobs, no matter what they do.

The CHAIRMAN. It would just seem—I know it is not fair to make this statement—but one would gain the impression in the industry, whether he be a coal producer or an oil producer or a gas producer, that it is the environmentalists or the tax reformers who are aggravating the energy problem. Whatever needs to be done, they are determined to do the opposite.

Mr. JONES. I think what needs to be done is obvious and they do take an exactly 180-degree tack. We applaud conservation, but we are not going to change the habits of the people in the United States in the short run. It is going to take all the energy we can possibly bring on to keep this economy moving in the direction it has got to move.

The CHAIRMAN. I made the statement at the time that I did not think that the Government's program would work down there. You cannot tell them, they are so popular. By the time they put the Louisiana program in effect, there was a cutback in production.

They are going to proceed to say, all right, we do not think anybody is serious. Everybody who is talking about increasing production of energy is a hypocrite. They are all a bunch of frauds, fakes, and hypocrites and we are going to prove it.

If that is the way they want to do business, we will do business that way.

It may be so popular that Texas may join.

Mr. JONES. It is a shame we have to polarize the country this way. I think it is past time that we do start looking past regionalism, and understand it. It is going to take Texas, Louisiana, Oklahoma, New Mexico gas and oil for the immediate future.

As Mr. Lawrence said, we have to bring on the maximum amount of gas and oil in this country. It is the only way to bridge the gap between now and 1985.

The CHAIRMAN. Does it seem quite fair that someone who accuses us of holding back on gas, when someone finds some gas and is trying to find out how much he has so he knows how big a pipeline to build, that the same fellow who is criticizing him comes from an area where they are doing everything they can to reduce production in the Atlantic Ocean.

Mr. JONES. That does not seem consistent to me, sir, but a lot of things they do do not. I do not try to come up with an answer.

The CHAIRMAN. Thank you very much.

[The prepared statements of Messrs. Walker and Jones follow:]

STATEMENT OF DR. CHARLS E. WALKER, CHAIRMAN, AMERICAN COUNCIL FOR CAPITAL FORMATION

SUMMARY OF RECOMMENDATIONS

1. The American Council for Capital Formation opposes enactment of H.R. 3477 as reported by the House Ways and Means Committee. We recommend instead an equitable permanent reduction in individual income taxes, matched by restraint in the growth of Federal spending, coupled with explicit measures that will significantly stimulate capital formation.

2. As to the latter, a minimal step would be to restore the Administration's original proposal for a business tax cut, taken by the taxpayer either as a 2-point increase in the investment tax credit or a 4-percent credit against payroll taxes.

3. We also recommend that the Committee consider a third option, namely, an across-the-board 2-point cut in the corporate tax rate. We believe that this would bolster business confidence, speed recovery, and ultimately gain rather than lose revenues.

Mr. Chairman and members of this distinguished committee: My name is Charles E. Walker. I am chairman of the American Council for Capital Formation, and I am accompanied by Dr. Richard Rahn, the Council's executive director. We are grateful for this opportunity to express the Council's views on H.R. 3477, "The Tax Reduction and Simplification Act of 1977."

The American Council for Capital Formation, Mr. Chairman, is supported by a diverse and growing group of individuals, businesses, and other organizations. We are convinced that the rate of capital formation, in the form of truly productive investment in new plant and equipment, must be stepped up significantly. Otherwise, this nation will be unable to create adequate jobs for a growing labor force, sustain a high rate of economic growth, compete effectively in world markets, and ultimately win the battle against inflation.

The American Council also believes that the Federal tax system impedes capital formation because it is biased in favor of consumption and against saving and productive investment. We therefore favor tax measures to eliminate this bias.

Given these convictions, the Council cannot support H.R. 3477 as reported by the House Ways and Means Committee. We do not oppose an equitable permanent reduction in individual income tax rates, provided that it is matched by restraint in the growth of Federal spending. Quite the contrary, we would applaud such action.

But the rebate proposal in H.R. 3477, although marginally justifiable when the ravages of extremely cold weather seemed to endanger the business recovery, now appears highly questionable, either as a stimulus for lasting consumption or as an indirect method of boosting capital formation. What the U.S. economy needs today is not a one-shot, fast-dissipating pump-primer, but tax actions to lower the after-tax cost of real capital, bolster business confidence, and thereby encourage capital spending. These tax actions should be permanent and dependable, not short-run and fleeting.

There are some who argue that all such capital-generating tax measures should be postponed until the Administration presents proposals for major structural changes later this year. We disagree. To be sure, the major benefit of such tax changes will accrue over the years ahead, but economists agree that, today, the major dragging factor in the business recovery is the failure of plant and equipment spending to rise significantly. Therefore, this Committee and the Congress can strike a double "blow for freedom"—by amending H.R. 3477 to include strongly stimulative capital formation measures, the current recovery will be bolstered and our long-run goals will also be more effectively served.

Mr. Chairman, rather than discussing the details of H.R. 3477 and proposed amendments, I would like to concentrate instead on certain economic, political, and public relations aspects of amending the tax laws to promote capital spending. Why does this prove so difficult?

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There are several reasons, all more apparent than real, including the contention that:

There is no "capital shortage";

Even if there is a "shortage," the public does not recognize the fact and therefore the legislative will to do something about it is weak;

The type of tax cuts which proponents of capital formation advocate are labeled by labor leaders, reporters, editorial writers and, as a result, the general public, as mere handouts to corporations and "Fat Cats"; and

The Government cannot "afford" the loss in revenue resulting from such reductions.

Let's look at each of these allegations.

NO CAPITAL SHORTAGE?

Semantics get in the way here, because we learned in Economics I that in a competitive market the amounts of real or financial capital demanded and supplied will, by definition, be equal. But last week Treasury Secretary Blumenthal put it aptly when he said:

We do have a capital shortage, in the sense that growth of physical plant and equipment is lagging behind the rate of expansion required to reach a full employment economy.

And he really hit the nail on the head in noting that, although recent growth rates in the stock of physical capital may be respectable by historical standards, "capital stock has not grown commensurately with growth in the labor force." The Secretary stated:

In the first half of this decade, the average amount of business capital per worker grew at only half the rate at which it had been growing in the 50's and 60's. In other words, we were not providing tools of production as fast as the growth in workers to use them. [Emphasis added.]

The Secretary concluded, in effect, that the balance in growth between "human capital" (the labor force) and physical capital was "out of whack" (those are my words, not his). And in reaching this conclusion, he joined a very respectable but diverse group of experts, including Professors Paul McCracken and David Meiselman, Federal Reserve Board Governor Henry Wallich, Alan Greenspan, The Wall Street Journal, the Congressional Budget Office, The Washington Post, and—I might add—the American Council for Capital Formation.

Yes, there is a "capital shortage." It is real. It is here. It will not go away on its own, or as a result of $10 billion in one-shot tax rebates to low- and middle-income Americans.

THE MAN ON THE STREET

If the highly regarded survey firm, Cambridge Report, is correct, the American people are also convinced that we have a problem. A survey in the first quarter of 1976 showed that the American people were woefully ignorant as to the meaning of the word "capital" (and, therefore, "capital formation"). Nevertheless, 25 percent believed that there is a "very serious" problem involved in "raising the dollars needed for business investment" in the years ahead, and 39 percent think the problem is "somewhat serious." Some 64 percent therefore believe that there is a problem that is at least "serious," and only 25 percent denied that the problem was "serious." The rest "did not know."

Also encouraging, 72 percent favored private investment over government investment, and two-thirds of those stated they would favor the private route even though it meant higher corporate profits. This last point is especially impressive when it is recognized that almost half of the respondents believed that corporate profits are too high.

This concern is reflected in Washington. Still another highly regarded polling firm, the Opinion Research Corporation, reported to its clients last year on interviews on the subject with "thoughtleaders" in the Nation's Capital. The results were as encouraging as they were surprising.

The question was framed as follows: "How serious do you think the shortage of investment capital facing U.S. industry will be over the next 10 years? Will it be very serious, somewhat serious, slightly serious, or don't you believe industry faces a capital shortage?" The "thought leaders" consisted of three groups: Legislators; officials of the Executive branch and regulatory agencies; and a combination of unions, public interest organizations, press and media. Here are the results:

[In percent]

	Very serious	Somewhat serious	Slightly serious	No shortage (or no answer)
Legislator	57	21	17	5
Exec/Reg agencies	57	33	5	5
Unions, etc	20	45	10	15 N.S. 10 N.A.

Most significant, of course, was the whopping response from 95 percent of the legislators that the problem is at least "serious," with 57 percent stating that it is "very serious" and 21 percent "somewhat serious." And perhaps the most surprising set of responses came from the "union-public interest-media group," with 65 percent stating that the problem is either "very" or "somewhat serious," and only 15 percent believing there is no capital shortage.

HANDOUTS TO BUSINESS AND THE RICH?

Why, then, doesn't Congress rush out today and enact a whole panoply of measures to promote capital formation? I think the Washington Post, in advocating tax incentives for additional investment, singled out the most important reason: Such cuts by definition reduce taxes on businesses which do the real investing in new plant and equipment, and on individuals who are in a position to save a substantial portion of their income—in other words, the people believed to benefit are those very corporate leaders and so-called Fat Cats whom Herblock inevitably portrays as corpulent, balding, vested, middle-aged men wearing dollar signs. (If you infer from this that the pictoral part of the Post's editorial page more than offsets what is often good economic advice in the left-hand column, then you are 100 percent correct.)

As to heavy taxation of people with high incomes, the public cannot have its cake and eat it, too. For job-creating investment to take place, someone has to save, and that means foregoing consumption. People with high incomes are in a better position to save than others. But the near doubling (in some instances) of capital gains rates since 1969 is hardly an incentive for a person to save and put the money into the type of equity financing so badly needed by the business sector.

Moreover, common sense tells us that more individual saving and investing would occur if the top marginal rates were reduced from 70 percent on so-called "unearned income" and 50 percent on "earned income." But even that 20-point differential is labelled as a "tax loophole" by some people. They would doubtless attack any effort to cut top marginal rates, calling it a handout to rich people.

Efforts to cut the very high marginal rates are also hampered by wide misunderstanding about the "fairness" of the Federal individual income tax system. Contrary to popular opinion, shaped largely by the press, the system is not regressive; it is in fact a naively progressive, ranging from average effective rates (*not* marginal rates) of less than zero for some of those who claim the earned income credit, to around 10 percent in the lowest bracket, up to 40 percent or more in the highest bracket.

Moreover, there are not thousands upon thousands of very rich people who pay no Federal income taxes. As the Treasury reported last week, in 1975 most taxpayers with incomes of $200,000 or over pay substantial taxes. The average effective tax rate is 35 percent and half of those taxpayers pay 40 percent or more. In addition, only 182 high-income individuals paid no taxes because of large deductions, and in the vast majority of instances the largest deduction was for interest expense. It is noteworthy that the Treasury report received scant attention in the press.

The conclusion is inescapable; popular conception notwithstanding, the Federal income tax system (excluding payroll taxes) is fair.

As to corporations, I know that I risk sounding like a broken record, but until reporters in general—and headline writers in particular—mend their ways, I am going to continue to point out at every opportunity that corporations don't pay taxes—people do. Corporate taxes ultimately are either passed forward to customers or backward to factors of production, that is, wage earners and suppliers of the savings to pay for new plant and equipment. To the extent the tax is passed forward to consumers, it is doubtless regressive, since low-income people spend a larger portion of their earnings on the products of industry than do high-income

individuals. But the point I want especially to emphasize is that headlines referring to a big cut in taxes "for business" are misleading. Much of the cut may be passed on to consumers, and if so, the cut is for the consumers, not business. If passed backwards, the cut is largely for wage earners, savers, and investors.

So, another conclusion that seems to me inescapable is that when it comes to productive tax reform for jobs, growth and inflation control, the press (with some exceptions) is usually part of the problem rather than the solution.

But in the same voice I would also criticize businessmen and educators. For too long we have done an exceedingly poor job in helping to promote better public understanding of how the U.S. economy really operates, and especially the true nature of the U.S. tax system. I am happy to report that, at long last, some significant progress is being made in dealing with this problem.

REVENUE IMPACT

Proposals to cut business taxes in order to promote capital formation are frequently attacked on the basis of revenue loss. "After all," these people say, "we already have huge deficits and this would simply make them bigger."

To be sure, every time a business tax cut is proposed, the revenue estimators at Treasury and on your staff plug into the computers and come up with estimates of the revenue that will be "lost" as a result. I intend no criticism of these able technicians in noting that they are almost always wrong. And it's not their fault; the state of the art is such that most revenue estimates relating to changes in business taxes simply aren't worth the powder to blow them up.

The basic reason is that the estimators have to assume that other things remain equal; but when business taxes are cut, decisions and actions that might have gone one way before the cut may turn out to be quite different. Take, for example, the 2-point increase in the investment tax credit proposed by the Administration. It is estimated to "cost" $1.5 billion. But a good case can be made—both in terms of logic and experience—that the cost will be "negative," that Uncle Sam will ultimately gain, not lose, revenue.

This is because the after-tax return from investing in new productive equipment will rise and businessmen will step up their capital spending. Employment will immediately benefit in the industries producing the equipment and, in the longer run, in the economy as a whole because we will be making up the shortfall of physical capital relative to human capital that Secretary Blumenthal referred to—workers will have more tools to work with.

Overall business activity will expand and profits will rise, from which the Government obtains a significant marginal increase in business tax payments. Payrolls also rise, so that taxable income of workers goes up, with still another boost to Federal revenues. And so on.

The record since World War II strongly supports the argument I have just presented. And there is every reason why it should. Taxes are a cost of doing business; the higher costs are, the more difficult it is to do business; so, a cut in business taxes is like a cut in any other cost—it encourages business activity, which in turn broadens the tax base and increases the taxable income of both individuals and corporations.

To be sure, the immediate impact of some capital formation measures (e.g., substantial integration of the corporate and individual income tax) could result in a sharp drop in revenues. But the answer here is not to avoid the action, but simply to phase it in smoothly over a period of several years. This approach can be especially effective, for if businessmen feel certain that the promised cuts will be forthcoming as planned, they in turn will adjust their long-range planning to the anticipated conditions down the road.

An important intangible aspect of the "revenue loss" argument should be noted. In business decisions, especially those that involve commitment of large amounts of resources for long periods of time, the state of business confidence relative to economic, political and social factors is crucial. A lack of confidence will lead to caution. Consequently, clear signals from Congress and the Administration that the problems of business—especially with respect to taxation and capital formation—are understood, and that appropriate corrective actions will be forthcoming, can in themselves lead to a faster pace of activity as fear and uncertainty are reduced.

CONCLUSION

The foregoing comment leads to my concluding point and the recommendations of the American Council concerning H.R. 3477. Unfortunately, business confidence,

which rose rapidly between the election and inauguration day, has sagged markedly since that time. One reason is a fear that the Federal Government—Congress and the Administration—is "soft on inflation," an image that the President's chief economic policymakers are striving hard to eliminate. I hope they are successful.

But still another reason is H.R. 3477 itself. Most businessmen believe that the rebate approach is unwise under current conditions. More important, H.R. 3477 includes an employment credit which has been almost universally criticized as ineffective and, according to some, even a new "tax shelter." There is nothing in the bill that will directly foster capital formation. Indeed, if the bill passes in its present form, capital spending might well decline because of the adverse effect on business confidence.

If this Committee and the Congress want the biggest "bang for the buck" from this legislation—and by "bang," I mean the creation of rewarding and lasting jobs, strong economic growth, and progress toward control of inflation—then significant capital formation measures should be included. At the least, the business tax cuts originally recommended by the Administration should be restored, although I should note that some of our members express concern over any tie-in between the Social Security base and the Federal income tax system, as proposed by the President.

As you know, the Administration proposed a 2-point increase in the investment tax credit or a 4-percent credit based on payroll taxes as an alternative to the taxpayer. The "cost" of these provisions is estimated at $2.6 billion. I would like to suggest that a third alternative be added, namely, a 2-point cut in the corporate rate. This alternative should apply to corporate taxpayers from "top to bottom," that is, the rate on the first $25,000 of income would be reduced from 20 to 18 percent, on the second $25,000 from 22 to 20 percent, and the surtax plus normal tax from 48 to 46 percent.

What would this "cost"? I am certain your revenue estimators can quickly give you figures in the traditional sense. But I submit that it would ultimately "cost" nothing and in fact constitute a very big net gain for the country. For in one action, this Committee and the Congress would be sending a signal to the business community. The word would be: "Yes, we understand the problem. This first step, however small, is simply a down payment on really significant measures to promote capital formation later in this Congress."

Thank you very much.

Statement of A. V. Jones, Jr.

SUMMARY

1. The long-term necessity to provide full employment, prevent unmanageable economic recession and contain inflation, will require an increasing capability to provide secure energy supplies.

2. Tax policy for energy resource development is a vital element in stimulating the energy supply required to assure economic growth.

3. This country is going to need the energy to provide 19 million additional jobs by 1985.

4. This will require that we increase our energy supply by approximately 48 percent.

5. We have but two choices: either undertake an all-out effort to maximize development and production of domestic oil and natural gas resources which provide 75 percent of domestic energy requirements or become ever more dependent on insecure and costly foreign sources.

6. To meet the nation's economic goals we must have a vigorous, healthy and expanding domestic petroleum industry. Instead of being encouraged by sound consistent policies, oil and gas producers have been confronted with a series of counterproductive government actions.

7. We should be utilizing 3,000 drilling rigs if we are to bring on new production adequate to reverse our dependence on foreign supplies. If we are to activate 3,000 rigs, the nation's independent producers must be fully mobilized. Instead drilling by independents will be seriously inhibited by the penalty tax on intangible drilling expenditures enacted last year. This tax treatment is counterproductive where we can least afford it, because it is imposed directly on drilling expenditures rather than on income. This provision should be eliminated as a major impediment to drilling.

8. Consideration must be given to providing encouragement of all energy resource development. To this end, we would encourage consideration of an Energy Development Investment Credit. At a minimum, a new investment credit for energy should make capital commitment to energy research, exploration and development at least as attractive as alternative investments in lower-risk industries.

My name is A. V. Jones, Jr. I am a partner in Jones Company, Ltd., an independent oil and gas exploration and production organization at Albany, Texas. I am appearing here as president of the Independent Petroleum Association of America (IPAA), a national organization of independent oil and natural gas producers. The IPAA has some 4,000 members who have a vital interest in the subject matter of these proceedings.

Mr. Chairman, this Committee is considering tax policies to stimulate the nation's economy. It should be apparent that the longterm necessity to provide full employment, prevent unmanageable economic recessions and contain inflation, will require an increasing capability to provide secure energy supplies. Experience has proven that tax policy for energy resource development is a vital element in stimulating the energy supply required to assure economic growth.

I call your attention to the chart, "Energy, Employment and Economic Growth, 1955–1976," which demonstrates that the use of energy, the growth of our economy (GNP) and employment levels are so closely related as to be almost mirror images of one another. It also illustrates that with each additional four million jobs there is an increase in energy consumption of one billion barrels of oil (or equivalent) and an increase in gross national product of approximately $100 billion.

As illustrated by the second chart, "Energy, Employment, and Economic Growth, 1975–1985," this country is going to need the energy to provide 19 million additional jobs by 1985. This is based on a projection of the labor force by the U.S. Department of Labor and assumes unemployment of 4 percent. To employ this many additional persons will require that we increase our energy supply by approximately 48 percent.

Concerted efforts must be made by government, industry, and individuals to conserve all forms of energy. However, because of the long time lags involved in installing more efficient energy-consuming equipment, and converting existing homes, factories, and energy use habits, these historical relationships can be expected to continue with little change through 1985. If we are to avoid economic stagnation and unacceptable unemployment, we have but two choices: either undertake an all-out effort to maximize development and production of domestic energy resources, 75 percent of which are oil and natural gas, or become ever more dependent on insecure and costly foreign sources.

Let's look for a moment at where we stand today. In January this year for the first time petroleum consumption exceeded twenty million barrels per day. Imports of petroleum exceeded domestic production—that is, we are approaching 50 percent dependency whereas as recently as nine years ago we had the ability to produce more oil and natural gas than we consumed. Our balance of trade reflected the worst deficit in the history of the United States with imported oil accounting for a major share. In 1976 the total cost of imported oil and natural gas was $37 billion. By comparison the total wellhead value of all domestic oil and gas—which provided 2½ times the energy equivalency—was about $36 billion. There appears to be no disagreement about the need for stimulating the economy. What does seem to be overlooked by both the Administration and Congress is the overwhelming evidence that to meet the nation's economic goals we must have a vigorous, healthy and expanding domestic petroleum industry. Instead of being encouraged by sound consistent policies, oil and gas producers have been confronted with the following:

1. March 29, 1975—enactment by Congress of Tax Reduction Act of 1975, substantially repealing percentage depletion for about 85 percent of domestic oil and gas. This long-standing tax policy has been left intact for some 100 other extractive industries.

2. February 1, 1976—rollback of approximately $1.50 per barrel for new crude oil;
3. September 16, 1976—enactment by Congress of Tax Reform Act of 1976, retroactively imposing punitive tax on expenditures—not on income of independent oil and gas producers;
4. July 1, 1976—imposition of a price freeze on all domestic crude oil;
5. December 31, 1976—a rollback of 20 cents per barrel for new domestic crude oil and continuation of existing price freeze on crude oil;
6. February 1, 1977—a retroactive doubling of rental fees on most oil and gas leases on federal onshore lands;
7. March 1, 1977—a rollback in U.S. crude oil prices of 45 cents per barrel on new oil.

The combined impact of these actions on domestic oil and gas producers is to remove roughly $5 billion annually which otherwise would be available for additional exploration and drilling. This listing should dispel any doubt as to why our domestic oil and gas production is declining and why we grow ever more dependent on insecure foreign oil. The 10,000 independent producers and explorers who drill most of the wells should be making a maximum effort in developing new supplies. But they are not because of the counterproductive effect of adverse government policy. During 1975 and 1976 active rotary rigs were at a standstill, averaging about 1,650 rigs. Twenty years ago there were over 2,600 rigs active. We should be utilizing 3,000 rigs if we are to bring on new production adequate to reverse our intollerable dependence on foreign supplies. This will require positive actions by the Congress and the Administration.

If we are to activate 3,000 rigs, the nation's independent producers must be fully mobilized. Drilling by indepenedents will be seriously inhibited by the penalty tax on intangible drilling expenditures enacted last year. Unfortunately this provision penalizes most seriously those who most aggressively are exploring for and developing oil and natural gas resources. Independents who committed substantial capital resources to drilling last year are only now discovering the tax effect of subjecting their IDC's to the 15 percent minimum tax. For many, their increased tax liabilities for 1976 can be met only by reducing their drilling budgets for 1977. This tax treatment is counterproductive where we can least afford it, because it is imposed directly on drilling expenditures rather than on income.

Clearly, the need to maximize domestic oil and gas development and production in the short term is being frustrated by this tax on drilling expenditures. According, we urge the Committee to reconsider this provision and eliminate it as a major impediment to drilling.

We further urge that consideration be given to providing encouragement of all energy resource development. To this end, we would encourage consideration of Energy Development Investment Credit to be in force until our present overdependence on insecure foreign energy supplies can be corrected. This can only be achieved by major efforts to stimulate the search for and development of all domestic energy resources—oil, natural gas, coal, synthetics, nuclear and solar. At a minimum, a new investment credit for energy should make capital commitment to energy research, exploration and development at least as attractive as alternative investments in lower-risk industries.

In conclusion, Mr. Chairman, I wish to emphasize that our industry is confused as to what our government wants it to do. We are not doing all that we are capable of doing. If the independent is to maximize his efforts he must have a clear signal from Congress and the Administration so as to offset the repeated disincentives that have been forthcoming the past two years.

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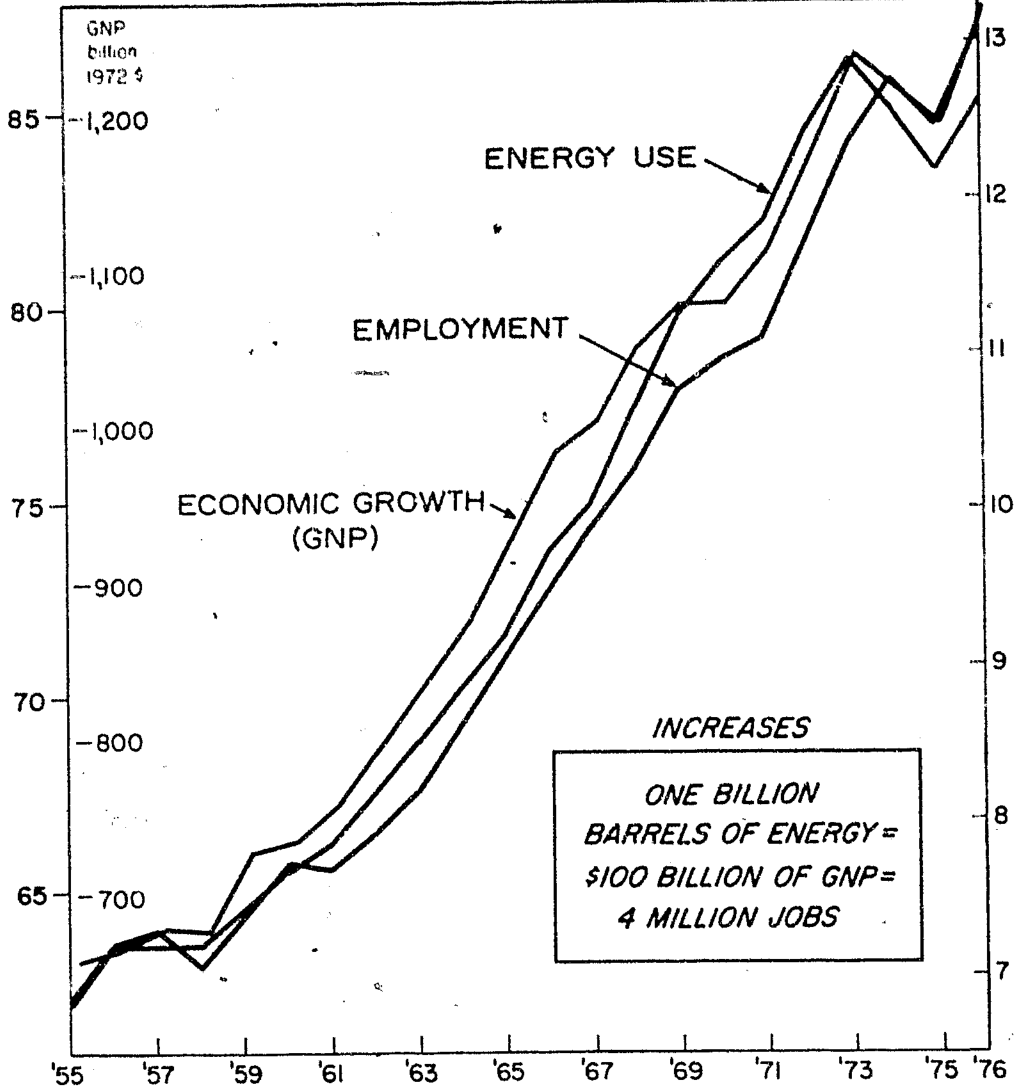
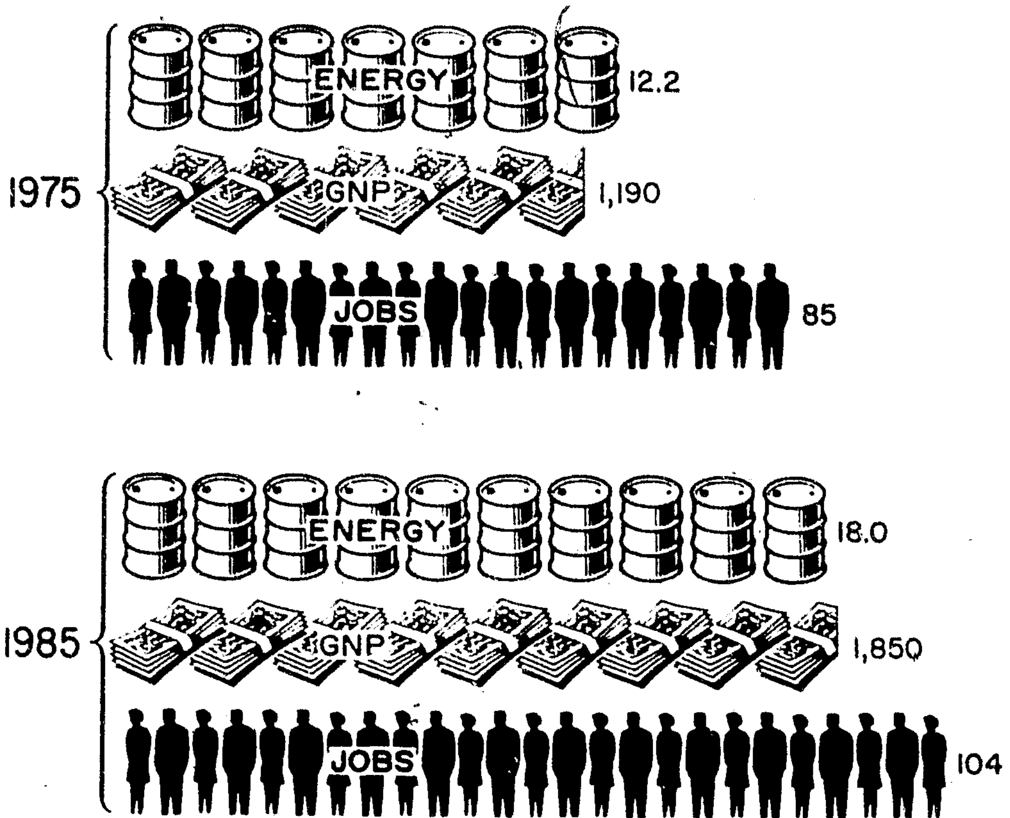

ENERGY
EMPLOYMENT &
ECONOMIC GROWTH
1955-1976
Employment millions
Energy billion barrels oil equivalent
GNP billion 1972 $
85
80
75
70
65
1,200
1,100
1,000
900
800
700
13
12
11
10
9
8
7
ENERGY USE
EMPLOYMENT
ECONOMIC GROWTH (GNP)
INCREASES
ONE BILLION BARRELS OF ENERGY = $100 BILLION OF GNP = 4 MILLION JOBS
'55 '57 '59 '61 '63 '65 '67 '69 '71 '73 '75 '76
Sources: U.S. Department of Interior, Commerce and Labor.
IPAA Chart - Feb. 1977

ENERGY EMPLOYMENT & ECONOMIC GROWTH

1975–1985

Energy in billion barrels of oil equivalent
Employment in millions of jobs
Economic growth in billion $ of GNP



Sources: U.S. Department of Interior, Commerce and Labor. IPAA Chart – Feb 1977

The CHAIRMAN. Now I would like to call the Chamber of Commerce witness, Dr. Jack Carlson.

Senator Hansen?

Senator HANSEN. I have no questions.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. Mr. Carlson, I want to ask you the same question that I asked Mr. Walker, namely your view of whether it would be helpful to the economy and would create jobs if tax incentives were offered to individuals to save, invest, put money in savings and loans.

Mr. CARLSON. I think both of those are useful and they are two different acts, the acts of investment and the acts of savings. Clearly, our country is saving less, thereby investing less, than most other industrialized countries. We need encouragement on the savings side as well as encouragement on the investment side.

The general thrust you have in mind I think, something we are going to have to turn to in future years.

Senator DANFORTH. Thank you.

The CHAIRMAN. Let me ask you why you said in your statement, everytime you refer to the natural gas shortage, you refer to it as the "Government-caused natural gas shortage"?

Mr. CARLSON. We have a classic example of the effects of price control. We have had price control on natural gas since the 1950's. It has been binding through the 1960's and 1970's. It is the primary reason for the accelerated dependency on Middle Eastern oil, a cheap source of energy as opposed to other sources. It is a primary factor contributing to the unemployment and poverty in the Appalachian States during the 1960's.

By holding the price down, the Government thereby discouraged both conservation and investment. When OPEC caused the market price to go up, I daresay that in Texas where they do not have price controls on intrastate gas, the amount of conservation that occurred within 2 years was phenomenal, and also that there was some additional supply. If gas prices had not been controlled across the country in 1975, we need not have had any shortages this past winter. Moreover, we would have had enough incentive for adequate storage at the consuming end. We did not have decontrolled prices and consequently we had the kind of shortage experienced in Ohio and elsewhere and the accompanying economic distress.

The CHAIRMAN. I will not prolong the hearing by dragging it out at this point, but I would appreciate it if you would give us a memorandum that we could submit for the record elaborating in greater detail your views on that subject.

There are a considerable number of people, particularly economists, who do feel that it is the Government's unwise price control efforts that in the main explain the fact that people are using natural gas that should not be using it. People are using a lot more than they should be using, converting to natural gas when you ought to be using coal, that is responsible for the failure, in large measure, of the coal producers to produce a great deal more of their product and also for the failure of producing gas as rapidly as we should produce it.

So you have a lot of people who are well-regarded economists who agree with your position. I would appreciate it if you would give us a more detailed outline or explanation of how you arrived at that conclusion.

Mr. CARLSON. I would be pleased to do so.

Mr. Chairman, may I hit a couple of other points dealing with Mr. Walker's question about the fact that your point that the investment tax credit clearly returns more than it costs to the Treasury.

I firmly believe it. You certainly show that you cannot go below a 6-percent unemployment rate until you increase your capacity at a faster rate than we are talking about. The difference between 6 percent and 5 percent—which could, in part, be encouraged by investment tax credit—would have a tremendous impact upon receipts in this country. So clearly, I think you are on the right track, that stimulating investment directly, lowering the cost of capital directly, comes back from the narrow standpoint of the Government and ends up in receipts in the long run.

The CHAIRMAN. I am convinced that our bookkeeping and budget keeping is counterproductive in this area. The fact that people make the investments and build the latest machinery, means that people can live a better life because they do less work and they produce a great deal more, working less hours. They produce a better quality of product. They increase the wealth of the country, spread among all of the people who are a part of our productive national effort. Overall, we all enjoy a better life because we have modern machinery and sophisticated equipment which turns out more and more goods and services.

The problem with those of us who are supposed to be running this government is that we have not been able to find ways to absorb all of the good things that industry is capable of producing and that agriculture is capable of producing. It is the fault of Government.

I do not take complete credit for it, but I am a part of this Government. I recognize it is the failure of our government to make the best use of our resources that causes us to have too many people unemployed and keeps us from producing nearly as much as we could to distribute all of that wealth among our people.

Even with that, the country is still doing pretty well. I do not know of anybody else who needs to build a big wall to keep people out. Nobody else seems to have that problem.

The Soviet Union is not worried about that, for example. They are one of our competitors. Red China, has a wall to keep people in their country. We are trying to find some way to keep that horde of people out because we could not accommodate as many as would like to come here.

With our failures and our shortcomings, being as imperfect as we are, you have to admit that what we have is still pretty good by comparison.

Mr. CARLSON. Yes, sir. I think the great weakness in the House bill is a lack of appreciation of the importance of investment at this time, not only for equipment but also for structures.

We are more short of capital to achieve a fully employed economy than we have been in decades. We are short-sighted if we do not

recognize that, because we will have double digit inflation if we go down below a 6-percent unemployment rate, unless we do something to increase the rate of investment.

The administration's contention that only by increasing sales can you facilitate investment has been shown to be defective. In this business cycle capacity additions are far behind the increase in sales, in comparison with other business recoveries.

Clearly we need to lower the cost of capital, and to reduce the risk of capital formation in order to encourage it. President Carter's investment tax credit is a move in that direction. And we also recommend a permanent larger cut in taxes for all individuals, and an increase in the corporate surtax exemption to $100,000 for both equipment and structures. Remember, the investment tax credit only covers equipment. It does not cover structures.

Structures are lagging behind seriously.

The CHAIRMAN. We should try to improve that. Thank you so much.

[The prepared statement of Mr. Carlson follows:]

STATEMENT OF JACK CARLSON, CHAMBER OF COMMERCE OF THE UNITED STATES

I am Jack Carlson, Vice President and Chief Economist of the Chamber of Commerce of the United States. Accompanying me is Robert R. Statham, Director, Tax and Finance Section of the National Chamber. We are pleased to comment on President Carter's and the House of Representatives' Emergency Economic Stimulus Program.

ADMINISTRATION PROGRAM

On January 31, 1977 President Carter proposed about $15½ billion of Federal stimulus for each of fiscal years 1977 and 1978 and $8 billion thereafter as additional stimulus to the economy. FY77 stimulus was to consist primarily of a one-shot tax rebate of $50 per person. One-half of the FP 78 stimulus was to be for accelerated Federal spending for public works, public jobs, public training and payments to cities. The remaining one-half was earmarked for more permanent tax cuts to low-income individuals and business.

However, on February 22, President Carter revised the FY77 and FY78 budgets proposed by former President Ford. The revision would effectively increase the stimulus to about $17 billion for FY77 and $27 billion for FY78, considerably higher than the $15½ billion level previously identified (see Attachment 1).

The direct stimulus to business would be meager—only $2.7 billion in total for either an incentive for expanding investment through an increase in the investment tax credit from 10 to 12%, or a wage subsidy through an income tax credit equal to 4% of an employer's social security tax payments. The wage subsidy is equivalent to one penny per-man hour. The Administration also proposes to extend the tax reductions enacted in 1975.

In essence, the President's current proposal is an attempt to raise the economic growth rate primarily by use of a one-time, $11.4 billion, tax rebate this year followed by a lower level of continuous stimulus.

HOUSE MODIFICATIONS

The House Ways and Means Committee has modified the Administration proposals by reducing or eliminating rebates to persons receiving more than $25,000 income and eliminating an increase in the investment tax credit from 10 to 12 percent or a tax subsidy based on social security payments. The House added a new wage subsidy for new hires up to $40,000 in the aggregate.

NATIONAL CHAMBER POSITION

Modest stimulus to the economy of the size initially proposed by the President can be justified. But such a stimulus should be primarily in the form of permanent tax cuts for both individuals and business and should not cause a faster growth of Government spending. Efforts to assist the structurally unemployed (those

who experience difficulty finding employment even during good times) should be concentrated in the private sector where four out of five career-jobs are located. Accordingly, the National Chamber recommends:

1. Direct stimulus through tax relief for job-creating investment in plant and equipment;
2. Increased permanent tax reductions;
3. Solving structural unemployment through incentives to private employers; and
4. Scaling down Federal spending proposals.

TOO LITTLE STIMULUS FOR INVESTMENT

There is too little stimulus for job-creating investment in plant and equipment in the President's proposal and none in the House Ways and Means proposal. Too much emphasis has been placed on public works and little or none on "private works" where nine-tenths of investment normally occurs. Non-residential investment in this recovery has been well below the rate of investment during earlier economic recoveries since World War II (see Attachment 2). Moreover, the ability to attract funds for necessary investment has declined from 12.3 percent to 10.7 percent. Also corporate profits taxes and corporate social security contributions are taking a larger proportion of corporate profits—59 percent in 1968 and 74 percent forecast for 1978. (See Attachment 3.)

Unless investment increases it will be impossible to have the necessary plant and equipment for workers when the economy approaches capacity operations. In the absence of a substantial increase in private investment, unemployment will remain high, more attempts to socialize job creation will be made and the danger of a return to double-digit inflation will be increased.

Stimulating consumer buying through individual tax cuts will not be enough to stimulate business investment on a timely basis. Business investment in equipment and structures is lagging behind growth of sales. It is also lagging behind capacity utilization and availability of loanable funds.

Stimulating investment now will achieve two objectives: faster job creation in the near term and providing tools for the larger work force in the longer term. (See Attachment 4.) Presumably this fact has not been made clear to the House or it would not have ignored "private works" by concentrating exclusively on "public works."

Clearly the House Ways and Means and to a lesser extent the Administration proposal, are anti-investment. There is no direct stimulus in the House Ways and Means proposal and only a small stimulus in the Adminstration proposal. The Administration would increase the investment tax credit from 10 to 12 percent only for equipment. No stimulus is provided for structures in either proposal. Only a massive public works program is proposed. In sharp contrast stimuli in 1975 and 1964 provided encouragement for both equipment and structures and at least twice the proportion.

We strongly recommend adoption of President Carter's proposed increase in the investment tax credit. Also we recommend that corporate surtax exemptions be increased to $100,000 with a 20 percent normal tax on the full amount subject to the surtax exemption.

PERMANENT TAX CUT IS PREFERABLE TO A ONE-TIME TAX CUT

While the President's proposed $11.4 billion rebate based on $50 per person will temporarily stimulate the economy, the effect will pass quickly and the timing may create problems. An $11.4 billion rebate effective May 1, 1977 will cause real disposable income and GNP to increase abruptly for a few months and then return to previous levels. The roller-coaster effect is also reflected in employment. When the tax cut is made permanent, real disposable income, GNP, and employment increase to higher plateau levels and remain there.

The roller-coaster effect of a tax rebate could be particularly injurious to the economy at this juncture because an inventory cycle might be triggered. Retail sales increased all through last year but business inventories in relation to sales, declined throughout the year. When retail sales were particularly high during the Christmas Season, inventories declined more rapidly. But inventories could not be replenished in January and February because bad weather and the government-caused natural gas shortage slowed production and deliveries. Now,

businessmen are attempting to build inventories based on the recent sales trend. This trend will be distorted when the Federal government passes out $50 checks in May. Retail sales will temporarily rise as happened in 1975. The resulting further decline in business inventories may induce an even greater than otherwise volume of inventory replenishing orders from business firms as happened in 1975. If this replenishment proves to be excessive, a sharp downturn in business orders will occur by next Fall and Winter, causing an employment cut-back. This pattern may have occurred following the tax rebate in 1975. Inventories were built up for a larger sales volume temporarily brought about by the rebate. It took business firms a full year to reduce inventories to a desirable level and caused unemployment to increase. Both the normal roller-coaster effect of temporary tax cuts and the abnormal conditions now, make a rebate a risky way to stimulate the economy.

Moreover, the unusually cold weather and government-caused shortage of natural gas has resulted in a temporary decline in both actual and potential output—by about $5 billion. Abrupt stimulus will tend to cause higher prices than would occur with a smaller but continuous stimulus. If, instead of a lump-sum increase of $50 in May, income increased $4.67 per month, then purchasing power would be spread throughout the year, greater supplies would be forthcoming and substitutes could more easily be found. The inflationary impact would be less.

As Federal Reserve Chairman Arthur Burns has observed, the risk of a slower growing economy will occur late in 1977 or 1978. Therefore, temporary stimulus now will be worn out by the time it is needed. A permanent individual tax cut would provide the stimulus through 1977 and 1978 and thus counter the likelihood of a slow-down later in the year or next.

TAX WAGE SUBSIDIES

The Administration has proposed an optional, small wage subsidy based on a tax credit equivalent to 4% of social security contributions. The House passed a tax credit up to $1,680 for new hires up to a limit of $40,000 per firm. Other legislators propose a wage subsidy limited to assisting unemployables (structural unemployment). All three proposals serve different purposes and assist companies differently.

An across-the-board wage subsidy as proposed by the Administration can provide additional cash flow to all industries. Retail and other labor-intensive industries would benefit most.

The House bill would assist significantly only new hires up to a maximum of 24, but would encourage jobs only in small firms and those growing rapidly. Synthetic materials would benefit while agricultural materials might not, faster growing export industries would benefit more and slower growth domestic industries would benefit less; service industries would benefit while primary industries would benefit less; the construction industry would benefit twice—from increased public works and the tax subsidy—while other industries would not; faster growing sun-belt-located companies would benefit more than snow-belt companies.

If eligibility for a wage subsidy were narrowed to the structurally unemployed, it could be considered a substitute for spending programs for the same purpose. But it would have the big advantage of creating productive jobs in the private sector and not dead-end jobs in the public sector. There would be some likelihood that private sector subsidized jobs could work into a permanent, career, unsubsidized job. Four-fifths of career jobs are now located in the private sector.

TOO MUCH PORK BARREL SPENDING

Proposals for large increase in Federal spending raises fears that the Federal government will become the engine of inflationary pressures. Increases in Federal spending should be limited for special purposes to stimulate the economy—such as helping overcome structural unemployment problems.

Public works are particularly bad for quickly stimulating the economy. Public works require a long time before jobs are created. Based upon estimates provided in the FY78 budget the Administration's public works program would create more jobs in 1979 through 1982 than during 1977 and 1978 (see Attachment 7).

Moreover, the potential for expanding construction is much greater through "private works" (structures) than public works. Yet public works are proposed to receive at least a two-fold increase and no stimulus is proposed for "private works" (factories and buildings). The investment tax credit only applies to equipment. This is clearly a serious oversight.

PUBLIC JOBS SHOULD BE LIMITED TO SOLVING STRUCTURAL UNEMPLOYMENT

If the government acts as the employer of last resort (structurally unemployed), it should do it in the least costly way and where the most jobs exist. Four-fifths of all new jobs are created in the private sector and jobs can be created easily with 25% subsidy of costs. Yet the thrust of the major stimulus proposals is to create jobs where less than one-fifth of the new jobs will be created and with 100% subsidies. A tax wage subsidy of modest size would be a preferable route to take on a pilot test basis before expanding it.

For overcoming cyclical unemployment, tax cuts for individuals and business, and spending increases for only essential government services should be used—but these must not replace job-creation in the private sector. Public service jobs for employable persons is a disservice to them. These jobs last for only one year at the longest and thus are dead-end. It is far better to provide permanent, career jobs in the private sector.

Public sector jobs cost $8,200 per year on the average or nearly twice the minimum wage, and thus create inequities for those who are working without subsidy, and for less.

Also public sector jobs do not always result in a net increase in employment. Often cities use public service job funds to pay for existing employees or employees they intended to hire anyway.

RECOMMENDATIONS

In conclusion, we recommend that the Senate:

Increase the size and include all taxpayers in a permanent tax cut for individuals;

Provide incentive for investment by increasing investment tax credit for equipment and increasing corporate surtax exemption to $100,000 for both equipment and structures; and

Provide incentives for hiring workers in the private sector, such as the Carter tax credit, House Ways and Means small business tax credit, and particularly tax credits for hiring the structurally unemployed on a test basis.

Attachments.

CARTER BUDGET OUTLAYS, REVISIONS, RECEIPTS, AND DEFICITS, FEB. 22, 1977

	Fiscal year—	
	1977	1978
Ford outlays	411.2	440.0
Carter spending increases	6.2	19.4
Carter outlays	417.4	459.4
Ford receipts (without Ford tax cuts)	360.0	409.6
Carter tax cuts	10.6	7.9
Carter receipts	349 4	401.6
Ford deficit	57.2	47.0
Carter deficit with administration forecast	68.0	57.7
Carter deficit with Chamber forecast	73.0	65.0

Sources: Fiscal Year 1978 Budget Revisions, February 1977; Forecasting Center, Chamber of Commerce of the United States.

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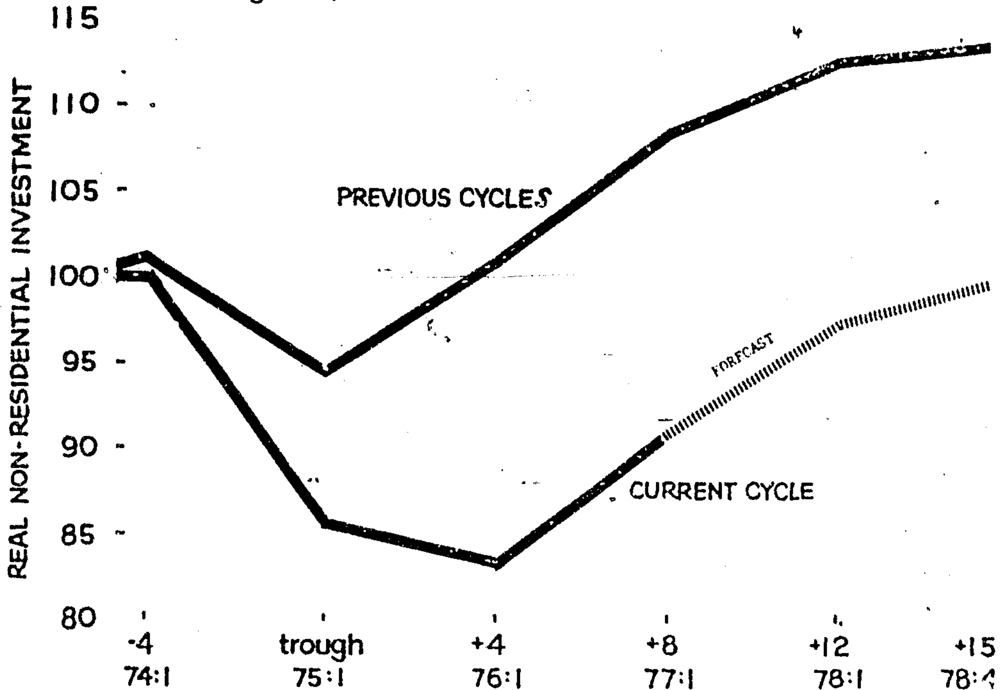

ATTACHMENT 2

CHANGES IN CORPORATE PROFITS, CORPORATE TAXES, AND CORPORATE TAX BURDEN, 1968 AND 1978

	1968		1978	
	Amount	Percent of national income	Amount	Percent of national income
National income	$711.1		$1,673.4	
Corporate profits	87.6	12.3	180.2	10.7
Corporate profits after taxes	54.4	7.6	114.7	6.9
Corporate profits taxes	33.2		65.5	
Corporate social security contributions	19.2		68.1	
Total	52.5		133.6	
Corporate profits taxes and social security payments as a percent of profits before taxes		59		74.1

ATTACHMENT 4

NEED FOR ENCOURAGING EQUIPMENT INVESTMENT

The ability of the private sector to create jobs and reduce unemployment depends on its ability to equip workers with the tools of production. To do so requires new investment in machinery and equipment. According to the 1976 Fortune survey of the "First 500", some of the industry medians of assets per employee are:

Petroleum refining	$196,927
Metal manufacturing	57,272
Pharmaceuticals	40,923
Metal products	30,625
Apparel	14,991

The median for all industries is $37,929.

An increase in the investment tax credit would stimulate additional orders for materials, and thereby prompt additional employment. New investment in

machinery and equipment ultimately means new orders for materials needed to be made into new products.

According to the November, 1976, McGraw-Hill Survey, 16 percent of the facilities of American business is 20 years old or older. According to the survey, business now considers 11 percent of its facilities technologically outmoded—the same share reported at the end of 1974 versus 10 percent at the end of 1972. The survey also indicates that for business to replace its outmoded facilities with the best plants and equipment, the total cost would be $235.71 billion.

With regard to fixed capital formation as a percent of gross national product, in the period 1970 to 1975, the United States ratio of 17.4 percent was signficantly lower than that of other major industrialized nations. The ratio of fixed capital formation to GNP for Japan was 35.1 percent, for France 28.9 percent and for West Germany 25.3 percent.

Most of the major industrialized nations offer capital cost recovery allowances superior to those provided in this country. Those nations have used such allowances to recover from the ravages of a world war, and rebuild their tools of production.

Our economic progress requires capital formation. Today's needs are greater than before. Laws and regulations that require major investments by business in anti-pollution equipment, restoration of environmental damage, energy economy, and additional safeguards for products and health—while worthy goals—increase the demand for capital but do not contribute to real income or productive job-formation. We suffer from overconsumption and underinvestment, and unless we encourage investment, the economy will lag and we will not reduce unemployment.

LONGER RUN TAX OBJECTIVES

While what is being sought is an immediate stimulus, it would appear that such a stimulus should be a first step toward a permanent solution to the Nation's long-range needs for capital formation and employment. The actions that are taken at this time to stimulate the economy should be those that will mesh with those that should be taken to encourage major capital formation. Recommendations to further stimulate the economy and recommendations for long-range capital formation go hand-in-hand.

In this regard the Chamber recommends the following changes in the tax laws:

1 To encourage modernization and expansion of productive facilities so as to make American industry fully capable of meeting its new demands, the concept of prompt capital recovery allowances designed to encourage replacement and expansion should take the place of outmoded concepts of useful lives which have been used unsuccessfully as a measure of depreciation and obsolescence. As a first step, the Asset Depreciation Range System should provide for a 40 percent variable capital cost recovery period applied to the 1962 Treasury guidelines. The goal should be a complete capital cost recovery system that groups assets in a few general classes to which a capital cost recovery percentage is applied to assets as a class.

2. A permanent full 12 percent investment tax credit should be provided, on an expenditure basis, uniformly applied to all business, and without limitations based on tax liability, and without any corresponding reductions in depreciation allowances.

3. Tax rates should be reduced to permit and encourage reinvestment of earnings in sufficient amounts to promote economic progress and provide jobs.

4. High tax rates have emphasized the unfairness and unsoundness of the double taxation of equity capital resulting from the taxation of corporate earnings and of corporate dividends received by individuals. This inequity should be removed.

5. The rate of taxation for capital gains should be reduced proportionate to the length of time an asset is held, with the reduction being gradual and continuous.

COMPARISON OF A $10,000,000,000 TAX REBATE AND PERMANENT TAX CUT INITIATED MAY 1977

[Seasonally adjusted annual rates in billions of dollars, percent, or jobs]

	Real GNP (percent change)		Employment (1,000's jobs)		Unemployment rate (percent)		Federal deficit[1] (billions)		Real disposable income (percent change)	
	Permanent tax cut[2]	Rebate[2] 2d quarter 1977	Permanent tax cut[2]	Rebate[2] 2d quarter 1977	Permanent tax cut[2]	Rebate[2] 2d quarter 1977	Permaennt tax cut[2]	Rebate[2] 2d quarter 1977	Permanent tax cut[2]	Rebate[2] 2d quarter 1977
1977	0.4	0.8	46	164	−0.1	−0.2	+$5.0	+$5.3	0.8	1.3
1st quarter	0	0	0	0	0	0	0	0	0	0
2d quarter	1.1	4.4	0	0	0	−.1	+8.4	+33.6	4.3	17.9
3d quarter	1.3	1.1	25	101	−.1	−.3	+6.4	+8.0	.8	−9.6
4th quarter	.6	−2.6	135	454	−.2	−.3	+5.4	+4.2	.5	−.9
1978	.2	−.9	310	121	−.2	−.1	+5.3	+.2	.3	−1.3
1st quarter	0	−2.2	120	−50	−.2	−.2	+5.1	+.8	0	−1.7
2d quarter	−.2	−.8	67	−203	−.2	−.1	+5.2	−.3	−.2	−.8
3d quarter	−.3	−.3	45	−82	−.2	0	+5.4	−.5	−.2	−.3
4th quarter	−.3	−.1	14	−111	−.2	0	+5.7	−.9	−.3	−.1

[1] Increase (+); decrease (−).
[2] $10,000,000,000.

Source: Chamber of Commerce Forecasting Center.

EXPANSION OF PUBLIC WORKS AND JOB CREATION

[Jobs in thousands and dollars in millions]

Fiscal year	Program expansion and date of appropriations							
	Existing program, $2,000,000,000, October 1976		Proposed program: $2,000,000,000, September 1977		Proposed program: $2,000,000,000, September 1978			
	Jobs	Amount spent	Jobs	Amount spent	Jobs	Amount spent	Jobs	Total, amount spent
1977	48	$800	0	0	0	0	48	$800
1978	48	800	48	$800	0	0	96	1,600
1979	12	200	48	800	48	$800	108	1,800
1980	12	200	12	200	48	800	72	1,200
1981			12	200	12	200	24	400
1982					12	200	12	200
Total	120	2,000	120	2,000	120	2,000	360	6,000

SUMMARY

Fiscal year	Amount spent (billions)	Temporary jobs created for a year or less
1977 and 1978	$2.4	144,000
1979–82	3.6	216,000

Source: Fiscal year 1978 budget and appendix p. 196 was used for the timing of the existing program. The same optimistic timing was applied to the proposed program.

The CHAIRMAN. We will be back here at 2 o'clock.

[Whereupon, at 1:15 p.m., the committee recessed, to reconvene at 2 p.m. this same day.]

AFTER RECESS

The CHAIRMAN. The committee will come to order.

Mr. Thompson, we would be happy to have your statement.

STATEMENT OF W. REID THOMPSON, PRESIDENT AND CHAIRMAN OF THE POTOMAC ELECTRIC POWER CO., ON BEHALF OF EDISON ELECTRIC INSTITUTE

Mr. THOMPSON. I am speaking on behalf of the Edison Electric Institute. I would like to make a 2- to 3-minute summary of our position in this matter.

We represent 99 percent of the investor-owned electric power industry in the country. We are here to support the President's proposal to stimulate the economy, with particular reference to the 2-percent investment tax credit. That is the portion of the proposal that applies to our industry.

As you already know, Mr. Chairman, the electric power industry is the largest consumer of capital of any industry in the United States. It is estimated that it will take 15 to 18 percent of the capital funds invested in the next few years and probably we will do some 50 percent of the common stock financing done in the entire economy.

The reason for that is that we have a massive capital construction program underway. If I may illustrate for a moment or two, the size of that program, we anticipate $122 billion in expenditures in the next 5 years. That compares with $73 billion over the past 5 years.

For a 10-year period, we are talking in the next 10 years of about $300 billion in capital expenditures and in the next 15-year period, we are talking about close to $600 billion—$570 billion or so.

Just a word, Mr. Chairman, to illustrate the significance of that kind of program. The investment in the electric power industry up to now, up to the last year, is about $186 billion. In the next 10 years, our outside financing requirements—that is, we must raise about 60 percent of our funds in the capital markets—our requirement from the capital markets alone in the next 10 years will exceed the entire investment to date in the electric power industry.

This comes at a time when the industry is not in as strong a position to do that financing as in the past.

As you know, many companies have had their bond ratings downgraded. Our coverage is not what it was in years past; our earnings are not what they were for several years.

The principal problem facing us in the years ahead is capital acquisition. Anything that can be done to enhance the ability of the utility industry to finance the needed construction including this 2-percent investment tax credit is vitally needed.

Therefore, we support the 2-percent credit proposal of the President.

We would like to make three quick observations, Mr. Chairman, as to how that credit will, or should be, applied.

We would urge the committee, in adopting that 2-percent credit, to take these three matters into consideration.

One is, we would urge the 2-percent credit be available on top of the existing 10-percent credit. The existing 10-percent credit has certain limitations—50 percent for some industry and phased in for the electric industry. We would urge the 2 percent be without that limitation.

We would further urge that the credit be applicable to work in progress as it is done, rather than when the plant is completed, as is the case with the present investment tax credit.

Finally, we think it is very important that the law be written so that the utility would have the option as to accounting and regulatory treatment. If the utility elects to normalize the benefits, then the ratemaking authorities must recognize it. That would enhance the use of the funds for capital acquisition rather than require that they be immediately flowed through to the earnings of the company.

With that statement, we appreciate your indulgence and would be glad to answer any questions.

The CHAIRMAN. Let me see what you have in mind about the flowthrough. I understand what normalization and what flowthrough is. Normalization is basically the view that the tax credit was for the investors. Eventually it works out—hopefully down the road it works out to better profits for the investors. Is that right?

Mr. THOMPSON. Perhaps it can be characterized that way.

What it basically does—and the law presently provides with respect to the investment tax credit that the utility may elect to normalize or flow through. If you flow through, then you take the immediate benefit into the earnings of the company. That passes right through to the customer.

If you normalize, you put it in a deferred account, the benefit, and you bleed it back throughout the life of the plant. Eventually, of course, the customers all get the benefit of it as a reduced expense, but spread over the life of the plant.

Normalization gives you the cash flow currently to invest in a plant. That is the object of the proposal in the first place.

You have the immediate dollars in hand, rather than flow them through to earnings immediately. You can bleed it into earnings over an amortization period.

The CHAIRMAN. If you flow it through, does that not take away the incentive to build a new plant from an investor point of view?

Mr. THOMPSON. It does in that you do not have the cash available. It strengthens your earnings, but it does not give you the immediate cash that it does when you normalize. Under the 6 percent credit, if you are already flowing through, you can flow this through. If you were not, you cannot flow it through. If you elected to normalize the 6 percent credit—even if you were flowing through the 4 percent credit, the law anticipates that the State regulatory authority will recognize that election. In other words, you are correct, Mr. Chairman.

The CHAIRMAN. If the company is flowing through now, could they be required to continue to flow through?

Mr. THOMPSON. I think not. If I understand the present law, even if a company was flowing through previous credits of previous tax benefits, it could elect to normalize this 6-percent benefit.

If a company did so elect, the regulatory authority is bound by the election, even though it has been a flow-through company in the past.

My company is a case in point. Pepco was a flow-through company until 2 years ago. We sought to normalize all of these benefits. In the district, the district commission, as the law said it must, recognized the 6-percent normalization, but did not let us normalize the 4-percent credit.

We think that the way the law is presently written, the way you wrote the law for the 6-percent credit is the way this one should be written.

The CHAIRMAN. I had taken the view that the purpose of the law was to encourage building new plants and equipment. We did not do that to cut rates. We are doing this to bring about the construction of modern plants and modern facilities and we hoped, by providing that incentive, we hoped to build a lot more facilities. Therefore, my view is that you cannot have your cake and eat it too. You cannot pay something out as an incentive for somebody to build a facility and pay it out to the customers at the same time. You have to make the choice. Do you want to do this to encourage new facilities to be built, or do you want to do it to cut electric rates?

Both of them are desirable objectives, but our purpose was not to reduce electric utility rates, but the purpose was to bring about construction of new facilities. You cannot do both. You have to choose which is your objective.

That being the case, I personally think—I go along with your suggestion. I voted for it in the past, and I will vote for it again.

Thank you very much.

Senator Hathaway?

Senator HATHAWAY. Thank you very much.

You say in your summary here that the investment credit is a proven vehicle. Can you show by some records that the investment credit has spurred purchases that would not have been made otherwise?

I do not have any doubts that you are right, but I would like to know upon what evidence you rely.

Mr. THOMPSON. What we are referring to there, Senator Hathaway, was committee print No. 7 prepared by the staff of the Joint Committee on Taxation in 1976 which made that observation. The study indicated that during the period 1962 to 1975 that during the periods when investment tax credits were available there was a notable and dramatic expansion of industrial production, whereas during that same period in intervals when it had been taken away, there was no such expansion.

The figures are in that report.

The CHAIRMAN. If I may interrupt—your authority for that is the Joint Committee on Taxation?

Mr. THOMPSON. Yes.

Of course, that is an extremely difficult thing to prove as to what caused, or did not cause, the expansion of the plants.

Of course, it is obvious that an incentive of this nature is bound to assist in some measure plant expansion. In the electric power industry, I should make the observation that there have been a number of plant cancellations and deferrals over the last 2 or 3 years of many thousands of megawatts of capacity.

There are three basic reasons why those deferrals have been made: a slackening of demand has caused companies to contract their plant and expansion program but many companies have stated categorically that they cut building plans because of a tight financial position and an inability to raise the capital.

Going into the 1980's, there may be power shortages because of capacity. A great deal of that is the inability to raise capital.

Anything to enhance the ability to raise capital would alleviate that problem.

The CHAIRMAN. By the way, Mr. Thompson, you may have noticed that Senator Kennedy was testifying in favor of the refundable investment tax credit. He h[illegible]ays agreed, nor has the group which worked with him [illegible] agreed, with you in their efforts to amend the tax law.

While they have differed with some of the things that your industry has favored, I note with interest that Senator Kennedy was speaking for a refundable investment tax credit, which would mean a company that is not making money, that is getting the worst of it for the time being, or a new company, would have the full benefit of the investment tax credit.

There are some of us who have been thinking about that for a long time, who think that that is correct, and this committee recommended that we move in that direction in the previous tax bill.

Due to a furious fight, we dropped it on the Senate floor this last time. It seems to me that the time is right for people to start thinking about the investment tax credit and the refundable tax credit, especially when you recognize that that is an extremely useful tool to bring about something that you want to achieve.

Basically what it does, as far as your industry is concerned, is reduce the cost of new plant and equipment by 10 percent.

Mr. THOMPSON. That is correct.

The CHAIRMAN. If that is what our purpose is, it should not depend on whether you are making a profit or not. You should get the benefit of it whether you have a good year or a bad year.

Basically, the investment tax credit, by my view, is a subsidy by way of the tax system for people buying new plant and new equipment. It is a far better of doing it than by an annual appropriations system.

A businessman knows he is entitled to it. As long as a man has to make a profit in order to have the benefit of it, in most businesses he is not sure he is really going to get it. It is something you say that you want him to have. If you really want him to have it, it seems to me you should say he gets it whether he made a profit or not, whether he is a new business or an old one.

Your industry for the most part is made up of old, established concerns, but even in the case of your industry, do you not sometimes have a problem in that you do not get the full benefit some companies do?

Mr. THOMPSON. There are some companies who have difficulty, extreme difficulty. You already have the carryforward and carryback provisions. On the point you raised, we have no philosophical quarrel. We do see the logic of what you are saying for the industry generally. It would benefit some of our companies, it would.

The CHAIRMAN. Let me reiterate the point that Senator Kennedy was testifying to this morning.

A nonprofit hospital would not get the benefit of the tax credit because they are not in business for a profit. Anything they make, they plow back in to provide more service to their patrons.

The same thing is true of a university. When you use a credit as is proposed by the House bill to encourage people to hire people and take them off the unemployment rolls, religious organizations, nonprofit organizations, many of them providing very desirable service, would not get the benefit because it is limited to a company that is operating for profit and actually making a profit.

If you really want to make it desirable to hire somebody and you are using a tax credit approach, it really does not make too much sense to say that one who does what you are seeking to encourage him to do would not have the benefit of it, and we have experienced the refundable tax credit and we think it makes good sense. I think the investment tax credit ought to be a refundable tax credit.

If we talk about it enough it will happen. Unfortunately, a lot of people do not understand what we are talking about. A lot of people think we should consider this as an annual appropriation instead of looking at it for exactly what it is, a useful tool to serve the purpose more efficiently and serve the purpose better than an annual appropriation to bring about the same purpose, or the same objective. I think we ought to use it.

It is as though you were working and you were a gardener and you have a hole in your shovel. Depending on what the chore is, use the tool that does the job best.

I think a refundable tax credit should be used in a limited way, but it is a useful tool potentially. There was a time when Treasury vigorously opposed the use of any tax credit for anything. Now I think we all agree that the investment tax credit is a very good thing. We just have not had much experience in working with the refundable tax credit.

In the area of the investment tax credit, I think that it would be a refinement that would make it a better tool.

Senator HATHAWAY. If the Chairman would yield on that point?

We could probably do the same thing if we liberalized the carry-forward rule for a profitmaking company.

The CHAIRMAN. If you think in these terms, let's take a new company. It might be several years before it falls in the black.

Senator HATHAWAY. They have a 7-year carry forward.

The CHAIRMAN. The point is that a small business or a new business concern getting going needs every dollar in cash flow that it can generate. If you take the view that when they buy the equipment they earn the tax credit, they can get it a lot quicker if you would permit it to be a refundable tax credit.

For small concerns, and even private individuals who want to use the jobs credit as a tax credit as suggested by the House bill, once you make it a refundable tax credit and they know they are going to get it, then you can set the stage for working out a procedure where they get it immediately the minute they earn it. They are entitled to it and can draw on it and can use that for working capital rather than having to wait until the end of the year, in the hopes that they are going to get it.

Mr. THOMPSON. That is analagous to the point we were making in the present law where you get the credit on the work you have currently done and do not wait until the plant is completed. That

86-032 O - 77 - 19

is particularly important to the electric power industry. That is one you get in the current year. We think that is important.

From the jobs credit standpoint, it does not affect us because we are capital-intensive but not employee intensive. We could not help in the stimulation of the economy. We could not benefit much in any sort of jobs proposal.

The CHAIRMAN. We may not get this thing done.

As Senator Hathaway says, even if we do not do anything about it in this tax bill before us right now, before we come up with this tax reform bill, we ought to mature our thinking on this refundable tax credit problem because, as far as business is concerned, in terms of being sure they get the credit because they did what you wanted them to do, you should pay them a reward for doing it, if it is worth doing at all.

The fact that you do it sooner provides a better cash flow, so a lot of good, solid companies like yours that have tried to improve their cash flow to avoid borrowing more money would have more cash on hand.

The fact that you get it sooner, when you make the investment or make the expenditure, helps that much more.

In your case, your industry came in and asked us to let you take the credit while the work was in progress because some of these atomic generators would not be completed for many years and we did that, but for all industry it could be helpful; instead of waiting until next April or waiting until the end of the taxable year, if at the time they make the payment for the equipment or for the plant, they could go ahead and take that credit right then and there and put the money into operation.

Let's say on the average they are getting their money 6 months sooner. They would have just that much more capital to put to work doing their job for their country.

Mr. THOMPSON. If as a matter of tax policy, you come to that conclusion, we would certainly welcome it. Cash flow is always a problem. The sooner we get it, the better off we are.

The CHAIRMAN. I am for the concept. If you people talk it up, you will find a lot of support for it.

Senator HATHAWAY. I agree with the chairman. I agree with the concept. We may disagree with some of the details. Also, the chairman brought up the old technical problem of the double dip aspect of taking a deduction for depreciating and getting the credit too. There is some overlap there which I understand in past years you wanted to eliminate, but Treasury decided they wanted to keep it in.

The CHAIRMAN. What was involved in the investment tax credit in the beginning was what I thought was sort of a rip-off. You could take the investment tax credit for 7 percent and depreciate the full cost of the equipment which you already had taken the 7 percent credit. It was my initial idea that if you got a 7 percent credit, I thought you should only be able to depreciate 93 percent of the cost. Subsequently, I came to look upon the thing the way the administration had in mind to begin with. It was in fact a tax advantage, a tax subsidy you might say, to encourage people to buy new plants

and new equipment and just as the joint committee report said, it worked. It stimulated the economy.

It has done a lot to modernize plants and equipment. It was something at the time that heated up the economy. Since that time, we have concluded that it was a good idea.

The 10 percent will continue; maybe we can add 2 percent in this bill.

Mr. THOMPSON. I hope so. I know you would be interested to hear that we conducted a survey of companies with respect to the status of ESOP plans. We had response back from 70 companies. Only 3 have determined not to adopt the ESOP plan, 42 have already adopted them; 10 are in the process of implementing them; and 13 are examining them and looking into them. Only 3 out of the 70 have determined not to adopt one.

So I think that indicates, on the face of it, the wisdom of that plan that you investigated and the tremendous acceptability of it and appreciation for it by the electric power industry, at least. As I say, the response is almost universal.

The CHAIRMAN. Could you give me a list of who the companies are that have decided to put their plans in?

Mr. THOMPSON. Yes, I will.

[The list referred to above follows:]

TABLE 1: *Electric Utilities Adopting Employee Stock Ownership Plans (ESOP)*

Atlantic City Electric Co.
Baltimore Gas & Electric Co.
Carolina Power & Light Co.
Central & South West Corp.
Central Maine Power Co.
Cincinnati Gas & Electric Co.
Commonwealth Edison Co.
Consolidated Edison Co. of N.Y.
Consumers Power Co.
Duke Power Co.
El Paso Electric Co.
Florida Power Corp.
Florida Power & Light Co.
Gulf States Utilities Co.
Idaho Power Co.
Iowa-Illinois Gas & Electric Co.
Iowa Power & Light Co.
Kansas City Power & Light Co.
Kentucky Utilities Co.
Long Island Lighting Co.
Middle South Utilities Co.
Minnesota Power & Light Co.
Northern Indiana Public Service Co.
Northern States Power Co.
Orange & Rockland Utilities Co.
Otter Tail Power Co.
Pacific Gas & Electric Co.
Pennsylvania Power & Light Co.
Philadelphia Electric Co.
Potomac Electric Power Co.
Public Service Co. of Colorado
Public Service Co. of New Mexico
Public Service Electric & Gas Co.
Public Service Indiana
South Carolina Electric & Gas Co.
Southwestern Public Service Co.
Tampa Electric Co.
Texas Utilities Co.
Tucson Gas & Electric Co.
Utah Power & Electric Co.
Wisconsin Power & Light Co.
Wisconsin Public Service Co.

SOURCE: Partial listing based on EEI Finance Committee Study, 1977.

TABLE 2: *Electric Utilities Planning to Adopt Employee Stock Ownership Plans (ESOP)*

Iowa Electric Light & Power Co.
Kansas Gas & Electric Co.
New England Electric System
New England Gas & Electric Association
Niagara Mohawk Power Corp.
Portland General Electric Co.
Southern California Edison Co.
Southern Company
Union Electric Co.
Wisconsin Electric Power Co.

SOURCE: Partial listing based on EEI Finance Committee Study, 1977.

The CHAIRMAN. Also, I would appreciate very much if you would provide for your company and for some others, if you have it available to you, just how much that is going to mean to the average worker over a period of years. You might know it right off the top of your head, because you are pretty familiar with those types of plans.

Can you tell me, for Potomac Electric Power Co. how much that 1 percent is going to amount to for an employee who will retire 35 years from now?

Mr. THOMPSON. I do not have the figure at hand. I can tell you what we have done with the plan. We set it up last year. Our investment was relatively low that year, on the low part of our cycle. Even so, the amount of money that went into the plan was about $600,000 and 43,000 shares of stock. It represented 1 percent of the employees' wages that first beginning year.

We estimated that as our construction program builds up as it is scheduled to do, it will rise dramatically. I do not have the figures in front of me, I can furnish them for the record as to what it would amount to per worker. I had it worked out at one point. I do not have it in front of me. I will furnish it for the record.

[The following was subsequently supplied for the record.]

The average PEPCO employee participating in the plan for a thirty-five year period commencing with the inception of the plan in 1975 would accumulate approximately $175,000.

Mr. THOMPSON. It has been extraordinarily well received by our employees. They are beginning to understand it and recognize it. It has the very effect that you anticipated it would of making them more conscious of the need to be business oriented and not antibusiness oriented.

The CHAIRMAN. I wonder if you would object—there may be reasons why you should not say for the record what your experience was when you told your workers you were going to do this and you were not going to ask for anything in return?

Mr. THOMPSON. Our experience was we had to make the basic decision as to whether we would instigate the plan initially only to management employees, then bargain with the union with it as the Treasury regulations provided, or we would initiate it for all our employees. We decided to go with the latter course, put it in effect for all of our employees, not make it under conditional bargaining.

The bargaining unit, the union people, were much pleased with the plan and of course, when they understood the plan, and were most cooperative with us in setting it up.

It was well received by the union people, by all employees. As people learn more about it, there is a continued favorable response. There was a learning process.

The CHAIRMAN. I was under the impression that when you presented that to your employees, you said that you were going to do this for them and were not asking for anything in return and my impression was that those people told you that they thought you were entitled to something in return.

Mr. THOMPSON. We were entitled to a great deal of appreciation on their part. There were some misunderstandings with respect to some issues that had been plaguing us, between us and the employees. We clarified these issues favorably all at the same time we put this plan in.

The CHAIRMAN. Thank you very much.
[The prepared statement of Mr. Thompson follows:]

STATEMENT OF EDISON ELECTRIC INSTITUTE

SUMMARY

A. There is a need to provide a stimulus to the economy. The program submitted by the President can be of assistance.

B. The investment credit is a proven vehicle that in the past has stimulated the economy through investment in capital facilities. The 2 percent credit can expand that investment and be a stimulus both in the short term and in the long term.

C. The Institute does not oppose the jobs credit provision recommended by the Committee on Ways and Means but believes the investment credit also should be enacted, made permanent and include the following:

1. Any existing 10 percent investment credit and ESOP credit be applied first against the utilization limitation; the 2 percent credit should be allowable beyond the limitation, but not to exceed total tax liability.
2. The investment credit should be available at the time of investment in accordance with existing provisions of the law to be consistent with the primary purpose of the Administration's proposals.
3. The investment credit should be subject to ratemaking and accounting options similar to those presently provided in the Internal Revenue Code.

STATEMENT

My name is W. Reid Thompson. I am President and Chairman of the Potomac Electric Power Company here in Washington. I appear today on behalf of the Edison Electric Institute. The Institute is the principal national association of investor-owned electric light and power companies in the United States. Its member companies serve 99 percent of the investor-owned segment of the industry and over 77 percent of all users of electricity in the country.

The Institute appreciates the opportunity of appearing today and making this statement to the Finance Committee.

It is apparent that there is a need to provide a stimulus to the economy to push it forward on the road to full recovery. We endorse, in principle, the economic program submitted to the Congress by the President. We do not oppose the new jobs credit that the Committee on Ways and Means proposes, but if such credit is deemed to be desirable, it should be added to, not substituted for, the business stimuli, particularly the investment credit, that are contained in the President's proposal.

The investment credit is a proven vehicle first enacted by the Congress in the Revenue Act of 1962 to provide a stimulus to the economy by encouraging investment in capital facilities. The investment credit has done just that. Committee Print 7, a paper on Capital Formation, prepared by the staff of the Joint Committee on Internal Revenue Taxation in 1976, illustrates the effectiveness of the investment credit stimulating investment by reference to new orders for general industrial machinery over the period from 1962–1975. The study concludes that during those periods when the investment credit was in effect orders for general industrial machinery increased—at times quite dramatically. During the periods when the credit was not in effect orders either declined or remained relatively constant.

We believe that the additional 2 percent investment credit now being proposed by the President will provide a stimulus to the economy as investment credits have done in the past. This will assist the electric power industry in enlarging its contribution to solving national energy problems. Clearly a key part of our national energy policy must be the replacement of scarce petroleum fuels with electric energy generated by non-petroleum sources.

Although the financial condition of the industry has improved from the severe depths of 1974 the industry has not yet fully recovered sound financial health. And sound financial health is a necessity in view of the tremendous construction program needed during the next few years to assure an adequate supply of electric power. We estimate that in the next five years (1977 through 1981) a total of $122 billion, in current dollars, will be required for construction to meet anticipated electric energy demands. This compares with construction

expenditures of $75 billion during the previous five years (1972 through 1976). Of the $122 billion required during the next five years it is estimated that about 60 percent ($73 billion) of the total must be obtained from outside sources. The industry's ability to attract investors in the competitive capital market at reasonable interest rates depends on its financial condition. The additional 2 percent investment credit would help in alleviating the burden of raising this immense amount of money to build needed energy facilities.

Rates of growth in electricity output are again beginning to track their historical pattern. Output in 1976 was 6.3 percent over 1975 and we estimate it will reach 7 percent in 1977. This resumption of the growing demand for electricity will shrink our present reserve margins thus mandating a continuing construction program but that program depends on the financial condition of the utilities.

For these reasons the Institute favors the enactment of the additional 2 percent investment credit as proposed by the President. It will provide a stimulus to the economy both short-term and long-term.

Because the construction of our facilities requires a long lead time, from 5 to 10 years to complete a single power plant, we strongly recommend that the entire investment credit provisions be made permanent. The prospect that the credit may be terminated in 1980 could well influence a decision as to whether it is economic to begin construction now or to delay a decision for the future.

In order to accomplish the objectives of the President's program, it is important that the new investment credit be fully available for utilization by taxpayers. In this regard, it is suggested that any existing 10 percent credit and ESOP credit should be applied first against the percentage of tax limitation applicable to utilization of credits; the additional 2 percent investment credit should be allowable beyond such limitation, but not to exceed total tax liability.

Consistent with the purpose of the President's proposals to stimulate the economy as quickly as possible, the 2 percent additional investment credit should be currently available at the time of the investment rather than delayed until the date property is placed in service. This would be consistent with existing provisions for "qualified progress expenditures" as established by the Tax Reduction Act of 1975 and is of particular significance to the electric utility industry due to the long lead times involved in the construction of power plants.

Finally, in order to more effectively achieve the job-stimulant objectives of the program for regulated businesses such as the electric utility industry, the 2 percent investment credit should be subject to rate-making and accounting options, similar to those presently provided in the Internal Revenue Code.

[Thereupon, at 2:40 p.m. the hearings in the above-entitled matter were recessed, to reconvene Thursday, March 10, 1977.]

TAX REDUCTION AND SIMPLIFICATION ACT OF 1977

THURSDAY, MARCH 10, 1977

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

The committee met, pursuant to recess, at 10 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Byrd, Jr., of Virginia, Nelson, Bentsen, Matsunaga, Curtis, Hansen, Packwood, and Danforth.

The CHAIRMAN. The committee will come to order.

The first witness on today's list is Mr. Andrew J. Biemiller, director, department of legislation, American Federation of Labor and Congress of Industrial Organizations.

Mr. Biemiller, we are pleased to have you before this committee. I know I, as chairman, am very happy to see you back. We look upon you as an old friend and confidant.

You have served for a long period of time. I know we are all pleased to have you talk about the major tax bill before us.

STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, ACCOMPANIED BY RUDOLPH OSWALD, DIRECTOR OF RESEARCH

Mr. BIEMILLER. Thank you.

I am accompanied by Dr. Rudolph Oswald, director of the department of research of the AFL-CIO.

We are pleased to present the views of the AFL-CIO on the proposed Tax Reduction and Simplification Act of 1977.

The purpose of the legislation is to stimulate consumer demand, production and employment. We agree wholeheartedly, for the economy critically needs stimulation.

We disagree with the method. We feel that there are much better, more effective ways to create jobs and revitalize and rebuild the economy.

The AFL-CIO has advocated a program that will create jobs and stimulate the economy through measures that can be targeted specifically to the areas, people and sectors of the economy that need Federal help the most and can make the most effective use of Federal funds.

Briefly, the program we call for involves direct job-creating programs—for public works, for housing, for public service employ-

ment, youth training and countercyclical aid to State and local governments.

The program would total $30 billion in 1977 and the result would be the direct creation of over 2 million new jobs it would generate. An additional result, of course, would be added public services and facilities.

We believe that at least that amount and that type of stimulus is needed to make a dent in the Nation's unemployment problem.

Just over 2 years ago, Mr. Chairman, the AFL-CIO did support a tax cut as part of an emergency program to prevent the economy from plunging into a depression. The economy in the winter of 1974-75 was on the brink of disaster. The Ford administration was unwilling to support any direct job-creation programs, and congressional attempts to do so were continually hamstrung by vetoes.

But today the situation is far different. We are not on the brink of a depression. We have a new President who is concerned about the unemployed. But the key issue of job creation still remains.

About 10 million men and women are still looking for work—despite the fact that the so-called economic recovery has been going on for 2 years—and even the most optimistic forecasters anticipate high levels of unemployment for years to come.

Thus we feel a stimulus program should be based on pinpointed, direct, job-creating programs that will put the economy on a faster, steadier and balanced upward course toward full employment and full production.

Emergency tax cuts and rebates cannot be targeted to specific areas of high unemployment where the need is greatest. They cannot be tailored to specific sectors of the economy, such as the construction industry, which is still in a catastrophic depression, or to financially strapped State and local governments. And, of course, they are no substitute for a job.

We remain firm in our conviction that there must be full-scale renovation of the tax law to insure tax justice, as President Carter has advocated. We feel that the administration is making a grievous error in using tax cuts as the key fiscal policy tool and diverting Federal funds from direct programs that would create jobs and finance needed public investment programs. We urge the Senate not to make the same mistake.

The rebate proposal adopted by the House is, in our view, an improvement over the administrations' proposal which would have provided rebates regardless of income. We would urge this committee, if it adopts a rebate proposal, to maintain the higher income phase-out provisions.

We support the extension of the 1977 individual tax cuts to 1978.

There is absolutely no jurisdiction for business tax cuts. The role rationale for such cuts is to give business a psychological uplift. Business would be much more inclined to hire workers and produce goods and services if they could be more certain they were going to have customers.

The corporate share of the tax burden has also dropped markedly in recent years—largely as a result of efforts to give business "incentives." The three major "incentives" enacted since 1971 currently cost the Nation's taxpayers about $12 billion a year in lost revenue. One

result is that the corporate share of the Nation's Federal income tax burden in 1976 was only 24 percent, down from 35 percent 10 years ago.

Certainly business confidence is criticol to a healthy economic recovery. But businessmen will hire mo and produce more only if they can sell more—not because of tax windfalls.

In our statement before the House Ways and Means Committee, we objected to the administration's proposal for 4-percent tax credit based on employer payroll taxes. We argued that corporations did not need more tax subsidies—whether based on wages, machinery and equipment purchases or any other expense incurred in the pursuit of profit.

We urged the Ways and Means Committee to end the futile search for a way to create jobs through business tax gimmickry.

Such devices waste Federal revenue through providing benefits to firms for doing what they would do anyway, and trend to benefit larger and more prosperous firms that are least in need of Federal aid. Attempts to meet some of the problems inherent in such devices—minimize exploitation of the tax benefits and assure that net new jobs are, in fact, created—end up as swapping one type of problem or inequity for another.

The proposed "New Jobs Tax Credit" of 40 percent of wages—up to $1,680 per year with a maximum of $40,000—for employers who increase employment by more than 3 percent illustrates our point. Despite the ceilings, base periods and complex rules to limit abuses and exploitation, under this proposal:

One, firms that are stable or in decline because of changes in demand for their product, foreign competition or the economic situation of their particular area or market could not benefit even though many of these firms would be small operations that are most in need of help.

Two, many firms that are expanding because of general economic conditions would receive windfall tax breaks. And, most likely, such firms would be the more profitable operations that are least in need.

Three, there is an incentive to hire low-wage and/or part-time workers rather than more skilled and/or full-time workers. An employer, for example, could receive twice as much of a tax credit by hiring two part-time workers at $5,000 per year rather than one full-time employee at $10,000.

Four, haphazard and inequitable effects could take place in industries such as contract construction, some needle trades, certain food processing and other industries which are characterized by large fluctuations of employment in particular firms. The proposal would also encourage the formation of small, temporary operations which require only a small investment. The tax incentive would encourage such firms to undermine established, stable organizations that provide jobs and pay taxes on a continuing basis.

Five, firms which are expanding by driving out competition or taking over functions previously performed by suppliers would benefit. Under such circumstances, the particular firm's workforce would grow, but other employers would be forced to lay off exactly the same number of workers. In effect, the Federal tax structure would be subsidizing an

increased concentration of industry and helping to drive out small business.

Six, under certain circumstances, as the administration has pointed out, an employer could actually make a profit from the credit—even if he hired a worker and told the worker to stay home.

In short, the New Jobs Tax Credit is just another tax loophole, would not cut unemployment and should be rejected.

Finally, we understand there is a strong likelihood that the matter of the sick pay exclusion might be considered by this committee. Although we do not know when the matter will be taken up, we do feel emergency action is necessary.

We urge:

One, that the sick pay exclusion in its pre-1976 form be reinstated for all of 1976. This would redress the wrong done by Congress in retroactively denying benefits to those who were ill during 1976 and were counting on the exclusion.

Two, the proposal offered by Senator Bayh and adopted by the Senate last year should be enacted effective January 1, 1977. That proposal would permit the up-to-$100 a week sick pay exclusion for individuals with income of $15,000 per year or less. Between $15,000 and $20,000 the benefits would phase out.

In that fashion, the sick pay exclusion would benefit those in need, the tax code would continue to recognize the fact that illness creates extraordinary expenses, and those who do not need the benefits would not receive them.

Such a measure would also conform with the disability income exclusion changes made in the 1976 act.

The CHAIRMAN. I am going to ask that all members confine themselves to five minutes in the first round of interrogation. I will ask the first question only because I was the first person in the room today.

Did you make this same presentation before the House Ways and Means Committee?

Mr. OSWALD. Senator Long, we made the same basic recommendations. We did not address the sick leave provisions, but the rest of the testimony was basically the same.

The CHAIRMAN. What I am concerned about is that the Ways and Means Committee often conducts their hearings first and writes the bill after that. I just want to know if what you said about the jobs credit plan was something that you advised them of, or is this the first chance that you have had to testify on that credit?

Mr. BIEMILLER. This the first opportunity that we have had to criticize their jobs program. It was not before the committee at that time.

The CHAIRMAN. I think that is significant.

When a committee puts together something and you have a very strong objection to it and you detail what you think is in error about it, it is significant, from my point of view, to know whether that committee had this testimony before them when they made that decision, or whether this is the first time that it is being presented.

You are telling me that your criticism of their jobs credit plan was not known to them in this detail?

Mr. BIEMILLER. Nor was their program known to us.

The CHAIRMAN. Do you have any thoughts about the desirability of expediting the construction of the interstate highway program

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or the desirability of discontinuing all of these projects that the President is putting a hold order on, including water power dams, navigation projects, flood control, and things of that sort?

Do you have an opinion on whether they should go forward or be held up?

Mr. BIEMILLER. We will be testifying before the budget committees of the respective Houses in the near future. My offhand reaction will be that we will probably urge that they be continued. We have not yet worked out our testimony on the budget.

The CHAIRMAN. I have not had a chance to talk to the President. It seems to me that there is not any one of these projects that is being held up at the present time that does not have a better benefit-cost ratio than some of the things we are going to be doing to try to put people to work.

For lack of something better, I would vote for the refund. But, on the other hand, you are not going to have nearly as much to show for it if you put it in public works that have had a careful study.

If he wants to restudy it, it is all right with me. It seems to me if you compare the cost-benefit ratio of what we are going to do, I would hope that those that have been carefully studied would have a higher cost-benefit ratio than those things that you come up with on the spur of the moment.

I am certain that they have to have a better cost-benefit ratio than a $50 tax credit. Although that may be good, you cannot be sure it is going to do what you want to achieve with it. In some respect, it is sort of like throwing $50 bills off the top of the Washington Monument. You hope that people will spend it wisely; you have no assurance of that.

But desirable public works that are going forward, it seems to me, is something that ought to be continued and even expedited. Even though, as you indicated, you may be able to put more people to work at $5,000 a job, that does not mean you are going to have anything to show for it by the time you are through.

You can put them to work picking up litter before the garbage truck gets there. On the other hand, it is a marginal undertaking when you could have put those people to work doing something of lasting value.

Mr. BIEMILLER. You state our basic case very well, Senator.

The CHAIRMAN. Thank you very much.

Senator Curtis?

Senator CURTIS. No questions.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. Mr. Biemiller, what is the median adjusted gross income of members of the AFL-CIO?

Mr. OSWALD. We have made no specific study of the median adjusted income of the AFL-CIO, but we represent people pretty well across all spectrums, from fairly well-paying jobs to very high paying jobs, from airline pilots to janitors, so that the 14 million members of the AFL-CIO are rather representatives of the total work force.

Senator DANFORTH. Could you make a guess?

Mr. OSWALD. Fairly close to the general national median income.

Senator DANFORTH. Which is what?

Mr. OSWALD. $15,000 is my recollection—median family income, you are asking?

Senator DANFORTH. Yes; either way you want to put it.

Are you talking about families or talking about individuals?

Mr. OSWALD. The AFL-CIO approximately reflect the median family income for the Nation as a whole. There is not much difference. The median is not affected very much by extreme income.

Senator DANFORTH. I am not sure that I am with you on that.

Mr. OSWALD. What I am saying is the mean would be affected by the number of people in poverty and the number of very rich people both of whom are not basically members of unions. A median is not affected very much by that, because it is the midpoint of all people.

To that extent, the median fairly well represents, I think, the general AFL-CIO membership.

Senator DANFORTH. You would say that the median income of an AFL-CIO family would be about $15,000?

Mr. OSWALD. That would be a fairly good approximation; yes.

Senator DANFORTH. If you were designing a tax reduction, designing a new rate scale, and you were going to pick the figure on the rate scale that would have maximum benefit for members of your union, what would it be?

Mr. OSWALD. Senator, we would approach the issue of taxes as a matter of overall national concern with tax justice, not just how it affects a particular member of the AFL-CIO.

Some of the things that concern our members are not just what they pay as individuals, but an overall concern with tax justice. They are concerned with the rich not paying their fair share as well as the tax burden on lower income people.

Senator DANFORTH. I understand that, but if you would just answer my question: What figure on the tax scale would be the one? If you looked at your tax tables now, where on the tax scale would you put your pencil to include most of your membership? Would it be at about $15,000, at about $20,000?

Mr. OSWALD. Our membership would be affected fairly well across the range, the midpoint being somewhere around $15,000, in terms of a family. I am not quite clear what your question is.

Senator DANFORTH. Just to simply find out how much people are making who are members of the AFL-CIO.

Mr. OSWALD. AFL-CIO members earn pretty much what the general population of working people earns.

Senator DANFORTH. Would it be fair to say that, if a reduction in the tax rates were aimed at the first $18,000 of adjusted gross income that that would be of benefit, of particular benefit, it would be targeted to the vast majority of the AFL-CIO?

Mr. OSWALD. We have asked that the House committee and this committee would look into changing the tax rates as a matter of total tax reform and tax justice, rather than in terms of an emergency jobs stimulus program.

We do not think that job creation is addressed best through changes in the tax structure. We would hope that you would not use this vehicle to make it a tax reform bill. We would hope that you would undertake the overall tax reform issue separately.

Senator DANFORTH. Mr. Chairman, if I may just reask my question, I am not talking about tax reform. I am talking about stimulus and tax rates.

My specific question to you was, would a tax reduction aimed at the first $18,000 of adjusted gross income be the kind of reduction which would really target, really would be designed for members of your union?

Mr. OSWALD. It does not put people back to work. That is why we have objected to this. We did testify before the House in terms of the rebate that, yes, it should be cut off at $25,000 and phased out between $25,000 and $30,000.

We are concerned that this bill does not provide jobs. We are not looking for a windfall for our members; that is not what we are asking for, nor are we looking for windfalls for corporations.

Senator DANFORTH. I am just asking a question about tax rates and it would, would it not, clearly?

Mr. OSWALD. Whatever you do in terms——

Senator DANFORTH. Tax relief for the first $18,000 of adjusted gross income would be of benefit particularly to working families?

Mr. OSWALD. It would provide them with money, but not necessarily a stimulus to the economy to put people back to work. I think that is the central issue here, how you get people back to work.

Senator DANFORTH. It would be a tax reduction that would be targeted to members of your union, would it not?

Mr. OSWALD. It would not be targeted to put people back to work.

Senator DANFORTH. It would be targeted at them, would it not?

Mr. BIEMILLER. Senator, the AFL-CIO, through convention and through statement of the executive council, has repeatedly said it is not the rates that bother us. What does bother us is getting people back to work and getting some tax justice into this tax code.

What is bothering our people most of all is the rather large number of individuals and corporations with large incomes who pay little or no taxes. That is what is bothering our people today, not their tax rates.

Senator DANFORTH. My time has expired. I wish I could pursue my question further.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. What Senator Danforth is driving at, are you saying scrap the rebate, scrap the refund and put it all in very targeted employment programs? The theory of the rebate is it is supposed to put people back to work. You have $50, you buy a toaster. General Electric has somebody make the toaster, in theory.

You do not agree with that theory?

Mr. OSWALD. Senator, we thought that was true 2 years ago, in 1975, when the economy was quickly going down that you needed some sort of special action quickly to stop the continuing descent. We are not in that situation anymore.

Our situation now is that the economy is growing. It is not growing fast enough, but there are large groups of people, particularly in our major metropolitan centers, who have not been called back to work.

We would like to have jobs targeted to put those people back.

Senator PACKWOOD. You would like a $30 billion program targeted at structural unemployment?

Mr. OSWALD. That is correct.

Senator PACKWOOD. Assuming you are going to have a rebate or refund, which would produce more jobs?

Mr. OSWALD. I am not convinced that either will produce jobs. We would really like to see changes in the tax rates held up for a general reevaluation of the whole tax law.

One of the things that our executive council spent time and great concern on in their last session was tax justice. We are talking about a quick tax stimulus policy because they adopted a policy of targeted jobs. They are concerned with getting a real reform of the tax structure.

Senator PACKWOOD. When you talk about that, you are talking about closing the so-called tax loopholes?

Mr. OSWALD. Closing loopholes is one concern. But in closing some of those loopholes you may also have additional income to make reductions in some of the other income tax rates. We want a review of the whole income tax structure and the impact of any changes. One of the problems, for example, of the reduction in the current administration proposal for the minimum standard deduction is for those people who do not itemize. Many in the $10,000 to $20,000 income bracket would not receive——

Senator PACKWOOD. Assuming $50,000 as a cutoff point, you are not seriously suggesting that if you were to confiscate all of the income above $50,000 it would make a significant difference to lowering the taxes on all of your members?

If you think it is unjust, that is fine. We can argue about it. I may agree with you on a lot of them and we may close a lot of them.

In terms of tax reduction for your members, it is not going to make any difference.

Mr. OSWALD. I think that the question of tax justice is very important in terms of how people view their tax contribution, relative to how other people abuse the tax system. Whether the total amount brought back to the Government amounts to $50 billion or $1 billion is not the issue, the issue is relative tax payment, of individuals and corporations.

Senator PACKWOOD. It would make us all feel better if people would pay their fair share. We should not confuse that with a tax stimulus or permanent shift in taxation.

Mr. OSWALD. There a number of various so-called loopholes that raise different amounts of money. We have studies indicating how much is lost—both corporate tax changes that I hope would be review as well as the individual income tax?

Senator PACKWOOD. If you were to confiscate all of the taxable income above $50,000 you would distribute $14.66 per capita once. Many people would not make over $50,000 the first year.

Mr. OSWALD. We have not urged that all over $50,000 be confiscated.

Senator PACKWOOD. If you did that, that is the only change you would have. If that would make everybody feel better, I do not know how long they would feel better until they would realize they did not get a substantial reduction in their taxes.

My time has expired.

The CHAIRMAN. Senator Bentsen?

Senator BENTSEN. No questions.

The CHAIRMAN. Thank you very much, Mr. Biemiller. I would like to interrogate you at great length, but I am usually left as the last man with the witnesses. Probably later on today I will discuss this matter with you further.

Thank you for a very fine statement.

Mr. BIEMILLER. Thank you, Mr. Chairman.

The CHAIRMAN. Next we will call Mr. Reginald Jones, chairman and chief executive officer, General Electric Co.

STATEMENT OF REGINALD JONES, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GENERAL ELECTRIC CO.

Mr. JONES. Let me thank you for this opportunity to testify before you distinguished gentlemen. We do agree that some stimulus is in order. As to the size of the stimulus, we feel, with an economy running at $1.7 trillion you need something over 1 percent to get some stimulus.

We feel the amounts being discussed are not unduly inflationary or out of order.

Briefly, the program that we have submitted covers three things: one, a $15 billion permanent tax reduction for individuals.

Second, $3 billion for business through a higher investment tax credit.

Third, about $5 billion to be spent for programs through CETA that would attack the structural unemployment problems that we have in the country.

As to individual tax cuts, why do we feel that they should be permanent rather than rebates? It is because our basic concern is the level of the economy in 1978.

All of the studies that we have made—and they have been verified by studies made by DRI and others—shows that a permanent tax reduction would make a difference in our gross national product next year of 1 percentage point in terms of growth. That is very important to us when we look at the fact that in 1978 we will have social security tax increases of roughly $7.5 billion, even at the existing legislative increased rates and increased coverage. So that we feel that the permanent tax reduction would carry us through 1977 and 1978.

We are very concerned about the confidence factor on the part of the American public and their rate, therefore, of consumer expenditures. Remember, when you gave a rebate in 1975, in the second quarter of 1975, savings jumped to an all-time high of 9.6 percent and they stayed at abnormally high rates in the third and fourth quarter, which only indicates to us that it takes about a year before rebates are fully expressed in terms of consumer expenditures.

This will mean a delay in the economy.

Our permanent tax reduction is aimed at the individuals in the lower income brackets. Questions were asked as to the average income, for example of AFL-CIO workers. The overall index of the Department of Labor for the all manufacturing average in 1972 was $7,550. In 1977, this year, that same figure will be $10,910, just taking into account inflation from 1972 to 1977.

The added tax by the end of 1977 of that same individual, just because he has moved up in brackets with our progressive structure, his tax bill over those 5 years will have moved up by an amount of $966. You gave back to him in 1975 and 1976 rebates and tax reductions of $719. We would like to return that balance of a couple of hundred plus through the form of a permanent tax reduction.

A family of four, for example, in the all manufacturing average, as I said, that figure in auto is $13,800; in steel, $14,600; in the of hundred plus through the form of a permanent tax reduction. construction crafts, $16,900. These reductions, we feel, are very much in order.

Let me put it another way. The permanent tax reductions that you gave over the last couple of years, by the final quarter of this year will equal $15.1 billion in annual rate, yet inflation has moved people up in brackets that has taken away from them $13.3 billion of the $15.1 billion that you intended to grant, so we are left with a savings to the individual out of all of those reductions of only $1.8 billion.

This program that we designed that we have given to you is, of course, aimed at the lower brackets—72 percent would go to people earning less than $20,000 in a family of four—that is including a working wife. Now, I understand that you are concerned about the loss of your tax revenue base but let me just make a very interesting point.

Here, I am not looking at ecenomic models, I am just looking at history.

In the last 30 years, the Congress has seen fit to make 10 cash reductions for individuals, 10 over the last 30 years. In all but one case—and that was in 1948—there was a 1-year's reduction in tax revenues, always less than the amount of the tax cut, and then in the succeeding years, tax revenues went to new highs. It is very, very interesting to look at that history. I do not think that we would erode the tax base with tax reductions; just the contrary—you will increase your revenues because of the improved economy.

Let me move to the corporate tax program. What we have requested is a 3-point increase in the investment tax credit. We have two concerns; they are capacity and productivity.

If we assume a real GNP growth rate of 5.4 percent in 1977 and 1978—that is the figure that is in the administration's latest budget document, then, by the fourth quarter of 1978 we will be operating at 91 percent of capacity. That is against the peak we hit in 1973 of 87.8 percent when we had all these bottlenecks occurring and price increases because of the shortage of supply.

The impact on inflation with that kind of bottleneck I do not need to discuss. We do need to add to capacity, start planning for that capacity addition now. There is a lag of a couple of years before you can get capacity in place.

We have a real time problem. We think an increase in the investment tax credit now would mean that, by the end of 1978, we would not be in the bottleneck situation. We would have capacity.

Furthermore, we would create a tremendous number of jobs as that capacity started to be built, not just in the construction crafts but in all metal cutting industries as well.

Our second concern is productivity. After all, this is the only real defense that we have against inflation. Inflation is, without question, the most serious problem bothering the American people.

Over the last 10 years, our growth in productivity has averaged only 1.6 percent per year, the lowest among the major industrialized nations. For the 20 years prior to that, it was 2.7 percent.

I would like to point out that real wages, which are the true concern of Mr. Biemiller, those real wages correlate directly to increases in productivity.

Real wages attract real increases in productivity directly.

Why are not businessmen spending? During this recovery, real business capital spending is up only 3 percent. That is against 15 percent during all of the previous postyear recovery cycles, a fraction of what it should be.

The Council of Economic Advisers said that we should be spending about 12 percent of our real GNP into business investment. That is against the historic average of 10.5, because we do have some catching up to do, but over the last 2 years, instead of running at 12 percent, or even at our historic 10.5, we have been running at 9.3 percent. Why?

Two reasons, again. One is lack of incentive; one is lack of confidence. The real after tax return on investment for underdepreciation in these inventory profits has fallen from 9.9 percent in 1965 almost 10 percent to 2.4 percent in 1975.

Last year, the year where we were all talking about record profits, it got back up to 3 percent. I ask you, Who is going to take the major risks that are involved when that is the kind of real return you are getting on your investment?

Confidence is also damaged by the fact that we are now beginning to realize that the market value of our companies is lower than the replacement cost of our assets. Perhaps you saw in the year-end report of the Council of Economic Advisers that the market value of our companies today is 83 percent of the replacement values or cost of the assets.

That is certainly destructive of confidence.

The increase in the investment tax credit would be the greatest signal that you gentlemen in the legislative branch could give to business that you are supporting business. The administration has come out now strongly signaling its support for business and we need that same kind of a signal from Congress.

I must say that we do not support the job credits schemes that were advanced by the House for all the reasons that were cited so well by the Treasury spokesmen. I cannot add anything to the list of reasons that Larry Woodworth and Secretary Blumenthal put before you.

In the interests of equity, because we realize that capital intensive industries would get a break, if you want to call it that, with a higher ITC, where labor-intensive businesses would not get that same stimulus. We do recognize the equity that was offered in the administration bill; namely, that if you were capital-intensive, you could go for a higher ITC; if you were labor intensive, you could go for some kind of credit against your social security taxes.

It may be that the ingenuity of your committee can devise some sort of job credits scheme th[illegible] replaces that, supplants it as an offset elec-

tion of labor-intensive industry, small businesses that are not capital intensive.

Really, when you think about the current job credits schemes, they do not apply to 66 percent of the labor force. We verified that number in our statement. We cannot think it is going to be a productive stimulus, which is what you are after.

We do believe that the ITC can be improved, not only by increasing the rate, which would give some temporary stimulus, putting that in for the next 2 or 3 years. Also, rather than going back all the way to what Senator Kennedy suggested, refunding the ITC, going to 100 percent than the 50 percent limit against tax liability; furthermore, making all ITC, in effect, deductible at the time that business spends the money—you have made adjustments for 2 years projects. I am thinking that there are many cases where we are required to make deposits to get specialized equipment built. It will not take perhaps 2 years to get it built.

If we could get the deduction for the ITC at the time we made the expenditure, and therefore put funds into the economy and start jobs, this would be very helpful.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much. You have made a very fine statement.

I am interested in what you said about going to 100 percent of the investment tax credit. I want to ask something about that.

Does it really seem fair that a new business, where somebody puts all of his savings, his heart, his whole effort, to make a new business succeed, that even though that venture should fail, that those people should not receive the same 10 percent subsidy from the Government to encourage them to buy new equipment?

Frankly, I know what it is to make money and to lose money. I know what it is to put my money in something, and not get a penny back from it, and then owe something on top of that. A lot of people do. We do not like to talk about it much.

Of all of the people who have been in the oil business and gone broke in that business, I do not know anybody who likes to tell about it. Former oil producers who have lost every nickel they put in trying to drill an oil well and finding a dry well, don't like to talk about it. In terms of equity, justice and fairness, if the Government is going to provide, by way of the tax system, a 10 percent subsidy for someone to buy equipment and put people to work, does it really seem quite fair that the company should not get that subsidy just because, with all the good hopes they had, they lost their money and did not quite manage to make it?

Mr. JONES. I recognize your concern, Mr. Chairman. I have thought an awful lot about this. I guess I am concerned on a couple of fronts.

You call the ITC a subsidy; perhaps that is one way to look at it. I look at it as a reduction of tax. Of course, if you have no earnings, you have paid no tax.

The CHAIRMAN. I was just talking to an oil company executive a few days ago who pointed out to me when you drive up to that pump it says you are paying a 3 cent tax to the Federal Government and 7 cents tax to the State government. As a practical matter, there is 25 cents

of tax in that gallon of gasoline, the average gallon. This fellow is paying all kinds of taxes in addition to that income tax.

Mr. JONES. Yes; that is true. Excise taxes are very substantial.

Also, I think when you are talking stimulus, new businesses are relatively insignificant in terms of capital expenditures. It takes some time before they can spend substantial amounts of capital.

I am also concerned too, if we went to the kind of a program where we had, in effect a refundable ITC with the concern that we all have about inflation, this would be too costly.

If we go from a 50 percent to a 100 percent limitation, the cost to the Federal Government would be roughly a half a billion dollars, where if we go to a program of fully refundable ITC we could be talking about seven to eight times that amount.

I would hope that the entire program would be one that would be directed at stimulus, and one not unduly inflationary.

The CHAIRMAN. I find a lot of appeal in what you say. Personally I have come to think that a refundable investment tax credit would be a very, very useful tool. If you want to subsidize something, it is actually better than an annual appropriation. With an annual appropriation, the businessman is led to believe he is going to get it. Oftentimes he finds out it does not work that way at all; when the time comes, he does not get it.

That is somewhat that way with the investment tax credit. A businessman is going to get the 10 percent credit, but after he gets in the business he finds out that maybe he gets it and then maybe he does not. He gets it provided Congress does not change its mind meanwhile and he gets it if he made a profit.

At least it has more security than an annual appropriation, if that is the kind of thing you have in mind. An annual appropriation—some enterprising Senator makes a stimulating speech on the Senate floor and there it goes, bang; that businessman has los what he was counting on in that appropriation bill.

I have seen some of that, and so have you.

If we put a refundable tax credit in the law, when you want to stimulate the economy it would be a very, very useful tool, and I think perhaps more efficient and more reliable than some of those measures which we are turning to more and more.

Mr. JONES. You make an excellent point. There is one thing that the free enterprise system cannot deal with, or the free market system cannot deal with, and that is uncertainty.

The greatest thing you did on the ITC was say, we will make that now permanent, at least out to 1980. That was so vital to us.

The concern I have on a refundable ITC, it may be refundable for 2 years and then be pulled off. The ITC is not a very good countercyclical device. It is a device we need to put in place to recognize we are depreciating historic costs and therefore not in a position to replace our assets when they wear out.

By eliminating the uncertainty, as you did, by saying, by God, you will have that until 1980, that was great. I was asked by the House Ways and Means Committee a good question: why do you think a two

or three point increase in the ITC would result in any stimulus in capital expenditures?

It is only going to be a couple of billion or $3 billion. I think the biggest reason is, again you would be eliminating uncertainty. We would be table to appreciate that, by God, Congress is going to go with the administration in supporting business in getting this economy moving.

The CHAIRMAN. Thank you very much.

Senator Curtis?

Senator CURTIS. It was a very good statement. Thank you.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. I have no questions.

The CHAIRMAN. Senator Byrd?

Senator BYRD. Just a question for clarification. Did you say that you favor a 100-percent tax credit?

Mr. JONES. On the ITC there is currently, as you know, a limitation of 50 percent. We would like to see that lifted and make the ITC apply 100 percent against your tax liability, against the taxes that had been paid.

Senator BYRD. The investment tax credit is 10 percent. You feel it would be well to put it at 12 percent?

Mr. JONES. We have asked in this paper for 13 percent. The administration is talking 12 percent.

Senator BYRD. Do you feel that there should be a limit beyond which that tax credit should not go?

Mr. JONES. That is a very interesting question and one that is very difficult to answer, how high is up? Is there a diminishing point here in returns, and so on.

Our feeling was that with the continued erosion of our depreciation practice in view of inflation that we do need a higher ITC to get us into a better position to replace these assets with more productive equipment. An increase in the ITC would be very helpful in that respect. It cuts about a third of the loss that we have had through inflation when it comes to replacing these assets.

Senator BYRD. What do you think about a liberalized depreciation allowance?

Mr. JONES. We are all for that, very much so.

Senator BYRD. How high do you think that one could realistically go on that?

Mr. JONES. You have allowed us, with reference to last in, first out, through inventory to get a true measure of protection of damages caused by our inventories. If you were to do that on depreciation by allowing us to depreciate either at replacement cost values or on an optimal basis to take the depreciation over whatever time period we felt that it was appropriate, you would accomplish the same thing on plant equipment that you have already done in inventories.

Senator BYRD. You have an operation in Canada.

Mr. JONES. Yes.

Senator BYRD. Has not Canada gone to a 50-percent depreciation?

Mr. JONES. Yes, Canada allows us a much shorter period over which to depreciate our plant and equipment.

Senator BYRD. How do you find that is working?

Mr. JONES. Let me just say we take advantage of it. We do depreciate at the rates allowed, yes.

Senator BYRD. Has the Canadian Government reached a decision? Do you know whether or not that will be continued?

Mr. JONES. No, I do not, but I have heard no talk along the lines that it would be discontinued. As a matter of fact, the depreciation practices in the United States as far as the length of time we are allowed to write down assets are way out of step with other industrialized nations.

Senator BYRD. You think it is?

Mr. JONES. Yes, we do. We have statistics on that for every major industrialized nation. In most nations now you can write down much more quickly than you can here.

Senator BYRD. In the long run the Government does not lose by that?

Mr. JONES. No.

Senator BYRD. Business would gain more quickly. They would gain in the short run but it would be most costly to the business later on. The Government would take in less at the moment, but more in later on.

Mr. JONES. There is no change in governmental revenues, but by advancing the speed by which you do depreciate, you enhance your cash flow. This puts you in a position, therefore, to make this expenditure for new equipment more rapidly.

Senator BYRD. It seems to me that that could be very helpful to business to liberalize the depreciation rates, yet not cost the Government in the long run any more than it is costing now.

Mr. JONES. It would be particularly beneficial to business if you allowed this. For example, a quick writeoff on all of these expenditures we are making for pollution control that do nothing to add to our capacity—sometimes it actually reduces capacity.

Senator BYRD. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Matsunaga?

Senator MATSUNAGA. The purpose of all of these tax incentive measurements primarily is to increase employment, and to reduce the high unemployment rate. Assuming that we accept what you have said here today, how many employees within the next fiscal year will General Electric be hiring?

Mr. JONES. That is a very good question, and one that I wish I could answer. The number of employees that we hire will depend upon two things: one, the markets for our products, and the markets for our products we would like to see enlarged. We would like to see increased consumer demand. That is why we argue for permanent tax reductions for individuals and particularly those in the lower income tax brackets. Our program is specifically aimed at that to increase demand, therefore spark the economy.

The second factor would be, if we moved to give business some help on ITC we would be spending more on plant and equipment and that would also increase jobs for those who supply us with machine tools and so on.

Our biggest suppliers, for example, are small businesses. We would like to increase our demands on them. We can do that as we spend money for plants and find markets for our products increased.

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Senator MATSUNAGA. Assuming you make your projections on the assumptions you have just made, have you had some experts, some economists, make a projection as to what you can expect under a program which you propose? Do you have any such figures on your projections?

The proponents of the job tax credit program project increased employment within the next 2 or 3 years, of something between $650,000 to $1.5 million.

Have you any such projections under your proposal?

Mr. JONES. We have run this program through our economic model and our economic model is one that we keep quite current. It is a model of the total economy and, if this program were adopted, our model would tell us that by the fourth quarter of this year the unemployment rate in the United States will be 6.8 percent; by the fourth quarter of 1978 and for the full year of 1978, 6.5 percent.

We do happen to feel very strongly that these studies that have been made by Michael Walker at the Wharton School, University of Pennsylvania, trying to determine what level of unemployment we can reach without rekindling inflation—we used to think in terms of 4 percent full employment kinds of situation. When you get down to 4 percent, that is about as low as we could do unless we wanted to risk a great deal of inflation.

The studies he has made is that rate is now 5.5 percent. The reason it is that high is, of course, the demographics—the increased youth, people between 16 and 19 are running between 10 and 11 percent. Since the founding of this Nation, they have run 6 percent.

Starting in 1981, they drift down again. By 1985, we are about to 6 or 7 percent. We have this enormous problem with demographics of youth 16 to 19. Coupled with that, we have a 20-point increase in women of working age that want to be in the work force. That is why this 5.5 percent seems to be an irreducible limit, unless we run into all kinds of inflationary difficulties.

We say that with this program we get down 6.8 this year and 6.5 the next year.

Senator MATSUNAGA. Thank you very much.

The CHAIRMAN. Thank you very much for a very thoughtful statement. We will give it a lot of consideration.

Mr. JONES. Thank you, Mr. Chairman.

[The prepared statement of Mr. Jones follows:]

EXECUTIVE SUMMARY

STATEMENT TO SENATE FINANCE COMMITTEE BY REGINALD H. JONES, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GENERAL ELECTRIC COMPANY

1. Unless consumer and business spending are stimulated, the United States will have such slow economic growth in the years ahead that high unemployment and all the related social problems will persist right through this Administration.

2. The Federal Government has been enjoying an unlegislated tax increase every year, as individuals are inflated into higher tax brackets and business pays taxes on earnings that are overstated by the effects of underdepreciation and phantom inventory profits. It is our view that the Congress should return this tax windfall to the private sector by a program of permanent tax reductions for both individuals and business—coupled with tight restraints on new spending programs.

3. Our recommendation is a $15 billion permanent tax reduction for individuals, targeted on restoring their tax losses due to inflation.

4. To stimulate capital investment, which is lagging badly, there should be a $3 billion tax reduction for business in the form of a permanent increase in the investment tax credit from 10% to 13%.

5. A temporary tax cut or lump-sum rebate, followed by what is in effect a tax increase next year, will not provide the reinforcing, year-after-year effect needed to stimulate sustained growth of economic activity and the tax base for future government revenues.

6. As to preserving the tax base—there have been quite a number of Federal tax reductions in the past three decades, under a variety of economic circumstances. In almost every case, there was only a one-year reduction of individual income tax revenues, usually less than the amount of the tax cut, and then revenues were higher than ever in the following year.

7. Why has capital spending been lagging? Real after-tax return on investment, adjusted for inflation, fell from 9.9% in 1965 to 2.4% in 1975, and in 1976 it rose to about 3%. This sort of return does not inspire management to take risks on new investment. Tax reform, in the form of an improved capital cost recovery program or a reduction in the corporate income tax rate, is an urgent long-term need. But the most effective way to stimulate business investment immediately and keep it going is to increase the investment tax credit permanently from 10% to 13%. The resulting increase in capital spending will create immediate employment in construction and manufacturing, and will also provide the expansion of industrial capacity that will be needed to absorb our fast-growing labor force.

8. The jobs-credit scheme in the House bill should be eliminated because it is arbitrary, discriminatory, and incapable of achieving its stated goals. The basic ecoonmic objection to the jobs-credit approach is that it uses the tax system to encourage inefficiency and inflation. And as Assistant Secretary of the Treasury Laurence Woodworth has pointed out, the incremental base and the $40,000 "cap" per company effectively excludes at least 66 percent of the labor market from participation, either because the employers' normal experience places them below the threshold or over the "cap."

9. Thus we urge that major reliance be placed on a permanent tax cut on the order of $18 billion a year—$15 billion for individuals and $3 billion for business. However, we do believe that as much as $5 billion of additional Federal funds could profitably be spent this year and next on an expanded CETA jobs program for the victims of structural unemployment, especially the minorities and teenagers in the big city centers.

STATEMENT

Speaking for the General Electric Company, we welcome this opportunity to present our views on the economy and to the distinguished members of the Senate Finance Commttee.

The economy is recovering well from the temporary effects of the abnormally cold winter, but the Congress has reason to be concerned about the overall levels of economic activity. Unless consumer and business spending are stimulated we will have such slow growth in the years ahead that high unemployment and all the related social problems will persist right through this Administration. There is so much slack in the economy right now that a fairly sizable program of *permanent tax cuts and job-oriented action programs* would not cause unmanageable inflation or deficits, but would strengthen the economy against *future* inflation and *future* deficits. Moreover, the world economy is in such precarious condition that stagnation here could lead the whole world into another recession, with dangerous consequences for all concerned.

So economic stimulus is needed and the real questions are the size and makeup of the program.

As to size—when you have a $1.7 trillion economy, it takes a fairly sizable program, something over one percent of GNP, to have any impact at all on the direction of the economy. If the government opts for one-shot tax rebates or heavy spending on public service jobs or job-credit schemes that might temporarily reduce the unemployment figures but don't really strengthen the economy, we'll face the same problems of stagnation and inflation in 1979 and 1980. In order to achieve sustained improvement right out into the 1980's, we should invest in a more permanent approach to our economic problems.

We're aware of the argument that the quickest and least expensive way to reduce unemployment is by public service jobs. Some of this will be required to get at the really difficult problems of minorities and teenagers, especially in the cities. We have specific proposals in our memo entitled "Taxes and Jobs," and I would like your permission to enter that memo on the record, along with this statement. But too heavy a reliance on this aspect of the program would disperse your resources in 1977 or '78 without stimulating the broader-based economic growth that must ultimately provide lasting jobs for our people, and *build the tax base* to support much-needed social programs.

Looking over the full span of this Administration and beyond, and the fulfillment of its aspirations for the people, your program should be designed to build permanent and productive employment in the private sector and help both the consumer and the businessman to overcome the debilitating effects of inflation that brought on so many of our problems in the first place.

As this Committee knows, the Federal Government has been enjoying an unlegislated tax increase every year, as individuals are inflated into higher tax brackets and business pays taxes on earnings that are overstated by the effects of underdepreciation and phantom inventory profits. It is our view that the Congress should return this tax windfall to the private sector by a program of permanent tax reductions for both individuals and business—coupled with tight restraints on new spending programs. Our recommendation is a $15 billion permanent tax reduction for individuals, targeted on restoring their tax losses due to inflation. And to stimulate capital investment, which is lagging badly, there should be a $3 billion tax reduction for business in the form of a permanent increase in the investment tax credit from 10 percent to 13 percent.

There has been much discussion of permanent versus temporary tax cuts or rebates. In our view, there is no doubt about the matter. A *permanent* tax cut making up for the effects of inflation is something that the working man and his wife can count on. When that money shows up week after week in his take-home pay, because of reduced withholding, that family will have the confidence to step up spending and take on new obligations.

A *temporary* tax cut or lump-sum rebate, followed by what is in effect a tax increase next year, will not provide the reinforcing, year-after-year effect needed to stimulate sustained growth of economic activity and the tax base for future government revenues.

We would much prefer to see a program of permanent tax cuts along the lines shown in considerable detail in our memo, "Taxes and Jobs." This program would put about $5 a week in take-home pay into the envelopes of the working people in this country, with 72 percent of the added income going to those whose earnings are less than $20,000 a year. We've worked out the impact on steel and auto workers and craftsmen and their families, with and without a working wife, to be sure we were being totally realistic. But let me just comment on the effect on the average working man in manufacturing.

The objective of our tax proposal is to restore the percentage of income taxes to gross income that existed prior to the big increase in inflation, for lower and middle income people. Go back to 1972. A family of four in the all-manufacturing average index of the Department of Labor had a gross income of $7,550 in 1972. That same family of four, taking into account only the effects of inflation, in 1977 would have a gross income of $10,910 a year. That family by the end of 1977 would have paid $966 more in income tax because of income inflated into higher tax brackets.

Your 1975 and '76 rebates and reductions would give back $719 of that, but we would prefer a program which would more nearly restore the full $966 of lost purchasing power that this family has suffered. This is the way to restore consumer confidence and induce a new and higher level of consumer spending in the years ahead.

Now we are well aware of this Committee's proper concern with the loss of any tax revenue. "Preserving the tax base" is the common argument presented by those who prefer government spending programs rather than tax reductions to stimulate the economy and reduce unemployment. And no one can view the present scale of Federal deficits with complacency.

But again, let me appeal to history—the actual experience of this country with

tax reductions since World War II. The Internal Revenue Service's *Statistics of Individual Income* show what has actually happened.

There have been quite a number of Federal tax reductions in the past three decades, under a variety of economic circumstances. In most cases there was only a one-year reduction in individual income tax revenues, usually much less than the amount of the tax cuts, and then revenues were higher than ever in the following year. In one case—1948—there was a two-year recovery period, and in others including the early 1970's there was actually an increase in revenues in the very years when taxes were cut. I can go into detail in the discussion period, but this is very important because it shows real experience, in contrast with all the theoretical arguments and computer models that try to tell us what will happen.

It takes courage for the Congress to reduce taxes and let the people keep more of what they have earned. But with this record of experience—three decades covering all kinds of economic situations—surely we can see the powerful stimulation that results when you have the confidence to restore purchasing power to the private sector through permanent tax reductions. You build the tax base when you strengthen the private sector. You weaken it when you siphon still more resources from the productive private sector into the ever-growing government sector.

To move on, the same thing is true for the businessman, who has also been damaged by inflation. Some economists wonder why, with so much money available from the banks these days, businessmen are not investing in new plant and equipment. The main reason is that years of inflation and underdepreciation have destroyed his profitability and his incentives to invest. Real after-tax return on investment, adjusted for inflation, fell from 9.9 percent in 1965 to 2.4 percent in 1975, and in 1976 it rose to about 3.7 percent. Certainly this sort of return does not inspire management to take risks on new investment.

Tax reform, in the form of an improved capital cost recovery program or a reduction in the corporate income tax rate, is an urgent long-term need. But the most effective way to stimulate business investment immediately and keep it going is to increase the investment tax credit permanently from 10 percent to 13 percent. We say permanently because you are dealing with a long-term problem of underinvestment and declining productivity gains in this country, and a temporary stimulus is not going to make much of a dent in the problem.

As a matter of equity to those labor-intensive businesses that do not make large capital investments, the Administration has proposed giving businessmen an option—either a 12 percent investment tax credit or a tax credit equivalent to 4 percent of the employer's social security fund contribution. It's an interesting idea, and for General Electric—which has both labor-intensive and capital-intensive product lines—the amount of tax credit would be about the same whichever option we chose.

However, businessmen and economists have pointed out that the social security tax credit concept is not really likely to cause anyone to go out and hire more people; the so-called incentive is only about two-tenths of a percent of the employment costs of a new employee. And more importantly, business hires additional workers only when market demand expands and the need for increased production becomes apparent, not merely because the cost per worker is lower.

Nevertheless, the House picked up the job-credit idea and expanded it so that substantial tax credits will be granted to certain small-sized companies which, on an incremental basis, add new workers to their payroll. At the same time, the House decided not to increase the investment tax credit—in my view, a serious mistake at a time when the economy needs increased capital spending both to create immediate employment in construction and manufacturing, and to provide the expansion of industrial capacity that will be needed to absorb a fast-growing labor force.

We understand the considerations of equity that make it desirable to offer some form of incentive to labor-intensive as well as capital-intensive industries. And we applaud the desire, expressed by the House Ways and Means Committee, to direct Federal attention to building jobs in the private sector instead of spending money on temporary public-service jobs.

Nevertheless, we believe the House jobs-credit program is bad legislation. The jobs-credit idea itself is an ineffective way to stimulate productive employment,

and the legislation is so hedged with exclusions as to make it arbitrary, discriminatory, and incapable of achieving its stated goals.

The basic economic objection to the jobs-credit approach is that we will be using the tax system to encourage inefficiency and inflation. Over the past ten years, U.S. productivity has increased only 1.6 percent per annum, versus 2.7 percent per annum in the preceding twenty years. Real wage gains have shown a similar decline. Tax credits to reward the hiring of unneeded workers will further reduce this country's gains in productivity, real wages, and real income. And when productivity gains slow down, we feed the fires of inflation.

President Carter has pointed out other weaknesses in the jobs-credit legislation. He has cited its "arbitrary effects on particular firms and industries." Companies with people on layoff are discriminated against because, by law, they must hire back the laid-off people first and thus would not receive the subsidy going to their competitors. It favors new businesses over established businesses, since the new firm is staffing up with new personnel while its established competitors have their staff in place.

It would clearly be a windfall for those companies and sections of the country that are expanding fastest, and many observers have noted that it favors the fast-growing Sunbelt over the more mature cities and states of the North where unemployment problems are the worst. And because the job credit would subsidize a larger proportion of the wage costs of part-time workers than of full-time workers, there is an incentive to hire more part-time workers—usually the second or third earners in the family—instead of the full-time breadwinners who are out of work.

But perhaps the worst aspect of the present House legislation was stated by Assistant Secretary of the Treasury Laurence Woodworth, whose experience with tax legislation is certainly worthy of respect. Speaking to the Senate Select Committee on Small Business on February 22, he commented on the restrictions—the incremental base and the $40,000 cap per company. He said, "An analysis of the effects of these restrictions on the credit suggest curious results. We are proffered an employment subsidy aimed toward increasing jobs, but the very terms of the credit exclude at least 66 percent of the labor market from participating, either because the employers' normal experience places them below the threshhold or over the 'cap'. The restrictions on the credit are thus self-defeating in terms of the objectives of the proposal. Beyond that, they appear unfair to the workers in the excluded markets."

I submit that, with all these very serious defects, the jobs-credit program should be eliminated, and the business portion of the tax bill should instead concentrate on increasing the investment tax credit by three percentage points. The investment tax credit directly stimulates investment, thus creating jobs to build the new plant and equipment and, at the same time, increasing industrial capacity which is a hedge against the inflationary pressure of shortages that are likely to appear by the end of 1978 or the beginning of 1979.

Thus we urge that major reliance be placed on a permanent tax cut on the order of $18 billion a year—$15 billion for individuals and $3 billion for business. However, we do believe that as much as $5 billion of additional Federal funds could profitably be spent this year and next on an expanded jobs program for the victims of structural unemployment, especially the minorities and teenagers in the big city centers.

It would probably be best to funnel these funds through the established CETA (Comprehensive Employment and Training Act) channels rather than lose valuable time developing new and untried approaches. I am prepared to expánded on that, if you wish.

Let me close with a reiteration of our convictions about the need for permanent tax cuts. A program that is too heavily concentrated on quick, short-term effects would not have the desired effects and you would face the same economic problems a few years hence. But our program, because it is designed for more permanent effects, would produce so much more economic activity that you would, in a year or two, see a net increase in Federal revenues through the creation of a larger and healthier private-sector tax base.

TAXES AND JOBS

1. U.S. ECONOMY HAS LOST MOMENTUM, NEEDS STIMULUS

Latest GE forecasts show sharply reduced real GNP growth, 8.1 percent unemployment in 1977 (with 8.4 percent by 1977–IV) unless economy stimulated and confidence revived.

Prompt tax reduction is the main lever to restore economic momentum and reduce cyclical unemployment.

Carefully designed learn-and-earn programs are also needed to reduce structural unemployment among minorities and teenagers.

2. PROPOSED PACKAGE TO REDUCE UNEMPLOYMENT

A permanent $15 billion tax cut for individuals, especially low and middle income.

A permanent $3 billion increase in the Investment Tax Credit for business, raising ITC from 10% to 13%.

A $5 billion Federal program designed to reduce structural unemployment.

3. THE $15 BILLION PERMANENT TAX REDUCTION FOR INDIVIDUALS

Change the tax structure to offset the effects of last four years of inflation.

Details attached. Key elements:

Reduce tax rates on low brackets. Increase tax credit per exemption from $35 to $50.

Revenue cost is about $15 billion at 1977 income levels ($13.4 b rate reduction and $1.6 b higher tax credit).

Cost increases by only about $0.5 b a year in 1978 and later years.

Over 70% of reduction to taxpayers with gross incomes under $20,000. (Average reduction about 19%.)

Less than 30% of reduction to taxpayers with gross incomes over $20,000. (Average reduction about 4%.)

Would help restore consumer and business confidence & spending, especially among working people in low/middle-income groups.

Would hopefully moderate wage demands because it offers real "catch-up" for inflation.

Would have limited inflationary impact as increased volume and possibly moderated wage demands favorably affect unit cost of output.

4. THE $3 BILLION INCREASE IN INVESTMENT TAX CREDIT FROM 10 PERCENT TO 13 PERCENT

Business lacks incentive and confidence to invest in expansion and modernization.

Uncertainty about economy; about inflation; about price controls or guidelines; about taxation of foreign-source income.

Real return on investment, adjusted for inflation, fell from 9.9% in 1965 to 2.4% in 1975. Little incentive to risk money on new technology, new plant and equipment, new ventures.

Plant and equipment spending, normally high at this stage of a recovery, is lagging seriously.

Industrial capacity pressures will emerge in basic industries. We will run out of capacity before we run out of unemployment, starting in 1970. Hence need to initiate expansion commitments *now*.

Permanent increase in ITC from 10% to 13% would be fastest way to stimulate business investment with least inflationary impact.

5. THE $5 BILLION STRUCTURAL UNEMPLOYMENT PROGRAM

CETA (Comprehensive Employment & Training Act) provides vehicle for expanded programs. It is in place and thus speeds implementation.

Presently funded at $5 billion for 1977, providing 310,000 jobs and serving 1.4 million people.

We propose additional $5 billion for CETA for calendar '77 (60%) and 9-mo '78 (40%):

$1.6 billion *for Urban Youth Corps* for earn & learn jobs in health service, cleanup of city property, schools, hospitals. Include skill training & counseling, later job placement.

(Est. 200,000 jobs costing $8,000 each.)

$300 million for *expanded Job Corps* for youth 16–21 who need more intensive *residential* earn & learn attention. The harder cases.

(Est. 40,000 served costing $7,500 each.)

$2.1 billion for one-time, one-year increase in *emergency public-service jobs*. Target to long-term unemployment and welfare recipients; community work projects with 12-month life span, specific purposes.

(Est. 210,000 jobs costing $10,000 each including equipment, supervision.)

$1 billion for *industry hire-and-train incentive contracts*, targeted to unemployed youth 18–24 and welfare recipients. Aim at businesses that are growing & hiring: service sector such as food, retail, repair, finance rather than industries that have employees on layoff.

(Est. 500,000 jobs costing $2,000 subsidy for each.)

6. POTENTIAL IMPACT OF THIS $23 BILLION PROGRAM

Would rekindle consumer and business confidence, restore momentum to the economic recovery, and relieve despair of many of the disadvantaged.

Would—because of its permanent nature—have a *multiplier* effect on cumulative economic growth over next two years, assuring continued improvement in 1978 and 1977.

Could cut unemployment rate from today's 8.1% to 6.9% by 1977–IV, and 6.5% by 1978–IV.

GENERAL ELECTRIC PROPOSAL FOR INCOME TAX REDUCTION

Rate Reduction and Higher Per Capita Tax Credit

Reduce tax rates on low brackets.

Taxable income (married—joint return)	Present rate (percent)	Proposed rate (percent)	Cumulative reduction
Less than $1,000	14	10	$40
$1,000 to $2,000	15	11	80
$2,000 to $3,000	16	12	120
$3,000 to $4,000	17	14	180
$4,000 to $8,000	19	17	230
$8,000 to $12,000	22	21	270
$12,000 to $16,000	25	25	270
$16,000 to $20,000	28	[1] 29	230
$20,000 to $24,000	32	[1] 33	190
$24,000 to $28,000	36	36	190
$28,000 and above		(1)	190

[1] Increase.

Make comparable reductions in rates for single taxpayers.

Increase tax credit per exemption from $35 to $50 (retain alternate credit of 2% of first $9,000 of taxable income).

Revenue Cost

About $15 billion at 1977 income levels (rate reduction $13.4 billion, higher tax credit $1.6 billion).

Cost increases by only about $0.5 billion a year in 1978 and later years, assuming a 6% rate of increase in incomes.

Reduction does not escalate for taxpayers with taxable incomes of $12,000 or more (married) or $8,000 or more (single).

Distribution of Tax Reduction

Over 70% of reduction to taxpayers with gross incomes under $20,000. Average reduction about 19%.

Less than 30% of reduction to taxpayers with gross incomes over $20,000. Average reduction about 4%.

PROPOSAL FOR INCOME TAX REDUCTION (16 PERCENT DEDUCTIONS ASSUMED)

Gross income	1977 tax		Reduction	
	Present law	Proposal	Amount	Percent
Family of 4:				
$11,200 (all manufacturing)	$879	$627	$252	28.7
$13,800 (auto)	1,338	1,074	264	19.7
$14,600 (steel)	1,478	1,215	263	17.8
$16,900 (crafts)	1,903	1,621	282	14.8
$18,700 (all manufacturing)[1]	2,257	1,967	290	12.8
$21,300 (auto)[1]	2,803	2,513	290	10.3
$22,100 (steel)[1]	2,971	2,681	290	9.8
$24,400 (crafts)[1]	3,499	3,224	275	7.9
$50,000	11,510	11,300	210	1.8
Married couple:				
$11,200 (all manufacturing)	1,152	930	222	19.3
$13,800 (auto)	1,660	1,409	251	15.1
$14,600 (steel)	1,808	1,550	258	14.3
$16,900 (crafts)	2,254	1,984	270	12.0
$18,700 (all manufacturing)[1]	2,632	2,362	270	10.3
$21,300 (auto)[1]	3,190	2,924	266	8.3
$22,100 (steel)[1]	3,378	3,119	259	7.7
$24,400 (crafts)[1]	3,919	3,679	240	6.1
$50,000	12,200	12,010	190	1.6
Single individual:				
$11,200 (all manufacturing)	1,582	1,367	215	13.6
$13,800 (auto)	2,137	1,922	215	10.1
$14,600 (steel)	2,319	2,104	215	9.3
$16,900 (crafts)	2,869	2,654	215	7.5
$50,000	14,735	14,520	215	1.5

[1] With working wife earning $7,500.

PROPOSED INCOME TAX REDUCTION BY ADJUSTED GROSS INCOME CLASSES (1977 LEVELS OF INCOME)

[Dollar amounts in billions]

Adjusted gross income class	Income tax—present law		Proposed reduction		
	Amount	Percent to total	Amount	Percent to total	Percent reduction
0 to $5,000	$1.7	1.1	$0.6	4.1	34.6
$5,000 to $10,000	10.3	6.8	2.8	18.6	26.8
$10,000 to $15,000	18.7	12.2	3.7	24.7	19.8
$15,000 to $20,000	25.8	16.8	3.7	24.7	14.3
$20,000 to $30,000	37.9	24.8	3.1	20.9	8.3
$30,000 to $50,000	23.7	15.5	.8	5.2	3.3
$50,000 to $100,000	17.5	11.4	.2	1.5	1.3
Over $100,000	17.4	11.4	.1	.3	.3
Total	153.0	100.0	15.0	100.0	9.8
Under $20,000	56.5	36.9	10.8	72.1	19.1
Over $20,000	96.5	63.1	4.2	27.9	4.3
Total	153.0	100.0	15.0	100.0	9.8

CORRECTION OF INFLATION INDUCED TAX INCREASES (16 PERCENT DEDUCTIONS ASSUMED)

1972 gross income	Inflation induced tax increase[1]			Tax reductions versus 1972–74 law				
				1975–76 rebate and reductions	1977		Total 1975–77	
	1973–76	1977	Total		Present law	Proposal	Present law	Proposal
Family of 4:								
$7,550 (all manufacturing)	$647	$319	$966	$512	$207	$453	$719	$965
$9,214 (auto)	631	321	952	388	164	432	552	820
$9,256 (steel)	632	323	955	389	165	433	554	822
$11,253 (crafts)	726	396	1,122	441	180	457	621	898
$12,550 (all manufacturing plus wife)	841	450	1,291	469	180	470	649	939
$14,214 (auto plus wife)	975	531	1,506	500	180	470	680	970
$14,256 (steel plus wife)	977	532	1,509	500	180	470	680	970
$16,253 (crafts plus wife)	1,145	626	1,771	500	180	463	680	963
Married couple:								
$7,550 (all manufacturing)	460	214	674	446	215	431	661	877
$9,214 (auto)	422	239	661	391	180	427	571	818
$9,256 (steel)	428	241	669	390	180	428	570	818
$11,253 (crafts)	625	319	944	414	180	450	594	864
$12,550 (all manufacturing plus wife)	644	368	1,012	440	180	450	620	890
$14,214 (auto plus wife)	788	429	1,217	440	180	450	620	890
$14,256 (steel plus wife)	791	430	1,221	440	180	450	620	890
$16,253 (crafts plus wife)	1,028	563	1,519	440	180	428	620	868
Single individual:								
$7,550 (all manufacturing)	484	242	726	339	168	383	507	722
$9,214 (auto)	485	259	744	378	180	395	558	773
$9,256 (steel	489	262	751	379	180	395	559	774
$11,253 (crafts)	612	342	954	410	180	395	590	805

[1] Increase in tax caused by application of stationary tax structure (low income allowance, allowance for exemptions, tax brackets and rates) to incomes rising with inflation.

CORRECTION OF INFLATION INDUCED TAX INCREASES, ILLUSTRATIVE EXAMPLE

[1972 gross income=all manufacturing average]

1972–74 LAW

Family of 4 (16 percent deductions)	1972	1973	1974	1975	1976	1977
Inflation rate (CPI) (percent)		6.2	11	9.1	[1] 6	[1] 6
Gross income [2]	$7,550	$8,018	$8,900	$9,710	$10,293	$10,910
Deductions	1,300	1,300	1,424	1,554	1,647	1,746
Exemptions (4)	3,000	3,000	3,000	3,000	3,000	3,000
Taxable income	3,250	3,718	4,476	5,156	5,646	6,164
Tax	493	572	710	840	933	1,031
Tax target [3]		523	581	633	671	712
Inflation-induced tax increase		49	129	207	262	319

ACTUAL LAW

	1975	1976	1977	Proposal
Gross income	$9,710	$10,293	$10,910	$10,910
Deductions	1,900	2,100	2,100	2,100
Exemptions (4)	3,000	3,000	3,000	3,000
Taxable income	4,810	5,193	5,810	5,810
Tax before credit	774	847	964	778
Tax credit	120	140	140	200
Net tax	654	707	824	578
Tax rebate (1974)	100			
Tax reduction	186	226	207	453

SUMMARY

	Correction		
	Amount	Actual law	Proposal
Inflation-induced tax increase:			
1973	$49		
1974	129	$100	$100
1975	207	186	186
1976	262	226	226
Total 1973-76	647	512	512
1977	319	207	453
Total 1973-77	966	719	965

[1] Estimate.
[2] Amounts for years after 1972 represent 1972 gross income and tax amounts increased for subsequent inflation.

CORRECTION OF INFLATION INDUCED TAX INCREASES (16 PERCENT DEDUCTIONS ASSUMED)

1972 gross income	Inflation induced tax increase [1]				Tax reductions under proposa versus 1972-74 law			
	1977	1978	1979	1980	1977	1978	1979	1980
Increase in CPI over 1972 (percent)	44.5	53.2	62.4	72.1				
Family of four:								
$7,550 (all manufacturing)	$319	$381	$447	$516	$453	$447	$440	$432
$9,214 (auto)	321	402	489	581	432	438	446	454
$9,256 (steel)	323	404	490	582	433	439	446	454
$11,253 (crafts)	396	482	584	708	457	464	470	470
$12,550 (all manufacturing and wife)	450	567	690	821	470	470	470	470
$14,214 (auto and wife)	531	651	791	962	470	470	466	455
$14,256 (steel and wife)	532	654	795	967	470	470	466	454
$16,253 (crafts and wife)	626	787	959	1,160	463	451	439	425
Married couple:								
$7,550 (all manufacturing)	214	259	318	380	431	442	441	429
$9,214 (auto)	239	295	356	420	427	433	441	449
$9,256 (steel)	241	298	358	422	428	434	441	449
$11,253 (crafts)	319	405	496	592	450	450	450	450
$12,550 (all manufacturing plus wife)	368	457	551	670	450	450	450	444
$14,214 (auto plus wife)	429	545	676	815	450	442	431	420
$14,256 (steel plus wife)	430	548	679	818	450	442	431	419
$16,253 (crafts plus wife)	563	695	862	1,064	428	416	403	390
Single individual:								
$7,550 (all manufacturing)	242	292	346	406	383	394	395	395
$9,214 (auto)	259	324	392	476	395	395	395	395
$9,256 (steel)	262	326	394	479	395	395	395	395
$11,253 (crafts)	342	426	528	642	395	395	395	395

[1] Increase in tax (over 1972 ratio to gross income) caused by application of stationary tax structure (low income allowance, allowance for exemptions, tax brackets and rates) to incomes rising with inflation.

The CHAIRMAN. Next, we will call Mr. John J. Motley, legislative affairs representative, National Federation of Independent Businesses. We are pleased to have you.

STATEMENT OF JOHN J. MOTLEY, LEGISLATIVE AFFAIRS REPRESENTATIVE, NATIONAL FEDERATION OF INDEPENDENT BUSINESSES

Mr. MOTLEY. Thank you, Mr. Chairman. I certainly appreciate the opportunity of appearing here today to discuss the business tax section of President Carter's economic stimulus program. I will submit my

very brief written statement for the record and I will summarize and make some points about small business.

First of all, a word about NFIB. We now have 491,000 member firms in all 50 States of the Union. We have 175,000 member firms in the 18 States that are represented by the members of this committee and in those States, our members employ 1.4 million people.

If I can, I would like to draw for you a picture of the American business community. According to the Small Business Administration, we now have between 9.5 and 10.5 million firms in this country. Approximately 96 percent of those firms are considered small. They employ approximately 55 percent of the nonagricultural, private work force in the country. Only 14 percent of those firms are corporations.

Let us refine this picture a little more. Of those, approximately 10 million firms, 4 million are employers. The rest of them are family owned operations or part-time businesses—somebody makes cabinets at night, et cetera.

Of the 4 million employers in this country, 1.4 million of them are corporations. The vast majority of the businesses in this country, then, are labor rather than capital-intensive. To give you an example of this, in the third quarter of 1976 we had a reduction of 134,000 jobs in the labor market. During that same third quarter, NFIB's 485,000 members had an increase of 72,000 jobs. This leads us to a conclusion that if we are looking to create jobs, maybe the small and middle-sized firm is the one we should try to stimulate.

We also believe that at present there is a bias in the tax code toward capital intensive firms and toward corporations. What bothers us about this bias is that it eventually washes out in the marketplace and becomes a competitive advantage. Therefore, firms that are growing find it difficult to compete because the tax code becomes a competitive advantage for larger firms.

With this as a backdrop, I would like to comment very briefly on the various options that have been proposed, by the President, by the Ways and Means Committee, and by some of the other witnesses.

As to the 4 percent credit against social security taxes, we would view that as little or no help, or little or no incentive to small firms. The typical small firm—I am talking about one with 8 to 10 employees, which is very typical, would get back roughly between $175 and $200. It would be a windfall. The guy would probably pocket it, and not do anything with the money at all.

For the larger employer——

Senator NELSON. A refund of how much?

Mr. MOTLEY. A refund of approximately $175.

Senator NELSON. How many employees?

Mr. MOTLEY. Roughly eight employees. Bruce Fielding, whom you know, Senator Nelson, estimated that for his firm which he considers a typical small business—he has eight full-time employees—he would receive a refund of $165.61. Because he pays self-employed social security taxes he would receive another $20-odd for himself.

At the same time, a 5 percent credit for a firm with 10,000 employees would be approximately a $250,000 credit. They would receive roughly the same size credit even if they were to let go 1,000 employees. The difference would not be that much.

Switching to the investment tax credit, there are a great many small firms that do use the investment tax credit. Unfortunately, the benefits of the credit fall mostly to large, capital-intensive firms. In 1972, the statistics show that 71 percent of the benefits of the investment tax credit went to less than .2 percent of the corporations in the country. In 1973, it was 66 percent to less than .1 percent. Corporations, again, account for only 14 percent of the businesses.

A third option which has been recommended is a reduction in the corporate tax rates. Our view is that this would simply be too limited because, again, only 14 percent of the firms in this country are corporations, roughly 1.4 out of 10 million businesses.

Of the choices available to us, we would prefer the employment tax credit because it is more inclusive. We believe that it would help more firms.

We realize that there are strong arguments against the employment tax credit, but we feel those same arguments can be made against the investment tax credit.

It has been said that the employee tax credit would be a windfall to certain firms who are going to hire employees anyway during the next year. The same can be said of the investment tax credit. Studies have pointed out that the investment tax credit really does not cause much new investment over and above what firms were going to invest anyway.

There are several other arguments which have been made against it, and we tend to feel that they can be made against other sections of the stimulus program also. Let me give you one example, though.

One of the members of the Council of Small and Independent Business Organizations, COSE out of Cleveland, immediately after the Ways and Means Committee made its decision on the employment tax credit, contacted 27 of its member firms—they have about 1,000—and they asked them what their plans would be, based upon the new jobs credit. They asked them how many employees they would hire immediately, how many they would hire throughout the remainder of 1977 and how many in 1978.

Their answers were as follows: 47 new employees immediately——

Senator NELSON. Forty-seven out of how many employers?

Mr. MOTLEY. Twenty-seven employers.

Two hundred and nineteen for the remainder of 1977 and 199 for 1978.

I would like to have more information on new hires to present to the committee, but we have not been able to get to our members yet. We have not asked our members in the States of the committee members how they would view this.

We do expect the results before the committee marks up the bill, and I would like to provide them to the chairman and members at that time, if I could.

In closing, I would simply like to make a couple of general comments.

Treasury Secretary Blumenthal has said that the administration wants to fight very hard for the investment tax credit to send the business community a signal. Considering how narrow the impact of the ITC is, I wonder to whom the Secretary wants to send that signal; certainly not to our members.

86-032—77——21

I would think that a signal of that nature would simply tell the small business community that the Carter administration, for all the rhetoric that it had on small business during the campaign, does not really understand their problem any more than previous administrations did.

The chamber of commerce and the NAM have also suggested alternatives.

The chamber of commerce has called the Ways and Means proposal antibusiness. I wonder how antibusiness it is if the chamber's proposal would only affect, at most, 10 percent of the businesses of this country. They are leaving 90 percent out. NAM's proposal, which is a reduction in the corporate tax rate—and we have quite a few members who are corporations—would also only affect roughly 10 percent of the business establishments in this country.

In conclusion, I simply would like to say, Mr. Chairman, that we opt for the most inclusive alternative to help the most number of firms, to stimulate those small and middle-sized firms that we think can provide jobs and provide them in a hurry.

I would be glad to answer any questions that you might have.

The CHAIRMAN. Let me ask you this. I think it would be most impressive to the members of this committee if your organization, or any organization that can communicate with their members and get a representative cross section, could actually get their opinions and provide us with the opinion of the average businessman as to how many more people they might hire.

Let me say in my State, if you could get those businessmen to sign a statement in good faith—it need not be notarized—saying if this is done we will do this. Obviously, a man still has a right and say it looked like the thing to do at the time, but changed circumstances have made it look different. But it would be very helpful to me if you could just give me a cross section of your business people, for example, in the State of Louisiana where I could go talk to those people, some of whom I would undoubtedly know personally, and say, for example, here is a person who has a cafeteria and the person had to discontinue the services of someone taking the trays and carrying food to the table for our customers. We had to switch to a procedure where you just ring a bell, only for those who are disabled, rather than providing the service to all customers.

If you gave us this advantage, we would restore that service and give better service to the public. We would expand our activity.

For example, in a grocery store you provide help to sack the groceries or to carry the groceries to the car for ladies, as was once the case. If one could say, yes, here is what we would do if we had this tax advantage.

If we could actually check that with you and you could give us more or less a convincing field study I know that the members on this committee would be far more impressed with this proposal.

Mr. MOTLEY. Senator, I would like to say that we anticipated your request. A week and a half ago, we contacted our members on this and you should be receiving some mail from our members in the State of Louisiana. They will also be sending to us signed cards as to how many jobs they will provide over the next year if a jobs tax credit of this nature is passed.

We should have this information for each of the members of the Finance Committee within 1 or 2 weeks.

The CHAIRMAN. In other words, if you can show me that a cross section of your people would do what you indicated, and make a good faith commitment of "here is what we will do if you will give us this tax incentive to do it," and we could actually verify that.

Mr. MOTLEY. We would be glad to provide you with the names and addresses of people who respond. We have asked them to write you as well as us. You should be receiving copies.

The CHAIRMAN. Somebody should be a clearinghouse for the information. I hope that your association could check.

How many members do you have in Louisiana, can you tell me that?

Mr. MOTLEY. Right now it is roughly around 5,400 firms.

The CHAIRMAN. It would seem to me that you might be in a position to do a cross-check of, say, 5 percent. If you checked with 350 firms, that is a more thorough sample than Gallup usually has when he makes his poll. From that cross section you could find out by saying, "here is what we are talking about. If that is the case, do you think you would hire more people? If so, what do you think you would put them to work doing?"

Maybe you might want to have a smaller sample of a hundred.

Mr. MOTLEY. We have a much larger sample. We are using in the State probably roughly half, 2,500 firms.

The CHAIRMAN. If you can bring us evidence as convincing as you stated here, with actual signed commitments from people that yes, if you give us this tax credit to hire people here is what we will do, I think that you can be assured that we will go along with it. We are like everybody else; we like to be convinced.

Mr. MOTLEY. Certainly.

The CHAIRMAN. Thank you very much.

Senator Curtis?

Senator CURTIS. In reference to the base period, would you state how that would work?

Mr. MOTLEY. The 103 percent?

Senator CURTIS. Yes.

Mr. MOTLEY. As I view or understand the Ways and Means proposal, Senator, the base is compared to the previous year's employment. If it exceeded the previous year's base by 3 percent it takes into account normal expansion of payroll.

Senator CURTIS. What would be the base year? The previous year?

Mr. MOTLEY. The previous year.

Senator CURTIS. I had experience with the Ways and Means Committee when they had the excess profits tax. They said here is the base; if you make more than that base, that is an excess profit. We had a lot of trouble with it because some companies had very high earnings in the base period and they paid no excess profits tax. Some companies had practically none, and they paid a tremendous excess profits tax.

Do you have any factor in there that would take care of business that had an unnatural base? Apparently it was not a typical one?

Mr. MOTLEY. Senator, I do not believe that there is. I do not know what they could do, what the Department of Treasury could do to take care of that situation. Certainly it is an inequitable one. Unfortunately,

in a lot of the things that we could do, some people and some firms are going to slip through the cracks and this will not be helpful to them.

If we had our choice—I believe you asked Milton Stewart, president of the National Small Business Association yesterday, if these are really problems that affect small business, or whether it is paperwork or Government regulations, et cetera. Those things are extremely important to small firms, but in one of the polls that we did, our members indicated by a rather substantial margin, that the tax code was the biggest problem that they were facing, that if they had their options in changing the tax code they would probably go in an entirely different direction.

We feel that these are three or four choices that are available to us now. We are looking at the most inclusive, even though the jobs tax credit would certainly exclude some firms whom it should not, that should be receiving some assistance, it is from our point of view the most inclusive of the four options that I went over. Therefore, we would opt for that.

Senator CURTIS. Thank you.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. No questions.

The CHAIRMAN. Senator Matsunaga?

Senator MATSUNAGA. Thank you, Mr. Chairman. I am sorry that I was out when you started.

As to the number of small businessmen among your members who will use ITC, do you have any estimate?

Mr. MOTLEY. Among our members, no, Senator. We do not at this time. I do feel, however, that quite a few members use it, incidentally, for very, very small amounts. We did a survey about 1½ years ago asking that question, but because of some problems that we had, the results were kind of obscured. We did not feel it was valid and did not release it. At that time the indication was that very few of them used it substantially.

We are certainly in favor of investment incentives, but we are basing our objection on the fact that most of the benefits of the investment tax credit are going to large, capital-intensive corporations and most of the business community is not capital-intensive and not corporate.

Senator MATSUNAGA. Being labor-intensive in the small business area, as I understand it, you are hiring at least 55 percent of the total labor force. Is my figure correct?

Mr. MOTLEY. That is what the Small Business Administration tells us. Those are their official figures.

Senator MATSUNAGA. From testimony presented before the House Ways and Means Committee, an overwhelming majority of small businessmen do not take advantage of ITC.

Mr. MOTLEY. That is true.

Senator MATSUNAGA. An overwhelming majority of the small businessmen have already indicated through the American Federation of Independent Businessmen as well as the National Association of Small Businessmen that they will use the job tax credit if presented. Is that correct?

Mr. MOTLEY. We do not have an outpouring feeling saying that they will use it at this time. We are in the process of getting it.

About 3 weeks ago, we wrote to roughly one-half of our members in the 18 States of the members represented on this committee and asked them to give us some indication of how they would use the jobs tax credit. We have included it in tax legislation that we were working for in the past because, again, we thought it would be favorable to labor-intensive firms.

The cost of putting somebody on the payroll, payroll taxes and fringe benefits, is a brake when you are on the line and making that decision of whether you are going to hire another employee. We feel that the jobs tax credit would push the small businessman over that line and make him hire somebody.

Small business is rather unique in this nature. A lot of it is dominated by families and what small businessmen tend to do in times of recession and times of crisis is to bring the family into the business more and when business gets good they go out and hire somebody and spend more time with the family. They take the family out of business. This is unique. It defies classifying as neatly as we would like to see business reactions classified sometimes.

Senator MATSUNAGA. Supposing we come up with a compromise, an ITC for big business and jobs credit for small businessmen. That would satisfy you?

Mr. MOTLEY. So long as the credit remains significant enough that we could have an indication 2 years from now whether it worked. We had our own proposal based on FICA wages that we thought was much more easily administered and would eliminate some of the administration's problems with the job credit, especially the firing of one employee and going out and hiring two part-time employees.

We estimated that somewhere in the neighborhood of $2,000 for the credit would give us a good indication. If we were to move under $1,000 we would feel it would not give us a good indication of whether that proved to be enough of an incentive. If we can keep it a large enough incentive, then I think we would have no objection at all to an either/or situation.

Senator MATSUNAGA. Thank you very much. My time has expired.

The CHAIRMAN. Senator Bentsen?

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

I am very pleased to receive your testimony. I am a strong supporter of the investment tax credit. We are utilizing about 78 to 80 percent of our productive capacity in this country. That really does not give you a true indication of what is happening, because that capacity is not being used to replace what is out of date and the least efficient.

If we are not careful, we are going to find ourselves in the same kind of condition that England is in its manufacturing capacity. They are so down at the heel they cannot compete in the world.

It is important to keep our manufacturing capacity modernized. That means larger industry and bigger confidence. They will get most of it; I agree with that.

But, in turn, I think they need it for the kind of return that they are getting on investment capital today but I do not agree with them a bit when they say, we cannot use the employment tax credit. I think that some of these men who head up some of the biggest—very able men who head up these large corporations, it has been too long since they have been the head of a small company.

I started mine with three people. Ultimately, it was a middle-sized company, but I think small businessmen are really up against the wall these days with Government regulation and all. All of that is a burden for big business, but they are better able to cope with it than small business.

I listened to the witnesses of the administration who rejected out of hand the employment tax credit. There is no attempt to try to make it work. They reject it. I think they make a mistake.

A man who has a 70-percent tax bracket and therefore he can write off a person he hired under the House bill, that is easy to correct and we can correct it in this legislation. They talked about how this proposal encouraged hiring a class of people, low-income workers.

What is wrong with that? On the other side of that same testimony by that same witness they were bragging about the fact that the tax cut that they had proposed was for low-income people. Some of the same arguments that were used to try to defeat the employment tax credit are being used against the investment tax credit. The idea that the employment tax credit would only go to people that were building their companies and growing is also true of the investment tax credit.

To say that the 4-percent credit on the social security tax, which works out to a maximum of about $38 per employee, is going to encourage anybody to hire and keep someone I do not think makes any sense at all. I think that it has to be an incremental approach.

I think that we can work out a way to take care of some of the objections that were made by the administration witnesses. Some of this is being done in Germany now; they think it has been effective.

I am going to support something along these lines, with the alternative being the investment tax credit for the capital intensive companies that need that. But I think the labor-intensive companies and the smaller companies need something, too. You have come up with something on FICA that will help in taking care of the objection of the administration to hiring part-time employees and we will look into that.

Mr. MOTLEY. Senator, I did not mean in our testimony to say that we were against investment incentive. We are certainly not.

What we have been against, I think, in the last couple of years since we really have taken a long, hard look at this, is the skewing in the tax code of the amount of incentive that goes to capital-intensive firms. Frankly what we are sayi[illegible] is if we are going to give incentives, let us give incentives to some of the smaller firms, too. Let us come up with an investment incentive that is beneficial to small firms.

We have a member in New England who has nine plants and does not use ADR because he says ADR is too complicated and it simply does not pay. If we cannot come up with investment incentives to help the small businessman, the only ones we are going to stimulate time after time are the very largest companies in this country which is going to lead to more concentration in larger companies. We are for competition.

As far as low income individuals are concerned, I came just yesterday from the hearings on the House side before the Education and Labor Committee on increasing the minimum wage to $3. The talk over there is low income, low income. If we are going to put low income people back to work by an employment tax credit, I do not see any-

thing wrong with that at all. That is one of the things that we want to try to do.

Senator BENTSEN. Thank you.

The CHAIRMAN. Senator Nelson?

Senator NELSON. Do you have that Cleaveland Cose group report?

Mr. MOTLEY. Chuck McDonald called me yesterday and asked me to be sure and mention it when I testified today.

Senator NELSON. I wonder if you could get it for me.

Mr. MOTLEY. Certainly.

Senator NELSON. I did not understand the statistic. You said they got a response from 27 employers of their 1,000 members.

Mr. MOTLEY. They did a telephone poll. They just called 27 members on the telephone.

Senator NELSON. That from that 27, a total of 47 people would be hired immediately?

Mr. MOTLEY. Immediately, 27.

Senator NELSON. A total of 119 by the end of the year and you said 199 would be employed next year, an additional 199?

Mr. MOTLEY. Additional. The credit would only be good for additional employment.

Senator NELSON. Did they identify the size of these firms?

Mr. MOTLEY. No; they did not, but I am sure that Cose would be glad to give you more information on it. Cose does represent firms in a metropolitan area that tend to be a little larger than what we would consider the normal small business of eight employees.

Senator NELSON. I wonder if you could get it and submit it to us? It makes a lot of difference whether the 27 employees average 10 employees or average 200.

Mr. MOTLEY. Certainly.

[The following information was subsequently supplied for the record:]

They vary in size—25 to 60 employees.

Senator NELSON. Thank you.

The CHAIRMAN. Senator Hansen?

Senator HANSEN. No questions.

The CHAIRMAN. Thank you very much.

Mr. MOTLEY. Thank you, Senator.

[The prepared statement of Mr. Motley follows:]

STATEMENT OF JOHN J. MOTLEY III, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

HIGHLIGHTS

The business tax section of President Carter's economic stimulus program will not achieve its stated purpose within the small business community and will end up being nothing more than a windfall for the nation's largest corporation.

If jobs are the goal then small, independent business is the way to go. During the third quarter of 1976 the number of people employed in the civilian workforce dropped by 134,000, while the number of jobs created by NFIB's 480,000 members jumped 72,000.

Simple arithmetic will show that the proposed 4 percent Social Security credit will only provide a typical small firm with between $150 and $225, while it could prove to be a windfall for a firm with 10,000 employees that could receive a refund of up to $280,000 even while dismissing 1,000 of its employees.

The additional 2 percent investment tax credit will be of little or no value to small firms. This type of credit is aimed at capital intensive businesses and most small firms are labor intensive. In 1973 two-thirds of the benefits from the investment tax credit went to less than 1 percent of the corporations and corporations make up only 14 percent of the American business community.

If Congress must work within the guidelines of the President's proposals, NFIB would support increasing and graduating both options so they would be real incentives to small firms.

If Congress intends to substitute its own proposals for the President's NFIB would prefer under the present circumstances and employment tax credit.

NFIB has its own employment tax credit proposal based on FICA wages which is attached.

NFIB supports the Ways and Means' employment tax credit passed by the House on Tuesday, March 8, 1977, and we will work for the Senate to adopt it also.

Mr. Chairman, Members of the Committee, I am John Motley, a legislative representative of the National Federation of Independent Business (NFIB), an organization of 491,000 small and independent firms located in all fifty states. It is a privilege for me to appear here today to discuss with you the action on the small business sector of H.R. 3477 and the business tax segment of President Carter's economic stimulus program.

The stated purpose of the President's business tax proposals is to create additional jobs by stimulating the economy and by offering incentives to businesses to hire new employees. NFIB believes that the Administration's proposal will not produce its intended effect and that most of its benefits will go to big business, which is capital instead of labor intensive. In short, unless President Carter's proposed business "tax-cuts" are significantly revised by Congress, they will prove to be nothing more than a windfall for the nation's largest corporations.

It is important to note before we go any further that most small firms, which account for over 95 percent of all the businesses in the United States, are labor intensive. They account for over 55 percent of the country's private, nonagricultural employment and provide the livelihood for over 100 million Americans. During the third quarter of 1976 the number of people employed in the civilian work force dropped by 134,000 (Business Conditions Digest, December, 1976, Bureau of Economic Analysis, U.S. Department of Commerce, p. 88), while during the same period NFIB's 480,000 member firms dated 72,000 (net) employees (Quarterly Economic Report for Small Business, January, 1977). NFIB has 175,000 member firms, employing 1,350,000 people, in the eighteen states represented by the Members of this Committee.

It is our understanding that President Carter's proposal would allow businesses to elect either of the following options: a four percent credit for Social Security taxes paid, or, an effective twelve percent investment tax credit. Neither of these alternatives would provide a particularly strong stimulus for small firms.

Some simple arithmetic by NFIB's Secretary Bruce G. Fielding, the president of an independent public accounting firm and a member of the IRS's Small Advisory Committee, will quickly show that small employers will receive little benefit from an "across-the-board" credit of four percent of the Social Security taxes they pay.

Example: If the credit was based on 1976 payroll taxes, my firm would receive a refund of $165.61. We employ seven full-time people, and one part-time person. The total wages paid those eight people in 1976 was approximately $83,000.

Mr. Fielding's firm is a typical small business, and he believes that the proposed Social Security tax credit would fall far short of the incentive needed for him to hire additional people.

Compare this with the benefits that would go to a large business.

Example: A firm with 10,000 employees and having a taxable Social Security wage base of $120,000,000 would receive a refund of $280,000, which is the equivalent of a $540,000 pre-tax profit. Even if this firm fired a thousand people it could still receive a refund of approximately $253,000.

This can only be considered a "windfall" and it would be another nail in the coffin of small, independent business.

The additional two percent investment tax credit option just increases the inherent inequity in an already lopsided tax incentive. Recent Internal Revenue Service statistics (1973) disclose that less than one percent of all the corporations received sixty-six percent of the benefits of the investment credit. This statistic becomes even more distorted when we take into consideration the fact that corporations comprise only fourteen percent of all U.S. business entities.

If Congress works within the outlines of the business section of the President's stimulus program, NFIB believes that both the credit for Social Security taxes and the Investment Tax Credit should be increased and graduated or it will not have any significant impact in the small business sector. To prevent the proposal from becoming a windfall for big business, it may also be necessary to limit the amount of credit that can be claimed by any one firm.

If, on the other hand, Congress intends to substitute its own jobs creation ideas for the business tax section of the President's proposal, NFIB would support and under the present circumstances prefer, an Employment Tax Credit. Such a credit should provide a large enough incentive to encourage small employers to hire additional people and should, to help ease the cash flow problem in small firms, provide for quarterly refunds. It should also be easy to calculate and easy to administer. NFIB would like to propose to the Committee an Employment Tax Credit proposal drafted by Mr. Fielding that would encompass these points.

The NFIB Employment Tax Credit would provide a maximum credit of twenty-five percent of the increase in FICA quarterly taxable wages. The quarterly wage increase is determined by comparing the quarterly wages in the current quarter with the same quarter for the previous year. The wages for the previous year's quarter are first adjusted by an index that would take into account increases in the cost-of-living increases in the FICA wage base and other factors, so that an increase in FICA taxable wages is primarily attributable to an increase in the number of employees, not just an increase in wages paid to the same employees.

The credit is twenty-five percent or the actual percentage of increase in FICA taxable wages, whichever is less. This provides an employer with a greater incentive to increase his workforce than an across-the-board credit.

The NFIB Employment Tax Credit also provides for recapture. In the event there is a decline in FICA taxable wages, the same formula would apply in calculating the recapture. However, in no event would the recapture exceed the credit allowed. The recapture provision would not apply after five years.

The employment tax credit or the recapture would be applied against the employer's quarterly payroll tax liability.

The principal beneficiary of NFIB's Employment Tax Credit would be the small employer, not the large corporations that would receive the lion's share of the benefits under the Administration's proposal. If jobs are the objective, an employment credit aimed at the small employer is the proper approach.

The House Ways and Means Committee recognized the need for this type of small business approach when it substituted a Job Credit provision for President Carter's proposal in H.R. 3477. While its specifics are different than the NFIB proposal and we still believe that our FICA approach is superior to the FUTA approach, it was passed with small, labor intensive firms clearly in mind and is a big step in the right direction. NFIB has endorsed the Committee's decision and we will fight to prevent big business and the Administration from reversing it in the Senate.

In a recent Wall Street Journal story on the President's business tax proposals (March 8, 1977), Treasury Secretary Blumenthal is reported to have indicated that the Administration considers its support of an additional Investment Tax Credit to be a "very important signal" to business. It may be a very important positive signal to Wall Street or Fortune's 500, but it will be a very different type of signal to 96 percent of the business community—a signal that the Carter Administration for all its small business rhetoric does not really understand their problems.

Mr. Chairman, thank you for giving me the opportunity to present NFIB's views on the President's proposal. If you or the Members of the Committee have any questions, I'll be delighted to try to answer them.

Employment tax credit quarter ended________________, 19__

1. FICA wages for current quarter________________ $
2. FICA wages for same quarter of prior year________________ $
3. Cost-of-living adjustment (percent of line 2)________________ $
4. Total (line 2, plus 3)________________ $
5. Increase (or decrease) in FICA wages (line 1, less 4)________________ $
6. Percent increase (or decrease) in FICA wages (line 5÷4)________________ $
7. Employment tax credits, less recaptures carried forward from prior quarter. (line 12, prior quarter's Form No. 6000)________________ $
8. Employment tax credits allowed in the same quarter 5 years prior to the current quarter. (line 10, Form No. 6000)________________ $
9. Employment tax credits subject to recapture (line 7, less 8)________________ $
10. If line 5 is an increase, employment tax credit to be applied against payroll tax liability for current quarter (line 5 × 6) but not in excess of 25 percent of line 5________________ $
11. If line 5 is a decrease, employment tax recapture to be added to payroll tax liability for current quarter (line 5 × 6) but not in excess of line 9_ $
12. Employment tax credits carried-forward to line 8, next quarter's Form No. 6000 (line 9, plus 10, or less 11)________________ $

The CHAIRMAN. Now, we will next hear from Mr. Edgar B. Speer, chairman of the United States Steel Corp. and chairman of the American Iron and Steel Institute.

STATEMENT OF EDGAR B. SPEER, CHAIRMAN OF THE UNITED STATES STEEL CORP. AND CHAIRMAN OF AMERICAN IRON & STEEL INSTITUTE

Mr. SPEER. Thank you, Mr. Chairman and members of the committee. I appreciate, of course, the opportunity to appear before this committee on behalf of the American Iron and Steel Institute to share our views about the current tax and economic proposals to stimulate the economy.

Our concern with the administration's recommendation is that they are heavily weighted toward expanding consumer income and spending and not enough toward expanding capital investment in tools and equipment. We feel that the changes made by the House Ways and Means Committee make the program even more biased against the capital investment which will provide permanent job opportunities in the private sector.

While the consumer is vitally important in the American economy, the real disappointment in the current economic recovery has been the low level of capital spending for the new job-creating tools of production. In the fourth quarter of last year, the consumer income adjusted for inflation was at an all-time high and some 4.5 percent above the prior peak level in 1973. Industrial production during that fourth quarter, however, was at precisely the same level as during the peak period of 1973.

But perhaps the most important statistic, because it reflects both business confidence and the ability of business to invest in new and better tools and equipment was the fact that investment in these tools was still nearly 12 percent below its prior peak of 1973. Business firms in recent years simply have not been able to justify large capital spend-

ing to create more products and services, and in the process, more self-sustaining jobs.

The House Ways and Means Committee's actions in substituting their version of the "job credit" while eliminating an increase in the investment credit will certainly not increase either the business confidence or ability to increase their rates of capital spending.

The Treasury Department's analysis of the "jobs credit" provision of the bill reported by Ways and Means indicates that about 66 percent of the employment market will be excluded by its limitations. I believe that there is also another restriction that is not so clearly recognized.

Many small business concerns primarily function as suppliers to the industries requiring large scale operations. There is certainly good reason to be concerned about the health and vitality of small business, but we believe that the growth of our economy is so securely linked to the success of business, both large and small, that selective approaches to solving the problems are self-defeating.

If I may, I would like to give an example of how important it is to our economy to be able to raise and invest large amounts of capital. In the steel industry, we appraise our market as growing at the rate of about 2.5 percent per year. This means that the steel industry will have to increase its capacity by about 30 million tons by the early 1980's.

The peak profit period for the industry was 1973–75 and if you use that as a base, the capital requirements to achieve this expansion will exceed available cash flow from operations plus reasonable additional borrowing by over $1 billion per year. I think that it is well to note that as we look at the steel industry today that 30 percent of its capacity is in the category that Senator Bentsen mentioned, 20 years of age or older. It is going to take the total ingenuity of the industry to replace that capacity through the breaking of bottlenecks and a cheap way of getting around additional expansion in present plants, which means that a large part of this 30-million-ton new capacity, is going to have to come from what we term greenfield sites, that is plants that are built in new sites from the ground up.

I think that this is rather fortunate in many respects. The technology that has been developed over the last two decades, along with the tremendous amount of research that has gone in the industry, that the industry has not been able to take full advantage of in the existing facilities that operate in this country.

With these new plantsites, there is no question that the breadth of that new technology can be built into facilities such as this.

As we look at energy uses by the steel industry—and the steel industry is one of the largest users of energy—we would reduce energy usage per ton of product produced by about 40 percent, which is a significant reduction.

Our productivity, as we take a look at it, would increase per unit of production produced by about 35 percent, which again is a very important aspect in this whole equation, and of course in the area of environment, the retrofitting of existing facilities with environmental control apparatus is a horrendous job and, at best, a compromise.

Building new facilities from scratch where pollution control apparatus can be built as a part of the operating equipment that is put in place at the time makes it a great deal easier, and of course, our suc-

cess in being able to control the environment both from a water and air affluent basis would be greater.

We believe that the smallest unit that would be built in this country from strictly an economic viewpoint would be one of a size of some 4 million tons, and I think as you take a look at a unit that size, there are important employment prospects that are involved that I am sure will be of interest to this committee.

If a decision, for example, were to proceed on such a facility, thousands of jobs—we estimate 12,000 jobs in the construction business would go into place for the construction of a plant this size.

At the completion of the construction work and when the plant went into production, 8,000 new jobs would be created which would be permanent jobs. Our past experience indicates that between 25,000 to 30,000 more permanent jobs would be created in industries, both large and medium, and quite a few small industries to support the plant and its workers.

So in one investment, we would have something in the neighborhood of between 35,000 and 45,000 new jobs, most of which would be in the small and mid-sized business support industries.

An investment decision by one member of the steel industry, of course, would create thousands of jobs for industrial employees of all sizes. We recommend that your committee adopt the minimum of the 12-percent investment tax credit as at least an alternative to the so-called job credit to give this current program more emphasis toward capital formation.

In addition, we estimate that at our present earning levels that 20 to 25 percent of our capital expenditures will be for air and water treatment facilities. That will take place, as we see it today, over the next 5 to 10 years. I hasten to say that it should be noted that these commitments are not discretionary commitments. The laws are in place and the dates for compliance have been established.

So that block of investment money must be set aside in order to meet the statutory requirements of both the air and water bills.

In years, of course, when the industry—and the steel industry is cyclical—capital expenditures may not be able to match the rates which we hope they will be able to do, the absolute requirements, for these nonproductive pollution facilities conceivably could reach 50, 75, or even 100 percent of the funds available for the industry to spend.

For these reasons, we believe that the expenditures for air and water treatment facilities and the newly legislated health and safety devices should be tax deductible as occurred.

Also, Mr. Chairman, we feel that attention should be given to making our capital recovery system more competitive with other industrial countries by making it more flexible and by allowing the recovery periods to be substantially shorter.

In summary, if we are to have a strong and vigorous economy with the steel industry as a part of it, encouragement to capital investment is absolutely essential. Therefore, we urge your committee to include in this package a minimum of a 12-percent investment credit and we urge your immediate action on the additional items that were mentioned in my remarks.

These changes are necessary if we are to meet the administration's expressed goal of creating jobs in the private sector.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. I have no questions.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. I have no questions.

The CHAIRMAN. Senator Matsunaga?

Senator MATSUNAGA. Thank you, Mr. Chairman.

I was very much interested in what you had to say about the process of the construction of new plants and I was especially impressed with the figure of increase in productivity by as much as 35 percent.

Would this in itself be an incentive for the steel industry to build new plants?

Mr. SPEER. I think that all of the incentives are in place but the money is not there, Senator. The industry, in fact, is not generating sufficient cash flow to take on, for instance, a $3 billion investment which is what is represented by building an integrated steel plant.

Senator MATSUNAGA. Assuming that we do amend the House measure and provide for the 12-percent investment tax credit, how many new steel plants would be breaking ground say in the next 3 years?

Mr. SPEER. What I am suggesting, sir, as an absolute minimum in this economy that we live in, if we are to supply the market demand, there is a requirement for 30 million tons of new capacity. If they were in blocks of, let us say, 4 million tons of capacity or 5 million tons of capacity, there would be somewhere in the neighborhood of about 50,000 new jobs in steel plants, which would exclude the jobs that would be created in transportation and the support of raw material and in the many, many aspects of the services that have to be provided, not just for the employees of those plants, but for the materials and supplies that the industry purchases from others in order to produce their product.

Senator MATSUNAGA. Would you say, without the ITC, that the industry would not go into the construction of these new plants, that is the additional 2 percent?

Mr. SPEER. That is a very general question. I think there are a number of aspects to it. They all add up to one thing, sir, that capital has to formulate a great deal more in the steel industry to be able to meet the challenge that the marketplace offers us, whether it is a combination of investment credit or a change in depreciation rules and regulations, whether we can write off at the time that we break ground rather than when we start a facility up. There are a number of aspects here that certainly will help in this capital formation problem that faces us today.

Senator MATSUNAGA. Thank you very much.

The CHAIRMAN. Senator Hansen?

Senator HANSEN. I have two questions, Mr. Speer.

No. 1, I have been interested over a period of time in the comparable handicaps that are placed on your foreign competitors insofar as environmental expenses go.

Do you have any idea how much conceivably the Japanese steelmaking industry may have to commit toward pollution control equipment and environmental concerns as compared with your operations here in this country?

Mr. SPEER. From my observation, the Japanese are on a parity with the American steel industry as far as environmental requirements are concerned.

Senator HANSEN. You do not view their competition as reflecting any advantages insofar as envronmental expenses go?

Mr. SPEER. Not as far as environmental expenses are concerned, but as far as other aspects——

Senator HANSEN. What are those other aspects?

Mr. SPEER. I do not think that there is any question that from all of the studies that we have made that the American steel industry produces products for the American market at the lowest price of any producer, including Japan and the world.

There is only one way that imports can come into this marketplace and that is through some sort of subsidization of the Government or some other outside influence.

For example, all of the oil that is purchased in Japan is purchased by the Government. It is sold to the steel industry at 30 percent of cost by the Government.

As far as I am concerned, that is a subsidy of a sort, and this is a known fact. There is no coverup. There are a number of aspects, it depends on which government you are looking at as to how they approach it.

Here is Japan with 2.5-percent unemployment. They have a No. 1 objective of employing their total work force. They are doing it very successfully—and I might say that they are doing it at the expense of the American economy because one out of every 2 tons of steel that comes into this country today comes from Japan.

Senator HANSEN. One-half?

Mr. SPEER. They established a record for imports even greater than the record for imports which they established in 1972 when foreign imports represented 18 percent of the market. Japan exceeded that by their absolute tons in this market in 1976.

Senator HANSEN. I think that it is true that the wages paid to Japanese employees is rising and may even tend to be approaching what is paid to the average American worker.

Could you give us an update as to what that relationship is insofar as to how your cost of production compares to theirs?

How much greater are wages paid?

Mr. SPEER. Our studies indicate—rather than talking wages, I would like to talk employment costs, because it is all-inclusive. It is indicated that the Japanese wages in the steel industry are about 76 percent of those paid by the American steel industry.

But I think beyond that, we need to recognize that 4 years ago, not very long ago, that 55 percent of the cost of producing steel was labor cost. That is true both in this country as well as around the world. Today, it just barely exceeds 40 percent and the materials that are purchased to produce the products have now assumed a major part of the total cost of production.

Senator HANSEN. I want to be sure I understood you. Did you say 4 years ago about 55 percent of the cost of producing 1 ton of steel was reflected in labor costs and that figure now has dropped to about 40 percent?

Mr. SPEER. That is correct.

Senator HANSEN. Materials and other expenses account for 60 percent?

Mr. SPEER. Yes.

You know, it comes into focus rather well when you take a look at a small item like energy, for example, that made up 8 percent of the manufacturing costs just 4 years ago now makes up 26 percent of the manufacturing cost. This is what changed the balance percentagewise from labor now to material cost, and of course, that also reflects a difference in the economics where Japan had the advantage in lower labor costs and labor was 55 percent of the cost of producing.

They had a big advantage.

But today, where only 40 percent of the cost is labor and 60 percent is in materials, where they produce no raw materials whatsoever within their border, to produce 1 ton of steel. They import it all. Their disadvantage is tremendous.

Senator HANSEN. They subsidize energy costs, so the oil actually costs the steel industry in Japan about 30 percent of what the real price is. It is a pretty healthy place at which to start.

Mr. SPEER. It is very helpful. It is hard to turn down if somebody offers you something like that. I might say that all of the raw materials are bought by cartel, also. The price they pay for them is something else.

Senator HANSEN. Thank you. My time has expired.

Senator MATSUNAGA [presiding]. Senator Packwood?

Senator PACKWOOD. We all have forms of subsidies such as the investment tax credit. I know all business, wonder about a variety of foreign subsidies.

The Japanese cost on fringe benefits, if you take a scale of 100, only 31 percent of the cost is wages, 69 percent is fringe benefits. They have an incredible array of business-supported social services in Japan: rent subsidies, housing subsidies, business-owned vacation retreats.

You are saying basically in the steel industry that Japan is in a bind because they have to import everything. How does Japan balance all of this? They cannot run that pea under the shell forever. If the government is subsidizing the steel industry tremendously in terms of both raw material cost and oil, how does Japan manage to compete so successfully around the world?

What are they giving up? What is the quid pro quo that enables them to do this so successfully?

Mr. SPEER. I think they already have identified those industries that they are going to rely on in exporting products. They have been well defined. They represent a large part of their GNP. Incidentally, when you take a look at the textile industry, the electronics industry, the steel industry, are good examples.

All of their other production has to be the quid pro quo as you said.

There is no question today when you talk to the steel-makers, as well as the government people throughout the world, that they are looking to export some part of their production in order to offset the high cost of oil and again attempt to achieve a balance of payments.

Senator PACKWOOD. For everything they export, they have to give up in meeting capacity.

Mr. SPEER. Of course they cannot have it both ways.

Senator PACKWOOD. What are they giving up domestically? What are they shorting themselves in that we are not?

Exports, although significant, are as big a part of the gross national product as is Japan.

Mr. SPEER. There are probably ways it could be looked at. The tourist trade. Going to Japan today costs somewhere in the neighborhood of about 165 percent of what it cost just 4 years ago. A mediocre room in a first-class hotel, they do not think anything about charging $75 to $100 a night.

Senator PACKWOOD. Is that right?

Mr. SPEER. Their food, it is probably the most expensive food in the world, excluding nowhere. As a matter of fact, we used to think New York was a very, very expensive place to visit. It is cheaper than London. It is cheaper than Tokyo and it is cheaper than a lot of places throughout this world today. Of course, most of these countries have made an all-out effort to attract the tourist trade. Japan has been one of them, and they have done a tremendously successful job.

But you take their steel industry—and all of the figures are not in yet for 1976; the last one I saw for their largest steel company, the only one up until the third quarter of last year that showed that it made a profit made less than 1 cent on the sales side.

Senator PACKWOOD. Less than 1 cent on the sales side?

Mr. SPEER. Yes; that was the biggest and the only one, Nippon Steel

Senator PACKWOOD. How can they meet it? If that is the best their major industries do, their whole system has to collapse someplace along the way.

Mr. SPEER. Well, I have a hunch that they are going to do whatever they have to do in order to continue their inroads into the major markets of the world. They are willing to take their lumps until such time. Then you will pay, and we will pay big.

Senator HANSEN. Is it not a fact that the nation of Japan does have some advantage that we do not enjoy? The part of the GNP going into national defense, for example, is very, very miniscule compared to our effort.

Senator PACKWOOD. The amount of money they put into capital is substantially greater than what we are putting in.

Mr. SPEER. Here we are talking about 12 percent going back into capital and Japan is 30–34 percent. We say, how do we compete with something like that?

I was more interested in the Senator's remarks here today that actually what we are doing is we are liquidating the industrial might of this country and we have been for a couple of decades. The steel industry has not built any new capacity until U.S. Steel built a plant down on the Delaware River in 1949, we broke ground. The first new-capacity—I am talking about brand new capacity. Everything else that is built is replacing obsolete facilities.

Right now today with the cash flow that the industry has and has had, the best we have been able to do is modernize existing facilities and gentlemen, I say to you, all you are doing is working your way out of business if it continues, and we will be in exactly the same position as Great Britain is today. We will be in exactly the same position as the British iron and steel industry is today—which, incidentally, recorded a £600 million loss.

Senator MATSUNAGA. I might interject here, since the answer evidently was not forthcoming from the witness, that the Japanese make up by selling Toyotas, Hondas and other cars to Americans at higher prices.

Thank you very much, Mr. Speer.
[The prepared statement of Mr. Speer follows:]

STATEMENT OF EDGAR B. SPEER, CHAIRMAN, UNITED STATES STEEL CORPORATION

Mr. Chairman and members of the committee, my name is Edgar B. Speer, chairman of the board of United States Steel Corp.

I appreciate the opportunity to appear before this committee on behalf of the American Iron and Steel Institute to share our views about the current tax and economic proposals to stimulate the economy.

Our concern with the administration's recommendation is that they are heavily weighted toward expanding consumer income and spending and not enough toward expanding capital investment in tools and equipment. We feel that the changes made by the House Ways and Means Committee, make the program even more biased against the capital investment which will provide permanent job opportunities in the private sector.

While the consumer is vitally important in the American economy, the real disappointment in the current economic recovery has been the low level of capital spending for the new job-creating tools of production. In the fourth quarter of last year, the consumer income adjusted for inflation was at an all-time high and some 4½ percent above the prior peak level in 1973. Industrial production during that fourth quarter, however, was at precisely the same level as during the peak period of 1973. But perhaps the most important statistic, because it reflects both business confidence and the ability of business to invest in new and better tools and equipment was the fact that investment in these tools was still nearly 12 percent *below* its prior peak of 1973. Business firms in recent years simply have not been able to justify large capital spending to create more products and services, and in the process, more self-sustaining jobs. The House Ways and Means Committee's actions in substituting their version of the "job credit", while eliminating an increase in the investment credit will certainly not increase either the business confidence or ability to increase their rates of capital spending.

The Treasury Department's analysis of the "jobs credit" provision of the bill reported by Ways and Means indicates that about 66 percent of the employment market will be excluded by its limitations. I believe that there is also another restriction that is not so clearly recognized. Many small business concerns primarily function as suppliers to the industries requiring large scale operations. There is certainly good reason to be concerned about the health and vitality of small business, but we believe that the growth of our economy is so securely linked to the success of business, both large and small, that selective approaches to solving the problems are self-defeating.

If I may, I would like to give an example of how important it is to our economy to be able to raise and invest large amounts of capital. In the steel industry, we appraise our market as growing at the rate of about 2½ percent per year. This means that the steel industry will have to increase its capacity by about 30 million tons by the early 1980's. Even if based upon the relatively high earnings levels for the industry in 1973–1975, the capital requirements to achieve this expansion will exceed available cash flows from operations plus reasonable additional borrowing by over $1 billion per year. If we are to continue to have a healthy domestic steel industry, we believe that expenditures of this magnitude must be made.

In considering this additional capacity, the steel industry will first look to rounding out or adding to its present facilities. This is not sufficient, however, to provide all of the additional capacity required. This means that consideration must *now* be given to possible "greenfield" steel making capacity. U.S. Steel Corporation has been studying this possibility and I can share some of our results to date with you.

We believe a new integrated facility must be designed for at least four million tons. Some important employment prospects are involved. If a decision to proceed can be made, thousands of jobs in the construction and machinery industries would be created. When full operations were achieved, about 8,000 permanent jobs would be directly created by this investment. In addition, at least 25,000 to 30,000 jobs in industries both large and small to support the plant and its workers would also be created. Thus, an investment decision by one member of the steel industry would create thousands of jobs for industrial employers of all sizes.

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We request that your committee reinstate the 12 percent investment credit as at least an elective alternative to the so-called "job credit" to give this current program more emphasis toward capital formation.

We also recommend that your committee give immediate consideration to a more thorough review of the bias in our tax law against capital formation. If the steel industry is able to form the capital that we think is necessary to keep up with the growth in the domestic steel market, under present interpretations of our laws over 20 to 25 percent of our capital expenditures will be for air and water treatment facilities alone in the next 5 to 10 years. It should be noted, however, that these commitments are not discretionary. In most cases the laws are in place and the dates for compliance have been established In years when the industry's capital expenditures may not be able to match the rates which we feel are necessary these absolute requirements for nonproductive facilities could approach 75 to 100 percent of available capital funds. In addition, these commitments are ongoing. One time compliance does not mean that the expenditures for compliance are over. In many instances, the technology is new and in some instances is not yet in existence. This leads us to believe that the obsolescence factor will be very high for pollution and safety equipment and replacement will continue to drain away capital funds from more productive facilities.

We also face the fact that operating costs for these facilities will be very substantial on a continuing basis. For these reasons, we believe that expenditures for air and water treatment facilities and newly-legislated health and safety devices should be tax deductible as incurred so that the cash can more quickly be recovered and reinvested in additional job-creating production facilities.

We also urge your committee's prompt consideration of the elimination of double taxation of dividend income to make equity financing more attractive as compared to incurring additional debt. This will make additional savings available for this type of investment. Attention should also be given to making our capital recovery system more competitive with other industrial countries by allowing it to be more flexible with the recovery periods substantially shortened.

We are pleased to note that when the President sent his program to the Congress, his message stated: "It is time to take our people off welfare and put them to work, with maximum emphasis on creating jobs in the private sector." This emphasis is appropriate but we feel that Ways and Means Committee action falls far short of that objective. Although their stimulus to the consumer is justified, it is temporary, and if expanded appreciably will tend to be inflationary. Any stimulus to capital investment, which is the most lagging segment in the economic recovery was largely ignored.

If we are to have a vigorous and healthy economy with a strong steel industry as a part of it, encouragement to capital investment is essential. If we should think that we can rely on foreign steel production to supply our markets, let me remind you of the OPEC countries' influence on energy cost in the United States. The same foreign dependence in steel will have equally disastrous effects. Foreign steel producers, who are heavily subsidized by their governments, sold steel in the United States at below fair prices when markets elsewhere were weak. When steel markets were tight in 1973 and 1974, domestic steel consumers paid premium prices to these same foreign producers in excess of the total price concessions that it had received in all prior years.

In closing, we urge your committee to include in this package at least the 12 percent investment credit which was in the President's proposal and we urge you to make it permanent. In addition, we urge your immediate attention to the additional items mentioned. These changes are necessary if we are to eliminate the bias against capital investment which is necessary to meet the Administration's expressed goal of "creating jobs in the private sector".

This concludes my remarks, Mr. Chairman.

Senator MATSUNAGA. Our next witness is Mr. Richard Dewey, chairman of the Coalition of National Voluntary Organizations.

Mr. DEWEY. Senator, I bring you the regrets of Barry Ewing, who could not be here today. My name is Richard Dewey, executive director of the Coalition of National Voluntary Organizations. With me today is Jack Moskowitz and Jack Myers.

The statement I am stating is that prepared by Mr. Ewing.

STATEMENT OF RICHARD DEWEY, EXECUTIVE DIRECTOR OF THE COALITION OF NATIONAL VOLUNTARY ORGANIZATIONS, ACCOMPANIED BY JACK MOSKOWITZ AND JACK MYERS

Mr. DEWEY. CONVO was established by national voluntary organizations to examine the history and accomplishments of the voluntary sector in improving the quality of American life and to study the means by which its efforts may be encouraged and improved. Its objectives are outlined in the attached statement of purpose. The organizations which have participated in the development of CONVO, listed alphabetically, are: American Association of Fund-Raising Counsel, Inc., American Counsel on Education, American Hospital Association, Associated Councils of the Arts, Community Service Bureau, Inc., Council for Financial Aid to Education, Council of Jewish Federations & Welfare Funds, Inc., Council on Foundations, Inc., National Assembly of National Voluntary Health & Social Welfare Organizations, Inc., National Center for Voluntary Action, National Conference of Catholic Charities, National Council on Philanthropy, National Health Council, Inc., National Urban League, United States Catholic Conference, and United Way of America.

These institutions represent virtually every facet of the voluntary sector: education, the arts, religious organizations, and federated fundraising organizations.

Our interest in this particular package stems largely from the extension and expansion of the standard deduction. We are in sympathy with the objectives stated by the President in his message. While one of the most important of these is tax simplification, primarily reflected in the proposed increase in the standard deduction to a flat $3,000 for couples and $2,400 for single persons, we find some difficulties that we would like to bring to the attention of the committee and Congress.

Although we support the objectives of the proposed change in the standard deduction, we do feel that Congress should be aware that modification would have a detrimental effect on the contributions to charities, particularly those which directly serve the public need.

As indicated by the Ways and Means Committee in ' s report, some 9.5 million low- and middle-income taxpayers will b removed from the rolls of those who itemize if the permanent increase in the standard approved by the House of Representatives is adopted.

Preliminary econometric projections made by Prof. Martin Feldstein of Harvard—who, with his colleagues, was responsible for much of the data which was so important to the deliberations of the Commission on Private Philanthropy and Public Needs, also known as the Filer Commission—suggest that an annual loss in contributions to charities of nearly $700 million has already occurred as the result of increases in the standard deduction since 1970. Additional annual losses exceeding $200 million in contributions can be expected to result from the change in the standard deduction approved by the House.

This cumulative effect on charitable contributions of periodic liberalization of the standard deduction is significant indeed. Moreover, a disproportionate share of this loss will probably be borne by organizations such as the United Way, which directly support public endeavors.

More important, this will further decrease the inducements to giving by those in low- and middle-income brackets. Because recent studies indicate that there is a strong correlation between giving and active participation in charitable endeavors, the effect may extend well beyond the mere loss of financial support. See, for example, the report of the Filer Commission, "Giving in America: Towards a Stronger Voluntary Sector," released after extensive studies more than a year ago.

The cumulative effect of the extension of the standard deduction would result in greater loss to the people who use the services in question than would be indicated by the above figures. According to the House Ways and Means Committee in its report, the loss to the Treasury will be on the order of $6.7 billion in the 1978 fiscal year.

If added to the private sector's annual loss of nearly $1 billion since 1970, the net reduction in moneys available for the sort of services that are needed by the people served by voluntary agencies is very substantial indeed.

This is particularly true at a time when the services are more in need, ~~more in demand~~ and more used than would be the case in a more profitable climate.

The loss of services in such areas as day care, job training and services to minorities, and so forth would be affected severely. Therefore, the loss of moneys available for the direct delivery of services would be particularly damaging to those who are in greatest need.

With this in mind, we would respectfully suggest that this may be an appropriate time for Congress to consider a change in the structure of the charitable contribution which is consistent with tax simplification and with the six objectives which the Filer Commission found most important in their studies of the philanthropic sectors, namely:

One, to increase the number of people who contribute significantly to and participate in not-for-profit activities.

Two, to increase the amount of giving.

Three, to increase the inducement to giving by those in low- and middle-income brackets.

Four, to preserve private choice in giving.

Five, to minimize income losses of not-for-profit organizations that depend on the current pattern of giving.

Six, to be as efficient as possible, that is, to raise more money than would be lost to the Treasury through the suggested change.

At the outset, we would note that in making this proposal, we proceed from three propositions:

One, that voluntarism historically has made, and continues to make, an important contribution to the entire pluralistic fabric of American life.

Two, that the charitable deduction is an effective instrument of public policy in generating support for voluntarism by maximizing incentives to contribute to the common good, while leaving the charitable organization unfettered in its service to mankind.

Three, that the charitable contribution is uniquely different from other deductible expenditures and should be treated differently in the formulation of tax policy. The qualities of a charitable contribution which distinguish it from all other deductible items is that it is a discretionary expenditure, not required or mandatory; it represents

a constructive act of citizenship; and it is essentially an unselfish act, in which the contributor does something for someone else. No other deductible expense has all these characteristics, and few have any of them.

Moreover, Professor Feldstein's econometric projections prepared for the Filer Commission established that the gifts generated by the tax deductions for charitable contributions substantially exceed any revenue which might be gained should they no longer be allowed.

The measure which we propose can be accomplished with modest changes in the income tax law. We would recommend that the uniqueness of the charitable contribution be recognized by treating it as an offset against gross income rather than as a deduction used in calculating taxable income.

Attached is a proposed amendment to section 62 of the Internal Revenue Code which would accomplish this purpose. A simple change could be added to insure that the limitation on the deduction remains the same as under present law. This would permit individuals who use the standard deduction to enjoy the benefit of the charitable contribution and thus encourage them to support charities. It would also result in a redistribution of the wealth of the Nation, placing more resources in the voluntary sector where it is available to meet the perceived needs of society and less for private advantage.

We would note that this recommendation is not original with Convo. In various forms it has been promoted over a number of years. It, of course, becomes more crucial as the number of taxpayers who utilize the standard deduction is increased.

A similar proposal was in fact the first and primary recommendation of the Filer Commission itself. The econometric projections made by Professor Feldstein indicate that giving would increase by $1.9 billion a year or an average of about $40 per taxpayer newly reached by the charitable deduction. The corresponding deduction in tax revenues was estimated to be on the order of $1.7 billion.

We think this change is entirely justified by the increase in support of charitable activities and enlistment of millions of volunteers in a new pattern of private giving and participation which would result.

Any loss in the Federal revenue will be more than offset by additional contributions made for the promotion of public purposes. At a minimum cost in simplification for those using the standard deduction who wish to take advantage of the charitable contribution, there would be a significant increase not just in giving but, more important, in the number of individuals who participate in support of not-for-profit activities to the great advantage of the Nation.

Particularly, it would increase the participation of those in low- and middle-income tax brackets, thus preserving and enhancing the broadest private support for public needs.

The democratization of giving patterns in this country has long been one of the objectives of tax reform and would be served by this amendment. We believe that the participation of these individuals is an essential ingredient to a health and viable sector which plays such an important part in the well-being of the Nation.

[The attachments to Mr. Dewey's statement follow:]

EXHIBIT A—COALITION OF NATIONAL VOLUNTARY ORGANIZATIONS

Statement of Purpose

A. To maximize the contribution of the voluntary sector in meeting America's human needs and to enrich the quality of American society.

B. To increase the public understanding of the history, the accomplishments. and the rich capacity of the voluntary sector to improve the quality of American life.

C. To gather and disseminate data on the scope and nature of the philanthropic process.

D. To assess current and emerging public needs in order to determine the extent by which these needs are being met or not being met by both voluntary and public efforts.

E. To study public policies which impact the voluntary sector and to recommend appropriate policies which encourage and strengthen a pluralistic society.

F. To promote the accountability and accessibility to the public of both donors and donee organizations.

EXHIBIT B

Proposed Amendment to Section 62

1. Section 62, relating to definition of adjusted gross income, is amended by adding immediately after paragraph (13) the following:

(14) CHARITABLE CONTRIBUTIONS.—The deduction allowed by Section 170.

2. Section 170(b)(1)(E), relating to charitable contributions, is amended to read as follows:

"(E) CONTRIBUTION BASE DEFINED.—For purposes of this section, the term "contribution base" means "adjusted gross income (computed without regard to the deduction provided in section 62(14) and without regard to any net operating loss carryback to the taxable year under section 172)."

3. Section 57(b)(1), relating to items of tax preference, is amended as follows:

(a) Subparagraph (A) is amended to read as follows:

"(A) Deductions allowable in arriving at adjusted gross income (other than that provided in section 64(14)),"

(b) The term "adjusted gross income" is changed to read: "adjusted gross income (computed without regard to the deduction provided in section 62(14))."

Senator MATSUNAGA. Mr. Dewey, I think you have touched upon an area in which many of us agree that Congress may have gon in the wrong direction. I am one of those who feel that giving should definitely be encouraged rather than discouraged.

I think that you suggest a good way of doing it, however, the vehicle here being offered may not be the one, because the bill which we are considering now, or the measure we would like to report c is the immediate one of reducing unemployment, by increasing employment. But let me assure you, as one member of this committee, I am going to pursue your suggestion.

Mr. DEWEY. Thank you, sir.

Senator MATSUNAGA. Senator Danforth?

Senator DANFORTH. There are, of course, at least two alternatives that are before us right now pertaining to stimulus, one is to provide some tax relief, very, very modest tax relief. Somebody said it is no more than indexing the tax reduction of a couple of years ago by adjusting the standard deduction. That is what you are addressing yourself to.

Another approach is to leave the standard deduction as is, but to reduce rates, particularly the rates for the middle- and low-income taxpayer.

I wonder if you have addressed yourself to that second possibility? Would it be correct for me to say that the effect of a rate reduction on charitable contributions would not be needed, but the effect of the standard deduction would be needed?

Mr. DEWEY. I wonder if I could defer my answer to Mr. Myers?

Mr. MYERS. I would say, insofar as this suggestion is concerned, obviously retaining the standard deduction at the present level would mean we would not lose any further annual gifts. We feel that we have lost in the past. It is the cumulative effect that bothers us.

As an alternative on the rates, we would have the same position with that. It does theoretically reduce giving, the lower the rate, the less tax incentive. At least, that giving that is related to tax incentive, so it would probably be—I would hesitate to say what it would be, but it would probably be sort of a washout, one way or the other.

I think our position is not anything against the standard deduction, but basically to call your attention to what is happening here and what has happened over the years and what will happen if we continue with the progressive liberalization of standard deduction. We want to encourage giving, and get as many people involved as is possible.

Senator DANFORTH. You do have projections, as I understand your testimony, by adjusting the standard deduction, more people would avail themselves of the standard deduction?

Mr. MYERS. Yes.

Senator DANFORTH. There are predictions as to how many people would avail themselves of the standard deduction insofar as that number of people is concerned.

Those people would have no tax incentives to make contributions. Is that correct?

Mr. MYERS. That is correct.

Senator DANFORTH. You say there are 9 million people?

Mr. MYERS. According to the Ways and Means Committee, 9 million people will no longer itemize deductions, about 4.5 million, or something like that, are people who would no longer pay taxes, so they would have no incentive, no tax incentive.

Senator DANFORTH. Maybe I am arguing my own position to you, but is it not pretty clear to you that it would be much more preferable, to have a rate reduction because it is not just going to kick people down? It would be sort of unusual, rare, that it would kick people into a lower bracket.

Mr. MYERS. I would agree.

Senator DANFORTH. In fact, it would keep people at about the same bracket, possibly, by offering a rate reduction, but provide them with more take-home pay that they could contribute.

Mr. MYERS. Which is an important part.

Senator DANFORTH. Can I get you to reassess your previous assessment?

Mr. MYERS. You are really asking me a question about what the effect is. I should say we are here obviously saying that changing the standard deduction, increasing it, takes a lot of people away from us who were there before, supporting us, at least in terms of a tax incentive, so it is going to be to our advantage of at least $200 million annually.

What the effect of a rate reduction would be would depend on how it were structured. It seems from the point of view of this bill to be of advantage to us.

Senator DANFORTH. The rate reduction would be an advantage to you—would be an increase over an adjustment in the standard?

Mr. MYERS. Depending on how it was structured, yes.

Senator DANFORTH. Continuing that, the rate reduction would be keyed, not people, but the first $18,000 of income. It would leave relatively untouched everybody below that. That would have a small effect?

Mr. MYERS. That would have a small effect on giving.

Senator DANFORTH. It would be more preferable than the standard deduction?

Mr. MYERS. I do not know if I can speak for someone like Professor Feldstein. My impression would be that.

Senator DANFORTH. Thank you.

Senator CURTIS. [presiding]. I was not here for the delivery of your statement, but I know something about the subject. What you are doing is raising the point that if the standard deduction gets so high and so attractive that more and more people are no longer itemizing, they will have no tax incentive for making donations, is that correct?

Mr. MYERS. That is correct. Also, there is a direct correlation between giving and doing volunteer work and we are afraid that if you lose givers you would lose the donations, and you would also lose volunteers.

Senator CURTIS. Are you speaking of all contributions and donations? Who constitutes your group?

Mr. DEWEY. Would you like me to read the list, sir?

Senator CURTIS. Summarize it, what groups constitute the chief members of your coalition.

Mr. DEWEY. The membership of CONVO are, in themselves, umbrella organizations within the voluntary sector. For example, the American Council on Education, the American Hospital Association, Associated Councils of the Arts, Council of Jewish Federations and Welfare Funds, National Conference of Catholic Charities, National Council on Philanthropy, National Urban League, United States Catholic Council, United Way of America. These are the members today.

Senator CURTIS. A special standard deduction is a product of the last 5 years.

Has there been a definable reduction in contributions by reason of the standard deduction?

Mr. MYERS. Yes, Senator.

We have estimated, on the base of projections which Dr. Feldstein did for the Filer Commission that since 1970 we have lost annually in gifts to all charities about $700 million by reason of changes in the standard deduction that have occurred since 1970.

He estimates an amount exceeding $200 million annually is likely to be lost by reason of the changes made in the House version of this bill. The increase in standard deduction would result in that.

Senator CURTIS. I will be giving further attention to this matter, and we thank you for your appearance.

Senator DANFORTH. Mr. Chairman, if I could ask one more question? It is the same question. I am looking for quotable quotes.

I recognize that you do not purport to be economists so I am just asking this to the best of your knowledge and belief, is it your belief—first, let me ask you this. You have studied, I take it, the administration's proposal with respect to adjusting the standard deduction?

Mr. MYERS. Yes.

Senator DANFORTH. It is your belief, as I understand it, that that proposal, if enacted into law, would have some effect on charitable contributions?

Mr. MYERS. Right.

Senator DANFORTH. What is your projection—this is repeating, but what is your best judgment as to the dollar effect on charitable contributions as a result of this proposed change in the standard deduction?

Mr. MYERS. Something in excess of $200 million annually loss of contributions and that is not my projection, that is Professor Feldstein's projection, based on the model that he developed for the Filer Commission.

Senator DANFORTH. You have not made a careful analysis, nor has one been made by anyone you know of, as to the effect on charitable contributions of an adjustment of tax rates on adjusted gross income of $18,000 and less?

Mr. MYERS. No, but I am quite sure it can be done.

Senator DANFORTH. Do you have an opinion that that kind of adjustment—recognizing that you are not an economist, but you are here to testify on a very important subject—do you have an opinion as to whether or not such a rate reduction based on the first $18,000 of adjusted gross income would have a comparable effect on reducing charitable contributions?

Mr. MYERS. My guess is that it would not.

Senator DANFORTH. Giving me the best quotable quote that you can think of, your guess is that it would not?

Mr. MYERS. My guess is that it would have less of an effect.

Senator DANFORTH. Do you agree with that?

Mr. DEWEY. Yes.

Mr. MOSKOWITZ. I would like to make this point. The concern of the charities here is the gradual erosion in the giving base. I am trying to back us off from the question in this stimulus package between the best way to go between the standard deduction and the decrease in rates, because our major interest is in getting the charitable contribution treated in a distinct way so that this erosion in the base of giving can end, and that there be a greater stimulus of giving.

I am trying to get off of your track, because we have no fixed position on the distinction on this very important argument. I have a personal opinion.

Senator DANFORTH. You are working a different side of the street than I am. I am very sympathetic to your position and I agree with Senator Matsunaga on the need for further study. I do not think it is in the cards right now.

I wonder if it would be asking too much if you could consult with an economist. Maybe it is just asking too much of you, but would it be possible for you to consult with Professor Feldstein or somebody else and ask him the question as to the effect, the relative effect—he has projected the effect of changing the standard deduction. What I

want to know is, what would the effect be of a reduction of tax rate limited to the first $18,000 of adjusted gross income?

We will provide you before you leave with a proposal with the actual rates. Could it be done?

Mr. MYERS. I suspect that it can. It depends on the model that he has and whether this can be incorporated. I believe that it can.

Senator DANFORTH. I hate to ask you for more work. I would really appreciate it if you could.

Mr. MYERS. We would be glad to do it.

[The material referred to above was subsequently supplied for the record.]

I believe we can respond to your request for an estimate of the affect on charitable giving of your proposal. This was that instead of increasing the standard deduction as proposed by the Administration and adopted by the House, there would be a reduction in the rate of tax imposed on individuals having income of less than $18,000. Taking figures which you provided us with respect to the actual rate changes, Professor Feldstein estimates that, if the standard deduction were retained but the rate of taxes on those having less than $18,000 reduced as you propose, there would be an annual increase in giving of approximately $237 million. Based on the same assumption, if the liberalization of the standard deduction as recommended by the Administration is adopted, there will be a loss in charitable contributions of approximately $242 million annually.

Senator DANFORTH. Thank you.

Senator CURTIS. Thank you very much.

We have three witnesses; it is now close to 12:30. We are not sure we can have a meeting this afternoon. We will proceed as best we can.

Our next witness is Mr. Blair Bolles, chairman, Executive Committee of the Ad Hoc Committee for an Effective Tax Credit.

STATEMENT OF BLAIR BOLLES, CHAIRMAN, EXECUTIVE COMMITTEE OF THE AD HOC COMMITTEE FOR AN EFFECTIVE TAX CREDIT, ACCOMPANIED BY WILLIAM CONDRELL, GENERAL COUNSEL, AND JAMES MORRISON, ASSISTANT GENERAL COUNSEL

Mr. BOLLES. Thank you, Mr. Chairman. I am appearing for Mr. Frederick Jaicks who is chairman of the board of Inland Steel Co. of Chicago, and he requests and asks me to express his regrets that unavoidable and unexpected circumstances prevent his being here.

He intended to appear, and I do appear, on behalf of the Ad Hoc Committee for an Effective Investment Tax Credit. I am chairman of the executive committee of that organization.

With me today are Mr. William Condrell, general counsel of the Effective Tax Credit Committee and James Morrison, assistant general counsel.

Before analyzing today's situation, I want to express my appreciation to the Finance Committee for the clear understanding it has shown over the years of the importance of the investment tax credit. I am sure if it were not for this committee we would not be so firmly entrenched in the credit as we are. It has shown us its comprehension by making possible the inclusion of the investment tax credit in a succession of laws over the last 15 years.

The investment tax credit is absolutely vital to industrial growth and prospects for high employment.

We welcome the President's proposed investment tax credit increase from 10 to 12 percent and we urge that the entire tax credit be made permanent. In our view, productive expansion and job creation cannot be predicated on economic stimulus that is either temporary or uncertain.

Long-term investment decisions requiring substantial outlays of funds must be based on long-term attractiveness and predictability. If long-term economic stimulation is to be achieved—and that, in my view, is the only way to provide new jobs—then this effective investment tax credit device must be given permanence.

Moreover, limitations should be done away with to permit all tax credits to be applied against tax liability. The continuing credit, in our view—our view means the views of the management leadership of more than 300 major companies in the United States—is the most effective way to increase production, reduce employment, and, importantly, create the millions of new jobs that our society will require from now through the early 1980's.

In addition, other significant advantages can be made available to the total economy by utilizing the most modern technology. If we have the continuing advantage of the credit. For example, a new steel plant would consume 30 percent less energy and significantly increase labor productivity if industry is encouraged by the tax law to put in place new equipment.

In the final quarter of 1976, consumer income adjusted for inflation was at a record high, up 4.5 percent above the prior peak of 1973. Industrial production for the fourth quarter of 1976 was at precisely the same level as in the peak 1973 period.

Advantages accrued to the consumer, but not to industry. Business investment for more efficient and productive capacity in the final 1976 quarter was almost 12 percent below its prior 1973 peak and 1974. I read this morning that yesterday the Commerce Department reported continuing disappointment in the level of industrial investment.

Now we do not find that the administration's proposal for an elective alternative social security tax credit is in conflict with the increased investment tax credit. Providing the option seems to be the sound way to go.

This would provide equitable benefits for companies operating at a loss and for companies unable to fully utilize the investment tax credit in view of existing limitations. But we view these primarily as short-term remedies. Neither a 4-percent social security credit nor a jobs credit without the increased investment credit will achieve what Congress and the administration both seek in terms of new jobs. Improved productivity in the long term insures economic growth.

This summarizes those specific recommendations contained in our prepared statement which has been distributed to you all. We respectfully urge the committee to report a bill with the following provisions:

First, an increase in the investment tax credit to 12 percent, without termination date. This will make the investment credit option compatible with the President's recommendation for the social security tax credit provision, which has no termination date.

Second, the incorporation of urgently needed technical improvements in the investment tax credit, as described in our prepared statement.

Aside from these, the ad hoc committee also urges the Congress and the administration to look with favor upon two other objectives, if not in the pending legislation, then at the earliest possible opportunity.

First, improved tax treatment of pollution control expenditures, and second, full modernization of the capital recovery provisions in the Tax Code.

I speak—that is, Chairman Jaicks speaks—with the experience of one whose industry has spent or committed more than $3 billion in mandated environmental control projects. They constitute a major economic burden which reduces capital available for productive economic purposes, and severely inhibit profitability. As for capital recovery, our highly industrialized society is among the least effective in recycling capital for productive uses. The Nation's low capital recovery rate has been highly damaging to American industry in the arena of international competition and has served as a damper on renewed innovation and productivity within our economic system.

Finally, we believe that the current international economic posture justifies a close, hard examination of our tax policies affecting savings and investment. An improvement in those policies will benefit not only business, but labor and the consumer. It is popular to favor tax policies that appear to encourage greater consumption directly, but increased capital growth favors consumption. That is what we are talking about: how to increase capital growth. It increases the consuming power of the employee. You cannot fend off the economic stagnation and inflation that hurts consumption, without providing primary impetus to capital formation.

The basic need is the full restoration of business confidence. The legislative actions noted above will indeed increase the confidence of business. To turn our backs on the improved investment tax credit in the present legislation before you would have the contrary effect.

Thank you, gentlemen.

Senator CURTIS. Senator Danforth?

Senator DANFORTH. I have no questions.

Senator CURTIS. We thank you very much for your appearance.

[The prepared statement of Mr. Jaicks follows:]

351

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AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT
Suite 821 1801 K Street N W Washington, D C 20006 (202) 659-1531

SUMMARY AND STATEMENT OF

FREDERICK C. JAICKS
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
INLAND STEEL COMPANY

ON BEHALF OF THE

AD HOC COMMITTEE FOR AN EFFECTIVE
INVESTMENT TAX CREDIT

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

WASHINGTON, D. C.

MARCH 10, 1977

The Ad Hoc Committee for an Effective Investment Tax Credit represents over 300 business firms engaged in manufacturing and service industries. The objective of the Committee is to improve the capital recovery provisions of the Internal Revenue Code, with particular emphasis on the preservation and strengthening of the investment tax credit provisions.

RECOMMENDATIONS

The Ad Hoc Committee generally supports President Carter's business tax proposals which would provide for an increase in the investment credit rate to 12 percent, or would allow the option of a four percent tax credit against the employer's share of social security payroll taxes; however, the investment tax credit increase should be enacted without a termination date.

The Ad Hoc Committee also recommends consideration of two other critically important tax provisions either now or when the tax reform bill is considered later in the year. First is adoption of a 2u percent investment credit rate for qualified pollution control equipment as a means of alleviating the impact of such mandated investments on the productive capacity of the U.S. economy.

And secondly, the Committee recommends that comprehensive reform of the capital recovery provisions of the

Tax Code be initiated as soon as possible to put and keep U.S. industries on a par with foreign trading partners whose governments already have or are in the process of liberalizing cost recovery measures in their tax structures.

JUSTIFICATION

The principal benefits of the increased capital investment stimulated by improvements in the investment tax credit would be (1) improved job opportunities in existing and new businesses, (2) increased productivity with resulting alleviation of inflationary pressures, (3) improved trade balances to aid in offsetting the high cost of energy imports, and (4) increased federal revenues resulting from higher levels of economic activity.

HISTORY OF THE INVESTMENT CREDIT

Since its enactment in 1962, the investment tax credit has been demonstrated to be the most effective single provision for stimulating productive investments in the economy. Its short and long-range benefits have been clearly indicated with each change in the law. However, attempts to use it to "fine tune" the economy, as has been attempted in the past and is still sometimes suggested, have failed primarily because of the need for business planners to anticipate well in advance

what tax benefits will be applicable to a particular investment. Short-term changes therefore have limited benefits. The real need of the U.S. economy for constant improvement in productivity, innovation and ongoing research and development is heavily dependent upon an investment credit rate which is both meaningful and permanent.

CONCLUSION

It is regrettable but true that the U.S. economy has slipped in its historic leadership position in the world. Private sector investment is now the lowest in the industrialized world, productivity gains also lag behind all other major industrial nations, business and personal savings are below the level required to meet known investment needs for the next decade, and other indices also show the need for vigorous, positive changes in public policy if we are to reverse the present discouraging trends.

We believe the single greatest factor to be that of incorporating more adequate cost recovery provisions in the Tax Code. A permanent increase in the investment tax credit to 12 percent would be a significant step toward that goal.

STATEMENT OF

FREDERICK C. JAICKS
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
INLAND STEEL COMPANY

ON BEHALF OF THE

AD HOC COMMITTEE FOR AN EFFECTIVE
INVESTMENT TAX CREDIT

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

WASHINGTON, D. C.

MARCH 10, 1977

86-032 O - 77 - 23

The Ad Hoc Committee for an Effective Investment Tax Credit is a voluntary group of 319 business firms and 52 supporting business associations. A list of the member companies and supporting associations is attached (see Appendix A).

The membership of the Ad Hoc Committee share the belief that the failure of our economy to fully recover from the worst and most persistant recession of the past 40 years requires immediate economic stimulus. In addition, they believe that the central economic concern facing this country presently and in the years ahead is the formation of sufficient capital to meet the unprecedented projected requirements for job-producing investments in American business and industry.

I. Economic Recovery Proposals

To date, progress in economic recovery has been disappointing. Without significant new action, recovery will continue to be a slow process. Employment is still lagging, production and business investment are still at or below 1973 levels. Our real economic growth rate is inadequate to meet employment goals. Our growth in labor productivity is disappointing. Total savings are grossly insufficient to meet projected capital investment needs over the next decade. And in many of these categories we are lagging behind the other major industrial nations of the world.

Considering the usual diversity of opinions among economists, the degree of present consensus favoring immediate economic stimulus is almost unprecedented. President Carter proposed an immediate action program in his January 31, 1977, message to Congress. Former President Ford also proposed an action program before leaving office as expressed in his Tax and Budget messages to the Congress.

President Carter's proposals, which are the subject of these hearings, express full awareness of the need to provide immediate economic stimulus to lower the high unemployment rate, create new jobs for the future, and to advance our economy at a satisfactory real growth rate. Although the views of members of the Ad Hoc Committee may vary on particular aspects of the President's January 31st Economic Recovery Proposals, the overall view is that the program is a move in the right direction.

There are features of the program affecting individual taxpayers as well as business taxpayers. Since we are a business organization with emphasis primarily on capital recovery provisions of the Tax Code, our testimony today will be limited to a discussion of those aspects of the program.

A. Tax Incentives for Business

A number of proposals for business tax incentives have been discussed recently, in addition to those incorporated

into the President's program. Principal among these are selective investment tax credit increases, and increases geared to incremental employment benefits. Also to be considered is the provision in the House Ways and Means Committee bill which would provide a direct tax credit based on new jobs created. We believe these have merit, but we also believe that the history of the investment tax credit amply demonstrates its remarkable effectiveness in stimulating job-producing investments throughout the economy. We question whether the benefits of additional qualifying standards would outweigh the additional costs of administration, and we believe the overall incentive impact would not be as great in relation to revenue costs as an across-the-board increase in the investment credit rate.

Therefore, as we will outline in greater detail later in this statement, the Ad Hoc Committee believes that present circumstances warrant a permanent two percent increase in the investment tax credit.

B. President Carter's Program

President Carter has recommended that businesses be allowed to elect either a credit against income taxes equal to four percent of the employer's portion of social security payroll taxes or an additional two percent investment tax credit on qualified investments--with the payroll

tax credit being permanent, but with the increased investment credit rate to be in effect only through 1980. The President's proposal also recommends that the one to one and one-half percent incremental credit applicable to companies with Employee Stock Ownership Plans (ESOPs) be continued.

1. Social Security Credit

The proposed credit equal to four percent of the employer's contribution to social security payments, if approved by Congress, would provide an economic stimulus to service industries and others not requiring heavy capital equipment purchases. The refundable nature of the payroll tax credit would make it of benefit to companies in a loss situation or to those unable to fully utilize the investment credit because of the present limitation related to income tax liability.

However, it would not be satisfactory by itself because it would fail to stimulate the type of long-term investments in those basic, capital-intensive industries which are most likely to generate the improved technology and higher manufacturing productivity from which new service industries and jobs arise.

2. Investment Tax Credit

Since the investment tax credit was first proposed by President Kennedy in 1961 and enacted by Congress in 1962, it has proven to be one of the most effective methods of

economic stimulus ever incorporated into the tax system. The success of the credit over the years it has been in effect--and the adverse impacts of its suspension and repeal in the late 1960's--is discussed in detail later in this statement.

The key to the effectiveness of the investment tax credit is the fact that taxpayers must earn the benefit through the purchase of productive equipment and facilities--purchases which result in more jobs in the manufacturer's sector and, as amply demonstrated through the years, more jobs in the operation of the purchaser as well. Thus, employment and productive capacity are expanded, inflationary pressures are reduced through efficiencies in operation, and federal revenues are most likely increased far beyond the initial cost to the Treasury. And, the benefits are permanent rather than temporary.

Specifically, the Ad Hoc Committee urges that the 12 percent investment tax credit be enacted on a permanent basis, without expiration date. The need for the type of investments stimulated by the investment credit is not short-term. That need is a permanent part of our economic life.

Other changes are required as well. Due to the limitation of the investment credit to 50 percent of tax liability in excess of $25,000, many companies are unable to fully utilize the investment credits otherwise available to them. In order to make the increase of the investment

tax credit to 12 percent effective as a stimulus and for the purpose designed, it is essential to increase the limitation at least in proportion to the increase in the credit itself. When the seven percent investment credit was adopted, the limitation was 50 percent of tax liability. Under the circumstances of the 12 percent credit an appropriate limit would be in the neighborhood of 75 percent.

Unfortunately, since the investment tax credit was enacted in 1962, there has been a tendency to utilize it as a counter-cyclical device. The credit is unsuited for this purpose, and its effectiveness has been reduced in the past by uncertainties of its availability and applicability to particular capital investments.

In particular, long lead time equipment acquisitions are affected by a termination date. Thus, downward changes in the credit rate cause distortions in planning of equipment purchases which can hinder the desired economic stimulus underlying the credit. It would be far better to enact the credit at a meaningful level on a permanent basis. A 12 percent rate is clearly justified as a means of providing both immediate and long-term economic stimulus.

In a recent analysis entitled Policy Alternatives For The Investment Tax Credit Professors Roger H. Gordon and Dale W. Jorgenson of Harvard University discuss in detail the effects of the use of the investment credit for

counter-cyclical policy. Their analysis, copies of which we believe have already been provided to the Committee, concludes that:

> The value of the tax credit for stabilization depends on the ability of the administrator to forecast future trends. From the historical choice of credit rates, it appears that this ability was so poor as to make use of a flexible instead of a constant credit rate detrimental to stabilization ... Uncertainty facing the administrator seems to be too large to make a flexible policy worthwhile. For example, reduction or suspension of the investment tax credit in late 1964 would have required accurate anticipation of the course of the Vietnam buildup. In 1964 U.S. fiscal policy was headed in precisely the opposite direction. In that year a major tax cut was instituted and the effectiveness of the investment tax credit was enhanced .... The implications of the changing defense policy were not apparent to fiscal policy makers until considerable time had elapsed.
>
> .... The investment tax credit was repealed in 1969 and not re-introduced until 1971. In retrospect this change in policy was in precisely the wrong direction. The investment tax credit should have been increased very substantially in order to counter-balance the effects of the Vietnam de-escalation.
>
> The tax credit, however, remains a powerful device to stimulate capital deepening. A constant fifteen percent credit rate for the next ten years would cause the capital stock in 1985 to be 12.5 percent higher than it would be under a seven percent rate. Thus our basic conclusion is that the choice of a rate for the investment tax credit should be based on long run objectives of capital deepening and desired average levels of demand for an extended period, and not on short run stabilization objectives.

It is clear from this and other studies that the credit is not a useful instrument for "fine tuning" the

economy. Rather it should be used as a means to provide the kind of economic stimulus needed to achieve both short and long-range economic goals.

II. Long-Range Business Tax Reform

There are several factors which contribute to the Ad Hoc Committee's conviction that substantial changes in Federal tax policy are necessary if we are to reduce unemployment, increase our rate of economic growth and halt the ongoing deterioration of our relative position in the world economy. Such changes are necessary to ensure sufficient jobs for a growing labor force. They are necessary if we are to overcome the problems of energy and raw material shortages. They are essential if we are to maintain the viability of our free enterprise system. And, certainly they are essential if we expect to provide opportunities for achieving a rising standard of living for all the citizens of this country.

It is essential that our economy be strengthened to the point where it is no longer subject to major fluctuations caused by oil embargos and changing weather patterns. Changes in present tax policy are necessitated by such factors as:

-- the reduced rate of private sector investment in the United States (now the lowest in the industrialized world);

-- the low rate of productivity gains in United States manufacturing (also the lowest in the industrialized world);

-- recent problems which have caused economic dislocations. It is impossible to predict what additional problems may occur in the future. Our economy must be strong enough to withstand these problems without undue hardship to the American people.

-- the inferior position of United States industry in terms of capital recovery tax provisions, compared to industry in other industrialized nations (the United States ranks at or near the bottom);

-- the shocking decline in real corporate profits relative to other components of the economy, resulting in inadequate business savings and increased reliance on debt financing;

-- growing requirements for major investments in environmental protection and improvement;

-- growing energy requirements.

These represent only a few of the economic indicators and known factors which point to the need for a revitalization of the United States economy through more realistic tax provisions for capital recovery. And let there be no question

about it ... these provisions are clearly one of the most important factors in determining the rate of saving and investment by business.

The Ad Hoc Committee strongly urges that the Congress take the following actions as an immediate step toward improved savings and capital formation:

1. Increase the investment tax credit to 12 percent without a termination date.

2. Adopt a 20 percent investment tax credit for investments in pollution control facilities.

3. Adopt a national Capital Recovery System for realistic depreciation of capital assets.

4. Enact urgently needed technical improvements in the investment credit provisions (described later in the statement).

In addition, the Ad Hoc Committee supports other long-term and interim steps discussed hereinafter.

A. Present Economic Considerations Warrant Prompt And Effective Action

The need for these and other measures to stimulate savings and investment has never been more critical. Our economy has been subjected to a prolonged period of inflation which has seriously distorted the distribution of national

income. Large Federal deficits have been regularly incurred, reducing total saving and creating enormous impact on the nation's financial markets and, at the same time, accelerating the shift of national resources from private investment in the economy to public sector expenditures.

And now, in addition to the problem of inflation, we find ourselves still struggling to come out of the most serious economic slump since the great depression of the 1930's. This economic crisis is further exacerbated by raw material and energy shortages which have contributed to both higher prices and declining production. Although some of the recent economic indicators imply an upturn in the economy, it is apparent that we have a long way to go if we are to significantly reduce current high levels of unemployment.

B. Productivity and Other Economic Indicators

Appended to this statement is a detailed review of the various factors which weigh heavily in favor of permanent economic stimulus to put and keep the United States on a par with other industrialized nations of the world (See Appendix B). Such factors as productivity trends, real growth, real income, capital requirements, business earnings, job creation, and savings and investment rates are inexorably related to the capital recovery systems in effect in various countries.

While most industrial nations have suffered greatly as a result of the economic slump of the past several years, there are ominous signs that--in the absence of substantive changes in the U.S. capital recovery system--there may result long-range dislocations in the U.S. economy which would bring about a realignment of international roles. This need not be the case. If the U.S. is relegated to a lesser status in the world economy it will be because we have failed to recognize in our tax laws the need for proper balance between capital investment and consumption.

In reviewing some of the specific indicators which argue forcefully for more realistic capital recovery provisions, it is appropriate that we look at those by which we can measure U.S. economic performance against that of other industrialized nations--Canada, France, West Germany, Japan, Italy and the United Kingdom.

The United States has fallen dramatically behind these trading partners in many respects, the most important being manufacturing productivity. During one year of the current recession, we experienced the first known decline in productivity in the history of the country--and certainly the first since records of economic indexes have been maintained. In this respect, the U.S. lags behind all of those countries mentioned, and very far behind most of them.

Capital formation is the major factor in productivity changes. A high rate of capital formation increases employment and productivity and permits higher real wages and an increased standard of living without excessive inflation. An inadequate rate of capital formation will make such national goals unattainable. In the past the U.S. has had the highest capital-to-labor ratio in the world, but the gap has narrowed over the past two decades as the U.S. rate of investment per worker has declined. If our economy is to perform at the level required to provide sufficient capital for jobs, for environmental protection, for energy independence, for government programs of security for the elderly and the disabled, for needed housing, for national defense, and for adequate research and development, these trends must be reversed.

How are sufficient savings to be generated to make increased investment possible? Historic levels of national savings would not be adequate to meet projected needs to the year 1985 and beyond. Clearly, extraordinary measures must be undertaken to make these essential investments possible. Virtually everyone agrees that corporate earnings must be a substantial source for reinvestments, but corporate profits have stagnated over the last decade, and capital recovery provisions have failed to keep pace with replacement costs of depreciated equipment and plant. In fact, the U.S. capital recovery system ranks at or near the bottom among the major industrialized nations. Many of these nations are continuing to liberalize their systems, making the gap even wider.

There is no question that liberalized depreciation provisions and the investment credit have been effective in the past in increasing employment and productivity, enhancing real growth, and improving federal revenues.

In each instance following adoption of the investment credit or changes in its incentive effects, new capital goods orders were correspondingly affected for good or bad. So were employment statistics and federal revenues. In spite of this demonstrated record of the value of capital recovery improvements to the overall economy, there are still those who believe that the benefits accrue only to the taxpayer.

We sincerely hope that, through the cooperative efforts of the new administration and the new Congress, this negative impression of the role of capital recovery in our economy can be reversed, and that we can get on with doing those things that are beneficial to the entire national economy.

C. Recommendations of the Ad Hoc Committee

1. Investment Tax Credit and Capital Recovery Allowances

a. Investment Tax Credit Rate

The Ad Hoc Committee recognizes that both individuals and businesses must be provided a tax climate favorable to a higher saving rate if the nation is to meet its capital demands. A realistic examination of the historical record shows that a substantial part of the necessary additional

saving will have to come from business. We advocate the immediate enactment of a permanent 12 percent investment tax credit as the most effective means of stimulating business saving and capital formation.

b. Capital Recovery Allowances

With the adoption of the Asset Depreciation Range (ADR) system of accounting in 1971, the United States finally moved away from attempting to base depreciation (cost recovery) on useful lives. The United States was the last industrialized nation to abandon the extreme complexities of basing depreciation on estimates of the useful life of productive facilities which by their nature were grossly inaccurate and unfair.

The ADR system is a definite improvement over our past system of depreciation. However, it has as its basis estimations of useful life. In addition, taxpayers are required to keep voluminous records in order to reflect depreciation on the myriad of assets required in their businesses. Due to this complexity, many taxpayers, particularly smaller ones, have not elected to use ADR and continue to use the old complex useful life system.

We have reached the point where our system of depreciation should be completely overhauled and replaced with a simple, logical system. The Ad Hoc Committee recommends a system along the lines of the Capital Recovery Allowances System contained in H.R. 7543, introduced in the last Congress.

Briefly described, this system would provide:

1. Property described in section 1245 of the Internal Revenue Code (machinery and equipment) with a five year or longer life, would be grouped together and subject to a five year write-off using double declining balance and sum-of-the-years digits methods of depreciation;

2. Pollution control facilities, whether equipment or structures, also would be subject to a five year write-off using double declining balance and sum-of-the-years digits methods of depreciation;

3. Productive property described in section 1250 of the Internal Revenue Code (buildings and other structures) would be subject to a 10 year write-off using double declining balance and sum-of-the-years digits methods of depreciation;

4. No salvage values would be used;

5. Taxpayers could elect deductions from zero to the maximum allowed for any year and unused deductions would be carried forward indefinitely;

6. The system would operate when costs are incurred; and

7. A full year convention could be applied to all costs.

The capital recovery allowance system would replace the present depreciation and ADR systems and the special amortization methods of capital recovery. Thus, this

86-033 O - 77 - 24

system would scrap the out-dated useful life concept which, due to factors such as technological changes and inflation never truly reflected useful life. The new system would be more logical and would alleviate the costly record keeping and administrative problems of the existing system.

A more important aspect of such a system is that it would increase capital formation to finance new investments, expanding capacity and employment and reducing inflationary pressures. Finally, our cost recovery system would be competitive in relation to those of other industrial nations.

c. Economic Effects

The Ad Hoc Committee is convinced that enactment of a 12 percent investment tax credit and a Capital Recovery Allowance System would greatly fortify economic recovery and place the economy on a significantly higher growth path. It would result in a substantial increase in private capital formation and, as a consequence, directly and indirectly increase employment throughout the economy. Resulting increases in investment, production and employment, moreover, would generate additional tax revenues for the Federal government. The effects are illustrated by the figures prepared by Norman B. Ture, Inc. which were contained in testimony presented by the Ad Hoc Committee to the Senate Committee on Finance on April 2, 1976. Dr. Ture projected that the adoption of a 12 percent investment tax credit and 40 percent elective deviations from ADR guideline lives (presently 20 percent) would result

by 1977 in $16.8 billion of additional capital outlays, 1,580,000 additional jobs and $51.6 billion of additional GNP. In addition, due to the additional economic activity there would be a $9.6 billion increase in Federal revenues. A 12 percent credit coupled with the proposed Capital Recovery Allowances System should provide even greater economic benefits.

2. Pollution Control Facilities

Environmental requirements have caused a major drain on capital funds which otherwise would have been invested in production facilities. For example, the Seventh Annual Report of the Council on Environmental Quality estimates expenditures for pollution control as $8.6 billion for operating and maintenance and $5.6 billion for capital expenditures in 1975 alone. In determining the capital expenditure estimates, the Council uses the cost of interest and depreciation only. By 1984, these costs are estimated to reach $20.9 billion for operating and maintenance and $19.1 billion for capital expenditures. For the decade 1975 through 1984 the overall cost is estimated at $258.8 billion of which $156.8 billion will be spent by private industry.

The following chart from the CEQ report shows projected incremental pollution control expenditures, by category, through 1984.

TABLE I-36. Estimated incremental pollution control expenditures (in billions of 1975 dollars): 1975-1984 [a]

Pollutant/source	1975: Operation and maintenance costs [b]	1975: Capital costs [b]	1975: Total annual costs [c]	1984: Operation and maintenance costs [d]	1984: Capital costs [b]	1984: Total annual costs [c]	Cumulative (1975-1984): Capital investment	Cumulative (1975-1984): Operation and maintenance costs [b]	Cumulative (1975-1984): Capital costs [b]	Cumulative (1975-1984): Total annual costs [c]
Air pollution										
Public	0.1	0.1	0.2	0.6	0.2	0.8	1.9	4.2	1.8	6.0
Private										
Mobile	3.4	1.8	4.9	1.3	4.4	5.7	20.1	20.9	31.7	52.6
Industrial	1.2	1.5	2.2	3.1	3.6	6.7	15.1	21.7	20.4	42.1
Utilities	0.6	0.6	1.2	2.7	2.7	5.4	15.6	15.4	15.4	30.8
Subtotal	5.3	3.7	9.0	7.7	10.9	18.6	61.7	62.2	74.3	136.5
Water pollution										
Public										
Federal	0.2	<0.05	0.2	0.2	0.1	0.3	2.0	2.1	0.4	2.5
State and local	1.1	0.2	1.3	4.8	2.3	7.1	24.3	26.6	11.2	35.8
Private										
Industrial	1.3	1.2	2.5	6.0	4.7	10.7	34.5	38.9	26.1	57.6
Utilities	0.4	0.3	0.7	0.9	0.5	1.4	2.3	7.2	4.3	11.5
Subtotal	2.8	1.7	4.7	11.9	7.6	19.5	63.0	68.8	42.0	110.8
Radiation										
Nuclear powerplants	<0.05	<0.05	<0.05	<0.05	<0.05	<0.05	0.2	0.1	<0.05	0.2
Solid waste										
Public	0.2	0.1	0.3	0.3	0.1	0.4	1.1	1.6	0.8	2.4
Private	0.3	0.1	0.4	0.7	0.2	0.9	0.8	4.3	0.2	4.5
Subtotal	0.5	0.2	0.7	1.0	0.3	1.3	1.9	5.9	1.0	7.9
Land reclamation										
Surface mining [d]										
Noise	NA	NA	NA	0.3	0.3	0.6	1.7	1.8	1.6	3.4
Total	8.6	5.6	14.4	20.9	19.1	40.0	190.5	139.3	113.9	258.5

[a] Incremental costs are expenditures made pursuant to federal environmental legislation beyond those that would have been made in the absence of this legislation.
[b] Interest and depreciation.
[c] Operation and maintenance plus capital costs.
[d] Not included in this year's estimate.
NA = not available.

Source: The Seventh Annual Report of the Council on Environmental Quality (1976)

The Report also contains the following charts demonstrating the impact of these pollution control costs on inflation, interest rates, the gross national product, and employment.

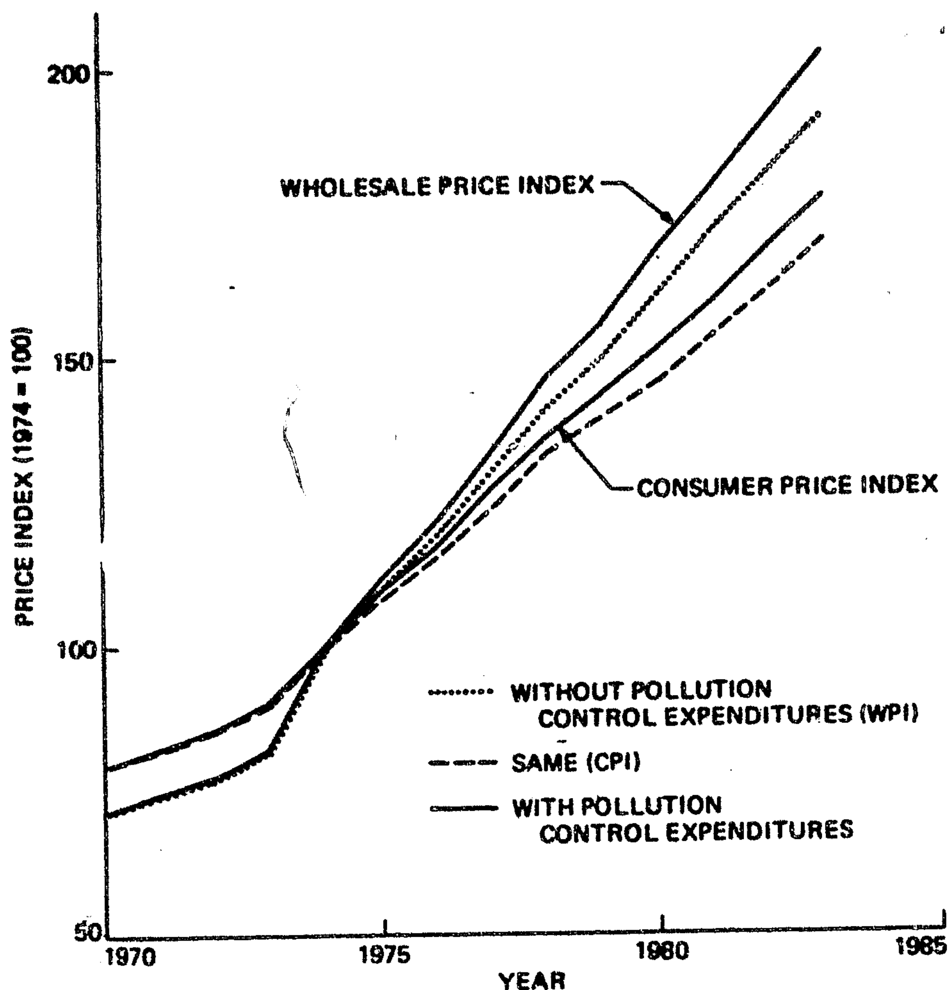

FIGURE I-14. Estimated Consumer and Wholesale Price Indices (CPI and WPI) with and without pollution abatement expenditures

Source: The Seventh Annual Report of the Council on Environmental Quality (1976)

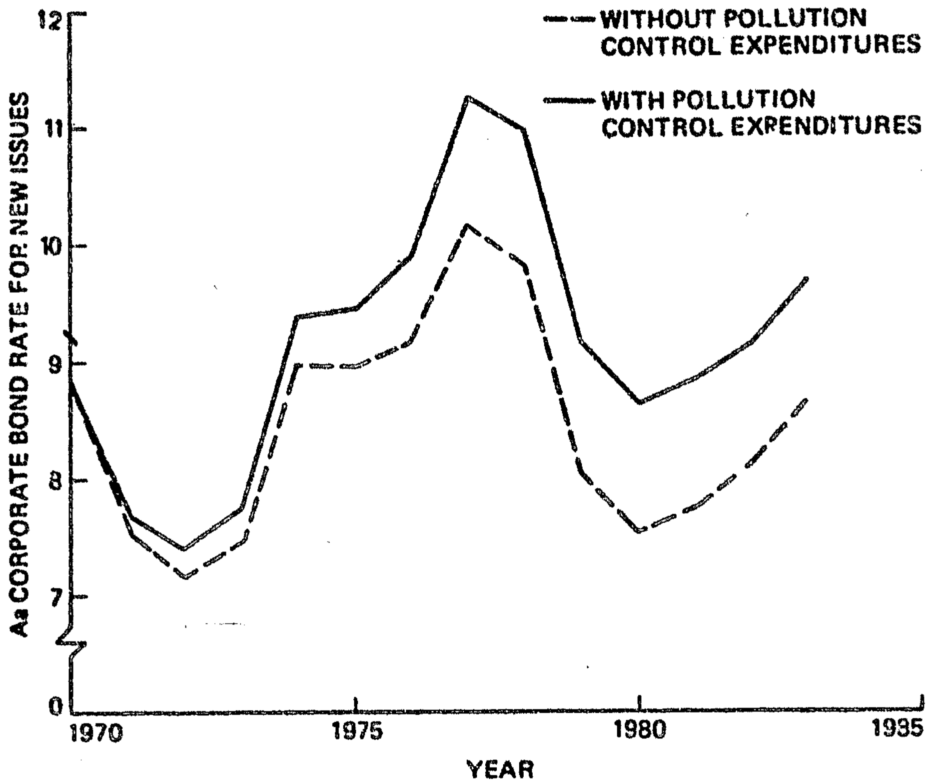

FIGURE I-16. Estimated interest rates with and without pollution control expenditures

Source: The Seventh Annual Report of the Council on Environmental Quality (1976)

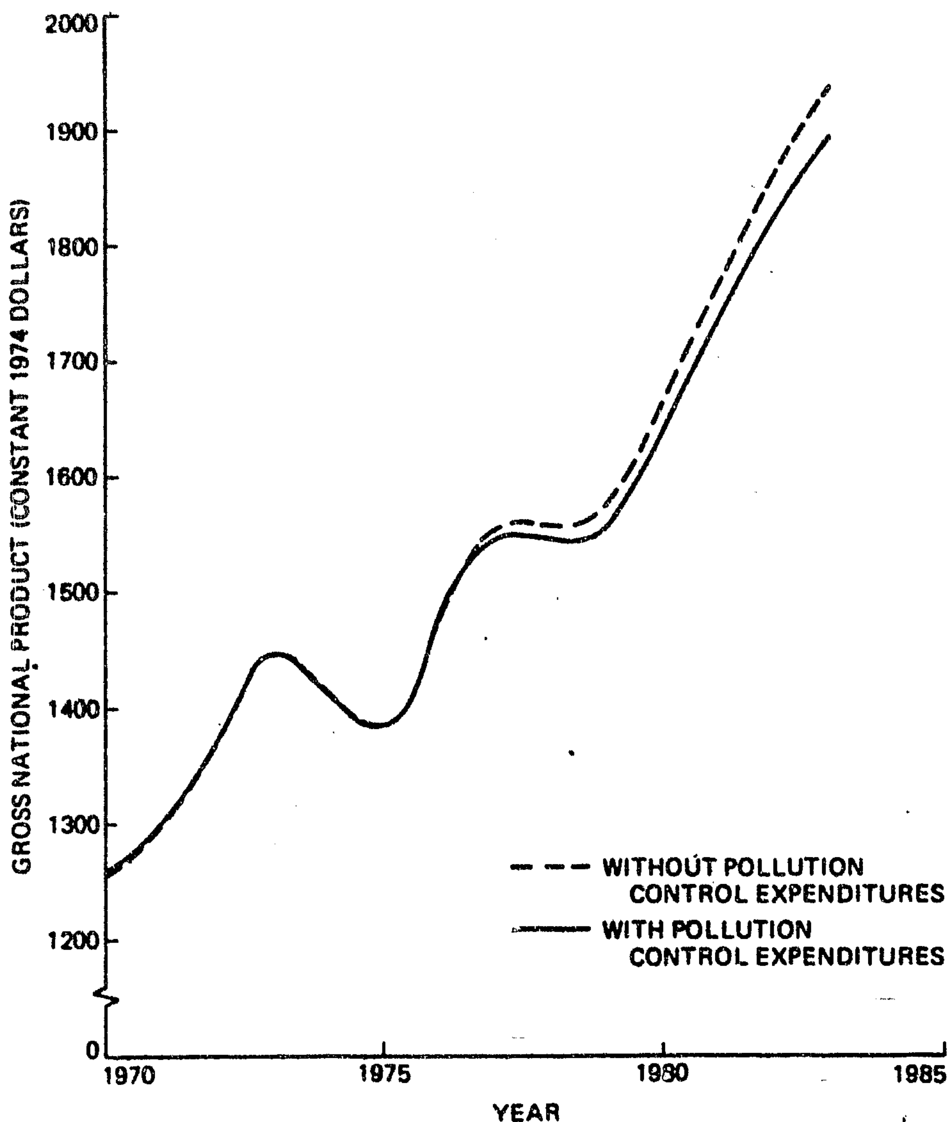

FIGURE I-15. Estimated Gross National Product with and without pollution abatement expenditures

Source: The Seventh Annual Report of the Council on Environmental Quality

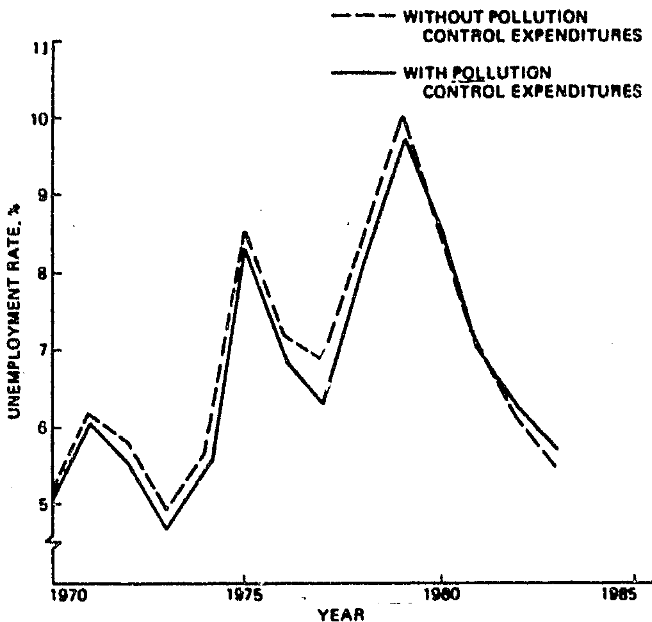

FIGURE I-17. Estimated unemployment rate with and without pollution abatement expenditures

Source: The Seventh Annual Report of the Council on Environmental Quality (1976)

The adverse effect of pollution control requirements on capital formation and employment is clear. In addition, consumers are already paying a substantial portion of this cost through inflation. While many of these requirements are essential, and others are certainly desirable, every effort should be made to reduce the resulting burden on capital and employment through tax incentives and other government programs.

a. Tax Reform Act of 1976

Last year, the Congress recognized the need for new tax treatment in the pollution control area. Section 2112 of the Tax Reform Act of 1976 reinstated section 169 of the Internal Revenue Code providing for five year amortization of pollution control facilities. In addition, prior law was changed to allow 50 percent of the investment tax credit for facilities qualifying for five year amortization. Finally, the definition of "pollution control facility" was amended to include the prevention of pollution as well as removing, altering, disposing or storing pollutants.

Unfortunately, the new provision remains overly restrictive. It is only applicable to equipment installed in old plants and it only applies to the percentage of cost of the equipment equal to the ratio of 15 years over estimated useful life.

More important than the restrictions placed on the ability to use the new provision is the fact that the incentive provided is not sufficient to encourage taxpayers to elect it. In fact, under most circumstances, the taxpayer receives more benefit from using regular accelerated depreciation under ADR and the full investment tax credit. For example, as Table I indicates, using the 16 year guideline life of the pulp and paper industry and the 18 year guideline life of the steel industry,

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the benefits without electing section 169 would be $498,000 and $490,729 respectively as opposed to $481,000 for both if the new provision is elected (assuming four and one-half percent after-tax present value factors). Obviously, these major industries along with virtually all other industries will not elect the new provision.

COMPARATIVE CASH FLOW BENEFITS

PULP & PAPER - PRIMARY STEEL INDUSTRIES

(Using 4-1/2% After-Tax Present Value Factors)

Investment - $1,000,000

Current Law	Current Value of Cash Flow	
	Pulp & Paper	Steel
*Depreciation Plus: 10% Investment Credit	$498,000	$490,729
**5-Year Amortization - 50% Investment Credit	481,000	481,000
Proposals		
(1) Depreciation Plus: 20% Investment Credit	598,000	590,729
(2) Current Deduction - No Credit	480,000	480,000
(3) Current Deduction Plus: 10% Investment Credit	580,000	580,000
(4) Current Deduction - 1/2 of 10% Credit	530,000	530,000
(5) 5-Year Amortization - 10% Credit	531,000	531,000
(6) 5-Year Amortization - 2/3 of 10% Credit	497,000	497,000

*Depreciation: Pulp & Paper - 16 year Guideline reduced to 13 years lower ADR limit, using DDB switching to SYD after 1-1/2 years.

Primary Steel - 18 year Guideline reduced to 14-1/2 years lower ADR limit, using DDB switching to SYD after 1-1/2 years.

**Enacted in Section 2112 of the Tax Reform Act of 1976.

TABLE I

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b. Ad Hoc Committee Proposal

Congress' action in the pollution control area in the Tax Reform Act of 1976 is appreciated by our Committee; however, the above analysis demonstrates the need for more meaningful provisions.

The Ad Hoc Committee supports a 20 percent investment tax credit for pollution control facilities in lieu of five year amortization under section 169. In addition, the new credit should be applicable to all pollution control facilities. The following simplified definition should be adopted for purposes of the new credit:

> The term 'air or water pollution control facility' means any facility (including buildings and equipment) the primary purpose of which is to abate, contain, control, or prevent actual or potential pollutants, wastes or heat from contaminating the atmosphere or bodies of water.

The adoption of this proposal would prevent the erosion of capital for non-productive purposes and should increase rather than decrease employment. Further, it would advance out nation's environmental goals at a significantly more rapid pace.

3. Availability of the Investment Credit

Due to the limitation of the investment credit to 50 percent of tax liability in excess of $25,000, many companies are unable to fully utilize the investment credits otherwise available to them. This problem was recognized by

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Congress in the Tax Reduction Act of 1975 when the 50 percent limitation on the amount of tax against which the credit can be applied was increased temporarily for public utilities. The Tax Reform Act of 1976 increased temporarily the percentage of tax against which the credit may be used for railroads and airlines. We see no reason why similar relief should not be provided to similarly situated companies in other industries.

The Ad Hoc Committee urges that public utilities, airlines and railroads be allowed to use investment credits against 100 percent of their tax liability on a permanent basis and that other taxpayers be allowed to use investment credits against 75 percent of their tax liability. The 75 percent limit is justified as a rough equivalent of the increase in the investment credit rate from seven to 12 percent. Without this modification the higher credit would not be meaningful to many taxpayers who could not utilize the additional credit and the intended economic stimulus would therefore be reduced.

Finally, to recognize inflation and assist small businesses, the $25,000 tax base against which the investment credit can be used in full should be raised to $150,000.

4. Applicability of the Investment Credit

There are two amendments which would improve the effectiveness of the investment credit by broadening its applicability. First, it should be applied to buildings used primarily for the manufacture, sale or distribution of

goods. Clearly, plant is as important to our economy as equipment and should be eligible for the investment credit.

Second, the seven year life requirement for full investment credit should be reduced to three years. This would make the investment credit more effective and would simplify the complex problems with varying levels of credit and recapture of credits in future years.

5. Other Proposals

There are a number of other proposals affecting capital formation which should be considered for purposes of general tax reform. Due to our growing energy crisis, credits for energy conserving devices and the development of new energy sources should be considered. Another area which should be considered is the elimination of the burdensome double tax on corporate profits.

III. Conclusion

There could be no more appropriate time for the Congress to review present tax provisions and tax policy in terms of national needs. Changes are definitely needed. We recognize the strong pressures on the Congress to emphasize consumption in tax policy. Yet, no nation in history has ever achieved or maintained significant economic strength without major emphasis on capital savings and capital investment. Overemphasis on consumption and neglect of the

capital sector is certain to be reflected in reduced production of consumer goods, higher prices for those goods produced, and reduction in quality because of the inability to maintain sufficient research and development programs.

However, if our tax laws are modified to help assure a satisfactory ratio between savings and consumption, increased production, output of goods and services and higher real income for workers will result. In addition there will be larger revenues to Federal, state and local governments to maintain needed public services.

The Ad Hoc Committee strongly urges that President Carter's business tax proposals be adopted with the modifications we have suggested. And we further urge that substantive changes in the pollution control and capital recovery features of the tax laws be given very high priority as a part of the long-range tax reform program envisioned by your Committee.

APPENDIX A

MEMBERSHIP OF AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT

February 1, 1977

A-T-O Inc.
Acme-Cleveland Corporation
Air Products and Chemicals, Inc.
Airco, Inc.
Akzona, Inc.
Albany International Corp.
Allegheny Ludlum Industries, Inc.
Allis-Chalmers Corporation
AMP Incorporated
AMAX, Inc.
Amerace Corporation
American Brands, Inc.
American Financial Corporation
American Greetings Corporation
American Hoist & Derrick Co.
American International Group, Inc.
American Petrofina Incorporated
American Telephone and Telegraph Company
Ampex Corporation
Amtel, Inc.
Arcata National Corporation
Arvin Industries, Inc.
Ashland Oil, Inc.
Anchor Hocking Corporation
Atlantic Richfield Company
Avnet, Inc.
Avon Products, Inc.

Bache Halsey Stuart Inc
Ball Corporation
Baltimore Gas and Electric Co.
Baxter Travenol Laboratories, Inc.
Beatrice Foods Co.
Beech Aircraft Corporation
Belden Corp.
Bemis Company, Inc.
The Boeing Company
Brunswick Corporation
The Budd Company
Bunker Ramo Corporation
Burlington Industries, Inc.
Burroughs Corporation
Butler Manufacturing Company

CBS Inc
CCI Corporation
CF Industries, Inc.
CPC International Inc.
The Carborundum Company
Carlisle Corporation
Carnation Company
Carpenter Technology Corporation
Carrier Corporation
Castle & Cooke, Inc.
The Ceco Corporation
Cessna Aircraft Company
Champion International Corp.
Chemetron Corporation
The Chesapeake and Ohio Railway Company
The Chesapeake Corporation of Virginia
Chicago Bridge & Iron Company
Chicago Pneumatic Tool Company
Chromalloy American Corporation
The Citizens and Southern National Bank
Clark Equipment Company
Clow Corporation
Coastal-States Gas Corp.
Coca-Cola Bottling Co. of New York
Collins & Aikman Corporation
Colt Industries Inc
Columbia Gas System Service Corporation
Columbus McKinnon Corporation
Commercial Shearing, Inc.
ConAgra, Inc.
Congoleum Corporation
Consolidated Foods Corporation
Consumers Power Company
Container Corporation of America
Continental Can Company
Continental Machines, Inc.
Continental Oil Company
Cooper Tire & Rubber Company
Copper Range Company
Crankshaft Machine Company
Cyclops Corporation
Crouse-Hinds Company
Cyprus Mines Corporation

Dana Corporation
Dart Industries, Inc.
Deere & Company
DeLaval Turbine, Inc.
Dennison Manufacturing Company
The Detroit Bank & Trust Company
Diamond Shamrock Corporation
Dibrell Brothers, Inc.
Di Giorgio Corporation

Dixie Yarns, Inc.
DoAll Company
R. R. Donnelley & Sons Company
Dover Corporation
Dresser Industries, Inc.

ESB Incorpora[illegible]
E-Systems, [illegible]
Eagle-Piche[illegible] [illegible]ries, Inc.
Earth Resources Company
Eaton Corporation
Echlin Mfg. Co.
Economics Laboratory, Inc.
Elgin National Industries, Inc.
Eltra Corporation
Emerson Electric Co.
Esmark, Inc.
Emery Industries, Inc.
Evans Products Company
Ex-Cell-O Corporation
Exxon Corporation

FMC Corporation
Fairfield Manufacturing Co., Inc.
Farmland Industries, Inc.
Federal-Mogul
Federal Paper Board Company, Inc.
Federated Department Stores, Inc.
The First National Bank of Chicago
The Flintkote Company
The Flying Tiger Corporation
Franklin Electric Co., Inc.
Fruehauf Corp.
Fulton Industries, Inc.
Fuqua Industries, Inc.

Gannett Co., Inc.
Garlock, Inc.
General Cable Corporation
General Cinema Corporation
General Dynamics Corporation
General Signal Corporation
General Telephone & Electronics Corporation
Getty Oil Company
Giddings & Lewis, Inc.
Globe-Union, Inc.
Gould, Inc.

Great Northern Nekoosa Corporation
Grief Bros. Corporation
Greyhound Leasing and Financial Corporation
Grow Chemical Corporation
Gulf Oil Corporation

H & H Industries, Incorporated
Harnischfeger Corporation
Harris Corporation
Harris Trust & Savings Bank
Harsco Corporation
Hart Schaffner & Marx
Hesston Corporation
Hewlett-Packard Company
Edward Hines Lumber Company
Houdaille Industries, Inc.
Household Finance Corporation
Hughes Tool Company

IC Industries, Inc.
Ideal Basic Industries, Inc.
Ingersoll-Rand Company
Inland Steel Company
International Business Machines Corporation
International Minerals & Chemical Corporation
International Multifoods Corporation
International Paper Company
International Telephone & Telegraph Corporation
Iowa Beef Processors, Inc.

Jewel Companies, Inc.
Josten's Inc.
Joy Manufacturing Company

Kansas Beef Industries, Inc.
Keebler Company
Kennecott Copper Corporation
Kerr-McGee Corporation
Kewanee Industries, Inc.
Kingsbury Machine Tool Corporation
Kirsch Company
Koppers Company, Inc.
Kraftco Corporation
Kuhlman Corporation

The LTV Corporation
Laclede Steel Company
Lance, Inc.
Land O'Lakes, Inc.
Lear Siegler, Inc.
Leaseway Transportation Corp.
Longview Fibre Company
The Louisiana Land and Exploration Company
Louisiana-Pacific Corporation
Lucky Stores, Inc.
Lukens Steel Company

MCA Inc.
Macmillan, Inc.
Marathon Oil Company
Marquette Cement Manufacturing Co.
Maryland Cup Corporation
Masonite Corporation
Melville Shoe Corporation
Mesa Petroleum Company
Michigan General Corporation
Michigan National Corp.
Microdot, Inc.
Midland-Ross Corporation
Mobil Oil Corporation
Modine Manufacturing Company
Mohasco Corporation
Monsanto Company
Moore McCormack Resources, Inc.
Morton-Norwich Products

NL Industries
NVF Company
Nalco Chemical Company
National Automatic Tool Company
National Distillers & Chemical Corporation
National Gypsum Company
National Presto Industries, Inc.
National Standard Company
National Starch and Chemical Corporation
Newmont Mining Corporation
Norris Industries, Inc.
Northwest Industries, Inc.

Oak Industries Inc.
Olin Corporation
Otis Elevator Company
Owens-Illinois, Inc.
Oxford Industries, Inc.

Pantasote Company
Parker Hannifin Corporation
Pechiney Ugine Kuhlmann Corporation
Perkin-Elmer Corporation
Peter Paul, Inc.
Phelps Dodge Corporation
Philip Morris Incorporated
Phillips Petroleum Company
Pitney-Bowes, Inc.
Pittsburgh-Des Moines Steel Company
Pittsburgh Forgings Company
Pittway Corporation
Portec, Inc.
Potlatch Corp.
PruLease Incorporated
Public Service Electric and Gas Company

Quaker State Oil Refining Corporation

Reed Tool Company
Reeves Brothers, Inc.
Reliance Electric Company
A. H. Robins Company, Inc.
Rockwell International Corp.
Rohm and Haas Company
Rohr Industries, Inc.
Roper Corporation
Royal Industries
Rubbermaid, Inc.
The Rucker Company
Russell Corporation

SWECO, Inc.
Safeguard Industries, Inc.
Safeway Stores, Inc.
St. Joe Minerals Corporation
St. Regis Paper Company
SANGAMO Weston, Inc.
Scott, Foresman & Company
Scott Paper Company
Seaboard Coast Line Industries, Inc.
G. D. Searle & Co.
The Signal Companies, Inc.
Sears, Roebuck and Co.
Southwest Forest Industries, Inc.
Stanadyne, Inc.
Standard Brands Incorporated

Standard Oil Company (Indiana)
Standard Oil Company (Ohio)
Standard Pressed Steel Co.
The Stanley Works
Stauffer Chemical Company
Sterling Drug Inc.
J. P. Stevens & Co., Inc.
Sunbeam Corporation
Sundstrand Corporation

TRW, Inc.
Tecumseh Products Company
Texaco, Inc.
Texas Commerce Bancshares, Inc.
Texas Eastern Transmission Corporation
Texas Industries, Inc.
Texasgulf, Inc.
Thiokol Corporation
Thomas & Betts Corporation
Time Incorporated
The Timken Company
Todd Shipyards Corporation
Transcontinental Gas Pipe Line Corporation
Tropicana Products, Inc.
Tyler Corporation
Ty-Miles, Inc.

UOP Inc.
UV Industries
Uarco, incorporated
Unarco Industries, Inc.
Union Carbide Corporation
Union First National Bank of Washington
United States Filter Corporation
Universal Leaf Tobacco Co.
Utah International Inc.

VF Corporation
VSI Corporation
The Valeron Corporation
Van Dorn Company
Vulcan Materials Company

Ward Foods, Inc.
Warner-Lambert Company
The Warner & Swasey Company

Wean United, Inc.
Weil-McLain Company, Inc.
Western Electric Co., Inc.
Western Publishing Company
Wheelabrator-Frye Inc.
Whirlpool Corporation
The Williams Companies
Winn-Dixie Stores, Inc.
Woodward Governor Company

Xerox Corporation

SUPPORTING ASSOCIATIONS

Air-Conditioning & Refrigeration Institute
American Boiler Manufacturers Association
American Chamber of Commerce Executives
American Consulting Engineers Council
American Dental Association
American Feed Manufacturers Association
American Iron & Steel Institute
American Land Development Association
American Machine Tool Distributors Association
American Meat Institute
American Pipe Fittings Association
American Textile Machinery Association
Apartment Owners & Managers
Association of America
Associated General Contractors of America
Concrete Plant Manufacturers Bureau
Dairy and Food Industries Supply Association
Edison Electric Institute
Expanded Shale Clay & Slate Institute
The Ferroalloys Association
Foodservice and Lodging Institute
Foreign Credit Interchange Bureau
The Gummed Industries Association, Inc.
Imported Hardwood Products Association
International Quorum of Motion Picture Producers
Mechanical Contractors Association of America
Meat Machinery Manufacturers Institute
Narrow Fabrics Institute, Inc.
National Air Transportation Associations
National Association of Home Manufacturers
National Association of Business and
Educational Radio, Inc.
National Association of Coin Laundry
Equipment Operators
National Association of Manufacturers
National Canners Association
National Concrete Masonry Association
National Industrial Distributors Association
National Ocean Industries Association
National Paper Box Association
National Ready Mix Concrete Association
National Tank Truck Carriers, Inc.
National Wool Growers Association
Northeastern Lumber Manufacturers Association
Packaging Machinery Manufacturers Institute
Portland Cement Association
Printing Industries of America, Inc.
Railway Progress Institute
Rubber Manufacturers Association
Screen Printing Association International
Shipbuilders Council of America
Truck Mixer Manufacturers Bureau
United Fresh Fruit & Vegetable Association
Woodworking Machinery Manufacturers of America
Woodworking Machinery Distributors Association

APPENDIX B

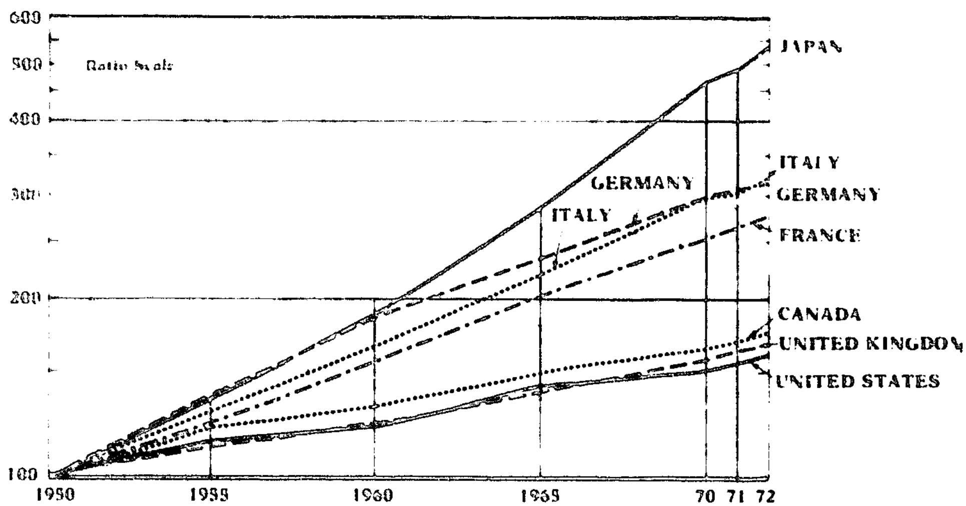
SUPPORTING ECONOMIC DATA AND ANALYSIS

I. PRODUCTIVITY AND OTHER ECONOMIC INDICATORS

In reviewing some of the specific indicators which argue forcefully for more realistic capital recovery provisions, it is appropriate that we look at those by which we can measure United States economic performance compared to other industrialized nations--Canada, France, West Germany, Japan, Italy and the United Kingdom.

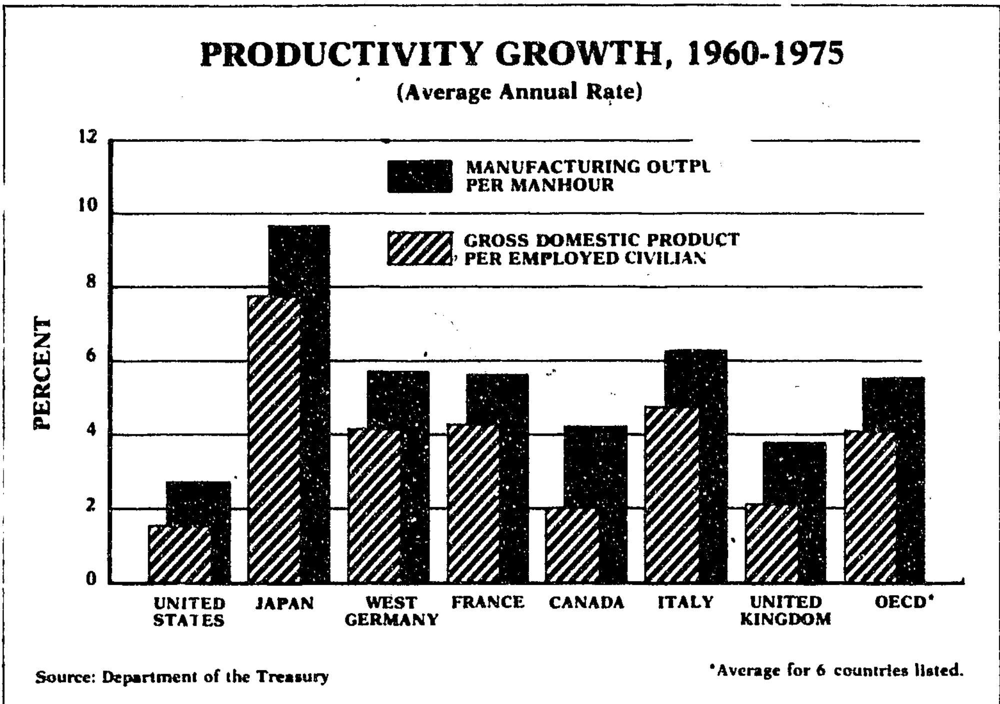
The United States has fallen dramatically behind our trading partners in many respects, the most important being manufacturing productivity. In 1974, we experienced a 2.2 percent decline in productivity--the first such decline, according to government sources, known to have occurred in the 200 year history of our country, and certainly the first since records of economic indexes have been maintained. In 1975 productivity increased, but only in the extremely small amount of 0.2 percent. The accompanying chart shows the changes in real GNP per employed civilian in the period 1950 to 1972, with the United States at the bottom of the scale in relation to other countries.

REAL GNP PER EMPLOYED CIVILIAN, 1950-72



Source: Bureau of Labor Statistics

The following graph measures the same national economies in terms of productivity growth over the period 1960-1975, with the United States again lagging behind all, and very far behind most.



This poor performance is not surprising in view of the level of United States investment during this period, and in view of the well established correlation between investment and real growth. The following Table 1 illustrates that United States investment as a percent of real national output has lagged behind that of other nations--in fact, being only one-half the ratio in Japan and West Germany.

Table 1

Investment as Percent of Real National Output
1960-1973 */

	Total Fixed **/	Nonresidential Fixed
U.S.	17.5	13.6
Japan	35.0	29.0
West Germany	35.8	20.0
France	24.5	18.2
Canada	21.8	17.4
Italy	20.5	14.4
United Kingdom	18.5	15.2
11 OECD Countries (1960-72)	24.7	19.4

*/ OECD concepts of investment and national product. 1973 estimated.

**/ Including residential.

Sources: OECD; United States Department of Treasury.

Capital formation is the major factor for increasing productivity. Without adequate capital formation, U.S. productivity will decrease and our competitive position in world markets will be eroded. In addition, a high rate of capital formation increases employment and productivity and permits higher real wages and an increased standard of living without excessive inflation.

One of the most striking parallels is the relationship between capital investment and wage rates by industry. Figure 1 shows 1971 capital investment data and compares it with production worker average earnings by related industry groupings.

Figure 1

CAPITAL INTENSITY AND WORKER EARNINGS

Industry	Capital Per Employee		Production Worker Average Earnings	
	CPE	Rank	Per Hour	Rank
Group 1				
Petroleum & Coal	$67,190	1	$ 4.57	1
Chemicals	36,450	2	3.94	3
Primary Metals	35,060	3	4.[illegible]3	2
Paper	29,440	4	3.67	4
Stone, Clay and Glass	20,550	5	3.66	5
Food	14,160	6	3.36	7
Rubber/Plastics	14,140	7	3.40	6
Tobacco	12,690	8	3.15	8/9
Lumber	10,270	9	3.15	8/9
Miscellaneous	6,490	10	2.97	10
Furniture	5,210	11	2.90	11
Leather	2,530	12	2.60	12
Apparel	2,110	13	2.49	13
Group 2				
Transportation Equipment	12,080	1	4.41	1
Non-Electric Equipment	11,640	2	3.99	3
Fabricated Metals	11,540	3	3.74	5
Ordnance	10,560	4	3.84	4
Instruments	9,410	5	3.52	6
Electrical Equipment	6,830	6	3.48	7
Printing	8,560	7	4.20	2
Group 3				
Textiles	10,840		2.57	

Source: Department of Labor

Reviewing this data indicating higher average earnings as capital per employee increases during his testimony before the Joint Economic Committee in mid-1975, the then Secretary of Labor Dunlop concluded:

> ... creation of jobs through investment capital broadens opportunities, thus allowing more upward mobility in salary and skills as people are promoted and new jobs created ... the most basic and far-reaching objective for national policy in this context should be to encourage development of new technologies and the formation of new capital. ... Also, the increase in output and income implied by new capital formation means a higher level of living and income for all Americans, whether or not they are employed by the industries involved with new capital formation and productivity gain.

In the past the U.S. has had the highest capital-to-labor ratio in the world; however, other nations have narrowed the gap significantly in the past two decades as the rate of investment per worker added to the labor force has fallen off in the U. S.

Figure 2

GROSS NONRESIDENTIAL FIXED INVESTMENT
PER PERSON ADDED TO CIVILIAN LABOR FORCE

[In 1958 Dollars]

Period	Amount
1956-60	$ 49,500
1961-65	55,300
1966-70	46,400
1971-74	1/ 41,000

1/ Estimate based on incomplete data for 1974.

Source: Statement of Paul W. McCracken before the Committee on Ways and Means, Jan. 29, 1975. Basic data from the Department of Commerce and Labor.

The evidence is overwhelming. If our economy is to perform at the level required to provide sufficient capital for jobs, for environmental protection, for energy independence, for government programs of security for the elderly and the disabled, for needed housing, for national defense, and for adequate research and development, these trends must be reversed.

II. CAPITAL FORMATION REQUIREMENTS (1976-1985)

There have been a number of meaningful projections of capital requirements for the decade 1976 through 1985 with conclusions falling in the range of $4 to $5 trillion. One method of calculating capital requirement utilizes as a goal the maintenance of the post-war average rate of increase in labor productivity and real wage rates while, t the same time, avoiding an unacceptable rate of unemployment. From previously cited comparisons with the record of other countries over the same period, such a goal is clearly only a minimum. By projecting these rates in employment and the capital-labor ratio through 1985, it is seen that business capital outlays will have to be in the range of $2.37 trillion (in constant 1974 dollars). By adding capital outlays for housing, environmental protection and predicted government sponsored programs, the figure rises to $3.54 trillion in constant 1974 dollars. (See zero inflation Table 3 *infra*.) And finally, assuming a conservative Federal deficit of $10 billion per year and a

three percent inflation factor, the total capital need rises to $4.3 trillion. (If the projection assumes a more realistic inflation factor of five percent, the total would be $4.9 trillion.)

We cite this example to demonstrate that what we are talking about in terms of needed capital formation is not "pie in the sky". It is absolutely fundamental to this nation's continued existence as a major economic force in the world.

Other examples were summarized in former Secretary of the Treasury Simon's statement to the Committee on Finance on March 7, 1976:

> Consider, for example, a recent study by the Bureau of Economic Analysis of the Department of Commerce on projected capital needs of the country in 1980--only four years away. That study concluded that, in order to achieve our goals of full employment, greater energy independence and pollution abatement, the ratio of fixed business investment to GNP for the decade of the seventies must be increased.

The following Table 2 contained in the Treasury statement summarizes a number of other studies containing similar findings.

Table 2

ACTUAL AND PROJECTED INVESTMENT AS A PERCENT OF GNP

	Average 1965-1974	NYSE 1/	Bosworth Duesenberry Carron 2/	Friedman 3/	G.E. 4/	DRI 5/	Chase Econometrics 6/
Gross private domestic investment	15.1	16.4	15.5	15.8	15.8	15.7	15.9
Non-residential fixed	10.4	12.1	11.3	11.5	11.4	11.0	11.8
Inventory	1.0	0.3	0.8	0.8	0.4	0.8	0.8
Residential	3.8	3.9	3.5	3.5	4.0	3.8	3.3

1/ The New York Stock Exchange, The Capital Needs and Savings Potential of the U.S. Economy: Projections Through 1985, September 1974. Figures shown are based on cumulative projections in current dollars, 1974-1985.

2/ Barry Bosworth, James S. Duesenberry, and Andrew S. Carron, Capital Needs in the Seventies, The Brookings Institution, 1975. Figures shown are based on estimates for 1980 in current dollars from Table 2-12, p. 39 (note the constant dollar 1980 figures in Table 2-11 project gross private domestic investment as 15.8 percent of GNP).

3/ Benjamin M. Friedman, "Financing the Next Five Years of Fixed Investment" in President's Authority to Adjust Imports of Petroleum, Public Debt Ceiling Increase; and Emergency Tax Proposals; Hearings before the Committee on Ways and Means, House of Representatives, January 1975, pp. 710-726. Figures shown are based on 1975-79 averages of current dollar projections.

4/ Reginald H. Jones, "Capital Requirements of Business, 1974-85," Testimony submitted to Subcommittee on Economic Growth, Joint Economic Committee, May 8, 1974. Figures shown are based on cumulative projections in current dollars, 1974-1985.

5/ Data Resources, Inc., Summer 1975, "Special Study: The Capital Shortage." Summary table on inside cover. 1985 data only, current dollars, standard forecast.

6/ Chase Econometrics August 1975. "The Next Ten Years: Inflation, Recession and Capital Shortage." 1984 data only, current dollars. Table, page #1 of 14. No recession run.

III. SAVINGS REQUIRED TO MEET CAPITAL NEEDS

We know that we must have the capital for productive investments. The next question is, how do we generate sufficient savings to make such investment possible?

The post-war average rate of national savings has been 15.7 percent. At this average level, assuming a three percent inflation rate, there will be a $500 billion gap in capital formation through the year 1985. Assuming a more realistic five percent inflation factor, the capital formation gap could be a staggering $575 billion. The accompanying Tables 3, 4 and 5 illustrate the required levels of private savings at varying rates of inflation. The United States has not been able to achieve these levels of savings in the past, and it is clear that extraordinary measures must be taken to make it possible in the future.

Table 3

Estimated Capital Requirements and Private Saving, 1975

(billions of dollars)

A. Zero Inflation

Year	CAPITAL REQUIREMENTS			GROSS PRIVATE SAVING	SAVING GAP
	Nonresidential Fixed Investment Plus Inventory Accumulation	Other Capital Outlays, Including Government Deficits	Total		
1975	174.5	81.6	256.1	235.8	20.3
76	181.6	84.7	266.3	244.7	21.6
77	189.2	88.4	277.6	253.9	23.7
78	197.2	92.3	289.5	263.4	26.1
79	205.3	97.0	302.3	273.3	29.0
1980	213.9	102.3	316.2	283.6	32.6
81	222.6	108.3	330.9	294.2	36.7
82	232.0	115.2	347.2	305.3	41.9
83	241.5	123.3	364.8	316.8	48.0
84	251.5	132.7	384.2	328.7	55.5
85	262.0	143.5	405.5	341.0	64.5
Total	2,371.3	1,169.3	3,540.6	3,140.7	399.9

Table 4

Estimated Capital Requirements and Private Saving, 1975

(billions of dollars)

B. Three Percent Inflation

Year	Capital Requirements	Gross Private Saving	Saving Gap
1975	263.8	242.9	20.9
76	282.5	259.6	22.9
77	303.3	277.4	25.9
78	325.8	296.5	29.3
79	350.5	316.8	33.7
1980	377.5	338.6	38.9
81	407.0	361.8	45.2
82	439.8	386.8	53.0
83	476.0	413.4	62.6
84	516.3	441.7	74.6
85	561.3	472.0	89.3
Total	4,303.8	3,807.5	496.3

Table 5

Estimated Capital Requirements and Private Saving, 1975

(billions of dollars)

C. Five Percent Inflation

Year	Capital Requirements	Gross Private Saving	Saving Gap
1975	268.9	247.6	21.3
76	293.6	269.8	23.8
77	321.3	293.9	27.4
78	351.9	320.2	31.7
79	358.8	348.8	37.0
1980	423.7	380.1	43.6
81	465.9	414.3	51.6
82	513.0	451.1	61.9
83	565.9	491.5	74.4
84	625.8	535.4	90.4
85	693.5	583.2	110.3
Total	4,909.3	4,335.9	573.4

Source: Norman B. Ture, Inc.
Prepared July 1975

IV. CORPORATE PROFITS AND FINANCIAL PROBLEMS

The flow of internal funds cannot keep pace with nominal capital outlays since depreciation allowances are based on original cost and not on replacement prices. Due to inflation, real corporate profits have been overstated. For example, the Treasury has stated that non-financial corporations reported after tax profits of $60.1 billion in 1975 as compared with $37.2 billion in 1965. These figures, when adjusted for inflation, are $35.8 billion in 1975 and $35.6 billion in 1965. Thus, there has been no real increase in corporate profits over the last decade. However, the corporate tax is applied to the profits without adjustment for inflation, resulting in a rise in the effective tax rate on true corporate profits from 43 percent in 1965 to 51 percent in 1975.

Corporations have increasingly turned to borrowing to finance capital investment. Average outside financing was 30 percent in 1964. In 1974, outside financing increased to over 60 percent of total capital needs. This result can be attributed to the effect of inflation on capital needs and profits.

Former Secretary of the Treasury Simon, in his March 7, 1976, statement, summarized the financial effects of increased corporate borrowings as follows:

> One of the factors which can inhibit the future growth of needed capital formation is the financial condition of American corporations.

> Analysis of debt-equity ratios indicates that corporate balance sheets have shown signs of deterioration over the past decade, which is a break from the pattern which persisted in earlier periods. Debt has increased dramatically, both in absolute terms and relative to assets and income. Interest costs have risen appreciably, roughly doubling over the past ten years. The combination of increased debt financing and higher interest rates has resulted in a decline in the coverage ratios reported by American corporations--that is, the ratio of earnings to interest charges. The ratio of liquid assets to debt has shrunk. As a result of these developments, there is a serious question about the potential capability of companies to be able to finance the capital investment that will be required to achieve our basic economic goals of reducing unemployment and inflation as I outlined earlier in my testimony.

Due to these changes in corporate financing, the liquidity of corporate balance sheets is severely reduced. Therefore, corporations are far less able to withstand even minor recessions, resulting in reduced confidence in lenders and investors. The final result is reduced corporate investment due to a reduction in available funds.

V. CAPITAL RECOVERY IS KEY TO BUSINESS SAVING AND INVESTMENT

While recognizing there are various avenues that must be explored for increasing total capital savings, by both business and individual savers, it is the intention of the Ad Hoc Committee in this statement to address the question of business savings only.

Commerce Department figures show that business savings, as a percent of total national savings, increased from 48.1 percent of the total in 1947 to 65.9 percent in 1974. Consequently, business saving is now the largest factor to be considered in an examination of the issue.

In turn, the major factors in business savings are the capital recovery allowances of the Internal Revenue Code. In 1974, these allowances accounted for 58 percent of total savings--the major provision being depreciation.

VI. INTERNATIONAL COMPARISON OF CAPITAL RECOVERY SYSTEMS

The low rate of capital investment and productivity increase in the United States is due, at least in part, to the fact that in recent years our capital recovery system ranks at or near the bottom among major industrial nations. This is illustrated by the comparison in Figure 3.

Figure 3 illustrates that, at the end of 1975, with the exception of Japan where special factors apply, the U.S. requires substantially longer cost recovery periods for its machinery and equipment than its major trading partners.

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Figure 3

	Representative cost recovery periods (years)	First taxable year	Aggregate cost recovery allowances (percentage of cost of assets) First 3 taxable years	First 7 taxable years
Canada	2 [1]	57.5	105.0	105.0
Sweden	5 [2]	60.0	95.7	130.0
Australia	6 [3]	50.0	70.0	110.0
France	8 [4, 5]	31.3	67.5	94.9 [6]
	8 [7]	25.0	57.8	86.7
W. Germany	9 [8]	16.7 [9]	49.6	88.8 [10]
Japan	11 [11]	34.5 [12]	56.9	81.4
	11 [13]	37.1 [12]	63.9	88.1
United States				
1975 Law [14]	10 1/2 [15]	29.5 [16]	60.7	94.5
1977 Proposal (12% credit)	10 1/2 [15]	33.5 [17]	64.7	98.5

Source: All data courtesy of Price Waterhouse & Co.

(For Footnotes, See Appendix C)

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And of course, many of these nations have recently taken significant steps to liberalize their capital recovery systems or are in the process of liberalizing that system. The comparison between the United States' capital is shifting in their favor--and we are already ranked close to the bottom of the list.

A. HISTORIC EFFECTS OF CHANGES IN DEPRECIATION PROVISIONS AND THE INVESTMENT CREDIT

There is no question that liberalized depreciation provisions and the investment credit have proven in the past to be effective in increasing employment and productivity, thus combating inflation and enhancing real growth. This fact can be illustrated in terms of capital investments, employment and Federal revenues.

1. Effects of Changes in Capital Recovery Provisions on Investment in Capital Facilities, 1962-1972

Following enactment of the original investment credit and adoption of the reduced guideline lives for depreciation in 1962, new orders for machine tools increased rapidly by 251 percent--from $144 million in the last quarter of 1961 to $514 million in the first quarter of 1966. New orders for producers capital goods increased by 82 percent--from $8.9 billion in the fourth quarter of 1961 to $16.2 billion in the third quarter of 1966.

The suspension of the investment credit in the third quarter of 1966 was followed in the next two quarters by a sharp drop in new orders for machine tools and producers capital goods--$130 million and $2.8 billion, respectively.

Restoration of the credit in the second quarter of 1967 led to a rapid build up in orders--producers capital goods increased 36 percent from $13.8 billion in the first quarter of 1967 to $18.8 billion in the second quarter of 1969. Machine tool orders in the same period increased 70 percent from $328 million to $558 million.

The repeal of the credit in 1969 resulted in a drop of $2.7 billion in new orders for producers capital goods through the second quarter of 1970. Machine tool orders were off $417 million, almost 75 percent, from the second quarter of 1969 through the end of 1970.

Following enactment of the new investment credit and the Asset Depreciation Range (ADR) System in 1971, orders for producers capital goods increased by $4.5 billion from the second quarter of 1971 through the third quarter of 1972. Machine tool orders rose by $103 million--almost 60 percent--in the same period, from $182 million to $285 million. The pattern is unmistakable. Capital facility investment is powerfully affected by changes in depreciation and particularly by changes in the investment tax credit.

2. Employment Effects, 1962-1972

Employment in capital goods and machine tool manufacturing industries in 1962-1972 also parallels changes in capital recovery tax provisions. Following enactment of the investment credit and adoption of the shorter guideline lines for depreciation in 1962, the number of employees in producers durable goods industries increased rapidly by 23 percent from 6.1 million in 1962 to 7.5 million in 1966. Suspension of the credit in the third quarter of 1966 slowed employment increases to only 2 2/3 percent in 1967. Following restoration of the credit in the second quarter of 1967, employment increased to about 8 million in 1969.

With the repeal of the credit in 1969, employment dropped by about 900,000 jobs--roughly 11 1/4 percent--in 1971. After enactment of the new credit and the ADR in 1971, employment increased from 7.1 million to 7.8 million--about 10 percent--in 1973.

The number of employees in machine tool manufacturing alone rose by 41 percent of 34,000 from 1962 through 1967. Output and employment in this industry was adversely affected by the cutback in the space program in 1968; between 1967 and 1969, employment dropped by 5 percent or 5,800 jobs. Repeal of the investment credit in 1969 resulted in a much steeper drop in jobs, from 110,600 in 1969 to 78,400 in 1971, a decline of 29 percent. After enactment of the new

credit and the ADR in 1971, machine tool employment increased by 3,700 jobs or by 4.7 percent in 1972.

The above discussion covers the capital goods sector only. Through the multiplier effect, the beneficial impact of the credit on employment in the capital goods sector was also reflected in higher employment throughout the economy by a factor of two to three times.

3. Revenue Effects of Changes in Capital Recovery Allowances, 1962-1972

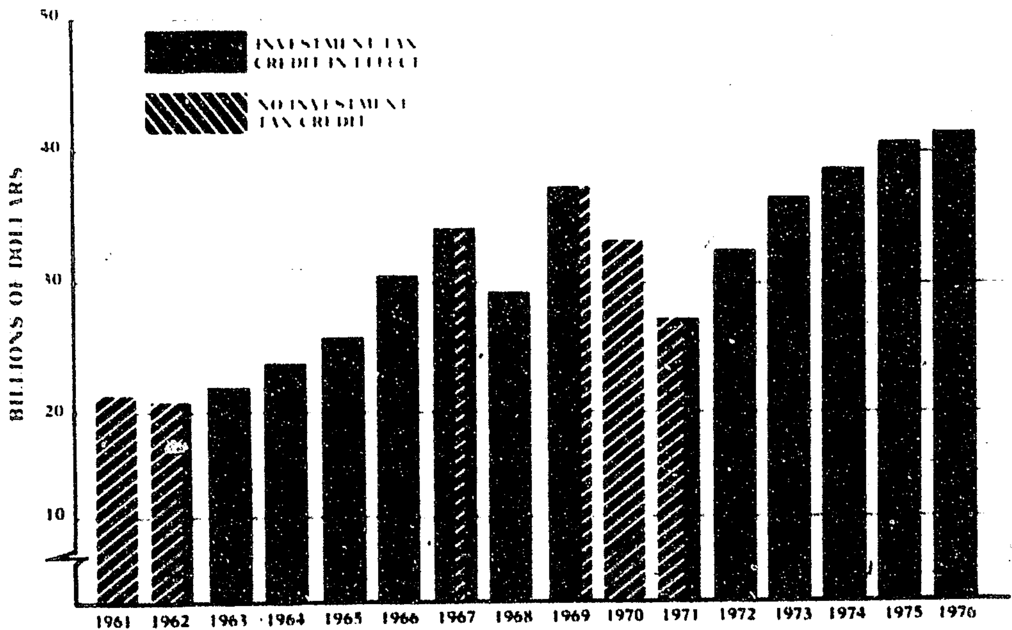
The investment tax credit and the shortening of tax lives have added an estimated $2.6 billion to Federal tax collections from all sources since 1962. In every year that the investment tax credit was in effect, Federal revenues were above the level they would otherwise have been, amounting to approximately $1 billion in 1972 alone.

Conversely, tax receipts fell each time the credit was removed. Suspension of the credit in 1966-67 and its repeal from 1969 until 1971 resulted in a $760 million decrease in Federal tax revenues below what would otherwise have been collected had the credit remained in effect.

These estimates follow from a calculation of the amount by which tax changes altered the cost of capital outlays resulting from enactment of the credit and issuance of the guideline lives in 1962, removal of the basis adjustment in 1964, suspension of the tax credit for two quarters in

1966 and 1967, its restoration in 1967, repeal in 1969 and reinstatement and approval of the Asset Depreciation Range in 1971. Each favorable change raised output, wages and profits, thereby expanding the Federal tax base. Conversely, each tax law change which increased the cost of capital outlays resulted in a lower level of output, wages and profits than would otherwise have occurred.

CORPORATION TAX REVENUES FISCAL YEARS 1961 - 1976
BUDGET RECEIPTS



SOURCE: NORMAN B. TURE, INC.

PREPARED BY THE AD HOC COMMITTEE FOR AN EFFECTIVE INVESTMENT TAX CREDIT

Table 6

Estimated Change in Federal Revenues Resulting
From Tax Credit and Shorter Tax Lives, 1962-72
(Calendar Years)

Year	Revenue Change (Millions of Dollars)	
1962	160	
1963	330	
1964	50	
1965	110	
1966		-50
1967	140	
1968	390	
1969		-230
1970		-480
1971	440	
1972	1,000	----
Total	2,620	-760
Net Change*	1,870	

*Note: Net change differs from sum of individual changes shown due to rounding.

Source: Norman B. Ture, Inc.

The patterns of fluctuations in these key areas demonstrate:

(1) that the investment credit accomplishes what its original proponents intended; and

(2) that it can be fully effective in stimulating needed, long-term growth only if its basic provisions (particularly the rate of the credit) are permanent features of the Tax Code.

APPENDIX C

FOOTNOTES

1. Canada has recently enacted an investment tax credit of five percent of the cost of new buildings, machinery and equipment acquired between June 24, 1975 and June 30, 1977, inclusive, to be used in manufacturing and processing and other specified activities. Taxpayers will be permitted to apply the credit to their federal income taxes up to $15,000 plus one-half of amount by which their federal tax otherwise would exceed $15,000. Any unused credit may be carried forward for up to five years. The cost of the property acquired will be reduced by any investment tax credit received. The effect of this credit is relatively small in view of the two year write-off allowed in Canada and the reduction in basis for depreciation purposes. In the first taxable year the 50 percent aggregate cost recovery would be 57.5 percent with full recovery still allowed in the second year. Aggregate recovery would be 105.

2. Modified declining balance method--30 percent rate plus additional 30 percent allowance in first taxable year (such additional allowance does not reduce recoverable cost); accumulated cost recovery may not be less than 20 percent f cost for each year asset is in service. A special investment allowance of 10 percent will apply to machinery and equipment acquired for use in business, agriculture or forestry, provided a purchase agreement

has been signed after October 15, 1975, and delivery made before the end of 1976. Losses resulting from the allowance may not be carried forward. As an alternative to the investment allowance, mainly for small businesses or those not making profits, an investment grant will be available under the same conditions. The investment grant is not taxable income and will be four percent of the purchase cost of up to S. Kr. 500,000 for each financial year.

3. Depreciation in Australia is based on an estimate of effective life and taxpayers may elect to use either the prime cost (straight line) method or the declining balance method. This computation is for assets acquired after January 1, 1976, and assumes that currently proposed legislation is enacted.

4. 250 percent declining balance method.

5. Although not considered, effect may be given to multiple shift operations by reducing service life of assets.

6. Method changed to straight line in sixth taxable year.

7. Machinery and equipment purchased between June 30, 1974, and July 1, 1975, limited to 200 percent declining balance method applicable to an asset with an eight year life.

8. The average cost recovery period for machinery and equipment in West Germany is eight to 10 years to which additional allowances are permitted for multiple shift operations; 25 percent of allowance for two shift operations and 50 percent of allowance for three shift operations. Allowances may be further increased when plant is located in certain areas, such as Berlin and areas bordering on Iron Curtain countries. The above table sets forth cost recovery allowances based on an average cost recovery period of nine years. The double declining balance method is used. A 25 percent 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 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. $320 can be expensed.

9. 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.

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10. Method changed to straight line in fifth taxable year. See 8 above.

11. Modified double declining balance method; 18.9 percent per Japanese government rate table, salvage built into rate.

12. Includes special first year allowance of 25 percent; allowance reduces recoverable base cost in second and succeeding years.

13. Depreciation in addition to ordinary depreciation in 11 above is allowed to give effect to multiple shift operations. Depreciation multiplied by factor of 1.28 gives effect to eight hours of daily average excess usage of an item of machinery and equipment.

14. With both investment credit and ADR.

15. 13 year recovery period reduced by 20 percent and rounded to nearest one-half year. Double declining balance method.

16. Includes 20 percent allowance equivalent to 10 percent investment credit (temporary credit enacted in the Tax Reduction Act of 1975) at effective 50 percent income tax rate. Credit does not reduce recoverable base cost.

17. Includes 24 percent allowance equivalent to proposed 12 percent investment credit at effective 50 percent income tax rate. Credit does not reduce recoverable base cost.

Senator CURTIS. We now call Mr. Roland M. Bixler, chairman, National Association of Manufacturers Taxation Committee.

STATEMENT OF ROLAND M. BIXLER, CHAIRMAN, NATIONAL ASSOCIATION OF MANUFACTURERS TAXATION COMMITTEE, ACCOMPANIED BY EDWARD A. SPRAGUE, VICE PRESIDENT AND MANAGER, FISCAL AND ECONOMIC POLICY DEPARTMENT

Mr. BIXLER. Mr. Chairman and members of the committee, my name is Roland M. Bixler, and I am president of J-B-T Instruments, Inc., of New Haven, Conn., a small electronics manufacturing firm employing under 100 people. I represent the National Association of Manufacturers as a director and as chairman of its Committee on Taxation. Accompanying me is Edward A. Sprague, vice president and manager of NAM's fiscal and economic policy department.

The NAM represents 13,000 members which employ a majority of our industrial labor force and which produce over 75 percent of the Nation's manufactured goods. It is interesting to note that 80 percent of NAM's members are small firms employing fewer than 500 persons.

My oral remarks will summarize our written statement submitted for the record outlining NAM's recommendations for the tax aspects of the stimulus package and commenting on both the administration proposals and H.R. 3477.

Given the uncertain, and even conflicting economic signals, of the last 2 months or so, we cannot emphasize too strongly the need for stable fiscal and tax policy. We have seen economic indicators and the unemployment level move up and down. The unusually severe winter weather resulted in energy shortages, and production shutdowns, layoffs, and much concern over another severe pause in the recovery.

It seems likely now that the economy is resuming its growth, and the reports of 2 million layoffs were overblown.

These observations are not intended to deny the real hardships of unemployment. Rather, we simply do not believe that government is smart enough or effective enough to catch each turn—or wiggle—in business activity with the right policy decision. Constant attempts to fine tune the economy are self-defeating and should be avoided.

Therefore, if a significant tax cut is to be enacted at this time, we believe that it should be primarily permanent relief to provide a relatively stable tax climate in which business and individuals can make rational plans for investment and consumption expenditures. Uncertainties over changes in corporate rates for small business and the investment credit—which were affected by three laws in the last 2 years—has lessened their impact and contributed to a somewhat wary attitude by business. This package should not compound the problem now by creating new, but temporary, tax changes.

In the last 2 years, there have been three changes in corporate tax law already. We can hardly expect the taxpayer to be responsive when the rules keep changing all the time. We have had that same thing through the years with the investment tax credit where it has become a yoyo, moving up and down over the years. We also think that this current package should not become a substitute for the structural tax reform which we understand that the Congress will be considering this fall.

Therefore we think that presently the package should be consistent with the existing tax structure rather than creating new mechanisms that could prove difficult to dismantle at a later time.

A little more specifically, in the business sector, we would favor a rate reduction. A reduced rate of tax on corporate income would maximize the market system's allocation of funds to productive uses and, therefore, would be the most productive of real wage gains. We propose an immediate across-the-board reduction in the normal tax to 20 percent—leaving a 46 percent top rate—and an extension of the corporate surtax exemption level—temporarily set at $50,000—to $60,000 in 1977 and to $100,000 in four additional steps by 1981. This would reduce tax obstacles to corporate operations in general, whether capital or labor-intensive, but give relatively more boost to small and moderate-size businesses.

The direct revenue impact of this rate reduction for 1977 on a calendar-year basis, would be about $2.9 billion and slightly more in later years.

But, as was pointed out by one of the members of the committee this morning, the effect of such tax changes can be to create more revenues in subsequent years.

We were especially interested in the testimony presented on this matter to the House Ways and Means Committee by Michael Evans of Chase Econometric Associates. The Chase presentation indicated that because of changed circumstances in the economy—in particular, the higher rates of return on total investment made necessary by more deeply imbedded inflation—a reduction in corporate income tax rates could have a more beneficial impact on business activity even over the relatively short term of 1 to 2 calendar years. In fact, according to the Chase analysis, per dollar of direct revenue cost, permanent corporate rate reduction would bring the best result in terms of maximizing real growth and minimizing inflationary potential as compared to other proposals being made.

We also favor an increase in the investment credit. A practical alternative to corporate rate reduction would be a 2 percentage point increase in the investment tax credit such as the elective 12-percent credit proposed by the administration. In our view, the credit has proved to be a valuable means of encouraging investment and employment in the private sector. It can have more stimulus per dollar of direct revenue cost for investment in productive facilities than is likely with other approaches.

There are a great many types of capital expenditures that would make us more productive in any business. A major shortcoming with the credit in recent years has been the continuous uncertainties as to its future because Congress has not been willing to enact a permanent credit above 7 percent. In our view, an increased credit should be made permanent and not subject to an uncertain expiration date.

Any increase in the investment credit should be accompanied by an across-the-board increase in the 50 percent income tax limitation since many firms would not be in a position to utilize an expanded investment credit because of the existing 50 percent of the tax liability limit.

In our view, the incremental job credit approach in the House bill does not present a sound approach. In its barest form, any type of

credit based on employment costs is a government wage subsidy because the compensation costs of both new and existing employees are fully deductible when paid. Unlike capital expenditures which are deductible over a number of years and subject to the ravages of inflation, employment costs are recovered completely during the taxable year.

It seems to us that you cannot say that the investment credit, like this job credit, is a subsidy. The other thing that I am personally very bothered about is that there is that $40,000 cap on this.

As Dr. Woodworth, who is now the Assistant Secretary of Treasury, pointed out to the Ways and Means Committee, 66 percent of the total work force would not be eligible for coverage by the jobs credit.

It seems to me that if the decision is going to be to go that way, there ought to be a better way to find it. Under the current tax law we have something called WIN—the work incentive program. I was shocked to find that only $10 million of tax reductions were realized in 1976 on that whole program that was supposed to encourage employment.

When I asked our accountant and asked our personnel manager why we were not using this provision, they said there are so many complications that it is not a practical kind of thing. Our outside accountant said that not one of his clients have found it effective.

Finally, of course, as far as individuals are concerned, in being consistent with reasonably stable tax policy, we are not prepared to say whether the economic package of the administration is the right dollar amount of stimulus or not, but we are concerned with the rebate concept. This is not because the proceeds may be saved, because I do not think there is anything wrong with saving them, but we think it is another fine-tuning attempt at government management of economic decisions.

We believe that individuals as well as business firms will make sounder and more rational decisions as to their investment and current consumption patterns if they have reasonable certainty of the prospect of permanent tax relief.

I think a person may buy a car, build an addition to his home or buy a color TV set, and what have you, if he has certainty of long-term reductions rather than the $50-per-person arrangement, as proposed.

If Congress is of a mind to reduce individual income taxes on the order of $15 billion, we believe the cuts should be both permanent and more balanced than in the House bill. An across-the-board cut in the individual income tax rate structure could serve this purpose.

I might also say one other thing about the incremental job credit. It would be better if it were on a FUTA base than a FICA base.

The reason for not putting it on the FICA base is that this would be the first erosion of the employer paying half the cost of social security. It would then be the excuse for getting into general revenues to pay social security, which I think is a fundamental issue that should be addressed at a different time.

In conclusion, our recommendations are these: Tax reductions in this package should be permanent, readily understood by taxpayers, and consistent with the existing tax structure.

Across-the-board rate reductions for individuals and corporations would provide such a package. We support those recommendations.

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Senator CURTIS. Mr. Bixler, yesterday we had an interesting colloquy between Chairman Long and Mr. Charls Walker about the feedback effect of various tax proposals that would tend to spur the economy.

Do you have any comment on that?

Mr. BIXLER. Along these lines, I referred to the chase study showing that permanent corporate rate reduction would produce the most results in GNP, the most lasting results over the full 2-year period. The investment credit would be a satisfactory means, and Mr. Sprague, am I right, that the least permanent effect would be accomplished by the incremental jobs proposal?

Mr. SPRAGUE. We did not attempt to do economic feedback analysis of the job credit itself. We thought about it. We asked our consultants whether they could get a handle on it. They have not been able to in the time available. We do not have any good idea what the effect of the incremental jobs credit would be.

Senator CURTIS. Mr. Bixler, we have four or five questions here, but I believe it will help emphasize in the record points you want to make if you would be willing to submit the answers to those in the record.

Mr. BIXLER. I would be happy to.

[The questions and answers follow:]

QUESTIONS FROM SENATOR CURTIS WITH NAM RESPONSE

Q1. Your statement emphasizes permanent tax reductions over one-shot rebates and temporary measures. Wouldn't your recommendations for permanent individual and corporate rate reductions merely add to long-term economic problems by increasing the federal deficit?

A. We strongly believe that a stable tax policy is necessary for sensible financial planning by both business and individuals. Permanent rate reductions would be a significant move towards stability and would encourage the type of economic growth which was most recently experienced following the 1964 tax reductions. In fact, we believe that the long-term effect of basic tax reduction is to increase economic activity, including investment and employment, to the point that the Treasury actually realizes increased revenues to at least partially, if not fully, offset the initial losses due to the reductions. Restraints on federal spending are needed to reduce the chronic deficits, but significant permanent tax reductions should not be bypassed because of the initial impact revenue estimates.

Q2. When you recommend that tax changes be "consistent" with the existing tax structure because of the expected resumption of tax reform considerations, what are you urging us to do? Why is this "consistency" important?

A. It is our firm hope that Congress will seriously consider and enact much-needed structural tax reforms in such areas as rates, double taxation of corporate earnings, and capital recovery techniques. Our concern with "consistency" is that new mechanisms created now will only add to the controversy which will be started later this year or next year when you begin to look at fundamental simplification of the tax law. When a new mechanism, such as a social security credit or an incremental jobs credit, becomes the law, it is very difficult to allow it to lapse. Taxpayers begin to expect that this is the way things should naturally be. If the purpose of this tax package is to provide economic stimulus, we believe that its components should be simple and readily implemented. Creating new provisions which will take some getting accustomed to would not seem to serve either the stimulus or tax simplification purposes.

Q3. Corporate rate reduction, as you have proposed it, would affect a great many businesses, but only those in the corporate form. Wouldn't either a higher investment credit or a jobs credit or depreciation reform be a broader based tax reduction mechanism affecting corporations, partnerships, and sole proprietorships alike?

A. The list of alternatives mentioned would affect many business taxpayers which do not operate in the corporate form—that is true. We believe that these firms and individuals should receive a tax reduction as well, and the NAM has

long supported significant reform of depreciation and capital recovery laws, which certainly would affect all business taxpayers. In this instance, we are urging both corporate and individual tax rate reductions on an across-the-board basis. Because the Internal Revenue Code treats partners as if they were sole proprietors, individual rate reductions would provide relief for the corporate form. We would like to see a number of reforms, such as lessening the double taxation of corporate earnings and providing more rapid recovery of invested capital. But for purposes of this package, we urge that simple rate reduction for both individuals and corporations be enacted. We think that our program would thus benefit business no matter what form the particular entity takes.

Q4. Your statement says that the proposed jobs credit would be a government wage subsidy but implies that the investment credit should not be viewed as a subsidy. Can you explain this distinction?

A. The distinction is a rather fundamental difference in the effect the two credits would have. All employment costs are fully deductible in the year they are paid. This includes wages, plus the employer's portion of social security taxes, contributions to retirement plans, unemployment taxes, fringe benefits, and other similar items. A tax credit in addition to this deductibility would be essentially the same as the Federal Government sending a check to every employer who hires new persons and thereby reduces the compensation costs of such persons. On the other hand, the investment credit is applied to the amounts expended for capital assets. Unlike employment costs, capital expenditures cannot be fully deducted in the year in which they incur. Rather, they are spread over a numbers of years, and the capital invested is subject to the erosion of its real value by inflation during that period. So, if a manufacturing asset must be depreciated over 10 years, the real value of the money which is recovered through tax reductions begins to fall if there is any inflation at all. The effect of the investment credit is to minimize this impact, not to provide a subsidy for capital expenses.

Question. Woud you provide this committee with your analysis of the need for feedback information on all revenue estimates.

Comments on the "Feedback" Effects of Tax Changes

There is an increasing awareness of the fact that changes in federal income tax policy do not occur in a vacuum. Such changes affect taxpayers' decision as to the amount of money they will have and consume, as well as how, when, and where to exercise these decisions. As both business and individual taxpayers change their financial behavior, the economy is affected also. Levels of capital outlays, consumer spending, and personal savings are changed, as are employment, output, real wages, and many other economic factors. These are often referred to as "feedback" effects.

These effects are real and, we believe, they can and should be taken into account during the tax legislative process. The initial impact revenue estimate use currently does not assume any "feedback" effects. Therefore, it does not reflect revenue gains or losses which are generated by them. The result is that tax legislation is enacted (or defeated) based heavily on revenue expectations which are not fully justified.

The process of estimating feedback effects is not anymore exact than that used for initial impact estimates. Both are based on assumptions and require projections as to what the economy will be like during a given period. However, it is our view that taking feedback into account is much more realistic and provides more comprehensive information than initial impact estimates alone. The NAM has been studying the development of a capability to measure these effects and to provide such analysis during testimony. It is our hope that, if a permanent project is adopted, it will be in place by the time the Senate next considers basic tax reform measures.

Senator CURTIS. Thank you very much.

[The prepared statement of Mr. Bixler follows:]

Statement of Roland M. Bixler on Behalf of the National Association of Manufacturers

My name is Roland M. Bixler, and I am president of J-B-T Instruments, Inc., of New Haven, Conn. I represent the National Association of Manufacturers as a director and as chairman of its committee on taxation. Accompanying me is Edward A. Sprague, vice president and manager of NAM's fiscal and economic policy department.

The NAM represents 13,000 members which employ a majority of our Industrial labor force and which produce over 75 percent of the nation's manufactured goods.

Our statement outlines NAM's recommendations for the tax aspects of the stimulus package and comments on both the Administration proposals and H.R. 3477 as passed by the House.

Given the uncertain and even conflicting economic signals of the last two months or so, we cannot emphasize too strongly the need for stable fiscal and tax policy. Moving into the first quarter of the new year, there were signs that the recent pause during the recovery had ended. Economic indicators were moving forward, and the unemployment levels dropped in January. Then came the unusually severe winter weather throughout much of the country, with accompanying energy shortages and the resulting production shutdowns and layoffs. Economic indicators turned down. But now the weather has moderated, and estimates of 2 million layoffs due to the cold and fuel shortages probably were overblown. It seems likely now that the economy will resume its growth.

These observations are not intended to deny the real hardships of unemployment. Rather, we simply do not believe that government is smart enough or effective enough to catch each turn—or wiggle—in business activity with the right policy decision. If it tries to intervene constantly, it only makes things worse. Stop-go policy decisions and constant attempts to fine tune the economy are self-defeating and should be avoided.

Therefore, if a significant tax cut is to be enacted at this time, we believe that it should be primarily *permanent relief* of the tax burden on the private sector. Both business and individuals need assurance of a relatively stable tax climate in order to make rational plans for investment and consumption expenditures, which in turn have a significant impact on employment, real wage rates, and general economic well-being. The uncertain duration of favorable changes in important tax provisions (such as corporate rates for small business and the investment credit), which were affected by three laws in the last two years, has lessened their impact and contributed to a wary attitude by business planners. New tax changes now should not compound this problem.

We believe that permanent tax reductions enacted now can be stimulative now, and the direct revenue impact could be relatively modest. It is essential that this current package not become a substitute for much-needed structural tax reform, which we assume the 95th Congress will consider this fall. Particularly with serious consideration of basic tax reform coming up, we believe that elements of the current package should be consistent with the existing tax structure rather than creating new structures or "incentive" programs that could prove difficult to dismantle. Furthermore, any tax reductions at this time should be of simple design in order to be implemented in short order and be readily understood by the taxpayers.

Applying the general range of direct revenue limits used by Administration and the House bill, we make the following specific recommendations:

I. BUSINESS SECTOR

A. Rate Reduction

The corporate rate structure itself continues to be the fundamental tax obstacle to productive investment and the creation of new employment opportunities in the private sector. The most recent across-the-board reduction in rates was in 1964. The 4 percentage point reduction then probably would have been even larger if the investment credit had not been adopted only two years earlier. Since that time, only the temporary 1975 increase in the surtax exemption to $50,000 for small business has been enacted. But even this rather limited rate reduction will expire at the end of this year unless further action is taken.

A reduced rate of tax on corporate income would maximize the market system's allocation of funds to productive uses and, therefore, would be the most productive of real wage gains. We propose an immediate across-the-board reduction in the normal tax to 20 percent (leaving a 46 percent top rate) and an extension of the corporate surtax exemption level (temporarily set at $50,000) to $60,000 in 1977 and to $100,000 in four additional steps by 1981. This would reduce tax obstacles to corporate operations in general, whether capital or labor-intensive, but give relatively more boost to small and moderate-size businesses.

The direct revenue impact of this rate reduction for 1977 (on a calendar basis) would be about $2.9 billion and slightly more in later years. This is in the approximate dollar range of tax relief for the business sector proposed by

the Administration and the House bill. It would be simple and easily understood and could be put in place immediately without any confusion as to new regulations, new qualifications, or campaigns to explain it. Such a rate reduction certainly would be on a very limited answer to the overall problem of correcting the tax system's bias against productive investment. But it would help and would not interfere with more basic reforms which could be instituted at a later time.

In this connection, we were interested in the testimony presented at the House Ways and Means Committee hearings by Michael Evans of Chase Econometric Associates. The Chase presentation indicated that because of changed circumstances in the economy—in particular, the higher rates of return on total investment made necessary by more deeply imbedded inflation—a reduction in corporate income tax rates could have a more beneficial impact on business activity even over the relatively short term of one to two calendar years. In fact, according to the Chase analysis, per dollar of direct revenue cost, permanent corporate rate reduction would bring the best result in terms of maximizing real growth and minimizing inflationary potential as compared to other proposals being made (tax rebates to individuals, personal income tax cuts, increased government spending, or an increased investment tax credit).

B. Increase in Investment Credit

A practical alternative to corporate rate reduction would be a 2 percentage point increase in the investment tax credit, such as the elective 12 percent credit proposed by the Administration. In our view, the credit has proved to be a valuable means of encouraging investment and employment in the private sector. It can have more stimulus per dollar of direct revenue cost for investment in productive facilities than is likely with other approaches.

A major shortcoming with the credit in recent years has been the continuous uncertainties as to its future because Congress has not been willing to enact a permanent credit above 7 percent. In our view, an increased credit should be made permannet and not subject to an uncertain expiration date. Much of the investment qualifying for the credit requires long lead times for rational economic planning, and decisions as to even marginal additions to such investment should be removed as far as possible from the political process.

Any increase in the investment credit should be accompanied by an across-the-board increase in the 50 percent income tax limitation. As many firms would not be in a position to utilize an expanded investment credit because of the existing 50 percent of tax liability limit, we suggest an increase in the limitation proportional to the increase in the investment credit above 7 percent. The direct revenue cost of increasing the investment credit by 2 percentage points is about $1.8 billion, depending on the income tax limitation and the option of using other approaches—again, within the ballpark of what the Administration has projected for the business sector.

C. Credit for Social Security Taxes

The Administration's proposed refundable credit equalling 4 percent of an employer's share of social security taxes does indicate recognition of the increasing burden of such taxes on marginal employment. Being refundable, the social security credit could be utilized by virtually all businesses (both corporations and partnerships) with any payroll costs. However, because of its limited size, the potential impact of employment is questionable. The program could be expanded, possibly with a higher credit at a later date, as has the investment credit, but this would further fractionalize the incentive features of the tax system and would move away from, rather than toward, simplification of tax law.

A credit for social security taxes also would introduce a questionable precedent in the financing of the overall OASDI program. It represents, in effect, a backdoor approach to general revenue financing. To adopt such a step in the context of a quick tax relief measure may not be appropriate.

D. Incremental Jobs Credit

In our view, the incremental job credit approach in the House bill does not present a sound approach. In its barest form, any form of credit based on employment costs is a government wage subsidy because the compensation costs of both new and existing employees are fully deductible when paid. Unlike capital expenditures, which are deductible over a number of years and subject to the ravages of inflation, employment costs are recovered completely during the taxable year.

The NAM has long argued with proponents of the "tax expenditure" concept who insist on categorizing various tax provisions affecting capital recovery and capital formation as tax equivalents to government payments. But in this situation where 100 percent of the employment cost is deductible currently from the employer's income, an employment credit would be purely a subsidy. There have been suggestions that employment credits are needed to reduce the impact of the minimum wage, of increasing social security costs, and of other factors tending to maintain structural unemployment. If these costs—which are fully tax deductible now—are problem areas, then they should be addressed directly. Enactment of a new tax credit—which probably would be under attack itself as a "tax expenditure" within a very short time—does not appear to be a desirable approach.

While the economics of an incremental credit would seem fairly straightforward—the higher the credit, the more incentive to employ—the actual outcome is questionable. Obviously, it would be of help to small businesses in expanding markets. And just as obviously, it would do nothing for our industrial base, even without the $40,000 cap. To produce in an efficient manner, you must invest before you employ, and this would apply regardless of the size of the firm. From the manufacturing sector viewpoint, the incremental job credit concept puts the cart before the horse.

What would happen two years down the road when the incentive is scheduled to expire is anybody's guess. But a good working assumption is that pressures to extend its life would prove irresistible, just as they have for the tax rebate of 1975. If it is not extended, of course, there is the question of what happens to those employees who would not have been hired had it not been for the existence of the wage subsidy.

Finally, the practical problems of administration and enforcement that would attend an incremental job credit seem to be significant. We could not enumerate them any better than was done by Assistant Secretary Woodworth when he testified on this matter before the Small Business Committee on February 22. The Treasury's study of the H.R. 3477 provision suggests that two-thirds of the labor force would be excluded from credit coverage by the $40,000 cap and by the 3 percent natural growth threshold. The potential impact of hiring new part-time workers rather than full-timers, the unlikely possibility of shifting overtime to new employees, and the invitation to abuse by some individual employers are a few of the major concerns.

We urge that this concept be abandoned.

II. INDIVIDUALS

In our view the most important objective is a less restrictive but reasonably stable tax policy. For this reason we have no comment as to whether the rebate part of the economic package presents the "right" dollar amount of stimulus for present conditions.

However, we are concerned with the rebate feature. This is not because the proceeds may be saved or used to reduce previous debts instead of spent on consumer goods, but because it would be yet another "fine-tuning" attempt at government management of economic decisions. We believe that individuals as well as business firms will make sounder, more rational decisions as to their investment and current consumption patterns if they have reasonable certainty of the prospect of permanent tax relief. And if permanent relief reduces the "options" for future federal spending programs, so much the better.

A second concern is that the proposals simply continue the bottom-weighting of the previous three tax reductions (1975, 1971, 1969) and would remove 3.7 million families from the tax rolls. Inflation has reduced purchasing power of individuals at all income levels, and other economic dislocations have affected many in the middle-income classes. Yet those who must itemize deductions, and this would include many in the middle-income class, would be limited to a one-shot, $50 per-capita rebate. Those further up the rate scale would realize no tax reductions at all. As noted before, we believe that any economic stimulus package should serve long-term objectives as well. But continual emphasis on income redistribution and shrinkage of the tax base through increases in the standard deduction seem inappropriate in legislation designed primarily to help get the economy moving.

If Congress is of a mind to reduce individual income taxes on the order of $15 billion, we believe the cuts should be both permanent and more balanced than in the House bill. An across-the-board cut in the individual income tax rate structure could serve this purpose.

Senator CURTIS. Our next witness is Mr. Edward G. Jordan.

We welcome you to the committee. I am sorry your spot on the witness list is such that we did not have as many people here as we would ordinarily if it were not during the noon hour.

Your statement has been received by the members of the committee. It will be received in full for the record at this point.

I have two or three questions that I would like to ask you. Have you any short summary that you would like to make at this time? If so, you may proceed.

STATEMENT OF JOHN SWEENEY, VICE PRESIDENT, CONSOLIDATED RAIL CORP., ACCOMPANIED BY H. LAWRENCE FOX, PEPPER, HAMILTON & SCHEETZ

Mr. SWEENEY. I apologize for the fact that a problem arose within ConRail that prevented Mr. Jordan from coming. I am John Sweeney. I would like to make a brief summary statement and have Mr. Jordan's prepared oral statement submitted for the record, along with ConRail's written testimony.

We are concerned about the fact that H.R. 3477 passed the House without one of President Carter's proposals which would have provided companies that did not make a profit with a refundable tax credit.

Senator CURTIS. Are you referring to the investment tax credit?

Mr. SWEENEY. Both investment tax and payroll tax credit.

We are of the opinion that a company such as ourselves and other railroads that provide a public service, which because of economic conditions cannot call themselves profitable, could offer a tremendous potential for an increase in employment if they were given the kind of tax credit refund proposed by the President.

There would be a substantial advantage, not only to the public in enlarging and bettering railroad service, but in increasing employment in the industry.

That is a very brief summary.

Senator CURTIS. I gather from your statement and from what you have said that your proposal for unemployment tax credit that is rebatable would benefit many other railroads other than this one that is somewhat Government connected?

Mr. SWEENEY. Yes, sir. There are substantial other railroads that are in exactly the same position as is ConRail.

Senator CURTIS. If we provide you with a rebatable credit, will it be used to hire additional employees?

Mr. SWEENEY. Yes, sir, either one or two ways. We would clearly reinvest those funds almost immediately in either one or two forms: in new equipment, which would mean increased employment for our supplier industry, or use it internally within our own workforce to increase track repair, expansion, and et cetera.

Senator CURTIS. Could you provide us with an estimate of how many employees might be hired?

Mr. SWEENEY. Yes, sir. We can tell you if we were to use the entire funds within ConRail itself, it would be 500 to 600 in the first and second year period.

Senator CURTIS. Would they be permanent employees or just someone that is temporary that might be as compared to the employees in the public service area?

Mr. SWEENEY. It is our judgment that every one of the people that we would put on, primarily in track expansion activity, would be eventually full-time members of the ConRail workforce—maintenance, yard repair, et cetera.

Senator CURTIS. I have been handed a note that there is a vote on the Senate floor. It happens to be an amendment that I am interested in.

Thank you very much for your appearance here, and the committee will stand adjourned.

[The oral and prepared statements of Mr. Jordan follow:]

STATEMENT OF EDWARD G. JORDAN, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, THE CONSOLIDATED RAIL CORPORATION

INTRODUCTION

Mr. Chairman, and members of the committee, my name is Edward G. Jordan and I am Chairman of the Board of ConRail. With me today is my counsel, H. Lawrence Fox of Pepper, Hamilton & Scheetz. With your permission, I submit herewith a written statement for the record.

Under the Regional Rail Reorganization Act of 1973, as amended, ConRail commenced operations on April 1, 1976 as a private railroad created out of portions of six bankrupt railroads in the northeastern and midwestern United States. It operates over a 17,000 mile system in 17 States and the District of Columbia, and as of March 1, 1977 employed over 99,000 people.

I appear before the committee to urge the adoption of a refundable employment tax credit based upon payroll tax contributions. This concept, proposed by President Carter in his economic stimulus package, has not been incorporated in H.R. 3477. The administration's proposal would permit a railroad to obtain a refundable credit based upon its annual Social Security or Railroad Retirement tax contributions during 1977 and 1978, as an alternative to an increase in the investment tax credit.

Because of ConRail's unique tax and employment status, I believe that a rebatable employment tax credit would help ConRail make a substantial contribution to increase economic vitality in the northeast and midwest regions, where unemployment levels are among the highest in the Nation. Moreover, the availability of a tax incentive will aid ConRail in expediting the rehabilitation of the restructured rail system. This combination will further stimulate economic stability and growth in those regions.

I would like to also make it clear that the position I put forth today on behalf of ConRail is shared by a number of railroads who are in a position similar to ours. As you know, a number of railroads are not in a tax-paying position yet provide transportation services which are essential to the continued economic well-being of the Nation. These other railroads would be able to utilize a refundable tax credit in the same manner as ConRail.

It is also my view that most of the profitable railroads in the country are enthusiastic about the President's initial proposal. Most would probably take advantage of the increased investment tax credit which the President put forth; others might utilize the employment tax credit available to them under the credit provisions set forth by the President.

Other employment related tax credit programs proposed so far, including the provisions in H.R. 3477, do not permit marginal profit companies to participate in an economic stimulus program. As this committee knows, ConRail will not incur any tax liability for a number of years. This results principally from: One, the tax legislation enacted in 1976 (whereby ConRail succeeded to the tax basis of the bankrupt railroads with respect to properties conveyed to it); two, the massive capital investment in track (we will be making during the next 10 years); and three, the anticipated initial annual operating losses (we expect to incur).

For companies like ConRail, especially those in the transportation industry, any economic downturn usually has an immediate and significant negative im-

pact on operations, revenues and costs. If Congress enacts a tax credit which is designed to offset a downturn but is not available to such companies, they are doubly disadvantaged in that they have suffered the results of the downturn and are unable to avail themselves of tax incentives specifically intended to reverse it. As a tool to assist non-taxpaying, capital-starved and labor-intensive industries in accelerating the nation's economic recovery, no concept could be more appropriate than a refundable tax credit based upon actual, existing employment.

Regardless of the outcome of this tax legislation, ConRail fully intends to meet its commitments under its financial arrangements with the Government and its own internal commitments to a plan for future profitability. I am here to make the case that such a refundable tax credit would provide a means by which we could accelerate our progress and assist in improving the economic situation of the country, particularly in the northeast.

A refundable employment tax credit, like the Administration's is suited to ConRail's situation in that it is an employment-related credit which is immediate, determinable and efficient. A limited incremental employment credits concept, such as the one in the House bill, imposes a statistical test, unachievable by most medium or large companies, under which a credit becomes available only after a certain minimum level of increased employment has been achieved. The House version also places an unrealistically low, and therefore inappropriate, monetary maximum on the amount of the credit.

It should be perfectly obvious that, even assuming a modification of the base test to accommodate the foregoing facts so that ConRail receives the $40,000 House bill cap, the ceiling is woefully inadequate. To train, equip and pay a single new employee costs ConRail approximately $30,000 in the first year. Thus, receipt of a $40,000 credit, even if refundable, would not enable ConRail to participate in reducing national unemployment by even two more people than it otherwise would. It should be noted that the Congressional Budget Office estimates that the cost of a single public works job ranges from $21,700 to $62,500 with an average of $42,000 per job.

ConRail believes that a meaningful credit goes to the heart of both the structural unemployment and rail industry problems in the northeast and midwest. For ConRail alone, a rebatable credit will provide a means by which the company can do its part to reduce regional unemployment and strengthen the long-term prospects for the continuation of essential rail transportation services in the region by a private enterprise company. These are goals which Congress, and members of this committee, have emphasized repeatedly in recent years.

In conclusion, we urge the committee to amend H.R. 3477 so that it will provide an economic employer stimulus to companies with facts like ConRail's. A way to accomplish such a result would be to enact a refundable payroll tax credit as proposed by the President; not one based upon incremental hiring and not limited by a dollar ceiling.

I appreciate the opportunity to testify and will be happy to answer any questions.

Summary of Written Statement of Edward G. Jordan, Chairman of the Board and Chief Executive Officer, Consolidated Rail Corporation

INTRODUCTION

ConRail is in favor of the passage of H.R. 3477 but believes the Bill should be modified so as to incorporate more tax incentives to aid private industry in reducing unemployment such as those contained in the administration's original proposals.

I. CONRAIL

ConRail is a private for-profit corporation, creation of which was mandated by Congress in the Regional Rail Reorganization Act of 1973, as amended ("the Act"). It operates over a 17,000 mile system in 17 States and the District of Columbia, and as of November 1976 employed 99,481 persons.

II. ADMINISTRATION'S PROPOSALS

President Carter's proposal would provide taxpayers with the option of a 2-percent increase in the existing investment tax credit or a rebatable tax credit based upon an employer's payroll tax contributions.

The new payroll tax credit concept was designed to provide labor-intensive and service businesses a tax incentive similar to that provided capital intensive firms by the investment tax credit. In addition, it would be fully refundable and, thus, provide relief to loss and marginal profit firms.

III. H. R. 3477, AS REPORTED BY THE COMMITTEE ON WAYS & MEANS

Under H.R. 3477, an employer is to receive a credit equal to forty percent of the first $4,200 of salary paid to certain additional employees. The credit is calculated on the increase in 1977 wages at $4,200 per employee over 103 percent of 1976 wages at $4,200 per employee. The new credit would expire after 1978.

There are several limitations on the credit. The overall amount cannot exceed 40 percent of total 1977 wages over 103 percent of 1976 wages. The maximum credit allowed an employer is restricted to $40,000 per year. Finally, the credit is not refundable.

IV. CONRAIL'S FACTS

Due to depreciation on massive capital investment in track and equipment rehabilitation over the next 10 years and anticipated operating losses during its initial period, ConRail will not incur any tax liability for a number of years. Therefore, ConRail is procluded from utilizing any tax credit unless it is refundable.

The incremental employment credit in H.R. 3477 does not provide proper recognition of ConRail's dramatic hiring program. The unqualified statistics test which is tied to increased hiring above 1976 employment levels precludes ConRail's participation in the proposed credit.

In creating ConRail, Congress assumed and encouraged a reorganized Northeast rail system under which a number of employees would leave ConRail during the period 1977–81, as a result of normal attrition, death, normal retirement and the employee protection benefits provided by Congress pursuant to title V of the act. Thus, few, if any, of these former employees will be placed on unemployment rolls. However, real employment figures indicate that ConRail will be dramatically increasing its employment rolls by a significant number of new persons, of which approximately 75 percent have been previously unemployed.

Even assuming a modification of the base test, the $40,000 House bill ceiling is woefully inadequate as a tax incentive. To train, equip and pay a single new employee costs ConRail approximately $30,000 in the first year. Thus, receipt of a $40,000 refundable credit, woud enable ConRail to hire less than two more people.

V. CONCLUSION

In conclusion, ConRail urges the committee to amend H.R. 3477 so that it will provide an economic stimulus to employer companies with facts like ConRail's. A way to accomplish such a result would be to enact a refundable payroll tax credit not based upon incremental hiring and not limited by a dollar ceiling.

WRITTEN STATEMENT OF EDWARD G. JORDAN, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, CONSOLIDATED RAIL CORPORATION

INTRODUCTION

The Chairman of the Board of ConRail Corporation ("ConRail") the Nation's largest railroad, is pleased to have the opportunity to submit this statement concerning the above-cited topic.

In brief, ConRail is in favor of the passage of H.R. 3477 but believes the Bill should be modified so as to incorporate more tax incentives to aid private industry in reducing unemployment such as those contained in the Administration's original proposals. This statement sets forth in detail the merits of such an amended Bill and why it should be enacted.

I. CONRAIL

ConRail is a private for-profit corporation, creation of which was mandated by Congress in the Regional Rail Reorganization Act of 1973, as amended ("the Act").[1] The purpose of the Act was to restructure the rail services operated by

[1] 45 USCA § 1701 et seq., Title III of the Act.

insolvent railroads[2] in the midwestern and northeastern part of the United States. By Federal statute, ConRail commenced operation on April 1, 1976. It operates over a 17,000 mile system in 17 States and the District of Columbia, and as of November 1976 employed 99,481 persons. A more detailed explanation of ConRail and its corporate and financial structure is contained in the attached portion of testimony submitted to the Committee on Ways and Means on March 12, 1976.

II. ADMINISTRATION'S PROPOSALS

On January 31, 1977, President Carter issued his message to Congress on "Recommendations for Economic Recovery." His message contained both tax and non-tax measures for economic stimulus. The proposal of most specific interest to corporations provided taxpayers with the option of a two percent increase in the existing investment tax credit or a rebatable tax credit based upon an employer's payroll tax contributions. The election would be for a five-year period.

The Administration noted that increasing the investment tax credit has proven to be an effective method of expanding capital and employment. However, the increased investment tax credit alone might fail to provide the intended stimulus to two groups of employers—those who are service-oriented and those who are marginally profitable or in a loss position.

The new payroll tax credit concept was designed to provide labor-intensive and service businesses a tax incentive (similar to that provided capital intensive firms by the investment tax credit) in the form of a credit based upon payroll taxes. In addition, it would be fully refundable and, thus, provide relief to loss and marginal profit firms which, due to little or no tax liability, are unable to use an investment tax credit based upon the cost of new equipment. The concept of a "human" tax credit will according to the Treasury, for the first time, permit numerous companies to utilize an investment credit type incentive to create new jobs.

III. H. R. 3477, AS REPORTED BY THE COMMITTEE ON WAYS & MEANS

The House Committee on Ways and Means held hearings on President Carter's proposal beginning on February 2, 1977. Industry testimony supported the 2-percent increase in the investment tax credit and was mildly supportive of the payroll tax credit, or a variation of it, provided it was elective. In particular, small business groups were in favor of some form of payroll tax credit.

During a 2-day Executive Session or "markup", the committee rejected the administration's proposals for business in favor of an incremental jobs credit approach (without any change in the investment tax credit) advanced by Chairman Ullman and other members of the committee. Under the bill, an employer is to receive a credit equal to 40 percent of the first $4,200 of salary paid to certain additional employees. The credit is calculated on the increase in 1977 wages at $4,200 per employee over 103 percent of 1976 wages at $4,200 per employee. The new credit would expire after 1978.

"The wages of employees for railroad service, as determined under the FUTA provisions of the Code (sec. 3306(c)(9)) are excluded from FUTA. Instead, the employer contributes a percentage of these wages to a fund maintained under the Railroad Unemployment Insurance Act (RUIA). In order to make the credit available to railroad employers, the bill provides that they are to use ⅞ of their RUIA wage base in lieu of the FUTA wage base. The RUIA system is based on wages up to $400 per month ($4,800 annually). The ⅞ ($4,200/$4,800) computation is designed to equate RUIA wages with FUTA wages."[3]

There are several limitations on the credit. The overall amount cannot exceed forty percent of total 1977 wages over 103 percent of 1976 wages. The maximum credit allowed an employer is restricted to 40,000 per year. Finally, the credit is increased by ten percent in the case of new handicapped employees and the $40,000 limit is not applicable to that portion of the credit.

Unlike the President's proposal, the credit is not refundable and can only be used against tax liability. A 3-year carryback and 7-year carryforward period are provided for unused credits.

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[2] Penn Central Transportation Co., Erie Lackawanna, Reading, Central Railroad of New Jersey, Lehigh Valley, Lehigh and Hudson River, and the Ann Arbor Railroad.

[3] House Report, Tax Reduction and Simplification Act of 1977, H.R. 3477.

IV. DEFICIENCIES IN H.R. 3477

The incremental employment credits concept adopted by the Committee on Ways and Means in H.R. 3477 is unfair and inefficient in its application to employers like ConRail. Assistant Secretary Laurence Woodworth in testimony before the Senate Small Business Committee on February 22, 1977, noted that ". . . the very terms of the [House] credit exclude at least sixty-six percent of the labor market from participating either because the employer's normal experience places them below the threshold or over the 'cap'." He cited Treasury statistics which indicate that employers who plan to hire more than 24 workers are effectively precluded from responding to the credit by further hiring. Moreover, the $40,000 ceiling will exclude approximately 36 percent of the labor market from any possible gains in employment in response to the credit. Applying these statistics to ConRail, the House Bill precludes the company from any meaningful participation in the economic stimulus program intended by enactment of H.R. 3477.

V. CONRAIL'S FACTS

As a result of tax legislation enacted by Congress in 1976,[4] Conrail succeeded to the tax basis of seven bankrupt railroads with respect to properties conveyed to it on April 1, 1976. Conrail will be depreciating the massive capital investment in track and equipment rehabilitation which it will be making during the next 10 years. The company also antcipates operating losses during its initial years. As a result of these three factors ConRail will not incur any tax liability for a number of years. Therefore, ConRail would be precluded from utilizing any tax credit which did not contain a provision for refundability.

In creating ConRail, Congress accepted the general outlines of the Final System Plan developed by the United States Railway Association which was predicated on a substantial reduction in the work forces which were employed by the predecessor bankrupt railroads. It was clear to Congress, and our operating experience has confirmed, that ConRail cannot become profitable unless it achieves the reductions contemplated in the Final System Plan.

Even though ConRail will undertake some substantial reduction in its work forces, it will simultaneously be hiring a significant number of new people. Because of the sizable reconstruction and rehabilitation program which will be undertaken—new track, new yards, and other facilities—we believe we could utilize a tax credit to further accelerate this effort.

ConRail's concern is that the employment tax credit concept in H.R. 3477 does not provide proper recognition and assistance to ConRail's unprecedented rehabilitation program. The incremental hiring program contains a test which is tied to a requirement for increased hiring above a certain 1976 emloyment level; and therefore, might preclude ConRail from participating in the proposed tax credit.

Congress accepted the reorganization plan which anticipated employment reductions as a result of normal attrition, death, normal retirement, and the employee protection benefits provided by Congress pursuant to title V of the Railroad Reorganization Act.[5] If an economic stimulus program is related solely to increases in employment over base, and thus ignores actual investment practices such as those of ConRail, a significant source for the reduction of unemployment will be eliminated.

It should be perfectly obvious, that even assuming a modification of the base test to accommodate the foregoing facts, so that ConRail receives the $40,000 House bill "cap", the ceiling is woefully inadequate as a tax incentive. To train, equip and pay a single new employee costs ConRail approximately $30,000 in the first year. Thus, receipt of a $40,000 credit, even if refundable, would not enable ConRail to participate further in reducing national unemployment by even two more people than it otherwise will. It should be noted that the Congressional Budget Office estimates that the cost of a single public works job ranges from $21,700 to $62,500 with an average of $42,000 per job.

VI. WHAT IS NEEDED FOR COMPANIES LIKE CONRAIL

ConRail will spend a great deal of money for material and human resources over the next few years in rehabilitating its facilities. Under its Congressionally approved structure, it is an example of a major employer which could avail it-

[4] Public Law 94–253.

[5] Title V of the Regional Rail Reorganization Act of 1973 provided a $250 million fund to protect the income of employees of the bankrupt railroads comprising ConRail.

self of a concept like a refundable employment tax credit. Although the rebatable credit concept proposed by the administration does not require that employers use the proceeds of a credit to create new jobs, I want to assure you that under existing ConRail programs, investments would be made, using the proceeds of the credit, which would result in increased permanent employment, either internally or for our suppliers. We think that ConRail should be included in any legislative effort to help reduce nationwide unemployment.

ConRail does not wish to imply that it does not fully intend to meet its commitments under its financing arrangements with the Government, or its own internal commitments to a plan for ConRail's future profitability, regardless of the outcome of this tax legislation. But ConRail does believe that a refundable tax credit would provide one more means by which it could accelerate our progress and assist in improving the economic situation of the country, particularly in the Northeast.

The enactment of a rebatable employment credit concept would provide ConRail with additional funds to increase economic activity in the area we serve, either because we could accelerate the purchase of equipment and materials necessary to accomplish rehabilitation or because we would be expanding discrete work forces where we believe the acceleration would be most advantageous to us.

ConRail believes that increasing the investment tax credit has proven to be an effective method of expanding capital and employment. Accordingly, a proposal to increase the credit is a sound one. However, an increased investment tax credit alone might fail to provide the intended stimulus to two groups of employers, those who are service-oriented and those who are marginally profitable or in a loss position. For the service-oriented employers, an employment tax credit will serve an analogous function to the investment tax credit, i.e., promoting capital and new jobs. In addition, a rebatable credit will aid employers which are marginally profitable or in a loss position. These employers gain little benefit from the investment tax credit since it is beneficial only to companies paying significant taxes. An employment credit that is refundable would, for the first time, permit numerous companies to avail themselves of a tax credit incentive and to utilize that incentive to create new jobs.

A number of railroads in a position similar to ConRail's, share our views. As you know, a number of such railroads are in a marginally profitable or net loss position, yet provide transportation services which are essential to the continued economic well-being of the Nation. These other railroads would be able to utilize a refundable tax credit in the same manner as ConRail.

It is my own personal view that most of the profitable railroads in the country, are enthusiastic about the administration's initial proposals. Most of them would probably take advantage of the increased investment tax credit as proposed; others might find it more advantageous to utilize the employment tax credit. To the extent that H.R. 3477 alters those available choices, all railroads are restricted in their ability to help stimulate the economy.

VII. CONCLUSION

In conclusion, ConRail urges the committee to amend H.R. 3477 so that it will provide an economic stimulus to companies with facts like ConRail's. A way to accomplish such a result would be to enact a refundable payrool tax credit not based upon incremental hiring and not limited by a dollar ceiling.

[Thereupon, at 12:55 p.m. the committee recessed to reconvene Friday, March 11, 1977.]

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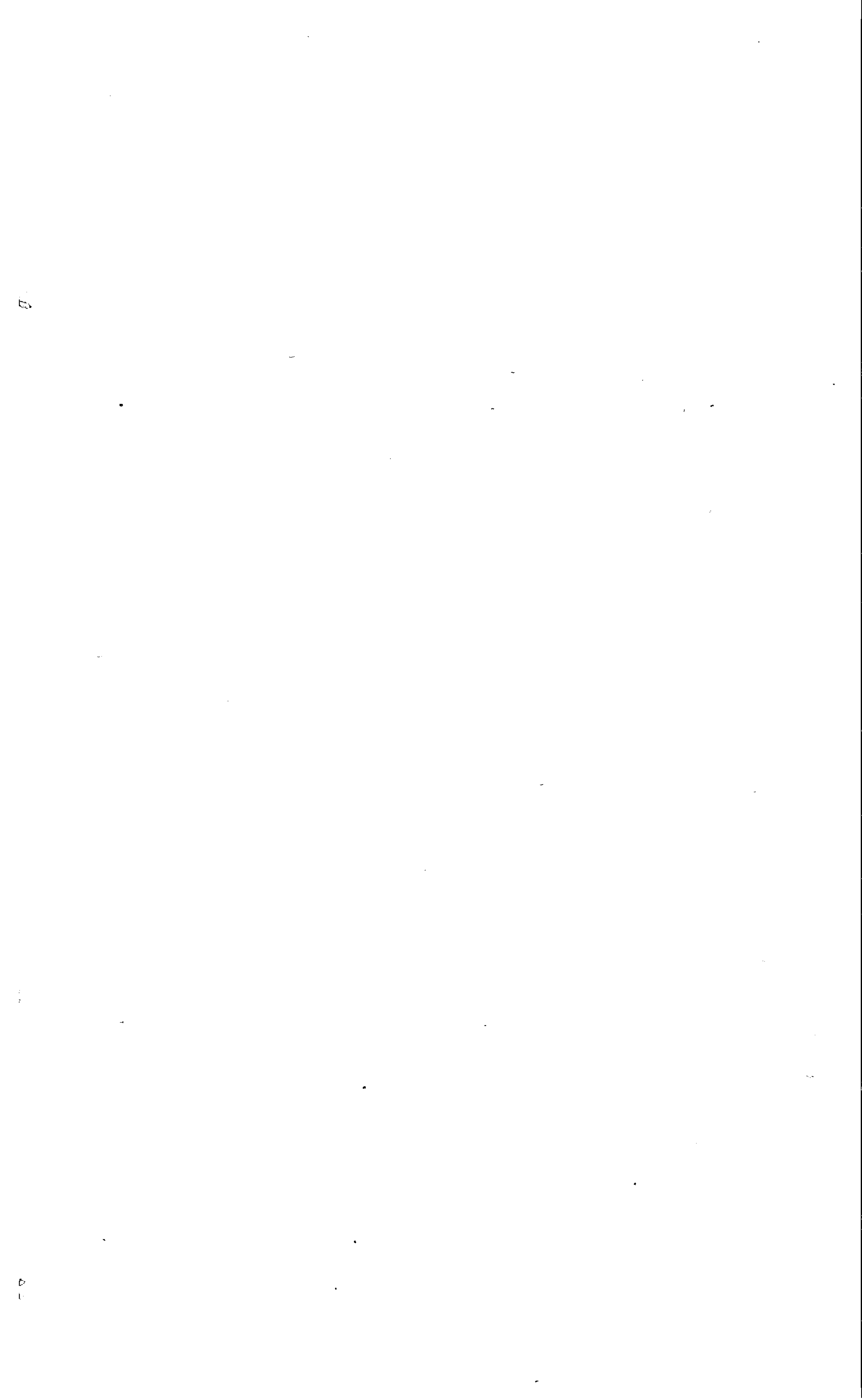

TAX REDUCTION AND SIMPLIFICATION ACT OF 1977

FRIDAY, MARCH 11, 1977

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

The committee met at 9:30 a.m., pursuant to recess, in room 2221, Dirksen Senate Office Building, Hon. Carl T. Curtis presiding.

Present: Senators Byrd, Jr., of Virginia, Matsunaga, Curtis, Hansen, Dole, Packwood, and Danforth.

Senator CURTIS. The committee will come to order.

Senator Long, our chairman, could not be here today. It was anticipated that perhaps the Senate would not be in session. Nevertheless it is the hour and we want to proceed with the committee's business. The first witness is Hon. Pete Domenici, U.S. Senator from New Mexico. Mr. Domenici, you may proceed.

STATEMENT OF HON. PETE V. DOMENICI, A U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator DOMENICI. Thank you, Mr. Chairman. First I want to thank the committee for providing an opportunity for four of us—Senators Javits, McClure, Percy and me—to present our views on this difficult issue, and I believe the other Senators will be along shortly, Mr. Chairman.

We have more or less coordinated our testimony and made an effort for a coordinated presentation this morning. We are appearing today as individual Senators who have closely followed and participated, as the chairman knows, in the development of options for stimulating the economy.

We are here because, during that process, we have developed some very strong views regarding the effectiveness of various proposals and consequently we have serious concerns about approaches which must naturally be the starting point for this committee's deliberations.

I refer to the stimulus proposals put forth by President Carter and the recent action of the House Ways and Means Committee. I personally find both of these deficient. I believe the Senators joining me will concur.

In effect, I find those approaches deficient on the revenue side for reasons I will briefly outline. While each of my colleagues will express concerns and opinions, I think it is fair to say that all four of us are strongly opposed to the proposed $50 per head payment to nearly every man, woman, and child in America. My opposition, Mr. Chairman and members of the committee, is based on a firm conviction that a per-

manent and broadly based income tax reduction is a much more equitable and effective means of insuring the economic recovery that is now underway.

On the other hand, the $50 per head payment is a gimmick of questionable stimulative effect, especially when there is historical evidence that permanent tax reductions produce positive results that can be measured by economic improvement and consequent reflows of revenue.

In any case, Mr. Chairman, the potential stimulative effect of a one-time payment, in my opinion, is reduced if the payment is not spent. I would cite the very recent report of the Joint Economic Committee released just yesterday and call th committee's attention to page 83, where it states: "Tax rebates have the disadvantage that a lower proportion tends to be spent than would occur if the tax change were permanent."

The Joint Economic Committee has also concluded, and I quote again: "Rebates have little secondary effect on business investment because businessmen are aware that the rebate-induced rise in consumer spending is only temporary."

A good deal has been said by the administration officials about the need for tax reform. Such statements are quickly followed by assertions that true-tax reform cannot be accomplished if permanent tax reductions are enacted now. Are we to hold the American middle class and the working men and women hostage, withholding from them the right to keep a greater proportion of what they earn—all in the name of tax reform? Are the American people to accept the proposition that this committee and the Congress must be pressured by the popular notion of lower taxes before we can have tax reform?

I think the answers to those question are emphatically, "No." Inflationary effect on taxpayers justifies a rate reduction now. Effective economic stimulation through a permanent tax reduction is needed now. To delay permanent tax reduction in the name of tax reform, in my opinion, is to deceive the American people.

The report of the Joint Economic Committee which I previously cited also confirms this point. On page 84 of that report, Mr. Chairman, while applauding the pledge to reform the tax system in 1979, the Joint Economic Committee also recognizes that, "tax reduction will be needed in 1978 [illegible]stain strong growth of the private sector." And I would merely say: "Why not now?"

Perhaps the real reason is the reluctance to give up or reduce future revenues because future needs might not be met. Again I ask: Are we to hold hostage the American taxpayers because we refuse to recognize that an expanding economy generated by permanent tax reductions will produce as much or more revenue than a weaker economy which is occasionally slipped a few expensive pep pills like the $50 phone book rebate? Are the American people to accept the proposition that the administration will not let this committee and the Congress follow the more economically sound and politically responsible course of permanent tax reduction in order to preserve its ability to fund more costly programs in the future?

These are serious questions that cannot be avoided. The Joint Economic Committee recognized that fact by emphasizing, once again on page 84 of its most current report that we cannot continue to commit such a large share of the GNP to personal income taxes and that there

must be a reduction in fiscal year 1978. And I would merely say: "Why not now?"

I recommend that the committee present to the Senate an annualized $12 to $13 billion tax reduction of a permanent nature, to be achieved by reduction in the rates for tax brackets of $18,000 adjusted gross income and below. Senate bill 730, introduced on February 11 and referred to this committee, has put this approach into legislative form.

A comparison of the job-creating effect of this approach with the $50 per head rebate illustrates its superiority as a stimulus action. For a revenue loss of $11.4 billion in fiscal year 1977, it is estimated that the $50 per head payment would generate, at most, about 150,000 jobs as of the end of calendar 1978 and it is downhill from there.

On the other hand, for a gross revenue loss of $17.3 billion in fiscal year 1977 and fiscal year 1978, the approach I recommend would produce about 525,000 permanent jobs. The ratio of jobs to dollars is higher for permanent tax reduction by a factor of 2.3 to 1, Mr. Chairman. Quantitatively and qualitatively, the permanent tax reduction is far superior as a vehicle for enduring economic stimulus and job creation.

For these and other reasons, which, I am sure, we will be pleased to discuss in detail later, we urge this committee to exercise its authority to recommend the specifics of tax legislation to the Congress by rejecting the $50 payment per head and adopting the broadly based tax reduction for individuals along the lines of S. 730.

Mr. Chairman, the balance of my statement covers two other suggestions. One is that we reduce the corporate income taxes for the smaller corporations of America up to $200,000 in taxable income. I have outlined that in detail and cited the bill that will do it and the economic effect that I believe would flow.

The other proposition that I discuss in my prepared statement is a very firm conviction on my part that it is time that we seriously consider the employment tax credit notion. I have my own views on the Carter proposals' being ineffective and I have my views expressed in detail as to why the Ways and Means tax credit is not the best approach.

I recommend that this committee take the lead and adopt a serious employment tax credit. I have outlined the specifics in my statement and would ask that which I have not read be made part of the record at this point.

Senator CURTIS. It will be made part of the record. Y[illegible] finished 30 seconds ahead of time.

[The prepared statement of Senator Domenici follows:]

STATEMENT OF SENATOR PETE V. DOMENICI

Mr. Chairman. I first want to thank you and your committee for providing an opportunity for the four of us, Senators, Javits, McClure, Percy, and me, to present our views on the difficult and complex issues involved in economic stimulation within the jurisdiction of this committee. We are appearing here today as individual Senators who have closely followed and directly participated in the development of options for stimulating the national economy.

We are here because during that process we have developed some very strong views regarding the effectiveness of various proposals and, consequently, we have extremely serious concerns about certain approaches which must naturally be the starting points for committee deliberations. I refer to the stimulus proposals put forth by President Carter and the recent action of the House Ways and Means

Committee. We find both these plans deficient on the revenue side for reasons we shall briefly outline.

While each of my colleagues will express individual concerns and opinions, I think it is fair to say that all four of us are strongly opposed to the proposed payment of $50 per head to nearly every man, woman, and child in America. My opposition, Mr. Chairman, is based on my firm conviction that a permanent and broadly-based income tax reduction is a much more equitable and effective means of insuring the economic recovery now under way. On the other hand, the $50 per head payment is a gimmick of questionable stimulative effect, especially when there is historical evidence that permanent tax reductions produce positive results that can be measured by economic improvement and consequent reflows of revenue.

In any case, Mr. Chairman, the potential stimulative effect of a one time payment is reduced if the payment is not spent. The report of the Joint Economic Committee released yesterday confirms on page 83 that, "Tax rebates have the disadvantage that a lower proportion tends to be spent that would occur if the tax change were permanent". The JEC also concluded that, "Rebates have little secondary effect on business investment because businessmen are aware that the rebate-induced rise in consumer spending is only temporary."

A good deal has been said by administration officials about the need for tax reform. Such statements are usually quickly followed by assertions that true tax reform cannot be accomplished if permanent tax reductions are enacted now. Are we to hold the American middle class and its working people hostage, withholding from them the right to keep a greater proportion of what they earn, all in the name of tax reform? Are the American people to accept the proposition that this committee and the Congress must be pressured by the politically popular notion of lower taxes before we will move on tax reform?

The answer to both questions must be emphatically "No." Inflationary effects on taxpayers justify a rate reduction now. Effective economic stimulation through a permanent tax reduction is needed now. To delay permanent tax reduction in the name of tax reform is to deceive the American people.

The report of the Joint Economic Committee also confirms this point. On page 84, the JEC report, while applauding the administration's pledge to reform the tax system in 1979, also recognizes that, "Tax reduction will be needed in 1978 to sustain strong growth of the private sector." Why not now?

Perhaps the real reason is the reluctance to give up or reduce future revenues because future needs might not be met. Again I ask—are we to hold hostage American taxpayers because we refuse to recognize that an expanding economy generated by permanent tax reductions will produce as much or more revenue than a weaker economy which is occasionally slipped a few expensive pep pills like this $50 phone book rebate? Are the American people to accept the proposition that the administration will not let this committee and the Congress follow the more economically sound and politically responsible course of permanent tax reduction in order to preserve its ability to fund more costly programs in the future? These are serious questions that cannot be avoided. The JEC recognized that fact by emphasizing on page 84 of its report that we cannot continue to commit such a large share of the GNP to personal income taxes and that there must be a reduction in fiscal year 1978. Again—why not now?

I recommend that the committee present to the Senate an annualized $12–$13 billion tax reduction of a permanent nature to be achieved by a reduction in rates for tax brackets of $18,000 adjusted gross income and below. S. 730 introduced on February 11 and referred to this committee has put this approach into legislative form.

A comparison of the job creation effect of this approach with the Carter $50-per-head payment illustrates its superiority as a stimulus action. For a revenue loss of $11.4 billion in fiscal year 1977, it is estimated that the $50 per head payment would generate at most about 150,000 jobs, as of the end of calendar 1978, and it's downhill from there. On the other hand, for a gross revenue loss of $17.3 billion in fiscal year 1977 and fiscal year 1978, the approach I recommend would produce about 525,000 permanent jobs. The ratio of jobs to dollars is higher for permanent tax reduction by a factor of roughly 2.3 to 1. Quantitatively and qualitatively, the permanent tax reduction is far superior as a vehicle for enduring economic stimulation and job creation.

For these and other reasons which we would be pleased to discuss in detail later, we urge this committee to exercise its authority to recommend the specifics of tax legislation to the Congress by rejecting the $50 payment per

head and adopting instead a payment, broadly based, tax reduction for individuals along the lines of S. 730.

Mr. Chairman, I am part of a growing number of people who feel that the employment tax credit is a notion whose time has come, at least to give it a genuine opportunity to increase employment and generate growth. I believe that an employment tax credit system can be devised which will provide significant assistance and incentive for securing and maintaining private employment for individuals not presently or adequately served by public training and employment programs. By such a program we would be able to take advantage of the unique allocation ability of the private sector while targeting our resources to the difficult and enduring problems of structural unemployment. Accordingly, I urge the committee to include in its tax bill a substantial employment tax credit component which provides for targeted employment as one of its major elements. This would mean rejecting both the Carter proposal and the House Ways and Means proposal for this component for one which has the characteristics I outlined.

The Carter credit against social security taxes is simply so insignificant as an incentive for businesses to increase employment that it would probably be used very slightly. This has been admitted by administration officials. On the other hand, the employment tax credit provision of the House Ways and Means Committee bill sets a credit limit of $40,000 per employer, and that is too low to produce much utilization by larger firms. In addition, the employment base level of 103 percent is too high and the tax credit percentage of 40 percent may well be too high also.

An acceptable legislative alternative already exists which embodies the characteristics I mentioned earlier. I urge the committee to consider carefully the employment tax credit structure contained in S. 731 which would allow a tax credit of $1 per hour during the first 6 months of employment and $.50 per hour during the second 6 months for all new employees who had been unemployed for 26 weeks or more. This approach is estimated to produce a reduction in unemployment of 450–550,000 at a cost of $0.4 billion in fiscal year 1977 and $1.9 billion in fiscal year 1978.

Finally, Mr. Chairman, I urge the committee to include what I consider to be an element that is crucial for long-term growth and expanded employment opportunities—a permanent reduction of the corporate tax rate. Such action is required, in my opinion, if we are to encourage investment and business expansion for the creation of jobs and to promote longer term economic growth to sustain the recovery beyond the immediate 1977–78 period. I urge the committee to fashion this part of its bill to encourage investment and expansion primarily by small competitive businesses. Not only do I believe that small business is critical to the continuation of a healthy free enterprise system, but I am also convinced that the bias in favor of small business which I recommend would in a particularly favorable impact on employment. One of the major reasons for this result is the fact that the fastest growing sector of the economy is in service-oriented businesses and these businesses are mostly small and labor intensive.

In this regard, Mr. Chairman, I urge the committee to include S. 732 in its deliberations for insertion in your final product. S. 732 would cut the corporate normal tax rate from the current level to 18 percent on the first $100,000 of corporate profits. Under such an approach, all corporations would receive some tax relief, but the greatest effect, of course, would be on smaller corporations.

I will yield now to my distinguished colleague from New York. I will be pleased to answer any questions after all four senators have had an opportunity to testify.

Thank you.

Senator CURTIS. If there is no objection, I think we ought to hear from all four of the distinguished quartet and then have the questions. Is that all right with you gentlemen?

Senator DANFORTH. Yes, Mr. Chairman. I am sure these are very busy men but I would hope we would not necessarily be limited to 10 minutes for each.

Senator CURTIS. With a panel, we will take a little more time.

I would like to call on the distinguished Senator from Idaho, Mr. McClure.

STATEMENT OF HON. JAMES A. McCLURE, A U.S. SENATOR FROM THE STATE OF IDAHO

Senator McCLURE. I thank the committee for the time given us as well as the opportunity to appear with my distinguished colleagues on this panel of minority members to make some suggestions because I think this committee is faced not only with a very real responsibility but also with a real opportunity to deal directly with some of the issues raised by the stimulus proposals currently under consideration.

The first and most obvious issue concerns the need for the stimulus itself. To the extent that you believe a sustained recovery requires the Federal Government to enlarge its deficit and thus expand aggregate demand, almost any stimulus package makes sense. Those who hold this view assume, first, that supply will somehow take care of itself and, second, that the components of a stimulus package are unimportant inasmuch as the size of the package determines its effectiveness.

With respect to the challenges associated with a continuing economic recovery, we must be aware of the dangers associated with allowing our reach to exceed our grasp. A real growth target of 6 percent a year for 5 years, as suggested by proponents of a large stimulus package, may be impossible to achieve.

In recent past, our economy has never been able to sustain a 6-percent rate of real growth for more than seven quarters, let alone 5 years. Should we adopt such an unreasonable goal, we will inevitably be forced in the future to create even larger temporary stimulus packages as real performance fails to meet our unrealistic standards.

In that case, I submit that each new package carry a printed legend which states that continued use will be hazardous to our economic health.

It is my further conviction that, apart from the size of any stimulus proposal, the most serious and critical review be given to its components. If current economic growth rates are less than one could reasonably expect and if the cause of slow growth was, in fact, a lack of aggregate demand, then stimulus—any stimulus—might do the trick.

Unfortunately, our problems are supply problems and investment problems, not consumption problems. Current economic growth rates have been reduced by poor weather, the lack of appropriate labor force skills, the reduced availability of energy and, finally, by low levels of capital formation in the recent past.

A careful analysis of our unemployment figures will indicate that 25 percent of our labor force, those aged 16 to 24 years, accounts for 50 percent of current unemployment. This group is largely unskilled or inexperienced. In order to reduce the general level of unemployment, these young people must be moved into productive employment. Massive and inflationary doses of fiscal stimulus would be required.

Another option, which is much more appropriate to this task, involves targeted outlays designed to increase the potential production and employability of the young and the unskilled. To approach this same problem with macroeconomic tools is roughly the equivalent of killing gnats with a sledgehammer. It is ineffective and it is inflationary.

With regard to targeted outlays designed to reduce unemployment, it is necessary for policymakers to recognize that training should be the point of emphasis. Public service jobs reflect a low training component and have limited longrun returns to both the individual and to the taxpayer.

Since the beginning of the recovery, 4.3 million jobs have been created. Over the last 3 months nearly 800,000 permanent jobs have opened up in the private sector. During this same recovery, the Federal Government has labored mightily to produce the mouse of 500,000 temporary dead end public service jobs.

When it comes to the employment question, let's stop kidding ourselves. At best, government can, through fiscal and monetary policy, create an environment which is compatible with high levels of private sector employment. That is the best that we can do, and so I ask: Why not the best?

The stimulus package proposed by the administration gives me little to look forward to with hope and will provide this Congress with nothing to look backward on with pride. It fails to recognize that continued economic growth is dependent upon and will demand increased levels of private investment. Investment is the key to productivity, and increased productivity is the prerequisite to price stability and higher real wages.

Our current standard of living did not result from the fact that Americans work longer and harder. Rather our material level of well-being has resulted from the fact that Americans work more efficiently and much of that efficiency can be related to the high investment levels associated with each newly created job.

The administration's package is consumption oriented rather than investment oriented. As such, it fails to recognize the relationship between investment and economic growth. The relationship between tax legislation and investment is well known.

If we look at the past three decades, we can identify three investment booms, or periods during which constant-dollar-fixed business investment rose by at least 10 percent for 2 or more years. Those periods were 1955 to 1956, 1963 to 1965, and 1972 to 1973.

The feature which is common to each of these periods is not that consumption surged in the prior year nor that capacity utilization rates were high but rather that each investment boom was preceded by comprehensive tax legislation designed to make investment more appealing.

In 1954 the excess profits tax was repealed and overall tax schedules were redesigned. In 1962 the investment tax credit was introduced and the ADR range was altered. In 1971 the tax credit was reinstated and ADR rates again adjusted.

This is not a "trickle down" philosophy. It does not say consumption must precede investment. It does, however, say that future noninflationary surges in consumption and employment must be preceded by increased levels of investment.

Finally, policymakers must be concerned with the level of the Federal deficit and the implications which the management of that debt hold for capital markets, interest rates and price levels. By the end of fiscal year 1977, Federal debt is expected to exceed $718 billion. During fiscal years 1977 and 1978, the Treasury must borrow $175 billion.

These activities, when coupled with normal Treasury refinancing requirements and rising private demands for credit, will inevitably cause interest rates to rise. At that point the Federal Reserve will be forced to choose between higher interest rates and reduced economic growth or debt monetization, inflation, and ultimate recession.

While all pitfalls cannot be avoided, the "no win" dilemma to which I have referred is not inevitable. A deficit which results from tax changes which restore confidence, permanently increasing purchasing power and fostering higher levels of business investment, could well be a constructive deficit—constructive in the sense that expanding demands are matched, at stable price levels, by increased quantities of goods and service produced by a work force which is more highly skilled and better equipped with more efficient and sophisticated tools.

In my opinion, the time has come for us to make a permanent investment in the American taxpayer and in the free market system. The rebates proposed by the administration represent a temporary loan to the taxpayer and ignore the continuing and expanding needs of the private sector. As such, they are shortsighted and contribute to rather than solve the problems with which the Nation is faced.

Senator CURTIS. Thank you for a very fine statement.

Now we will hear the statement of the distinguished Senator from New York, Mr. Javits.

Senator JAVITS. I prefer to go last; I arrived last.

Senator CURTIS. I call upon the distinguished Senator from Illinois, Mr. Percy.

STATEMENT OF HON. CHARLES H. PERCY, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator PERCY. Thank you, Mr. Chairman. I intend to comment on two aspects of this. I am delighted to be with my colleagues who have done a good job in providing leadership in this area.

I would like to comment first of all on the obvious fact there are no Democratic Senators present this morning. I talked to Senator Long yesterday. I have testified before this committee for some 25 years now, beginning in the early fifties. Understandably he is away and he expressed his deep regret at that.

This is not a partisan matter. Republicans should be talking to each other. We do not have to convince ourselves of this. I really hope the Democratic staff members will take note of the fact. There has been no partisanship as far as our relationship with this administration.

This administration sent a bill to this committee asking for power to reorganize the Government and in 2 weeks it was passed 92 to nothing on the floor of the Senate, voted unanimously out of the Government Affairs Committee. The Democrats in the House have yet to act on that. They are blocking it right now. They will act.

The energy reorganization bill was sent up and we held hearings 2 days later. We will be reporting that bill out to the floor—a complicated reorganization of our entire energy program in the executive branch of the Government—we will be reporting that out—Senator Javits, I believe I am right—in 2 to 3 weeks from Government Affairs.

I would hope, therefore, in the tremendously important matter of taxes, that we would also have a bipartisan approach. I have talked

to just as many Democrats and Independents as I have Republicans.

The point of view I am going to express is that in the whole country I dont know a citizen who would put a bill in for a $50 tax rebate. I dont know any group I have talked with, whether the west or south side of Chicago, who doesn't think we are out of our cotton-picking minds to do that. Lower-income people and middle-income people think we are crazy. All the furor we have on a few million dollars pay increases for judges and Congressmen and Senators and here is $11.8 billion right down the drain. And that is about the effect it will have.

Arthur Burns said to me the stimulating effect will be maybe 4 to 5 weeks. Now, what kind of a policy is that—to spend $12 billion for a 4- to 5-week possible stimulus? And I really think the sanity of the Congress ought to be in question here. This is our power; the Constitution provides that we shall have the power over the purse, we shall have the power to levy taxes. This is just not an executive branch initiative. The Constitution puts a tremendous responsibility on us.

I just ask the Members of the Senate and House and members of the staff in this room to talk to people and see whether it makes sense to them, after they have paid their 1976 taxes and they still have some money in the bank, for us to go out at the marketplace and borrow $11.7 billion to give them $50 back.

Just look at the city of New York and the pressure that puts on the money marketplace. Look what this is going to do to housing money; look what it is going to do to small business; look what it is going to do to farmers. It is going to drive interest costs up. And we are reeling over our own Federal debt. It is going to cost a tremendous amount of money.

I have talked to people to see if they really feel this is going to do any good. I have talked to merchants all over this country including the chairman of the board of Sears, Roebuck, who ought to know something about marketing and merchandising. It just makes no sense to anyone, including the people who are going to get it, and then to send money back to people who have not even sent money in. This is really a reverse kind of approach.

Not wanting to just trust my own judgment, not wanting to just trust the average people you can talk to, hundreds of whom I have talked to about this, I went and wrote to some of our outstanding economists such as Murray Weidenbaum, director of the Center for the Study of American Business at Washington University. I ask unanimous consent that all of the letters I received on the subject be incorporated in the record.

Senator CURTIS. Without objection, so ordered.

[The letters referred to follow:]

STANFORD UNIVERSITY,
Stanford, Calif., February 28, 1977.

Senator CHARLES H. PERCY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PERCY: This is in response to your mailgram of February 21, inquiring about my views on tax changes to stimulate economic activity. I am sorry that absence from the campus has delayed my reply.

I agree that moderate stimulus is needed to urge the economy upward from its present level toward higher employment, but a tax reduction of about the level recommended by the President should be the maximum approved by Congress now. The economy is showing substantial signs of stronger growth,

and delayed effects of a large tax cut now could contribute to over-stimulus by the end of the year or 1978.

I strongly favor permanent tax cuts over temporary cuts or tax rebates. This is because most of our evidence suggests that temporary cuts do not have as strong an impact on consumer and business spending as do "permanent" ones. While the tax rebate or temporary tax cut will clearly stimulate consumer spending to some extent (perhaps 40–50% of the amount rebated), we are unclear as to just how fast the total effect will take place, and hence unclear as to whether it will occur rapidly enough to do much good in the quick stimulus needed at this time. By contrast, a "permanent" tax cut is more predictable in its affect on consumer spending, both as to amount and as to timing.

At least as important as the issue of permanent versus temporary cuts is that of consumer versus business investment stimulus. I believe the economy badly needs stimulus to more business investment, both as a short run matter and for longer run healthy growth of the economy. Slow growth in business investment has been perhaps the major factor holding back the development of the economy over the past year or so, and without a substantial surge in private investment it is unclear that the present upswing wil continue strongly and robustly. Without substantial increases in private investment and plant capacity, there is a good chance that the upswing will run into severe capacity restraints in 1978, which could readily shut off the recovery well short of high level employment and stimulate inflation instead. Equally important, the evidence suggests that we will have difficulty meeting our basic national, private and social goals without a higher level of aggregate private investment than we are now getting. A tax cut now should be applied significantly to business investment as well as to consumer spending. For this purpose, I urge extension of the investment tax credit or a reduction in basic corporate income tax rates as a larger part of the present package. I urge you to support the original Carter proposal for business tax cuts over the amended proposal passed by the House, if that choice must be made.

Respectfully,

G. L. BACH.

TOWNSEND-GREENSPAN AND CO., INC.,
New York, N.Y., February 25, 1977.

Senator CHARLES PERCY,
Dirksen Senate Office Building,
Washington, D.C.

DEAR SENATOR: I very much agree with your view that permanent tax cuts are far more preferable than temporary tax reductions or rebates. In my view, the economy is recovering in a fairly solid fashion; no particular one-shot type of stimulus is needed. I am concerned however that although capital investment continues to rise, it is falling far short of our longer-term needs. Consequently, some stimulus in this area is essential. Ideally, it would entail a significant cut in corporate income taxes or some increase in the investment tax credit, with emphasis on increasing the tax credit for longer lived-assets. Currently, the investment tax credit unduly favors investment in short-lived assets.

While individual income tax cuts for the purposes of stimulus, are, to my mind, unnecessary at this stage, it is important that we recognize the need—from the longer term perspective—to periodically cut income tax rates. This would prevent the tax burden on the average family from rising and eating into consumer purchasing power, as inflation pushes individual families into higher income brackets. In effect, the graduated income tax in a period of inflation causes an increasing proportion of the average family's real income to be taxed.

The enclosed tables, prepared by President Ford's Office of Management and Budget, illustrate the need to periodically cut tax rates following periods of inflation, if only to maintain a stable rate of taxation.

My best regards.

Cordially,

ALAN GREENSPAN.

MEDIAN INCOME AND INCOME TAXES, SINGLE INDIVIDUAL[1]

	1976	1977	1978	1979	1980	1981	1982
Median income	$5,330	$5,850	$6,420	$7,100	$7,770	$8,310	$8,770
Federal income taxes:							
Under current law	$420	$508	$605	$734	$861	$964	$1,061
Taxes as percentage of income	7.9	8.7	9.4	10.3	11.1	11.6	[2] 12.1
Under President's tax program		$444	$540	$659	$723	$773	$816
Taxes as percentage of income		7.6	8.4	9.3	9.3	9.3	[3] 9.3
Further tax reduction to 1977 average tax rate			$488	$540	$590	$632	$667
Taxes as percentage of income			7.6	7.6	7.6	7.6	7.6

[1] Assumes deductions equal to 16 percent of income or standard deduction whichever is higher.
[2] The average tax rate in 1982 is 53 percent higher than in 1976.
[3] The average tax rate in 1982 is 18 percent higher than in 1976.

MEDIAN INCOME AND INCOME TAXES, FAMILY OF 4[1]

	1976	1977	1978	1979	1980	1981	1982
Median income	$17,300	$18,990	$20,840	$23,040	$25,210	$26,970	$28,460
Federal income taxes:							
Under current law (extended)	$1,977	$2,318	$2,706	$3,179	$3,689	$4,103	$4,490
Taxes as percentage of income	11.4	12.2	13.0	13.8	14.6	15.2	[2] 15.8
Under President's tax program		$2,069	$2,456	$2,918	$3,202	$3,425	$3,614
Taxes as a percentage of income		10.9	11.8	12.7	12.7	12.7	[3] 12.7
Further tax reduction to 1977 average tax rate			$2,272	$2,511	$2,748	$2,940	$3,102
Taxes as a percentage of income			10.9	10.9	10.9	10.9	10.9

[1] Assumes deductions equal to 15 percent of income or standard deduction whichever is higher.
[2] The average tax rate in 1982 is 39 percent higher than in 1976.
[3] The average tax rate in 1982 is 11 percent higher than in 1976.

WASHINGTON UNIVERSITY,
St. Louis, Mo., February 28, 1977.

Hon. CHARLES H. PERCY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PERCY: This is in response to your letter of February 21. I strongly share your preference for the enactment of permanent cuts in individual and coporate tax rates rather than temporary tax reductions or expenditure increases.

I spell out the rationale in the attached testimony that I presented to the House Budget Committee on December 15. A permanent tax reduction would have many benefits. It would avoid the problem of a sudden increase in tax payments in the following year. It would enable the Federal Reserve to follow a more stable monetary policy. It would provide a degree of confidence to consumers and business executives alike in their private planning.

It would also demonstrate a high degree of responsiveness to the widespread citizen concerns over both big government and high taxes. Unlike a series of temporary reductions, a permanent tax cut would mean that long-run expenditure planning in the government would be made in the context of a smaller future flow of federal revenue, thus providing useful fiscal restraint.

Best wishes.

Sincerely,

MURRAY L. WEIDENBAUM, *Director.*

SOME PERSPECTIVE ON ECONOMIC POLICY

(By Murray L. Weidenbaum)

A STATEMENT TO THE COMMITTEE ON THE BUDGET, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, D.C., DECEMBER 15, 1976

This is the time of year that the innocent bystander is likely to get caught in the cross fire of conflicting economic forecasters. Many liberal economists are urging ambitious new expenditure programs and large tax reductions in order

to prop up what they see as a sagging economy. In contrast, conservative economists are generally defending the status quo in economic policy.

Some perspective is necessary. Despite the moanings of the professional doom-sayers, the trend of economic activity in the United States is not headed downward, but continues upward. In the July-September 1976 quarter, the Gross National Product rose at an annual rate of 8.2 percent. Even after adjusting for the impact of inflation, "real" growth for the quarter was 3.8 percent. Virtually every economic forecaster is projecting a growth rate in 1977 at that level or higher.

Total employment is also rising steadily, from 85.6 million in November 1975 to 88.1 million in November 1976—an increase of 2.5 million jobs in twelve months.

THE TREND OF THE ECONOMY

Here is what my economic crystal ball shows: For 1976, economic growth will be 6 percent and the inflation rate will average 5 percent, with the Gross National Product rising 11 percent for the year. In 1977, I expect another 11 percent increase in GNP, but with the growth and inflation rates reversed—5 percent real growth and 6 percent inflation. Unemployment is likely to average 7 percent, with a moderate declining trend through the year.

There will be no boom areas in 1977. In recent months, the economy has been growing more slowly than generally expected. I foresee an upturn, but one of modest proportions. This moderate expansion will be accompanied by a recovery in housing, especially the construction of single family units, a rise in business inventories, and some expansion in capital investment. Consumer spending will grow at about the same rate as the economy as a whole. The federal budget for fiscal 1977 is anticipated to show a deficit of $55 billion or more on the basis of present policy. Although a decline from the fiscal 1976 deficit of $66 billion, that would still be a substantial injection of purchasing power into the economy.

THE EMERGING ECONOMIC POLICY DEBATE

An important policy issue is emerging: Are the projected rates of economic growth and job creation rapid enough to be accepted by the public and the government? Before answering that question, we must consider the important subject of inflation.

Over the past twelve months, the consumer price index rose by about 6 percent, while the wholesale price index is now 4 percent higher than a year ago. This is not double digit inflation, but it is substantially above historical experience. Future price prospects are not rosy. Another round of oil price increases is being seriously considered by the Organization of Petroleum Exporting Countries. Major union agreements provide for increases in wages and fringe benefits substantially above productivity growth, in addition to cost of living increases. Surely, the potential for another acceleration in the rate of inflation is present.

The concern about inflation is not limited to conservatives. Liberal economists now talk about "guideposts," "jawboning" and other forms of governmental involvement in private wage and price decisionmaking. President-elect Carter already has done some mild "jawboning" in the case of steel.

The economy is growing, but not at a pace rapid enough to make substantial progress in bringing down the unemployment rate, which appears to be stalled at a high level close to 8 percent. Simultaneously, the inflationary pressures in the economy are clearly evident and painful past experience tells us that they should not be ignored.

The upshot of all this is not to oppose all proposals for action or change. Rather, we should be wary of bold initiatives which attempt to deal with one of the two major economic problems while ignoring the other, and which would damage public confidence generally. For example, it has become fashionable to urge upon the incoming administration that it embrace a major program of public works and government employment as a stimulative device. That approach would be undesirable for many reasons, both technical and philosophical.

Such long lead time expenditure programs cannot be cranked up quickly. They involve lengthy authorization and appropriation hearings in the Congress and extended contracting and hiring procedures on the part of the many federal, state, and local government units that would be involved in carrying them out.

Also, the expenditure approach means a bigger public sector of the American economy, and thus less opportunity for private activities. In addition adverse

incentive effects on the labor force of the private sector will occur as government becomes the employer of "last resort." Moreover, the advocates of greater government spending ignore the likelihood that much of the celebrated "underrun" in federal expenditures during the past year will be made up by an overrun in the coming year (a sort of fiscal whiplash). Once again, the danger in turning on the spending spigot is that the resulting flow will be too much too late.

A DESIRABLE TYPE OF TAX CUT

A moderate degree of additional stimulus is now a sensible and desirable move in economic policy. The tax side of the budget is more promising than the expenditure side. But here the danger is that the result may be a disguised welfare-type handout rather than a legitimate reduction in existing tax burdens. Witness the rising interest in a "refundable" tax rebate with a low "ceiling."

In plain English, such proposals mean that Treasury checks will be sent to taxpayers and non-taxpayers alike, and that citizens with high tax loads will not get much more if any of a tax reduction than those with low tax loads. Also, the concentration on personal tax reduction ignores the continuing problem of the corporate income tax becoming increasingly severe in its real effects during an inflationary period (when depreciation allowances, for example, do not cover the cost of replacing capital equipment).

Those of us who have been contending that American industry is operating closer to full capacity than the official statistics show have recently been vindicated. The Federal Reserve Board has now amended upward its data on capacity utilization. For the July-September quarter of 1976, it now shows that manufacturing companies are operating at 80.9 percent of capacity, while the earlier figure for the same time period was 73.6 percent.

We are not that far from the peak of 87.8 percent of capacity which occurred in the shortage-prone third quarter of 1973. A reduction in corporate tax rates would provide additional financing for the increases in industrial capacity which will be required to avoid bottleneck situations as the economy grows during 1977 and beyond.

A permanent across-the-board reduction in personal and corporate tax rates is the preferred way of providing added fiscal stimulus to the economy—equivalent to approximately $10 billion of current federal revenue. This approach would provide a degree to confidence to consumers and business executives alike in their private planning. It would also demonstrate a high degree of responsiveness by the President and the Congress to the widespread voter concerns over both big government and high taxes. We need to recall that the social security tax rises on January 1 in the form of increasing the maximum amount of annual earnings subject to social security taxation from $15,300 to $16,500.

Unlike a one-shot rebate, a permanent tax reduction would avoid the problem of a sudden increase in tax payments during the following year. It would also enable the Federal Reserve System to follow a more stable monetary policy, which is necessary to support economic growth while continuing to dampen inflationary pressures. Of perhaps greatest importance, a permanent reduction in federal taxation would mean that long-run expenditure planning in the public sector would have to be made in the context of a smaller flow of future federal revenues than would otherwise be the case. That could be a useful restraint on the proponents of vast new expenditure programs, who tend to surface at the beginning of every presidential administration.

ADDITIONAL CHANGES IN PUBLIC POLICY

But fiscal and monetary policy changes will not be adequate to deal with the problem of high unemployment in an inflation-prone economy. The Congress needs to face up to the difficult but necessary task of reducing and hopefully eliminating those government programs which give an inflationary bias to the economy—and often increase unemployment at the same time—programs which are an anachronistic legacy of the 1930s.

It is no coincidence that unemployment is highest in those sectors of the labor market where government regulation is most severe. Unemployment rates in construction, for example, are higher than in the industrial economy. In the construction area, the Davis-Bacon Act (that legacy of the 1930s) tends to inflate costs and thus price homes and other construction out of the reach of many potential buyers.

With reference to the serious problem of high unemployment among teenagers, we must turn to that triumph of the heart over the mind: the minimum wage law. A recent study published by our Center for the Study of American Business showed that one increase in the statutory minimum wage law literally priced 320,000 teenagers out of the labor market.

Surely, jobs at or below the minimum wage do not yield incomes sufficient to support an entire family. But they do provide that essential work experience which enables now unemployed youth to gain the skills that subsequently will earn them adequate wages and enable them to participate fully in the mainstream of our society.

My basic point here is that it is unwise to try to offset the effects of these and other government regulations with an overly expansionary and, hence overly inflationary, macroeconomic policy approach. The more sensible approach is to reduce those government-imposed obstacles to employment and price stability.

CONCLUSION

With the prospect of continued steady improvement in the economy, we now have an opportunity to provide cautious, moderate stimulus with one eye to decreasing unemployment, but with the other eye trained on continuing to control and to reduce inflationary pressures.

A forward looking economic policy for 1977 would indeed give a needed lift to a slow-growing economy—hence the rising support for stimulus in the form of a tax cut. But a new departure in public policy should be more comprehensive. It is essential that any new approach to economic policy begin by shucking off the lingering vestiges of policies of a bygone era, and thus reducing the continuing burden of budgetary and economic costs that restrain the discretion of policymakers.

The elimination of the subsidies (regulatory, tax, expenditure, and credit) enacted during the 1930s and 1940s would free up the public and private resources to deal with current and future priorities. Otherwise, the Congress and the Carter Administration will find—as did their predecessors—that they lack the resources to continue the existing gamut of activities and simultaneously take on important new responsibilities.

THE UNIVERSITY OF MICHIGAN,
Ann Arbor, Mich., February 23, 1977.

Hon. CHARLES H. PERCY,
U.S. Senate,
Washington, D.C.

DEAR CHUCK: This is in response to your telegram, which I received yesterday.

Permanent tax reduction is clearly vastly superior to a rebate. A rebate is in essence a temporary tax reduction, and a temporary stimulus will inevitably produce a temporary (and fading) effect. My program would be a $12 billion personal income tax reduction, to raise after-tax personal incomes by 1 percent, together with requiring companies to take economic depreciation for tax purposes (which would be perhaps $5–6 billion of revenue).

With such an increase in after-tax income the basic demand for output could be expected to rise. With higher sales and an increased generation of internal funds companies could be expected to enlarge their capital budgets, and this gets at the specific weakness in the current economic situation. Two years after the low point of the recession, which is where we now are, capital outlays in real terms should have increased 10–12 percent instead of the 3 percent that has actually occurred. Most other major indicators are roughly on track.

You will find enclosed my testimony before the Senate Budget Committee on this matter.

Regards,

PAUL W. McCRACKEN.

TESTIMONY OF PAUL W. McCRACKEN BEFORE THE SENATE BUDGET COMMITTEE WASHINGTON, D.C., JANUARY 11, 1977

Mr. Chairman, I appreciate deeply this opportunity to appear again before your Committee. This Committee's work and responsibilities represent key elements in the new budget process, and all citizens are indebted to you for your labors in making these procedures effective.

I

As 1977 opens there is, of course, no paucity of reasons for concern about the state of the economy. While the year-to-year increase from 1975 to 1976 in the value of the nation's output of goods and services was a strong 11 percent, and over 6 percent in real terms after removing the effect of inflation, the profile of the economy's movement through the year raised questions about the sustainability of the expansion. In the first quarter civilian employment rose at the monthly average rate of 432,000, but the figure was roughly 50,000 for the final quarter, with outright declines in September and October. While month-to-month movements in the statisttics are often quite erratic, these figures must be evaluated against the on-going increase in the work force, whose basic trend is now rising at the rate of roughly 125,000 per month. A year ago, in short, job opportunities in the U.S. economy were opening up more than three times as rapidly as the underlying basic growth in the labor force, but in last year's final quarter the pace of job creation was opening up employment opportunities for only about half of the normal monthly net increase in the work force.

A major key weakness in the economy is investment. This shortfall is of substantial proportions. On the basis of experience during the last decade, by the third quarter of 1976 nonresidential fixed investment in real terms might have been expected to have been running at a rate something like 11 percent higher than that in early 1975. In fact, investment as thus measured was up only 2.7 percent.

This sluggishness of investment was not to be explained by an abnormally slow recovery of the economy. The rise of real GNP from the first quarter of 1975 to the third quarter of 1976 was 9.6 percent, and in no other recovery after a recession during the last two decades did the output of goods and services rise by that amount during a comparable period of time. The weakness of investment since early 1975 is not to be explained by the sluggish rate of general economic expansion.

RISE OF NONRESIDENTIAL FIXED INVESTMENT AFTER RECESSIONS

[Dollar amounts in billions, 1972 prices, at seasonally adjusted annual rates]

Year-quarter of recession low	Outlays in— Low quarter	Outlays in— 6 quarters later	Percent increase
1954—3	$55.9	$64.2	14.8
1958—2	58.5	64.5	10.3
1961—1	64.0	72.2	12.8
1970—4	106.0	114.6	8.1
1975—1	114.4	117.5	2.7

Source: Basic data from Department of Commerce.

RISE OF GNP AFTER RECESSIONS

[Dollar amounts in billions, 1972 prices, at seasonally adjusted annual rates]

Year-quarter of recession low	Real GNP in— Low quarter	Real GNP in— 6 quarters later	Percent change
1954—3	$614.4	$664.1	8.1
1958—2	668.2	726.2	8.7
1961—1	736.6	804.3	9.2
1970—4	1,071.4	1,163.0	8.5
1975—1	1,161.1	1,272.2	9.6

Source: Basic data from Department of Commerce.

Moreover, the evidence we have bearing on 1977 suggests that investment activity will continue to be sluggish. Projections of plant and equipment outlays for the first half of this year indicate a rise at a 5.4 percent annual rate. This would translate into something like a 1½ percent per year rate in real terms.

Now this investment weakness has more significance for us than its temporarily adverse effect on current business conditions. It represents the pace of activity that builds the new plants and new stores and new mines which as they go into

86-032—77——29

operation open up the new job opportunities which we shall be needing. If we do not get investment activity rising more rapidly, we shall find that as the economic expansion continues our basic "plant" capacity becomes quite fully utilized while the unemployment rate is still too high.

We must also recognize that the unsatisfactory state of the world economy has exerted an adverse effect on business conditions here at home. Since the Committee will have specific hearings on this aspect of the problem, only a few comments on this are in order here. During the year ending with the third quarter, our domestic demand for goods and services rose 11.6 percent. The demand for domestic output, however, rose only 10.4 percent. The reason for this gas was that, with their sluggish business conditions at home, our major trading partners did not increase their purchases from us as rapidly as, with our own more rapidly rising economy, we increased our purchases from them. Now this 1.2 percentage point difference may seem to be a demure little figure, but this gap significantly altered the performance of the U.S. economy in 1976. If the total demand for U.S. output had risen as rapidly as demand here at home for goods and services, employment today would be roughly 500,000 higher, and the unemployment rate would be in the 7½ percent zone.

A major challenge for the new government will be to work out policies with Japan and Germany, the other two major economies with some room for maneuver, by which there can be a coordinated expansion. Fortunately the President-Elect will find in Prime Minister Fukuda and Chancellor Schmidt two exceptionally sophisticated students of economic developments and policy.

II

In spite of these concerns we are, I believe, entitled to take a reasonably optimistic view about our economic prospects. For one thing the evidence we have in hand suggests that by November the economy was moving out of its becalmed state. Employment, production, retail sales, incomes—all of these major indicators seem to be moving upward again.

Moreover, as we moved into 1977 the economy was in a fundamentally better state of balance than it has been for several years. This is evident in the inventory position of businesses. For a variety of reasons businesses came out of the 1974–75 recession with inventories both heavy and unbalanced. By the end of last year inventories in the aggregate were more in line with sales trends, and imbalances were pretty well worked off. From the first quarter of 1975 to last year's third quarter the ratio of nonfarm business inventories to final sales, both in constant dollars, had declined 6 percent—a greater reduction than occurred in the recoveries of 1961 or 1971.

The capital structures of businesses have also been substantially strengthened. As the inflation inevitably became added to interest rates, these high rates disorganized equity markets, and businesses turned to the bond market for funds. In 1974, for example, the gross proceeds from common stock offering were down 63 percent from those in 1972, while proceeds from bonds rose 23 percent. As the bond market became overloaded, companies turned increasingly to short-term borrowing—in many cases in effect financing brick and mortar by issuing commercial paper or borrowing short-term from the banks. Short-term corporate borrowing more than doubled from 1972 to 1974, rising from 24.3 percent to 34.9 percent of corporate external sources of funds.[1] At the onset of the 1974–75 recession, many companies found themselves unusually illiquid and in a quite vulnerable financial position.

These financial weaknesses have largely been repaired. Corporate short-term debt in 1975 and 1976 actually declined, and close to $100 billion of long-term money was raised. Businesses are now in a fundamentally better position to finance a sustained expansion.

Finally, more progress has been made during the last year toward a better stability of the cost-price level than would have been predicted a year ago. As 1976 closed out the basic level of the rate of inflation was at about, or even slightly below, 5 percent. And labor costs per unit of output were rising at less than 4 perecnt in 1976.

We can say that the more stable price level which will make fear of inflation less dominant in the plans of businesses and consumers is now within our grasp if we exercise reasonable patience.

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[1] Cf. "Prospects for the Credit Markets in 1977," Solomon Brothers, 1977, p. 24.

ANNUAL RATE OF INCREASE IN PRICES AND LABOR COSTS, 1976

[Annual percentage rate from previous quarter]

	Consumer prices	GNP deflator	Compensation of employees[1]	Hourly earnings[2]	Unit labor costs[1]
Quarter:					
1	2.9	3.2	9.5	7.2	3.5
2	6.1	5.2	8.9	6.6	3.3
3	5.8	4.4	6.9	7.1	3.9
4[3]	3.7	NA	NA	6.6	NA

[1] For private nonfarm businesses.
[2] For the private nonagricultural economy. Adjusted for interindustry shifts and overtime in manufacturing.
[3] Increase from September to November annualized.

Source: Economic Indicators, December 1976, pp. 3, 15, 16, 24.

NA—not available.

III

What are the implications of these comments for policy, and particularly budget policy? A strong case can be made that we are on the right track and little change is needed. The economy is now in a good state of balance. Moreover, monetary policy, as calibrated by the rate of increase in the money stock, has been rising along a path supportive of strong expansion. The economy seems to move along the trial blazed earlier by the money stock, broadly defined to include time deposits (i.e., M_2). It is, in fact, interesting to note that during the last decade the average of the ratio derived by dividing GNP into the money stock (M_2) two quarters earlier, to allow time for monetary changes to affect the economy, has been 40.4 percent. Moreover, if we allow ourselves a half a percentage point on either side of this average, we would catch 33 of the 40 quarters. (This ratio for the third quarter of 1976 was 39.6 percent.)

The broadly defined money stock has been rising at about an 11 percent rate during the last year and at over a 12 percent per year rate during the final quarter of 1976. It would be a substantial departure from historical experience if we did not see GNP during the first half of 1977 increasing at roughly the same rate.

Introducing some further fiscal expansion at this time is, however, desirable. The forces that energize an expansion are complex. While the relationship between the money stock and GNP is close, we cannot be certain about the extent to which the rise in the money stock activates a rise in GNP, and the extent to which the rise in GNP activates the processes producing an expansion in the money supply. The cause-and-effect relationship, in short, may be a two-way street. It is a simple matter of prudence not to bet all of our chips on one policy horse. Moreover, we ought to be able to sustain a 6 percent per year rate of expansion in real output through 1978 and probably through 1979 *if the expansion is balanced and includes enough capital formation for the new facilities whose completion will open up needed new job opportunities.*

What would be the guidelines and general features of such a program? First, the objective should be to get the unemployed back to work as promptly as possible and into employment that does not represent dead-end jobs. Second, it is becoming increasingly clear that something is wrong in processes generating investment in our economy, and that a part of the problem is to be found in the fiscal operations of government. Third, it also seems clear that at the central core of the unemployed are upwards of one million who are not apt to have the experience of a regularly-earned pay check except through direct programs of government employment. I shall not, however, pursue this matter further here since experience seems to suggest that devising effective programs is a complex and difficult task in itself. In any case, these are matters that extend beyond the range of my own professional experience and competence.

The first requirement for a more vigorous rate of expansion is a higher level of consumer buying. With the resulting higher operating rates for industry, one basic requirement for a quickening in the pace of capital formation would be realized. Now the fact is that consumers are already spending a normal fraction of their after-tax incomes. To be precise personal outlays in the first three quarters of 1976 were equal to 93.2 percent of disposable personal income, and the average for the 10 years 1965–1974 was 93.1 percent. If consumer spending is to rise, after-tax incomes must rise, and the only effective way to do this without

also increasing labor costs per unit of output is by reducing their taxes. While there is no magic "right" figure, if this action is to be large enough to be significant it ought to increase after-tax personal incomes by 1 percent, and that means $12 billion in an economy already generating after-tax personal incomes at the rate of $1200 billion per year.

Would the extra take-home pay be spent? On this we have had substantial historical experience—in 1975, in 1964, and in 1954. In the second quarter of 1975 the spending rate was only 90.4 percent, reflecting the immediate effect of the rise in take-home incomes because of the tax reduction. Consumers began promptly to adjust their spending upward, and by the first quarter of 1976 the spending rate was 93.1 percent, precisely the decade average.

While low operating rates have been part of the short-fall of capital formation, a part of this problem has been created by the fiscal operations of government itself. The fact is that because accounting procedures did not require, as should have been the case, that the current value of capital expiring be charged as a cost in the current period, the proportion of true corporate income paid in taxes has increased sharply. In 1976 corporate profits taxes will be about 54 percent of corporate income as thus more accurately measured, compared with 41 percent a decade ago. And real retained earnings this year will be 60 percent below those in 1966, compared to a 40 percent increase in real compensation of employees.

Few things would do more to improve the prospects for operating the economy with declining and eventually low rates of unemployment than for the Congress to provide that corporations charge as a current cost the current value of capital expiring, and for the corporate income tax to be levied against this more accurate measurement of profits. This underestimate of true depreciation and therefore over-statement of profits is estimated in the national income and product accounts to be running about $15 billion per year. An assessment of current corporate profits tax rates against profits as thus more accurately measured would, therefore, presumably reduce revenues about $6 billion.

CORPORATE INCOME, 1966-76

[Dollar amounts in billions]

Item	1966	1976	Increase (percent)
Corporate profits [2]	$82.5	$120.0	45.5
Less: Corporate profits taxes	33.7	64.5	91.4
Dividends	19.4	35.0	80.4
Equals: Retained earnings	29.4	20.5	−30.3
In 1972 dollars:			
Rtained earnings [3]	38.3	15.0	−60.8
Dividends [4]	24.5	26.4	7.8
Compensation of employees [4]	554.0	775.0	39.9
Profits taxes as percent true profits	40.8	53.8	31.9

[1] Preliminary estimates based on incomplete data.
[2] After the inventory valuation and capital consumption adjustments.
[3] Deflated by the GNP price index for nonresidential fixed investment.
[4] Deflated by the GNP price index for personal consumption expenditures.

Source: Basic data from Department of Commerce.

One further point. It would be unfortunate if this major issue could not get a careful hearing because of rhetoric about "give-aways to business" or "tax relief to business vs. tax relief to people." This is palpably a false issue. There is no disembodied thing called a corporation or a business that pays any taxes. People pay taxes. People are the only beneficiaries of tax reductions. And the people whose material well-being is at stake here are not the affluent, who will do well enough with no action, but ordinary people who will need the jobs opening up because more new capacity will then be built, and others already employed whose aspirations for improvements in their real incomes will not be realized unless more new and productive equipment is put in place.

While tax reduction is a far more effective way to create new jobs than increased spending, there is a case currently for a modest public works program such as the $4 billion package recently in public discussions. That case is quite simply that in real terms public construction was in 1976 about 13 percent lower

than in 1971, in an economy whose real output was 14 percent larger. There is, in short, needed work to be done, and public construction has been lagging.

Would a $22 billion package, as suggested here, be too much? History suggests that it would not be out of line. Our problem is that we find it difficult to think in terms of an economy whose GNP this year will approach $1,860 billion. While a $22 billion package in absolute terms is large, relative to GNP it would be in line with actions taken in 1975 or 1954 and substantially smaller than the tax reduction in 1964–65.

Tax Reduction As a Percent of GNP

Tax Reduction of:	Percent
1954	1.2
1964	2.0
1975	1.8
1977 ($22 billion)	1.2

Source: Basic data from various Economic Reports of the President.

IV

Since details of the President-Elect's program were not available when this testimony was prepared, only a few quick comments can be made here. The President-Elect is, in my judgment, correct about the desirability of some fiscal stimulus. The size order of the package is not unreasonable if the $30 billion is to be spread over two years. It would equal about 1½ percent of the average GNP for 1977 and 1978.

The basic strategic assumption of a large but one-shot early tax rebate with higher subsequent spending is less commendable. The one-shot rebate is just that, a temporary and fading stimulus, and it does not provide the sustained improvement in take-home pay that can be the basis for long-run consumer commitments. Moreover, public spending is not apt to be as effective in creating new job opportunities with a reasonable prospect of durability as a permanent tax reduction.

The basic weakness of the program, however, is that it addresses the inter-related problems of over-taxed corporate income and low investment inadequately and too obliquely. If we want an economy that is not only expanding but building a wide base for low unemployment and permanent jobs that are not dead-end, these inter-related issues must be examined squarely.

Senator PERCY. Mr. Weidenbaum mentioned four advantages of a permanent tax cut over this temporary rebate idea. Permanent cuts would provide a degree of confidence to consumers and business executives alike in their private planning.

For 25 years I tried to figure out whether customers had confidence to buy our consumer products. That it is not an impulse purchase; it is a considered judgment purchase, a luxury item; and then we sat there year after year trying to decide whether to expand or contract.

It was all based on our sense of confidence as to what the future was going to be. Do you think people are going to develop confidence if they feel we are so worried about this economy that we have to give back $12 billion of money we do not have, of money they have already paid in? I don't think it will build confidence. It will erode confidence.

But if you give a permanent tax cut, they are going to have confidence in future income. And people do not spend present income; they spend future income. We always mortgage out the future. But if we do not have a permanent tax cut, we are not going to spend that $50 or $200; we are going to stick it under the mattress or someplace like that, but we are not going to go out and buy a home or automobile or big-ticket item.

The second thing Murray Weidenbaum said about a permanent tax cut: "It demonstrates a high degree of responsiveness to the widespread citizen concern over both big government and high taxes." That is a very telling point.

His third is: "A permanent tax cut would avoid the problem of a sudden increase in tax payments in the following year, which would be regressive."

Finally he says: "They would enable the Federal Reserve to follow a more stable monetary policy," with which certainly Arthur Burns agrees.

George Bach, professor of economics at the Graduate School of Business at Stanford University, had a very strong statement. I will read one sentence: "By contrast, a permanent tax cut is more predictable in its effect on consumer spending, both as to amount and to timing."

Ask anyone, whether it is a delicatessen store owner or whether it is the head of Sears, Roebuck, whether or not people are going to buy based on their future expectation that tax rates are coming down.

A very telling point on those tax rates is made by Alan Greenspan: "The permanent tax rate would prevent the tax burden on the average family from rising and eating into consumer purchasing power as inflation pushes individual families into higher income tax brackets"—a Democratic, Independent, Republican family, it doesn't matter what they are, the effect is the same.

What we are trying to do with a permanent cut is prevent an increase in taxes as inflation and wage rates push people into higher brackets.

In sum, a $50 tax rebate will provide, first, a small and very short-lived stimulus. Second, it will add to the deficit more than it will return in increased revenues. Third, it will not contribute to the consumer and business confidence that is so vitally needed for long-term, stable economic growth.

I just feel this: In talking with members of the administration, I get a sense of uncertainty. There must have been a lot of divisiveness inside the administration. I think we would be doing them a big favor. It is not politically easy to come along and shoot Santa Claus, who is willing to pass out $50 bills all over the country, but I tend to think politically it is a sound thing for us to do.

Let's not erode judgment in this Congress by doing this kind of thing. Let's restore confidence by saying no; we are not going to be in the giveaway business; we don't have it to give away. What we are going to do is adjust Government spending to a permanent tax cut and take into account the inflationary effects.

Finally, I would like to say that every piece of legislation we pass should have something in it regarding conservation. Our whole foreign policy is at stake today and we know that we are now subject to all kinds of problems if we do not have a rational energy policy.

This committee voted out a fine measure that provided a 30-percent residential insulation tax credit for the first $750. It was passed by the Senate. Why should we go back on that? Why not put it in this bill? Why wait?

We agreed on public works; we put a strong measure in to provide for conservation of energy and we did it unanimously, and we will insist on it in conference. Every piece of legislation we pass ought to have that principle involved in it.

Let's not wait on this one. It is urgent that we do it now. And when you consider that we can provide and show to individuals, as the reports have indicated, that if they will put in ceiling insulation, they get their return back in 2.3 years. If they put in wall insulation, they will get their money back in 6 years. If they put storm windows on, they will get their money back in 5½ years. If they put a clock thermostat in, they will get their money back, 50 percent a year, in less than 2 years. And for siding and weatherstripping, they get it back in 2 years.

If we give them a stimulant to do it, that is going to stimulate the building industry. We have something like 70 million homes in this country that need work done on them alone. Every factory and office building I know could stand some work.

That is the way to stimulate the economy. That is putting money where it will really pay off. We know we will get an investment. We know it will go to work immediately in jobs.

George Meany told me yesterday on the phone there is nothing more urgent we can do than to work for energy conservation. It will provide jobs for people who are out of work and it serves the national interest, Mr. Chairman. We will save all that energy for years to come, make ourselves less dependent on outside suppliers, and become a more independent and strong-minded Nation.

That is the way to stimulate the economy. That is where a businessman would put his money. I think when we are spending the taxpayer's money we ought to get a return on investment and be able to approve it.

If this committee cannot report a provision like that, I can assure this committee with every breath I have and every breath, I think, my colleagues have, that we are going to fight this out on the floor in a struggle that I think the American people, the labor unions, and the business community of this country will back up and support.

I therefore urge and hope that we will, in a bipartisan sense, report out a bill that represents the best thinking both parties can put into it and not just take carte blanche and send back the package that has come here from the executive branch of Government. I think it is time we simply say this has to be worked out between us properly and in a nonpartisan way and in a way that makes sense. Thank you.

Senator CURTIS. Thank you for your statement and for your endorsement of what this committee has already done.

Our next witness is the distinguished Senator from New York, Mr. Javits.

May I say something just before you start. At the close of your testimony and your interrogation, we want to invite you to join us on the committee. We are going to hear from some additional tax witnesses. They are entitled to an audience, and you will be permitted to take part in the questioning. I am sure they are all going to be good.

The first witness is the gentleman I have visited with several times. He has some very important testimony relating to employment and some rather small but very effective proposals that could be done to

our tax code. I hope all four of you will be able to stay and ask them questions.

Senator Javits, my speech is not charged against your time.

STATEMENT OF HON. JACOB K. JAVITS, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator JAVITS. I think I can live with or without the minute.

Mr. Chairman, my purpose in asking the Chair's indulgence to go last is because I wish to speak of the organized effort which has been made by the minority to present an alternative to the President's tax package and the dignity and consideration to which that is entitled.

I have no quarrels with whether individual members are here or not. I do not have a 100-percent attendance record at committee sessions myself, nor does anybody else. But I do think we are talking to the country.

And, Mr. Chairman, just as we have paid respect to the President's proposals, with our right to differ and debate I think it is only in the American spirit that respect should be paid to the minority's proposals, especially when the minority has taken the initiative and the study work and has practically unanimously adopted a set of principles and policies which are an alternative to the President's program and for which the Chair has heard, even though not focused directly on the minority's package, the individual items of that package most expertly and intelligently discussed.

And so, Mr. Chairman, I ask unanimous consent that the highlights of the tax package offered by the minority in the Senate may be made part of my remarks at this point. May I have that permission?

Senator CURTIS. Without objection, so ordered.

[The proposals referred to follow:]

TWO MILLION JOBS THAT LAST—A PROGRAM FOR PERMANENT JOBS AND INVESTMENT FOR AMERICANS

(By The Republican Conference on behalf of the Republican Members, U.S. Senate)

I. SUMMARY

Highlights

1. Permanent personal tax reductions effective April 1, 1977, totaling $17.3 billion in fiscal year 1977 and fiscal year 1978. The savings from these tax cuts would approximate $180–$210 per year for the family of four in the $15,000–$20,000 adjusted gross income brackets. Lesser amounts would go to higher income brackets.

2. A targeted youth employment and training program totaling $3.1 billion in fiscal year 1977 and fiscal year 1978.

3. A targeted employment tax credit encouraging the private sector to hire persons unemployed over 26 weeks; $1 credit per hour for the first 6 months, $0.50 per hour for the second 6 months; estimated $2.3 billion total revenue cost in fiscal year 1977 and fiscal year 1978.

4. Longer term investment incentives through (a) permanent tax reductions emphasizing small businesses, and (b) several programs designed to encourage smaller investors; total $2.8 billion in fiscal year 1977 and fiscal year 1978.

5. A housing rehabilitation program through GNMA; $200 million outlay in fiscal year 1978.

6. An energy conservation incentive through 30 percent tax credit on the first $750 of residential insulation investment; $500 million total in fiscal year 1977 and fiscal year 1978.

7. The job impact of the package is to create 1.83 to 2.3 million new jobs by the end of 1978, including 450,000 training and work experience positions.

8. For a total gross cost of $26.2 billion over fiscal years 1977 and 1978 (the net cost of $21.1 billion), the unemployment rate is reduced to an estimated 5.5 percent by the end of calendar 1978 from the current level of 7.9 percent. Moreover, the longer term investment components in the package should insure a sustained recovery with additional jobs created in 1979 and beyond to accommodate the expected growth in the labor force.

Economic analysis

There is little doubt that the economy is continuing a broadly based recovery. Moderate growth appears to be assured over the next several quarters and additional economic stimulus is not required in the near future to avoid a recession. However, there is evidence that an economic package to sustain the recovery is probably needed in order to assure significant and continued improvement in the unemployment rate and to reinforce consumer and business expectations which have been formed on the presumption that a stimulus package was forthcoming. Moreover, the impact of the exceptionally cold winter may require additional adjustments for humanitarian or economic reasons, but that question will be approached apart from this package. Since Congressional action on some type of stimulus package is likely, considerable care must be exercised regarding the size and the components of that package. Too much stimulus will likely cause another inflation cycle and the wrong components of the package will merely be an inefficient way of adding to the deficit and adding to inflation without a lasting improvement in the unemployment picture.

A successful stimulus package must recognize that the current unemployment problem consists of several component parts, each of which requires a different solution. Of the 7.9 percent current unemployment level, only about 1.5 to 2 percentage points is considered cyclical unemployment; that is, unemployment which might improve with demand generated by a broad stimulus program. As much as 3 percentage points of the current unemployment picture is structural unemployment; that is, unemployment caused by labor force skills and behavior that are not appropriate for available employment opportunities, or those that flow naturally from an improving economy. The solution to this problem requires sharply focused programs. Finally, there is a longer term need for capital formation in order to provide expanding employment opportunities at rising real wages. Unless that problem is addressed at this time, inflationary pressures caused by shortages, decreased output per worker and lack of additional employment opportunities appear likely in the future. To avoid these future problems, it is recommended that the Federal Government formally declare a national policy in support of adequate capital investment in the private sector.

Given the above analysis, the following criteria are essential to any economic package:

(1) In attacking unemployment caused by lack of demand, it must be recognized that temporary solutions have had very limited success in the past; thus, permanent, confidence-building solutions must be used now and this means a permanent tax cut, not some form of temporary gimmick.

(2) The package must include programs which are focused on the special unemployment problems of youth and minorities (50 percent of the present unemployment consists of persons aged 16–24).

(3) The package must provide for the longer term economic growth in order to sustain the recovery beyond the immediate 1977–78 period. This requires programs which encourage investment for creation of future jobs.

(4) The package must utilize the private sector, rather than the government sector, to the fullest extent possible in the creation of jobs and in training and work experience programs.

(5) The package must attempt to minimize the inflationary impact of its components.

The Republican package proposed here was designed with these criteria in mind. Starting with a goal of reducing unemployment to the rate of approximately 5½ percent by the end of calendar year 1978. Table I identifies the number of additional jobs needed to be created. With about a 2 percent growth in the labor force and the Congressional Budget Office current estimate of projected economic growth (3½–5%), about 0.9 percentage points of unemployment will be eliminated by normal economic growth alone using the midpoint of the CBO range. This still leaves an additional 1.5 million jobs which must be created to reduce unemployment to the goal of 5½ percent. Table II provides details of the proposed economic package, including costs and job creation estimates for each component. Table III compares the package proposed here with the Carter Administration package. In summary, for less cost ($26.2 billion gross cost here versus $31.2 billion for the Carter package), more jobs are created by this proposed package (1.83–2.3 million versus a Carter estimate of 1.2–1.5 million). This difference is primarily due to the fact that the Carter temporary rebates create only temporary demand, and thus only have temporary job creation impacts.

That the tax cut should be permanent rather than a temporary rebate is very important. Background studies have shown that temporary rebates are primarily used by consumers to reduce debt or add to savings and do not give sufficient confidence to consumers that they will incur installment debts. The January 27, 1977 Harris Poll confirms these studies as 62 percent of those surveyed said they would "put the money in the bank" or "pay off debts." Only 21 percent said they would "buy things they need." Thus, a temporary rebate would not appear to provide a stimulus to sales of major durables or non-durable purchases, an important objective of any stimulus program.

Regarding inflation, the Republican package can be expected to have a more favorable impact on inflation than the Carter proposal. The inflation pressures associated with employment increases are moderated by the focus on structural employment, the reduction of labor costs from the employment tax credit, and the investment incentives. Moreover, the temporary rebates of the Carter package are likely to create a surge in the money supply or a sharp increase in interest rates.

In summary, rather than to solve all economic problems through macroeconomic stimulation and publicly initiated projects of low productivity, the package described here attempts to address specific problems with specific solutions.

TABLE I.—EMPLOYMENT PROJECTIONS

	Average for year 1977	Average for quarter 1977:4	Average for year 1978	Average for quarter 1978:4
Labor force (millions)		97.8		100.0
Growth rate (without additional stimulus)[1] (percent)	3.5–5.0		3.5–5.5	
Unemployment rate (without additional stimulus)[1] (percent).		7.1–7.8		6.6–7.6
Unemployed (millions)		6.9–7.6		6.6–7.6
Employed (millions)		90.2–90.9		92.4–93.4
Assume approximate midpoint of above growth range (without additional stimulus) (percent)	4.5		4.5	
Unemployment rate (percent)		7.3		7.0
Unemployed (millions)		7.2		7.0
Employed (millions)		90.6		93.0
Possible policy objective:				
Unemployment rate (percent)				5.5
Unemployed (millions)				5.5
Employed (millions) (if reach unemployment objective)				94.5
Additional jobs needed (millions)				1.5
Proposed stimulus package: Jobs created (millions)				[2] 1.83–2.3

[1] According to CBO report, "The Disappointing Recovery," Jan. 11, 1977.
[2] This total includes 450,000 training and work experience positions created by the package.

TABLE II.—DETAILS OF THE REPUBLICAN ECONOMIC PACKAGE

[Dollar amounts in billions]

	Fiscal year— 1977	Fiscal year— 1978	2-yr cumulative cost	Jobs by end of calendar 1978 (thousands)
1. Permanent personal tax reduction (affects all taxpayers, emphasis for low and middle income, effective Apr. 1, 1977)	$4.5	$12.8	$17.3	450-600
2. Structural unemployment policies:				
(a) Youth employment and training, new CETA title VII	1.0	2.1	3.1	[1] 700-800
(b) Targeted employment tax credit (persons unemployed 26 weeks or longer)	.4	1.9	2.3	450-550
3. Policies to stimulate long-term investment				[2] 100-200
(a) Permanent corporate tax reduction for small business (cut rate to 18 percent for 1st $100,000 profit; effective Jan. 1, 1978)	0	2.1	2.1	
(b) Increase in dividend exclusion to $600 (helps stimulate equity investment, effective Jan. 1, 1978)		.2	.2	
(c) Interest income exclusion ($100 exclusion, helps smaller savers, effective Jan. 1, 1978)		.2	.2	
(d) Accelerated depreciation for investment in high unemployment areas (retroactive to Jan. 1, 1977)		.2	.2	
(e) Broadened stock ownership plan to encourage common stock ownership (effective Jan. 1, 1978)		.1	.1	
4. Program to stimulate housing rehabilitation (budget authority—$1,000,000,000 in fiscal year 1977, $2,000,000,000 in fiscal year 1978; but outlays small)		.2	.2	80-100
5. Energy conservation: Home insulation tax credit	.2	.3	.5	50
Gross cost	6.1	20.1	26.2	
Total jobs (includes 450,000 training and work experience positions created)				1,830-2,300
Less: Expenditures saved due to higher employment	-.8	-4.3	-5.1	
Net cost	5.3	15.8	21.1	

[1] Includes 450,000 training and work experience positions created.
[2] For 3(a), 3(b), 3(c), 3(d), and 3(e).

Note: The net cost figures only reflect direct Federal expenditures saved from higher employment (unemployment compensation, food stamps, AFDC, and medicaid) and do not reflect tax revenue increases generated by higher employment.

TABLE III. COMPARISON OF PACKAGES

	Republican	Carter
2-year costs (billions):		
Gross cost	$26.2	$31.2
Less: Expenditures saved due to higher employment	-5.1	-4.2
Net cost	21.1	27.0

[In thousands]

	Republican: By end of 1977	Republican: Cumulative total by end of 1978	Carter: By end of 1977	Carter: Cumulative total by end of 1978
Job impact:				
Total jobs created	550-750	1,830-2,300	940-1,040	1,215-1,515
Newly created training and work experience positions included in jobs totals	(250)	(450)	(200)	(350)

Note: The jobs numbers included in the Carter totals are those claimed by the administration. There is some doubt that these numbers will flow from the Carter package.

TABLE IV.—EXAMPLES OF PERSONAL INCOME TAX RELIEF (JOINT RETURN, FAMILY OF 4)

	Adjusted gross income	Tax liability[2]		Savings
		Current	Proposed	
Taxable income:[1]				
$5,000	$10,100	$670	$490	$180
$10,000	15,500	1,640	1,430	210
$15,000	20,800	2,830	2,650	180
$20,000	25,800	41200	4,110	90
$30,000	35,800	7,700	7,650	50
$50,000	55,800	16,880	16,830	50

PERCENTAGE DISTRIBUTION OF TOTAL TAX REDUCTION BY ADJUSTED GROSS INCOME CLASS[3]

0 to $5,000	4.8
$5,000 to $10,000	24.3
$10,000 to $15,000	29.1
$15,000 to $20,000	23.6
$20,000 to $30,000	15.2
$30,000 to $50,000	2.1
$50,000 to $100,000	.5
Over $100,000	.1

[1] Using standard deduction.
[2] Includes general tax credit.
[3] Percentages do not add to 100 percent due to rounding.

Senator JAVITS. Now, the three points which I think are critical—and I will not repeat some very strong and fine arguments made by my colleagues—are these:

1. The rebate. I do not think there is any question about the fact the basis for that is not proven, that it is a most improvident expenditure and that it should be rejected. In place of it, the Congress should have tax reductions.

There is one other reason for that, and that is that I believe by the time they get the rebate—which could be, say, April, May, or June—the economy would have gone up to such an extent that it would be really ridiculous just to load $10 billion more into it.

This is an enormous economy roughly $1,650 billion a year. $10 billion is not going to make it or break it, and the Government does not have that many shots in its armory in order to affect constructively the economy. So one wasted of this magnitude, which represents in round figures one-third of the total tax stimulus package even in the President's—and it is wasted; I think that case has been clearly made—is just very, very improvident.

I hope very much we won't do it, and I like very much Senator Percy's very strong determination expressed on that score.

Second, Mr. Chairman, is investment incentive. What is really feared about this particular recession is not that we will not recover in 1977, 1978. This country is vital enough so that recovery will occur. Maybe the upward slope will not be as steep as we would like, but it will continue. The real danger is, a real crack in 1979 or maybe even as early as 1978 because none of the profound structural problems have been dealt with. This is the real danger which faces the American economy. And the package which has been proposed by the minority very heavily targets in on that particular proposition. And it is very, very much worth the consideration of the country.

The energy conservation part has already been talked about. What has not been talked about adequately as yet is the cut in business

taxes respecting small business, cut to a much lower rate of tax for the first $100,000 of profits, which takes in a number practically 90 percent or more of American business.

That is real incentive and in intelligent approach to long-term investment incentives through the effort, for example, to reward new employees among the hard core unemployed, which is a very important feature of the program of the minority.

Something for housing—even the Democrats said nothing whatever was done for housing in their program. We do something for housing in respect to the rehabilitation effort, which is a critical element of housing especially with the high cost of housing today.

Over and beyond everything else, targeted help for youth, which we figure in our package of $2.5 billion and the whole Human Resources Committee, which I have the honor to be the ranking member, has already voted that that amount be asked for in its budgetary allocation thus signaling bipartisan finding on that score.

The Democrats always turn to us, and I am a very fit Senator to say that, not to be stiff-necked about being partisan, and yet we see this morning not a single Democratic Senator present.

Generally speaking kind of an attitude, well, you have got only 38 Members in the Senate, what is that about? But that is not the function of a minority, and it is not the way in which our system operates, and if anything—speaking for one Senator—it steels me even more strongly in my determination that this is the right line along which to proceed.

One other element of the package which very importantly needs mention is the people's capitalism. That is stock ownership by individual investors. Now, Senator Curtis was heavily responsible for including this item in the package, and I agree as the chairman of the subcommittee that drafted it that we should include it because it is the symbolic effect which is critically important. We ought to go in for people's capitalism on a really major scale in this country. That is a real rationale in terms of our system and whether we do it BSOP's or do it by more ESOP's or some other enlightened system of stock ownership or any combination of them that we can wrestle out.

The fact is, we should be committed to that principle, which I think is absolutely irrefutable if we are going to make this system mean anything.

Mr. Chairman, I would like to include at this point an explanation of each item I have referred to in economic terms as also part of the record before this committee.

Senator CURTIS. Without objection, so ordered.

[The explanation of the items follow:]

POLICIES TO COMBAT CYCLICAL UNEMPLOYMENT

Economic recovery since the 1975 second quarter trough has been characterized by an initial inventory liquidation of historic proportions and a gradual rebuilding to normal levels. The consumer sector suffered from lack of demand for both durable and nondurable goods. The initial drop in consumer durable purchases was so great that even though the rate of increase of durable purchases has matched previous recoveries and is expected to remain strong, the overall level is still low. Consumer spending on nondurables is forecast to remain sluggish for the foreseeable future. Business spending for plant and equipment has been extremely low throughout the recovery and although corporate financial structure has greatly improved, investment shows few signs of regaining strength soon.

Permanent individual income tax cut

To provide a strong and lasting stimulus to the consumer sector, any stimulus package should include a *permanent* tax rate reduction directed primarily toward low and middle income individuals. The higher realized and anticipated utilization rates of existing production facilities will at the same time provide the kind of stimulus to investment in plant and equipment that is needed at the present time. The permanent nature of the tax cut is important. Many studies have indicated that potential consumers require the security of the permanent reduction to incorporate their new purchasing power into their spending stream. These same studies indicate that temprorary reductions—or rebates—are likely to be used largely to reduce debt or will be put into savings (note the Harris opinion survey, January 27, 1977, among other studies). A tax rebate would thus contribute a relatively small and short-lived stimulus. Only a tax cut of a permanent nature (for example, a rate reduction or increased personal tax credit) would provide the strong and steady support for private spending that is essential for continued growth.

If fiscal policy were to duplicate the size of the 1964 tax cut, which some economists (though not all) view as a successful application of stimulus, the magnitude would be 2 percent of GNP, or about $35 billion. There are, however, at least three arguments which mitigate against a cut of that magnitude:

1. A portion of the 1964 tax cut was called for by the increasing drag upon after-tax income as inflation forced consumers into progressively higher marginal tax brackets. There had been no tax reduction for the preceding seven years before 1964; however, in the current situation, the 1975 tax cut and its recent extension has, to some extent, lessened but not totally obviated this need. While the entire tax cut provides economic stimulus relative to current policy projections, at least $6 billion of tax reduction can be viewed as necessary to offset the tax-increasing effects of inflation since the 1975 tax cut.

2. The composition of the industrial economy and labor force has changed radically since a decade ago, as has been illustrated earlier. Industry is more service oriented and requires more skilled labor. Also, a much larger production of current unemployment is structural in nature. Targeted job policies would be a much more effective approach to this problem than exclusive use of aggregate demand stimulus and would entail less risk of inflation aggregated by labor and product shortages.

3. Due to the extraordinary rates of inflation experienced in recent years, producers and consumers may be more sensitive to inflation, and, therefore, price decisions in the economy may be very sensitive to demand-stimulus policies.

An annualized $12–$13 billion tax reduction of a permanent nature would be sufficient to reduce cyclical unemployment problems and *a reduction in rates for tax brackets of $18,000 adjusted gross income and below is recommended.* This reduction is directed toward lower adjusted gross income barckets because taxpayers in these brackets tend to spend a greater average share of their income than relatively higher AGI classes. By adjusting all brackets $18,000 or below, some tax relief is provided to *all* taxpayers, but the maximum benefit goes to the 60 percent of all taxpayers who are in the tax brackets of $18,000 and under. Total personal income tax collections are reduced 7½ percent with the reduction being 14 percent of the tax liability for those individuals in adjusted gross income brackets of $18,000 or less. These brackets receive nearly 80 percent of the tax relief.

The tax liability savings for the various adjusted gross income classes is shown on Table IX.

TABLE IX.—EXAMPLES OF PERSONAL INCOME TAX RELIEF JOINT RETURN, FAMILY OF 4

Taxable income [1]	Adjusted gross income	Tax liability [2]		Savings
		Current	Proposed	
$5,000	$10,100	$670	$490	$180
$10,000	15,500	1,640	1,430	210
$15,000	20,800	2,830	2,650	180
$20,000	25,800	4,200	4,110	90
$30,000	35,800	7,700	7,650	50
$50,000	55,800	16,880	16,830	50

[1] Using standard deduction.
[2] Includes general tax credit.

Percentage Distribution of Total Tax Reduction by Adjusted Gross Income Class [1]

$0 to $5,000	4.8
$5,000 to $10,000	24.3
$10,000 to $15,000	29.1
$15,000 to $20,000	23.6
$20,000 to $30,000	15.2
$30,000 to $50,000	2.1
$50,000 to $100,000	.5
Over $100,000	.1

[1] Percentages do not add to 100 percent due to rounding.

TARGETED PROGRAMS TO COMBAT STRUCTURAL UNEMPLOYMENT

This paper has made the case that a considerable proportion of unemployment at the present time is structural in nature confined in many cases to labor force subsegments, and not totally susceptible to programs aimed at restimulating aggregate demand. For this reason, it is imperative that any stimulus package contain major elements directed toward these structural elements.

A. Youth unemployment

As the 3.6 million unemployed youth ages 16 to 24 (including 1.8 million under age 20) make a disproportionate share of the unemployed (nearly 50%), a specific program which focuses on youth is essential to addressing the structural unemployment problem. *A newly introduced CETA Title VII, The Youth Employment Act (YEA)*, which provides for comprehensive manpower services for youth, including work experience, on-the-job training, classroom training and public service employment is recommended for this stimulus package. YEA makes efficient use of the available CETA structure and provides flexibility to allow prime sponsors to structure the program to meet the needs of 14–24 year old youths in individual localities. The existing CETA Title I mechanisms, including the comprehensive planning process, the conditions for receipt of assistance, manpower councils at the State and local levels, and other administrative procedures, are incorporated by reference, eliminating the need for a new bureaucratic agency. A bonus is provided for prime sponsors who engage in cooperative projects with local or State education agencies. YEA provides for private sector involvement as well as public sector employment. Authorization is $1.0 billion in FY 77 and $2.8 billion in FY 78 ($0.7 billion of the FY 78 total is attributable to the CETA Title III Summer Youth Program which is combined with activities of the new title, leaving a net increase of $2.1 billion for youth employment).

The Comprehensive Employment and Training Act (CETA) is written in seven titles directed toward both cyclical and structural unemployment problems. The titles direct funds to State and local government for funding jobs for the unemployed, the long-term unemployed, the disadvantaged, older Americans, American Indians, Summer Youth Programs and job training. For FY 76, the outlays and actual jobs funded are shown in the tables prepared by CBO (Tables 6 and 7). For FY 77, $3.3 billion in BA and $2.3 billion in outlays has been appropriated for Title I–V. Though a supplemental is required for funding Title VI, room is available in the budget to provide 500,000 Title VI jobs at an average cost of $8,200 per job—$3.2 billion in BA and $2.0 billion in outlays. Already 260,000 individual slots are provided for under the continuing resolution for CETA Title VI. Such jobs must be filled by individuals unemployed 15 weeks or longer. These additional 240,000 job placements are not included in this package as they are already authorized and included in the current services budget. It should be understood that the Carter Stimulus package takes credit for these jobs already authorized.

B. Employment tax credit

In addressing the structural unemployment problem, it is desirable to rely whenever possible on the unique allocation ability of the private sector and to provide direct encouragement to the employment initiatives of labor force participants and employers. A *targeted* employment tax credit program can provide significant assistance and incentive in securing private employment for individuals not presently or adequately served by public training and employment programs. Employment of persons who face particular difficulty in finding a job and acquiring marketable skills and experience would be encouraged while total employment in the economy is increased. This approach represents a partnership

of the government and the private sector in resolving the difficult unemployment problem faced by the economy.

The wage cost incurred by business can be a major factor in determining whether a particular potential employee will be hired and whether additional workers will be hired. Wage costs may also strongly affect the prices charged and the resulting level of sales and production. The government recognizes the uncertainty and possible financial sacrifice faced by many businesses in hiring persons whose initial skills and experience do not match existing or potential job openings. Businesses cannot profitably hire workers and pay a wage that is in excess of the revenue generated by the employees productivity. Payment of an employment tax credit to private employers can be an effective way to bring about easier and more extensive employment (shorter job search and less unemployment) of targeted labor force groups and increased total employment in the economy.

An employment tax credit program targeted on individuals who have been unemployed for 26 weeks or longer is recommended. This approach would focus benefits on those most in need for work experience and earned income, and whose unemployment demonstrates an inability to secure a job without assistance.

Since extended unemployment is most prevalent in areas with high overall unemployment rates, this target would also serve to focus program benefits in high unemployment regions. There are presently approximately 1.3 million people who have been unemployed 26 weeks or longer. Between the second quarter of 1977 and the fourth quarter of 1978, as many as 3.0 million persons may have experienced unemployment of this duration. A tax credit of $1.00 per household per hour during the first six months of employment and $.50 per hour during the second six months is estimated to bring about 450–550 thousand reduction in unemployment by the end of 1978 at a cost of $0.4 billion in FY 77 and $1.9 billion in FY 78.

A variety of targeted or general program designs and administrative mechanisms are possible. A tax credit is easy to administer and would allow prompt implementation and employment at the initiative of business and eligible employees. Program information could be disseminated quickly through existing Treasury, Labor and Commerce Department channels.

The employment tax credit approach can fill an important gap in existing manpower and employment programs. Such a program can encourage and financially enable employers to provide a period of skill adjustment or on-the-job training for those who are not being reached by institutional manpower programs, for individuals who do not need extensive formal training or re-training, and for persons who encounter serious difficulty bridging the gap from public training and employment programs to private sector employment. In addition, by enabling businesses to hire additional workers at a lower net cost, the employment tax credit approach can have a direct favorable impact on the rate of inflation and total employment. That is, it provides a stimulus directly to the supply side of the market. This stimulus would be particularly effective in increasing employment at the present time when businesses generally have excess production capacity, as now, when the economy is in a recovery phase. Additional employees can more readily be put to work with existing underutilized equipment.

Because this approach to stimulating the economy has not been tried extensively, the exact effects of the employment tax credit are not known. As compared to other methods of attempting to increase employment, however, the employment tax credit directly encourages productive private sector jobs with high prospects of permanent employment. Those employed under the credit will be earning full wages paid mostly by private employers and will be paying taxes rather than drawing unemployment compensation and other income supplements. The emploment tax credit could easily be extended to a broader eligibility if it proves as successful as anticipated in expanding employment without added inflation.

POLICIES FOR LONG-TERM GROWTH AND EMPLOYMENT

Increased consumer demand resulting from reduced tax drain and targeted policies without an undue increase in the overall rate of unemployment will do much to encourage capital investment, yet business decisions are such that an expectation of continued increased profitability over the useful life of the capital is required to evoke the outlay

A. Corporate tax rate reduction

A permanent cut of the corporate normal tax rate from the current level (20 percent on the first $25,000 corporate profits, 22 percent on the second $25,000, and 48 percent thereafter) to 18 percent on the first $100,000 of corporate profits is recommended and would provide a reduction in corporate tax collections of about $2.1 billion for fiscal year 1978 (assuming a 1/1/78 effective date). In order to maintain the current 48 percent rate on profits in excess of $100,000, the surtax would have to be increased from 26 percent to 30 percent; however, this would have absolutely no tax dollar impact on profits over $100,000. The economic effect of this proposal should be to stimulate small business, although *all* corporations would receive some tax relief from the proposal. It should be noted that most service-oriented businesses are relatively small and labor intensive. Further, the service sector is the fastest growing sector in the economy. Consequently, the proposal should have a particularly favorable impact on employment.

B. Increased dividend and interest exclusion

An increase in the dividend exclusion from the current $100 ($200/joint return) to $600 ($1200/joint return) is recommended and is estimated to reduce FY 78 revenues by approximately $.2 billion. The addition of a $100 ($200/joint return) interest exclusion is recommended and is expected to further reduce revenues in FY 78 by $.2 billion. Both of these measures have an effective date of January 1, 1978. It is anticipated that these two proposals will encourage saving and investment through increasing their after tax rates of return. Further, the current tax system levies excessive burdens on dividend income through the combined effects of the corporate and individual income tax. This proposal should reduce this inequity. Finally, these exclusions will provide a measure of tax simplification for the recipients of small amounts of interest and dividend income.

C. Accelerated depreciation for high unemployment areas

In an effort to encourage investment in areas with high unemployment, accelerated depreciation for new plant and equipment is recommended. Specifically, for areas with unemployment rates in excess of 7 percent, it is proposed that (1) for buildings, straightline depreciation over a period equal to one-half their useful lives be allowed, and (2) for equipment, firms be allowed to amortize

In an effort to encourage investment in areas with high unemployment, accererated depreciation for new plant and equipment is recommended. Specifically, over five years with a full investment tax credit (under current law, a full investment tax credit is allowed only for seven-year or greater amortization periods). This incentive would be limited to projects begun in calendar year 1977 and completed within 36 months. The revenue loss associated with this proposal is negligible for FY 77 and $0.2 billion for FY 78.

D. Stock ownership proposal for lower and middle income investors

A stock ownership proposal designed to encourage common stock ownership by lower and middle income investors is recommended. Under such plans, there is a $1500 limit on the maximum amount of the annual contribution eligible for the exclusion from income tax, and the income earned by such plans will be tax exempt. Taxation is deferred until the benefits are actually distributed at which time they will generally be subject to tax at capital gain rates. The maximum benefit accrues to those persons in the income brackets of $20,000 or under, but the proposal also benefits individuals in the $20,000 to $40,000 income brackets.

ENERGY CONSERVATION THROUGH HOME INSULATION CREDIT

Current concern over the energy crisis and the resultant implications for the economy underscore the need for energy conservation. A tax credit designed to encourage residential insulation (including thermal windows, storm doors, etc.) is proposed as a part of this stimulus package—specifically, a refundable credit of 30 percent of the first $750 insulation expenditure (maximum credit of $225). It is further suggested that the provision be effective for the period between January 1. 1977 and December 31, 1978. The revenue losses associated with this proposal are estimated to be $0.2 billion for FY 77 and $0.3 billion for FY 78.

86-032 O - 77 - 30

As noted earlier, the home insulation tax credit is only the first of what may prove to be several proposals related to moderating the economic cost of the severe winter. Additional time is required to assess the exact nature of the winter's impact so that appropriate Federal responses can be designed. It was not intended that the home insulation tax credit be the only program addressing this problem.

CYCLICAL PROBLEMS IN THE HOUSING INDUSTRY

Though unemployment in the construction industry remains relatively high, the housing industry component is showing definite signs of recovery. The preliminary estimate of privately owned housing starts in 1976 is 1,539,700. This is 33 percent above the total of 1,160,400 for 1975. Privately owned housing units were started in December 1976 at an estimated seasonally adjusted annual rate of 1,940,000. This was 13 percent above the revised November 1976 rate of 1,716,000 and 51 percent above the December 1975 rate of 1,283,000.

The December seasonally adjusted annual rate for single family housing starts was 1,323,000 units compared with the November rate of 1,237,000. The rate in December for units in apartment buildings with 5 or more units was 502,000 compared with the revised November rate of 382,000. The December rate for units in buildings with 2 to 4 units was 115,000. Housing starts do not include mobile homes.

Funds available at savings and loan institutions (which finance 45 percent of all single-family home mortgages) continue to be abundant. Savings capital at these institutions has risen from $243.0 billion in December, 1974, to $286.0 billion in December, 1975, and to $330.3 billion in December of 1976. Over this same period total conventional, VA, and FHA loans outstanding by savings and loan institutions have risen from $249.3 billion in December, 1974 to $273.7 billion in December, 1975 and to $319.6 billion in December, 1976. Nevertheless, this stimulus package contains four elements which would have considerable impact upon unemployment in the construction industry.

1. By adding to the Federal deficit smaller amounts with more prompt impacts than other packages, less pressure is placed upon interest rates as the economy recovers toward full employment. Lower nominal interest rates may be the single most beneficial factor in promoting recovery in the construction industry.

2. As indicated later in this paper under "Policies for Long-Term Growth," an interest income exclusion from taxes is recommended. This interest exclusion from individual income tax liability encourages a continued flow of savings to thrift institutions.

3. A permanent cut in the corporate and individual income tax rates encourages long-term investment in durable goods and new plant and equipment. This is an effect which temporary rebates would not have.

4. To encourage construction while at the same time directing money to central city regions, it is recommended that Budget Authority be added to the Government National Mortgage Association (GNMA) budget for rehabilitation of housing units. At present, GNMA does not have a secondary market in rehabilitation mortgages, but the omission could be redressed by administrative changes. Budget Authority would be $2.0 billion in FY 77 and $1.0 billion in FY 78. Outlay cost, assuming that GNMA could sell the mortgages under a "tandem" procedure, would be the difference in the sales price of a note bearing a 7½ percent GNMA interest and the market interest. This would add approximately $.2 billion to the FY 78 budget, though nothing would be added in FY 77 as the program takes 6–15 months to obtain loan commitments but FHA approval could be expedited to reduce this delay. The amounts indicated would be sufficient to upgrade (not add to housing stock) about 75,000 units. It should be noted, however, that data regarding costs are very uncertain since the program has never operated under a rehabilitation scheme.

In the longer term, there is a continuing need to examine the way in which we finance the purchase and sale of housing. A number of imaginative proposals for recasting the mortgage instrument have been made, including proposals for an equity-adjusted mortgage which would allow the purchasers to make lower payments during the early years and higher payments during later years, thus tailoring the payment stream to expected increases in income. Also worthy of consideration are the variable rate mortgages and other alternative mortgage instruments.

STIMULUS PACKAGE EFFECTS ON GROWTH, EMPLOYMENT AND INFLATION

An economic stimulus package of the type indicated by this analysis would produce employment and growth results somewhat better than the 6% real growth rate (1977 and 1978) and the 6% unemployment rate (end of 1978) suggested by President Carter and others as appropriate economic goals. In addition, a smaller budget deficit over a long period and lower inflation rates than associated with other stimulus packages yielding the same goals can be anticipated because of the targeted nature of the program.

It is difficult to predict the precise numerical effects of any economic stimulus policy, and misleading to calculate the effects of a stimulus package as the single summation of the estimated effects of its parts. This is particularly true of the stimulus package described here. The employment tax credit program to stimulate employment and training is a novel approach which introduces direct incentives, the effects of which are difficult to predict from historical data. Similarly, past experience is insufficient to gauge the economy's response to the innovative and substantially increased focus on the problem of structural unemployment. Thus, the conclusion concerning the growth and employment goals that could be achieved is based on disaggregated or microeconomic comparisons of the focused and unique nature of this stimulus approach compared to conventional estimates of other, more traditional stimulus packages.

Finally, the longer-run absorption of an expanding labor force at growing real wage levels requires an adequate flow of savings into productive capital formation. Although industry utilization rates now appear to be below the full capacity range, policies are needed which are compatible with bringing capital foundations as a percent of GNP back to, or above, levels of the last two decades. In furtherance of these policies, the Federal Government should formally declare a national policy in support of adequate capital investment in the private sector.

In addressing these components of the present and future unemployment problem, the analysis and policy decisions must be increasingly disaggregated and microeconomic in focus. The appropriateness of simple macroeconomic measures of U.S. economic performance and the effectiveness of macroeconomic policies to solve our economic problems are highly questionable. The trade-offs associated with this approach appear to be increasingly unfavorable. For this reason, we must look to policies which provide incentives and direction resulting in more optional employment, production, and pricing decisions in the private economy. It is only in this that the main distributional problem in our economic system—unemployment—can be satisfactorily resolved over time.

Senator JAVITS. In summary, Mr. Chairman, we want the timing on the rebate, if nothing else, let alone its unlikely spending to improve consumption, let alone the fact that it is investment that is meaningful in our recovery, not these transient consumption expenditures that have been referred to.

I do not believe the American people are going to be hoodwinked or misled by a $50 tip.

Some will, but this is a big country with a lot of people and they have shown their brains in many States to see through such nonsense as is being offered to them in that. That is one.

Point 2, the real danger in structural unemployment and the difficulties with our economy, with one-half of the total number of unemployed under 24 years of age can reiterate and reiterate and paint in larger letters on every building represents a bankruptcy of our economy, not a recession.

And yet there is no mind to reorganize that economy when we have a change to wit through the tax system at this particular point.

And finally, Mr. Chairman, the fact we must target in our remedies to the targets which are presented by our difficulties and this we do in the package we have presented. We hope that our package will have the same consideration the President's will and that the Congress will be

selective in choosing from us what is good for us, and from the President what is good for him. Nobody will try to win a victory, which will be a victory at the expense of the American people for simply the political purpose, well, my program did it. That would be a curse and not a blessing to the country.

Thank you.

Senator CURTIS. I thank you, Mr. Javits.

Senator Packwood, may I say while we will observe the 10-minute limitation, it will not impinge on your questioning but we will come back.

Senator PACKWOOD. I think we all pretty much agree on the rebate versus the tax reduction. I find more difference of opinion even among Republicans and among Democrats on the jobs tax credit package versus the investment tax credit versus the 4 percent social security alternative.

I am curious if any of you would address yourself to that. Is there a preferred one of the three or should we have any of that in this package?

Senator JAVITS. If I may, I think this question is a very tight one mainly because of the difficulty of finding a way to do it. I do not think there is much difference of trying to attract employment for the hardcore unemployed. I would like to see us address ourselves to it. There have been many efforts. I do not believe it is insoluble. It is worth trying. It may be slightly wasteful in the sense you may not get 90-percent return. But if we can get 70- or 75-percent return or even 66⅔ return, it does address itself to a very keen factor which is now to break this nut of the hardcore unemployed.

But I would not do that at the expense of encouraging investment in America and the modernization of the American business plant. So I would seek to divide what I have available in the package between those two things, but I would like to see an experiment with employment if only for the training part to encourage major enterprises to take on people in order to give the training which comes from having the job and learning the skills which are inherent in it.

Senator McCLURE. Mr. Chairman, I would like to make just this comment.

First of all, any analysis of what has happened in economic growth in the past would indicate that what has become known as Okun's law does not apply evenly throughout all of the labor groups within the economy. It is not just a question of the youth employment, which is another example of the same thing; the hard core unemployed are also not affected in the same way by general economic stimulus and general economic growth as others.

So you may want a targeted approach in regard to the hardcore unemployment rather than simply general economic upgrading. As far as the social security 4-percent credit is concerned, that is dealing with the problems of the cost of creating new jobs, what is the cost to the employer of a new job. That simply reduces that particular burden on a cost of employment from 11.7 percent of payroll to 11.66 percent of payroll.

To put it in those terms, it becomes obvious that it is almost nothing. If you are really trying to reach through to a hardcore unemployment, it is a very ineffective tool.

Senator PACKWOOD. Do you think we would reach through to it any better with the House approach, which is the 40 percent subsidy but a cap of 24 employees does not cover employers who employ two-thirds of the people in the country?

Senator JAVITS. I do not think so because it does not discriminate between the segments of the unemployed. I think the alternative the House Ways and Means Committee gave of an investment tax credit or a reduction in social security or credit for social security taxes paid are both macrotools rather than microtools in dealing with hardcore unemployed.

Perhaps it would be helpful if I inserted in the record at this point a table which we developed through the data research, DRI, model as to the effects on different segments of the population by economic growth. It clearly indicates that economic growth of itself affects different groups within the labor population in a much different way.

Mr. Chairman, I would ask that that table be inserted in the record at this point.

Senator CURTIS. Without objection, so ordered.

[The table referred to follows:]

RESPONSIVENESS OF LABOR FORCE SEGMENTS TO CHANGES IN GNP GAP [1]

[In percent]

Labor force segment	Reduction in gap required to reduce segment's unemployment rate 1 percent	Segment's unemployment rate at which changes in aggregate demand no longer reduce their unemployment rate
Married males	2.20	1.7
Females	2.94	5.0
Nonwhite	4.80	7.2
Teenage	5.56	12.6
Teenage males	6.02	12.0
Teenage females	4.54	14.1
Teenage nonwhite	10.10	25.3

[1] Data based on the period 1966 to 1976.

Senator DOMENICI. Could I address the question?

I think the danger, Senator Packwood, is that you would assume that by conventional macroeconomic approaches that you are going to be able to solve the problem of structural unemployment including youth and hardcore. I think there is ample evidence the package you have before you from the House, almost any macrostimulus package, unless you wanted it to be four or five times higher than we are talking about, is going to have a minimum national impact on the structural unemployment problem, or to put it in Senator McClure's words, you would have to spend so much, macroeconomically speaking, that you would be kind of hitting a gnat with a sledge hammer.

So I think you are left with the option of, do you do nothing or do you, as Senator Javits indicated, experiment? And it appears to me that you could very well serve the American people by experimenting with some targeted kind of subsidy program, the kind perhaps that Senator Bentsen has spoken of, Senator Dole has spoken of which subsidizes for a limited period of time a well defined category of structural unemployed.

I think there is real danger, Senator Packwood, in limiting, as the House did, to the small companies in America. They should not be excluded, but I believe we would not be accomplishing a very meaningful experiment to limit it as they did because it would not be a broad enough base test.

I would also say this: As far as the administration social security experiment, at another hearing I asked the Secretary of the Treasury very pointedly whether he thought his former company, the one he was president of, one of the major American companies that employed many people, would really employ really very many more people under that approach. I can tell you without quoting him verbatim, he smiled as he answered and said he really don't believe it would cause them to hire anyone.

Senator PACKAWOOD. Should we increase the investment tax credit from 10 to 12 percent? That is an across-the-board approach to encourage capital investment. It may be a way to attack the undercapitalization, the lack of capital investment in our industries generally.

Senator DOMENICI. I will give you a quick intuitive answer. I am not as expert on it as you members of the committee are and some of my fellow Senators. I think it is certainly a good macrotool, but I do not think we ought to assume that it would have very much impact on that very significant amount of unemployment that is structural.

Senator CURTIS. Senator Packwood, we will return to you to continue, but we will rotate now to Senator Danforth.

The Chair will refrain from questioning until you have both finished.

Senator Danforth.

Senator DANFORTH. Mr. Chairman, I just say I am a little pessimistic this morning because I have thought that we were part of a deliberative body and the group that had the best ideas would be the ones that would prevail.

I share the disappointment of the panel of witnesses this morning that there has been an apparent boycott by the majority members of this committee and also that there is such a very small representation of the press at this meeting because I think this panel has presented concepts that are worthy of consideration.

I know the time and attention and work that went into preparing the package that you have presented to us, and I think it is fair to say, correct me if I am wrong, that you do not have any pride of partisan authorship. Your view, I think, and certainly my view is that we are trying to enrich the thought process in developing the best possible stimulus package. We are not arguing whether or not there should be any in this package. We are trying to provide the best stimulus package. And your proposal is one that should get bipartisan attention because we have to recognize that the thing we are trying to do is to solve the human tragedy of unemployment. It is more than statistics, it is more than 7 or 8 million people unemployed. It is the transience of the individual lives affected by that, and hopefully what is more important than partisanship that can be attached to one proposal or another is the concept that it is going to try to do something about this tragedy.

As I understand it, your position is very simple. Your position is that the package that you propose is better than the package that the President proposes.

As I understand it, you are saying your proposal will create more jobs, that it will create longer lasting jobs, that it will do so at less cost to the Government and that it will do so with a less effect on inflation that the President's proposal or the House's program.

What I would like to ask you is, do you have any kind of technical evidence, econometric models, statistical evidence that would demonstrate that your proposal, in fact, works better, that it would put more people on the payrolls and that it would be less costly as far as the Government is concerned?

Senator JAVITS. I just want to say, then I will yield to Senator Domenici, that I put into the record, I did not because of the time limitation read the economic analysis which demonstrates we do produce more jobs by $300 to $500 that it does cost less money by $3 billion to $4 billion and based upon experience of what has happened in other tax reductions, that it is a more foolproof approach.

But I would like to join you, Senator Danforth, with what you said and what we tried to say. That that is, we are not insulted or dismayed by the fact apparently they are not particularly interested on this on the Democratic side. We hope it is only because the people are busy. They will hear us.

There are lots of ways we can make and make sure of it. I am personally determined that every one of these issues will be aired on the Senate floor when we have a tax bill. We have got to consider every one. If they cannot be considered adequately here, then they will be considered on the floor with adequate time to be sure they really are considered, they are not just brushed. Having been considered and acted upon by the Senate, I think that is all we can ask for.

Senator DOMENICI. In response to that question, I would take just one aspect, Senator Danforth, and submit evidence as to the tax rebate versus the permanent tax cut. I would cite for the record Congressional Budget Office's January 11, 1977 analysis called the Disappointing Recovery. On page 18 they indicate "Index studies reveal a temporary tax cut is probably less effective in reducing unemployment than a permanent tax cut of the same size."

And they proceed to say "A higher fraction of the temporary cut, how much higher is not at all settled among the economists, is likely to be added to savings rather than spent."

I have the result of the Chase Econometrics' model, by Michael Evans, and I will ask this be made part of the record. They actually took the rebate and the tax cut. They conclude that by 1978 the prices will be up 2 percent with the rebate. With the personal cut, inflation will have a 1-percent increase, that is a 2 to 1 better result.

In terms of employment, the 1-percent increase for the tax rebate, 3 percent for the permanent tax cut. That is as solid as Chase's model is reliable. I would ask that be made part of the record.

Senator CURTIS. Without objection, it will be incorporated in the record.

[Chase's model results follow:]

TABLE 3.—COMPARISON OF ALTERNATIVE METHODS OF FISCAL STIMULUS

	GNP [1]	GNP [2]	Employment [3]	Prices [4]
Increase by 2d quarter 1978 in:				
Due to $10,000,000,000 of—				
Tax rebate	11	6	0.2	0.1
Personal income tax cut [5]	11	8	.2	0
Investment tax credit [5]	2	1	0	0
Corporate income tax cut [5]	14	9	.2	.1
Increased Government spending [6]	14	9	.4	.1
Increased by 2d quarter 1979 in:				
Due to $10,000,000,000 of—				
Tax rebate	3	1	.1	.2
Personal income tax cut [5]	18	11	.3	.1
Investment tax credit [5]	9	6	.1	−.1
Corporate income tax cut [5]	20	13	.3	−.2
Increased Government spending [6]	15	8	.3	.3

[1] GNP=gross national product in billions of current dollars.
[2] GNP=gross national product in billions of constant (1972) dollars.
[3] Employment=number of jobs in millions.
[4] Prices=Consumer Price Index, 1967=100.
[5] At 1977 levels of income.
[6] $5,000,000,000 public works; $5,000,000,000 job creation.

Senator DOMENICI. I would state, Harris conducted a poll on January 27. Is is just that, a poll, but a very broad based one. It suggested that 21 percent of the consumers plan to spend all the anticipated $50 on things they need. The remainder will be distributed as follows: 33 percent plan to put the money in the bank; 29 percent plan to pay off debts; 15 percent plan some combination of debt reduction and savings and spending.

I would ask that that summary be made part of the record.

Senator CURTIS. Without objection, so ordered.

[The Harris poll referred to follows:]

HARRIS POLL, JANUARY 27, 1977

33 percent plan to "put the money in the bank."
29 percent plan to "pay off old debts."
Only 21 percent plan to "buy things they need."
15 percent plan some combination of above.

Senator JAVITS. We also include the National City Bank of New York, its monthly economic letter coming essentially to the conclusion that rebates are essentially saved. That is the historic experience.

Senator CURTIS. Without objection, so ordered.

[The National City Bank of New York monthly economic letter follows:]

RUNNING THE REBATE UP THE ECONOMETRIC FLAGPOLE

The track record on tax rebates, such as that proposed by President Carter, shows them to be fine on the hundred-yard dash but lacking in long-distance stamina. In other words, the proposed program would provide the economy with a windfall gain in income and purchasing power—a one-shot increase in disposable income that would be absorbed quickly and just as quickly forgotten.

Gains from previous rebate programs, such as the one in 1975, have largely been "saved," if saving includes investment by consumers in durable goods—automobiles, furniture, household equipment, to name a few. And that time, too, while the refunds eventually were translated into increased consumption, they showed up as having "borrowed" from future quarters' sales.

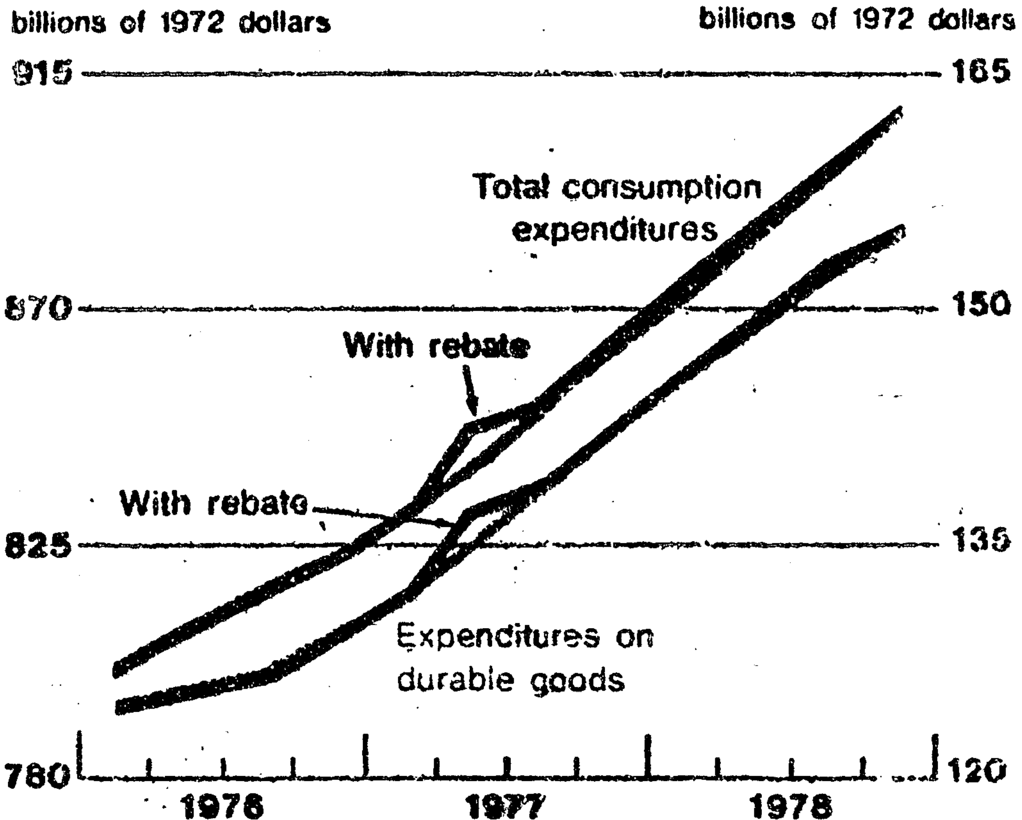
To get some idea of just what effect a tax rebate of $12 billion beginning in the second quarter would have, Citibank economists ran such a scenario through their econometric model of the U.S. economy and compared the results with the pattern of consumption they believe would prevail in the absence of a rebate.

Since consumer durables represent a large share of consumer investment, it could be expected that they would gain most heavily, while spending on non-durables—food, beverages, clothing and shoes—and such services as housing and transportation would get less of a kick from this transitory change in income.

And so it turned out. For 1977's second quarter, when the rebates are expected to be distributed, total personal consumption of goods and services, with the distorting influence of inflation removed, is seen to rise by an annual rate $6–7 billion higher than would be expected with no rebate program. In the area of durable goods, the rebate could mean as much as $2 billion in additional expenditures, largely in the furniture and household-equipment category. The annual growth rate is double in that area what would be expected with no rebate.

In the nondurables category, rebates provide some $4–4.5 billion in the second quarter, with clothing and shoes alone accounting for $2 billion of the increase. Services remain virtually unaffected.

With the third quarter of 1977, the economy begins to return to its long-term growth track (chart). But rates of change in growth form a slightly different pattern. Rates of change climb considerably above long-term track in the first quarter of the rebate, then drop bleow the long-term track before returning to it. The reason for this is that the stronger economic growth when the rebate is distributed is essentially borrowed from future consumption. And because of this, the effects of the rebate are largely washed out.



When the impact of the rebate is compared on a year-over-year basis—1977 over 1976—it becomes apparent how temporary the additional growth really is. Total personal consumption spending is seen to rise at a 4.5–5 percent rate under both scenarios. And the spreads in growth rates of the component categories are insignificant from the perspective of the entire year.

Senator DANFORTH. On Tuesday, Charles Schultze was asked about the difference of approach between a rebate and a permanent tax cut, and he said, and this is a paraphrase, but I think it is a fair paraphrase, that he was not certain which would create the most number of jobs, but that there were other criteria that he wanted to bear in mind. And

I would like to particularly offer those for you and ask for your comments on them.

He said that if we had a permanent tax cut, it would tend to foreclose options for the future and that those options would be a balanced budget by 1981. He thinks that a permanent tax cut would make it more likely that we would have a deficit by 1981 than would a rebate.

He further said that the administration wants to send to the Congress in September a comprehensive tax reform package and that it would be more likely that they could get the tax reform package implemented if it were tied to a permanent tax reduction that may be or may not be submitted at that time.

And a third alternative that he did not want to foreclose is that if you have a rebate instead of a permanent tax reduction, a couple of years from now he believes there would be more money available in the Federal Government to spend in other ways—social programs and the like.

I would like your comments on that answer by Mr. Schultze.

Senator McClure. May I comment on it? Your first point and third point and his first point and third point are identically the same. He said, if I understood what you said there, the tax cut now would be more likely to yield a deficit in 1981. The third point was it would reduce the amount of money that was available to the Federal Government to spend in other programs in 1981. Those are the same points. All they are saying is, they want to have a program for tax increase rather than leaving the money with people of the country. I think that is a very clear choice we will make.

With regard to the question of whether or not a permanent tax cut is necessary to be held off now so that it can be put into a tax reform package later, I think that was the major point Senator Domenici addressed in his opening remarks, that the American taxpayer ought not to be held hostage for that kind of demand for tax reform. I think this committee is perfectly capable and certainly has in mind coming out with a good tax reform bill. And I think this committee in exercising that responsibility will do so. I have no doubt. I do not think you have to be held hostage either to that kind of pressure generated for permanent tax cut. I just do not think the argument is well taken.

May I also, in regard to your last question, I would like to quote from my colloquy which took place before the Joint Economic Committee on February 24 when Mr. Burt Lance was before that committee and Congressman Clarence Brown of Ohio asked this question. Just to paraphrase Congressman Brown's question he says, "but the rebate is a sort of quick fix that doesn't get any place?" He made that comment after having said the permanent tax cut was better. And Mr. Lance's response was "I understand your comments and I happen to agree with you on a permanent tax reduction."

Senator Javits. May I say one word on that, Mr. Chairman?

It seems to me it is high time we got to the place when tax reform was divorced from economic considerations of reducing and increasing taxes. It has been the curse of tax reform. It is what has held up tax reform. It is complicated tax reform, worse than we could do. We should not consider it even if we ought to in connection with tax reform. It is begging the question. That is to me the key and cardinal point. If they really want tax reform, then leave out any question of

how it cuts except inherent in the reform itself which is a desire of the social and economic reform.

That, it seems to me, is the best answer and the other answers have been given by my colleagues.

Senator PERCY. I will not comment on the second point. I agree with what has been said. The first point, I think, is invalid. The whole purpose of the tax stimulus program is to stimulate the economy which increases revenue, which increases payments to the Federal Treasury. You have a better chance to balance your budget if you have a good flow coming in from individual and corporate taxes. The wrong kind of stimulant will be $12 billion spent with not any real return on it, and that will add to an unbalanced budget, not to a balanced budget.

The first point is totally refuted, I think, by all the evidence we can put forward. The third point, with respect to more dollars being in the Federal Treasury if there is not a permanent reduction, certainly is invalidated by the same arguments I just made. But I have no doubt we will find ways to spend money if we have it.

Our whole point is, you are going to have more money to spend if you do the stimulant in the right way rather than the wrong way. But I think we expressed the hope of a lot of people. We are just not going to pile up money to find programs to spend it on. The whole human cry of this country has been to cut down the number of programs.

Let's go out with a zero-base budget for all the programs that are continuing on and growing like Topsy because no one knows how to shut them off. A lot are totally ineffective and ought to be cut out. We ought to go through that pruning process and have the discipline we think is necessary by permanent reduction saying we are not going to have that income unless the economy is stimulated. If it is, fine, but you do not spend money you do not have. You start cutting programs that are ineffective and not serving their objectives.

Senator MCCLURE. I agree with what Senator Percy has to say about the relative effects of the two approaches.

My first comments to the answer are with regard to this view of the effect of the actions, not my view of the effect of the actions.

Senator DOMENICI. Let me respond also quickly, Senator, to your question. I agree wholeheartedly that to hold tax reform hostage to a needed tax reduction that inflation has absolutely mandated on us to come sooner or later is ridiculous. It is almost insulting to assume that our taxpayers are entitled to a reduction, permanent in nature, now just because we have really used inflation to tax them more, I think that almost indicates that we do not really want reform unless we can tie it to something else that is acceptable. I think that is rather insulting to our conscience and our sense of responsibility.

On the issue of keeping the tax base intact so we can pay for future programs, that is holding a needed tax reform hostage also. But it is also very shortsided. The only way the United States is going to pay for social programs that it needs and if it determines that it needs more than it has at a given time is to put ourself on a path of regular, strong, annual GNP growth and then agree that we are only going to take a fixed percentage of that growth. The problem with inflation impacting on our income taxes without even wanting to, the percentage of our GNP that is being taken for taxes is increasing and we are

creating a false image of the balance between private sector, that is everyone and all consumers, and public sector.

I believe the soon-to-be issued Joint Economic Committee's report will substantiate, Senator Danforth, that in 1978, the part of GNP that is income taxed and "public" is going to be recommended to be reduced because by its very nature, its growth is causing the economy which gives the golden eggs to be less able to supply that strength, vigor, and growth. So I do not think on either score permanent tax reduction should be held hostage to either of those two ideas.

Senator PACKWOOD. I have no more questions.

Senator CURTIS. Do you have any questions, Mr. Danforth?

Senator DANFORTH. Yes.

Senator CURTIS. Proceed.

Senator DANFORTH. Let me say this, the Republicans of the Senate who developed this package has been characterized as the champion of the fat cat, of the wealthy, of the privileged. What group of taxpayers would benefit most from the stimulus package that you are preparing?

Senator JAVITS. My estimate would be the group of taxpayers in the range under $18,000 rate down to the lowest bracket. That would be the group, and above that, it is very minor. The chart which I have put in shows that in dollars. It is very, very small for that. Not even comparably small, just very small in absolute figures. They only get the benefit above that figure of what they benefit from at the lower brackets of their own.

Senator DANFORTH. The principal beneficiaries are the blue collar workers, the young people who are just starting families, these are the principal beneficiaries of this.

Senator JAVITS. And small business.

Senator DOMENICI. Right.

Senator JAVITS. I ask unanimous consent, Mr. Chairman, that a table as to the distribution of the tax cuts which we will be making by income levels be included in the record and it shows that about 80 percent of the aggregate falls in the bracket $5,000 to $20,000 with the highest bracket of again being about 30 percent and the $10,000 to $15,000 bracket.

Senator CURTIS. Without objection, so ordered.

[The table referred to follows:]

TABLE IX.—EXAMPLES OF PERSONAL INCOME TAX RELIEF: JOINT RETURN, FAMILY OF 4

Taxable income [1]	Adjusted gross income	Tax liability [2]		Savings
		Current	Proposed	
$5,000	$10,100	$670	$490	$180
$10,000	15,500	1,640	1,430	210
$15,000	20,800	2,830	2,650	180
$20,000	25,800	4,200	4,110	90
$30,000	35,800	7,700	7,650	50
$50,000	55,800	16,880	16,830	50

[1] Using standard deduction.
[2] Includes general tax credit.

Percentage distribution of total tax reduction by adjusted gross income class [1]

	Percent
$0 to $5,000	4.8
$5,000 to $10,000	24.3
$10,000 to $15,000	29.1
$15,000 to $20,000	23.6
$20,000 to $30,000	15.2
$30,000 to $50,000	2.1
$50,000 to $100,000	.5
Over $100,000	.1

[1] Percentages do not add to 100 percent due to rounding.

Senator DANFORTH. So, Senator Domenici, when you talk about taxpayers being held hostage for tax reform or for more money to be spent here in Washington, you are not talking so much about taxpayers in toto, you are talking about a particular group of taxpayers, are you not?

Senator DOMENICI. Yes. Senator Danforth, in my prepared remarks, I referred to the hostage issue on this very point with reference to the tax cut, and I referred to the working men and women of America being the ones that are hostage.

The facts are that they pay most of the taxes anyway. Therefore, the rebate would be holding them hostage and when you speak of paying for the social programs and not wanting to cut their taxes so we can pay for those programs, you are talking about that group again because they pay most of the taxes in this country. We are, in effect, saying to them, even if the rate of taxes is inordinately high, more than it ought to be, we are going to hold you hostage to make sure you, not someone else, you, that group, can pay for the social programs of the future.

Senator DANFORTH. So the choice the Congress has to make is between a rebate on the one hand and a permanent tax reduction on the other. Yes, we can pay for a rebate but the people who are paying for the rebate in effect are the low-income taxpayer and the middle-income taxpayer, not the wealthy taxpayer, isn't that right?

Senator DOMENICI. That is absolutely right.

Senator DANFORTH. Senator Percy, you said you have talked to a lot of people about this, not necessarily economists. But you are from a neighboring State of mine, and I wonder if the same reaction when you go home to Illinois that the $50 rebate is the same reaction that I get when I go home to Missouri—namely, laughter. That when you mention it to any audience—urban, rural, anywhere you go, people tend to snicker at the idea of the $50 rebate.

Senator PERCY. We look on it as a political gimmick in a sense. The average people do deal in sound economics. It does not matter if it was the president of the bank in Springfield, who came to see me yesterday or the citizens of Peoria. I spent 12 hours there and listened: anyone who wanted to come in and talk with me, ask any questions, in person or on the telephone. The people of Peoria, it doesn't matter who they are, black or white, low income or high income, just think there is no sense to this.

In economics, I took a degree from the University of Chicago. Paul Douglas was one of my professors. I do not believe economics is a slide rule thing, because of one factor, it involves people. It is more almost a social psychologist you need to determine what people are going to do. You cannot with a slide rule determine if we abolished all charitable contribution deductibility how much of the revenue would fall to churches. You know it would drop off considerably, but you need a human psychologist to determine how much of that money goes to the church because they need it or because it is deductible and the Government is paying part of it, in a sense, and subsidizing that gift.

So, too, here economics is more, I think, an art than a science. It is more a matter of determining how people are going to react and what they are going to do as a result of the manipulations we do on the tax bill here.

All I can do is talk to people. All I know is that people tell me, hundreds of them, thousands of them—Missouri and Illinois are the same in this regard—give me a permanent tax reduction and tell me the Government is not going to spend so much in the future and I will spend more. You give me a check back, but you are not going to reduce my rates in the future. In fact, they are in effect going to go up with inflation, and I am just going to hang on to my money because I am a little worried that you won't have any money down there. You have to borrow it to give me money back to stimulate the economy when you are going in debt deeper and deeper to do it.

I would like to say in closing, we are certainly grateful to have Senator Byrd here. We hope to have his vote and his voice and his influence. I will tell you, you will run into a lot of strong colleagues that will talk on your side of the fence on these particular issues here.

Senator BYRD. That sounds very good, Senator Percy. May I say one thing, you left out when you mentioned the Government was in debt and had to borrow the money, the interest payments on this $11.4 billion.

Senator PERCY. Seven-and-a-half percent average compounded forever.

Senator BYRD. And it will go on for 100 years at least.

Senator PERCY. I said forever, Senator Byrd.

Senator BYRD. You are more accurate than the Senator from Virginia.

Senator CURTIS. Senator Danforth, are you through?

Senator DANFORTH. No.

Do you have any feeling as to which kinds of purchases would be induced by a permanent tax cut versus a rebate? Would people be more likely to buy, say, a new car or a television set or a washing machine with a one-shot $50 rebate or with a permanent tax cut?

Senator PERCY. Everyone I have ever talked to, retail merchants, bankers, everyone says people spend future income. And future income only comes to them in the form of a tax cut. They are going to keep more rather than the Government taking more. Therefore, they will go out and start to spend the future. You cannot even tell how far ahead, 25 years maybe. They might even buy a home. They are not going to buy a home with $50 or $200. They are not going to buy a good car for that. And it is going to worry them. It is going to worry them as to our sanity and where we are getting the money. They know we are just borrowing it.

Senator JAVITS. The acid test and proof of the figure watch is the amount of consumer borrowing. These big ticket items are all consumer borrowing items and you are borrowing on your future budget. The thing is just as simple as that. That is the key index figure and when that index figure goes down, then you know that you are in big trouble with big ticket items and with employment and everything else.

That is why we say what we do. That is what a person will calculate for his future. He can figure on that much more income, he is going to want to take a long-range obligation which he has got to do on credit.

Senator McCLURE. May I make one comment on the immediate effect because I think a lot of arguments for the rebate, is this the only way to have an immediate effect on the economy, and I think the immediate effect of a $50 rebate is very low compared to the immediate effect of a permanent tax cut.

One example, not just the big ticket item, not the confidence the spender has, the consumer has, what would you do if you were a small-town merchant? There is a $50 rebate. You know the people in your town are going to have a $50 check to spend. Are you going to hire more clerks in your store, get more inventory and they say they are going to spend it and I will take it out of inventory and be cautious about replacing it? If there is more work, I will keep the clerks on a couple more hours a day. If there is going to be a permanent tax cut, that merchant is going to say, my people are going to have more money to spend this year and next year, and they immediately start building up their inventory and they start making plans to expand their work force. When they make their plans immediately, there is a tremendous impulse in the economy rather than a very, very small one from a $50 rebate.

Senator CURTIS. The Chair has a few questions. I will try to be brief because we have other witnesses here who came from some distance to testify before us today.

Senator Javits, do you feel there is a real need for additional capital formation?

Senator JAVITS. Yes; I believe the United States will require vast amounts of capital.

Senator CURTIS. In that connection I would like to ask you, at the present time the Congress has limited the amount of interest that can be deducted permanently from investment. For instance, if someone borrows $500,000 at 8 percent to invest in a business to make it grow, he is going to pay $40,000 in interest. The Congress limited the current reduction on that interest to $10,000. Do you agree with that, do you think it is a wise action?

Senator JAVITS. I would like to study that, Senator Curtis. But in principle, I believe the cost of the borrowing for productive purposes should be, get the best deductibility possible. I do not know about the finite details of that particular item to testify to it.

Senator CURTIS. I think what the Congress has done in their tax legislation, particularly from 1969 on, has assured the American economy a continued depression and continued inflation.

I would like to ask you one other thing. If this individual puts his money in and loses it, the Congress has recently changed the law that his capital loss as against any other income is limited to 50 percent rather than as it use to be at 100 percent. Do you think that is a good idea?

Senator JAVITS. I want to be familiar with the finite details. I think our encouragement for entrepreneurship where the entrepreneurship is for constructive purposes is unsound. It would be a much sound favoring, risk taking for productive experiences.

Senator CURTIS. At the present time, our capital gain rates can go as high as 42.5 percent or thereabouts. Since you represent the money capital of the world, do you think that is conducive to employment and productivity?

Senator JAVITS. I have had grave doubts about the capital gains proposition. Again, I would wish to make a distinction between strict gambling and speculation, stock exchange, buying and selling and investment for productive purposes and, again, I believe we are at or approaching the point in respect to capital gains and losses with respect to investment in terms of the productivity of our economy which is counterproductive for the total of American economics.

Senator CURTIS. I happen to be very much concerned about the tax burden of the people who make $18,000 or less, and I think it ought to have the intention and the action of the Congress. I would like to ask you this question. Do you think the economic well-being of the people of low income is affected by our tax policy toward those people in the higher levels?

Senator JAVITS. I think it is affected by any discouragement of a material character to investments and productive enterprise, and I believe it is more harmful than beneficial in terms of whatever additional money is raised from higher tax brackets. We are, however, living in a democracy where the appearance of things is also important, and we must give that some consideration. I believe it is up to us to not only be far more hard-headed but also much more explicit and patient in explaining to the people how little this means.

The classic example, Senator Curtis, of course, is Franklin D. Roosevelt's famous limitation or talk of limiting incomes of $25,000 each. When it was shown how ridiculous this would be as any redistribution of the static wealth—what is the whole fallacy in any such idea. It does not mean anything. It is like this $50 rebate. It is a great deal of money to no purpose and a great deal of money in a global sum but without having an effect and, as a matter of fact, having a very regressive effect.

It is our job because we are politicians, and there is a certain element of rebellion in the individual modest- and low-income of unfairness that people are not able to do much more or not being taxed enough, we have to be very patient and very understanding, one, in trying to go as far as we can on that part of it, the human satisfaction and in explaining the finite details of precisely what it means in economic terms and how much it really raises.

Those are, as I see, problems.

Senator CURTIS. Senator Percy, do you believe there is a great need for capital formation?

Senator PERCY. Yes; we need about a trillion-five-hundred-billion for capital expansion in the next 10 years. The reason I have put so much emphasis on energy is that it appears at the absolute minimum, if we do not grow at the compound rate of 2.8 percent in use of energy as we are now, the minimum we will need is $650 billion to a trillion dol-

lars for energy alone. That is up to the two-thirds of total capital we are going to have available.

Senator CURTIS. Do you feel the limitation on interest deduction now in the law has any effect on the raising of capital?

Senator PERCY. Yes; I would say so. I am not an expert in that field. I do not know what really would be the total net effect. I could not give you any figures on it.

Senator CURTIS. If we need more capital and are urging people to invest, do you feel the change of recent years to cut the losses they can charge off against other income from 100 percent to 50 percent is conducive of capital formation and full production of jobs in this country?

Senator PERCY. Could you go back over that provision once again?

Senator CURTIS. It use to be that you could deduct over a period of time 100 percent of your capital loss against your other income. The Congress recently—by recent I mean within the last few years—changed that to 50 percent. Do you think that has an effect on capital formation and the full production of jobs?

Senator PERCY. I think so. If you had 100 percent, people could deduct all of it, rather than half of it and would be less reticent to make the initial investment.

Senator CURTIS. I think so. I think the Congress has been carried away by a handful of orators.

Senator PERCY. I think that should be very harmful to smaller businesses. They are the ones talking the high risk. That is not going to affect General Motors, Ford, or DuPont. It is going to affect the small business people and those who invest in small businesses who have to look to the possibility that if they do have a loss, they cannot fully write that off. When investors make a profit, they do not get to pay half the tax on it, they have to pay all the tax on it.

Senator CURTIS. How much capital does it take to create a job?

Senator PERCY. In the steel industry today it takes around $30,000. It depends on industry, of course. I would say $20,000 to $25,000, and it is going up very, very rapidly.

In Illinois, I use the rule of thumb figure of $25,000 per job. But you go through a nuclear plant, as I did the other day. They have a total of 100 employees per shift furnishing energy for 3 States. That is a pretty automated operation. The capital behind every job there probably must be a quarter of a million dollars to half a million dollars.

Senator MCCLURE. Could I supplement that?

Senator CURTIS. I have a question for you, too.

Senator MCCLURE. As I recall the figure is between $38,000 and $41,000 in the industrial sector.

Senator CURTIS. Senator Percy, let me repeat, I think that every tax bracket is paying until it hurts. I think the people who receive a poor and modest-income are paying too much. But I would like to ask you, do you think the individuals in modest-income brackets whether we fix it at $18,000 or what, that their economic well-being is affected by what kind of a tax policy we have toward the people in the upper brackets?

Senator PERCY. There isn't any question about it. There is an interrelationship. I think both sides, the Democrats and Republicans, felt in this tax stimulus package, we ought to emphasize the lower-income people because they are spending much more.

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Senator CURTIS. I do not think there is any question about it.

Senator PERCY. I think we have both emphasized the lower income and middle income. Particularly they are the ones that really can spend their extra money if that is not taxed away from them.

Senator CURTIS. I wholeheartedly endorse that, but I think it should be done by spending less rather than increasing the tax.

Senator PERCY. I think so.

If I can make a concluding statement for the benefit of Senators Byrd and Hansen who were not here earlier, if we relate the $50 rebate, which we are all against here, to what people do with it, you can look at the last time we did this. You can see it is even more so with increased energy costs. It is just going to pay bills. That is all. It is not going to really stimulate new parts of the economy.

If you take that and then take the 30 percent credit against insulation of buildings up to $750, as far as that is concerned, there is a known quantity. You can really measure that.

First of all, you do not have to give a dollar of credit unless someone spends two and a half to three times as much as your credit. You only give it after they have made that expenditure. You can prove it. You are not guessing. You can prove it because they have the invoices to show it. And you know the Government is going to get a return and they are going to get a return in energy conservation.

So there is a cost effective return on investment that is irrefutable, while scattering those $50 bills around you cannot prove anything. In fact, the best judgment we can get is that it is not going to have much of an effect. But that 30% credit affects everyone. Seventy million homes will be affected by that. Rich or poor, it is a credit. Right at the bottom line, the dollar means just as much to the low-income homeowner as it does to the high income homeowner. It is a very fair and equitable way of doing it.

Senator CURTIS. Senator.

Senator JAVITS. Senator Curtis, may we be excused?

Senator CURTIS. Sure.

Senator HANSEN. I was hoping Senator Javits would respond to one question.

Senator Javits, a number of the economists and other commentators have observed on what seems to be an apparent unfairness in the application of capital gains tax rates on the assets when you consider the length of a period of time during which they have been held. And the often observed conclusion being, if you have an asset for 25 years, the appreciation and value of that particular asset will reflect the impact of inflation in far greater degree than would be the case in the sale of an asset that has been held only a year.

Would you comment on that?

Senator JAVITS. Yes; I think it is impractical. I realize they have, but I think it is impractical. I think in terms of economic impact and political impact that capital gains—these parameters which we are operating within now, that is 6 months, a year, et cetera, are about the only practical parameters that are going to have a measurable effect.

The other idea may please some people, displease other people, but not an appreciable effect. The appreciable effect is in the 6-month, 1-year, 1½-year turnaround. That is from my judgment.

Senator HANSEN. Would you care to comment, Senator Percy?

Senator PERCY. I support what Senator Javits said.

Senator CURTIS. Senator McClure, I will be brief. You have served on the Interior Committee in other capacities involved in energy production. Is the need for capital formation important to our energy program?

Senator McCLURE. There could be no doubt that it is. All of the most easily exploited energy sources have already been exploited. The low cost ones that remain are outside the United States, and they are low cost only in terms of what it cost them to produce. It does not mean it is low cost in our markets. But the best estimate that I have seen for the capital investment required to meet the energy needs between now and 1985 is $1,350 billion.

Senator Percy made some reference to a similar figure of $1,560 billion over the next few years. Either figure is staggering. If we continue to have the standard of living we have and have the number of jobs we must have in our society, we are going to have to meet that energy need.

Senator CURTIS. Senator Byrd, do you have a question?

Senator BYRD. Just a brief statement. The Senate Armed Services Committee is meeting now on the national shipbuilding program. The Secretary of the Navy and Chief of Naval Operations will be there. For that reason I will not be able to be present for the remainder of this meeting.

Senator CURTIS. We understand.

Our next witness is Dr. William F. Ballhaus.

If you will have a seat and give the reporter your name, address, and business, and for whom you appear.

STATEMENT OF WILLIAM F. BALLHAUS, PRESIDENT, BECKMAN INSTRUMENTS, INC.

Mr. BALLHAUS. My name is William F. Ballhaus. I am president of Beckman Instruments, Inc., in Fullerton, Calif., and am appearing as an individual.

Senator CURTIS. Mr. Ballhaus, do you have a written statement you want to go in the record?

Mr. BALLHAUS. Yes, sir.

Senator CURTIS. Would you wish to summarize or would you like to present that, or what are your wishes?

You may proceed in any manner you wish.

Mr. BALLHAUS. I will summarize.

Thank you, sir.

The point I am going to make has to do with the importance of investment in creating economic growth and in solving our problems of inflation, unemployment, and deficit.

During the depths of the depression in 1971, as chief executive of our company, we took long-range investment positions in spite of the depression. The effect of those long-range decisions and investments has been to show continued growth in our company even through the depression of 1973–74.

Is is not an empty theory that investment creates jobs and provides growth, but is based on actual practical experience.

If we look at the country prior to 1969, we find that the Consumer Price Index rose at a compound growth rate of about 1.7[illegible] percent per year for the 10 years prior to 1969. Since then the compound growth rate has reached 6.59 percent with a peak of 12.2 percent in 1974. In spite of this where technology and investments have been available, prices have come down sharply over this same period.

Capital investment drives prices down because capital investment improves productivity a[illegible] only way to create the permanent new jobs that we need.

The Tax Reform Act of 1969 and subsequent revisions through 1976 have dramatically influenced the personal investment climate in this country that more than 10 million people who normally would be investors have decided not to invest.

It is interesting that their investment portfolio average $10,100. That is over $100 billion of equity capital that has not been invested since 1969. The result has been significant increases in the Consumer Price Index; unacceptable increases in unemployment, up to as high as 8 million people; and severe budget deficits.

Over the 14 years from 1960 to 1974, unemployment rates in the United States have been three to four times the rate of Germany and Japan.

Improvement in productivity in the United States was only about 2 to 3 percent over the last 15 years. In Germany it was 5.8 to 6.7 percent, and 10.7 to 11.2 percent in Japan.

Private investment in Germany and Japan has been two to three times the rate of private investment in the United States.

It is very interesting, as I read from the tax codes in Germany, "Individuals are generally not taxed on gains from the sale or other disposition of nonbusiness property."

In Japan, "Gains from the transfer of securities are exempted from Japanese individual income taxes."

I think it is fairly evident that the Japanese and Germans have a much better investment climate than we do in the United States.

Certainly OPEC countries oil prices and more recently coffee prices have been responsible for some of the inflation in the United States. However, the lack of personal private investment has caused more unemployment and growth in the Consumer Price Index than any other single force in our economy.

Four specific provisions in the tax laws of 1969 through 1976 have been responsible for the serious deterioration in the investment climate in the United States.

First, capital gains taxes have increased from 25 percent to between 42.5 and 52.5 percent, depending upon if you have or do not have other income. Capital loss writeoffs have been reduced from 100 percent to 50 percent since 1969. The tax law enacted last year limits the deduction of excess investment interest to $10,000. Minimum taxes and tax references associated with capital gains have increased individuals' taxes from 30 to 35 percent. These provisions alone have driven 10 million Americans out of the investment mode. The result has been unprecedented increase in the Consumer Price Index, unacceptable levels of unemployment and severe Federal budget deficits.

If our country is to have any possibility of reducing unemployment, controlling inflation and balancing our national budget, there must be

a significant improvement in the personal investment climate. If we do not create such a favorable investment climate, we are only a decade or so behind Great Britain's sad slide into inefficient socialism.

Without realizing the impact of the 1969 true 1976 tax laws changes, we have driven up the cost of unemployment benefits paid from an average of 1969 of about $2.1 billion to the 6-year average of about $6.6 billion since 1969. Unemployment benefits reached $12.56 billion in 1975.

We have made investment decisions for individuals more than twice as difficult as they used to be. We have also made the mobility of capital more than twice as difficult as it used to be. The ability to move capital from areas of surpluses into areas of shortages is of fundamental importance to economic growth.

In December 1976, the Research and Policy Committee for the Committee for Economic Development stated:

> No more urgent and important tasks await the new President and Congress than the establishment of policies that will foster determined progress toward sustaining higher employment without inflation.

In 1976, the Congress integrated gift and inheritance taxes. The result has been that the Government is now the beneficiary of a specific percentage of every individual's estate whether it is given to his children or left through inheritance. Congress should go further and integrate capital gains taxes with gift and inheritance taxes.

My suggestion for reducing unemployment, controlling inflation and eventually balancing the national budget consists of four specific steps.

1. Permit taxes on capital gains to be deferred so long as an individual continues to invest all proceeds. When the investors stop investing, tax the total capital gains at inheritance tax rates, which incidentally go up to as high as 70 percent.
2. Allow 100 percent writeoff of all capital investment losses against other income. If you want, you can put a limit on that.
3. Allow 100 percent writeoff against other income of interest paid on funds borrowed to invest and risk, except in tax-free municipals.
4. Abolish all tax preferences on capital gains.

These four simple changes in the Internal Revenue Code should restore the personal investment climate in the United States to a level which will motivate personal investors to invest at a rate which would significantly improve productivity of our country. Then consumer prices will be driven down and new jobs, products, and services will be created. Unemployment will be reduced and the real economic growth of our country will be such that taxes associated with the new jobs and the revived economic growth will eventually be more than sufficient to balance the Federal budget and provide for the welfare and other services required to meet our country's needs.

On the basis of my experience in operating under the revisions of 1969 to 1976 tax laws such recommended changes are essential to bring unemployment to acceptable levels, to reduce the rise in consumer price index to acceptable levels, and to provide the taxes necessary to balance our Federal budget in the years to come.

Senator CURTIS. Dr. Ballhaus, I am very glad that you responded to the invitation that I extended to you to come to testify before this committee. I think you have given us some very valuable information.

I believe you stated there are 10 million future investors now than there were a few years ago. Over how many years has that taken place?

Mr. BALLHAUS. The numbers I gave were from 1969 to 1976.

Senator CURTIS. Where do those figures come from? How do you arrive at the 10 million?

Mr. BALLHAUS. Let me tell you how I arrived at it. The labor force in 1969 went up 14.7 percent to the 1975's labor force of about 92.6 million employed, around 8 million unemployed. It is close to 100 million. What I did was, I looked at the shareholders in 1969 and there were 30.8 million shareholders with 80-some million workers. The share was down 8.1 percent.

Senator CURTIS. What is the source of those figures?

Mr. BALLHAUS. The New York Stock Exchange study of 1975, sir.

Senator CURTIS. I may return for some more questions.

At this time I call on Senator Packwood.

Senator PACKWOOD. I agree with your statement completely. Tell me about the Beckman Co. How many people does it employ and what do you make?

Mr. BALLHAUS. We make scientific instruments, medical instruments, and industrial process instruments. We employ a little over 8,000 people throughout the world with most of them employed in the United States.

Senator PACKWOOD. How old is the company?

Mr. BALLHAUS. The company is 43 years old this year, sir.

Senator PACKWOOD. I have no other questions. Thank you.

Senator CURTIS. Senator Danforth.

Senator DANFORTH. I have no questions.

Senator CURTIS. Senator Hansen.

Senator HANSEN. Mr. Ballhaus, thank you for your statement. If I understand the four points that you think are most important, then I find them on page 4 of your statement.

Mr. BALLHAUS. Yes, sir.

Senator HANSEN. You would recommend permitting the taxes on capital gains to be deferred so long as an individual continues to invest until the investor stops investing?

Mr. BALLHAUS. Just as in the case of a home, sir, or if you bought Beckman and stayed with it 20 years, you don't pay capital gains either.

Senator HANSEN. One of the problems now that I find increasingly of concern to people is that they may have a substantial amount of equity in a property and yet because of the capital gains tax they just sort of feel there is no way they can sell it and give it to something that might be more productive.

Mr. BALLHAUS. May I refer you to the last chart on supplement one. The problem you are talking about is capital mobility. And if we just look at my suggestion, there is no difficulty with capital mobility. Under the 1964 law the maximum factor was only 25 percent, you will see if you had a 10 times appreciation factor, under the 1964 law, you would have to get a 29-percent immediate rate of return. The instant you sold and bought something else you would have to have that kind of return to come out even. Under the 1976 tax law, you would have to get a 62-percent rate of return. What has happened is, that since the

1969–76 law has been put into effect, we have more than doubled the cost of moving into areas of shortages from areas with large surpluses. The result is we will not get the capital we need.

Senator HANSEN. The first point you made would obviate that first prohibition or obstacle. To that end, if you sold one property and invested in another and invested all the dollars you got out of the first property, there would not be any tax.

Mr. BALLHAUS. Right. And in the middle of this book, you will see the taxes created by the system that I propose will actually be greater by 95 percent over a 20-year period. The present worth of those will be 20 percent greater under my system. What is even more interesting is, with the added jobs, we will create 4.4 times as many jobs and will create three times as many other taxes. Each $10,000 investment would create $187,000 new taxes under this concept. Where under the present law, it would only create $64,000 in other taxes. As you can see it is a very powerful incentive to capital mobility and also to national growth.

Senator HANSEN. I have no further questions, Mr. Chairman.

Senator CURTIS. Senator Matsunaga.

Senator MATSUNAGA. I have no questions.

Senator CURTIS. Doctor, I have given considerable thought to the various points that you have raised. If you were to choose one of them that would have the greatest impact if we couldn't buy your entire package, what one of the tax changes that you have proposed would you put at the top of the list?

Mr. BALLHAUS. I would put the rollover of capital gains or deferral of capital gains taxes until a person disinvests. I think that is the most important thing for the good of our country to mobilize capital in areas of shortages and create jobs and products in those areas. It is the most powerful of the items, sir.

Senator CURTIS. Which one of your proposals do you think would have the greatest impact in bringing young people and new investors into investment?

Mr. BALLHAUS. The second proposal. Small investors stopped investing after the 1969 tax law. Roughly 5.8 million small investors who had portfolios from zero to $10,000, stopped investing after the 1969 tax law, because—you asked this question of Senator Percy—the risk reward ratio has gone up by a factor of greater than 2.

In other words, they used to be able to write off 100 percent of their losses against other income. Now they can only write off 50 percent of their losses against other income. That is a deterrent of the small investor who really is the backbone of creating new industry in this country. The small investor is the one who will take a risk and finance new growing companies.

It is interesting to note that 649 small companies went to the market in 1969, and they raised $1.1 billion in capital. By 1974, only nine companies went to the market and they raised only $16 million. What is happening is, if you look at the curve of actual degradation of investment and flipover and look at the unemployment curve, you will find as investment went down, unemployment went down; as investment came back up unemployment went out to 8 million people.

What is even more important is that small companies like this create jobs at 66 times the growth rate of large companies. This is not the most important thing in attracting the small investors.

Senator HANSEN. Is that contained in this book?

Mr. BALLHAUS. Yes, sir, not the 66 number. That came from a Department of Commerce study.

Senator HANSEN. How do you define a small company?

Mr. BALLHAUS. $5 million net worth or less.

Senator HANSEN. May I have those figures again?

Mr. BALLHAUS. Yes, sir, they create jobs at a rate 66 times faster than large companies. That is in a Department of Commerce report just published in December 1976, sir.

Senator CURTIS. When money is taken by individuals, placed into investment, it affects the inflation rate in two ways, does it not? One, that money is not in a competitive consumer market. That lowers prices.

Mr. BALLHAUS. That is correct.

Senator CURTIS. Second, if it is in a productive enterprise, that capital is needed to produce efficiency which means lower goods.

Mr. BALLHAUS. Low cost of goods and more jobs, yes, sir.

Senator CURTIS. I do not want to be misunderstood on what I heard this morning. I think the people in the low income brackets have a very heavy tax burden. They should have special attention and emphasis any time we reduce taxes.

My point is, I do not think we should stop there. Do you feel the economic well-being, the individuals with very modest income and low- and middle-size income is directly affected by our tax policy?

Mr. BALLHAUS. Yes, sir.

Senator CURTIS. And I am talking about the overall policy and not just the low rates, of the upper income brackets and, if so, why?

Mr. BALLHAUS. The worst tax of all on the poor is the tax of inflation. May I give you an example? If you take the first chart in the first document, you will find the Consumer Price Index grew 1.78 percent for 10 years in a row prior to 1969. Since 1969 it has grown 6.59 percent compounded. If you had retired under the prior conditions at, say, an income of $500 per month, and you say now you are going to have to live under these conditions of 6.59 percent growth, you would need a pension of $3,820 a month to come out even with that growth in consumer prices.

Senator HANSEN. $500 as compared with?

Mr. BALLHAUS. The low-income persons because inflation is the worst tax of all.

Senator HANSEN. $500.

Mr. BALLHAUS. This is $500. If you retired on $500 after working for 44 years under these conditions and then if conditions continue and you got a pension of $500 a month, you may live comfortably.

Senator CURTIS. What do you mean by "these conditions"? That does not mean anything to the reporter.

Mr. BALLHAUS. Under the 6.59 percent, growth in Consumer Price Index for the 44 years, when you finally retire, you would need a pension of $3,820 to live as comfortably.

Senator CURTIS. It is quite self-evident that increased capital formation makes more jobs, is it not?

Mr. BALLHAUS. Yes.

Senator CURTIS. The more jobs available, the better jobs the already employed get and the greater opportunity for the unemployed to get a job, correct?

Mr. BALLHAUS. Correct.

Senator CURTIS. Senator Matsunaga, have you any questions?

Senator MATSUNAGA. No.

Senator CURTIS. We thank you for your appearance.

If there are other matters arising out of questions here you wish to submit as part of your statement, please do so.

You have been most helpful and have built up a good record.

[The following material was subsequently supplied for the record.]

QUESTION BY SENATOR CURTIS

1. What do you estimate the loss in Federal tax revenue would be if we adopt your first suggestion that we roll over capital gains?

Answer. If this change were made the increase in personal, private investment would be so quick that new jobs, new products, new taxes would be created in a very short time. Last year total personal gains were less than $15 billion, if we estimate the average tax [illegible] loss of $4.5 billion next year, but reduced unemployment benefits paid out and increased personal income, corporate income, social insurance, and excise taxes would more than recover the loss. My suggestion is self-financing and self-generating.

[The prepared statement with attachments of Mr. Ballhaus follow:]

SUMMARY OF TESTIMONY BY WILLIAM F. BALLHAUS, PRESIDENT BECKMAN INSTRUMENTS, INC. FULLERTON, CALIFORNIA

HOW TO PUT 4 MILLION AMERICANS BACK TO WORK AND BRING INFLATION UNDER CONTROL WITHOUT RAISING TAXES

Summary

May I qualify myself this morning by stating that I have a bachelor's and engineer's degree from Stanford University, and a Ph. D. from The California Institute of Technology. I am a registered civil and mechanical engineer in the state of California, a member of the National Academy of Engineering, a Fellow of the American Institute of Aeronautics and Astronautics, and for the past twelve years have been president of a corporation which has survived three depressions in those twelve years. For your information I am submitting a copy of Beckman Instruments' latest six months report,[1] which includes results of operations for the last five and a half years. My experiences for the last twelve years have been forged in the crucible of economic realities which have prevailed for those years.

For the ten years prior to 1969, the Consumer Price Index rose at a compound annual rate of only 1.78 percent per year. Since 1969 we have seen that index rise at a compound annual rate of 6.59 percent, reaching a peak of 12.2 percent in 1974. In spite of this, where technology and investment have been available, prices have come down sharply over the years.

There is only one way to reduce prices of products while material and labor costs are rising, and that is through capital investment. Capital investment drives prices down because it improves productivity.

The Tax Reform Act of 1969 and subsequent revisions through 1976 have so drastically deteriorated the personal investment climate in this country that more than ten million people who normally would be investors have decided not to invest. At the average portfolio size of $10,000 per investor, over 100 billion dollars have not been invested by individuals who were motivated not to invest by the severe penalties of the 1969–1976 tax laws. The result has been significant increases in the Consumer Price Index, unacceptable increases in the rate of unemployment, and severe Federal Budget deficits.

Over the 14 years 1960–1974 the unemployment rate in the United States had been three to four times that of Germany and Japan. The improvement in productivity in the United States has been two to three percent over the last 15 years

[1] To be made a part of the official committee files.

compared to 5.8 to 6.7 percent in Germany and 10.7 to 11.2 percent in Japan. Private investment in Germany and Japan has been two to three times the rate of private investment in the United States.

Certainly the OPEC countries' oil prices and coffee prices have been responsible for some inflation in the United States, but the lack of personal private investment has caused more unemployment and more increase in the Consumer Price Index than any other single force in our economy.

Four specific provisions in the tax laws of 1969 through 1976 have been responsible for the serious deterioration of the personal investment climate in the United States.

1. Capital gains taxes have increased from 25 percent to between 42½ and 52½ percent as a maximum.

2. Capital loss write-offs have been reduced from 100 percent to 50 percent since 1969.

3. Excess investment interest has now been limited to $10,000.

4. Minimum taxes and tax preferences associated with capital gains have increased individuals' taxes from 30 to 35 percent.

These provisions have driven ten million Americans out of the investment mode. The result has been unprecedented increases in the Consumer Price Index, unacceptable levels of unemployment, and severe Federal Budget deficits. If our country is to have any possibility of reducing unemployment, controlling inflation, and balancing our national budget, there must be a significant improvement in the personal investment climate. If we don't create such a favorable investment climate, we are only a decade or so behind Great Britain's sad slide into inefficient socialism.

Without realizing the impact of the 1969 through 1976 tax laws changes, we have driven up the cost of unemployment benefits paid from an average of 2.1 billion dollars for the four years prior to 1969 to the peak of 12.56 billion dollars in 1975. We have made investment decisions for individuals more than twice as difficult, and we have made the mobility of capital, which is the ability to move capital from areas of surpluses into areas of shortages, more than twice as difficult as it was prior to 1969.

In December 1976 the Research and Policy Committee of the Committee for Economic Development stated: "No more urgent and important task awaits the new President and congress than the establishment of policies that will foster determined progress toward sustained high employment without inflation."

In 1976 the congress integrated gift and inheritance taxes. The result has been that the government is the beneficiary of a specific percentage of every individual's estate whether it is given away or left through inheritance. Congress should go further and integrate capital gains taxes with gift and inheritance taxes.

My suggestion for reducing unemployment, controlling inflation, and eventually balancing the national budget consists of four specific steps:

1. Permit the taxes on capital gains to be deferred so long as an individual continues to invest, until the investor stops investing. Then tax the total capital gains at inheritance tax rates.

2. Allow 100 percent write-off of all capital investment losses against other income.

3. Allow 100 percent write-off against other income of interest paid on funds borrowed to invest, except in tax-free municipal bonds.

4. Abolish tax preferences on capital gains.

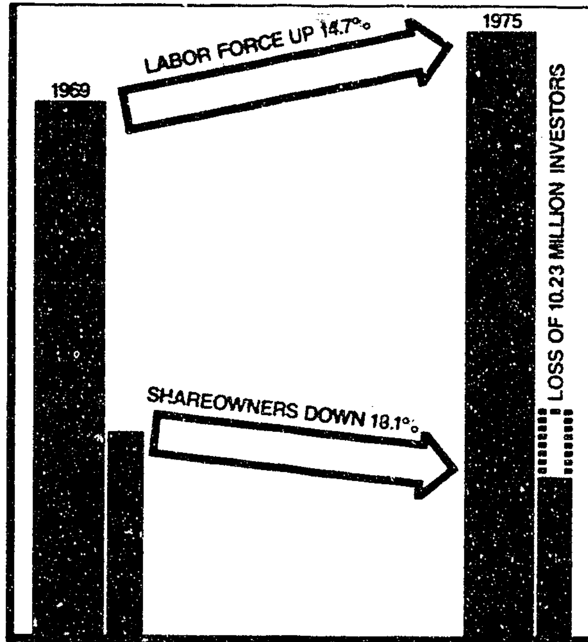
These four simple changes in the Internal Revenue Code should restore the personal investment climate in the United States to a level which would motivate personal investors to invest at a rate which would significantly improve the productivity of our country. Then consumer prices would be driven down and new jobs, products, and services would be created; unemployment would be driven down, and the real economic growth of our country would be such that taxes associated with the new jobs and the revived economic growth would eventually be sufficient to balance the Federal Budget and provide for the welfare and other services required to meet our country's needs.

On the basis of my experience in operating under the revisions of the 1969 through 1976 tax laws, such recommended changes are essential to bring unemployment to acceptable levels, to reduce the rise in the Consumer Price Index to acceptable levels, and to provide the taxes necessary to balance our Federal Budget in the years to come.

How to put 4 million Americans back to work and bring inflation under control without raising taxes.

by
Wm. F. Ballhaus
President
Beckman Instruments, Inc.
Fullerton, CA 92634

LABOR FORCE UP SHAREOWNERS DOWN



CAPITAL INVESTMENT IS THE ONLY ANSWER.

It drives prices down at the same time it improves productivity.

Prior to 1969, there was a delicate balance between incentives for consumer spending and personal investment.

That balance was responsible for the low 1.78% annual consumer price increases and the low 3.4% unemployment rate.

But since 1969 that balance has been terribly upset.

Example: In 1969, with an 80.7 million labor force there were 30.8 million investors.

By 1975, the labor force had grown to 93 million. But investors had shrunk to 25.27 million.

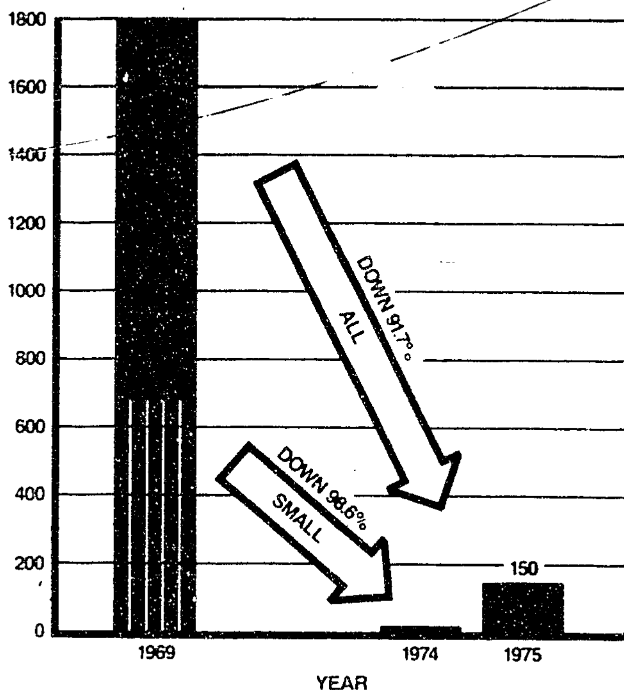
If investors had invested in 1975 as they did in 1969 – there would have been 35.5 million of them.

That's a loss of 10.23 million people who are not interested in investing.

In 1969, for example, the average size portfolio of investors was $7,100. By 1975, it was $10,100.

If investors had been motivated to invest at the same rate in 1975 as in 1969, that portfolio would have been 10.23 million investors times $10,100 – or $103 billion in equity capital available for new

COMPANIES RAISING NEW EQUITY CAPITAL



jobs, new products and new services. With the new equity capital, additional funds could be borrowed at a 20% debt equity rate and 4.129 million new jobs could be created in the private sector alone.

Thus reducing our unemployment rate to 3½%, even lower than 1966, 1967, 1968 and 1969!

This adverse investment climate has had other serious economic effects.

In 1969, some 1800 companies raised new equity capital to provide new jobs, new products and new services.

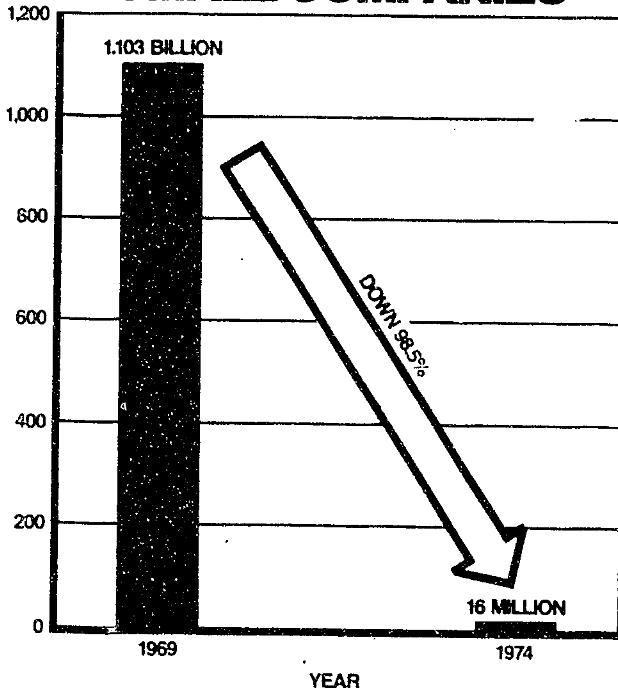
649 were small companies (less than $5 million net worth) which raised $1.1 billion in new capital.

By 1974, only 9 small companies raised $16.1 million equity capital. That's a 98½% reduction.

By 1975, only 150 companies raised new equity capital – a 91.7% reduction in the total of companies investing in new jobs, new products and new services.

From 1969 to 1974, small business equity capital undertakings had decreased by 98½%, according to a December 1976 Department of Commerce report. (That same report showed small companies creating new jobs at a rate 66

EQUITY CAPITAL RAISED BY SMALL COMPANIES

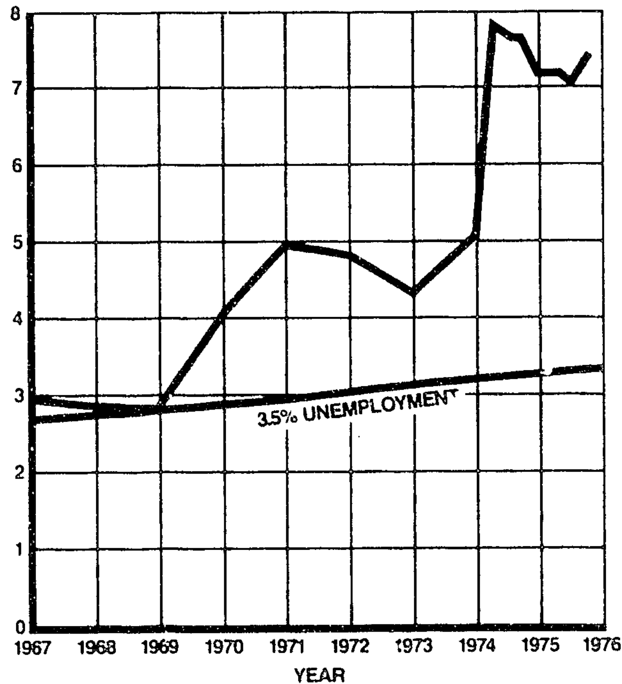


times faster than very large companies because of their own faster rate of growth.)

What caused this precipitous falloff in the corporate expansion needed to create new jobs?

The Tax Reform Act of 1969—and its subsequent revisions—have caused changes which discourage private investment. In these ways:

1. **Higher capital gains tax rates.** Before 1969, tax rates were 25% maximum. Since 1969 and through 1976, these tax rates are up to a maximum of 42½%—a 70% increase!
2. **Reduced capital write-offs against other income.** Prior to 1969, an investor could write-off 100% of his capital loss against other income. Since 1969, the investor is permitted to write-off only 50%.
3. **Reduction of interest expense on borrowed funds to make an investment.** Before 1969, this interest was fully deductible. Now, only $10,000 of an investor's interest is deductible.
4. **Tax preference and minimum taxes associated with capital gains.** An individual's taxes can go as high as 30% higher than



they were prior to 1969. Congress has taken a long step by integrating gift and inheritance taxes. But it needs to go further and integrate capital gains taxes with gift and inheritance taxes.

How to reduce unemployment <u>and</u> inflation:

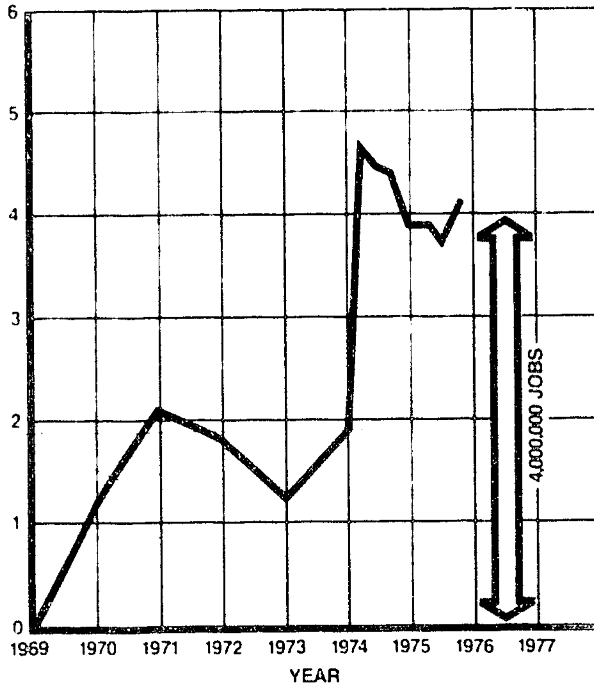
A. Allow all taxes on capital gains to be deferred until an investor stops investing. Then tax the total capital gain ' inheritance and gift tax rates.
B. Allow 100% write-off of all capital investment losses against other income.
C. Allow 100% write-off against other income of interest paid on funds borrowed to invest, except in tax-free municipal bonds.
D. Abolish tax preferences on capital gains.

Less than 3 million people were unemployed in 1967, 1968 and 1969.

In fact, our unemployment rate reached 3½% in 1969.

Since that year, the negative environment for private investment has resulted in close to 8 million people unemployed! In fact, the goal – the norm – has been established as 3½% unemployment.

If we analyze the figures, to achieve 3½%



unemployment in 1977, it would require 4 million more jobs.

And if investors in 1975 had invested at the same rate as they did in 1969, enough capital would have been provided to create over 4 million jobs just from the equity capital and the small amount of debt that would go with it.

So we could solve our unemployment problem without raising taxes or creating an artificial impetus to the economy.

Inflation? Certainly $120 billion in capital invested could permit companies to drive prices of products down like they used to do prior to 1969.

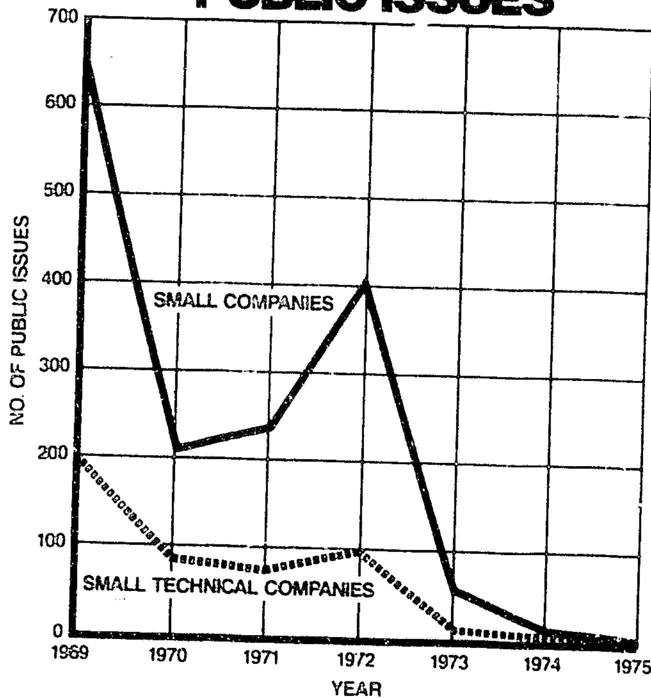
We could then get back to relative price stability where our consumer price index would grow at some amount or rate less than 2% a year.

This is the sane, simple, sensible long-range solution to the unemployment and inflation problems facing Americans today.

There are parallel proofs to its soundness.

In the United States, our people save and invest today between 5% and 7% of their incomes. Our productivity increase has been 2% to 3% over the last 10 years.

In Germany, where people have a much



better investment climate, they invest nearly 14% of their incomes. Productivity increase of workers has been between 6.7% and 6.8% per year, for ten years in a row.

In Japan, the investment climate has been even better. There, individuals invest between 20% and 21% of their incomes. And the productivity of the Japanese laborer has increased 10.7% to 11% per year for the last decade.

How long do all of us in America have to suffer before our leaders in government get the message?

We can put 4 million people back to work and control inflation without raising taxes.

Simply by encouraging the small investor to invest. By making it easier for him to risk his capital to create the new jobs, products and services America must have to survive.

If we don't create a climate favorable to investment, we're only a decade or so behind Great Britain's sad slide into inefficient socialism.

The choice is ours.

And time is short.

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Supplement 1

How to put 4 million Americans back to work and bring inflation under control without raising taxes.

by
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February, 1977

The 1976 Joint Economic Committee Report of the Congress of the United States observes that there is a long-term economic problem that needs careful attention: capital formation.

"Effectively designed proposals to stimulate capital formation should be given careful consideration."

Item VII on capital formation states

To solve the problem two basics are necessary
1) A major change in the tax structure
2) A change in attitude about the relative importance of saving or investing money versus spending it on consumables

Our present tax structure encourages consumption and discourages savings/investments by placing a heavier tax liability on dollars saved/invested than on dollars spent As a result it stifles capital formation a fundamental prerequisite for solid economic growth

If we are to have a healthy economy in this country Congress must take steps at once to modify our Federal tax policies to direct more financial resources into personal investment to improve productivity

The 1976 Joint Economic Committee Report calls for types of tax incentives that will facilitate capital investment and thereby enhance the ability of the private sector to grow to provide new jobs and to increase productivity and wages to help us achieve energy independence and in general to promote the economic well being of our citizens

Relief has been a long time coming.

If you compare the unemployment rates in the USA West Germany and Japan for the years where there is valid data 1960 to 1974 (Chart I) you see that the high in the United States was something like 6 7%. The average over those 14 years was 4 9%. The low 3 %

Compare this with Japan during those same 14 years Japans high was 1 7% the average 1 3% the low 1 1%

Compare Americas unemployment figures with West Germanys for those years Germanys high was 2 1% their average 8% their low 3%

Why hasn t the United States had as low unemployment rates as Japan and Germany? **Simply the relative lack of private investment in this country. People in Germany and Japan invest at 2 and 3 times the rate of U.S. people!**

1960-1974 UNEMPLOYMENT RATES

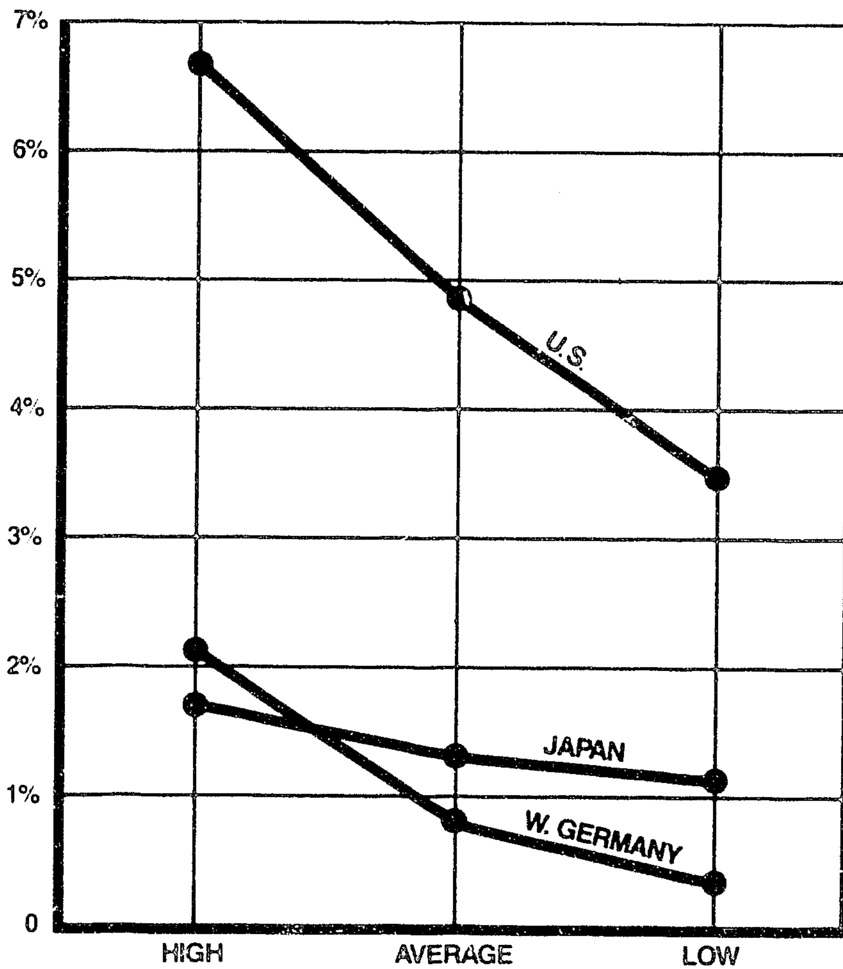

Chart I

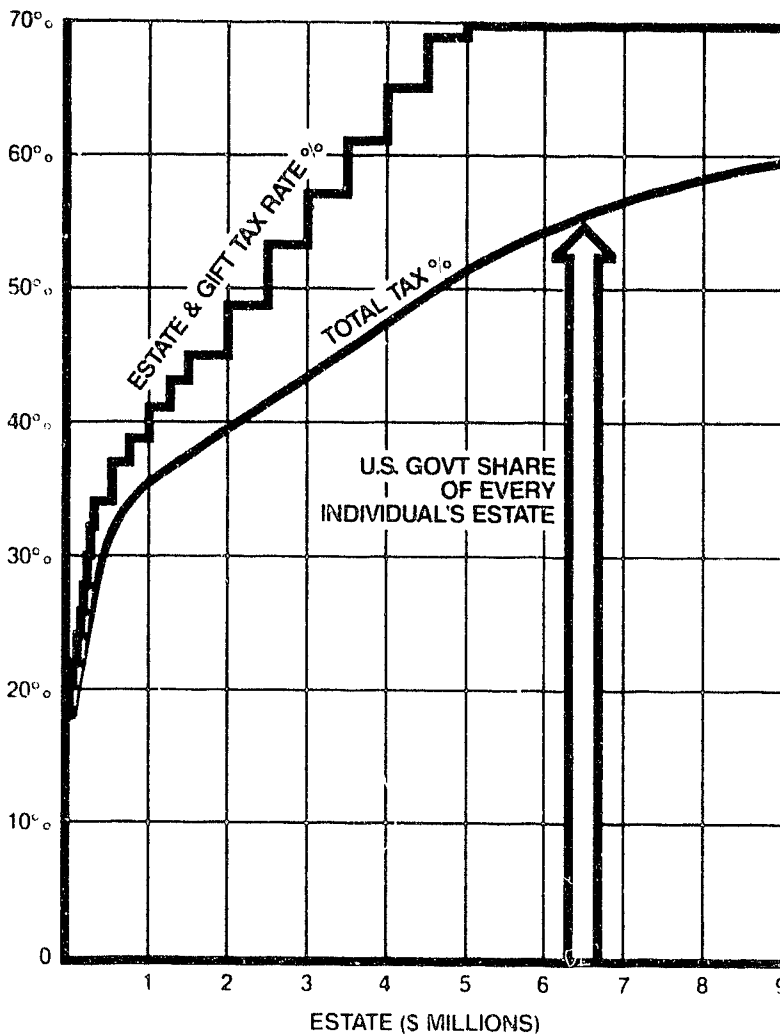

Chart II

[illegible]

[illegible]

NEW JOBS CREATED BY INTEGRATED CAPITAL GAINS TAX

$10,000 INVESTMENT 20% RETURN

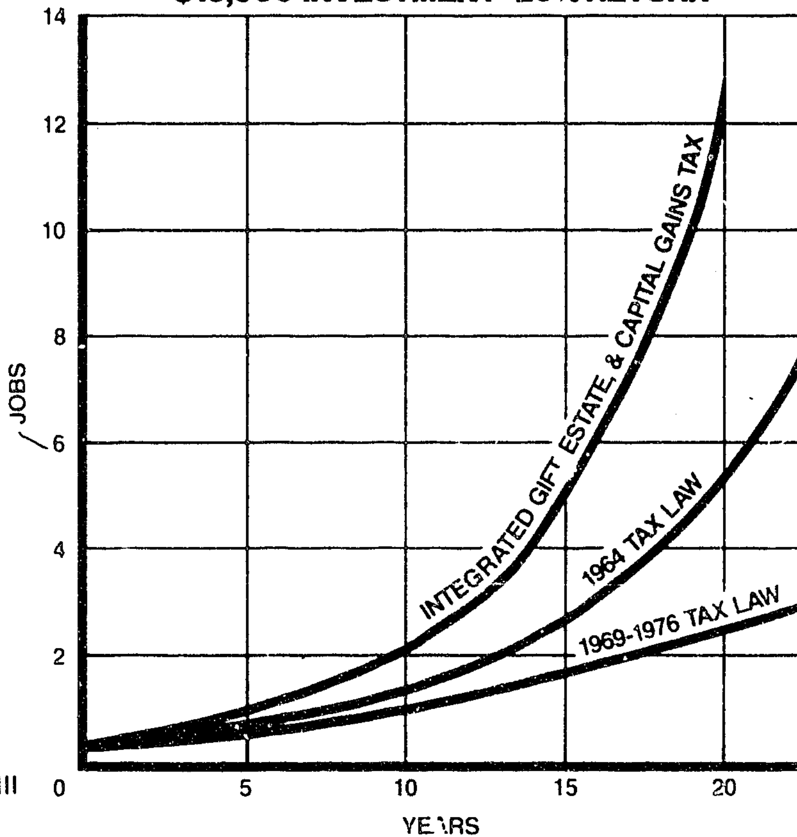

Chart III

It's worth studying the effects of integrating gift, estate and capital gains taxes upon the jobs that can be created by investment.

If you follow, for example, the 1969-1976 tax law (Chart III) and make a $10,000 investment with a 20% return and sell your investment each year, then pay the capital gains tax — and again reinvest each year — your original $10,000 will have created 2.9 jobs.

Now if you make the same $10,000 investment with a 20% rate of return and use the integrated gift, estate and capital gains taxes (meaning a person pays **no** capital gains taxes as long as he continues **to invest** all the proceeds), we find that the same $10,000 investment creates about 1[illegible] 8 jobs over the 20 years. (It's worth noting that each job created produces other tax revenues and unemployment benefit savings.)

TOTAL INDIVIDUAL, CORPORATE, AND SOCIAL INSURANCE TAXES PROVIDED PER EMPLOYED CIVILIAN

	Federal Budget Receipts -- $ Billions •						• Employed Civil Labor Force (2)	Sub-total Receipts Employed Labor Force	
Fiscal Year	Indiv Income Tax	Corp Income Tax	Social Insur Taxes	Sub-total	All Other (1)	Total	(1000)		
1975	$122 4	$40 6	$86 5	$249 5	$31 5	$281 0	84 783	$2.943	Average
1974	119 0	38 6	76.8	234 4	30 5	264 9	85.936	2 720	$2.575
1973	103 2	36 2	64 6	204 0	28 2	232 2	84 409	2.417	per job
1972	94 7	32 2	53 9	180 8	27 8	208 6	8 , 02	2.213	
1971	86 2	26 8	48 6	161 6	26 8	188 4	79 120	2 042	
1970	90 4	32 8	45 3	168 5	25 2	193 7	78.627	2 143	
1969	87 2	36 7	39.9	163 8	23 9	187 8	77.902	2.103	

Source U S Office of Management and Budget The Budget of the United States Government, annual Quoted in Statistical Abstract of the United States 1976 Bureau of the Census page 230

• Source U S Bureau of Labor Statistics. Employment and Earnings monthly Quoted in Statistical Abstract of the United States. 1976. page 356

(1) Includes Excise Taxes. Estate and Gift Taxes. Customs Duties and Others

Table I

Table I shows the individual income taxes corporate income taxes social insurance taxes and subtotal compared to the employed civilian labor force.

It also shows that the taxes each job created for the last four years averaged $2.575

If you use $2 500 as the average annual taxes created by each job you find that for the individual who invested $10 000 and had a 20% annual rate of return the amount of other taxes created over a 20 year period (under the integrated estate, gift and capital gains taxes) would be $187 500

By comparison, if you invest under the rules of the 1969 76 tax law the total other taxes created for 20 years would be only $64 000 Chart IV

Even more illuminating prior to 1969 the U S economy created jobs at an annual rate of about 2 24% of the work force Since 1969 the economy has been able to produce jobs at a rate of only 1 21% of the work force For the last six years the rate of creating new jobs is down 46% (Chart V)

Under the 1964 tax law with a maximum capital gains tax rate of 25%, the jobs creation possibility was about twice as good as the jobs creation possibility under the 1969 76 tax law This 2 to 1 ratio dovetails neatly with the 2 24% and the 1 21 (Charts III and V)

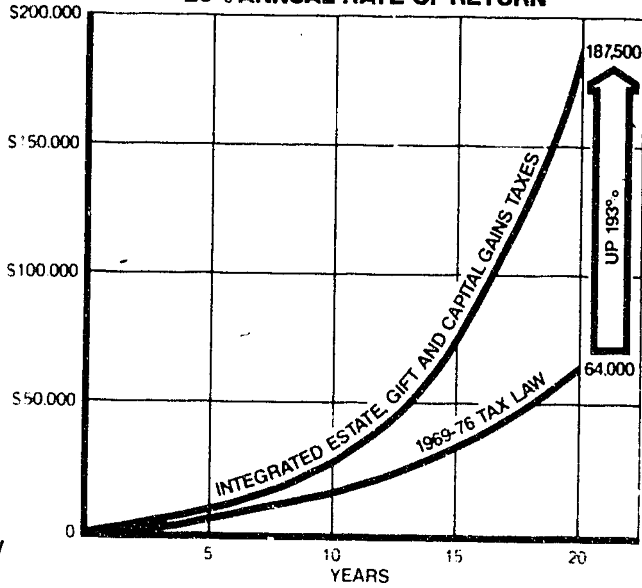

Chart IV

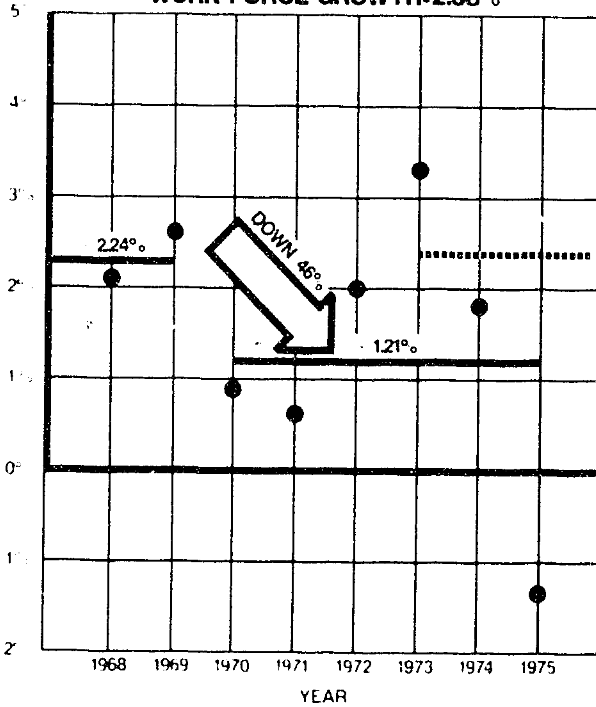

Chart V

EFFECT OF 1969-76 TAX LAW UPON CAPITAL GAINS TAXES PAID, JOBS CREATED, AND JOB-RELATED TAXES CREATED BY A $10,000 INVESTMENT AT A 20% PRETAX RETURN

Year	Capital Invest.	Pretax Gain	Net Gain	Capital Gains Tax	Present Value Capital Gains Taxes	Jobs Created	Job-Related Taxes Created	Cumul Job-Related Taxes
0	$10.000	$ -0-	$ -0-	$ -0-	$ -0-	.33	$ 833	$ -0-
1	11.150	2.000	1.150	850	794	37	925	1.758
2	12.432	2.230	1.282	948	828	.41	1.025	2.783
3	13.862	2.486	1.430	1.056	862	46	1.150	3.933
4	15.456	2.772	1.594	1.178	899	52	1.300	5.233
5	17.233	3.091	1.777	1.314	937	57	1.425	6.658
6	19.215	3.447	1.982	1.465	976	64	1 600	8.258
7	21.425	3.843	2.210	1.633	1.017	71	1.775	10.033
8	23.889	4.285	2.464	1.821	1.060	80	2.000	12.033
9	26.636	4.778	2.747	2.031	1.105	89	2.225	14.258
10	29.699	5.327	3.063	2.264	1 151	.99	2.475	16.733
11	33.115	5.940	3.415	2.525	1.200	1 10	2.750	19.483
12	36.923	6.623	3.808	2.815	1.250	1.23	3.075	22.558
13	41.169	7.385	4.246	3.139	1.303	1.37	3.425	25.983
14	45.904	8.234	4.734	3.500	1.357	1 53	3.825	29.808
15	51.183	9.181	5.279	3 902	1.414	1.71	4.275	34.083
16	57.069	10.237	5.886	4.351	1.474	1.90	4.750	38.833
17	63.632	11.414	6.563	4.851	1.536	2.12	5.300	44.133
18	70.949	12.726	7.318	5.408	1.600	2.36	5.900	50.033
19	79.108	14.190	8.159	6.031	1.668	2.64	6.600	56.633
20	88.206	15.822	9.097	6.725	1.738	2.94	7 350	63.983
				$57.807	$24.169		$63.983	

Table II

If you compare the effect of the 1969-76 tax law upon capital gains taxes paid, jobs created and job related taxes created, you find the total capital gains taxes paid is $57,807. (Table II) (Present value of all of those taxes is $24,169.) The jobs created shows the growth from .33 in the first year up to 2.94 in the last year. The jobs related taxes total $63,983.

Now compare that with the integrated estate, gift and capital gains taxes approach. In this case you pay no taxes for 19 years. When you stop investing after the 20th year, you're charged estate tax on your total capital gain. That comes to 95% more than the other system — $112,748 (Table III).

You'll note, too, that the present value of those integrated taxes is $29,136 as against $24,169 for the 1969-76 tax method or 21% higher.

Most important, while the jobs created starts at about the same level for both systems, in 20 years the integrated system creates 12.8 jobs compared to 2.9. And the job related taxes created are $187,500 versus $63,983 (Chart IV).

EFFECT OF INTEGRATED ESTATE, GIFT, AND CAPITAL GAINS TAX UPON TAXES PAID, JOBS CREATED, AND JOB-RELATED TAXES CREATED BY A $10,000 INVESTMENT AT A 20% PRETAX RETURN

Year	Capital Invest.	Integrated Tax	[illegible]sent Value Integrated Taxes	Jobs Created	Job-Related Taxes Created	Cumulative Job-Related Taxes
0	$ 10.000	$ -0-	$ -0-	.33	$ 833	$ 833
1	12.000	-0-	-0-	.40	1.000	1.833
2	14.400	-0-	-0-	.48	1.200	3.033
3	17.280	-0-	-0-	.58	1.440	4.473
4	20.736	-0-	-0-	.69	1.728	6.201
5	24.883	-0-	-0-	.83	2.074	8.275
6	2[illegible]60	-0-	-0-	1.00	2.488	10.763
7	3[illegible].832	-0-	-0-	1.19	2.986	13.749
8	42.998	-0-	-0-	1.43	3.583	17.332
9	51.598	-0-	-0-	1.72	4.300	21.632
10	61.917	-0-	-0-	2.06	5.160	26.792
11	74.301	-0-	-0-	2.48	6.192	32.984
12	89.161	-0-	-0-	2.97	7.430	40.414
13	106.993	-0	-0-	3.57	8.916	49.330
[illegible]	128.392	-0	-0-	4.28	10.699	60.029
15	154.070	-0-	-0-	5.14	12.839	72.868
16	184.884	-0-	-0-	6.16	15.407	88.275
17	221.861	-0-	-0-	7.40	18.488	106.763
18	266.233	-0-	-0-	8.87	22.186	128.949
19	319.480	-0-	-0-	10.65	26.623	155.572
20	383.376	112.748*	29.136	12.78	31.948	187.520
					$187.520	

Table III

*Estate Tax Rate on Total Capital Gain

What you need to recognize is that when someone decides to invest, that decision is good for all of us. It creates jobs, thus reducing unemployment. It brings the prices of products down by improving productivity. And it increases the amount of taxes available for other purposes because each employed person pays more taxes th[illegible]n an unemployed person and no longer needs unemployment benefits.

Unemployment benefits paid for the four years 1966, 1967, 1968 and 1969 averaged $2.11 billion per year. Since 1969, the average has gone up 213% to $6.61 billion per year for the six years subsequent to 1969. (Chart VI [illegible] over)

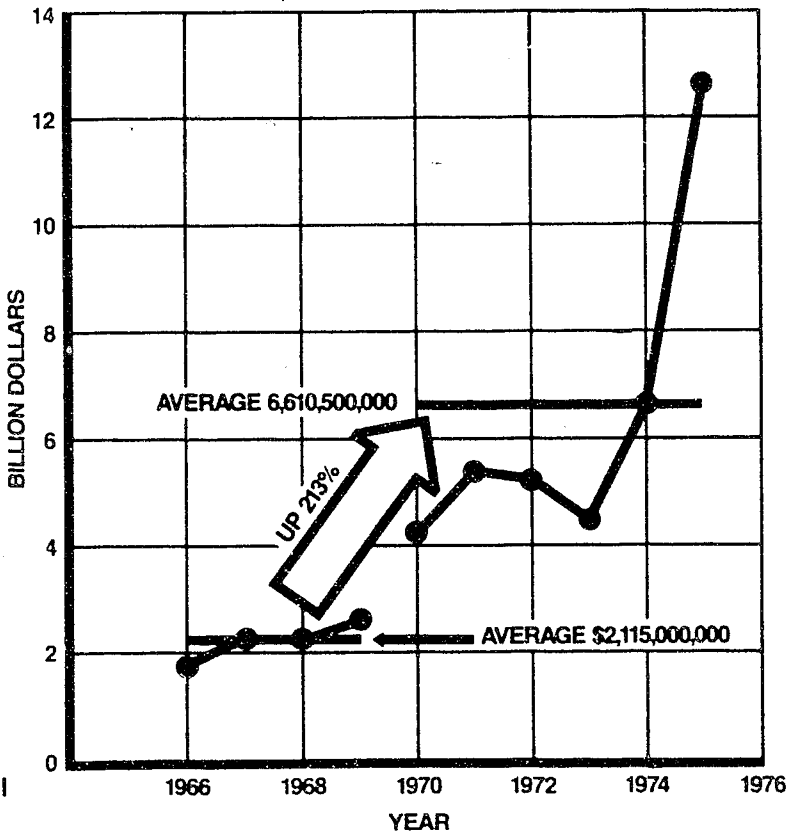

Chart VI

When we create employment, we not only create more taxes to be used for more purposes, but we also reduce the amount of taxes required to fund unemployment benefits. (Chart VI)

It's simple. When a person **consumes,** he uses up resources without creating something for the future.

When, in contrast, he decides to **invest,** he helps to create something for everyone for the future.

The problem? Our tax laws now severely penalize investment and reward consumption.

Investment helps everyone. But the investor can't spend the money he has put into securities until he stops investing. If you can change tax laws so that taxes are collected from the investor on the total gain in his estate **after he has stopped investing,** you'd create an incentive for him to assume further investment risks. By taking the risk, he does more than help his own cause. **He helps everyone in the country.**

That's why America desperately needs an economic climate that is conducive to investing. It's long overdue. And the price you pay for not having it is growing every day.

Difficulty in investing.

For instance, under the 1976 tax law, you must realize a 74% greater appreciation on your investment simply to regain the taxes you've paid.

Under the 1964 tax law, you need a 33% greater appreciation

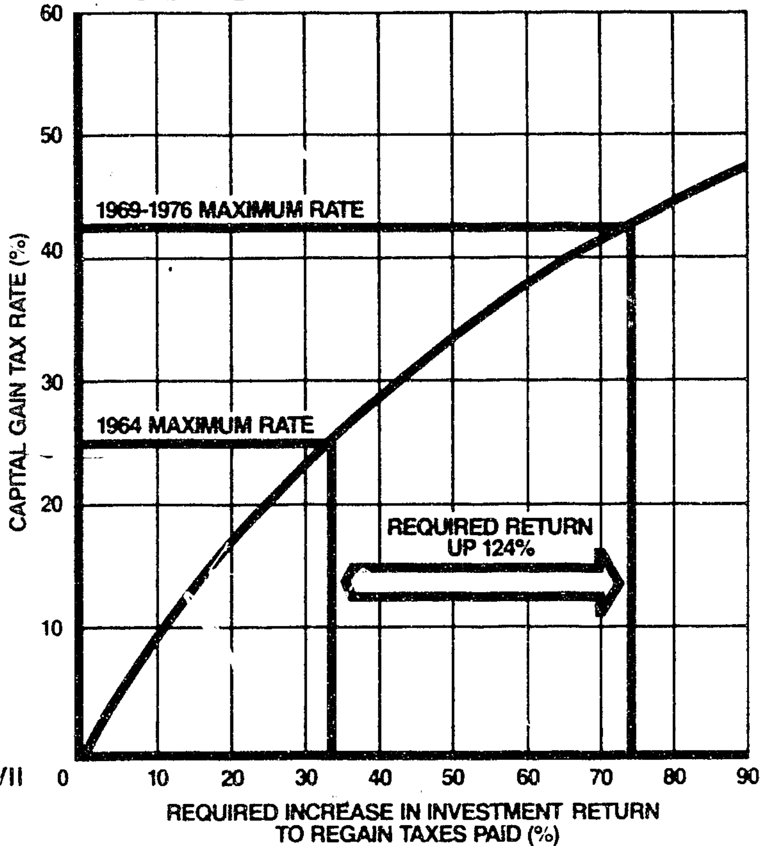

Chart VII

to pay your taxes. Between 1964 and 1976, the required added appreciation went up 124%. (Chart VII) You have to get that much more return on your investment just to break even after taxes!

Under the proposed integrated tax law, you don't need **any** extra appreciation.

This illustrates the much greater difficulty of making an investing decision in today's tax world

You have another problem, too: **lack of capital mobility.** That's the ability to move your capital from areas in which there is an excess to areas where there are shortages.

Under the 1964 tax law if, after a number of years, you had a 6½-times capital gain, you'd need a 27% immediate investment return just to come out even when changing your investment. Under the 1976 tax law, you would need a 56% return. The investment difficulty is up over 100%.

(Chart VIII – over)

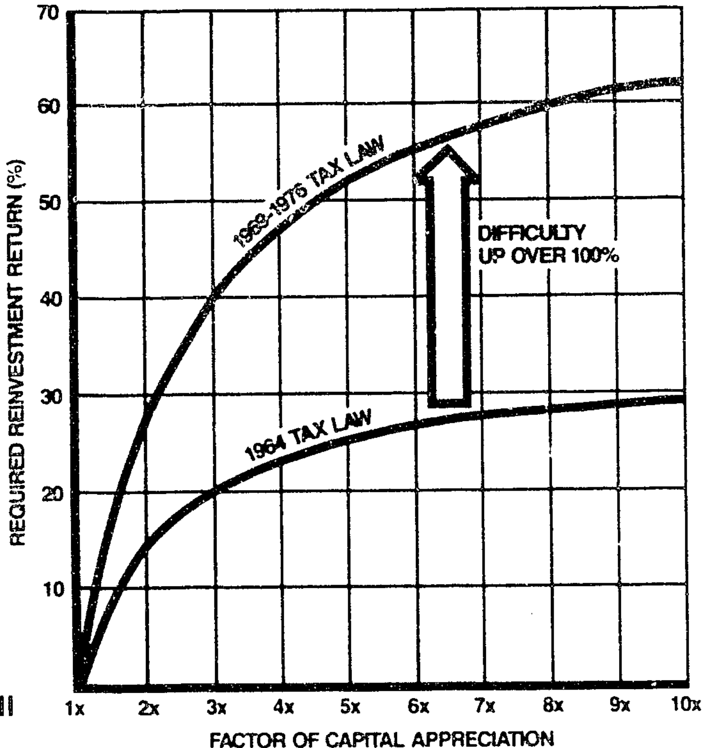

Chart VIII

But under the proposed integrated tax law, there would be no difficulty at all in moving your capital to areas of shortage.

An example of the investor's dilemma under present tax laws: Let's say you bought U.S. Steel for $10,000 twenty years ago and it's now worth $100,000. You've decided to get into solar energy, which our country surely needs.

If you sell your U.S. Steel under the 1976 tax law, you need a 62% immediate investment return just to break even. Obviously, you have very little incentive to sell steel and reinvest in solar energy even if it makes all the sense in the world as an investment opportunity. So you stay put. And our country suffers. The tax deck is stacked against you.

There would be no penalty, no difficulty in moving your investment under our proposed integrated tax law. You could continually follow the opportunities, build your estate, and help create new jobs as you lower prices through increased productivity and production efficiency. When you **did** choose to withdraw from capital investment, you'd have a larger estate that was able to pay substantially more taxes and still reward your risk-taking.

In December, 1976, the Research and Policy Committee for Economic Development commented: **"No more urgent and important task awaits the new President and Congress than the establishment of policies that will foster determined progress toward sustained high employment without inflation."**

The integrated tax system should be one of those policies. Its benefits seem so obvious, only one question can be asked:

What are we waiting for?

Senator CURTIS. Now, we will call Norma Pace, senior vice president of the American Paper Institute, Inc.

STATEMENT OF NORMA PACE, SENIOR VICE PRESIDENT, AMERICAN PAPER INSTITUTE, INC.

Senator CURTIS. Please give your full name and title and address and for whom you appear to the reporter and then do you have a written statement?

Ms. PACE. Yes; and it has been submitted.

Senator CURTIS. It will be incorporated in the record in full. You may proceed as you wish.

Ms. PACE. I am an economist and senior vice president of the American Paper Institute.

I have with me Ken Christianson, assistant comptroller, The Continental Group, Inc., and chairman of the API Tax Committee.

Our association represents producers of pulp, paper, and paperboard, an industry whose net seles exceed $39 billion. We are a capital intensive industry with investment in primary facilities averaging $65,000 per employee. It is, therefore, natural that we are concerned about the specific business tax provisions of President Carter's stimulus program and the program that has come from the House Ways and Means Committee. But our interest is broader than that. Paper and paperboard sales are very closely linked to the GNP and a healthy growing economy. Accordingly, we welcome this opportunity to share with you our thoughts on the condition of the economy and our suggestions for job creation and stable growth.

There are many ways to return the economy to full employment levels, and I am certain that all that have been articulated before this group. More Government spending, lower taxes, easier money, and lower interest rates have all been proposed either individually or in tandem and it is fair to say that each can succeed in its own way. What we seek is a stable, firm, and lasting program for restoring full employment. This implies that whatever program we devise must meet the tests of: (1) Balancing supply with demand, that is, investment with consumption; (2) inhibiting further inflation; and (3) reducing unemployment.

We suggest that this committee must incorporate significant business tax reductions in the program if these three tests are to be met. Let me start with the performance of the economy.

1. We are recovering from the freeze faster and better than anticipated only a few weeks ago. There are some lingering effects, but these will be minimized by the proposed tax rebate to individuals.

2. The foundation for recovery has never been stronger. Inventories are lean. The growing number of individuals in the 20–34 bracket suggests strong consumer needs and the potential in a healthy pace of retail sales. Retail trade is already in a healthy recovery.

3. What is lacking is business confidence; confidence that will permit businesses to take the long leadtime risks in investment that the present situation requires. Capital spending is advancing but only in a defensive sense; that is, money is spent for those projects that involve small additions to capacity, replacement of obsoleted plant

and equipment, and there to meet new energy, safety, and environmental regulations. There is both an unwillingness by businessmen to go beyond these basic requirements and an inability to justify the risks on the basis of cost and return on investment.

When consumer confidence drops, we quickly move to increase the liquidity of consumers and thereby encourage spending. Why doesn't the same logic apply to business spending? Why do we take business confidence for granted? This seems to be the basic flaw in the modification to the administration's tax proposals that the House Ways and Means Committee made. It fails to recognize that our economy is on aa collision course with policies that stimulate demand but inhibit supply.

A study of the announced additions to capacity in the paper industry for the next 3 years, for example, shows that the domestic supply of many grades of paper and paperboard will fall short of the demand levels generated by a full employment GNP level. Since it takes 4 years on the average to bring new paper and paperboard capacity on stream, this is a matter of concern now for manufacturers, their suppliers and customers and indeed for national policy.

The capital formation problem and the joblessness problem are closely linked as the following two observations will indicate:

One, employment in the capital goods industries themselves is lagging. Combining the employment figures in the construction and machinery industries, for example, we see that employment in December 1976 was 360,00 below the 1973 levels (I have avoided using data for January and February because of the impact of the freeze on job statistics). Clearly there is a need to increase employment in this lagging sector and a cut in business taxes will help.

A second point is, this country's stock of available man-hours is growing faster than the stock of physical plant. The result is excess labor and slower growth in the economy with less efficiency. This trend is continuing and before too long this slowdown in the pace of improvement in the standard of living will produce ever greater conflicts within the system. Workers will resent pensioners, young workers will conflict with older ones and the growing presence of women and minorities in the labor force will generate more conflicts than necessary. The answers are policies that contribute to growth and these must include policies that encourage investment.

There are many analysts who contend that an increase in consumer spending will automatically trigger an increase in investment. I do not dispute that relationship, but I am deeply concerned over the timing of these investments vis-a-vis consumption. Econometric models which lead to conclusion that investment can be taken for granted fail to recognize the discontinuity between investment and consumption under today's condition. The reason for this discontinuity is that we have built rigidities into the investment process through costly and time consuming regulations. The infusion of liquidity into business through tax cuts will help create more flexibility in the investment process.

Let me use the paper industry as an illustration. API estimates that to meet the demands of an economy that is returning to the full employment path outlined by the Administrator, capacity will have to advance 14 million tons during the 1977–89 period. Announced capac-

ity changes suggest that the industry will be 8 million tons short of that amount. The reasons for the failure of the industry to invest more in new capacity lie in the pressures in financing caused by two major considerations:

First, the need of the industry to divert 30 percent of its capital outlays to retrofit existing facilities to meet unnecessarily burdensome regulations. Right now companies are evaluating the economics of investments needed to make mills conform with the 1983 water standards. Some claim that they may shut down more mills because of the high cost of environmental outlays to meet these standards.

A second reason is the high cost of new capacity which does not yield a sufficient return based upon current prices and market conditions.

We estimate our industry will need to spend $37 billion in the next 4 years to meet the needs.

Internally generated funds will provide only half of those needs. The alternatives are to increase revenues through higher receipts per ton of paper and paperboard sold; to increase borrowing beyond prudent levels or to postpone investment decisions.

Liquidity can help unplug many of these investment decisions. Recessions do not start because businessmen cancel projects; they start because businessmen just "wait and see." it is time to speed up investment decisions and tax policies are crucial to this speedup.

I have addressed myself only to the stimulus program in this paper, and I notice the discussion this morning has gone beyond those. But we recommend that President Carter's original proposal which would permit the alternative of an additional 2-percent investment tax credit should not only be maintained but also be broadened to provide more support to business confidence and a wider range of alternatives:

A permanent and large increase in the investment tax credit should be considered. And for projects with long lead times, that credit should be available on an expenditure basis without the current phase-in period. In any event, a 20-percent credit for capital expenditures for pollution abatement is needed.

A reduction in the corporate income tax rate of 2 percent should be considered.

And if an alternative job credit proposal is desired, it must be more carefully planned and specified than the current proposals.

With these options available, businessmen can choose the investment and tax assistance programs most compatible with their business needs. These will add to the cash flow of business and accelerate spending which in turn will provide employment and income with substantial multipliers for the whole economy.

Capital goods dollars have a large multiplier effect in the economy since they increase the demand for goods and services to produce the machinery and later to produce the product itself. The payroll of these added employees flows into consumer spending. And the added benefit of the capital goods outlays is that they provide the capacity needed to produce the additional goods demanded, certainly a non-inflationary way to stimulate demand and jobs.

We are a nation of active consumers who have always taken supply for granted. We have come to expect this from our system. To pursue policies that do not recognize the urgent need to insure supplies in the

future is to shortchange the average American and the average job seeker.

Thank you.

Senator Matsunaga [presiding].

Thank you, Ms. Norma Pace.

Senator Packwood.

Senator Matsunaga. Senator Hansen.

Senator Hansen. I have no questions at this point.

Senator Matsunaga. Senator Dole.

Senator Dole. I am a late arrival. I pass.

Senator Curtis. Mr. Chairman, I have a question or two.

Were you in the room when the discussion about the need for capital formation occurred?

Ms. Pace. Yes, I was.

Senator Curtis. Do you think there is such a need?

Ms. Pace. There is an urgent need. It is one of our most critical problems today. I put that as even above unemployment because I think we will never reach full employment without more capital formation.

Senator Curtis. I am for investment credit because it is here, the people understand it and they depend on it. Do you agree, however, that other features of our tax policy that discourages investment should have attention?

Ms. Pace. Yes, I do. As I said earlier, we only try to concern ourselves here with the specific proposals that are before us, but certainly removing the double taxation on dividends, reducing the capital gains taxes and increasing the rewards for the risk are very necessary if this country is to continue to have the supplies that it is accustomed to.

Senator Curtis. Because when we consider all the risks of investment, we have to recognize that they are a part of a lot of other risks or many other risks to the investors. It is not only that he might lose or his taxes might be harsh, but he takes a risk that he is investing in something that might become obsolete. He is taking the risk that he might be buying prolonged labor trouble in the company involved. He is taking many other risks.

Ms. Pace. And, Senator, in our industry, we take a 30-percent risk for something for which we receive no productivity. Benefit; that is the environmental regulations. So you can see we are in need of some tax relief in that area.

Senator Curtis. I am tempted to make an hour-and-a half speech, but I will pass.

I think we are going to have to draw a balance between our environmental needs and our economic needs, and I think we are going to have to ask some very penetrating questions of our emotional, militant environmentalists who may be right, but some of them may be wrong and are not well grounded in their facts.

Ms. Pace. I think increasingly the studies are beginning to show that we can attain what the average American wants in the way of clean air and water and in other quality-of-life matters without this kind of heavy regulatory environment that we have been subjected to with the high costs and loss of efficiency. We can get those same ends without that.

Senator CURTIS. I rejoice every time we get a foot of snow. It washes the air more than all the plannings of the environmentalists can do in 10 years. That is all.

Senator MATSUNAGA. Ms. Pace, on page 3 of your testimony you state, "If an alternative job credit proposal is desired, it must be more carefully planned and specified." Do you have any suggestions as to how such a plan can be more carefully programed?

Ms. PACE. I feel the problem of structural unemployment is a deep-rooted one in the U.S. economy. I do agree that just pressuring demand and supply increases will not necessarily solve the structural part of the unemployment problem. Therefore, we need some special cures. But I do not think a hastily enacted program like the proposed job credit program is needed. Structure unemployment is a problem that has been with us for several years, and we should take a little more time to make certain that the kind of program we devise to solve that problem really gets at the root of it. I do not think this program does. I think it presents the chance for too many abuses and misuses. I do not think it can really help do what it is intended to do. Training programs to me are far more meaningful. We could be more creative about these.

Senator MATSUNAGA. Do you agree the greatest area in which we can increase employment is within the small business sector?

Ms. PACE. I think a healthy economy and balanced properly incentives produce that result. The history of our growth is that we have seen our greatest developments come from small businesses which gradually become big businesses. If you have a productive facility, a good idea, and you can get the financing—that is one of the big problems—I think this will happen. I am not about to encourage every small businessman to employ someone if he is not efficient or productive. I think it is costly to the average consumer.

Senator MATSUNAGA. What about the paper industry—is that operated more by big business or small business?

Ms. PACE. We have a majority of small producers among our membership. In tonnage terms, the contribution of larger companies is more, but in terms of number of members, we have more that are in the smaller category producing all kinds of papers. Some are very small operations.

Senator MATSUNAGA. Assuming then under the job tax credit program—I do not know whether you are familiar with the proposals or not.

Ms. PACE. Yes, I am.

Senator MATSUNAGA. That a producer of paper will be given credit up to 50 percent of all wages he pays for every new employee he hires. Do you suppose this would be an incentive for a big producer to hire more people?

Ms. PACE. We questioned some of our small manufacturers, and we had a negative response in general. It really does not help them, because their problems lie more in the investment and tax areas.

Senator MATSUNAGA. Do you have any questions?

Senator DOLE. I want to pursue just briefly the employment tax credit. It has not been tried. It has been kicking around for a long time. In 1965 on the House side we referred to it as a human investment credit. Maybe it will be broadened some on the Senate side, but

the important fact is that it is in the private sector. It seems to me it is a step up in public service jobs programs. Maybe you don't share that view although it is probably less expensive.

Ms. PACE. You mean you would rather have a job credit encouraging the private sector to do the job than public service employment?

Senator DOLE. Right.

Ms. PACE. I agree with that philosophy and think it is fine. I am not sure the kind of program that is now being considered is the right kind, is the right way to do it. I think we need more time to consider just who it is we are trying to help and how best we can help them. We are trying to make a blanket rule now.

Senator DOLE. I remember when the investment tax credit was passed quickly, too. They probably had some abuses early on. I think now it is successful and should be increased to 12 percent, but there are a number of us on this committee who would like to try the wage subsidy, employment tax credit, whatever name it may have. I do not have much enthusiasm for the House version.

Ms. PACE. The only support I had for the social security tax credit was that it did balance out the fact that the capital intensive industries were getting a benefit under the program and those that were less capital intensive were not. I thought this was a way to divide up the benefits, and if you will, increase the cash flow of business. That is all it does, and it does encourage spending which eventually creates jobs. To me, that is the whole problem here. It is to get liquidity into the system whichever way we can and to prove that spending encourages meaningful job creation.

Senator DOLE. Thank you.

Senator CURTIS. Mr. Chairman, I have a question.

Several industries and some groups have urged us to make the investment tax credit a refundable credit. Do you have any comment on that?

Ms. PACE. With some of our members, this would be helpful. Some of them cannot take full advantage of the credit because of their low profitability. The smaller ones especially would be helped by this. We made a survey on that.

Senator CURTIS. It is a problem. It calls for considerable outflow of money from the Treasury. One of our able staff members here has raised the suggestion that perhaps if we would not decide to go to a refundable tax credit we could make it a lesser amount than if they chose to carry it forward. That might be worth considering if we decide we can go to a refundable credit.

Ms. PACE. Yes; that would be one way. It would be harmful in the long run to encourage inefficient operations and penalize efficient ones which is sometimes what happens inadvertently when we try to redress some of those wrongs. I agree that solution is a good one.

Senator CURTIS. Would you not agree there are some businesses that are not showing the profit that desperately need to invest in equipment?

Ms. PACE. I certainly do. I think this is one way to help them.

Senator CURTIS. I am not recommending an across-the-board refundable credit, but I do think that some industries and groups have made a rather strong case for it.

Senator MATSUNAGA. Are there further questions?
If not, thank you very much Ms. Pace.
[The prepared statement of Ms. Pace follows:]

PREPARED TESTIMONY OF THE AMERICAN PAPER INSTITUTE

SUMMARY

Condition of the economy

1. We are recovering from the freeze faster and better than anticipated only a few weeks ago.

2. The foundation for recovery has never been stronger. Inventories are lean. Strong consumer needs suggest a potential for a healthy pace of retail sales.

3. Business confidence is lacking and major involvements in new projects lag. Capital expenditures are being made only for projects involving small additions to capacity, replacement of obsolete plant and equipment, and to meet new energy, safety and environmental regulations. Our economy is on a collision course with policies that stimulate demand but inhibit supply.

Capital formation problem

1. Employment in the capital goods industries is lagging.

2. This country's stock of available man-hours is growing faster than the stock of physical plant.

Condition of the paper industry

A study of announced additions to capacity in the paper industry for the next three years shows that the domestic supply of many grades of paper and paperboard will fall short of the demand levels generated by the full employment GNP level.

API estimates that to meet demands of our expanding economy capacity will have to advance 14 million tons during the 1977–80 period. Announced capacity changes indicate the industry will be 8 million tons short of that amount.

Reasons include:

1. Need of our industry to divert 30% of its capital outlays to retrofit existing facilities to meet unnecessarily burdensome regulations.

2. The high cost of new capacity which does not yield sufficient return based upon current prices and market conditions.

Our estimates of capital requirements during the next four years are about $37 billion. Internally generated funds will provide only half of those needs.

Recommendations

It is time to speed up investment decisions and tax policies are crucial to this speed-up.

1. We support President Carter's original proposal which would permit the alternative of an additional 2% investment tax credit.

2. A permanent and larger increase in the investment tax credit should be considered. A 20% tax credit for capital expenditures for pollution abatement is needed.

3. A reduction in the corporate income tax of 2% should be considered.

4. If an alternative job credit proposal is desired, it must be more carefully planned and specified than current proposals.

STATEMENT

My name is Norma Pace. I am an Economist and Senior Vice President of the American Paper Institute. I have with me Ken Christianson, Assistant Comptroller, The Continental Group, Inc., and Chairman of the API Tax Committee.

Our association represents producers of pulp, paper and paperboard, an industry whose net sales exceed $39 billion. We are a capital intensive industry with investment in primary facilities averaging $65,000 per employee. It is, therefore, natural that we are concerned about the specific business tax provisions of President Carter's stimulus program. But our interest is broader than that. Paper and paperboard sales are very closely linked to the GNP and a healthy growing economy. Accordingly, we welcome this opportunity to share with you our thoughts on the condition of the economy, and our suggestions for job creation and stable growth.

There are many ways to return the economy to full employment levels, and I am certain that all have been articulated before this group. More government spending, lower taxes, easier money and lower interest rates have all been proposed either individually or in tandem and it is fair to say that each can succeed in its own way. What we seek is a stable, firm and lasting program for restoring full employment. This implies that whatever program we devise must meet the tests of: (1) balancing supply with demand, i.e., investment with consumption; (2) inhibiting further inflation; and (3) reducing unemployment.

We suggest that this Committee must incorporate significant business tax reductions in the program if these three tests are to be met. Let me start with the performance of the economy.

1. We are recovering from the freeze faster and better than anticipated only a few weeks ago. There are some lingering effects, but these will be minimized by the proposed tax rebate to individuals.

2. The foundation for recovery has never been stronger. Inventories are lean. The growing number of individuals in the 20–34 bracket suggests strong consumer needs and the potential for a healthy pace of retail sales. Retail trade is already in a healthy recovery.

3. What is lacking is business confidence; confidence that will permit businesses to take the long lead time risks in investment that the present situation requires. Capital spending is advancing but only in a defensive sense; that is, money is spent for those projects that involve small additions to capacity, replacement of obsoleted plant and equipment, and to meet new energy, safety and environmental regulations. There is both an unwillingness by businessmen to go beyond these basic requirements and an inability to justify the risks on the basis of cost and return on investment.

When consumer confidence drops, we quickly move to increase the liquidity of consumers and thereby encourage spending. Why doesn't the same logic apply to business spending? Why do we take business confidence for granted? This is the basic flaw in the modification to the Administration's tax proposals that the House Ways and Means Committee made. It fails to recognize that our economy is on a collision course with policies that stimulate demand but inhibit supply.

A study of the announced additions to capacity in the paper industry for the next three years, for example, shows that the domestic supply of many grades of paper and paperboard will fall short of the demand levels generated by a full employment GNP. Since it takes four years on the average to bring new paper and paperboard capacity on stream, this is a matter of concern *now* for manufacturers, their suppliers and customers and indeed for national policy.

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1. Employment in the capital goods industries is lagging. Combining the employment figures in the construction and machinery industries, for example, we see that employment in December 1976 was 360,000 below the 1973 levels (I have avoided using data for January and February because of the impact of the freeze on job statistics). Clearly there is a need to increase employment in this lagging sector and a cut in business taxes will help.

2. This country's stock of available manhours is growing faster than the stock of physical plant. The result is excess labor and slower growth in the economy with less efficiency. This trend is continuing and before too long this slowdown in the pace of improvement in the standard of living will produce ever greater conflicts within the system. Workers will resent pensioners, young workers will conflict with older ones and the growing presence of women and minorities in the work force will generate more conflicts than necessary. The answers are policies that contribute to growth and these must include policies that encourage investment.

There are many analysts who contend that an increase in consumer spending will automatically trigger an advance in investment. I do not dispute that relationship but I am deeply concerned over the timing of these investments vis-a-vis consumption. Econometric models which lead to the conclusion that investment can be taken for granted fail to recognize the discontinuity between investment and consumption under today's conditions. The reason for this discontinuity is that we have built rigidities into the investment process through costly and time consuming regulations. The infusion of liquidity into business through tax cuts will create more flexibility in the investment process.

Let me use the paper industry as an illustration.

API estimates that to meet the demands of an economy that is returning to the full employment path outlined by the Administration, capacity will have to advance 14 million tons during the 1977–1980 period. Announced capacity changes suggest that the industry will be 8 million tons short of that amount. The reasons for the failure of the industry to invest more in new capacity lie in the pressures on financing caused by two major considerations: (1) the need of the industry to divert 30% of its capital outlays to retrofit existing facilities to meet unnecessarily burdensome regulations. Right now companies are evaluating the economics of investments needed to make mills conform with the 1983 water standards. Some claim that they may shut down more mills because of the high cost of environmental outlays to meet these standards; and (2) the high cost of new capacity which does not yield a sufficient return based upon current prices and market conditions.

Our estimates of capital requirements needed to meet demand during the next four years are about $37 billion. Internally generated funds will provide only half of those needs. The alternatives are to increase revenues through higher receipts per ton of paper and paperboard sold; to increase borrowing beyond prudent levels or to postpone investment decisions.

Liquidity can help unplug many of these investment decisions. Recessions do not start because businessmen cancel projects; they start because businessmen just "wait and see." It is time to speed up investment decisions and tax policies are crucial to this speed up.

President Carter's original proposal which would permit the alternative of an additional 2% investment tax credit should not only be maintained but also be broadened to provide more support to business confidence and a wider range of alternatives:

1. A permanent and large increase in the investment tax credit should be considered. For projects with long lead times the credit should be available on an expenditure basis without the current phase-in period. In any event a 20% tax credit for capital expenditures for pollution abatement is needed.
2. A reduction in the corporate income tax rate of 2% should be considered.
3. If an alternative job credit proposal is desired, it must be more carefully planned and specified.

With these options available, businessmen can choose the investment and tax assistance programs most compatible with their business needs. These will add to the cash flow of business and accelerate spending which in turn will provide employment and income with substantial multipliers for the whole economy.

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We are a nation of active consumers who have always taken supply for granted. We have come to expect this from our system. To pursue policies that do not recognize the urgent need to insure supplies in the future is to shortchange the average American and the average job seeker.

Senator MATSUNAGA. Our next witness is Donald H. Schwab, director of National Legislative Service, Veterans of Foreign Wars.

STATEMENT OF DONALD H. SCHWAB, DIRECTOR, NATIONAL LEGISLATIVE SERVICE, VETERANS OF FOREIGN WARS

Senator MATSUNAGA. Senator Dole.

Senator DOLE. Let me say this testimony is with reference to the sick pay exclusion. I hope to offer an amendment to the stimulus package or some other bill floating through here very quickly because we need immediate action. I have asked permission for representative testimony and we are pleased you are here. Right now I notice your testimony mentioned there were only eight cosponsors. Now there are 34 so there is a great deal of interest in this provision.

Mr. SCHWAB. Thank you, sir.

Senator MATSUNAGA. Will you state your name, your organization which you represent and the capacity which you represent such organization for the record, and you may proceed.

Mr. SCHWAB. My name is Donald H. Schwab. My title is director of the National Legislative Service of the Veterans of Foreign Wars of the United States.

Mr. Chairman, members of the committee, I thank you for the privilege of presenting to this distinguished committee the views of the Veterans of Foreign Wars of the United States regarding sick pay exclusion as enunciated in section 505 of the Tax Reform Act of 1976, Public Law 94-455.

As you are aware, the authority for sick pay exclusion as it existed for 18 years prior to the passage of Public Law 94-455 was an Internal Revenue Service ruling of 1958, identified as "RR-58-43." This ruling permitted deductions of $100 per week from the taxable income of Federal retirees retired for physical disability, but whose entire retired pay was not based upon such disability.

Furthermore, the beneficiaries of this ruling could neither have been subsequently employed by the Federal Government nor have reached retirement age. The rationale for RR 58-43 was to assist those, whose careers were prematurely terminated by disqualifying disabilities prior to having completed a full career, to get over the difficult period of adjustment to retirement age, at which time they became eligible for other tax credits available to all elderly persons.

The new, more stringent qualifying criteria for sick pay exclusion parallels the social security disability standard in that those taxpayers under 65 years of age must be permanently and totally disabled, unable to engage in any substantial, gainful employment by reason of a medically determinable physical or mental impairment which can be reasonably expected to result in death, or has lasted or can be expected to last for not less than 12 months.

Therefore, more than one-half million Federal retirees, 380,000 from our Armed Forces, and 189,000 from civil service, who previously qualified for this benefit, cannot meet the new test for sick pay exclusion. The loss of this benefit came as a severe financial reversal for these retirees, but, most unfortunately, their plight was compounded by the retroactive effective date of subsection (c), section 505 of Public Law 94-455, applicable to taxable years beginning after January 1, 1976.

This means, of course, they not only owe considerable money not withheld from their income during the calendar year 1976, but an added penalty for the same reason. It is our opinion this unjust retroactive effective date is the result of administrative oversight, the outgrowth of legislation drafted in the calendar year 1975, upon which the Committee on Ways and Means of the U.S. House of Representative held hearings in 1975.

Two of the bills presently before you, S. 4, introduced by Hon. Bob Dole—as Senator Dole pointed out, it no longer has 8 cosponsors but 34—and S. 62 introduced by Hon. Charles Mathias, Jr., would provide that the changes made to the Tax Reform Act of 1976 to the exclusion for sick pay shall only apply to taxable years beginning after January 1, 1977. The Veterans of Foreign Wars strongly supports these bills as the proper vehicles to correct administrative oversight.

Thank you.

Senator CURTIS. We appreciate your testimony here today, and I want to ask you this one question.

For this to be of pratcical help, it should be acted upon quite soon, should it not?

Mr. SCHWAB. Yes, sir, it should. I have had informal information from the Internal Revenue Service. They are going to hold off the penalty on the tax until the last day.

Senator CURTIS. That does not eliminate the worry, confusion and the concern on the part of the people who never hear about the penalty being withheld.

Mr. SCHWAB. No, sir, it does not.

Senator CURTIS. Senator Hansen.

Senator HANSEN. I have no questions.

Let me compliment you, Mr. Schwab, for your excellent statement. Whenever we pass legislation that applies retroactively, I think we do great damage in industry to our citizens. And here is an example of just such a situation. I think you make a compelling case. I hope that the Congress will act very expeditiously in undoing the injustice that I think has been done to a great many of our citizens.

Thank you very much.

Senator CURTIS. Senator Dole.

Senator DOLE. I just underscore that. The Tax Reform Act of 1976 became law on October 4 and I am certain many who may have benefited from this provision, from the ruling made 8 years earlier do not even know about it now. I assume you have made some effort to at least signal your members as other groups have done that the tax deadline is April 15. Unless we do something very soon, it is going to require them to borrow money or that some amend filed tax returns or some may get into difficulty because of something they did not understand.

So there is this urgency and we have had numerous inquiries. I am certain you have had a great many. I want to make one letter I received a part of the record. Hopefully the chairman and others of this committee will see fit to attaching this very simple amendment that deals with the retroactive provision to the stimulus package. If not, then find some bill very quickly that we can add it to and get it passed next week or so.

[The letter referred to follows:]

FALLS CHURCH, VA., *February 27, 1977.*

Hon. ROBERT DOLE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR DOLE: I understand you are sponsoring a bill to delay the disability-sick pay exclusion from 1976 to 1 January 1977. My retirement took place 31 December 1973 because my hearing became so bad that even with a hearing aid I found myself unable to understand completely those who addressed me from 10′ to 15′ and beyond.

The bad hearing is a service connected disability which stemmed from a skull fracture during military duty in 1943. Although hearing, taste and smell left me until I had completed 44 days hospitalization, I gradually recovered enough to insist on remaining in service until I had completed 42 months of active duty and was able to stay in the Active U.S. Army Reserve until retired in 1972.

Upon release from active duty I joined the U.S. Geological Survey in the field and office, 1946–57, when I switched to the U.S. Army Corps of Engineers R & D (Topo). From 1958 my hearing gradually retrogressed, but with the aid of a hearing aid from VA I was able to continue, and obtaining a waiver remained in

the U.S. Army Reserve as an officer instructing in topographis subjects, in addition to my job as General Engineer.

At present I have a 90 decibel loss in my left ear and 50 decibel loss in the right, with an eyeglass hearing aid I am able to get by. Last year I was 64 this year 65. I protest the ex post factor change in the disability deduction. If my hearing had been better I could have stayed in my CE job until age 70. At one time it was suggested that those of us who retired from the Government, disabled or otherwise could better serve our country by working part time or otherwise. The tax change works a hardship on those who served their country when needed.

Very truly,

ABRAHAM ANSON,
Lt. Col. U.S. Army (Ret.).

Mr. SCHWAB. You can count on our help, Senator.

Senator CURTIS. I want to inform you that the agenda has been assembled for the markup on this bill for Tuesday, March 15. Due to the alertness of Senator Dole, this proposal is already on the staff's agenda and will have attention.

We thank you for your appearance here.

We call our next witness, Mr. D. E. Warfield, chairman, tax and fiscal affairs committee, the Associated General Contractors of America.

Mr. Warfield, for the purposes of the record, will you give your full name and title, address and so forth, to the reporter and identify your associate in a like manner. Then you may proceed as you wish. If you have a written statement, it will be incorporated.

STATEMENT OF D. E. WARFIELD, CHAIRMAN, TAX AND FISCAL AFFAIRS COMMITTEE, THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

Mr. WARFIELD. My name is Donald Warfield. I am executive vice president of Brown & Root, Inc., a Houston construction company, and I am appearing here as chairman of the tax and fiscal affairs committee of the Associated General Contractors of America, better known as AGC.

Senator CURTIS. Who is with you?

Mr. WARFIELD. Mr. Travis Brown, who is tax counsel to the Associated General Contractors.

Senator CURTIS. Proceed.

Mr. WARFIELD. This association is composed of some 8,200 contractors who do approximately 60 percent of all the construction work in the United States and Puerto Rico.

The importance to the committee of this sector is that construction has historically produced some 10 to 12 percent of the gross national product. We are in a recession at this point where our share of the gross national product is down to approximately 8 percent.

Of course, representing this large a segment of our economy, we are very interested in the tax policies of our Nation, and we want to thank you gentlemen for the opportunity to express our opinions before you this morning.

A matter of critical importance to us, of course, is the matter of capital recovery. The investment tax credit, in our opinion, continues to afford a much needed measure of aid to general contractors and our clients in their efforts to retain adequate funds to purchase necessary

machinery and equipment. And in the case of our clients, this is not something that can be turned off and turned on.

In many cases, the projects that they are considering will be in process for the next 4 years, or even in the case of major powerplants and other energy-related projects will go on for as long as 7 or 8 years. There is a need to know now that the investment tax credit is permanent. We urge that the investment tax credit be increased to 12 percent on a permanent basis. We think that it has been proven that an investment credit does create jobs and helps create a healthy economy.

For similar reasons, the AGC strongly supports the allowance for accelerated depreciation. In our particular industry, where our equipment is worked out of doors at all times and under extreme conditions, we would like to recommend doubling the present reduction in asset lives allowed under the Asset Depreciation Range system to permit a 40-percent range.

Improved capital formation provisions for a 12-percent investment credit and more liberal depreciation allowances would greatly assist this important industry to reduce its present 14 to 16 percent unemployment rate. Unemployment in the construction industry has risen from an average of about 10 percent in 1974 to 18 percent in 1975. It continued in the 15-to-20-percent bracket in 1976, and in January of this year, according to Labor Department statistics, is still at roughly 15 percent. These percentages are nearly twice that of the total economy. They show a need for tax incentives to stimulate more construction work in this country. When we talk about numbers, we are talking about 660,000 unemployed construction workers at the present time.

We strongly endorse the provisions of House bill 3477 extending through 1978 the individual and corporate tax cuts that would otherwise expire at the end of the current year. Economic conditions, in our opinion, certainly justify extension of these cuts.

We agree that a job tax credit may have merit in stimulating business and more employment. We think its principal benefit would accrue to the many members of the AGC who operate small, closely held businesses. However, we think the measure as now proposed by the House, with its normal growth factor of 3 percent and other limitations, would be difficult to understand and administer. Such a measure, in our opinion, needs further study and should be considered as a possible supplement to, rather than a substitute for, needed increase in the investment tax credit and depreciation allowances.

Senator DOLE. Could I interrupt, Mr. Chairman?

Senator CURTIS. Certainly.

Senator DOLE. That is the way most of us consider it, not as a supplement but as a condition. I favor the increased investment tax credit, but I also favor some form of job credit, and I agree the one in the House is so restrictive it will never benefit anyone.

Mr. WARFIELD. I represent an individual company to which probably the benefit would mean very little with its limitations. But the predominant number of the members of this association are closely held businesses and $40,000 as an incentive to hire people will mean a great deal to them. We certainly favor the job tax credit.

Senator DOLE. The theory being that it is cheaper to create a job in the private sector than it is in the public sector through 100 percent public funds and that job ends as soon as the appropriations end.

Hopefully this would lead to full-time, permanent, meaningful employment for someone. That is the theory. I know sometimes theory sounds good, but it doesn't work that way. In this case, I think the theory would work.

Mr. WARFIELD. I think this is an industry that uses a large portion of unskilled labor and I think they will touch this hard core unemployed with this incentive.

I would just for a minute like to say something about the Tax Reform Act. I think one of its provisions has had a detrimental effect on stimulating our economy: that is, the reduction in wages of overseas construction workers who were exempt from taxation.

Senator DOLE. We did that last year, did we not?

Mr. WARFIELD. Yes, sir. And it was retroactive to the first of the year, which raised a great deal of concern and caused many of our employees to return from overseas.

Senator DOLE. Is there some measure dealing with this problem?

Mr. WARFIELD. I am not aware of it, if there has been a measure to stop the retroactive effect of the change in section 911. I would hope that such a measure could be tacked on to the present bill.

We are now bidding work against foreign competitors that will not start for 6 or 8 months; but when we lose work because of increased costs today, it has an effect for 4 or 5 years. Again, the same thing. I have covered that in much greater detail in the written presentation.

I would like to say there are some things that are not clearly in the tax bill that I think, maybe, need to be clarified with regard to this industry. We produce something like $1 billion 600 million worth of export of U.S. goods a year, because we do buy U.S. goods when American contractors are working overseas. If we cannot get this work, we are going to have a deterrent to the economy rather than a stimulus.

Senator CURTIS. May I interject right there. This committee adopted a rule that in connection with this immediate bill we would only take up those things which the members gave notice, and one of the things on which that notice has been given and is on the agenda is the foreign income tax exclusion. So it will have attention next week.

Mr. WARFIELD. Very good.

Another thing, we had two other points that we would like to make, and I will cover them quickly because they are in the written presentation.

The AGC strongly supports the comments we have heard this morning about taxation of capital gains and losses. Capital investment has to be encouraged to provide necessary modern housing and production facilities essential to the improvement of our living standards and our economy. Capital gains treatment should be further liberalized, especially in view of the large part inflation plays in these gains.

To tax inflationary gains, in our opinion, is unrealistic and unfair. A reduced taxation of capital gains would be in line with treatment afforded by other countries and would encourage the needed investment in production facilities and housing in the United States.

One other point, we think there is a serious inequity in our present taxing system in the double taxation of corporate profits. I will not go through what the corporation pays. The double taxation has contributed to undesirable economic results—increase of use of debt financing,

rise in long-term interest rates, decline in market value of equity securities, and diversion of investment capital from stocks into channels involving less risk. The inability of corporations to raise sufficient amounts of equity capital is one of the great deterrents in our economy at this point. There is a clear need for further relief from double taxation of corporate profits.

A practical solution would be to provide for either a deduction for corporate dividend payments or a gross up of dividends received by the shareholders with credit for the corporate taxes that have been paid.

In conclusion, again, I would like to express the appreciation of the AGC's 8,200 members for giving us an opportunity to state our views. We will be pleased to give you any additional data that may be helpful in your consideration of the tax reform to stimulate the Nation's economy.

Senator CURTIS. Thank you very much for your contribution.

I have a question or two.

Is there a need for capital in your business?

Mr. WARFIELD. Yes, sir.

Senator CURTIS. Were you in the hearing room earlier today when we were discussing this with other witnesses?

Mr. WARFIELD. Yes.

Senator CURTIS. Do you have an opinion on whether or not the change by the Congress in limiting the amount of interest that can be deducted from ordinary income currently in regard to investments is a good thing or a bad thing?

Mr. WARFIELD. This is an opinion. I believe it is a bad thing because I know it has an effect on my thinking about investments.

Senator CURTIS. It was one of those things presented here on the idea of a loophole that really does not gain much revenue, but in my opinion, it lessens the amount of investment.

Mr. WARFIELD. It dries up the source of funds. I believe—much needed source of funds.

Senator CURTIS. Do you think it is in the interest of people who are job hunting to have a capital gains tax that can reach as high as 42.5 percent?

Mr. WARFIELD. No, sir, because it tends to cut down the odds of investment paying off; and as long as that is true, people will not move their money from one investment to another. They will take the safer investment, the corporate bond or some debt securities, rather than investing in the business.

Senator CURTIS. Do you think it is desirable we get young people and new investors to start to make investments?

Mr. WARFIELD. Yes, sir, because I think that a part of our whole way of life is our free enterprise system. I think that for these young people who are workers investing in these firms, it is the only way they are going to recognize the benefits of this system.

Senator CURTIS. Suppose they have a loss, do you think their loss should be their loss charge off even though it has not been carried on for several years? Should it be limited to 50 percent of their loss?

Mr. WARFIELD. No, sir, I do not believe that is fair. I think that, again, increases the odds against your making a successful investment, and, therefore it tends to reduce investment.

Senator CURTIS. I agree so much with all the witnesses and my colleagues who are concerned about the heavy load of taxes in the lower brackets. It is heavy. It is heavy. I want relief to be brought here. But I also think that everybody's tax bracket is burdened and although the tax policy applied to the lower brackets is important if we are going to have full production and full employment we must address ourselves to the problems that confront everyone who pays taxes today.

Mr. WARFIELD. Yes, sir, I certainly agree.

Senator CURTIS. We thank you very much for your appearance.

[The prepared statement of Mr. Warfield follows:]

PREPARED STATEMENT OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, PRESENTED BY DON WARFIELD

My name is Don Warfield. I am Executive Vice President of the construction firm of Brown & Root, Inc., Houston, Texas and I am appearing before your Committee as Chairman of the Tax and Fiscal Affairs Committee of the Associated General Contractors of America (AGC). This association is composed of more than 8,200 of the leading construction contractors throughout the United States and Puerto Rico.

The importance to the American economy of the construction industry is evident from the fact that this industry's goods and services normally account for 10 to 12 percent of the country's gross national product. AGC members are involved in all types of utility and building construction (including all types of energy production construction), and their work constitutes approximately 60 percent of the contract construction performed in the United States and Puerto Rico.

Representing such a sizable portion of the National's business, AGC members are keenly interested in and vitally affected by federal tax policies. We welcome this opportunity to express our members' views to your Committee.

INVESTMENT CREDIT AND ACCELERATED DEPRECIATION

A matter of critical importance to general contractors is the treatment of capital recovery for tax purposes. While the construction industry is vast in size, it is made up predominantly of small businesses. The industry is highly competitive, with no one general contractor performing as much as one percent of the total volume of construction work.

The investment tax credit affords a much needed measure of aid to general contractors and their clients in their efforts to retain adequate funds to purchase necessary machinery and equipment. We are convinced that the investment credit contributes to its intended purposes of improving productivity, reducing unemployment, and of increasing American industry's ability to compete in foreign markets. We urge that the investment credit be increased to 12 percent and maintained permanently at that level. This would be of tremendous benefit in the necessary plnning prior to any decision to proceed with major projects.

For similar reasons, AGC strongly supports the allowance for accelerated depreciation and recommends doubling the present reduction in asset lives allowed under the Asset Depreciation Range system to permit a 40 percent range.

The purchase price of construction equipment is high but its useful life is of short duration. It is worked hard, out of doors, and under widely varying conditions. There are marked differences in the wear on machinery under various soil, rock and weather conditions. For any contractor, the useful life of his equipment varies with the type of work he does and the abilities of the men he employs. The same machine may be useless after six months on one type of job but have a life of several years on other types of work.

The construction industry, even under its present depressed conditions, accounts for approximately 8 percent of the gross national product. Improved capital formation provisions for a 12 percent investment [illegible] it and more liberal depreciation allowances would greatly assist this impor[illegible]t industry to reduce its present 14 to 16 percent unemployment rate. Unemployment in the construction industry has risen from an average of about 10 percent in 1974 to 18

percent in 1975. It continued in the 15 to 20 percent range throughout 1976, and in January, 1977, was still at roughly 15 percent. These rates are nearly twice as high as historical averages. They show the need for tax incentives to stimulate more construction and more jobs in construction.

INDIVIDUAL AND CORPORATE TAX RATES

AGC strongly endorses the provisions of H.R. 3477 extending through 1978 the individual and corporate tax cuts that would otherwise expire at the end of the current year of 1977. Economic conditions throughout the nation fully justify this extension.

JOBS TAX CREDIT

We agree that a jobs tax credit may be of merit in stimulating business and more employment. Its principal benefit would accrue to the many members of AGC who operate small, closely held businesses.

However, we think that the measure as now proposed, with its normal growth factor of 3 percent and other limitations, would be difficult to understand and to administer. Such a measure needs further study, and in our opinion, should be considered as a possible supplement to, rather than any substitute for, needed increases in the investment credit and depreciation allowances.

FOREIGN SOURCE EARNED INCOME EXCLUSION—SECTION 911

The so-called "earned income exclusion" contained in Section 911 of the tax law was in substance first enacted in 1926 when, using the language of the House Committee Report of that year, this provision was inserted ". . . to put all Americans who are working abroad in a position of equality with their competitors . . .".

Since then this provision has been reviewed at least nine times with frequent changes, but a basic premise has always been that some exclusion of the income of U.S. citizens residing abroad would be [illegible]ained to preserve this "equality" between Americans and their foreign competitors.

The provision has been criticized frequently as providing an undue economic advantage for foreign residency. We [illegible] that this is true in many cases, but that is not the principal point of my appearing before you. We are concerned about the action of Congress in reducing the tax exclusion for the wages of Americans who [illegible] working on the construction of a permanent facility abroad. The reasons fo[illegible] concern may be briefly summarized as follows:

1. United States construction companies who build permanent facilities abroad get the jobs on the basis of competitive bidding against foreign competitors, such as the German, Japanese, French, or Korean companies.
2. No industrial nation in the world except the United States taxes its citizens who are working in a foreign country.
3. Therefore, if a United States company, utilizing American skilled labor for construction abroad, must pay these Americans enough to induce them to work overseas plus an additional amount so that they can pay income taxes that they don't pay now, the labor cost to the U.S. companies may very well increase to the point where our bids would not be competitive with the bids of companies utilizing foreign skilled labor.
4. Some foreign countries consider the domestic benefits flowing from the sale of materials and equipment to their international construction companies so important that they directly subsidize the bids of these companies or assume an ownership position. Of course, we receive no such U.S. subsidies.

In 1974 there were approximately 7,600 American employees abroad working for the 30 major U.S. construction companies and about 9,500 in 1975. These foreign projects created approximately 28,000 additional jobs in the United States in 1974 and 38,000 in 1975—a ratio of about four workers in the United States for each American working abroad. This is primarily because American companies working on these projects generally order American materials and equipment. If a foreign construction company gets the job, the materials and equipment come from its home country.

In order to build permanent facilities, we must go abroad; we can't build harbors, airports, and the like in the U.S. and then move them to the foreign country. Consequently, it is not a question of exporting jobs from the United States by working abroad, it is a question of maintaining both the jobs of the U.S. construction workers abroad and the jobs of those in the United States who back them up.

To illustrate this point, the value of the United States goods exported to the foreign construction projects increased from $1,100,000,000 in 1974 to $1,600,000,000 in 1975. Over the years, this has been of tremendous assistance to our balance of payments. When we consider that our basic balance of payment surplus for 1975 was 1.4 billion dollars and this was the first surplus year since the Department of Commerce started keeping such records in 1960, you can readily see the importance of construction exports to our economy.

Additional wage costs to American contractors resulting from the 1976 amendment reducing the foreign income exclusions of Section 911 will tend to make us less competitive in foreign markets and cause a significant drop in U.S. exports.

There are a number of actions the Congress can take to offset the negative affect of the 1976 revisions to Section 911. We recommend:

1. Follow the recommendation of the House Ways and Means Committee task force chaired last year by Representative Dan Rostenkowski and retain the $20,000 exclusion for overseas employees of U.S. construction and engineering firms.

2. Recognize that allowances, or reimbursement, for schooling costs for dependent children in foreign countries are not income to the American worker. These allowances simply cover additional cost of services furnished by various governmental bodies in the U.S. for Americans residing at home.

3. Recognize that allowances, or reimbursement, for vacation transportation are not additional income to the American worker. This cost would not have been incurred had the employee remained at home.

4. Recognize that allowances, or reimbursement, of excess cost of living are not additional income to the American worker. Such allowances, by definition, are given only to allow the employee "to maintain a standard of living comparable to that maintained in the United States". The cost of housing in the middle east is a major problem for employees of U.S. construction companies. In many areas housing costs will be 75 percent to 150 percent of the employees' U.S. base pay. Legislation is needed to insure the exclusion from income of the value of foreign housing furnished employees to the extent such value exceeds U.S. costs for comparable housing.

If one considers, in the words of Mr. Justice Holmes, that "taxes are what we pay for civilized society," it is clear that the American working abroad receives less for his tax dollar than does the man or woman remaining in America. The life and property of the American overseas does not have the protections and the rights available here. This is as it should be since each sovereign nation can and does impose its own laws on people residing in its borders. However, the American residing abroad is in some ways like a city dweller who has no municipal services. Unless he receives comparable services to those received by Americans residing at home, he is being treated unjustly without an offsetting tax exclusion for the reimbursement of his own costs in obtaining these services.

TAXATION OF CAPITAL GAINS AND LOSSES

AGC wishes to stress the distinction between capital gains and ordinary income, and to point out the need for a decrease in capital gain rates. Capital investment must be encouraged to provide the necessary modern housing and production facilities essential to the improvement of our living standards. Capital gain treatment should be further liberalized, especially in view of the large part that inflation plays in increasing prices. To tax inflationary gains is in large measure unrealistic and unfair. A reduced taxation of capital gains would be in line with treatment afforded by other countries and would encourage the needed investment in production facilities and housing in the United States.

DOUBLE TAXATION OF CORPORATE PROFITS

A serious inequity in our present taxing system is the double taxation of corporation profits. The corporation pays 48 percent on its pre-tax profits and then the shareowner is taxed on the dividends he receives on the corporation's after-tax profits.

This double taxation has contributed to the following undesirable economic results: increasing use of debt financing, rise in long-term interest rates, decline in market value of equity securities, diversion of investment capital from stocks into channels involving less risk, and inability of corporations to raise sufficient amounts of equity capital.

The very limited methods of relieving the double tax burden which have been tried have been ineffective in achieving the desired economic consequences. These

include the 4 percent tax credit for shareholders on dividends received, which was repealed in 1964, and the $100 dividend exclusion which is still in the tax law.

There is a clear need for relief from double taxation of corporate profits. A practical solution would be to provide for a deduction for corporate dividend payments, or a gross-up of dividends received by shareholders with a credit for the corporate tax.

CONCLUSION

Again, may I express the appreciation of the AGC's 8200 member firms for giving us an opportunity to share our views. We will be pleased to give you any additional data that may be helpful in your consideration of tax reform to stimulate and improve the nation's economy.

We have in the room a witness who was not listed but if he will come forward and identify himself, we will have his statement placed in the record as though delivered.

Senator CURTIS. Is Mr. Barlow here?

Please give us your name and address and tell us who you represent.

STATEMENT OF WALLACE D. BARLOW, EXECUTIVE DIRECTOR, SHARE THE WORK COALITION

Mr. BARLOW. I am Wallace D. Barlow. I was formerly employed by the Senate as their advisor on energy. I was discharged in 1949 to create a patronage for the Democrats. I am now endeavoring to represent the 20 million unemployed persons of the free world. I am not going to read the statement.

Senator CURTIS. We are past time and——

Mr. BARLOW. I would like to first mention, I am taking a strong position in opposition to the new jobs tax credit. I think it is an invitation to fraud. I am saying only the employer knows if he has really created a job or merely laid off a person in order to reemploy him at a new location.

Senator CURTIS. Don't you feel our general tax policy should be such as to make the employment of more people profitable without a tax credit?

Mr. BARLOW. I agree with you 100 percent. My proposal would tilt the corporate tax. There would be six times as many jobs created for the same $1 million.

Senator CURTIS. What do you mean by "tilt"?

Mr. BARLOW. We would tax the labor intensive industries at a very low rate, like 30 percent instead of 48 percent. We would tax the capital intensive industries at a higher rate. This is all explained in graphical form.

Senator CURTIS. Your statement and the graph will be incorporated and we thank you for your contribution.

Mr. BARLOW. Thank you, sir.

[The prepared statement of Mr. Barlow follows:]

PREPARED STATEMENT OF WALLACE D. BARLOW, EXECUTIVE DIRECTOR, SHARE THE WORK COALITION

Mr. Chairman and Members: I am Wallace D. Barlow. I was formerly employed by the U.S. Senate as their advisor on energy. I was discharged in 1949 to create patronage for the Democrats. I am now endeavoring to represent the twenty million unemployed persons of the Free World.

We oppose the so-called economic stimulus program for three reasons:

1. An authoritative recent study by Hudson Research shows a strong inverse correlation between government expenditures as a percentage of the Gross Na-

tional Product and growth of the GNP. No growth=No new jobs. See Fig. 1. The diversion of resources into the public sector leaves less resources available to the more productive private sector. The proposed thirty-one billion dollar payoff to George Meany would amount to 1.8 percent of the GNP. This would increase U.S. government expenditures to 25 percent of the GNP, the second highest in the World. If the Hudson Research data are correct, this would reduce growth in the GNP to about 4.1 percent. Result: More private sector jobs would be wiped out than the "public service" jobs created.

The real need is for job careers, not for temporary jobs. We need jobs that our people can enter as apprentices and leave thirty years later as master mechanics.

2. President Carter's proposed restoration of the WPA would be futile. The WPA did not work in the 1930's and unemployment persisted until the outbreak of World War II. This antiquated Keynesian approach would destroy investor's confidence and check the strong economic recovery which has been under way for many months. Keynesianism is like alcohol—a steady diet leads to disaster. Fig. 2, based on a recent study by the OECD, shows clearly that budget deficits do not create growth in the Gross National Product. (A small surplus appears to be the best option.)

3. President Carter wants to increase the investment tax credit from 10 percent to 12 percent. We oppose this, since our data shows that the nations without investment tax credits have much less unemployment. Please see Fig. 3, which is based on data from my article, "A Solution to Unemployment for Industrialized Nations", which was well received by the Atlantic Economic Conference in October of 1976. Supplementing Fig. 3, the United Kingdom has the most liberal policy on investment tax credits and the lowest growth rate—2.5 percent.

The Share the Work Coalition advocates an alternate approach, which deals with the disease; not with one of the symptoms. In closing, I will describe it briefly: Fig. 4, based on Census data, shows that the labor content of manufactures in the U.S., has fallen from 51 percent in 1840 to 28 percent. This is the real source of our unemployment, crime and moral decay. The Share the Work Coalition does not propose to repeal the industrial revolution. However, we have a plan which will moderate its impact on our quality of life. We have discovered that the variation in labor content among industries is very large. It varies from 9 percent for the soap industry to 50 percent for foundries. Therefore, a million spent with the high labor content industries will create six times as many jobs.

We have adequate support for a bill to amend Section 11b of the Internal Revenue Code to strike out "48 percent" and to provide for a higher corporation tax rate for the low labor content industries and a lower rate for the high labor content industries. Fig. 5 shows wages as a percent of value added on the horizontal scale and the proposed tax rates on the vertical scale. We would then tilt the rate by increasing angle A until unemployment declines to the desired level! The tax would continue to yield about 45 billion, but resources would be transferred from the automated industries to the labor intensive industries. The consumer will pay more for his soap and less for his castings.

Industries will try to minimize their taxes by moving from right to left in Fig. 5. This will not frustrate the objective of the plan, since they are adopting more labor intensive modes of production. In fact, this may be the most beneficial aspect of the plan, since price inelasticities do not interfere.

The Ford administration's position appears in the attached letter from the White House. In January, we asked the Carter administration to include our plan in their legislative package. There has been no response, as yet.

Taxation as an instrument of economic policy has been available since 1538. The Coalition believes that the time has come to put it to work to rescue the Free Enterprise system. It will be far cheaper than the hiring of millions of case workers.

We are gratified that the House struck out the proposed investment tax credit. Our Fig. 3, which showed that unemployment is only one-third as high in industrialized countries without investment tax credits, may have been helpful.

We strongly oppose the "New Jobs Tax Credit." Only the employer knows if he has really created a job or merely laid off a person in order to reemploy him at a new location. This monstrosity is an invitation to fraud and would create a new racket: job simulation. Thousands of new IRS agents would be required.

A better approach is the shortening of the work week or the work year. Our own proposal to shorten the work year by 6 percent would create five million jobs and would cost nothing. We would triple the holidays, as has been done in Sweden. Similarly, it would cost nothing to "tilt" the corporation tax, and the tilt could be changed from year to year.

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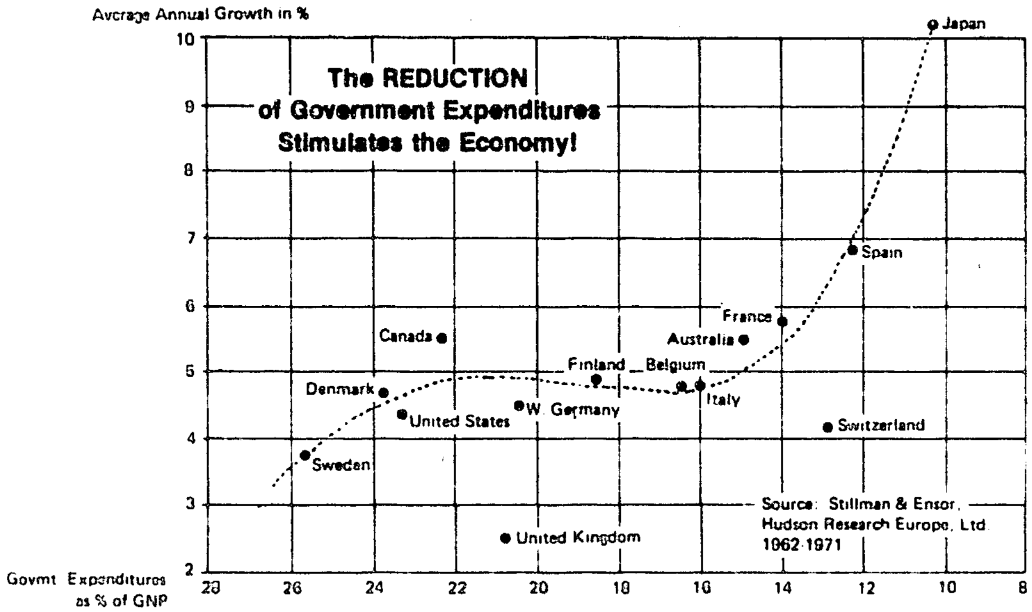


FIGURE 1

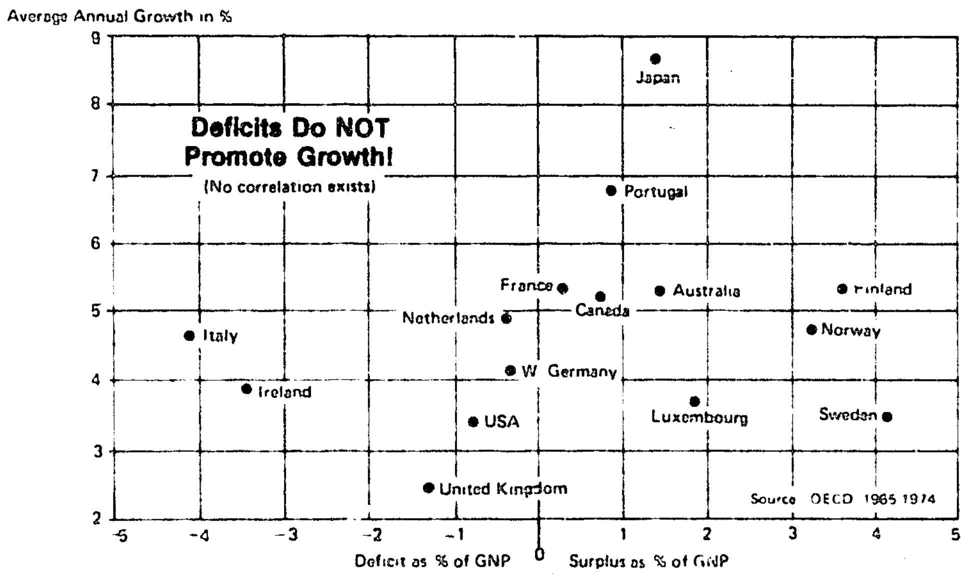


FIGURE 2

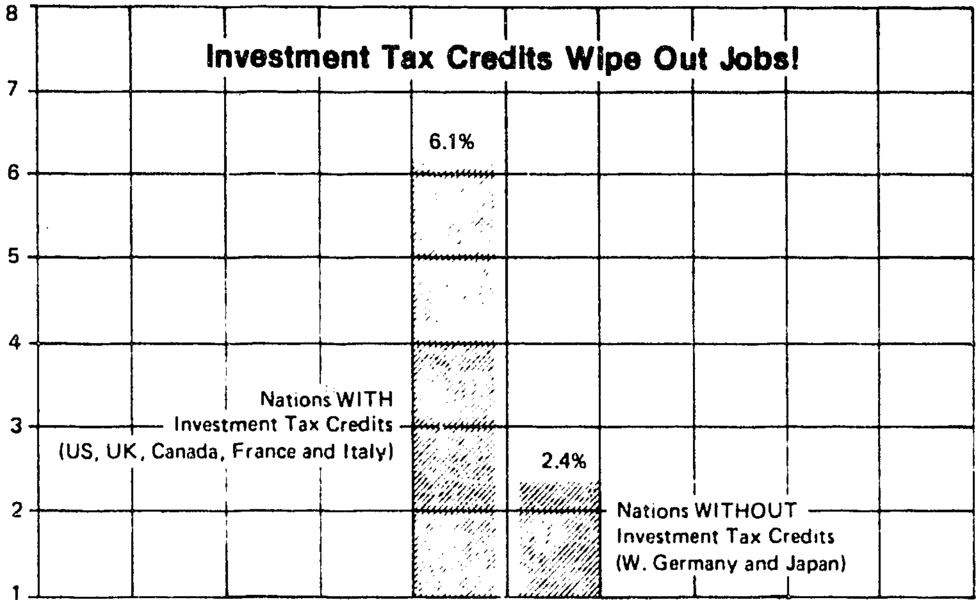


FIGURE 3

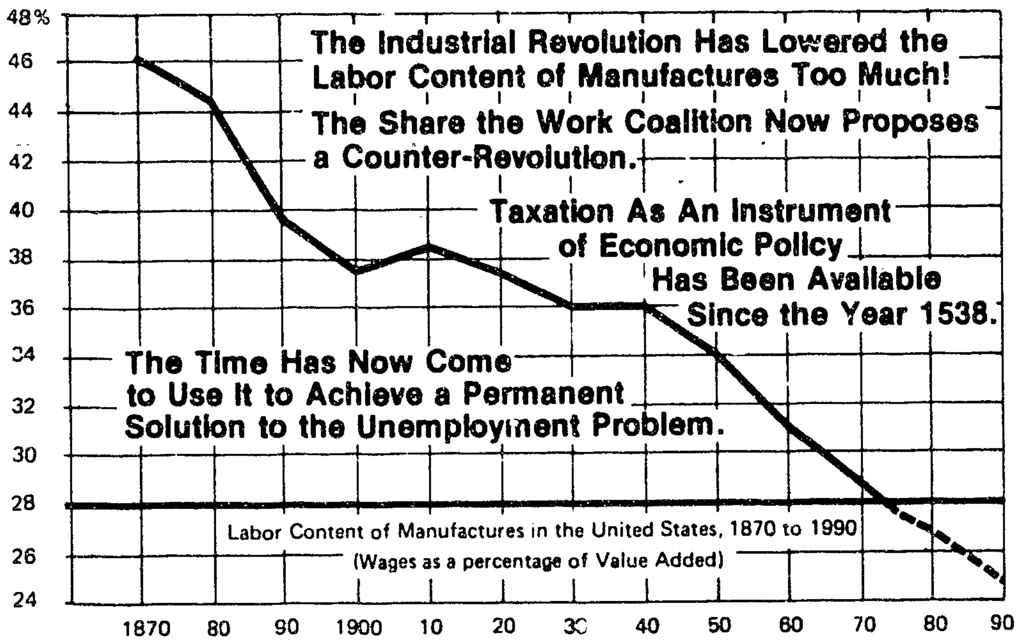


FIGURE 4

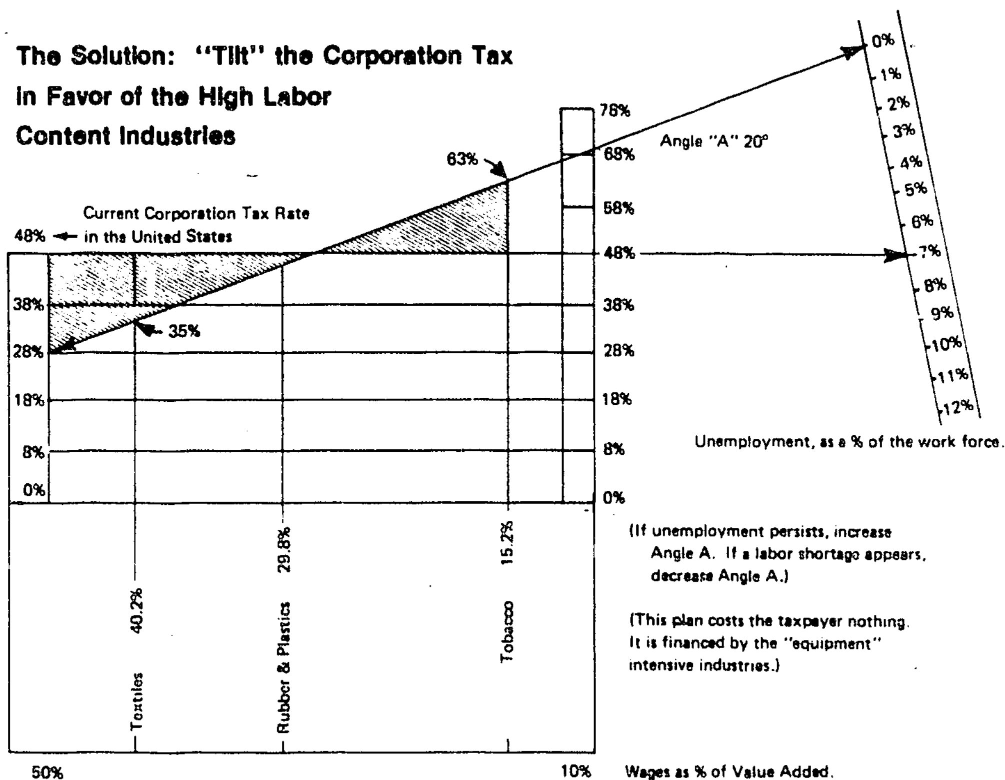


FIGURE 5

THE WHITE HOUSE,
Washington, D.C., October 19, 1976.

WALLACE D. BARLOW, P.E.,
Director, International Institute for Resource Economics,
Washington, D.C.

DEAR MR. BARLOW: The President asked me to thank you for your October 7 letter, enclosing a copy of your article urging corporate tax incentives in favor of high labor content industries.

We welcome the opportunity to consider innovative approaches on the employment question but, as you correctly suggested, the implications for reduced productivity need to be weighed. We are intensifying our review of the productivity outlook and will study your proposal in this context.

Your interest and thoughtful contributions are appreciated.

Sincerely,

L. WILLIAM SEIDMAN,
Assistant to the President
for Economic Affairs.

Comment by WDB: Productivity per person will fall under any "share the work" plan; but total production will increase. The polls show that most Americans want a more modest and less materialistic life style. I hold that the quality of life is more important than productivity. (Perhaps the Republicans do not want a seller's market for labor.) February 4th, 1977.

Senator CURTIS. The committee is adjourned.

[Whereupon, at 12:15 p.m., the committee adjourned.]

APPENDIX A

Communications Received by the Committee Showing an Interest in These Hearings

STATEMENT OF SENATOR MOYNIHAN

Mr. Chairman, the recently established Coalition of Northeastern Governors (CONEG) has proposed a business tax measure to stimulate employment. This proposal establishes accelerated depreciation for manufacturing equipment in high unemployment states. The fundamental concept of this proposal is to target tax expenditures to the areas of greatest need.

Due to circumstances beyond the control of the Governors, a spokesman was unable to appear before this Committee to present testimony on this proposal. However, I have testimony that was given before the House Ways and Means Committee by a CONEG representative and I would like to submit that into the record at this time. In addition I have available a draft of the proposed legislation with an accompanying statement of explanation.

Mr. Chairman, I hope the Committee will give this proposal its utmost consideration as an element of the Economic Stimulus Package. Additional information is available from the Coalition of Northeastern Governors and my office concerning this proposal.

G. WILLIAM MILLER, CHAIRMAN, TEXTRON, INC., PROVIDENCE, R.I., AND MEMBER, ADVISORY BOARD OF THE COALITION OF NORTHEASTERN GOVERNORS (CONEG)

ACCELERATED DEPRECIATION FOR INVESTMENT IN STATES WITH HIGH UNEMPLOYMENT

I would first like to thank you, Mr. Chairman and the members of this Committee, for this opportunity to testify on behalf of the Advisory Board of the Coalition of Northeastern Governors on President Carter's proposed economic program.

CONEG was organized last summer to work toward improving the climate for economic development and investment in the Northeastern region, which for some time has seriously lagged behind the overall economic progress of the country. The Chairman of the Coalition is Governor Hugh Carey of New York, and the participating states are Connecticut, Maine, Massachusetts, New Jersey, New York, Pennsylvania, Rhode Island and Vermont. The Advisory Board is comprised of a representative of each Governor and a member from the private sector appointed by each Governor. I have been appointed from the State of Rhode Island.

Climate for New Economic Initiatives

This is a crucial time for the economy of our country, our states, and our Northeastern and other regions. The nation has turned the corner and has been working its way out of one of the worst recessions that any of us can recall. Yet, there is widespread concern as to whether the recovery can be sustained so as to reach the desired level of well-being for every American which must be an essential national goal.

The recovery so far has not produced a sufficient number of jobs. The fundamental need is for more jobs—full employment without triggering unacceptable levels of inflation.

The proposal President Carter has placed before Congress and the American people is certainly timely and deserves prompt response. The President is to be

applauded for placing high priority in his new Administration on economic initiatives.

My purpose today, however, is not to critique the various elements of the President's proposal. You have heard from a great many well-informed people in that regard.

Rather, I would like to call attention to the crucial need for policies and programs that can overcome the chronic problem of structural unemployment in the Northeast and other regions. In our view, more is needed to accomplish this than only countercyclical actions.

In the last analysis, the goal of full employment with price stability cannot be achieved for the entire nation unless the regional pockets of structural employment are eliminated.

CONEG Proposal to Encourage Investments for J-bs in High Unemployment States

The Governors of the Northeastern Coalition believe that policies are urgently needed to stimulate job creation in distressed areas. Toward this end, at their Saratoga Springs Conference in November, attended by well over a hundred private and public representatives, the Governors unanimously adopted a proposal for more rapid depreciation allowances for new investments in states with high unemployment.

This would encourage job creating investments in areas which are in greatest need of employment opportunities.

Specifically, the proposal is to permit firms investing in manufacturing equipment in states where the five-year moving average of unemployment rates exceeds the national average to calculate their Federal tax liabilities using depreciation rates which are twice those presently allowed. Since there will always be states with unemployment rates above the national average even when times are good, and to reduce the cost to the Treasury, the further restriction that the five-year state unemployment rate must exceed 6 percent should be added. Thus, the program would be designed to aid those areas which truly are in economic difficulty and would phase out automatically as unemployment rates decline.

Advantages of CONEG Proposal

The CONEG proposal has a number of advantages:

The benefit would be available only in states with serious economic difficulty.

The program would be self-administering.

There would not be a reduction of taxes, only a deferral so that the investing firm would be able to recover invested capital more rapidly.

There would be low risk of adding to inflationary pressures.

The cost to the Treasury would be modest, and the deferred taxes should be recovered later.

Gains to the Treasury from increased personal income and reduced transfer payments would partially offset costs.

There would be an automatic phase out in any state when the five-year average unemployment rate f- '- below 6 percent.

Northeastern Economic . .nditions

This Committee is quite familiar with the relative deterioration of economic conditions in New England and the Mid-Atlantic states.

There is perhaps no better way to demonstrate the region's difficulties than to compare its unemployment rates with those for the entire country. In the second quarter of 1973, unemployment in the Northeast stood at 5.3 percent, more than 10 percent higher than the national average of 4.8 percent. That is disturbing enough, but by the second quarter of 1976, with recovery well underway, the Northeast unemployment rate was 9.2 percent, running 24 percent higher than the national average.

Even more distressing, the unemployment rate for adults in the Northeast was 22 percent above the national average in 1973, and in the second quarter of 1976 the Northeast experience was an alarming 43 percent worse than the national unemployment rate for adults.

The economic problems of the Northeast clearly are only partly cyclical in nature. The problems are fundamentally secular in nature—chronic and pervasive.

For some time capital has been flowing out of the Northeast to other areas with new industrial developments. At the same time, state and local governments in our region have borne the burden of rapidly rising expenditures for

social programs associated with the influx of poor from other parts of the country.

New England and the Mid-Atlantic area has also been hard hit by the dramatic increase in oil prices. This has created a fiscal drag which has contributed to depression-level unemployment.

For many reasons, including the earlier development of manufacturing industries, plant and equipment in the Northeastern region has not been renewed at a pace sufficient to maintain even modest growth rates, let alone keep pace with the national average. Some capital surveys indicate that the average age of plant and equipment in the Northeast is nearly 38 percent older than capital stock in the rest of the Nation.

Regional underinvestment has led to obsolete plant and equipment, which, in turn, has yielded lower productivity, which again, in turn, provides further disincentives to capital expansion and renewal.

Studies of New England's economy, which I believe can be generalized to the region as a whole, reveal that since 1968 the region's share of total capital spending has declined precipitously from about 4.3 percent to only 3.7 percent, or about 15 percent below the ratio that consistently prevailed during the 1950's and 1960's. Some studies forecast a further erosion of this ratio down to only 2.9 percent for the rest of the decade.

In other to reverse these adverse trends and bring about conditions for revitalization of the Northeast the Coalition Governors and their Advisory Board believe that there is a critical need for increased investment in manufacturing industries.

Incentives for capital investment

The proposed increase in the investment tax credit from 10 to 12 percent is a step in the right direction for the economy as a whole. Personally, I favor this proposal.

However, as a general measure for countercyclical stimulus, it should be recognized that such an increase will give aid to those areas where economic activity is already at a satisfactory level without doing anything to improve the relative position of regions which are lagging behind in economic recovery.

It would be desrable to provide both the increased investment tax and the more rapid depreciation for investments in high unemployment areas. If there must be a choice between the two, then the CONEG proposal would be the most effective means for helping to create permanent jobs in the areas of greatest need.

Application of CONEG proposal

Private businesses generally make investment decisions on the basis of calculations related to return on investment or discounted cash flow. More rapid depreciation allowance improves cash flow, results in faster capital recovery, reduces risk, and thus encourages investment.

As you know, accelerated depreciation alters only the timing, not the absolute amount, of a firm's tax liability. The firm pays less in the early years of an investment's life, more later. Benefits will vary from firm to firm, depending on a number of factors including the level of investment, asset life, the depreciation method currently employed, profit position and cost of funds.

Although it is not possible to estimate the cost and benefit of an accelerated depreciation program with any precision, a rough estimate of its magnitude can be made. The staff of the Federal Reserve Bank of Boston has estimated that, on the basis of 1976 investment levels, the reduction in revenues to the Treasury of instituting the CONEG proposal would be approximately $900 million in the first year. (This is assuming manufacturing equipment was placed in service in states where the average unemployment rate for the years 1971–1975 exceeded the national average.) Firms in the Mid-Atlantic and New England states would benefit to the extent of $228 million and $108 million respectively in the first year. States in other parts of the country where unemployment is high would receive the balance. The revenue impact would peak out at about $1.9 billion in the fourth or fifth year and then diminish steadily toward zero.

On the other side of the ledger, the Treasury would have increased revenues as a result of increased personal income from more employment, increased profits of capital goods producers, increased taxable income deriving from the multiplier effect of higher economic activity, and lower costs of transfer payments. It has not been possible to quantify these gains.

In any case, the program, if enacted, would cost the Treasury nothing in the long run since the tax effect for qualified investments would be merely to defer the time of tax payment.

Merits of capital investment

The CONEG proposal should be considered in the light of the established merits of capital spending as a means of creating jobs without unleashing inflation.

During the period from the end of 1960 through the end of 1965, the United States experienced the longest period of uninterupted economic expansion with price stability in its peacetime history. For sixty months the economy moved steadily ahead, with GNP growing at a real rate of 6 percent. Unemployment declined from 7 percent to 4 percent. Prices were virtually unchanged. Unit labor costs increased less than 1 percent per year.

The expansion continued, of course, through 1969, but after 1965 it began to be influenced by Viet Nam and the consequent seeds of inflation.

One characteristic of the 1961–1965 experience was the role of capital investment in economic growth. In 1960 capital expenditures for plant and equipment totaled $36.7 billion, 7.3 percent of GNP. They increased steadily and in 1966 reached $63.5 billion, 8.4 percent of a larger GNP and a new record of annual dollar expenditures. Remember also that prices were more or less constant over those years.

Capital spending was encouraged at that time by new policies which accelerated the recovery of invested capital. The investment tax credit was introduced in 1972; depreciation was liberalized in the same year.

I suggest that there was a correlation among the economic growth, full employment, price stability and expanded fixed investment.

The experiences in Germany and Japan suggest the same correlation. Among the free-world industrialized nations in the post-war era, these two countries have established the best records of economic growth, full employment and relative price stability. (Recently Japan was vulnerable to the inflationary impact of oil price increases, but even this has begun to work its way out.)

German and Japanese industries have consistently maintained high rates of capital investment. Over the past ten years, expenditures for plant and equipment in Germany have averaged 24.3 percent of GNP and in Japan they have averaged 17.9 percent of GNP, compared with only 7.8 percent in the United States. This level of investment has been fostered by much higher rates for recapture of invested capital. The rate of capital recovery in Germany and in Japan is substantially greater than in the United States.

The argument has been made that stimulus for capital spending at this time will not be effective because of the current low level of plant utilization—because of slack in the production base, if you will. This point of view is not borne out by historical data. In 1960 capacity utilization stood at 80.1 percent. As a result of policies to encourage investment, what followed was a dramatic and sustained increase in capital spending which accompanied the record peacetime, non-inflationary growth of the first half of the 60's.

By coincidence, the rate of capacity utilization was 80.8 percent in the third quarter of 1976. This, along with other reasons, suggests that there is no barrier to enacting programs that will expand capital spending.

Full employment policy

There is universal support for the proposition that every American able and willing to work should have a decent job. In the Employment Act of 1946, Congress laid down a national policy for full employment.

At that time, Congress wisely called for this policy to be carried out "in a manner calculated to foster and promote free competitive enterprise and the general welfare."

The proposal of the Coalition of Northeast Governors is consistent with the Congressional mandate.

Conclusion

Capital spending offers the most reliable avenue for creating jobs without triggering renewed inflation. Programs which encourage plant and equipment expenditures in areas with high structural unemployment offer a responsive and responsible solution.

The CONEG proposal for more rapid depreciation for fixed investment in states with high unemployment should be included as a complementary feature of any economic recovery program.

I urge your favorable consideration.

Many thanks to this Committee for offering me the opportunity to present these views.

[H.R. ——, —— Cong., — sess.]

A BILL To amend the Internal Revenue Code of 1954 to encourage manufacturing-related investments in any State which has an unemployment rate which exceeds the national unemployment rate

Be it enacted by the Senate and House of Representatives of the United States of America assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Accelerated Depreciation Allowance Act of 1977."

SEC. 2. AMENDMENTS OF 1954 CODE.

Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

SEC. 3. ACCELERATED DEPRECIATION OF QUALIFIED MANUFACTURING PROPERTY IN HIGH UNEMPLOYMENT STATES.

(a) In General.—Part VI of subchapter B of Chapter 1 (Relating to itemized deductions for individuals and corporations) is amended by adding at the end thereof the following new section:

"SEC. 189. ACCELERATED DEPRECIATION OF QUALIFIED MANUFACTURING PROPERTY IN UNEMPLOYMENT STATES

"(a) Allowance of Deduction.—Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis of any qualified manufacturing property (as defined in section (d)) based on the useful life of the equipment. Such amortization deduction shall be an amount equal to twice the allowable depreciation of the qualified manufacturing property allowed under section 167.

"(b) Election of Amortization.—The election of the taxpayer to take the amortization deduction and to begin the amortization period with the month following the month in which the qualified manufacturing property was placed in service shall be made by filing a statement with the return for the taxable year in which the qualified property was placed in service, in such manner and in such form as the Secretary or his delegate may by regulations prescribe.

"(c) Termination of Amortization Deduction.—

"(1) Taxpayer's Election to Terminate.—A taxpayer who has elected under subsection (b) to take the amortization deduction with respect to any qualified property 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 on his return for the taxable year in which such month falls. 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 equipment or facility.

"(2) Constructive Termination.—If at any time during the amortization period any qualified property ceases to meet the requirements of subsection (d) of this section, the taxpayer shall be deemed to have terminated his election under subsection (b). Such termination shall be effective beginning with the month following the month in which such cessation occurs.

"(d) Qualified Manufacturing Property Defined.—For purposes of this section, the term 'qualified manufacturing property' means—

"(1) any new section 38 property—

"(A) which is a plant or facility placed in service by the taxpayer in a high unemployment State for use by the taxpayer in a trade or business of manufacturing or producing goods, or

"(B) which is machinery or equipment placed in service by the taxpayer in or in connection with a plant or facility described in clause (A), or

"(2) any progress expenditure property (as defined in section 46(d)(2) which is being constructed, reconstructed, or erected for purposes of being placed in service as a plant or facility described in subparagraph (1)(A) or being placed

in service as machinery or equipment in or in connection with such a plant or facility.

The term 'qualified manufacturing property' does not include any property which is used predominantly outside the State in which it is placed in service, or which, in the case of a plant or facility, is substantially used other than in a trade or business of manufacturing or producing goods, or in the case of machinery or equipment, is substantially used other than in or in connection with a plant or facility used in such a trade or business.

"(e) Other definitions and special rules.—For purposes of this section—

"(1) Excess unemployment percentage.—The term 'excess unemployment percentage' means, with respect to any State, the amount by which the 5-year unemployment rate for the State for the calendar year in which the determination date falls exceeds the 5-year unemployment rate for the United States for such year.

"(2) High unemployment State.—The term 'high unemployment State' means any State for which the 5-year unemployment rate for the calendar year in which the determination date falls exceeds 6%.

"(3) Determination date.—The determination date is the latest of—

"(A) the day on which the taxpayer entered into a contract to acquire such property if such contract, on such day and at all times thereafter, is binding on the taxpayer:

"(B) in the case of property constructed, reconstructed, or erected by the taxpayer, on which the physical work on the construction, reconstruction, or erection of such property began; or

"(C) the date of the enactment of the Accelerated Depreciation Allowance Act of 1977.

"(4) 5-year unemployment rate.—The 5-year unemployment rate for any calendar year is the percentage of unemployed for the 5-year period ending December 31 of the preceding calendar year. The percentage of unemployed for any State and for the United States for each 5-year period shall be determined by the Secretary of Labor and, not later than ____ of the year following each such period, certified to the Secretary and published in the Federal Register.

"(5) State.—The term 'State' includes the District of Columbia."

"(6) General Rule.—For purposes of this section, the amortizable basis for any qualified manufacturing property is the adjusted basis (for determining gain) of such equipment or facility.

"(7) Special Rules.—

"(A) Amortizable Basis.—The amortizable basis of any qualified property with respect to which an election has been made under subsection (a) shall not be increased, for purposes of this section, for amounts chargeable to capital account for additions or improvements made more than 2 years after the amortization period has begun.

"(B) Nonqualifying Basis.—The depreciation provided by section 167 shall, notwithstanding subsection (a), be allowed with respect to the portion of the amortizable basis which is not taken into account in applying this section

"(8) Special Rules for Public Utility Property.—In the case of a taxpayer who makes an election pursuant to subsection (a) with respect to public utility property (as defined in section 167(1)(3)(A)), the allowance of deductions pursuant to this section shall be considered to be a method of depreciation described in section 167(1)(2)(B).

"(f) Runaway Shop Limitation.—Notwithstanding any other provision of this section, subsection (a) shall not apply to any qualified manufacturing property if a ~~substantial~~ purpose for constructing or purchasing such property was to relocate operations involving significant employment from one labor market area to another labor market area and if such relocation will result in a decrease in employment at the original location.

"(g) Life Tenant and Remainderman.—In the case of any qualified manufacturing property held by one person for life with remained to another person, the deduction under this section shall be computed as if the life tenant were the absolute owner of the facility and shall be allowable to the life tenant.

"(h) 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 sections 1245 and 1250.".

(b) Conforming Amendments.—

(1) The last sentence of section 46(c)(2) (relating to applicable percentage) is amended by deleting the period and adding at the end thereof the following: "; however, in the case of property for which a taxpayer makes an election under section 189, the useful life of such property shall be determined without regard to section 189.".

(2) Section 57(a) (relating to items of tax preference) is amended by adding immediately after paragraph (11) the following new paragraph:

"(12) Amortization of Qualifying Equipment and Qualifying Facilities.—With respect to any qualifying equipment or qualifying facility for which an election is in effect under section 189, the amount by which the deduction allowable for the taxable year under such section exceeds the depreciation deduction which would otherwise be allowable under section 167.".

(3) Section 642(f) (relating to amortization deduction for estates and trusts) is amended by striking out "and 188" and inserting in lieu thereof "188, and 189".

(4) Section 1082(a)(2)(B) (relating to basis in certain exchanges) is amended by striking out "or 188" and inserting in lieu thereof "188 or 189(a)(1)".

(5) Section 1245(a) (relating to gain from dispositions of certain depreciable property) is amended—

(A) by striking out "or 188" each place it appears in paragraphs (2) and (3)(D) and inserting in lieu thereof, "185, or 189(a)(1)"; and

(B) by striking out "or 185" in paragraph (2)(D) and inserting in lieu thereof, "185, or 189".

(6) Section 1250(b) (relating to definition of additional depreciation) is amended by adding at the end thereof the following new paragraph:

"(5) Special Rule for Section 189 Amortization.—The term 'additional depreciation' includes, in the case of any property described in section 189(d), the amortization deductions allowed under section 189(a) with respect to such property; except that, in the case of property held more than 1 year, it means such deductions only to the extent that they exceed the amount of the depreciation adjustments which would have resulted if such property had been depreciated on a straight line basis over its useful life (determined without regard to section 189).".

(c) Clerical Amendments.—The table of sections for part VI of subchapter B of chapter 1 is amended by adding at the end thereof the following:

"Sec. 189. Amortization of qualifying equipment and qualifying facilities in high unemployment areas.".

(d) Effective Date.—The amendment made by this section shall apply to—

(1) qualifying equipment acquired pursuant to a binding order placed after October 1, 1976, and before October 1, 1981, and placed in service not later than three years after such order is placed, and

(2) qualifying facilities the construction, reconstruction, or erection of which is commenced by the taxpayer after October 1, 1976, and before October 1, 1981, and placed in service not later than three years after such commencement.

A Proposal for a Program of More Rapid Depreciation Allowances in High Unemployment Areas

Summary

During the last few years a great deal of evidence has emerged that the economies of many of our older industrial areas, particularly in the Northeast and Midwest, suffer from serious structural problems. Although the economic difficulties of these areas reflect in large part the recent national recession they are not recovering as well as the rest of the nation. The economic problems of these areas has resulted in higher unemployment and fiscal distress for many state and local governments. A wide variety of programs to revitalize older indus-

trial areas has been proposed. Some of these programs would take considerable time to become operational. One approach which could be undertaken almost immediately is a program to stimulate private investment in older industrial areas by granting more generous depreciation allowances for tax purposes.

Specifically, firms investing in manufacturing equipment in states where the five year moving average of unemployment rates exceeds 6 percent could be allowed to calculate their federal tax liabilities using depreciation rates which are twice those presently allowed A simple trigger mechanism would make all states whose rate is above 6 percent eligible when the national rate is above that level. Therefore, the program would be restricted to aiding those areas which are truly in economic difficulty and would phase out automatically as unemployment rates decline.

Accelerated depreciation alters the timing although not the absolute amount of a firm's tax liability. The firm pays less in the early years of an investment's life, more later; and by postponing some tax payments it is effectively granted an interest free loan from the Federal Treasury. The dollar benefit to the firm is the discounted present value of the stream of the change in tax liability. This benefit will vary from firm to firm and depends on a number of factors including the level of investment, asset life, the depreciation method currently employed, profit position and cost of funds. Because data are not available on these characteristics for the average firm in any state or region, it is not possible to estimate the benefit of such a program with any precision. However, by making some simplifying assumptions it is possible to develop a very rough estimate of the magnitude of a program allowing accelerated depreciation in high unemployment areas. On the basis of 1976 investment levels, if manufacturing equipment placed in service in states where the average unemployment rate for the years 1972–1976 exceeded the national average were depreciated at twice the fastest rate now allowed, the cost to the Treasury in the first year would roughly be $964 million. The average unemployment rate for the nation for this period was 6.4 percent. If all states were included whose rate was above 6 percent, even if below the national average, the cost would be approximately $1.3 billion. As Table 1 indicates the benefit of this program would be fairly widely distributed. Most of the benefit would accrue to industries in older industrialized regions including states in the Northeast, Mid-Atlantic, Great Lakes and Pacific Northwest regions. Up to 27 states would be eligible.

HOW A PROGRAM ALLOWING MORE RAPID DEPRECIATION ON A REGIONAL BASIS WOULD WORK

Depreciation Method

Depreciation deductions allow a company to recover tax free the cost of capital consumed in producing income. Under present law, equipment may be depreciated either on a straight line basis over its life or according to a variety of methods providing for a greater write off in the asset's early life. The total amount depreciated is the same regardless of method. However, by writing off a greater share of the asset's value sooner a firm can postpone some of its tax liability. The most favorable depreciation method currently allowed by the I.R.S. is the double declining balance method. This method can be applied only to certain assets, primarily those eligible for the investment tax credit. Under this method a firm can deduct 20 percent in the first year of the cost of an asset with a 10 year life span rather than a proportional 10 percent. A regional accelerated depreciation program could allow a further doubling of this allowance. The following example shows how this would work for a manufacturer buying a piece of equipment for $1,000,000 with a life span of 10 years—assuming the manufacturer is already using the double declining balance method of depreciation and is taxed at a 48 percent rate:

Manufacturer in area with more than 6 percent unemployment: $1,000,000 times 40 percent equals $400,000 depreciation.

Manufacturer in area with less than 6 percent unemployment: $1,000,000 times 20 percent equals $200,000 depreciation.

$200,000 difference times 48 percent (tax rate) equals $96,000 tax savings.

Thus, a producer in an area with the accelerated depreciation allowance

would "save" $96,000 in taxes in the first year. While the firm may have to pay these taxes in some future years in the interim it has benefited from an interest free loan.

Eligible Property and Industries

A regional accelerated depreciation allowance could use the same eligibility criteria currently employed by the I.R.S. for the double declining balance method. The double declining balance method can be applied to most tangible personal property with a life greater than three years; except in specific cases buildings are excluded. In general the same property is eligible for accelerated depreciation as for the investment tax credit.

In order to maximize its impact relative to cost to the Treasury an accelerated depreciation program should apply only to manufacturing. The purpose of this program is to offset some of the locational disadvantages of the older industrialized areas. While there are exceptions, manufacturing is the most mobile industrial sector. A substantial segment of the manufacturing industry sells to a national market and is not dependent on particular resources. Thus, these industries seek the lowest-cost production locations. To the older industrialized area's misfortune an increasing number of firms are finding these locations in the South and West.

Area eligibility

The objective of regionally focused accelerated depreciation is to stimulate the economies of areas with chronically high unemployment. Determining area eligibility by a five year moving average unemployment rate would channel funds to regions which had long-run economic problems independent of the national business cycle. While several different measures of unemployment could be used, the use of five year moving averages has several advantages. Unemployment rates are very volatile in the short-run. A program based entirely on current data would make an area with a temporarily high unemployment rate resulting from a brief downturn in the local economy eligible for the assistance. This temporary downturn in local economic conditions could be a result of a heavy concentration in cyclically sensitive industries rather than long-term economic problems and the primary objective of this program is not to be countercyclical but to address longer-term imbalances between regions. Also, state unemployment rates are not as reliable as the national rate. Because of the relatively small sample sizes these rates, particularly for smaller states, are subject to significant statistical variation. However, this variation is not systematic and therefore will cancel out over several years.

Determining area eligibility by a long-run average of unemployment rates has the further advantage of increasing a firm's certainty about the applicability of the more accelerated depreciation schedule. Whether the investment qualifies for the more rapid depreciation rate will depend on the unemployment measure at the time the property is put on site. Unemployment rates can change between the planning stages of an investment and the actual acquisition. However, if a five year moving average is used, even a substantial change in an area's unemployment rate in one year is unlikely to make an area with generally high unemployment rates ineligible. Finally, a firm considering investing in an area may be concerned about eligibility in the future as well as today. Since long-run averages change slowly, they are a more reliable guide to future eligibility than are current rates.

SUMMARY AND CONCLUSIONS

A regional accelerated depreciation allowance could be an effective way to stimulate private investment in high unemployment areas. This increased private investment would have a multiplier effect on the economies of distressed areas and by enhancing their competitive position could significantly improve their long-run economic growth. The primary thrust of this approach is to offset the locational disadvantages of manufacturing in certain regions. However, because more states or regions would become eligible when the national unemployment rate increases the program would also have a countercyclical feature.

ESTIMATE OF TAX SAVINGS FROM A PROGRAM OF ACCELERATED DEPRECIATION

[Dollar amounts in millions]

	Average unemployment rate (percent)		Estimated manufacturing investment in 1976	1st yr benefit of accelerated depreciation
	1971-75	1972-76		
United States	6.1	6.4		
Alaska	10.1	9.5	$33	$2
Washington	8.8	8.6	506	32
Rhode Island	8.3	8.4	153	10
Michigan	8.3	8.8	3,483	219
California	8.1	8.1	2,339	147
Connecticut	7.8	8.0	485	31
Oregon	7.7	8.2	430	27
Louisiana	7.6	7.4	710	45
Massachusetts	7.6	8.3	815	51
Nevada	7.4	7.7	37	2
Oregon	7.7	8.2	430	27
Maine	7.3	7.6	211	13
Vermont	7.1	7.7	48	3
Hawaii	7.0	7.5	51	3
New York	6.9	7.7	2,265	142
New Jersey	6.7	7.7	1,370	86
Montana	6.7	6.6	101	6
West Virginia	6.4	6.7	332	21
Utah	6.3	6.2	100	6
New Mexico	6.2	6.8	40	3
Idaho	6.2	6.2	102	6
Florida	6.1	6.9	693	44
Washington, D.C.		7.0	23	1
Arizona		6.7	297	19
South Carolina		6.6	764	48
Delaware		6.4	140	9
Pennsylvania		6.3	2,169	136
Ohio		6.2	2,638	165
Total eligible investment:				
Using 1971-75 rates			14,312	900
Using 1972-76 rates			25,334	964
Using 1972-76 rates above 6 percent			20,343	1,277

Source: 1972 Census of Manufacturers, "Expenditures for Plant and Equipment" table 4. Bureau of Labor Statistics, "Handbook of Labor Statistics," table 39. Estimates of 1976 investment made by Research Department, Federal Reserve Bank of Boston.

STATEMENT OF MARGARET COX SULLIVAN, PRESIDENT, STOCKHOLDERS OF AMERICA, INC.

Mr. Chairman and Members of the Committee on Finance: I appreciate the opportunity to present our views before this distinguished committee. My name is Margaret Cox Sullivan, president of Stockholders of America, Inc., a national, nonprofit, nonpartisan membership organization of individual stockholders headquartered in Washington, D.C.

Our motive is not to criticize nor attempt to analyze the Emergency Economic Stimulus program President put forth nor H.R. 3477 The Tax Reduction and Simplification Act of 1977, but rather to speak to an aspect which, in our judgment, would immediately act as a stimulus to the economy. We sincerely hope this committee will consider our proposal in its deliberations.

As an incentive to attract investment, to put capital to work, and to create jobs, we advocate a tax credit for individual stockholders for the taxes already paid on the income earned by the corporations; thus eliminating double taxation.

The need for investment capital is crucial. It has been estimated that over the next 10 years industry will need $4.5 trillion. We have allowed our great American business machine to get rusty, our equipment is becoming obsolete and many industries operate short of capacity. We have to realize that 67 percent of all metal working machinery in this country is more than 12 years old. Whereas in Japan the figure is only 30 percent and in Germany 37 percent. That's typical of all our plant and equipment; and it shows why our long-term production advantages are fading.

Given the equity investment needed, we can rebuild our great economic engine and expand our economy. Jobs can be created in the private sector and our country can return to a position of a lower unemployment rate. We can then work towards creating jobs for the 10 million more who will be coming into the work force by 1980. To a large degree, this equity investment will have to come from the American people.

Historically, it has been the individual investors, the stockholders, the little guys, who have been the source of equity capital. They've been called the strongest ingredient, the backbone of our capital markets; their role is vital. They are the capital force of our country. Just as the millions of workers in the labor force supply labor services, so capital services are supplied by the capital force—the millions who invest in the American business system.

Our capital raising process, the equity capital markets, has been successful because we have provided a mechanism—an auction market—where individuals with diversified interests and judgments can invest in companies of their choice and share in the ownership of these companies. The success and strength of our free enterprise system come from this large ownership base. Our system is often called People's Capitalism and that is a good description. Why? Because through this system it is possible for everyone to be a capitalist and indeed stockholders do come from all walks of life. They are the school teachers, telephone operators, linemen, barbers, shopkeepers, salesmen, office workers, construction workers, pilots, truck drivers, doctors, lawyers, and retired people. Further, many companies have stock purchase plans so their employees—office workers, workers in the plants and factories, and service workers can become stockholders.

It is this system which has made possible the building out of a wilderness the greatest industrialized nation on the face of the earth with its citizens enjoying the highest standard of living. We must continue to insure the constant flow of capital which is the financial fuel—the driving force—to keep this system going.

Yet, something has happened which should be viewed as an emergency and we must correct it with emergency measures. According to the latest statistics released by the New York Stock Exchange, the number of individual stockholders declined by 18 percent from 1970–75. For the first time since 1952 when such statistics were recorded, the number of stockholders did not substantially increase, but slid from approximately 32 million to 25.2 million. This is particularly jolting alongside estimates that there should be 50 million stockholders by 1980 to meet the expanding capital needs for a growing work force, to keep our industrial leadership in the world, to keep our country strong, and to keep our standard of living. Further, it must be kept in mind that at the same period in our national history when the number of stockholders was growing, we as a country were enjoying rapid, prosperous economic expansion.

Stockholders of America, Inc. not only conducts a continuing survey of its own member-opinions, we also survey stockholders at random for their opinions. In all surveys, the unfair double taxation on dividends comes up as the number one issue. The answer was an overwhelming yes in one survey to the question: "Would elimination of double taxation on dividends lead you to buy more stock?" There is no doubt that this double taxation inhibits capital from flowing into corporate equity investments. Therefore we strongly advocate a stockholder tax credit to compensate for this inequity of taxing income earned by the corporations twice; once at the corporate level and again at the stockholder level.

The double taxation on corporate profits applies only to the income attributed to equity investment. Corporations must earn enough gross income to cover the interest payments made to compensate bond holders and other creditors for the monies they have supplied, but interest payments are deductible at the corporate level and therefore not included in the net income which is taxable to the corporations. The fact that interest income on debt is taxed only once, while income on equity investment is taxed twice creates a very heavy bias toward debt financing. The double tax on equity earnings is therefore a major contributor to the dangerous increase in debt/equity ratios in recent years. The stockholder tax credit would substantially increase the return on equity to the investors making equity investments more competitive with debt from the viewpoint of the investor. Climbing debt ratios make business highly vulnerable to business cycle changes. The growth on high debt ratios is a very undesirable development which

tends to cause bankruptcies, generally suppresses economic growth, and stymies the ability of business to expand and modernize.

As each additional borrowing leaves the business more susceptible, investors—the stockholders—become anxious and potential new investors less interested, as we have seen. Our markets will not work without individual investors; they make the market. The millions of differing individual decisions made daily in diversified market transactions are needed for liquidity, for a true auction, and a more realistic value of stocks. Further, the individual has a different pattern of investing than the large financial institutions. Fund managers, either because of regulation or fiduciary responsibilities, invest primarily in the well-established companies and for the most part in a favored few. The individual, in his own frame of interest, and judgment, with his own capital may make investments in the smaller, often more venturesome high risk companies—which may become the Xeroxes, the IBM's or the Duponts of the future.

One only has to follow the financial press these days to see the great lack of new issues and certainly a great lack of new companies. This at a time when the capital needs for research and development of new technologies in many fields—particularly energy—are crucial.

In order to encourage and attract individual investment, we strongly urge the Committee to initiate legislation to allow the individual stockholders a tax credit on their individual tax return for the amount of taxes already paid by the corporation. A version of our proposal was recently suggested in 1975 by the then Secretary of the Treasury, William E. Simon.

Let me explain.

Assume my share of stock in a corporation earned $1, under our present tax before the corporation makes any distribution, it has to pay in taxes 48 cents of that $1. If the entire amount is distributed, I would receive 52 cents. If I'm in the 20 percent bracket, I would pay 10 cents. If I'm in the 70 percent bracket, I would pay 36 cents. In effect, the $1 per share earned by the corporation on my stock, after the 20 percent tax rate on my income, has been taxed at about 60 percent; at the 70 percent rate, nearly 85 percent. Under the proposed method, a corporation would report on its Form 1099 that my share has earned $1, but the corporation would also report that it has already paid 48 cents in taxes. If the entire 52 cents is distributed, I would be treated as if I had originally received the same amount of gross income as the amount earned on my share of stock, i.e $1, and am given a credit for the tax the corporation has already paid, i.e. 48 cents. Accordingly, if the 52 cents is distributed to me, I would "gross it up" by the amount of tax attributable to the 52 cents I received, i.e. 48 cents. Thus I would report a $1 income. If my tax rate is 20 percent, I would owe 20 cents and therefore have a 28-cent rebate. If my tax rate is 70 percent, I would owe 70 cents, but 48 cents has already been paid by the corporation so I would only owe 22 cents. Under this plan, if I'm in the 20-percent bracket, I pay 20 percent rather than 60 percent. If I'm in the 70-percent bracket, I pay 70 percent rather than the 85 percent under the current system.

This, of course, would make equity investing more attractive to the individual. Our proposed stockholder tax credit could be handled very easily on the current 1099 Form and would require only minor adaptations to the 1940 Form.

Eliminating the double taxation on dividends by this method would have a great impact both economically and psychologically. Its possible effect on the investment climate should be immediate and an increase of revenue into the Treasury should follow from the expanding economy.

Note.—Corporations are charged 20 percent tax on the first $25,000 of earned income. 22 percent on the next $25,000 and 48 percent thereafter. Mutual funds that meet the criteria of regulated investment companies pay no taxes on their distribution; the individual stockholder in the mutual fund would pay taxes in income at his/her individual bracket.

MANUFACTURING CHEMISTS ASSOCIATION,
Washington, D.C., March 11, 1977.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This statement is being submitted in response to your Press Release, dated February 23, 1977, announcing that the Committee on Finance would hear testimony on H.R. 3477, the Tax Reduction and Simplifica-

tion Act of 1977. We request that this letter be included in the record of the hearing.

The Manufacturing Chemists Association is a non-profit trade association having 189 United States company members representing more than 90 percent of the production capacity of basic industrial chemicals within this country.

The President has recommended that businesses be allowed to take either a credit against income taxes equal to four percent of Social Security payroll taxes paid by the employer, or an additional two percent credit for new investment in machinery or equipment. As reported by the Committee on Ways and Means, H.R. 3477 would substitute for those alternative credits a "new jobs tax credit." The new jobs tax credit equals 40 percent of additions to the first $4200 of wages paid to additional employees in 1977 and 1978, but the maximum total credit for any employer or taxpayer is limited to $40,000. A controlled group of corporations is treated as one taxpayer for this purpose. Thus, although the new jobs tax credit is directed toward the problem of unemployment, its major impact would be on small businesses.

The chemical industry is a capital intensive industry requiring large amounts of capital to modernize its plants and equipment, to increase its productivity and to improve its competitive capabilities throughout the world. Insufficient capital investment curbs productivity, limiting growth, and, therefore, job opportunities. With an increasing labor force the result is more unemployment. The United States in fact has been falling short of raising the amount of capital needed to maintain growth necessary to absorb its ever-increasing work force.

The substituted new job tax credit, with its maximum limitation of $40,000, would have minimal impact on the problems of the chemical industry. The President's original proposal of a credit equal to four percent of Social Security payroll taxes would have a much more beneficial impact on service industries and the additional two percent of investment credit would perform a similar function for capital-intensive industries. Without an increase in capital investment employment in the industry will not rise significantly.

There are several reasons for the shortage of capital. The heavy reliance on income taxes, the double taxation of corporate earnings, and the tax on capital gains have resulted in a bias against savings and investment. Also, the recent fiscal and monetary policies of the United States have put it in competition with business for needed funds. Further, the high rate of inflation over the last ten years has exacerbated the problem. Because of inflation, depreciation reserves have been insufficient to replace wornout assets.

The investment needed to comply with higher environmental standards has contributed to the capital shortage. Corporate spending for pollution control and occupational safety factors will grow at a tremendous rate in future years. Such investments, however necessary, do not directly increase productivity but, instead, divert already scarce capital funds.

Increase of the investment tax credit to 12 percent an important step toward these more basic reforms. It can be easily and quickly taken and will stimulate investment now in new plant and equipment. New plant investment will create more efficiency and lower prices. Hence, it is contrainflationary. Corporate investment decisions, however, are deliberate and carefully planned. Therefore, a temporary increase in the investment tax credit will not be nearly as effective. Business should be able to rely on strong, steady Government support for all of its expansion efforts. If this nation's caiptal requirements are to be met, longer-range solutions are needed. The Congress can begin to meet that need by making the 12 percent investment tax credit permanent.

We accordingly support the President's proposal to provide incentives to business. A job credit would be a part of that proposal if desired. We suggest, however, that more meaningful stimulus would result if the recommended increase to 12 percent in the investment credit were made permanent. We are concerned that a temporary stimulus will not provide the full range of desired results of improving the economy and creating new employment. This arises from the inability of firms to initiate new programs where the stimulus is of such short duration.

Consistent with the foregoing views, if the nation's basic capital formation problem is to be solved and a sound base for full employment is to be established, we suggest the following steps be considered:

(1) Reduce the corporate tax rate. A greater proportion of profits would then be available for reinvestment or, if paid in dividends, the higher yield to individuals would encourage new investment in equities.

(2) Review the capital recovery system so that the cost of manufacturing facilities will be recovered over a short period of years. This could include liberalization of the ADR system and accelerated writeoff of pollution control facilities.

(3) Reduce double taxation of corporate earnings by either adopting a split-rate system whereby distributed earnings would be taxed at a rate lower than retained earnings, or by allowing shareholders a credit or a deduction for taxes paid by the corporation.

(4) Reconsider present methods of taxing capital gains including possibly allowing reinvestment rollovers to be excluded from tax, or providing that the tax rate diminish as the holding period of the capital assets increases.

Sincerely,

W. J. DRIVER.

STATEMENT OF THE COUNCIL OF JEWISH FEDERATIONS AND WELFARE FUNDS

The Council of Jewish Federations and Welfare Funds is the association of central Jewish community organizations located in almost every major city in the United States. These organizations obtain over $460 million annually from 1,000,000 contributors.

The vast network of Jewish humanitarian services made possible by these gifts includes over 800 hospitals and clinics, institutions and agencies for care of the aged, agencies providing family and child welfare, youth and community centers, centers for college youth on campuses, vocational guidance, placement and rehabilitation services; and a variety of other forms of assistance. A minimum estimate of persons individually served annually is over 1,200,000. Many are served without regard to race or creed, particularly in Jewish hospitals where over 65 per cent of those served are other than Jewish.

The expenditures for these services total over $2 billion annually. Thus, contributed dollars have a multiplier effect because the services they finance generate additional support.

Any proposal which would have the effect of reducing charitable support could set off a reaction in which much more could be lost than the level of charitable support, in terms of dollars, agencies' services to individuals, and volunteer services to charities.

Our concern is with the effects of the economic stimulus program which, while designed to help overcome hardship in human needs, inadvertently would increase distress by reducing the funds of the human services agencies which depend upon voluntary philanthropy. We do not oppose tax reduction or simplification; but we do have a proper concern as to how these objectives are accomplished.

The proposal in the economic stimulus measure to increase the standard deduction will remove the incentive of tax deductions for philanthropic gifts for additional millions of taxpayers. It would therefore reduce their charitable assistance to agencies serving persons in economic distress. That is because the standard deduction enables those who make no charitable gifts to get the same tax benefits as those who do.

The benefits intended for taxpayers by increasing the ceiling for the standard deduction should not be achieved at the expense of charitable organizations serving needy persons. Rather, these benefits can be realized by having charitable contributions deducted in the computation of adjusted gross income. This will provide the incentive for all taxpayers to assist most generously others in need through voluntary philanthropic contributions.

The effectiveness of the tax deductions as an incentive to charitable gifts has been substantiated in the studies made by Professor Martin Feldstein of Harvard University for the Commission on Private Philanthropy and Public Needs. These studies have emphasized further that the total sums contributed to the charities are greater than the revenue loss to government.

Just because the charitable deduction has been included in the past as an itemized deduction is not a reason to ignore the difference between it and other itemized deductions. The Congress, in 1976, recognized the need to differentiate deductions; it amended the law to remove alimony from the list of itemized deductions, and made it a deduction in computing adjusted gross income.

The tax laws have long recognize that an allowance must be made for the support of charities not only to encourage voluntary charitable giving, but also to

recognize and allow for the citizen's role in meeting his obligation to support charitable, religious and educational causes.

This positive governmental recognition encourages citizens to contribute for charitable causes. The key to this policy is that charitable giving is voluntary and the donor is giving up something of value.

The charitable deduction is distinguishable from other itemized deductions. When a person contributes to a charity, what ver the tax abatement, he reduces his own net income voluntarily. Charitable deductions have nothing in common with economic transactions designed to produce a profit or acquire more worldly goods, such as interest payments. Nor do they have anything to do with mandatory transactions such as state and local taxes. Charitable contributions should not be lumped with these dissimilar deductions. Charitable contributions should be treated separately as a subtraction from adjusted gross income because this conforms to the reality of the contributor's option to reduce his net income.

No one is compelled to give; hence, if the services provided by organized charities are to be maintained at their present level, it is important that the tax laws encourage giving; discouragement, on the other hand, can simply result in loss of gifts when individuals exercise their option not to give.

Moreover, the donor does not benefit from the charitable gift; the benefit derived is realized by the beneficiaries of the charitable gift, mainly the persons in need who are served and assisted by charitable agencies. If the tax laws are changed to reduce the encouragement to charitable giving, the donor may choose not to make the gift at all. That would reduce the support of charities and thereby hurt needy people by depriving them of assistance and, as a result, would impair the well-being of society.

The Congressional encouragement of publicly supported charities evidences one of the proudest attributes of the American people: The impulse toward voluntary association to meet human needs. People are better people if they give. Giving patterns affect the quality of the community. If government discourages giving, and people are thereby encouraged not to care, there will be more unsolved human problems, not fewer.

With the greatly increased unemployment and the exhaustion of resources, the dislocations and distress of many families, the need is for greater support of human needs by voluntary philanthropy. The incentive for charitable giving should be encouraged, not deterred, to provide the dollars to maintain and augment charitable, educational and religious institutions to improve the quailty of life. The harm to these purposes in extension of the standard deduction can be prevented by providing for deduction of charitable contributions in computation of adjusted gross income.

Statement of Frederic W. Hickman, On Behalf of Trans Union Corporation, Chicago, Illinois

SUMMARY

1. Increasing the investment credit will create a disincentive to invest for Trans Union and similar companies, unless the increase is made transferable or refundable.

2. Nationwide, nearly a third of the proposed 2 percent increase will be unused in the absence of transferability or refundability.

3. Making an increase in the credit transferable or refundable would allow it to be used fully by all companies.

4. Trans Union is very capital intensive. It is the kind of company with the greatest potential for increased capital spending. It is the kind of company where the credit ought to be—but isn't—effective in promoting capital spending.

5. As the credit gets higher and higher, more and more of it will go unused because companies are more likely to bump the "income limitation" ceiling, i.e., the credit can't exceed 50 percent of tax liability.

6. Because of the "income limitation," Trans Union will not be able to use an additional 2 percent credit unless it cuts back on new investments. An increase in the credit will be a disincentive rather than an incentive to invest.

7. Other companies likely to be adversely affected are: capital intensive companies (which account for most of the total capital investment), small companies, rapidly growing companies and companies in financial trouble.

8. Trans Union's single most important business is the rail car business. The cost of a rail car is the single most important cost involved in calculating the prices to be charged to customers. If Trans Union's competitors can use the credit they reduce their cost by 12 percent and can charge less. If Trans Union cannot use the credit its costs—and its prices—will be correspondingly higher. If it cannot use the credit it must either make subnormal profits or quote prices too high to be competitive.

9. There is a great deal of investment the company has not made because it has been unable to use the credit and the investment would, as a result, be noncompetitive and unprofitable.

10. As the credit goes higher, the tax law will create an increasing bias for companies to merge (in order to bring excess credits together with headroom under the income limitation).

11. The credit should be made either transferable or refundable. The credit is already transferable in the case of lessors/lessees. The earned income credit is a precedent for refundability.

12. Simply increasing the "income limitation" (even to 100 percent of tax liability), would not eliminate the disincentive effect of the credit for Trans Union. It would still not be able to use the credit for "marginal" investments.

STATEMENT

In brief

Any increase in the investment credit should be drafted so that it can be utilized by all taxpayers. Nearly a third of the proposed 2 percent increase will go unused unless the increase is made transferable or refundable.

Unless such changes are made, the credit will operate as a disincentive rather than as incentive to invest for Trans Union and companies in a similar situation.

Description of Trans Union Corp.

Trans Union is one of the 500 largest corporations, with revenues of more than $700 million. The corporation was previously known as Union Tank Car Company. The three largest components of its business are:

Rail car manufacture and leasing.—The bulk of the nation's railroad cars are owned by the railroads. However, where special purpose cars are required, the railroads do not customarily supply them and shippers must purchase or lease their own cars. The company has owned, maintained and leased such cars for 85 years. The company is the largest supplier of cars for the petroleum and liquefied gas industries. In recent years the company has also leased cars to railroads and equipment to other industries. The company makes no tax shelter or leverage leases.

Shipping.—Trans Union owns a large fleet of vessels. It has concentrated on technologically advanced shipping operations. As a result it has been able to operate its entire U.S. flag fleet without government subsidies. The Trans Union fleet is the largest U.S. flag carrier between the United States and the Middle East.

Water treatment.—The company is the leading supplier of water treatment facilities to electric utilities and a major supplier of such equipment to other energy industries. It is heavily involved in the expanding field of pollution control.

The investment credit as a disincentive

Trans Union is a capital-intensive company—the kind of company that has the greatest potential for increased capital spending. It has a record of making hundreds of millions of dollars of capital investments annually and a potential for making millions more under the right circumstances. It is the kind of company where the credit is supposed to be the most effective.

Nonetheless, as presently structured, the investment credit will operate as a disincentive to the company's making new investments.

The income limitation as the source of the disincentive

Under present rules, the investment credit cannot be used to the extent it exceeds 50 percent of the taxpayer's tax. The higher the credit goes, the more likely it is to bump that ceiling.

The very companies which the credit should help the most are the companies most likely to be penalized.

Capital intensive companies are the source of most capital spending. By definition, such companies have large capital investments in relation to their income. Thus the income limitations are likely to nullify the credit.

Young companies, small companies, rapidly expanding companies and companies in temporary financial difficulty are heavily penalized by the income limitation because their capital investment needs are typically large in relation to their income.

A 12 percent credit is a 12 percent plus reduction in the cost of a company's capital assets. Companies that cannot use their credits are placed at a competitive disadvantage. They must compete in the marketplace against competitors which can buy their productive assets cheaper.

The credit, as it presently operates, requires Trans Union to be overly restrictive in making new investments

Trans Union's case illustrates the basic defect in the present credit.

Trans Union has $21 million of unused investment tax credit from prior years. It will take years to use these carryovers even on a future program of restricted investments.

Even at 10 percent, the new investment the company would like to make in 1977 will create credits substantially in excess of the income limitation. That will make the $21 million of unused credits grow still further. A 12 percent credit will make matters still worse.

The existence of the credit with the income limitation is a disincentive to Trans Union's stepping up its level of investment over what is absolutely necessary. As the company approaches each investment decision, it must take into account that some competitor can make the investment at 12 percent less. In the leasing segment of the business, for example, that can be an insuperable cost disadvantage. The cost of the capital asset is the company's dominant cost and a 12 percent cost differential means it must often quote too h[illegible] a rental to get the business.

There is a great deal of investment which the company has not made because its inability to use the credit makes it noncompetitive with companies which can use it. For example, the inability to use the credit has caused the company to rule out the expansion of its U.S. flag fleet. In order to be competitive in shipping, it must consider foreign flag vessels, where there is no credit to distort pricing policies. The company has been an expert in transportation equipment for nearly a century, yet must confine its investment in that area to those selected activities which are most critical to its competitive position. If the credit is increased without change, its investment decisions will be even more restrictive. If the credit is modified so it can be utilized, the company can expand broadly in its field of greatest expertise.

If the company were part of some still larger, less capital intensive business—say, a major retailer—the income limitation ceiling would be higher and it could use the credit. It makes no sense to turn the availability of the credit on what kind of conglomerate a company is part of. That kind of tax bias puts a large premium on companies merging into ever larger units. Mergers may be fine in particular cases, but there is no reason why the tax system should affirmatively promote them while the Department of Justice and the FTC are trying to discourage them.

Provisions to prevent loss of the credit don't work well

Congress originally provided that taxpayers could transfer and shift the credit to others in order to keep from losing it, but those provisions do not now work well.

It was originally provided that the credit might be transferred forward by the owner to a user/lessee (who would, in return, pay more rent). That provision still works well where it is possible to "transfer the credit forward."

When the credit was originally enacted, it was also possible for the economic owner to "transfer the credit backward" by having a financing company be the technical owner and leasing the asset to the investing company. The Internal Revenue Service has recently so changed the rules that, as a practical matter, this transfer no longer works in most cases.

Simply increasing the income limitation will not eliminate the disincentive effect of the credit

Some have suggested increasing the income limitation to 100 percent of the taxpayer's tax liability (or to some lesser percentage between 100 percent and the present 50 percent). That would provide the company with more cash flow, but would not eliminate the disincentive effect of the credit.

The credit is intended as an incentive to companies to make additional investments "at the margin," i.e., to make investments which they would not otherwise make. But even with a 100 percent income limitation, the credit would not provide that incentive for Trans Union and companies in its situation. The company has been investing at a rate that exceeds even a 100 percent income limitation. It would like to invest even more, but the extra investments which are optional (i.e., the "marginal investments") are not profitable because of the credit, as those competitors that can still utilize the credit can make similar investments for less money and, by thus lowering their costs, can quote lower prices to customers than Trans Union can. The net effect is that the existence of the credit is presently a disincentive to Trans Union's making additional optional investments, and that would continue to be true even with a 100 percent limitation.

Recommendation: That the credit be made transferable

The problem with the investment credit is the income limitation. There are at least two methods to eliminate that problem:

1. *Make the credit refundable.*—The income limitation would simply be eliminated. Where the credit exceeds the taxpayer's tax liability, the excess would be refunded. This would be the simplest and most direct way of eliminating the problem. The Administration's proposal for a credit for social security taxes would operate in this way.

2. *Make the credit transferable.*—The income limitation would be unchanged. Taxpayers would be permitted, however, to transfer their own credits, for consideration, to other taxpayers that could use them. Limited transferability—i.e., between lessors and lessees—has been permitted since the credit was first enacted. This proposal would build upon and broaden those existing provisions.

Revenue cost.—The cost of making the credit transferable or refundable would be $600 million.

STATEMENT OF J. JOSEPH VACCA, PRESIDENT, NATIONAL ASSOCIATION OF LETTER CARRIERS, AFL–CIO

My name is J. Joseph Vacca, and I am the president of the National Association of Letter Carriers, AFL–CIO, representing 230,000 letter carriers throughout the entire Nation.

A substantial number of our Members are disability retirees who are desperately concerned with the unanticipated tax liability due April 15th resulting from the change in the tax treatment of their disability income.

As the Committee is surely well aware, the Tax Reform Act of 1976 contained an unjust provision denying to disabled retirees a $5200 per year sick pay exclusion from their taxable income. The punitive nature of this tax increase to those in our society least able to pay, was further emphasized when Congress made the effective date of this revision January 1, 1976. No annuitant was prepared for this savagery and, therefore, the tax liability due April 15th caught them completely off guard.

There is a recognition on the part of a substantial number of Representatives and Senators that this is an example of Congressional overkill. Although I personally believe the Congress went too far in making any changes to the tax treatment of the sick pay income—period—there clearly is no question that making that unfair revision retroactive was adding insult to injury.

Therefore, I urge the Committee to favorably report S. 4 introduced by Senator Dole which will change the effective date of this undesirable tax provision to January 1, 1977. That action, at least, will demonstrate an awareness in Congress of the unfortunate plight of the disabled retiree created by this ill-conceived revision of the Tax Code. It is our hope that this belated awareness will bring about a more sensitive understanding of the extent of the injustice and harm done to these annuitants by the basic change in the elimination of the sick pay exclusion. Perhaps your willingness to delay the impact of this unwise legisla-

tion will bear the more desirable fruit of repealing the new provision in its entirety.

That action is really the only conscionable one to rectify this circumstance.

STATEMENT OF KEVIN O'SULLIVAN, EXECUTIVE DIRECTOR, AMERICAN SOCIETY FOR TRAINING AND DEVELOPMENT, INC.

Mr. Chairman and Members of the Committee: The more than 12,000 national members of the American Society for Training and Development represent the field of human resource development in the world of work, a field in which employers are investing an estimated $100 billion annually.

Our field of employee training, education and development is a major factor in building an effective national workforce. We believe that employers using their in-place and tested job training capabilities for productive manpower development is a realistic and practical means of economic stimulus.

Accordingly, we wish to voice our strong support for the employment expansion tax credit approach embodied in H.R. 3477. We urge you to adopt the jobs tax credit mechanism for your version of the bill as well as make two related additions for which we see a strong need.

One is provision for an experimental tax credit for employers to train jobless youth. The other is revival of the now expired section 188 five-year amortization provisions for capital expenditures in acquiring, building or rehabilitating on-the-job training and child care facilities.

We have not seen any definitive figures on how many jobs could be generated by adoption of the jobs tax credit provisions of H.R. 3477. Yet given the fact that youth ages 16 through 24 currently account for nearly one-half of the nation's unemployed, one can assume that a fair amount of those hired under employment expansion provisions could be youth. But unskilled young people—and especially those from disadvantaged backgrounds who are disproportionately represented among the unemployed—historically have required substantial investment on the part of employers for on-the-job training and development.

To encourage employers to hire those youthful would-be workers who most need a job, we urged the members of the Senate Finance Committee to include an experimental tax credit for employers to help offset their training costs of newly hired disadvantaged youth. Such an incentive could be tied to any employment expansion tax credit or stand alone.

A tax credit to train unskilled youth is an experiment that deserves to be tried. We are convinced it would be successful. Industry is committed to performance-oriented training. Accountability is built into its system. We are talking here about offering incentives for employers to provide real jobs teaching readily marketable skills in the real world of work for youth who need both jobs and skills. In the long run, any "cost" to the government from lost revenue would be replaced by the contribution to society of effecient, productive workers.

Responsible advocacy for such an experiment is not unheard of. In December of last year the National Commission for Manpower Policy recommended exploration of "New ways to use tax and other incentives to encourage employers to hire, train and retrain hard-to-employ persons." You now have a viable opportunity to do this in H.R. 3477.

As a related matter, we also urge the committee to restore the five-year amortization provisions for capital expenditures to "acquire, construct, reconstruct or rehabilitate" facilities for on-the-job training of employees (and prospective employees) and for child care center facilities to serve the children of employees. Applicability of the provision expired on January 1st of this year.

When section 188 was included in the Revenue Act of 1971 (P.L. 92-178), the committee said this expiration date would "give Congress an opportunity to review the effectiveness of the provision after it has been in effect for five year." We respectfully suggest that the time has come to do just that.

To the best of our knowledge, section 188 was permitted to expire without appropriate review. Yet an informal survey of our society's membership suggests that the provision was of substantial utility in helphing employers provide modern facilities for those training experiences found to be most effective, the kind of training with a real job waiting at the end. We strongly urge you to revive this worthwhile provision, at the very least until you have given it the fair scrutiny originally promised.

The American Society for Training and Development supports your efforts and those of the Administration to more actively involve the private sector in strategies to stimulate the economy and combat structural ills. We believe that inclusion of the two provisions we have advocated here—a youth training tax credit and restoration of the training/child care facilities section 188—would be entirely in keeping with the spirit and goals of the legislation you are preparing to draft. When the Nation adopts means of developing relevant manpower skills, it really is investing in its most important resource, the human resource.

Thank you for this opportunity to present our views.

STATEMENT OF COMMITTEE ON FEDERAL FINANCE, COUNCIL OF STATE CHAMBERS OF COMMERCE

The Federal Finance Committee of the Council of State Chambers of Commerce welcomes the opportunity to comment on the House-approved tax bill, H.R. 3477, which is intended to implement by legislation a major part of the President's Economic Stimulus Program. As we understand the basic objectives of that program, they are to stimulate greater consumer spending and to encourage increased investment in production facilities, with the expected result being more jobs and lower unemployment.

We suggest that a necessary ingredient to stimulating consumer spending and business investment is greater confidence in the future course of the economy, particularly the inflation aspect. Another is to permit an increase in funds available for consumption spending and investment by relief from the rising real burden of taxes.

The proposed tax rebates and $50 payments to recipients of benefits under various income transfer programs, at an estimated cost of $11.4 billion under the President's proposal and $10.1 billion under H.R. 3477, would no doubt generate some temporary increase in consumer spending. But this distribution of money borrowed by the Treasury can hardly be expected to build consumer confidence in the economy.

In place of this one-shot stimulus, we recommend a permanent across-the-board reduction in individual income taxes. Through reduced withholding it would provide a sustained increase in consumer purchasing power and, we believe, would tend to improve consumer confidence. Moreover, it would not require the sudden heavy Treasury borrowing needed to finance the rebate which could very well put upward pressure on interest rates.

The major lagging sector during the 1975–76 economic recovery has been business investment for expansion and improvement of plant and equipment. This was graphically pointed out by Charles L. Schultze, Chairman of the Council of Economic Advisers, in testimony before the House Budget Committee on January 27. He noted the change in four major economic indicators seven quarters after the trough of the recent recession in relation to the prior peak for each indicator and compared the changes with the average for prior postwar recoveries. During the prior recoveries gross national products, consumer income, and industrial production all rose on the average at least 7.7 percent from the prior peak in dollars adjusted for inflation. Business investment rose 5.3 percent on the average. After seven quarters of the 1975–76 recovery, GNP had risen 3.1 percent in real dollars and consumer income 4.4 percent. Industrial production had just reached its prior peak, but business investment was still 11.8 percent below its prior peak.

The potential for job creation by expanded business investment is obvious. It is not only the jobs that will have to be filled in expanded facilities and operations, but also jobs with construction contractors and with producers of machinery and equipment. It is our view that removal of disincentives to business investment should be a priority means of creating jobs. These disincentives are lack of confidence in the stability of the economy and the inability of business, primarily because of inflation, to recover the cost of capital investments under present tax laws.

Lack of confidence in economic stability in the period ahead could be ameliorated considerably by a restrained fiscal policy. The existing tax disincentive to investment could be lessened by allowing more rapid recovery of investments in plants, machinery, and equipment and by a larger permanent investment credit. These are the approaches to encouraging job-creating investment that we recommend.

In recognition of the lag in business investment, the President has proposed a 2-percent additional investment credit to be available through 1980. To encourage additional hiring of employees he proposed a permanent refundable income tax credit equal to 4 percent of the employer's share of the Social Security tax. The taxpayer would have the option of choosing either the increased investment credit or the credit related to the Social Security tax, with the election being binding for each year through 1980. However, both of these proposals were left out of H.R. 3477 and in their place the House approved a tax credit designed to encourage small employers to hire additional workers. The credit available to employers would be 40 percent of the first $4,200 of wages with respect to each new employee hired in 1977 and 1978 in excess of 103 percent of the prior year's base, but the maximum allowable credit would be $40,000.

Thus, while the House bill makes an attempt to encourage employment of more workers, particularly by small business, it does nothing to encourage significant new investment. We suggest that, at the very least, the additional 2-percent investment credit proposed by the President should be added to the bill as an option to the tax credit provision in H.R. 3477. Preferably, the new total investment credit of 12 percent should be made permanent.

Finally, we want to express strong reservations about inclusion in this emergency legislation of a costly tax reform and simplification measure such as the revision in the standard deduction for individuals. At an annual revenue cost of $4 billion, we suggest that it should more appropriately be considered in connection with more comprehensive tax reform legislation when its merits could be compared with other possible reforms. At such time the economic and equity effects of alternative proposals could be weighed against the proposal approved by the House.

AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.,
Washington, D.C., March 10, 1977.

Re H.R. 3477, Tax Reduction and Simplification Act of 1977.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The American Textile Manufacturers Institute, Inc. (ATMI) is pleased to take this opportunity to comment on H.R. 3477, "Tax Reduction and Simplification Act of 1977", as passed by the House of Representatives on March 8, 1977. ATMI is primarily concerned with the proposed tax changes affecting businesses.

ATMI represents approximately 85 percent of the nation's spinning, weaving, knitting and finishing capacity for processing cotton, wool, silk and man-made fibers. The textile industry plays a major role in the U.S. economy and is one of the largest employers in the manufacturing sector. It is also among the industries hardest hit by the prolonged recession during 1975, with employment falling by more than 15 percent and profits disappearing.

Textile plants are located in forty-seven states, and in many small communities the textile plant is the main source of jobs. In addition, many other industries, such as cotton and wool growers, synthetic fiber manufacturers, the apparel industry, machinery manufacturers, dyestuff and chemical plants, transportation companies and electrical utilities, are, to a greater or lesser extent, directly involved with the textile industry. In essence, the needs and welfare of the textile industry reflect the larger needs and welfare of American industry in general.

I. Purpose of H.R. 3477 and its shortcomings

The Ways and Means Committee Report on H.R. 3477 indicates that the primary purpose of this legislation is to stimulate consumer demand, the production of goods and services and employment in order to ensure sustained economic growth in the next few years. With regard to the business sector of the economy, this economic stimulus would be accomplished in two ways—(1) by extending through 1978 the corporate tax rate reductions for small business, and (2) by enacting a new jobs tax credit for a two-year period.

ATMI is in agreement with the avowed goals of H.R. 3477. Moreover, it has no objections to the manner in which the House of Representatives has attempted to implement such goals, provided it is recognized by the Senate Finance Committee and the Senate at large that other options should be made available to businesses which would otherwise receive only minimal assistance from the proposed jobs tax credit.

A brief analysis of the new proposed jobs tax credit quickly reveals that its main thrust is in the area of spurring employment in small business. In general, the proposed jobs tax credit would provide a credit of 40 percent on the first $4,200 of wages paid to each net new employee hired by a business during 1977 and 1978. The credit only applies on an incremental basis of 103 percent of the preceding year's wage base. Moreover, there is a limit of $40,000 of credit for each employer.

From these limitations, it is apparent that the maximum number of employees which any one employer could hire and claim jobs tax credit with respect thereto would be 24. Obviously, the ceiling on the proposed jobs tax credit renders it of limited value to medium and large businesses. ATMI believes that a stimulus to increase employment is as essential, if not more so, for medium and large businesses.

Another drawback to the proposed jobs tax credit is that it provides an incentive only to businesses which increase employment. The proposal does nothing to stimulate employment in low growth, or declining, industries and hence is discriminatory, unless an alternative credit is open to them. ATMI believes that it is short-sighted to focus a program designed to reduce the nation's unemployment rate solely on that area of commerce which has the potential to hire additional employees. Moreover, it should be emphasized that the jobs tax credit of itself, would do nothing to nurture the country's growth and productivity.

Finally, the expected impact of the proposed jobs tax credit on increased employment is premised on the view that if the cost of labor is reduced significantly for a business through tax incentives, such a business will almost certainly hire additional employees because such actions would increase its profitability. ATMI contends that the foregoing premise is far from universal it its application. Industries, such as textiles, which are heavily dependent upon capital investment would not be spurred to increase employment to any great extent merely because the marginal cost of hiring new employees for the next two years is lowered by a jobs tax credit. Instead, as ATMI has brought to your attention on numerous occasions, the textile industry is in desperate need of new capital in order to modernize its equipment, meet foreign competition and increase the number of jobs in the industry. Toward this end, greater tax incentives are needed to promote capital investment. This, in turn, will create new jobs.

A brief look at the textile industry demonstrates that the proposed jobs tax credit would help few members of the textile industry. Historically, the textile industry has had great difficulties in raising capital for expansion. Both the traditional debt and equity markets have been close to it. Accordingly, expansion and modernization have been financed internally. This source of capital has proved to be woefully inadequate. The proposed jobs tax credit would do nothing to alleviate this problem.

Secondly, improvements in machine technology in the industry are causing machinery and equipment to become obsolete at an accelerating pace. The failure to modernize means that textile companies will cease to be competitive. This is hardly a situation which is conducive to increased hiring. Again, the proposed jobs tax credit would do little to aid in this area.

Third, the tremendous increase in Government regulations in such areas as health, safety and pollution have taken their toll in absorbing vast amounts of industry capital. Moreover, funds spent to comply with such regulations invariably do nothing to increase productivity and, therefore, do nothing to spur increased employment.

Finally, in recent years there has been a tremendous increase in foreign competition in the textile field. Such competition constitutes a continuing threat to the vitality of the industry. Here, again, the proposed jobs tax credit would do little to attack the root causes of unemployment in the textile indusry.

Accordingly, ATMI believes that any legislation designed to increase production and employment must offer additional options, beyond a jobs tax credit, which have been successful in the past in achieving their purposes.

ATMI PROPOSAL

ATMI recommends that in addition to the proposed jobs tax credit, businesses be given the option of choosing between an additional two percent investment credit and a credit equal to four percent of Social Security payroll taxes paid

by an employer. In essence, ATMI suggests that the Carter Administration's tax proposals be combined with the House proposals so that an employer may choose between any one of three options.

ATMI believes that it would be desirable to retain the proposed jobs tax credit for those smaller businesses for which it would be beneficial in promoting increased employment. On the other hand, for medium-size and larger businesses increased employment would be more effectively promoted by offering such businesses a choice between an increased investment credit and a payroll tax credit.

While ATMI has long been a strong proponent of increased investment credits to spur capital investment and increased jobs in the textile industry, it is mindful of the criticism in recent years that the investment credit is too heavily weighted in favor of capital intensive industries. ATMI feels that an appropriate accommodation to such criticism is possible through the enactment of a jobs tax credit or a payroll tax credit as alternatives to an increased investment credit.

ATMI believes that of these alternatives, the additional investment credit would be the approach which would be most successful in promoting increased productivity and employment in the textile industry.

Respectfully,

W. RAY SHOCKLEY, *Executive Vice President.*

THE WHITE HOUSE,
Washington, October 19, 1976.

WALLACE D. BARLOW, P.E.
Director, International Institute for Resources Economics,
Washington, D.C.

DEAR DR. BARLOW: The President asked me to thank you for your October 7 letter, enclosing a copy of your article urging corporate tax incentives in favor of high labor content industries.

We welcome the opportunity to consider innovative approaches on the employment question but, as you correctly suggested, the implications for reduced productivity need to be weighed. We are intensifying our review of the productivity outlook and will study your proposal in this context.

Your interest and thoughtful contributions are appreciated.

Sincerely,

L. WILLIAM SEIDMAN,
Assistant to the President for Economic Affairs.

Comment by WDB. Productivity per person will fall under any "share the work" plan; but total production will increase. The polls show that most Americans want a more modest and less materialistic life style. I hold that the quality of life is more important than productivity. (Perhaps the Republicans do not want a seller's market for labor.) February 4th, 1977.

STATEMENT OF JOHN C. DAVIDSON IN BEHALF OF THE TAX COUNCIL

My name is John C. Davidson. I submit this statement in behalf of the Tax Council of which I am President and a Director. The Council is a policy organization supported by business memberships. Its policies are directed towards federal tax policies which would more adequately reflect the public interest in higher levels of savings and capital formation.

SUMMARY

1. *Investment credit.*

(a) A two percentage point increase in the investment credit providing a total rate of 12 percent would make a significant contribution towards a stronger and less inflationary economy as we move into a period of optimum use of existing capacity.

(b) Removal of the provision for termination of the credit in 1980 would be an important signal to business that there is developing a more capital conscious approach to tax changes.

(c) The purposes of the credit would be better served if its limitation to 50 percent of a taxpayer's liability were increased in proportion to the increase of the rate above seven percent.

2. *Standard deduction.*—Removal of the percentage limitation on use of the standard deduction would further narrow the tax base, increase the progressivity of the tax structure and severely restrict flexibility for objective consideration of other options to improve the equity of the personal income tax.

3. *The marriage tax penalty.*—The marriage tax penalty would become more deeply imbedded in federal tax law if the percentage limitation on use of the standard deduction is removed from the tax law.

By contrast, without the removal of the percentage limitation, there seemingly would be revenue margin in H.R. 3477 in the range of what would be needed to completely eliminate the marriage tax penalty.

4. *Objectives of tax revision.*—The proposal for removing the percentage limitation on use of the standard deduction brings into sharper focus the inconsistencies and conflicts which have developed between the objectives of conventional tax reform, tax simplification and tax reform to reflect the public interest in higher levels of capital formation, job creation and economic growth.

5. *The attack on high incomes and wealth.*—A question which deserves objective consideration is whether the attack on high incomes and wealth which has been the leading edge of the tax reform movement over the past quarter century has been counter educational as regards the general public interest in capital accummulation, use and conservation.

6. *Priority for capital formation.*—The ultimate question is whether the conflict between objectives of tax revision should be resolved this year by giving priority to the general public interest in achieving a higher level of gross capital spending in relation to gross national product.

DISCUSSION

1. *Investment credit.*

(a) The value of a two percentage point increase in the rate of investment credit becomes more apparent when we compare the proposed new total rate of 12 percent with the rate of seven precent which existed when the economy last operated in the zone of full practical use of capacity. At that time, the funding of new capital formation became too dependent on expansion of bank credit. The total increase of 5 percentage points, or seventy percent, in the rate of investment credit should ease the problem of excessive demand on bank credit as the economy again moves into a period of optimum use of capacity. It should always be kept in mind that business capital spending provides some of the best paying and most sought after jobs in the economy, and the new plant and equipment but in place by such spending is the primary source of both the increased productivity which mean increases in real wages and living standards and in the increased production which mean more new and better jobs and decreased unemployment. We urge enactment of the option for a two percentage point increase in the rate of credit.

(b) There is a cloud of uncertainty overhanging the planning and undertaking of long range capital spending projects due to a number of factors. One is the present provision which extends the credit only through 1980. Its removal would permit more realistic planning and encourage business to believe there is developing a more capital conscious approach to tax changes.

(c) The limitation of the credit to 50 percent of a taxpayer's liability serves to penalize young enterprises, rapidly expanding enterprises, those with temporary earnings difficulties and, on an overall basis, capital intensive enterprises. For all such enterprises, capital expenditures become more expensive at the margin created by the 50 percent limit and, in many cases, the limit undoubtedly serves to put a ceiling on capital spending programs.

Enterprises which had reached the 50 percent limit under the seven percent credit have not been able to take current advantage of the ten percent credit, and of course the situation would be aggravated in this respect by an increase in the rate to 12 percent. The Council therefore recommends that the 50 percent limitation be increased in proportion to the increase in the rate above seven percent.

2. *Standard deduction.*—A major objective of conventional tax reform through the years has been broadening of the personal income tax base. In fact this consideration has encouraged many thoughtful people in middle and higher income brackets to support the movement even though they found the tactics of

reform zealots to be distasteful and careless of truth. Removal of the percentage limitation on the standard deduction would be expecially disturbing to these people because it would narrow the base of income tax and thus increase its progressivity.

Removal of the limitation would increase the number of taxpayers using the standard deduction only from 70 to 75 percent of the total, but would serve to lock-in the approach to comprehensive tax reform before the comprehensive program being developed by the Administration is laid before the public and the Congress. Although there may be advantages to this approach which are not now perceived by taxpayers including members of the Council's Tax Policy Committee, members of the Committee are strongly of the view that they and other taxpayer groups should have the opportunity to examine and appraise the whole before facing the prospect of living with such an important part of it.

It is recognized that the reason why the removal proposal has been brought forth at this ~~time is political~~ momentum which has developed for simplification personal tax reporting. The present momentum, however, would seem stronger than the underlying case which raises the possibility of a serious backlash from trading out specific tax provisions which people value and cherish for a less complicated tax return. In a nation which devotes so much of its resources to education, moreover, the attribution of low levels of intelligence to taxpayers generally is at best a questionable reason for making it too easy by pay taxes. Withholding insures that the government will get its revenue, and it could well be that wrestling with tax returns is an exercise which makes for greater citizen interest in governmental affairs.

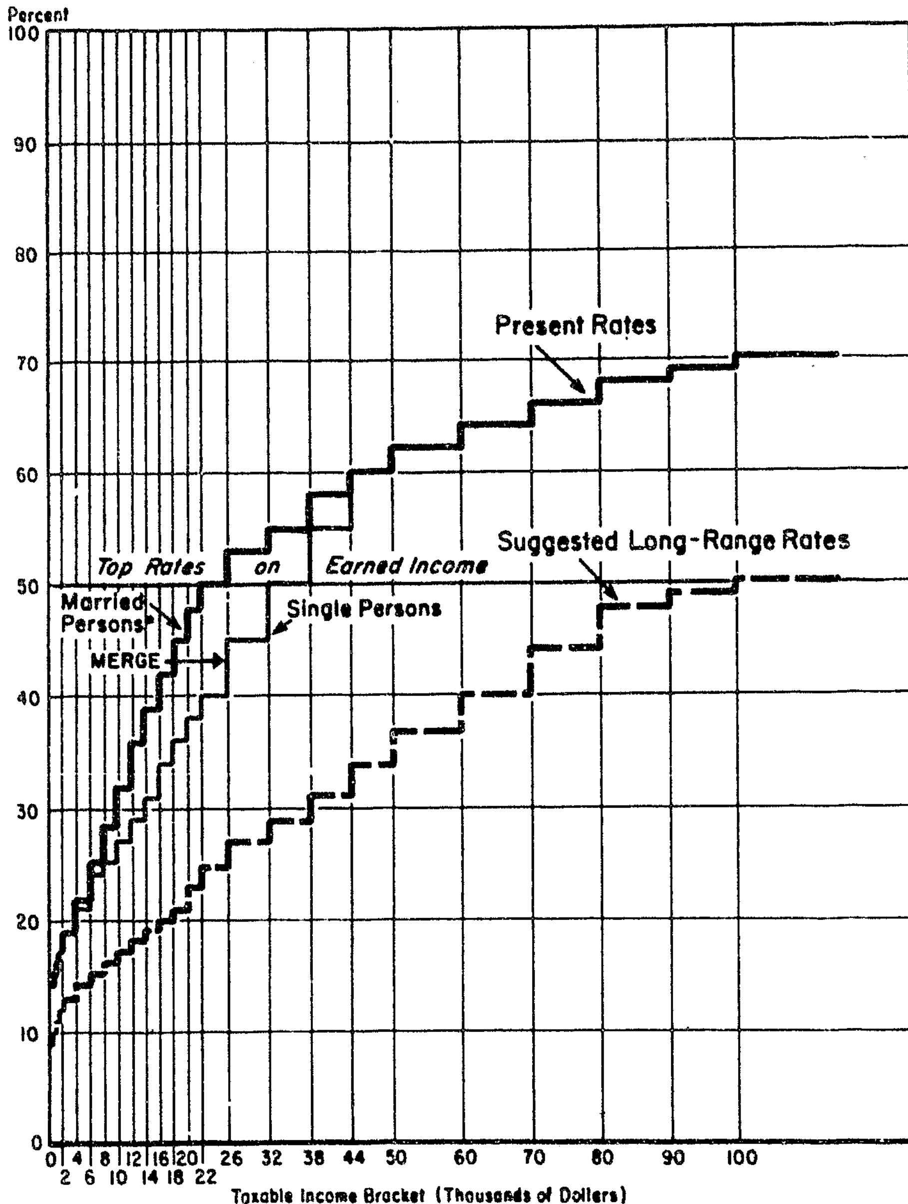
3. *The marriage tax penalty.*—The "marriage tax penalty" is largely the product of the tax reform movement. It results from a special tax rate for single taxpayers enacted in 1969 and a more liberal standard deduction for single taxpayers than for a married couple.

Insofar as rates are concerned, before 1969 two married people making the same income and filing separate tax returns would pay the same tax as two single people. The marriage penalty was limited to the tax on $500 (one half the standard deduction permitted single taxpayers and married couple filing joint returns). However, 20 years earlier the Congress had enacted the split income provision which made it possible for each of two married people, through a joint return, to pay tax on one-half of their total income regardless of how receipt of the income was divided between them. This provision was subsequently singled out as a target by one of the more zealous branches of the tax reform movement, and a small but vocal group of single taxpayers became active in the late 1960's.

While married taxpayers in and out of Congress sat on their hands, the Congress was persuaded in 1969 to create a substantial marriage penalty by enacting a special rate scale for single taxpayers through the steeply progressive brackets and doubling the size of the standard deduction. The special rate scale is shown on the following chart which also shows the reform and reduction of all of the rates which the Council has advocated for a number of years. The standard deduction has since been increased so that two single taxpayers have a two thousand dollar advantage over a married couple. The marriage penalty for a couple each making $23,150 is now $2,640, or 25 percent over what two single ~~people would pay regardless of living together.~~

Strange as it may seem, there apparently was little if any attention in the 1969 proceedings to the situation of married couples earning similar salaries. As regards the rates, the aim was to give a single taxpayer a lower rate than a married couple filing a joint return. It seems that the visualization of the married couple did not extend beyond a single income producer or one of the marriage partners earning much more than the other. What was then apparently conceived of as essentially a discrimination against working women who were single was transformed into a discrimination against the working wife entering the realm of equal pay. This obviously is an intolerable situation, but one which could be readily corrected now by using the revenue saving which would result from retaining the percentage limitation on use of the standard deduction. There would be nothing discriminatory about this move. The married taxpayer would simply catch up to the tax status of the single taxpayer.

Reform and Reduction of Personal Income Tax Rates



*On separate returns and split incomes

THE TAX COUNCIL
April 1972

The Council proposal is simply that the single tax rate be merged into the overall rate scale as shown on the chart and that the standard deduction for married couples be increased to double that of the deduction for single taxpayers, or to $4,800. While the tax writing process can not avoid value judgements as to living costs at the lowest income levels, the process should not involve such judgements with respect to higher income levels where there is significant discretionary income and living costs vary as much because of choice of lifestyle as they do as between single and married people. In this era, the only alternative to establishing equality in standard deductions for married couples would be the impossible one of denying that equality to single taxpayers who choose to live together.

It seems hardly necessary to state that it is just as desirable public policy to keep the tax situation equalized between married couples, regardless of how much income if any each marriage partner contributes to the family income, as it is to equalize the situation between married and single taxpayers earning equal income. The only shortcoming of the 1948 law which initiated the split income concept in federal taxation was that it did not also equalize the situation as regards the standard deduction.

4. *Objectives of tax revision.*—Major tax problems in addition to the aggravated marriage tax penalty now being confronted have come out of the reform movement. There is a need for sorting out of objectives and analytical review of the general public interest in tax reform before going forward with another too broad a brush of comprehensive reform.

5. *The attack on high incomes and wealth.*—The underlying question here is whether there is justification for singling out high incomes and wealth as a class of taxpayers especially favored in the tax laws. If review of the pertinent data indicates that the answer is "no", the public is ill served by the distortions of fact to which it has been continuously exposed for many years.

6. *Priority for capital formation.*—The aspect of tax reform which bears most directly and heavily on the overall economic performance of the economy is the impact of taxes on the supply of capital and hence on the rate of capital formation. In the Council's revised policy program released a year ago, we estimated a tax drain on actual and potential capital supply of $70 billion annually. Other estimators might come up with a lower figure, but whatever the total it would seem that the general public interest would lie in priority attention to this area. There is no comparable urgency with respect to other facets of tax reform.

THE TAX COUNCIL,
Washington, D.C., March 10, 1977.

Washington, D.C., March 10, 1977—The Congress was urged today to repeal the "marriage penalty tax" as an alternative to removing from the tax law the percentage limitation on use of the standard deduction.

In a statement submitted to the Senate Finance Committee, Tax Council President John C. Davidson said that two married people each earning $23,150 now pay $2,640, or 25 percent more tax than two single taxpayers earning similar incomes. Urging complete elimination of the penalty, he said this would be achieved by applying to married taxpayers the single rate enacted in 1969 and by providing to them a standard deduction double that available to single taxpayers. He indicated this could be financed by not removing from the tax law the percentage limitation on use of the standard deduction recommended by the President and as provided in the House bill pending before the Committee. He added that there would be nothing discriminatory about the result; the married taxpayer would simply catch up to the tax status enjoyed by the single taxpayer.

In supporting the option of a two percentage point increase in the investment credit as recommended by the President, Mr. Davidson said the new rate of 12 percent "would make a significant contribution towards a stronger and less-inflationary economy as we move into a period of optimum use of existing capacity." He made the further points that removal from the tax law of the provision for terminating the credit in 1980 would be an important signal to business that there is developing a more capital conscious approach to tax policy, and that the purposes of the credit would be better served if its limitation to 50 percent of a taxpayer's liability were increased in proportion to the increase of the rate of credit above seven percent. He noted that the 50 percent limitation serves to penalize young enterprises, rapidly expanding enterprises, those with temporary earning difficulties and, on an overall basis, capital intensive enterprises.

The Council is a policy organization supported by business.

STATEMENT OF THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES

The National Association of Retired Federal Employees (NARFE) is a 275,000 membered Association composed exclusively of retirees of the Federal and District of Columbia Governments, their survivors and spouses.

Serving as spokesman for the interests of the 1.5 million Civil Service annuitants and survivors, NARFE supports the proposals of the Carter Administration to stimulate our nation's economy through a program of tax reductions and

simplifications. As the Committee on Finance and the Senate consider the Administration's proposals and various amendments, we would hope that some relief would be forthcoming for low-income and disabled federal retirees.

Our Association is requesting Congress to correct two major oversights which have, and will continue to have, a devastating economic impact on low-income and disabled annuitants. Specifically, we are asking that Congress (1) extend the President's tax rebate proposal to include low-income civil service annuitants who had no tax liability during the previous year, and (2) incorporate into the tax package the substance of S. 4, which would postpone from 1976 to 1977 the effective date of the "sick pay exclusion" amendments passed last October.

A provision of the President's tax proposal presently authorizes tax rebates for 1976 only to individuals who pay taxes or who receive Social Security benefits. The majority of Federal retirees do not receive Social Security and thousands of these retirees' incomes are so low as to preclude them from any tax liability. Therefore, this particular group of low-income elderly will recognize no benefit at all from the rebate program, although they are the very ones most likely to need and therefore spend rebate monies.

We therefore request that the legislation under consideration be amended so that the elderly without tax liabilities or Social Security income are included among those eligible for a rebate.

In urging that the provisions of S. 4 be amended to the current tax proposal, we are seeking redress of what we believe was an oversight in the 1976 Tax Reform Act. Sec. 505 of that Act eliminated thousands of disability retirees from the benefits of the "sick pay exclusion" which had previously been available to them. Although this change was not enacted until October 1976, it was retroactive to the beginning of the year. The retroactivity of this provision brought numerous disabled taxpayers face to face with unexpected tax liabilities of as much as $1,000, which they simply do not have, and place many more in the position of being penalized for underestimating their 1976 taxes.

NARFE appeared before the Senate Finance Committee in April 1976 to oppose any change in the "sick pay exclusion". While we maintain that last year's changes are arbitrary and unjust, we are primarily concerned at this time with enactment of a one-year extension of the effective date to avoid massive confusion among unsuspecting, disabled taxpayers. The minor loss of revenue which would be incurred by enactment of S. 4 should present no problem since it has already been included in the budget resolution for FY 1977.

We therefore strongly support the change of the effective date of the "sick pay exclusion" from 1976 to 1977 as embodied in the provisions of S. 4, introduced by Senator Robert Dole and co-sponsored by approximately a third of his colleagues. Identical legislation in the House of Representatives has been sponsored by more than one-third of the House members. We believe the inequity of the retroactive effective date is evidenced by the strong bi-partisan support of correcting legislation.

American Gas Association,
Arlington, Va., January 21, 1977.

A.G.A. Member Company Delegates.
A.G.A. Government Relations Specialists.

Attached for your information are A.G.A. communications on matters of current importance to all member companies.

1. Natural gas legislation

As the energy emergency in much of the nation worsens and in follow up of the A.G.A. Board decision to support early passage of "emergency—only" legislation as reported in my letter of January 14, we have written Rep. John D. Dingell (D-Mich), Chairman, Subcommittee on Energy and Power, House Interstate and Foreign Commerce Committee; and, Senator Adlai E. Stevenson (D-Ill), Chairman, Subcommittee on Oil and Natural Gas Production and Distribution, Senate Commerce Committee. This letter urges their respective committees to report out and seek floor passage of emergency legislation by February 1 and requests similar treatment by March 1 for a bill deregulating field price controls on new gas. It also emphasizes that mandatory allocations between companies would be counter productive. The text of this letter is enclosed.

This obviously is a crucial matter at this time and is receiving top level Administration and Congressional attention. On this, his first full day in office, Dr. James Schlesinger, assistant to the President for Energy, is meeting with

representatives of ten major pipelines, Senator Stevenson and Rep. Dingell to discuss emergency legislation including the adverse impact that would follow any attempt to legislate mandatory allocation and interconnections between systems. The outcome of this meeting is unknown at this writing.

2. Letter to Dr. James Schlesinger

A.G.A. has today delivered a letter to Dr. James Schlesinger congratulating him on his appointment to the nation's top energy position and outlining some of the key natural gas supply issues that will require his early attention. In addition tc providing him with a brief outline of the justification and need for these initiatives, we have requested an early meeting with him for our Chairman and President and other key industry leaders to discuss the nation's energy future and the significant role the gas industry must play. If you have any ideas that might be useful in future face-to-face contacts at this level, we would be interested in hearing them.

3. CBS-TV "60 Minutes" program

As you all are probably aware, "60 Minutes" belatedly backed down somewhat and on January 16 at the tail end of the show stated that they were passing on a warning from the Federal Energy Administration to the effect that flue dampers must be installed by a qualified professional. They are just now recognizing the safety aspects of this matter which we repeatedly emphasized to them in the original taped interview in my office last fall and which were stressed in a full two-day meeting between members of A.G.A. staff and the "60 Minutes" program director. A.G.A. has received only about 30 queries on the "60 Minutes" show and actually very few of these were hostile. I am enclosing a sample letter which we have used in reply to these and which you might find useful in connection with any inquiries you may continue to receive. It includes an exact quote of the CBS January 16 safety warning.

Very truly yours,

GEORGE H. LAWRENCE.

Enclosures.

AMERICAN GAS ASSOCIATION,
Arlington, Va., January 18, 1977.

Hon. JOHN D. DINGELL,
Chairman, Subcommittee on Energy and Power, House Interstate and Foreign Commerce Committee, U.S. House of Representatives, Washington, D.C.

Hon. ADLAI E. STEVENSON,
Chairman, Subcommittee on Oil and Natural Gas Production and Distribution, Senate Commerce Committee, U.S. Senate, Washington, D.C.

DEAR CHAIRMAN DINGELL AND STEVENSON: The American Gas Association on January 13 announced support for immediate passage of emergency natural gas legislation. We take this as a step to provide—hopefully within a matter of days—the maximum legal and regulatory flexibility for all gas companies to exercise all possible steps to best alleviate emergency situations wherever they exist.

We emphasize that in the public interest such legislation must *not* become a vehicle for any delay in proceeding on a parallel emergency time-frame to consider, report out and bring to a floor vote a bill to remove the Federal field price controls on new natural gas. Further, this emergency legislation must *not* become the vehicle for some form of Federally mandated interconnections and allocations between gas companies; this can only be counter productive in that instead of providing the maximum flexibility referred to above, this would force each company to resort to maximum legal recourse to protect its own priority consumers.

The suggested emergency legislation contemplates a simple bill of the type introduced last session which would provide for extension of the emergency purchasing authority from non-jurisdictional sources at prices exempt from FPC jurisdiction for a period of 180 days. Qualifying purchasers would be any pipeline company with a curtailment plan on file with the FPC and which is curtailing pursuant to that plan; to be more restrictive is to bog down the FPC in proceedings as to who qualifies and deprives all companies of optimum interchange capability and flexibility to respond to other companies' emergency needs. The emergency period would extend through September 1977 to cover the summer period for replenishing storage.

We would further emphasize these points regarding the emergency legislation:

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(1) The extent of accessible intrastate supplies available to the interstate market today is not known—primarily because of present severe weather conditions in producing areas. However, since there is more likely to be early weather relief in the producing states of the Southwest than in the Northern tier states, this can especially be a factor in refilling storage this spring when interstate supplies will be at their lowest and in alleviating summer curtailments which could well be necessary to refill storage. In any event, we view such brief emergency legislation as providing the best set of circumstances under which immediate voluntary industry efforts can be successful. And we repeat, it is such voluntary efforts which offer the best hope for relieving the truly human need emergencies which could arise.

(2) While the FPC decision of last Friday with respect to emergency sales is an encouraging step which should bring more gas interstate, it is expected to be challenged in Court, as have previous FPC emergency sale decisions. The recommended emergency legislation would both clarify and expand the Commission's authority to permit such emergency measures.

Finally, we would emphasize that the same reasons which prompt A.G.A.'s support for emergency legislation are even more persuasive in prompting the need for the immediate deregulation of new gas because this is what will add new gas supplies. This is a step which is vital to consumers and the economy and which can wait no longer. The emergency provisions add no new gas whatsoever; they are simply a vehicle to permit the FPC and natural gas companies to have the optimum short-term flexibility in moving existing supplies to points of critical shortage, hopefully to avert human need emergencies and avoidable plant closings and job losses this winter.

Therefore, we most respectfully urge each of you as Chairmen of your respective energy subcommittees to proceed forthwith on parallel courses (a) to report out and seek floor passage of emergency only legislation by February 1, and (b) to report out and seek floor passage of legislation to remove Federal field price controls on all new natural gas by March 1 to permit the essential exploration and production incentives for vital new supplies to begin working. We submit that this is not an unrealistic timetable. The issues are well known to your subcommittees and to all members of both full Commerce Committees. Indeed, they are well known to virtually all members of Congress.

The facts in support of such an accelerated legislative timetable are compelling. We appreciate your consideration of this request.

Very truly yours,

GEORGE H. LAWRENCE.

AMERICAN GAS ASSOCIATION,
Arlington, Va., January 19, 1977.

Dr. JAMES SCHLESINGER,
Assistant to the President for Energy,
The White House, Washington, D.C.

DEAR DR. SCHLESINGER: On behalf of the American Gas Association (A.G.A.) and its 300 member gas distribution and transmission companies, I wish to congratulate you on your appointment by President Carter to the Nation's top energy position. It is my hope that we in the Gas Industry can work closely with you and the new Administration in achieving our essential energy goals in an efficient and environmentally acceptable manner.

As you know, the natural gas industry currently supplies 30 percent of all the energy consumed in the U.S. In terms of production from U.S. resources, gas accounts for over 35 percent, representing the largest component. Unfortunately, the production of natural gas, our cleanest fuel, has been declining for the past three years; thus, I would like to take this opportunity to present our Industry's views concerning how this serious trend can be halted. Because Federal policies regarding natural gas can influence gas supplies in such a major way, I am sure the following issues will be among the most important that will require your early attention.

1. Natural gas deregulation

Until last year, the regulated wellhead price for natural gas transported in interstate pipelines, which supplies about two-thirds of all gas customers, has been $0.51 per Mcf or about $3 per barrel oil equivalent. Recently, the FPC in Opinion 770A has increased this price ceiling for new gas production to $1.42 per Mcf or about $8 per barrel. While this increase will provide some needed

additional incentive for offshore exploration and production, additional onshore production will not be forthcoming at this price since new onshore gas is already being contracted for in the intrastate, unregulated markets at $1.50 to $2.00 per Mcf. We strongly believe, as long as new gas prices are artificially held far below the prices of alternative energy sources, that neither adequate incentives for aggressive domestic exploration and development will exist, nor will conservation measures be seriously employed by consumers.

While some have argued that the economic costs to the U.S. consumers resulting from complete deregulation of new gas will be large, it is estimated, based on FPC's calculation of the impact of Opinion 770A, that the first-year cost to the Nation would be less than an additional $1 billion or about 3 percent of our annual $35 billion per year foreign oil bill. Furthermore, a recent study entitled "Energy and Jobs," performed at the International Institute for Economic Research, concludes that deregulation of natural gas prices will not only lead to significant increases in real GNP within four years but will also result in substantial long-term increases in annual employment.

Given these arguments, coupled with the fact that natural gas is clearly our cleanest energy source, we believe immediate and complete deregulation of new gas prices must be an essential component of any realistic national energy policy. We are greatly encouraged that the President, during his campaign, stated support for this policy, and since Congress has thoroughly debated the issue and there is no significant environmental opposition to this proposal, we strongly urge its early enactment.

2. Commercialization of coal gasification technology

In the last session of Congress, legislation to provide loan guarantees for the first several commercial coal gasification plants passed the full Senate twice by overwhelming votes but failed in the House—the second time by only one vote. The purpose of this legislation was to provide Federal assistance to share with industry the economic, regulatory, and other risks associated with these large, first-of-a-kind ventures.

We believe early commercialization of coal gasification technology represents one of the most important actions to limit, in the long term, our growing dependence on foreign energy sources. It represents the most economic, efficient, and environmentally sound way to use our vast domestic coal resources. For example, the energy content of gas made from coal is almost 70 percent of that of the coal it uses—about twice that of electricity. The air pollution associated with a coal gasification plant is estimated by CEQ to be less than one-fifth of a scrubber-equipped electric power plant producing the same number of usable Btu's. And although the critics of current generation Lurgi gasification technology argue its production cost of $3.50 to $4.00 and delivered cost of $5.00 per million Btu is much higher than current conventional gas prices, they fail to compare its cost with its major alternative, electricity, which in most parts of the country is $10.00 per million Btu and higher—more than twice the delivered price of gas from coal.

With an aggressive national effort to bring this technology into commercial use, we can provide a *domestic* alternative as conventional domestic gas resources begin to be depleted in the latter part of the century. However, the Federal government must assist in this effort. The risk of failure to a particular company or its partners is substantial, since the $1 billion investment for a coal gasification plant approximately equals the net worth of the largest of our member companies. This, combined with the fact that these companies have regulated rates of return on equity of generally less than 15 percent, which limit their ability to assume all but the most normal business risks, makes private sector financing of the first few plants virtually impossible.

For these reasons, we believe that loan guarantees covering 75 percent of the cost of the initial pioneer coal gasification plants are urgently needed if this industry is to continue to meet the large projected demands for gas in the late 1980s and early 1990s without resorting to substantial increases in imports.

3. Gasification of petroleum feedstocks and LNG import policy

During the period while needed price incentives, such as deregulation, are beginning to work—usually three to five years—and before coal gasification begins to make a major contribution to U.S. gas supplies in the early 1990s, there will be a critical need for additional sources of gas to supplement our conventional natural gas production. Under the Ford Administration, regulations were imposed that largely prohibit the use of petroleum feedstocks to produce sub-

stitute natural gas (SNG). The Energy Resources Council also established a 1985 "target" of 2 Tcf per year of liquefied natural gas (LNG) imports.

While we understand that the intent of these policies is to discourage further import dependence, LNG and SNG represent the most available supplemental gas sources. Furthermore, we not only believe the current policies will fail to substantially limit import dependence but also they will result in an additional economic cost to the Nation. In the absence of a viable alternative, it makes no more sense, in our view, to restrict the use of petroleum-based feedstocks or imported LNG to make gas than it does to limit oil imports, particularly when the most serious U.S. supply problem is currently natural gas. Moreover, forcing gas customers to alternative fuels not only results in substantial changeover costs, but in most cases will only result in switching to imported oil such as is happening this winter as gas shortages worsen. In other instances, it will mean switching to direct coal burning, with attendant environmental problems.

To best meet the current emergencies of the type dramatized this winter, the gasification of liquid petroleum hydrocarbons is by far the most immediately available and least capital intensive supplemental gas supply source. For these reasons and also the fact that world supplies of such hydrocarbons are projected to increase, we urge you to reexamine these restrictive policies as you begin to formulate the Administration's energy program.

4. Outer Continental Shelf (OCS) development

Another essential near-term gas supply measure, in addition to gas deregu'ation, is the expeditious development of our OCS gas resources. Both from an energy and environmental viewpoint, the OCS offers an attractive source of additional conventional gas supplies. It is a little realized fact that ocean pollution resulting from offshore drilling represents less than 3 percent of all pollution sources, and the pollution from such drilling comes from oil spills. From an overall environmental standpoint, the net effect of additional clean gas supplies from expanded OCS drilling will clearly be positive.

It is vitally important, therefore, that the leasing program initiated by the Department of Interior not sustain further slippage. In this regard, we fully support the incorporation of this program into the new Department of Energy to ensure that these activities receive adequate priority and attention. It is also important that OCS legislation developed in Congress ensure that such OCS development will proceed in a manner free from the long delays that other large Federal energy initiatives have encountered.

5. Research and development priorities

Although 75 percent of our Nation's energy is currently derived from oil and gas, and the most significant and urgent problems facing the U.S. with respect to declining domestic energy supplies relate to these fuels, our Nation's energy R&D program is heavily weighted toward an implied policy of electrification. We believe this strategy is questionable considering current energy infrastructure and the environmental impact, cost, and efficiency of resource utilization that results from massive electrification.

Of the approximately $2.5 billion budgeted by ERDA for direct energy R&D in fiscal year 1977, over 75 percent of this amount is committed to projects related to electricity. ERDA currently has over 15 different major research approaches to electrification—in the coal area, in solar, in geothermal, in nuclear fission, and in fusion. By contrast, there are only three major research approaches in the gas area, with the total funding for all projects related to gas totaling less than 7 percent of the $2.5 billion.

While electricity must continue to play an important role in our Nation's energy future, its cost is high, its substitutability for gas in many applications is sometimes not possible, it would entail substantial changeover costs, and it is inefficient in many applications. Thus, we believe the balance in our Nation's energy R&D budget, particularly the emphasis on research on new methods to produce gaseous fuels, needs to be re-examined.

6. Alaskan gas pipeline

While Congress has established a timetable for all decisions in connection with this major project, there are steps that the Administration can take at various stages to ensure its expeditious completion. In this regard, we strongly urge your active support.

7. Conservation

In addition to the major gas supply issues discussed here, I also want to emphasize our industry's commitment to aggressive conservation efforts as evidenced by our long-standing and recently accelerated conservation programs. We believe it is particularly important to our Nation's conservation, efficiency, and environmental goals that we stretch our gas supplies. Gas, after all, is our most efficient and cleanest fuel since it does not pollute air, land, or water and need not be transformed to be used.

These are a few, although the most important, of the issues which concern our A.G.A. member companies. We believe it is essential in formulating the energy program for President Carter that you understand the Gas Industry's views. In this connection, I am requesting that in the very near future you meet with me and Robert Seymour, the Chairman of the A.G.A., and several other key industry leaders to initiate a dialogue concerning our Nation's energy future and the significant role the Gas Industry must play.

With best wishes for your success.

Sincerely,

GEORGE H. LAWRENCE.

AMERICAN GAS ASSOCIATION,
Arlington, Va.

(Text of typical letter used by A.G.A. in response to the approximately 30 letters and phone calls received on the Dec. 26 "60 Minutes" CBS-TV program. Supplementary information provided by GAMA was included in those letters which requested details as to where "Vent-O-Matic" types devices could be obtained.)

Thank you for your inquiry regarding the recent "60 Minutes" program. Your letter affords us an opportunity to rectify distortious which we have pointed out to CBS News. We are pleased to discuss these points with you and want you to know this information, which would have contributed to a balanced report on this matter, was in the possession of CBS News.

First, the American Gas Association and its members have a clear record of active support for natural gas conservation practices dating back to 1970, three years before the Arab oil embargo. We have developed and communicated to the public many programs promoting conservation. Moreover, we have cooperated with government agencies, including the Federal Energy Administration, in their efforts to encourage conservation.

It is patently untrue that gas interests have a financial motivation for opposing conservation. In fact, the reverse is true. Utility financial success is determined much more by total plant and distribution size (number of users served) than by volume of gas delivered to any individual customer.

As we have emphasized since 1970 when it became evident that a gas (indeed, an energy) shortage appeared inevitable, conservation will stretch the supplies we have. The greater availability of gas as a result of conservation also will help consumers avoid having to switch to alternate, more expensive forms of energy. And this is in the consumers' financial best interest, as well as our own.

Second, it is a gross distortion of the facts to infer that A.G.A. develops or controls standards for gas appliances. These standards are prepared by an independent standards-writing committee operating under the rules and procedures of the American National Standards Institute. Half of its members are representatives of governmental agencies or other general interest groups, designated by A.G.A., and approximately 25 percent are representatives of gas appliance and equipment manufacturers, designated by the Gas Appliance Manufacturers Association. In this case, six of the seven governmental members voted against adoption of the proposed standard for Vent-O-Matic because of safety considerations.

Third, the CBS report failed to note, though its staff had the information, that as early as 1968 A.G.A. tested and certified three different furnaces embodying the flue damper in question. Factory-installation of flue dampers would eliminate the safety concerns that could result from faulty installation of flue dampening devices which are added to existing venting systems. We understand CBS interviewed one of the two brothers who actually invented and developed the device, and he expressed complete satisfaction with the treatment he received from A G.A. But this interview, like 95 percent of the CBS interview with A.G.A. spokesmen, was not used on the Dec. 26 program.

A further index to the depth of safety concerns about automatic flue damper devices is the fact that they are banned in Canada through official government action. This, too, was known to CBS.

Contrary to the impression given by "60 Minutes," Michigan Consolidated Gas Company in Detroit is not acting alone to investigate conservation methods, but is one of more than 40 companies in the United States participating in an A.G.A.-coordinated program field testing a variety of energy saving devices—including Vent-O-Matic—to ascertain their efficacy and efficiency, and methods for installing and using them safely. Actual savings, of course, vary from area to area depending on cost, weather, typical flue or chimney design, local building codes and other factors.

This is but a part of the overall program in which A.G.A. and its members are vigorously encouraging conservation by all consumers, industry and commerical as well as residential, since A.G.A. and its members regard conservation as a major means for increasing the availability of this premium fuel to as many consumers as possible. But this must be done in a manner which does not jeopardize personal safety.

We repeatedly explained to CBS that safety was the Z-21 Committee's reason in choosing not to develop a standard for the device as an add-on, or retrofit, accessory. "60 Minutes" belittled this concern in the Dec. 26 program. However, on the Jan. 16 program, in closing comments a spokesman, Dan Rather, said:

"We also feel obligated to pass on a warning from the Federal Energy Administration about the furnace flue dampers we reported on a few weeks ago. Make sure it is installed by a qualified professional and have him brief you on how it works. In other words: be careful."

Sincerely,

G. H. LAWRENCE.

STATEMENT OF THE PUBLIC EMPLOYEE DEPARTMENT, AFL-CIO, ON SICK PAY EXCLUSION

The action of the 94th Congress as part of Tax Reform Act of 1976, ended the exclusion of up to $100 a week sick pay for federal employees, narrowing it to those totally and permanently disabled. We hope that, in due course, this mistake will be repealed.

The twenty-nine national unions of the AFL-CIO which comprise this Department include hundreds of thousands of federal and postal employees who one day will join the ranks of federal annuitants. Accordingly, our concern is very great on this issue.

The immediate question is even more pressing: that is to bring about the passage of S 4 and H.R. 318. While it does not meet the general problem, it does alleviate the pressing problem that under the new law sums are taxable for calendar year 1976 even though those receiving the sick pay could not have anticipated the sudden, new tax liability. While the amount of tax lost to the government by passage of S 4--H.R. 318, compared to the total budget, would be quite small, the surprise tax liability caused by the Tax Reform Act of 1976 is raising substantial personal problems for sick pay recipients. For that reason we join the AFL-CIO, many of our affiliated unions and others in support of S 4 and H.R. 318. This bill will defer the new tax liability through calendar year 1976.

Since the tax filing deadline is only some five weeks away, it is vital that the committees act favorably and promptly and that the Rules Committee clear the way for prompt floor action. We feel confident that the other House of Congress will follow with its companion bill.

We appreciate the opportunity to present this statement to the Committee and trust that you share our sense of urgency regarding the approval of S 4 and H.R. 318.

STATEMENT OF NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION

SUMMARY

I. Introduction:

A. President Carter is to be commended for including an additional 2 percent Investment Tax Credit in his economic stimulus package.

B. The "new jobs tax credit" adopted by the House Ways and Means Committee is administratively unworkable and will be ineffective in significantly increasing United States employment.

C. NMTBA urges the Committee to amend H.R. 3477 and to restore the 12 percent Investment Tax Credit originally suggested by President Carter.

II. Recent statistical information demonstrates the need for a 12 percent Tax Credit.

A. U.S. has the highest percentage of obsolete machine tools and the lowest percentage of machine tools under 10 years of age, of any of the industrial nations.
B. West Germany has moved ahead of the U.S. as the world leader in the production of machine tools.
C. The Soviet Union has moved ahead of the U.S. as the world leader in the consumption of machine tools.
D. All of the Western industrial nations have a higher rate of capital formation in relation to GNP than the U.S. (See Exhibit A).
E. All of the Western industrial nations have a higher rate of increase in productivity than the U.S. (See Exhibit B).
F. U.S. has the lowest tax allowances for capital costs of any of the leading industrial nations.

III. No government can of should expect business to invest in production facilities if the after-tax cost is so great and the cost recovery period so long and uncertain that business has no assurance of recouping its cost and realizing a reasonable return on its investment.

IV. The machine tool industry is a most reliable barometer for measuring the economic health of the nation and for determining the impact and effect on industry of changes in the capital recovery tax provisions.

A. NMTBA is grateful for the contribution made to our nation's economy by the Kennedy-sponsored Investment Tax Credit.
B. Exhibit D dramatically illustrates the close correlation between domestic machine tool orders and the availability of the Investment Tax Credit and the ADR's.
C. Exhibit E shows the relationship of machine tool industry employment to availability of the Investment Tax Credit.
D. The 1969 repeal of the Investment Tax Credit, coupled with price controls, resulted in the 1974 depression in the machine tool industry.
E. The 1975 increase in the 7 percent Investment Tax Credit to 10 percent sparked an upturn in orders.

V. A permanent 12 percent Investment Tax Credit is necessary to stimulate machine tool orders and employment to pre-1974 levels.

A. A temporary, "on and off" Investment Tax Credit will not induce or secure the requisite investment.
B. A permament 12 percent Investment Tax Credit is necessary to counter-balance the effects on inflation.
C. A permanent 12 percent Investment Tax Credit will help reduce unemployment.

VI. Conclusion

A. NMTBA urges adoption of President Carter's recommendation that businesses be permitted the option of taking a 12 percent Investment Tax Credit.
B. The additional 2 percent credit should be made permanent.
C. If the Committee is enamored of the House Ways and Means Committee's "new jobs tax credit," it should be adopted in addition to—not in lieu of— President Carter's business tax incentive proposals.

Statement

The NMTBA is a national trade association with 360 member companies accounting for about 90 percent of the United States' machine tool production.

Most of the member companies are small businessmen. Over 70 percent of these companies have less than 250 employees. The entire industry has approximately 86,000 employees.

We are grateful for this opportunity to present the industry's views on the tax aspects of President Carter's economic stimulus package.

We believe that modernization of America's industrial facilities and the jobs resulting therefrom will best be served by inclusion in the package of an additional 2% Investment Tax Credit; and we commend the President for recommending this much-needed economic stimulus.

High unemployment and inflation continue to plague the health of our national economy. To insure the investment and capital formation necessary for economic growth, for the creation of new jobs, and to remain competitive with other nations, we must insure that sufficient after-tax earnings will be available for investment, and (on a long-range basis) change the disincentives under present tax law into incentives for future investment.

Unfortunately, the House Ways and Means Committee has seen fit to substitute its own business tax incentive plan for that recommended by President Carter. This plan, which the Carter Administration has denounced as administratively unworkable, is not likely to significantly improve the American employment picture. Most businesses hire new workers, because they are needed—not because someone is willing to contribute $1,680 toward the first year's salary.

Therefore, we urge this distinguished Committee to amend H.R. 3477 and to restore the 12 percent Investment Tax Credit originally suggested by President Carter.

It might be well for the Committee to review and analyze the following alarming statistics, which show that the American Machine Tool Industry is rapidly losing its competitive advantage. This trend, if allowed to continue, has vast implications for the productivity of all U.S. industry and for the viability of our industrial defense base.

1. A recent U.S. Commerce Department survey and the American Machinist's 11th Metalworking Equipment Inventory disclose that once again the United States has the highest percentage of overage and obsolete machine tools, and the lowest percentage of machine tools under 10 years of age, of any of the industrial nations. Not only does the Soviet Union have a higher percentage of machine tools under 10 years old (57 percent) as compared with the United States (33 percent), but the total number of machine tools in the Soviet Union (4.4 million) is now greater than the number in the United States (3.8 million).

2. The U.S. Machine Tool Industry has lost its position as world leader in the production of machine tools. The February, 1977 issue of American Machinist magazine discusses that West Germany has again overtaken the U.S. in the production of machine tools—$2,393,200 to $2,030,000—and that the U.S. is closely followed by the U.S.S.R. ($1,915,200) and Japan ($1,078,600).

The United States is still the leader in engineering and design, and in the production of the most technologically advanced machine tools, but the gap is constantly narrowing.

3. Probably the most significant statistic and the one that has the clearest warning for the United States in terms of its industrial and defense capability is the comparison of the consumption of machine tools in the leading industrial nations. This is an important indicator of industrial growth and technological advancement.

According to the February, 1977 issue of American Machinist, the Soviet Union has moved ahead of the United States in the consumption of machine tools—$2,293,100 to $1,835,000—with West Germany ($991,100) and Japan ($832,600) ranked third and fourth.

4. All of the industrial nations in the western world have a higher rate of capital formation in relation to GNP than the United States. (See Exhibit A)

5. All of these nations have a higher rate of increase in productivity than the United States. (See chart attached as Exhibit B)

6. And finally, the United States has the lowest tax allowances for capital costs of any of the leading industrial nations. (See Exhibit C)

These other nations, in patterning their industrial growth after the United States, have learned the simple rule of economics that the United States once knew so well, but somewhat inexplicably seems to have forgotten: no government can or should expect business to invest in production facilities if the after-tax cost is so great and the cost recovery period so long and uncertain that business has no assurance of recouping its cost and realizing a reasonable return on its investment.

The necessity for determining and reporting income and the cost of producing it on an annual basis does not alter the fact that in a very real sense there is no profit, no assurance of profit, nothing but risk until the cost is completely written off against income.

Unfortunately, under our tax system, the after-tax cost has been so great, the cost recovery periods so long, and the constant threat of adverse legislation so

fraught with uncertainties, that business has not been able to assume this risk, or to plan or invest adequately to increase productivity as required.

Economists and the Government have come to recognize that the small but essential machine tool industry is a most reliable barometer for measuring the economic health of the nation, and for determining the impact and effect on industry of changes in the capital recovery tax provisions—depreciation and the investment credit.

NMTBA recognizes and is grateful for the great contribution made to our Nation's economy by the Kennedy Administration, which conceived and instituted the investment tax credit in the early 1960's. Unfortunately, the investment tax credit was repealed in 1969. This action, we believe, contributed materially to the 1970 recession.

The 1971 restoration of the 7 percent credit bolstered the economy by increasing jobs, productivity and exports from 1971 to 1974. Exhibit D illustrates in the most dramatic way the close correlation between domestic machine tool orders and the availability of the investment credit and the depreciation allowances of the ADR system. The total annual machine tool shipments of the industry were estimated at $2,059,600,000 in 1976 as compared with $1,057,870,000 in 1971, the year the 7 percent investment credit was reinstated and the ADR system was adopted.

We are also submitting a chart (marked Exhibit E) showing the relationship of machine tool industry employment to domestic orders measured in constant dollars in the industry for the period 1960–1976. When read in conjunction with Exhibit D, it indicates the positive effect that increasing capital recovery allowances has on jobs.

However, the investment credit finally could not offset the combined and cumulative effects of price controls, double-digit inflation, and the worst recession since the 1930's. A strong case can be made that the repeal of the investment credit in 1969 actually triggered and intensified the subsequent inflation, and that the 1971 credit and ADR came too late to prevent or effectively moderate it.

Unfortunately, as the accompanying charts show (Exhibts F and G), the industry sustained substantial losses in 1971 and 1972. This was principally a consequence of inflation and government price control policies which had an unfair impact on the machine tool industry and other industries with long lead times from order date to delivery date, and has brought these industries full cycle once again to a renewed need for a further tax policy change, for the reasons this Committee documented so well in its 1971 report.

You will note from Exhibit D the precipitous decline in orders beginning in 1974. At first glance this 1974 decline might seem to challenge the validity of the proposition, clearly supported by the chart for all the years beginning in 1960 through 1973, that investment in productive equipment depends on adequate capital recovery tax allowances, and that there is a close correlation between orders and the availability of these allowances.

Actually, the steep decline in 1974 orders that departs from the historical pattern can be readily explained by the intervening disastrous impact of another government policy—price controls—which deepened the recession. This unwise policy completely dominated the economy and almost completely dictated corporate decisions against further capital investment in 1974.

Somewhat paradoxically, this 1974 aberration actually serves upon analysis to bolster the position that orders and investment do depend on adequate capital cost allowances as the NMTBA chart had so clearly established for prior years.

As the chart shows, the momentum provided by the 7 percent credit and the ADR sustained orders and investment through the years 1971, 1972 and 1973 despite price controls and the resulting low profits and losses the capital goods industries were realizing all through this period. These orders finally plummeted as industry ran out of steam and capital due to the disastrous effects of price controls—unreasonably low prices and low profits, incredibly high interest rates, double-digit inflation, and the resulting critical shortages of raw material and components. It is clear that without increased capital cost allowances, new orders would have plummeted long before 1974.

It is significant to note that with the enactment of the 10 percent investment credit in 1975 following the termination of price controls in 1974, machine tool orders immediately increased. This would seem to be proof positive of the immediate stimulative effect of increased tax allowances on capital investment.

However, although the increase from 7 percent to 10 percent in the investment credit has quite clearly sparked an upturn in orders, it starts from the second

lowest level of new orders since 1961, when the investment credit was first proposed. We cannot hope to improve employment without a much greater increase in industrial productivity than these figures indicate. However, economic indicators show that it will take more than the present 10 percent investment credit to sustain and improve the 1975 upturn.

The temporary investment credit which has been on and off the books since 1961, will not induce or secure the requisite investment.

The after-tax cost and risk are simply too great. Business has no assurance or adequate writeoffs for longer range projects and investments. Only with a permanent 12 percent investment tax credit can the United States attain the requisite productivity to be competitive.

Second, a permanent 12 percent investment tax credit is necessary to counterbalance the effects of inflation. There are those who charge that such a provision would amount to a tax "subsidy" of business. That is far from the truth. Those who charge "subsidy" have the burden of proving that such a cost allowance is (1) not properly warranted to make up for the inadequate capital cost tax allowances of the past (the question is really only one of timing of the allowances), and (2) that it is in excess of the actual facility costs incurred over the period of use in producing the income taxed.

A permanent 12 percent investment credit would also help to reduce unemployment. It is axiomatic that workers cannot be productive without the tools of production, which are becoming increasingly expensive. We cannot hope to maintain, let alone expand, present employment without substantial investment in the machinery and equipment that form the basis of well-paying jobs.

For these reasons, NMTBA urges the adoption of President Carter's recommendation that businesses be permitted the option of taking a 12 percent investment tax credit, in an effort to stimulate economic recovery and increase jobs. We further recommend that this additional 2 percent investment tax credit be made a permanent part of the tax structure.

If the Committee desires to experiment with the so-called "new jobs credit" currently contained in H.R. 3477, it should do so in addition to the 12 percent investment tax credit originally suggested by President Carter—not in lieu of this important incentive to the purchase of new capital equipment and the jobs required to produce them.

EXHIBIT A

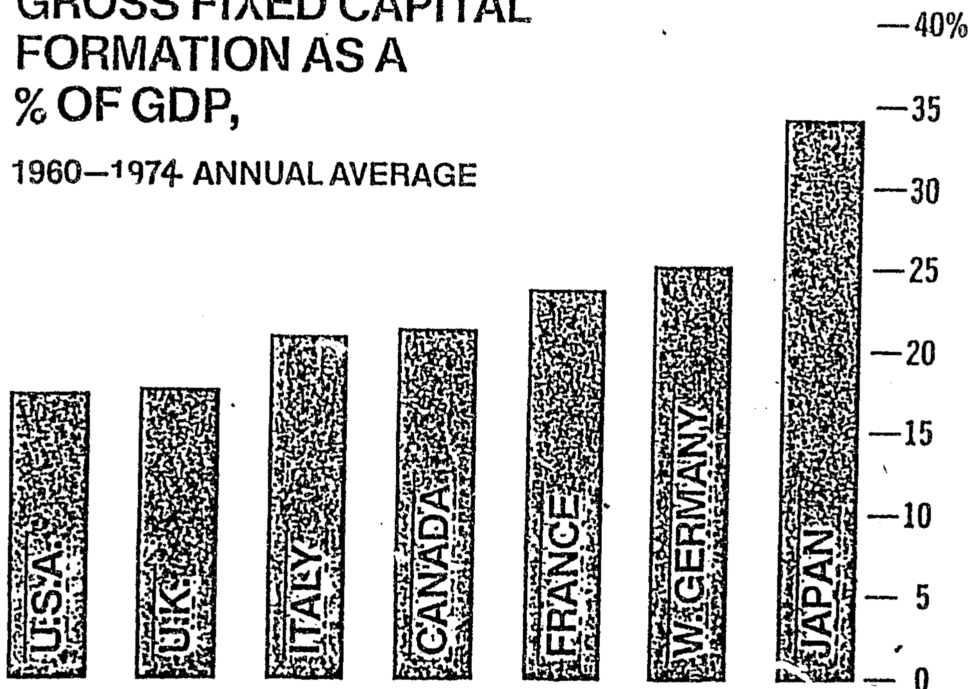
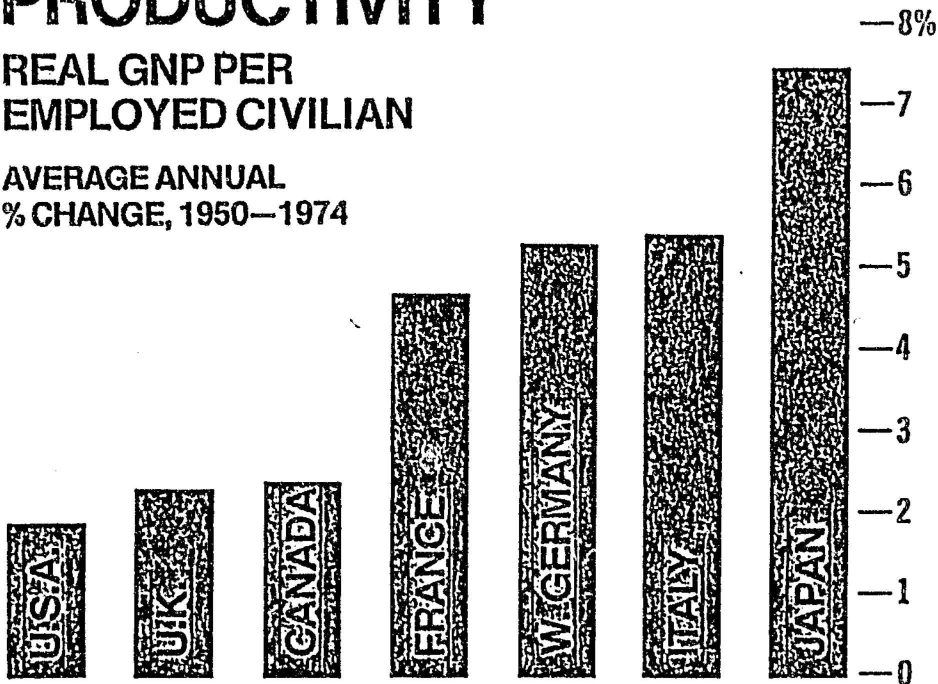


EXHIBIT B



·Prepared by National Machine Tool Builders' Association

EXHIBIT C

COST RECOVERY ALLOWABLE FOR TAX PURPOSES ON MACHINERY AND EQUIPMENT (PERCENT OF ORIGINAL COST)

Country	1st year	3d year	7th year
United States:			
1970 (without investment credit or ADR)	7.7	33.9	66.1
Current (10 percent) investment credit and 20 percent ADR)	29.5	60.7	94.5
With (7 percent) investment credit and 20 percent ADR)	23.5	54.7	88.5
With (7 percent investment credit only)	21.7	47.9	80.1
United Kingdom	100.0	100.0	100.0
Japan	37.1	63.9	88.1
France	31.3	67.5	94.9
Sweden	60.0	95.7	130.0
Italy	19.6	67.9	100.0
Belgium	20.0	48.8	89.0
Canada	57.5	105.0	105.0
Netherlands	14.0	58.0	108.0
West Germany	16.7	49.6	88.8
Australia	50.0	70.0	110.0

Note: These capital cost recovery allowances are based on statutory or other published provisions of law. As such they do not reflect informal or ad hoc arrangements that are frequently available in foreign countries—but not in the United States—to increase the rate of cost recovery actually allowed to industrial producers in those countries.

Source: Report of the President's Task Force on Business Taxation, September 1970, pp. 28–29 updated by Price Watehouse & Co.

Exhibit D

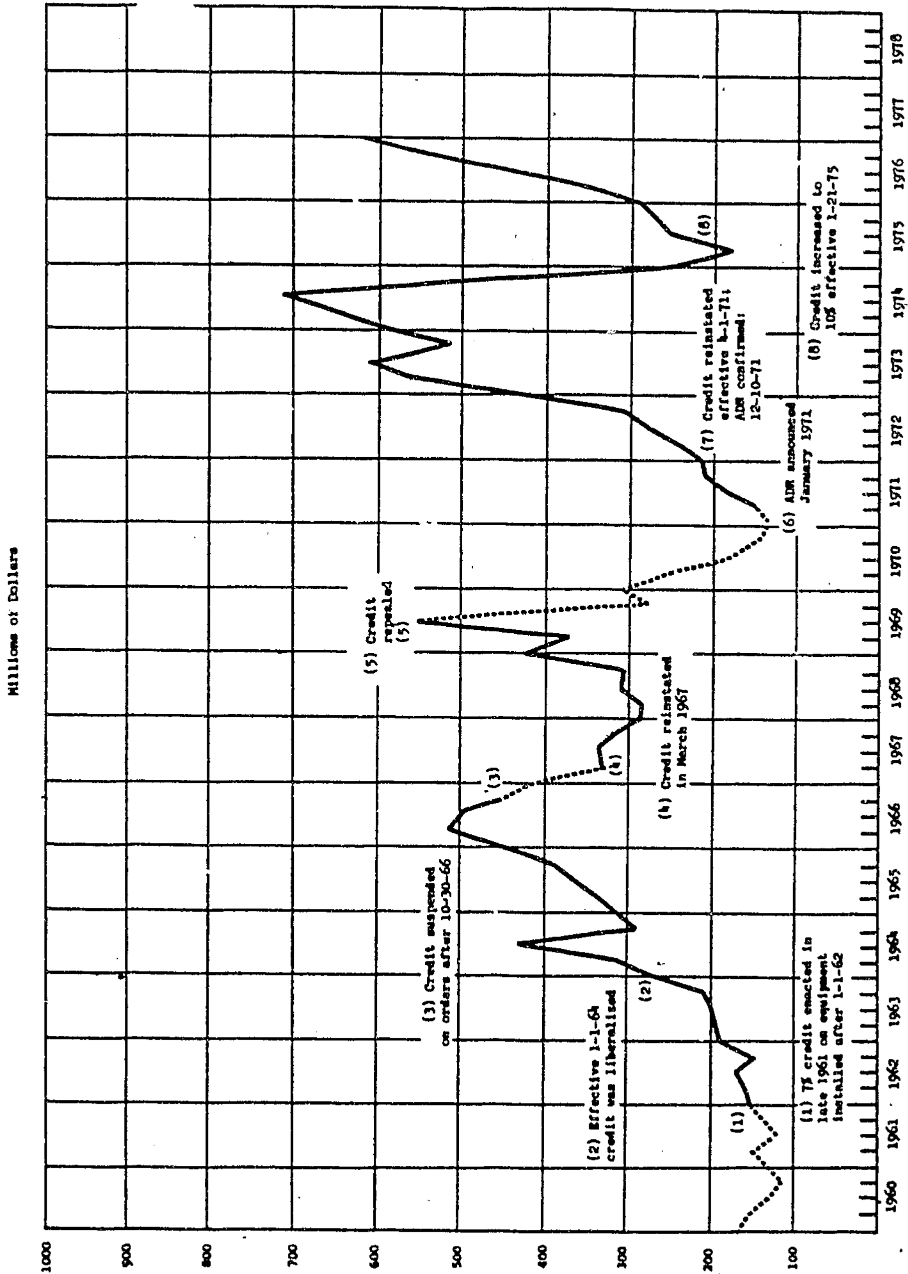


EXHIBIT E

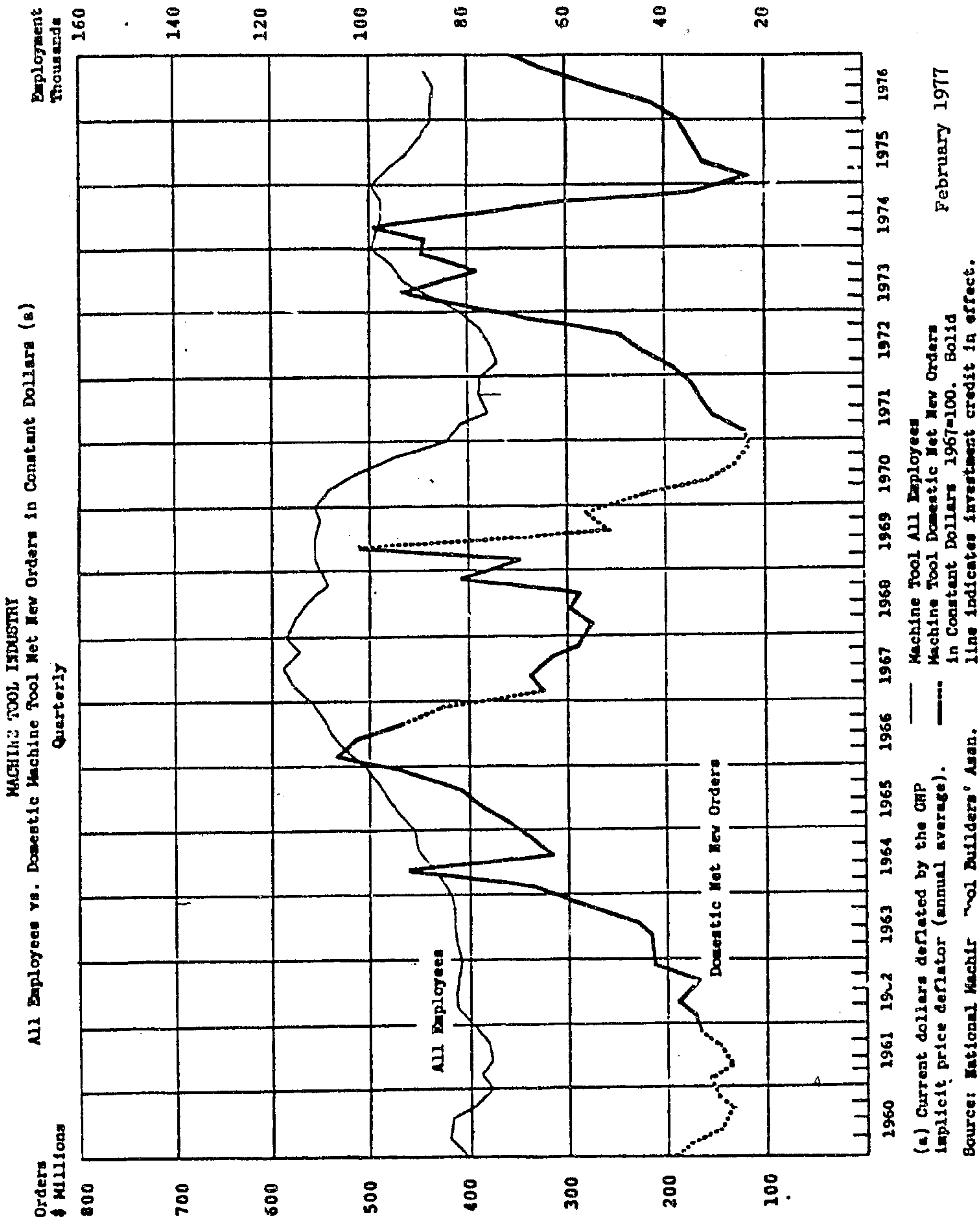


EXHIBIT F

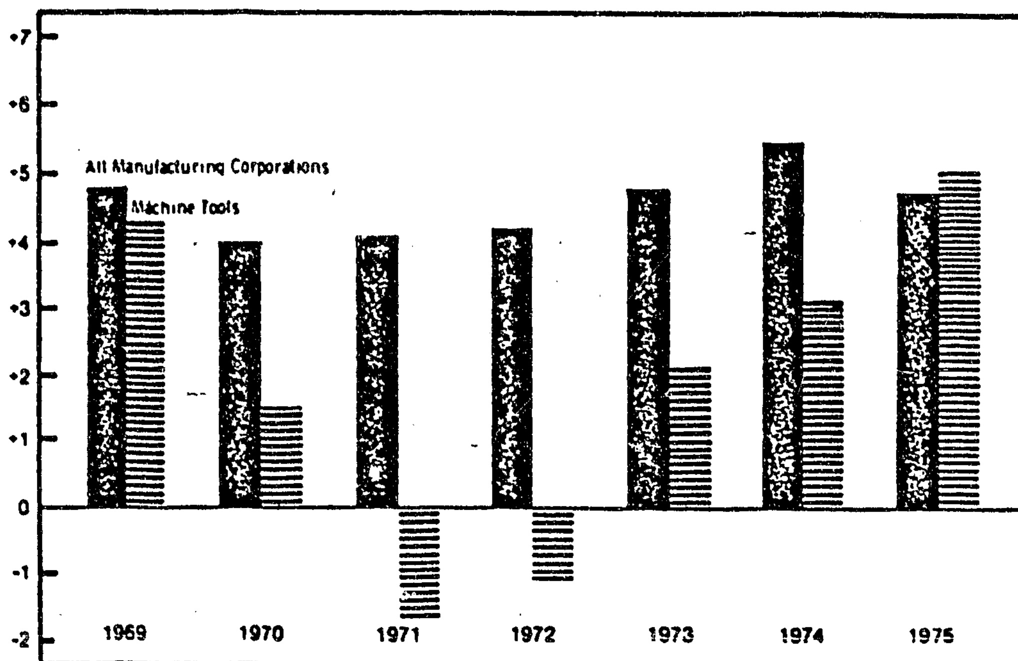


EXHIBIT G

AVERAGE NET INCOME OF ALL MANUFACTURING CORPORATIONS AND MA[illegible]INE TOOL COMPANIES SURVEYED 1965 TO DATE

Year	Net income after taxes			
	As percent of sales		As percent of assets	
	All manufacturers [1]	Machine tool manufacturers [2]	All manufacturers [1]	Machine tool manufacturers [2]
1965	5.6	6.0	7.7	7.7
1966	5.6	6.5	7.7	8.8
1967	5.0	6.4	6.6	8.8
1968	5.1	5.6	6.6	7.3
1969	4.8	4.3	6.1	5.1
1970	4.0	1.5	4.9	1.9
1971	4.1	(1.7)	5.1	(1.7)
1972	4.3	(1.1)	5.5	(1.2)
1973	4.7	2.4	6.5	2.7
1974	5.5	3.2	7.6	4.1
1975	4.6	4.9	6.0	7.0

[1] Except newspapers.
[2] Data based on the machine tool activities of about 100 companies.

Note: Figures in parentheses represent negative figures.

Source: National Machine Tool Builders' Association, Federal Trade Commission, "Quarterly Financial Report for Manufacturing Corporations" (quarterly).

AVERAGE NET INCOME OF MACHINE TOOL COMPANIES[1]

[Income data in percent of net sales, 1965 to date]

Year	Millions of dollars		Net income			Surveyed companies[1] as percent of total industry
	Total industry shipments	Sales of surveyed companies[1]	As percent of sales		As percent of assets	
			Before taxes	After taxes	After taxes	
1965	$2,107	$1,139	11.2	6.0	7.7	[illegible].0
1966	2,554	1,368	12.1	6.5	8.8	53.6
1967	2,841	1,425	12.1	6.4	8.8	50.2
1968	2,817	1,353	11.6	5.6	7.3	48.1
1969	2,835	1,251	8.9	4.3	5.1	44.1
1970	2,598	1,116	3.8	1.5	1.9	43.0
1971	2,019	739	(2.7)	(1.7)	(1.7)	36.6
1972	2,112	936	(1.3)	(1.1)	(1.2)	44.3
1973	2,596	1,270	4.3	2.4	2.7	48.9
1974	(2)	1,349	5.6	3.2	4.1	(2)
1975	(2)	1,532	8.9	4.9	7.0	(2)

[1] Data based on the machine tool activities of about 100 companies.
[2] Not available.

Note: Figures in parentheses represent negative figures.

Sources: National Machine Tool Builders Association; U.S. Bureau of the Census, Annual Survey of Manufactures.

The Small Business Credit: Liberals Design a Tax Shelter

(By Gerard M. Brannon and Thomas J. Reese)[1]

The liberals on the House Ways and Means Committee have devised a tax shelter that would make a conservative blush. After years of fighting for tax reform one would think the liberals would have learned a lot about tax shelter abuses. But when they turned their minds to tax subsidies during consideration of the economic stimulus package, the result was a beautiful loophole they called the small business job credit.

The credit is equal to 40% of salaries of newly-hired workers up to a maximum of $40,000 per employer. The basic problem is that the measure will not provide much of an incentive for additional employment at the billion-dollar-plus cost. Moreover, high-bracket taxpayers could find it profitable to employ additional people even if they did no work.

Effects of credit

The provision, approved February 17 as part of the economic stimulus package, will have a bizarre effect on hiring policies and will add substantial complexity to the tax law. While no one can be certain of the ultimate cost, the revenue estimators bravely came up with a cost of $700 million for the remainder of fiscal 1977 and $2.4 billion for fiscal 1978.

While the shelter potential of the provision is eye-catching, the most fundamental problem is that it will concentrate on hiring the least productive workers who are almost certain to be dropped when the credit ends. This may be attractive politically but it is poor economic policy for the long run. A more prudent program would be to provide a smaller credit for a broader cross-section of employers. But politicians seem to have high discount rates—jobs now are worth more than more permanent jobs in the future.

The liberals do not get all the blame for the new tax shelter. The original idea came from Chairman Al Ullman, D-Oreg., and Ranking Minority Member Barber B. Conable, R-N.Y. The goal was the ostensibly admirable one of wanting the tax reduction to be targeted on the additional employees hired as a result of it. This

[1] Dr. Gerard M. Brannon is chairman of the Economics Department at Georgetown University. He formerly was director of the Treasury Department's Office of Tax Analysis. Dr. Thomas J. Reese is legislative director of Taxation with Representation, which describes itself as a public interest taxpayers' lobby.

yearning for an incremental tax break is dear to the hearts of the revenue committee members. For example, Congress last year limited the domestic international sales corporation (DISC) tax subsidy to exports above a certain base. Another favorite idea of many reformers, including Sen. Edward M. Kennedy, D-Mass., is to make the investment tax credit incremental. All such proposals have a similar defect: they require complex data to determine whether the taxpayer really had the increase to justify the credit and they are subject to manipulation to produce phony increases.

Ullman and Conable did not think the Carter proposal—an optional two-point increase (to 12%) in the investment tax credit or a credit equal to 4% of payroll taxes paid by employers—would do much to inspire the hiring of new workers. So they offered a program to benefit only those employers who increased their work force. The Ullman credit would have been equal to 25% of salaries for that part of total salaries more than 3% above 1976 levels.

Several tax panel members objected to this on the ground that the lion's share of the credit would go to large corporations. The liberals wanted to put a cap on the credit so a business could not reduce its taxes by more than a specified amount. The cap, however, would have substantially reduced the tax cut for business and the idea did not receive majority support.

Defects not pointed out

So the liberals, led by freshman Raymond F. Lederer, D–Pa., proposed an increase in the credit to 40% but with a cap of $40,000 per taxpayer. Another liberal, Martha Keys, D–Kans., persuaded the panel to approve a 50% credit for handicapped workers.

No one on the committee appeared to recognize the tax shelter implications of the credit. The attitude of many liberals seemed to be that if $2 billion-plus in tax breaks were to be wasted, they should not be wasted on corporate giants.

The technical experts present, including Laurence N. Woodworth, Assistant Secretary of the Treasury for Tax Policy, and Bernard M. Shapiro, Woodworth's successor as chief of staff of the Joint Committee on Taxation, did not call attention to the defects.

Last week, however, Woodworth attacked the jobs credit idea in testimony before the Senate Small Business Committee and the Joint Tax Committee staff is drafting an amendment for consideration by the Senate Finance Committee which would limit the shelter abuse potential.

The shelter abuse potential can be illustrated by the following example: If an individual hired 25 employees at $4,000 a year each, he could deduct $100,000 from his gross income. If he was in the 70% bracket, this would mean a tax savings of $70,000. The 40% tax credit would be worth the maximum $40,000, adding up to a total tax reduction of $110,000, or 110% of the actual cost of the employees.

In the extreme case of the employees bringing in no revenue, the net gain from hiring new employees of $10,000 can be applied to taxes owed on income from other sources. If there was revenue, the 70% taxpayer would keep 30% and still have the $10,000 to offset taxes. The 50% credit for the handicapped could offset even more taxes since there is no cap.

An amendment being drafted by the JCT staff to be considered by the Senate Finance Committee would result in the deduction for the salaries of the workers being reduced dollar-for-dollar by the amount of the tax credit. This would prevent the situation possible under the Ways and Means version where an employer could have tax benefits of more than 100% of the costs of hiring the new employees. But ending this abuse potential does not make the credit a good idea.

Effect on employment

Will the new employee tax credit increase jobs? The answer to this simple question is "of course it will." If the government lays out a lot of money to get people to stand on their heads, more people will stand on their heads.

A more sensible question to ask is "will the revenue loss from this credit be an efficient investment of government funds in a significant amount of increased employment?" The answer to this is "Of course it won't."

This indictment of inefficiency is based on our analysis of the structure of the credit.

Small business relief

A striking fact is that the new credit is quite irrelevant to the employment decision for most private employment, which takes place in the larger corpora-

tions. (About 75% of employee compensation in the private sector occurs in corporations and most of this in large corporations.)

In fact, no employer can get the credit for more than 24 additional employees as can be seen from the following table:

	Maximum growth in employment	
	No credit	Maximum credit
Initial work force:		
0	0	24
100	3	27
1,000	30	54
10,000	300	324
100,000	3,000	3,024

For a firm with up to 100 workers, the credit should have an impact on most decisions to grow or not. By the time we examine a firm with 1,000 workers it turns out that there is no credit for growth up to 30 workers (3%) and maximum credit is reached when the growth is 5.4%. For a growing firm, the credit is irrelevant on deciding whether to expand more significantly, say, from an expected growth of 6% to 12%. The same credit applies in either case. For the marginal firm, the credit is irrelevant for a small expansion, say from 1% to 3%.

For really large firms the credit incentive becomes a joke. A firm with 10,000 employees would only find the credit made a difference for choosing between expansion plans of 3.0% and 3.2%.

The incentive will be even more inefficient when one considers that in the small business area there is usually enormous turnover. The normal pattern is for new ventures to be tried. These all show big growth at first (from a small base). Many collapse after a few years but some continue to grow and offer stable, long-run employment.

The ones that collapse after a few years throw their employees back on unemployment. But this is precisely what the new credit is giving an incentive for! New employees eligible for the credit are almost free. (In some cases, as we showed, they are free.) Much of the stimulated new employment will not meet any economic test of the market place, but it will collapse as soon as the credit is no longer available. What kind of employment is this?

(*Tax tip:* If you have a shabby apartment house try to get rid of as many tenants as you can this year and rent the premises to "small" independents who will hire people, tailor shops, secretarial services, massage parlors, etc. The lease terms can take advantage of the fact that the wage bill will be almost free. After a year all the businesses will fold but you will have made enough money to convert your shabby building into a hotel.)

Limitations of tax law

Ostensibly the new credit is designed to reward an increase in employment but the hard fact is that our tax law is not structured to identify real changes in firms. It is complicated enough when we measure current net income but rules that hang on real business issues become fantastic in their complexity.

To start with, there is supposed to be no credit for taking over the employees of a going trade or business. But most new or growing businesses acquire a building that is being used for something now, and that may be similar to the new use. If I buy a building used for a drive-in eatery and open a sit-down restaurant is this a new business? What if I convert it to a grocery store?

The tax law is simply not structured to decide this esoterica and arguments about it will abound. Consider the construction industry where "firms" of crews of artisans are formed merely to carry out a particular subcontract. If the carpentry work is subcontracted, to the "new" firm of Carpenters, Inc., is this new employment?

The Joint Tax Committee staff is drafting some rules to limit the $40,000 maximum credit to one per each controlled group. Thus, in the example above, each group of carpenters would have to be 50% owned by different individuals if each group was to be eligible for the $40,000 maximum credit.

The potential for similar abuses has always been present in the case of the federal unemployment tax and this traditionally has been difficult for the Internal Revenue Service to police.

86-032 O - 77 - 37

In addition, even though there are some rules designed to keep a firm from firing a $6,000 r year worker and hiring two at $4,000 each (which would save money under the credit), the enforcement problems are substantial. It would be a riot to listen in on some small businessman when he is justifying his personnel policy to his friendly Internal Revenue agent!

The revenue agent will presumably be anxious to get through the argument about recent dismissals because it is still necessary to find out if an increase in the taxpayer's employees is related to a simultaneous decrease in the employees of a related taxpayer!

All of this stuff is not only a source of compilation but it undercuts the incentive aspect of the credit. If a firm happens to be in the happy combination of circumstances where the prospective credit could influence a growth decision it will still have to face a whole thicket of tests it must pass before the credit is in the bag. This must greatly dilute the incentive.

Conclusion

It should be plain that the Congress, being mostly made up of lawyers, has little interest in tax simplification. Only another lawyer would drool at the prospect of litigating a case that hung on whether some "growth" in employment was a new or an acquired trade or business.

Since the world is a complicated place, we can see the point of some complex tax provisions which are necessary to establish tax equity. Make-work complexities, however, are another matter, especially when they are designed to con labor into thinking that a piece of small business tax relief is meant to help working people.

In point of fact, Assistant Secretary Woodworth said in Senate testimony last week that the credit would exclude at least 66% of the labor market from participation, because the employer's normal growth places him either below the threshold or over the cap.

A better alternative would have been the 4% payroll tax credit portion of the Carter package. The two-point temporary increase in the investment credit, apparently included to attract some elements of the business community, would act too slowly to provide much immediate stimulus.

Statement of Edward J. Gaffney, President, Ortho-Kinetics, Inc.

Contents and Summary

This testimony is in favor of the Section on Reduction in Business Taxes of HR 3477—Tax Reduction and Simplification Act of 1977.

Job creation in the private sector is vital to the future of the United States. Private Sector jobs generate wealth that leads to more jobs. Public jobs consume wealth and lead to fewer future jobs.

Private Sector jobs are available in small and medium-sized growing businesses that have created new products and unsaturated markets. Such businesses create jobs (grow) as rapidly as they can gather cash to meet payrolls.

The profit of a growing business end up in increased receivables and inventory. Cash is always in short supply and is the limiting factor in job creation (growth). Corporate income taxes are a severe cash drain on all such businesses and limit job creation.

The attached statement of February 4, 1975 in favor of increasing the point at which the corporate surtax applies shows the effects of cash loss because of corporate income tax and job creation that would occur with reduced taxation. The projections of column 3 of Table 1 were accurate. Unfortunately paper profits were considerably higher than anticipated resulting in a sizable year end tax cash outlay. This reduction in cash flow not only stopped job creation but forced a layoff.

The job creation proposal dated October 5, 1976 proposes a tax credit for job creation and indicates that such a tax credit will lead to improved cash flow for the government as well as create jobs in the private sector. The jobs are there. Providing cash for filling them will reduce unemployment and lead to more job creation in the future.

Let's do it!

PROPOSAL TO MAXIMIZE JOB CREATION IN THE PRIVATE SECTOR AT NO COST TO GOVERNMENT

Growing businesses create jobs.

Small and medium size growth businesses create jobs (growth) as rapidly as they can get cash to work with. This usually comes from retained earnings from profits. The cash for this type of job creation is drastically reduced by payment of business income taxes in cash.

When a job is created in the private sector, government expenditures are reduced in the following ways:

A. Reduction of unemployment compensation.
B. Reduction of welfare payments.
C. Reduction of food stamp purchases.
D. Administration of above.

When a job is created in the private sector, governments receive income in the following ways:

A. Income Tax Payroll Deductions.
B. Unemployment Compensation Tax.
C. Social Security Tax.
D. Sales Tax and other point of purchase taxes on purchases by the employee.
E. Business Income Tax on profits generated by the job.
F. Multiples of above because of increased economic activity caused by new employee spending wages.

If the government expenditure reduction, and the government income caused by private sector new jobs are made available to the job creator, cash is available to create new jobs at no expense to the government or tax payers.

Allowing a tax credit equal to the amount of government income a new job would generate plus the amount of government expenditure reduction would not cost the government any money and would provide an excellent incentive to create new jobs in the private sector.

Doing it through the tax credit method does it only after the fact and avoids creation of more bureaucracy, paper work, and government expense.

Government income from a new job is approximated as follows:

	Percent
Income tax payroll deduction	16.0
Social security tax	11.7
Unemployment compensation tax	3.0
Sales tax and/or State income tax	5.0
Total	35.7

Government expenditure reduction when a new job is created is estimated as 40 to 60 percent of the wages of the new job.

This makes the total cash available for new job creation in the private sector at 75% or more of the wages paid plus any income tax paid on the profits created by the job.

Allowing a tax credit of 50% of new job wages to the creator of the job would improve government cash flow and government income.

At the same time, private enterprises would have an incentive to create new jobs and some cash assistance to do it with at no cost to government or tax payers.

I therefore propose that 50% of the first twelve months wages paid on all new jobs be allowed as a direct tax credit to any job creating business.

To ensure that job replacements or transfers, and cyclical upswings don't create tax reduction, the total number of employees and their payroll at year end should be compared to the average number of employees and their average total payroll for the previous three years. The tax credit would then be 50% of the payroll increase over the three year average. This method would tend to favor those businesses creating jobs continually which places the tax credit where it will do the most good.

This proposal is also anti-inflationary as it reduces the cash requirement in growing businesses thus reducing the need to raise prices to generate cash.

Care should be taken to avoid generation of new paperwork, expenses and bureaucracy by using only direct tax credits and avoiding contracts and payments now used in some programs.

The money available from State Governments can be employed by adjusting revenue sharing to the States in accordance with job creation within the States as determined by tax return.

An alternate method would be to allow the job creator to keep the taxes deducted from new payroll and be exempted from paying payroll taxes (U.C., Social Security, etc.) for the twelve month period beginning with each new job hire. This would have the advantage of encouraging non-profit organizations to create jobs, and would not penalize a business that is creating jobs but not showing a profit.

It may be desirable to restrict this plan to smaller businesses as defined by the SBA to avoid the extremes that would be caused by industries such as the auto industry.

STATEMENT BY E. J. GAFFNEY, PRESIDENT, ORTHO-KINETICS

My name is Edward J. Gaffney, president of Ortho-Kinetics, Inc. Ortho-Kinetics manufactures and sells products to aid handicapped people, such as the cushion-lift chair to help people to their feet, and many specialized wheelchairs for handicapped children as well as adults. Ortho-Kinetics was incorporated in 1963.

The biggest problem we in small, growing businesses face is finding sufficient capital with which to grow. Most of us must grow out of profit, and our profit determines how fast we can grow. Usually, the market place is so large compared to our businesses that we have a very tiny piece of it, and growth is limited only by our willingness to do the job and our ability to raise cash to pay the people and buy the materials and tools required.

My company can grow at approximately 60% each year with its present profitability. The biggest problem is cash flow. Column 1 of Table I shows the company's condition at the end of the last fiscal year. Column 2 shows the projected condition at the end of the present year.

It is easy to see from this that all profit in a growing corporation ends up in inventory and receivables, and no cash is available to pay the taxes. In order to finance that growth, it is necessary to generate $56,900 of cash (Income—Tax Paid+Prepaid Tax+Depreciation—Change in Receivables—Change in Inventory—Federal Quarterly Tax Payments=Shortage).

Projections for the 1975–76 fiscal year are shown in Column 3.

If the Federal Income Tax Surcharge did not apply, the 1974–75 year would be as shown in Column 4.

Since it is possible to generate the cash shortage shown in Column 3, the extra cash available from the elimination of the surtax will make possible a much larger growth, a shown in Column 5.

The increased growth would generate forty-three (43) new jobs instead of eighteen (18) new jobs possible under the present tax system.

If this kind of taxation relief is provided, all the rapidly growing small and medium sized corporations will cerate new jobs in the same way.

I, therefore, propose that the Surtax Exemption Limit be raised from the current $25,000 to the first $1 million of income, and that quarterly tax payments be made only on the surtax when it applies.

The current limit was imposed in 1938 when National Corporate Income was only $7 billion. It is now about $140 billion, or twenty (20) times higher.

This ratio times the $25,000 Surtax Exemption would increase the Surtax Exemption to $500,000.

Gross National Product and National Income have also increased proportionately.

It is clear that fairness and original intent would dictate such an increase in that limit.

The effect it would have on employment makes it urgent and desirable in this year of economic problems.

The revenue loss to the Federal Government is shown in Table II and is $4.3 billion, compared to the $6 billion projected in reducing the surtax from 48 percent to 42 percent in President Ford's proposal.

Table III shows the taxes payable by corporations of various profit levels. All corporations benefit from this, but more of the revenue reduction is passed to the smaller growing corporations than is the case when the surtax is reduced. Since increasing jobs is done with less dollars in those corporations, this will develop more jobs for the dollars available.

Table IV shows the effective tax rates in corporations of various sizes, showing the smaller corporations paying a higher percentage than the larger corporations, indicating the need for more tax relief and capital retention in the smaller corporations than in the large corporations.

This proposal also reduces inflationary pressure, since it will reduce the interest requirements, as well as taxes, both of which must be added to prices, since the price we get for our products must cover all of our expenses.

But the major cause of inflation is the high level of spending of all governments, and inflation will not be lessened for very long unless government reduces its spending to a more reasonable percentage of the GNP.

The increased level of government activity not only drains away personal income (45 percent of all income ends up in government expenses), but it adds heavily to the paperwork required of all businesses, increasing the cost of doing business and, again, raising prices.

From 1965 through 1973, personal income increased 78 percent. Retail prices increased only 60 percent, so the goods created in the private sector were a better bargain. The cost of government caused the tax payments of the man who earned 78 percent more to increase 185 percent to the Federal Government, 220 percent to State Government and 285 percent to Social Security.

If price controls are necessary, they should be applied only to government spending, not to goods produced in the private sector.

TABLE I

Year	1973-74 (1)	Present tax projected 1974-75 (2)	Present tax projected 1975-76 (3)	Proposed tax projected 1974-75 (4)	Proposed tax projected 1975-76 (5)
Sales	$820,000	$1,250,000	$2,000,000	$1,250,000	$3,150,000
Taxable income	52,000	120,000	200,000	120,000	315,000
Accrued taxes	18,200	51,000	89,500	26,400	69,300
Federal taxes paid	[1]	30,900	83,300	30,900	13,700
Inventory	65,000	140,000	240,000		340,000
		Up 75,000	Up 100,000	Up 75,000	Up 200,000
Receivables	128,000	208,000	330,000		418,000
		Up 80,000	Up 122,000	Up 80,000	Up 210,000
Depreciation	6,600	9,000	12,000	9,000	15,400
Cash shortage	[2]	56,900	93,300	56,900	93,300
Employees	32	47 (up 15)	65 (up 18)	47	90 (up 43)

[1] Last year's—prepaid plus new quarterly.
[2] Income—tax paid—inv. change—rec. change plus dep.

Note: Jobs created by proposed tax relief, 25; proposed reduction of tax revenue for the years 1974-75 and 1975-76 $44,800.

Wouldn't taxes on the 25 new jobs more than make up for the lost corporate tax revenue?

TABLE II [1]

Surtax exemption:	*Revenue lost*
$100,000	$1,523,452,000
$250,000	2,947,433,000
$500,000	3,431,787,000
$1,000,000	4,256,348,000

[1] Prepared from information from the attached study, furnished by the Small Business Administration.

ESTIMATED DIFFERENCES BETWEEN A $25,000 AND A $100,000 SURTAX EXEMPTION BY SIZE OF INCOME, 1970

Income taxed at normal and surtax rates	Number of returns	Effective tax rate exemption (percent) $25,000	Effective tax rate exemption (percent) $100,000	Effective tax rate exemption (percent) Change in rate	Average tax per firm (exemptions) $25,000	Average tax per firm (exemptions) $100,000	Average tax per firm (exemptions) Saving per firm	Total tax exemptions (thousands) $25,000	Total tax exemptions (thousands) $100,000	Total tax exemptions (thousands) Loss to Government
Total, all returns	734, 443	44.9	42.7	−2.2	$42, 569	$40, 495	$2, 074	$31, 264, 855	$29, 741, 403	$1, 523, 452
Under $5,000	286, 729	22.0	22.0	None	339	339	None	97, 359	97, 359	None
$5,000 to under $10,000	105, 946	22.0	22.0	None	1, 483	1, 483	None	157, 071	157, 071	None
$10,000 to under $15,000	70, 483	22.0	22.0	None	2, 607	2, 607	None	[illegible]	183, 715	None
$15,000 to under $20,000	50, 256	22.0	22.0	None	3, 726	3, 726	None	[illegible]	187, 248	None
$20,000 to under $25,000	52, 060	22.0	22.0	None	4, 859	4, 859	None	[illegible]	252, 980	None
$25,000	18, 583	22.0	22.0	None	5, 857	5, 587	None	[illegible]	103, 828	None
Subtotal	584, 057	22.0	22.0	None	1, 682	1, 682	None	[illegible]	982, 200	None
$26,000 to under $30,000	15, 709	24.8	22.0	−2.8	6, 925	6, 153	772	[illegible]	96, 661	12, 128
$30,000 to under $35,000	17, 773	27.6	22.0	−5.6	8, 816	7, 019	1, 797	[illegible]	124, 766	31, 927
$35,000 to under $40,000	12, 496	30.4	22.0	−8.4	11, 211	8, 117	3, 094	[illegible]	101, 438	38, 658
$40,000 to under $45,000	10, 065	32.5	22.0	−10.5	13, 601	9, 212	4, 389	[illegible]	92, 728	44, 166
$45,000 to under $50,000	8, 296	34.1	22.0	−12.1	15, 999	10, 311	5, 688	132, 726	85, 548	47, 178
Subtotal	64, 339	29.6	22.0	−7.6	10, 494	7, 789	2, 705	675, 198	501, 141	174, 057
$50,000 to under $60,000	13, 438	36.0	22.0	−14.0	19, 474	11, 904	7, 570	261, 688	159, 974	101, 714
$60,000 to under $70,000	9, 460	37.9	22.0	−15.9	24, 279	14, 106	10, 173	229, 675	133, 451	96, 224
$70,000 to under $80,000	7, 281	39.2	22.0	−17.2	29, 155	16, 342	12, 813	212, 280	118, 986	93, 294
$80,000 to under $90,000	6, 014	40.3	22.0	−18.3	34, 041	18, 581	15, 460	204, 722	111, 748	92, 974
$90,000 to under $100,000	4, 642	41.1	22.0	−19.1	38, 731	20, 730	18, 001	179, 787	96, 232	83, 555
Subtotal	40, 835	38.6	22.0	−16.6	26, 648	15, 192	11, 456	1, 088, 152	620, 391	467, 761
$100,000 to under $150,000	14, 675	42.7	26.6	−16.1	51, 887	32, 387	19, 500	761, 449	475, 287	286, 162
$150,000 to under $200,000	7, 577	44.2	32.9	−11.3	76, 304	56, 804	19, 500	578, 157	430, 405	147, 752
$200,000 to under $250,000	4, 429	45.1	36.3	−8.8	100, 210	80, 710	19, 500	443, 829	357, 463	86, 366
Subtotal	26, 681	43.7	30.1	−13.6	66, 843	47, 343	19, 500	1, 783, 435	1, 263, 155	520, 280
$250,000 to under $500,000	9, 175	46.1	40.6	−5.5	161, 037	141, 537	19, 500	1, 477, 512	1, 298, 600	178, 912
$500,000 to under $1,000,000	4, 550	47.1	44.3	−2.8	327, 130	307, 630	19, 500	1, 488, 440	1, 399, 715	88, 725
Subtotal	13, 725	46.6	42.4	−4.2	216, 099	196, 599	19, 500	2, 965, 952	2, 698, 315	267, 637

TABLE III

Corporate income	Present tax	Surtax reduced to 42 percent	$1,000,000 surtax exemption	$500,000 surtax exemption plus 45 percent surtax
$25,000	$5, 500	$5, 500	$5, 500	$5, 500
$50,000	17, 500	16, 000	11, 000	11, 000
$100,000	41, 500	37, 000	22, 000	22, 000
$250,000	113, 500	100, 000	55, 000	55, 000
$500,000	233, 500	205, 000	110, 000	110, 000
$1,000,000	473, 500	415, 000	220, 000	335, 000
$10,000,000	4, 793, 500	4, 195, 000	4, 540, 000	4, 385, 000
$50,000,000	23, 993, 500	20, 995, 000	23, 740, 000	22, 385, 000

EXHIBIT II

TABLE IV.—EFFECTIVE RATES OF FEDERAL TAXATION: MANUFACTURING CORPORATIONS BY ASSET SIZE, 1971

Asset size (millions)	Profits before Federal taxes	Profits after taxes	Effective tax rate
All manufacturing corporations	16. 5	9. 675	41. 36
Under $1	14. 975	7. 30	51. 25
$1 to $5	17. 375	8. 575	50. 64
$5 to $10	18. 075	8. 70	51. 86
$10 to $25	16. 325	7. 95	51. 30
$25 to $50	15. 875	7. 825	50. 70
$50 to $100	16. 075	8. 225	48. 83
$100 to $250	17. 20	9. 275	46. 07
$250 to $1,000	17. 675	9. 85	44. 27
$1,000 and over	16. 00	10. 375	35. 15

Source: FTC Quarterly Financial Report, 4th quarter, 1971, p. 11, table 5.

Note: Profit rates based on percentage of stockholders equity.

EFFECTIVE RATES OF FEDERAL TAXATION OF MFG. CORPS. BY ASSET SIZE, 1971

ASSET SIZE	PROFITS RETAINED	TAXES PAID	EFFECTIVE TAX RATE
UNDER $1 MILL.	7.30	14.975*	51.25
$1-5 "	8.57	17.375*	50.64
$5-10 "	8.7	18.075*	51.86
$10-25 "	7.9	16.325*	51.30
$25-50 "	7.8	15.875*	50.70
$50-100 "	8.225	16.075*	48.83
$100-250 "	9.27	17.20*	46.07
$250-1,000 "	9.85	17.675*	44.27
OVER $1,000 "	10.375	16.00*	35.15

*TOTAL PROFITS

24.4

OVER $1 BILLION

SOURCE: Testimony Of Hon. Charles Vanik before the Joint Economic Committee, July, 1972.

SOURCE: FTC Quarterly Financial Report, Fourth Quarter, 1971, p. 11, Table 1

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

Our 10.2 million member Associations generally support the specifics of H.R. 3477, the Tax Reduction and Simplification Act. However, we have certain reservations about the economic justification for it and certain recommendations for its improvement.

If, as some economists insist, we are into the second year of the recovery phase of the business cycle, then, based on past business cycle patterns, we should be moving into the boom phase. The index of leading indicators, which had declined for three months in the middle of 1976, resumed its upward trend in September and October. Industrial production, which also declined mid-year, moved sharply ahead in October. In the final quarter, retail and final sales were regarded as definitely satisfactory. Last year's inflation rate of 4.8 percent was less than expected.

On the other hand, 4th quarter GNP rose at only a 3 percent rate. The unemployment rate was 7.8 percent—high by any standard. Nevertheless, there are those who would argue that the GNP rate of growth would have been much higher except for a slowness in inventory building and that exclusive focus on the rate of employment ignores the fact that the labor force expanded by 2.8 million during 1976.

For some, the statistics (and the projections based thereon) suggest a lackluster economic performance and a need for some measure of fiscal stimulation. For others, the same statistics suggest precisely the opposite.

Our Associations are concerned that, if it turns out that we really are in the lifting phase of the business cycle, the Administration's economic stimulus package may end up generating an inflation rate increment that can only be detrimental to the elderly. We hope that something was learned from our economic experiences of the 1960's. The fiscal policies pursued during that decade launched us into the inflation rates of the 1970's before it was realized that the Federal Government lacks the fire extinguishers necessary to cool off an overheated economy. We know how to stimulate, but our system apparently lacks the disciplinary tools to reverse the "chain reaction." As a result, we have ended up with chronic inflation.

Our Associations find the current "hard core" annual rate of inflation of 5 to 6 percent wholly unacceptable. We fear that too much additional stimulation may leave us with even a higher rate by the last quarter of this year or the first quarter of next year. Even though the weight of authority seems to support the conclusion that the economy does indeed need some additional measure of fiscal stimulation, we urge your Committee to examine thoroughly the economic justification for the tax cut aspects of the Administration's proposal (as altered by the Committee on Ways and Means) and attempt to determine, from the most recent statistics, the appropriate magnitude of any stimulation found to be necessary.

With respect to the specifics of the Ways and Means Committee's version of H.R. 3477, our Associations wish to offer the following comments and recommendations. First, since a rebate with respect to 1976 tax liability has apparently been accepted as part of any tax stimulus package, we approve of the Administration's inclusion of the $50 special payment for recipients of Social Security, Railroad Retirement, and Supplemental Security Income. We also endorse the Ways and Means Committee's decision to deny "double-dipping" (which would have had a cost estimated at $1 billion) in the case of those who have 1976 tax liability in excess of $50 and are beneficiaries of one or more of these programs. However, we must object to the Committee's failure to prevent double-dipping in the case of recipients of Aid to Families with Dependent Children (who were added as an additional special payment class). Perhaps the savings that would accrue by eliminating double-dipping among AFDC recipients could be used to finance the inclusion of additional classes of non-taxpayers in the category of those eligible for the special payment—as, for example, retired teachers living on small pensions from state or local public retirement systems or federal retirees with small annuities.

Second, we support the Ways and Means Committee's decision to increase the standard deduction to $2,400 in the case of single returns and to $3,000 in the case of joint returns. Third, we support the Committee's decision to extend the general tax credit and to count the exemptions for age and blindness in its computation. Fourth, we support the extension of the earned income credit but we continue to recommend that individuals and families without dependent children be made eligible for it: these classes of individuals and families are as much in need of social security payroll tax relief as families with dependents in the home. Fifth, we have serious reservations with respect to the Ways and Means Committee's new jobs tax credit. We fear it will provide little help either for those companies that are the largest potential employers or for declining businesses in economically depressed areas of the Northeast and mid-West where unemployment is the highest. We think the Administration's original alternative business tax reductions (an increase in the investment tax credit or a refundable income tax credit based on a fraction of social security payroll taxes) were preferable and more likely to achieve the optimum result.

Finally, assuming your Committee determines to develop a tax cut package, our Associations would urge that you use any such package as a vehicle to remedy retroactive tax increases that occurred as a result of the enactment of the Tax Reform Act at the beginning of the last quarter of last year. Specifically, our

Associations object strongly to the retroactive income tax increases that resulted from the changes made with respect to "sick pay" under IRC § 105 (d) and with respect to "retirement income" under IRC § 37. We urge your Committee to approve, as a part of any tax stimulus package, a provision postponing the effective date of the "sick pay" changes (S. 4 has been introduced to achieve this and the Senate Budget Committee's version of the 3rd concurrent resolution for fiscal 1977 has specifically accommodated the revenue loss for this item). The Internal Revenue Service by its own admission has no authority to abate estimated tax underpayment penalties that are attributable to this (and other) retroactive changes in the tax law.

With respect to the Tax Reform Act's changes in the IRC § 37 credit, we urge that those who were able to use the old retirement income credit but have now been cut off because of the very restrictive income-phase-out feature of the new Tax Credit for the Elderly be allowed to use the former provisions, at least for taxable year 1976. This will allow time for a reconsideration of the specifics of the new credit for persons age 65 and older; certainly the changes that were made ought to be reconsidered. To us the issue there is clear: In an attempt to simplify the computation of the old retirement income credit and restore roughly equal tax treatment between social security and non-social security retirees, the Congress has made matters even more complex and has created new inequities without really eliminating the old ones.

In summary, our Associations hope that your Committee will re-examine the economic justification for the tax cut package. If such stimulus can safely be provided without generating an additional surge in inflation, we would urge favorable consideration of our comments on the merits of H.R. 3477 (as reported by the Committee on Ways and Means). Finally, we urge that any tax reduction package which your Committee may develop be used as a vehicle to postpone the effective date of the 1976 Tax Reform Act's changes in the tax treatment of "sick pay" (disability retirement income) and to restore (for at least the last taxable year) the former benefit of the retirement income credit to those who were adversely affected by the changes made in IRC § 37.

Statement of Joseph H. Crown of New York, N.Y.

The Tax Reduction and Simplification Act of 1977 aims to strengthen the economy by spurring greater consumer spending, expand production and reduce unemployment. As a secondary function, the legislation seeks to simplify the tax returns and the tax computation for the overwhelming majority of individual taxpayers.

The simplification goal has been substantially advanced. The Bill increases the standard deduction, converting it into a floor under itemized deductions. The Bill sets what is now the standard deduction at $2,400 for single persons, and $3,000 for married couples, filing joint returns. These amounts will be built into rate schedules and tax tables as a zero-rate bracket, so that the initial 14% bracket will begin at $2,401 for single returns and $3,001 for joint returns. The reduction in withholding rates due to the standard deduction change is to go into effect on May 1, 1977.

It is heartening to see that the House made provisions for a one-year extension of the general tax credit (to wit, the greater of $35 per person, or 2% of the first $9,000 of taxable income (and the earned income credit).

But for this extension, these credits would otherwise expire at the end of 1977. These provisions are of great financial assistance to the low-income taxpayer and their continuance is most imperative.

The tax table adopted by the new legislation will make the task of the typical taxpayer much easier in computing his tax. The new tax tables, into which have been built the standard deduction, the personal exemptions and the general tax credit, will be welcomed by the mass of taxpayers.

The Bill provides for a refund of 1976 individual income taxes which will amount to $50 per taxpayer and dependent. The refund will be phased out as adjusted gross income (AGI) rises from $25,000 to $30,000. Hence, a family of four would receive a $200 refund if its AGI were $25,000, a $100 refund at AGI of $27,500, and no refund if its AGI were $30,000 or more. The Bill also provides for $50 payments to beneficiaries of several income-maintenance programs, including Social Security, Supplemental Security Income, Railroad Retirement,

Aid to Families with Dependent Children, Veterans Administration Pensions and Disability Benefits, and Black Lung Benefits. The tax refunds and related payments are estimated to approximate $10.1 billion in the current fiscal year ending September 30th.

Although the objective of the tax refund and related payments is most commendable, I believe that the objectives of the Bill could be better accomplished by more direct spending on jobs in public service programs and in public works. There is widespread opinion among economists that temporary tax cuts are not conducive to expansion of the economy and reduction of unemployment. It is imperative to lower the unemployment rate which presently is set at 7.5%. Human lives are here involved, and money spent directly on jobs would alleviate more effectively the suffering of those now jobless.

We urge the Senate Finance Committee to endorse the new jobs tax credit incorporated in the Bill. Thereunder, an employer will receive a credit equal to 40% of the first $4,200 (a total of $1,680) of wages paid to each additional employee. This credit, it is to be noted, is to be equal to 40% of the difference between 1977 wages up to $4,200 per employee, and 103% of 1976 wages up to $4,200 per employee; the 3% increase in the base was intended to reflect the anticipated normal growth in employment.

As a safeguard, the Bill would prevent an employer from merely substituting part-time or part-year new employees for old employees by providing that the credit cannot exceed 40% of the difference between total 1977 wages and 103% of total 1976 wages. The new jobs credit will also be available for the same adjusted increase in employment in 1978 over 1977 levels. It is to be noted that the new jobs credit expires after 1978.

The House Ways and Means Committee is to be commended for directing the primary benefit of the credit to smaller businesses. This is accomplished by fixing the maximum credit allowable to an employer at $40,000 per year. Then, the legislation is especially notable in that it provides an additional 10% credit for the first $4,200 of wages paid for additional handicapped employees; and this additional credit will not be subject to the $40,000 limit.

The new jobs tax credit will be an important stimulus in creating new jobs. Most important, the legislation has carefully adopted special rules to prevent abuse in cases of separate businesses under common ownership, sales and purchases of businesses, changes in business form, and dismissal for the purpose of securing or increasing the credit.

There are those who oppose the new jobs tax credit and favor instead an increase in the investment tax credit. In our judgment, such a change would be undesirable. The investment tax credit, predicated on the acquisition of new machinery and technological processes, can only serve to decrease employment and increase unemployment, and therefore runs in the opposite direction to the goals desired.

We believe that the novel approach adopted by the House, in substituting a new jobs tax credit for the administration's elective business tax credit proposal, should be endorsed by the Senate Finance Committee.

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS,
New York, N.Y., March 17, 1977.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The National Association of Mutual Savings Banks would like to bring to your attention an inequity in the tax laws relating to the investment tax credit that would be further extended under a proposal in the Carter Administration's economic stimulus plan. Mutual savings banks and savings and loan associations are limited, under Section 46(e) of the Internal Revenue Code, to an allowable investment credit equal to one-half of that permitted to other corporations including commercial banks.

It has been suggested that this limitation originally related to the fact that mutual savings banks and other thrift institutions have the option of utilizing a special "percentage of income" bad debt deduction in computing their tax

liability. This special bad debt deduction was provided for in the 1969 Tax Reform Act which substantially altered the method of taxing mutual savings banks and other thrift institutions. Under the special bad debt deduction, savings banks may deduct a specified percentage of taxable income in computing their bad debt deduction. The degree to which savings banks may utilize this deduction relates directly to, and serves as a stimulus to, their investment in residential mortgages. To realize the full advantage of the special bad debt deduction, it is essential that a high percentage of a savings bank's assets be invested in residential mortgages.

While this special bad debt deduction has proved to be an incentive to investment in housing, the effect of the 1969 Tax Reform Act has been to increase significantly the taxes paid by thrift institutions. Furthermore, under the statutory authority establishing the special bad debt deduction, the applicable percentage in arriving at the special bad debt deduction has decreased from an original 60 percent of taxable income in 1969 to the present 42 percent and will ultimately level out at 40 percent in 1979. It is apparent that this special bad debt deduction has become less advantageous to mutual savings banks and other thrift institutions since 1969.

It is the position of the savings bank industry that the limitations on the investment credit available to thrift institutions has little jusification, particularly in view of the decreasing significance of the special bad debt deduction. Furthermore, a good many savings banks do not utilize the special bad debt deduction and compute their reserve for bad debts and ultimate tax liability in the same manner as other corporations, including commercial banks, which all utilize the full benefits and incentives of the investment tax credit.

The four-year extension of the 10 percent tax credit in the 1976 Tax Reform Act, and the Administration's proposal to increase the investment tax credit to 12 percent with an option available to take a credit equal to 4 percent of an employer's Social Security tax contributions plus the 10 percent investment credit, emphasize the importance our industry attaches to removing what we consider an inequitable limitation. Any increase in the investment credit will obviously emphasize the limitations imposed upon savings banks and savings and loan associations under the present law. In this regard, we would refer to the recent developments in the field of electronic banking—an area which is only beginning to realize what should be major innovations in all areas of banking. By its nature, electronic banking and electronic funds transfer involve significant investment in computers and other equipment. The savings bank industry would suffer a crucial disadvantage in its efforts to compete with commercial banks in the emerging area of electronic banking if savings banks are unable to utilize the same investment opportunities as commercial banks who are entitled to 100 percent of the investment tax credit.

We would respectfully request that the Senate Finance Committee consider repeal of Section 46(e) of the Internal Revenue Code and thereby eliminate the limitation on the use of the credit by thrift institutions. We would also ask that our comments be included in the Hearing Record.

Sincerely,

KENNETH L. BIRCHBY,
Chairman, Committee on Taxation.

APPENDIX B

Questions Submitted by Senator Curtis To Be Asked of Secretary Blumenthal

Question 1. Are you personally in favor of gun control?

Answer. One aspect of gun control involves more effective enforcement of existing Federal firearms laws. I support this, with particular emphasis on reducing the use of firearms in violent crimes. I have not as yet developed a firm opinion on the other aspect of the gun control question, that is, whether additional Federal firearms legislation is need

Question 2. If the answer is yes, what types of gun control do you support?

Answer. I am not sufficiently familiar with the details of all of the proposed amendments to the firearm laws to be able to say at this time exactly what I would support. For example, more than 60 bills to amend the existing firearms laws have been introduced in this session of Congress. Many of these proposals would impose a mandatory minimum sentence for the use of firearms in violent crimes. This I believe I would support. Other proposals would either impose greater restrictions on the purchase, sale or possession of firearms, or would remove all existing restrictions by repealing the Gun Control Act of 1968. It is on these diverse proposals that I am not yet prepared to state an opinion. The matter is under study within the administration and I am confident that if and when the Administration submits its firearms proposal it will reflect that we have attempted to strike a careful balance between preventing use of firearms in violent crime and respect for the rights of law-abiding citizens to own and use firearms for lawful purposes.

Question 3. Have you or will you in your official capacity recommend to the President proposals for additional Federal gun control legislation?

Answer. I have not yet recommended any additional firearms legislation to the President. Whether I will, and if so the specific form it will take, depends on the results of discussions within the Treasury Department and between Treasury officials and those in the Department of Justice and other interested agencies.

Question 4. If "yes" to question No. 2 or No. 3, are you aware of the citizens of Massachusetts rejecting by nearly 3 to 1 a referendum ban on the private ownership of firearms with barrel lengths of 16 inches or less?

Answer. Yes.

Question 5. Have you had any discussions with Mr. Carter or his top aides about proposals for additional gun controls?

Answer. No.

Question 6. Who?

Answer. Not applicable.

Question 7. Will the new administration seek to introduce proposals for more gun controls?

Answer. I do not know for sure. As in my answer to question 3, all I can suggest is that proposals in this area will have to await the development of official Administration policy.

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