EXECUTIVE SESSION

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THURSDAY, SEPTEMBER 7, 1978

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United States Senate,

Committee on Finance,

Washington, D.C.

The Committee met, pursuant to notice, at 10:15 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (Chairman of the Committee) presiding.

Present: Senators Long, Talmadge, Ribicoff, Byrd, Nelson, Gravel, Bentsen, Hathaway, Matsunaga, Moynihan, Curtis, Hansen, Dole, Packwood, Roth and Danforth.

The Chairman. This meeting will come to order.

Let me just make one or two points in starting. I believe that Mr. Shapiro had a proposed schedule there, or Mr. Stern had a proposed schedule. I know for the first few days I am satisfied that it would be all right with me to stay on those subjects in the outline and I would hope that, as we go along, we can agree to a few ground rules to expedite the consideration.

Let me suggest one thing, from my point of view -- I am not trying to commit anybody to it right now; I hope that we can agree to it -- I would hope that on this bill that we would keep off amendments which would involve only a single taxpayer. I am used to it, so I should not complain.

I have enjoyed reading three articles about myself on three separate days as though I were in charge of the Boston Patriots bill, for example. I think that the members know I was not here at the hearings and I was not here when the amendment was voted on. I do not know why the reporters do not find out who made the motion, whose amendment it was, who introduced the bill, something like that, who was interested in it.

To read those articles, one would think that the Chairman of the Committee was the only one who knew anything about it. I do not know the first thing about that amendment.

I would hope that we would not have, for example, the Boston Patriots amendment offered on this bill. It is all right with me if the Senate would like to vote it, but I would like to send it on another bill, so if the President wants to sign it, he can sign it; if he wants to veto it, he can veto it.

I would hope that the amendments that we consider here on this bill would be amendments that are sufficiently broad that they involve a class of taxpayers or a considerable number of people, that we try to keep off those amendments that affect just one taxpayer, or one or two taxpayers, and try to have something that involves more than something that is parallel to a private relief bill.

Of course, Senators both here and on the Floor have the right to propose it if they want to. I would hope that we could sort of keep this this way.

Senator Curtis. Mr. Chairman, if you would yield, I think for my part, the Chairman's request is very good. We have an important tax bill to consider here, and we do not need any additional barriers in the way of getting it completed.

I might say for the record that a great many of these private bills are very justified. We cannot have a tax program that collects as much money as we do and have this maze of tax legislation which the Congress passes without having some situations that have to be looked into where there is a rough spot and many times are very unfair. At the same time, those bills for an individual or small group do meet with a lot of opposition on the Floor, considerable ridicule, and they are worth a fight. But, on the other hand, they cannot be used to impede important national legislation.

So, as far as I am concerned, Mr. Chairman, I want to cooperate with you. I am sure many of the other members of the Committee do also. It would be my hope that today at this first session that we could take up such matters as the Chairman wanted, but I would hope that we could have sort of an overall look at the situation and what you were sort of outlining for us to consider and that we might be instructed as to what is in the House bill.

I think it would save time, later on, if we do not jump in too quickly to try to change various sections, or offer amendments until we see what the whole picture is.

The Chairman. I appreciate that.

May I just indicate something that I would like for Mr. Shapiro and the two staff members to bring out here, in short order? That is, if we are going to do justice in the way that we had originally conceived to the taxpayers, we are going to need everything that is in that Budget Resolution on the Senate side. The House, apparently, on their side, is only allowing enough room to take care of what the House bill did. Is that correct, Mr. Shapiro?

Mr. Shapiro. That is correct, Mr. Chairman. On the blackboard to the right here is the current budget situation. The left column shows you the Second Budget Resolution. Both the House and Senate has agreed to it.

You can see on the left side that the House Budget Resolution is $19.9 billion; the Senate Budget Resolution, which was agreed to last evening, is $23.4 billion.

Right below that is the House version of the tax bill, $18.3 billion. The difference between the House Second Budget Resolution and the Senate Budget Resolution is the fact that the House adjusted their tax cut downwards to take into account that the House-passed tax bill is a lesser amount, and that is for the fiscal year.

That does not fully cover the Social Security tax increase that would take effect next January, or the inflation tax increase for 1978.

The Senate Budget Resolution that you have agreed to would allow for additional tax cuts for individuals to cover the Social Security tax increase completely, the inflation tax increase completely, and some other adjustments to the extent that the Committee and the Senate would like to do so.

You should focus on the right side of the board. Those are the additional items which have to be included in the total Budget Resolution. It is the tax cut, plus the others. What is put on the blackboard are the measures that have passed the House and the Senate with an asterisk. That means that the whole House or Senate has not acted.

On the top is the tax cut bill, $18.3 billion. As you can see, since the House Budget Resolution is $19.9, that only gives $1.6 billion for all other items.

The Senate Budget Resolution, as I indicated, which is $23.4 billion, would allow for a larger tax cut plus taking into account some additional items.

Going down the blackboard on the right side, the tuition tax credit that both houses have acted on, the Senate is $.6 billion the House is $.7 billion.

There has been no indication to date of the time for the Conference. Presumably, you will have a Conference which will come back with a figure between that $.6 billion to $.7 billion range.

The energy tax bill presents a unique situation, because those revenue estimates are out of the bill passed by both houses.

In view of the fact that time has delayed the matter, they are not accurate to date. For example, in the House bill, you see a plus $.3 billion, $.1 billion. Most of that increase was from the COET.

Some of the other provisions, which assumed that the energy tax bill would have been passed by the end of last year, so that the taxes would be beginning in January of 1978 and be picking up the revenue. It is quite obvious that that bill would not have any revenue effect, or very slight, even if passed, so that that revenue pick-up would not be real, even if the bill were to pass with all the provisions in the House in it.

The Senate bill is essentially a $5 billion tax reduction because there is not a COET in the bill and you have an additional tax cut. There is an additional problem that should be focused on in the energy tax bill. That is, that many of the credits -- for example, the individual credits, the residential credits for insulation, and solar were effective April 20, 1977. That meant that you would have two fiscal years involved that these credits would be available. The fact that the tax bill has not passed, and if you were to assume that whatever action you took on an energy tax bill this year, at least on the energy tax credits, you would have the doubling up in this fiscal year, meaning that the credits that would be available retroactive to April 20, 1977, if you were to agree to that, which was in both bills, would not only -- that retroactive effect and the current effect would both be in this fiscal year.

So, therefore, that should be taken into account in your overall revenue picture.

The next item was put in to show that it is a double counting -- no total, in these charts. In the Senate passed bills, you had the Hart amendment that brought out the residential amendments, $1.3 billion. That amount is also in the $5.1, so you cannot add up that column.

We wanted to point out, if you are willing to deal with the residential credits, you would be in the neighborhood of the $1.3 billion.

As you know, the Hart amendment was not the same as passed by the Senate. It is in that same ballpark of a revenue estimate.

The next item is the earned income credit -- I am sorry, the income earned abroad, Section 911. The Senate has already passed this bill; for the fiscal year 1979, it is $200 million. The Ways and Means Committee has passed out its bill -- $500 million for fiscal year 1979. The House bill has not gone to the House Floor yet. There is a minimum of $200 million that has to be taken into account, and probably between $200 million and $500 million when we get into conference.

The next item is the noisy aircraft bill that has been reported out by the Ways and Means Committee that has not been considered on the House Floor. This is an adjustment from the passenger and freight ticket taxes, presently 8 percent ticket tax on passengers in view of the noise problem. The Administration Committee made a proposal which the Ways and Means Committee has agreed to to shift two percentage points from the ticket tax on the airway trust fund and allow that to be made available to the airlines in order to either refurbish their planes, buy new engines or buy new planes to reduce the noise problem. That is approximately $400 million.

The Finance Committee has not acted on it. You had initial consideration of the fact that the House has not sent it over to you yet. You have deferred action until the House has passed its bill.

The last item on the board is a miscellaneous item which we generally put in. It is approximately $100 million, to cover miscellaneous items that you have considered or will consider, that are tax measures and miscellaneous tariff measures.

The elderly credit is one of the items that you previously agreed to. When you look at the Senate Budget Resolution of $23.4 billion, all of these items -- the energy items, the miscellaneous items -- have to be included with the tax bill to meet that $23.4. It should also be noted, there will be a conference on the Second Budget Resolution and that will be very important to the Finance Committee. If they did not agree, whatever figure they agreed to less than a Senate figure would reduce the amount of money you would have in the Committee to adjust.

As I indicated, the House figure adjusted exactly for the

House-passed tax bill. The Senate figure adjusted the figure, which was the same figure you had in the First Budget Resolution. Any adjustment made to go downward would affect your action and the amount of money you would have for the tax bill, as well as the miscellaneous items.

The Chairman. One other point that I think the Committee ought to note, I really feel that we made a commitment -- I know I did, and I think others did in one respect or the other -- that we would pass a tax cut to pretty well offset either in whole or for the most part the increase in Social Security taxes, in so far as the rank and file taxpayers were concerned.

While I do not know that we guaranteed it, a lot of people feel -- and I think it would be good -- if we tried to make taxpayers whole, as far as we could, for inflation.

As I understand it, under the Budget Resolution there would be enough money to make each class of taxpayer whole for the Social Security tax and for one year's inflation. We have had two year's inflation since the last major structural change of the revenue code, and there is just not enough money in the Budget Resolution to make the taxpayers whole for two years of inflation. There is enough to make them whole for one year's inflation. Is that correct?

Mr. Shapiro. That is correct. You do have enough money in the Senate Second Budget Resolution to cover the Social Security tax increase that you passed last December that will take effect next January.

Senator Dole. $8 billion?

Mr. Shapiro. $6.5 billion, with the employee share. It is a little over $6 billion. We are not talking about the employer, but the individuals.

We are not talking about the previous legislative increase that took effect this January; that was under the old law. We are talking about the new law that you passed last December that will take effect in January, 1979.

In addition to that, you have inflation tax increases of approximately 7 percent on inflation for this year, 1978. Senator Long had reference to the 1977 tax reduction act that you passed, and that was done in the early part of 1977, and the inflation adjustment -- we will have materials that will talk about that this morning for the 1978 inflation increase.

Senator Dole. Are those different figures than Chairman Miller was using yesterday? He had $8 billion on the inflation side and $8 billion on the Social Security.

Mr. Shapiro. The inflation figure we have is a little bit higher than the one Chairman Miller had. Previously, we were talking about 6 percent inflation, and that was the figure that the House used in the 6 percent. But, in view of the recent economic data that we had, we have adjusted our materials to a 7 percent inflation figure which is $8 billion.

The Social Security increase that we have is approximately

$3.2 billion . We are only talking about the employee share, the individual. We are not focusing on the employer share. It is making the employee whole for the Social Security increase.

We have a table and statistical material that has all the information.

Senator Long, how would the Committee likt to proceed? We had anticipated as to have a general summary and overview of the House bill, the major revenue items that are listed on the blackboard, and then we could go and show you, after getting a feel for the House bill in general, we can go and talk about the Social Security and inflation increases, then show what the House bill does to take care of that.

The Chairman. Why do you not proceed the way you had planned to proceed? Then we can judge from there how we want to go.

Senator Bentsen. If I could ask a question for clarification, on that $18.3 billion, is that on an annualized fiscal year or is that for the remaining part of the fiscal year?

Mr. Shapiro. For the remaining part of the fiscal year.

Senator Bentsen. What is this number over here on the House side of $15 billion?

Mr. Shapiro. Right now, in the Budget Resolution, it takes into account all the increases that are necessary. One of the problems that is causing some confusion is what do do about the extension of the temporary tax cuts. For example, in 1975, we enacted temporary tax cuts that would be continued in '76, '77 and

'78 that expire at the end of this year. When the Administration made its original proposal, you heard about the $25 billion tax cut. That did not include the extension of the temporary tax cuts. People are receiving those today.

The $25 billion tax cut was in addition to that.

From the standpoint of the tax cut that you hear, whether it is the Administration's $25 billion or the House's $15 billion, that is talking about an additional tax cut over continuing the temporary tax cuts. The people already had that; this is an additional one. That is one piece of it.

The Budget Committee, however, has to focus on the additional revenue, by the tax cuts. They have to look, not only at the additional tax cuts, but the continuation of the temporary tax cuts. At the end of 1978, they expire, and you have to extend that.

The $18.3 billion includes both pieces, the extension plus. Let me give an example on a fiscal year basis.

The House bill is approximately $9.3 billion to $9.4 billion on a fiscal year. That is three-quarters of a calendar year. The fiscal year is October 1 to September 30.

The tax cuts in the House bill take effect on January 1. That means that the $9.3 billion represents three-quarters of a full year. The $15 or $16.3 billion that you hear in the House bill is one calendar year, a full year effect, which in a fiscal year, on a three-quarters basis, is $9.3 billion.

So when you look at the $18.3 billion for example, let me add it up for you. It would be helpful to say that is the Budget Committee's counting. That is the $9.3 billion under the House bill. It includes the $8.2 billion, which is an extension of the temporary tax cuts, plus the jobs credit which was not in the original Administration extension bill, but was proposed by both Houses, and the combination of all of that totals to $18.3 billion.

We are talking about different things. That is why there is some confusion over the size of the cut.

What we will be talking to you about in the Committee and the figures we will be using is additional tax cuts over and above the extension of the temporary cuts.

Senator Bentsen. But the Budget Resolution covers the extension of the cuts plus?

Mr. Shapiro. That is correct. We are assuming in both houses you are talking about the extension of the cuts. That is an assumption, that all figures we are talking about is an additional cut above the extension of the temporary cuts.

The Chairman. Give that to me again, to be sure I understand it.

How much a temporary cut are we talking a bout extending?

Mr. Shapiro. Approximately $8.2 billion.

The Chairman. $8.2 billion. All right.

In addition to the $8.2 billion, how much cut do we think we have authorized under the previous Budget Resolution, and then the Senate-passed Budget Resolution?

Mr. Shapiro. The Senate-passed Budget Resolution, we should work from the Senate, because that is what you are working under, $23.4 billion; until there is a Conference, that is what your figure is.

The Chairman. $23.4 billion. All right.

That leaves $15.2 billion.

Mr. Shapiro. $15.2 billion.

The Chairman. $15.2 billion.

How much of that has the House used up?

Mr. Shapiro. $9.4 billion.

The Chairman. $9.4 billion.

Mr. Shapiro. Then you have to add $.7 billion for the jobs credits, so it is $10.1 billion you have to add, Senator.

The Chairman. You subtract that?

The Chairman. You have to subtract another $.7 billion from what you have there for the jobs credit. The Administration did not propose extending the jobs credit; in the Budget Resolution, they had that figured in -- $.7 billion, subtract another $.7 billion from what you have on your paper. That should leave you $5.1 billion.

The Chairman. That is what we have, then, to try to make up for the shortcomings in the House bill that has been criticized that the low-income people were not getting enough and the middle-income people.

Mr. Shapiro. Plus everything else, Senator. That includes the tuition tax credit, anything on energy taxes or anything miscellaneous. Anything you would do in taxes would have to come from within that $5.1 billion.

The Chairman. Senator Roth?

Senator Roth. Yes, Mr. Chairman.

The question I want to raise is the effect or impact of feedback. As I understand the CBO, they have figured -- it depends on the nature of the tax, number one, but number two, CBO takes a rather -- shall we say very conservative point of view with respect to feedback in comparison with other economic models.

I just wanted to raise the question, how do we resolve that question? I know it is the minority opinion of the budget that was given to us yesterday. They pointed out that there was greater feecback so that a greater tax cut was permissible than the CBO office seemed to approve.

Mr. Chairman, I suppose that is a decision that finally has to be made on the Senate Floor, whose figures they will accept, but it seems to me that this is a very important point, because it does affect the flexibility as to what this Committee can do.

The Chairman. I think it is a very important point. I think, in large measure, I agree with your thoughts about that matter, Mr. Roth. I am pretty well on record about my attitude toward it. Mr. Shapiro might explain how it looks to him from where he is sitting, what he hears from the Budget Committee or the CBO and the Administration and the others, how they are analyzing it. And he might help to bring us together, or else point out where our differences are.

Mr. Shapiro. I am going to have Jim Wetzler talk to that. Jim has talked to the people who have done the Administration budget as well as the CBO and Budget Committees. He has a good feel for exactly what he does.

The only thing I want to start off by saying in general, feedback is taken into account in the overall budget that is submitted and therefore when you have a $25 billion tax cut by changing it in some direction, it is already in there. When you add or have new items or additional cuts, you do have feedback.

I would like to have Jim go into more detail and explain exactly how that is taken into account from an economic standpoint.

Mr. Wetzler. Senator Roth, the way they try to do the budget, they need some economic assumptions to determine what the level of income will be, to denote how much revenue is coming in, how much unemployment compensation they will have to pay.

So both the Administration and the Budget Committees attempt to make the budget a consistent document by making economic assumptions that areconsistent with their budget. They take into account the tax cuts or spending increases or whatever that are going to be in the budget for that year, and what the Administration and the Budget Committee are concerned about, if they take the stimulative effects of the tax cuts into account and the economic assumptions, and then if the tax writing committees take those same effects into account in estimating the revenue effects of the tax cut, then, in fact, those would be counted twice, and the budget will wind up overestimating revenues, because they will count the economic effects of the tax cut in their overall economic assumptions and then we will count it a second time in measuring the feedback effects.

I think, however, that argument really only holds to the extent that we are talking about tax cuts that affect, you know, these aggregate magnitudes -- Gross National Product, the rate of inflation, the rate of unemployment, the sorts of things that the Budget Committee is concerned with in making those estimates.

I do not think that the Budget Committee objects to taking into account feedback effects on a smaller scale -- for example, the effect, if you increase the charitable deduction -- for example, you generate more contributions, that will have a bigger revenue loss. I do not think there is any objection of the Budget Committee on that.

Senator Roth. As I understand it, the major argument -- I do not think anybody is suggesting that we count feecback twice, once in the budget and when we get here. That is not the economic argument.

The economic argument is that the models in the past have been static and that they have been given little attention. We have gone through that in the hearings, Mr. Chairman.

I have to admit that I think, in a sense, you have a guesstimate, period. But the real problem is in trying to frame a tax package. I think an important consideration is what is going to be the impact on the economy and how we can get it moving and to just say that we take the most conservative, old-fashioned point of view could be doing a great disservice.

There are great differences in what the Treasury, and what CBO, as I understand, that some of the feedback would be half as high as others, and what concerns me, and I think what concerns the Chairman in the discussions we had earlier, is that we need better models that would give us a better picture. But what concerns me here is that we may not take as vigorous action that is in the best interests of the economy because of the old-fashioned point of view of the CBO.

Senator Bentsen. Let me comment.

What Mr. Wetzler says, it appears that they are being selective where they will consider feedback. He says on some of these issues they will, and on some they will not, some of the smaller ones, that they would.

I am wondering if their own particular objectives are not influencing how they are utilizing the feedback.

The Chairman. Mr. Sunley?

Mr. Sunley. Mr. Chairman, maybe I could explain the feedback issue in terms of the macro effect that Mr. Wetzler is discussing. By using Table 7 in the set of tables that the Joint Committee prepared, which reflects an econometric simulation done by DRI, Data Resources Inc., on Table 7, I think the Joint Committee has prepared a set of statistical tables for the individual income tax cut dated September 5 of this year.

Table 7, which is the next to the last table, is an attempt to show how the economy will be if we adopt the House-passed bill compared to how the economy would be if all we did was to extend the temporary tax cuts which are about to expire.

Now, in the first row in that table, the first bank of numbers in that table is real GNP at 1972 prices and it indicates that, for 1979, if all the Congress did was to pass the extension of the temporary tax cuts, the real GNP would be $1,423 billion in 1979 and then if you look down further in the table, there is a bank of numbers on the Federal surplus, surplus or deficit, on the National Income Account basis, and it indicates that in 1979 the deficit would be $25.8 billion. There would be a deficit.

This concept of deficit is not quite the same as how we keep track of surplus and deficit in the Federal budget. This is the National Income Account concept, but for our purposes here we can use it.

What DRI is saying, if all we did was to extend the temporary tax cut, we would have a deficit in 1979 of $25.8 billion. Then the DRI simulates what would happen to the economy if, in fact, the tax cut in the House-passed bill was enacted, and we will see, in 1979, they indicate that real GNP would be $1,428 billion, in real terms, $5 billion higher -- real terms, using 1972 dollars -- $5 billion higher; in terms of current dollars, I understand that is about $10 billion higher.

They are saying money GNP in 1979 would be $10 billion higher.

They also say that, with this larger tax cut, the Federal deficit, instead of being $25.8 billion, would be $38.4 billion. That is current dollars.

The bank on the Federal surplus is in terms of 1979 dollars.

Senator Moynihan. Why do you use '78 dollars for GNP and '79 dollars on the other?

Mr. Sunley. I would prefer to have the GNP figures in the first bank.

The GNP will be higher if you enact a larger tax cut, and in real terms, it is $5 billion; in this year's dollars, or next year's dollars, it is about $10 billion higher.

They indicate the difference in the deficit would be $25.8 billion, if you only did the extension. If you enact the House-passed tax cut, the deficit would be $38.4 billion.

The difference between those two numbers is $12.6 billion. They are saying that the deficit would in fact be $12.6 billion larger if you enacted the tax cut in the House-passed bill.

Senator Curtis. For what year?

Mr. Sunley. For 1979.

Senator Curtis. If we pass the House-passed bill, the deficit would be $38 billion?

Mr. Sunley. Yes.

Senator Curtis. What would it be if we passed no tax bill?

Mr. Sunley. No tax bill, not even extend -- do not pass the extension of the existing tax cut?

Senator Curtis. Extending.

Mr. Sunley. Extending.

$25.8 billion.

Senator Curtis. Then you are contending that this would add to the deficit?

Mr. Sunley. This is the DRI simulation. I just want to go through how they look at it, which is very similar to how we look at it. It is consistent -- our numbers would be slightly different, but the concept, I think, is the same.

If I could just say one more thing, then I think we would see what the feedback argument is.

The static revenue loss shown in the last row of this table, that is $15.6 billion, what that means, at the higher GNP level which we would have if we adopted the tax cut, which means a higher level of personal income and a higher level of corporate profits, at those income levels, the tax cut in the House-passed bill would cost $15.6 billion, at those higher income levels, but the deficit only increases by $12.6 billion.

What that implies is that the $10 billion growth in money GNP and the difference between a world with or without the tax reduction, the additional tax reduction, does, in fact, generate additional tax receipts for the Treasury of about $3 billion. That is the difference between the $15.6 static revenue estimate and the $12.6 billion difference in the two deficit figures that the DRI model produces.

Senator Curtis. These are all estimates projected in the future?

Mr. Sunley. That is correct.

Senator Curtis. I have a table here. It will not take long to submit it for the record.

In 1963, the Treasury Department estimated that our tax reduction would cost $2.4 billion. There was an actual revenue gain of $7 billion.

In '64, the estimated loss, $5.2 billion; actual gain, $6 billion.

1965, we were told by the Treasury that the revenue loss would be $13.3 billion and the actual happening was a gain of $4 billion.

1966, the Treasury estimated that we would lose $20 billion of revenue; we actually gained $14 billion.

In 1967, Treasury estimated a loss of $23.7 billion; we actually had a gain of $19 billion.

In 1968, we were told by the Treasury that they estimated a loss of $24.4 billion; we actually picked up $4 billion.

Over a period of time, the Treasury estimated $89 billion lost in revenue by taxations of the Congresss; we actually had a plus of $54 billion, for a difference in estimates of $143 billion from '63 to '68.

Now, those are not estimates.

The Chairman. I would like to know if Treasury agrees with that, and how that is arrived at, because that is very important.

Mr. Sunley. I think, Mr. Chairman, that that is very important. I think there has been a considerable misunderstanding over these numbers, which we have seen before.

In each of those years, 1963 to 1964, if you went back and looked at the President's budget submitted to Congress, the President's budget did indicate that the Administration expected total Federal receipts would increase from one year to the next, even though the President was proposing a tax reduction. Otherwise, the tax reductions are measured in terms of reductions from what receipts would have been if there was not a tax reduction but the budget estimates also show what receips are going to be given the growth of income in the economy.

Otherwise, in the 1964 budget, we estimated that the fiscal year 1963 receipts would be $125 billion and we estimated the next year that the receipts would be $109 billion.

The Chairman. Let me stand up so I can see over the reporter, because I cannot see half the time because of the reporter.

It seems to me that when we were talking about the investment tax credit, I was led to believe that every point of that investment tax credit would present us with a revenue loss of $900 billion. Now, for people to get the investment tax credit, they had to get the equipment, a 10 percent credit on the equipment.

Now, just the manufacture and purchasing of the equipment itself did a lot for the economy and because people manufactured and put into place additional equipment, built more plants, ~~expanded the Gross National Product, contractors made profits,~~ workers made salaries and so forth. There was a tremendous amount of economic activity generated because people responded to that change in the tax law.

It is hard to say what the amount was, but my impression was that those Treasury estimates did not give us any feedback. Later on, when we repealed the investment tax credit, we estimated we were going to save the same -- at that time, there was a 7 percent credit, save $5 billion or $6 billion. We did not save any $5 billion or $6 billion. We lost more than that because of the effect it had on the economy.

People cancelled orders, everybody cut back, and the economy went into the doldrums. We had to come back and renew it. When we renewed it again, that went down as though that were going to be a tax cut. It would cost us money.

It helped move the economy, so we made money on it.

All I am saying is that if this is something that we think is going to do good for the economy and move the economy and generate revenue to the government, we should so estimate. To do otherwise, I think, is to assume what you are doing will not work. If you think it is going to work, you ought to estimate that you are going to get the benefit of it.

If so, it seems to me as though a tax cut does not cost as near as much as the static figures would estimate. Just to pull somebody's tax return and assume he is going to do the same thing this year that he did last year when you are passing a law to get him to do something entirely different, it seems to me that that has to be an erroneous assumption.

Mr. Sunley. Mr. Chairman, we fully agree that tax reductions will stimulate the economy and that the stimulus to the economy will generate additional income to the economy, thereby additional tax receipts. As I said, looking at the DRI simulation, which is very similar to the simulations underlying the President's budget, enacting the larger budget in the House bill, it will increase the deficit by $12.6 billion.

Otherwise, in fact, the higher GNP generated in 1979 will provide a $3 billion feedback in revenue.

It seems to me that there are two ways --

The Chairman. Are we saying that a $23 billion tax cut will only cost $12 billion in revenues?

Mr. Sunley. In static, $15.6, in the DRI -- this does not include the extensions. This is only the additional, the new tax cuts. On an NIA basis, the static revenue basis was $15.6 billion.

They are saying, compared to a static revenue basis, estimated base on the higher income levels that would be attained if the tax cut were enacted, that tax cut would appear to cost $15.6 billion, but the change in the deficit that would occur would be $12.6 billion, and it seems to me that there are two ways that we can work on presenting the numbers.

One possibility, taking ~~the feedback effects, that, in fact,~~ the first year you get back about 20 percent of the tax cut. That is what the DRI model would show. That is a little bit higher than what the Administration gets in its own internal work, but we could work with that 20 percent figure.

Then it says that what we want is a tax reduction with feedback of about $12.6 billion.

Or you can say, let's not take the feedback effect. As we add up the effect of each tax cut, and if we do it before beedback effects, we want about $15.6 billion. I do not think that it is appropriate to say that the $15.6 billion figure is consistent with the kind of tax cut that the House bill passed which would provide a level of stimulus that the House wanted to provide.

The Administration, as you know, prefers a somewhat larger tax reduction. The size of the tax reduction that the Administration prefers, the $19.4 billion figure in calendar year '79, that is a part of the mid-session budget review which is before the feedback effects.

If we want to have a feedback effect of 20 percent the first year, you cut a dollar, you get enough growth in the economy to generate 20 cents of additional revenue, then we do not want a $19.4 billion cut. If we want to do it taking the feedback effects into account, you want about 80 percent of $19.4 billion.

I do not think it matters to us which way you do the arithmetic, as long as we are consistent, but we do not want a $19.4 billion tax cut with a 20 percent feedback effect built into it.

The Chairman. This will become important as we go along, because my present impression is that you have estimates over there that that kind of cut in capital gains which I think I would like to vote for would cost the Treasury a lot of money.

I have estimates from men who have served as Secretary of the Treasury -- not one, but several of them; about seven who understand what this is about and who have had similar responsibility and have served this country with distinction -- who say in their judgment we would make money. It would have a positive effect. We would make more money than we lose by that kind of reduction in capital gains taxation. That would be good.

To fail to cut the capital gains tax would be counter-productive. It appears that we are taxing to the point where we are being counterproductive, stifling the economy and holding back production and denying ourselves jobs by an unrealistic tax rate. And, in due course, I will provide the letters written by men who have served this nation as Secretary of Treasury and Undersecretary and who have done a great job.

They are thinking about the fact that these changes will stimulate activity that would not occur otherwise.

Mr. Sunley. Chairman Long?

Senator Bentsen. Mr. Chairman, I think he makes the point that we ought to be sure that we are comparing apples to apples. I think we have to use the feedback provision that you are talking about instead of the static analysis in answering his point. Otherwise, I do not think we have a fully informed judgment as to what the effect this Committee's action has accomplished on the economy and, as we go along, we ought to have that cranked into our thinking process in arriving at whatever that decision might be, whatever that feedback is, and not use the static analysis approach.

And that, also correlating what Treasury wants and what the Administration is talking about.

The one thing I did not understand is why you used the National Income Account instead of the unified budget. Is there any particular reason for that, and is there any significant variation in the projections?

Mr. Sunley. The simulation of the data resources is essentially a National Income Account simulation. There is a different concept of the Federal government sector in the National Income Accounts that is somewhat unique. We cannot translate NIA deficit figures into Federal budget.

You can make those kinds of transitions.

Senator Bentsen. Is that a significant difference or not in trying to correlate what you have done?

Mr. Sunley. On certain kinds of things, it is significant. For example, the earned income credit in the National Income Account is treated as an expenditure. It has no effect on revenues.

The refundable portion of the earned income credit is income there. Earned income is when they accrue, not when they are paid individually. It is treated when the money is paid over to the Federal government, not when the liability is accrued.

There are certain rules in the National Income Account that are somewhat different than when we count revenue in the Federal budget. It is essentially a cash basis. We can translate back and forth.

Senator Bentsen. When you give me these numbers, what I am trying to find out, when you talk about a deficit in 1979 of the House bill extended is $38.4 billion and do that on a National

Income Account basis, would that be significantly different than if we did it on a unified budget?

Mr. Wetzler. The major difference -- this is calendar year 1979. The unified budget is on a fiscal year basis. Aside from that, they are going to be within a couple of billion dollars of each other. There will not be significant differences.

Senator Bentsen. I have not been here long enough to think of $2 billion as not being significant.

Mr. Wetzler. The inaccuracy of the forecast is more than a couple of billion dollars.

Mr. Sunley. Mr. Long, I would like to make one distinction for the Committee. The capital gains issue and the feedback effect relating to capital gains is a separate issue from the impact of tax cuts on increasing the general level of activity in the economy, and therefore that kind of feedback, the macro-feedback, the feedback effect that we have all been discussing in the capital gains area is you lower the tax rate on capital gains and people may realize more gains and therefore, under our tax system, capital gains taxes are only paid when gains are realized. We will see some offsets -- some will say a full offset of the tax cut -- due to the fact that there are increased realizations.

Here, I will say we have always recognized on the Joint Committee staff, Treasury, there may, in fact, be a significant feedback effect due to increased realizations that would have an impact on revenue.

The problem has always been trying to determine what would be a reasonable estimate of that feedback effect in terms of the short run effect and the long run. There are different stories with respect to each.

I would hope that we and the Joint Committee could work together on this, when you get to the capital gains portion of your mark-up, that we would be able to say, we do not know what the answer is, but here are some assumptions that you could make that would seem reasonable to us within the range of possibility.

In fact, there is a feedback effect, and if you think the response is large, here is the impact on revenues you would get. We would have no problem with working with the Joint Committee staff, and I would hope that we could.

We do not know what the answer is. I do not think anybody knows what the answer is. I must say I am a little doubtful that it is possible to cut the capital gains tax and realizations would be so much that it would pay for itself. That does not mean that there is, in fact, a significant offset, and the Committee might want to take that into effect.

The Chairman. In my judgment, Mr. Sunley, you have provisions in the tax law -- you did not write them, but they are there -- you have provisions in this tax law at rates so high that they are costing us money. I wish the Treasury would just do a study of what we achieved with the tax cuts that we voted in 1964.

President Kennedy came in with the estimate, if we would reduce that tax rate from 92 percent down to 70 percent and cut the capital gains rate and put in the investment tax credit, the biggest tax cut in history, over a period of time we would make money for the government by doing it. And I am convinced, I personally think, we did it.

That would look like some great achievement. Actually, all we did was just stop doing something that was silly, and that was to try to think you are going to make money with a 92 percent tax rate. We stopped doing something that was absolutely assinine, which rather than give ourselves credit for it, we should have blamed ourselves that we waited all those years to do it, because it was losing us money.

Just like a 100 percent tax is not going to bring the government 100 percent of what a man earns; it is going to lose him what he was collecting because he is going to quit working if he cannot keep what he earns.

I just think, rather than us sit here until the whole nation has been convinced that we are not looking at the counterproductive aspects of our system, that we ought to start moving before that fact -- and I am not here to say that that necessarily means that any particular thing is right, but I look at our experience with the investment tax credit. For years, we were just estimating that thing on a purely static basis. It was going to cost $9 billion without any feedback.

Finally I got Larry Woodworth to see if he could come up with some estimate. He finally got Dr. Klein from the Wharton School to estimate that you had about a 30 percent feedback.

Instead of having to carry the burden of saying that this was going to cost us $9 billion, we could have said it is only going to cost us $6 billion when you take the feedback into effect. Actually, in my judgment, it probably had a great deal more feedback than that.

Senator Curtis. Mr. Chairman?

The Chairman. Senator Curtis?

Senator Curtis. One question.

Table 7 is based upon the forecast made by DRI?

Mr. Sunley. Yes.

Senator Curtis. Will you produce a Table 7 with the figures computed by Chase Econometrics?

Mr. Wetzler. We will ask them to do it.

Senator Curtis. Will you produce a comparable table based on the Wharton model?

Mr. Wetzler. We will ask them if they are willing to do it.

Senator Curtis. Thank you very much.

The Chairman. Senator Hansen?

Senator Hansen. Mr. Chairman, I appreciate the difficulty and I compliment Mr. Sunley for what he is trying to do. I appreciate the difficulty of trying to come up with firm figures as to what may happen, recognizing that this is not a static economy. But, if I understood you correctly, sir, I think you said if the capital gains taxes were cut, there would be some feedback. I would ask you, what happened in 1969 when capital gains taxes were raised? Could you tell us?

Mr. Sunley. Here, we would think that, in fact, although realizations did go down, '68 was a big year.

Senator Hansen. Not what you think, what happened? My question is, what did happen?

Mr. Sunley. I think that the increases in taxes did lead to an increase in Federal revenues, probably not as large as the static estimate, because there were some offsetting feedback effects. I do not think that it was the case that if you increase the taxes the realizations decline so much due to the tax change that, in fact, Federal receipts decline.

Senator Hansen. What I meant to ask you, if I may repeat it one more time, not your explanation of what you think happened, but what, in fact, did happen. Did capital gains taxes drop or did they raise, or did they hold static in '69?

You may have your observation; I may have mine. But I want to know the facts, if you have it.

Mr. Sunley. I will get it in just a second.

If I recall, realized gains by individuals peaked in 1968. They fell in the immediate years after 1968, including 1969, the year which the Congress was considering what became the Tax

Reform Act of 1969.

They peaked again in 1972, which was the first year after the phasing in of the higher tax rates.

The '69 Act increased the taxes on capital gains over a three-year period, 1970, 1971 and 1972, from '72 to '73 and the capital gains rates were higher.

You might assume that you would have had a surge of realizations of capital gains in 1971 because everybody was on notice that the full effect of the repeal of the 25 percent alternative tax was going to take effect next year and, in fact, investment advisory services were advising clients that you might want to realize gains this year, because the tax rate on capital gains is going up again next year.

In fact, we do not have any indication that people showed realizations realized in 1972 and 1971 because 1972 is a banner year in realized capital gains.

Let me figure the exact figure --

Senator Bentsen. I think you would have to look at the economic situation in '71. As I recall, '71 was a year times were not good and there were not a lot of capital gains to be realized for economic reasons other than just tax reasons.

Mr. Sunley. Mr. Bentsen, I would agree with you completely. The point that I would like to make is that it is very difficult, just looking at the historical data, to see any effect that you can distinguish from all the other things that are going on.

The figures are, in 1968, which was a peak year, total gains were $35.6 billion. In 1969, they fell to $39.4 billion; in 1970, to $20.8 billion. That is the low point.

Senator Hansen. What was it?

Mr. Sunley. $20.8 billion.

Senator Hansen. Tell me what the $20.8 billion is. Is that the amount of taxes paid on capital gains, or the total amount?

Mr. Sunley. Total amount of capital gains before the 50 percent exclusion.

Senator Hansen. These figures of $35.6 billion for '68, the $31.4 billion for '69 and the $20.8 billion for '70, are the capital gains that were reported on income tax returns?

Mr. Sunley. On individual income tax returns. In 1971, they rose to $28.3 billion. In 1972, they peaked again at $35.9 billion. In 1973, it declined to $35.8 billion, essentially the same.

All I am saying is that it is very difficult, given the tax change that was enacted in '69, to explain the pattern of total gains by tax considerations alone. There are other factors that we know are important. When the economy went into a recession, it has got to be important.

Realistically, some have suggested that 1968 was a high year because people were anticipating what Congress was going to do in 1969. I do not think that is true. We have to remember, in March of 1968, President Johnson indicated that he would not run, and I think that the tax bill that President Johnson was committed to submit to Congress no longer became important, that the new Administration did not make any proposals until 1969.

I really cannot believe that the high realizations in '68 were in anticipation that Congress was going to change the law in '69.

Senator Byrd. If you would yield at that point. Could you give the Committee a table showing those figures? The explanation would be one thing, but if we could have the actual figures, then each of us could probably put our own interpretation on the figures.

Mr. Shapiro. Senator Byrd, the staff has anticipated to furnish the Committee members with all of the information on capital gains. What we generally do, the schedule you have before you, we will have staff material on every topic, according to the Committee rules, two days before you have it. All the information being discussed now we had planned to distribute to you about Monday.

Senator Byrd. If you could give the raw figures that Senator Hansen asked for --

Mr. Shapiro. All of the information that has been discussed so far and some additional information that we think will be helpful will be furnished to the Committee two days before you take it up.

Senator Byrd. Thank you.

The Chairman. Mr. Roth?

Senator Roth. Mr. Chairman, I would like to make three points. The reason I brought up this question of feedback is that I think it is a very important factor in determining what direction we go, and I do want to congratulate the Treasury, because I think this is the first time that I am aware that they have publicly recognized the importance of feedback.

My concern is this, that there are different estimates. It is a well-known fact that both CBO and Treasury take the very conservative point of view on feedback estimating -- as a general rule, 20 percent -- where others estimate as high as 40 percent.

That is point number one, that I think that feedback is an important consideration.

Point number two, in looking at the figures of CBO which we are basically discussing at this time, is that there has been criticism by leading economists of the CBO model.

For example, Michael Evans of Chase Econometrics has said that the CBO model, he criticized that it was too small-minded, that it tried to condense all economic relationships to four or five equations and it makes no distinctions -- this is a point that the Assistant Secretary of Treasury just made -- that the CBO model makes no distinction between the short-term and the long-term.

That brings me back to my original question, that there are different guesstimates -- if you want to call them that -- on feedback, and it seems to me, in the final analysis, that these are decisions that we are going to have to make as judgment decisions.

The final point that I would like to make, Mr. Chairman, is that the kind of tax cuts that we make directly affect feedback. If you make cuts only on the low end of the economic scale, of course you are going to affect demand, primarily demand, and that has an inflationary impact.

On the other hand, if we fashion other kinds of tax cuts, we can have more direct impact on the economy which, in turn, will create a more planned economy and create larger feedbacks.

So I think this is a very important factor that this Committee ought to keep in mind, that the kind of tax cuts that we make will have a direct impact on what direction this economy is moving, and it would be a mistake to take a sterile or static model -- and keep in mind the fact that the Treasury -- I think it was Mr. Fowler who said that Treasury is essentially concerned with revenue, how much revenue they can collect, not so much as to what the collection of the economy is.

Senator Talmadge. Senator Hansen first sought recognition.

Senator Hansen. If you would be able to provide us, I would also like to have what taxes were collected by Treasury for the years '68 through '73. If think, if I understood you correctly, you gave us the capital gains realized on the sale of qualifying properties by taxpayers for those years and, if you could provide us also with the actual Treasury receipts, that would be of interest to me.

Mr. Sunley. The Treasury receipts relating to capital gains, taxes on capital gains?

Senator Hansen. Yes.

Mr. Sunley. The table which I was reading from had both total gains and taxes paid on capital gains income on it, and I understand the table is being xeroxed now for distribution.

Senator Talmadge. Senator Moynihan?

Senator Moynihan. Mr. Chairman, I would like to make just a friendly remark about the Treasury and the CBO, if I can, in their estimates here.

As we all know at this table politics is arguing about the future. That is why it is interesting. But the people who give us advice probably should be as conservative as possible in what they say will happen. And if they think they are open about this, we are not speculating beyond what we can predictably say in a static model.

There is one point that I think we have not learned today, and we could learn something from the DRI model. It is a very powerful model. Dr. Eckstein is a very powerful economist.

I gather that you have not made any difference in your aggregate 20 percent feedback. You only estimated 20 percent feedback from capital gains, and so you do not -- there is no suggestion that there might be a different proportion, owing to this realization.

I assume that the general effect is the economic stimulus effect, but the point Mr. Sunley made about the realization is different, because it does not derive from change in Gross National Product.

Mr. Wetzler. I will check with DRI and see what they assume.

Senator Moynihan. Why do we not find out? They have put a number here. Maybe they put 40 percent and, for all we know, maybe they have just stated 20.

Is that a point?

Mr. Sunley. It is my understanding, my guess -- I may be wrong -- in the DRI simulation that the capital gains tax reduction is treated just the same as any other individual reduction, so that the feedback that we are getting is not due to increased realizations which, I say, is a separate issue which we should focus on. But this is a stimulus due to a tax cut's putting money in people's pockets, leading to increased spending in the economy.

Senator Moynihan. As against the one-time effect.

Mr. Sunley. If I may point out one other thing from the DRI table. The 20 percent figure, the $3 billion reduction on $15.6 billion is the first year feedback effect. If you look into the other columns of the table, you will see that the feedback is, in fact, 30 percent, so I think the DRI model, looking at these tables, would suggest that, in the first year, you get about 20 cents back on the dollar. Then there is the additional stimulating effects that take a couple of quarters to work itself out through the economy and also you may get 30 cents back for each dollar of tax reduction.

The point that I think still remains is that the Treasury and this Administration and previous Administrations have, in fact, taken these kinds of macro-feedback effects into account. We may have been remiss in making it clear to this Committee and other Committees how this has been done, that the budget does include, when there is a tax cut being proposed, we do estimate the impact of that tax cut on increasing ~~the level of GNP on the~~ economy and then we estimate the level of receipts that we get that was at the higher GNP level.

We say that this is the ~~level of stimulus we think we ought to have.~~ You can really look at that number in two different ways. You can take the number before feedback and say that is something like $15.6 billion or the DRI simulation, or you can say, after feedback it should be $12.6 billion.

That $3 billion difference is, in fact, in the receipts of the budget. It does show up there.

Trying to get the impact on the deficit, I do not think that we have doubled counted. We can do our arithmetic either way, as long as we are clear that if we are doing it with a feedback effect built in that the size of the tax cut we want with feedback is smaller than the tax cut we want without feedback.

Senator Hansen. Thank you, sir.

Senator Talmadge. Senator Matsunaga?

Senator Matsunaga. It seems that the table that was passed around by Senator Curtis ought to provide some basis which DRI could have used in its calculations as to what the feedback ought to be and what the net deficit as a consequence would be. You do not know, Mr. Sunley, what the basis was relative to the 20 percent feedback that DRI used?

I know that is simply that DRI in its estimates indicated that tax cuts could be expected to lead to moderately higher economic growth, lower employment and higher price levels.

I think that it would be to the advantage of this Committee to know what the basis of this was.

Mr. Sunley. Mr. Matsunaga, as I understand what this table is, the first line of the table, "U.S. Treasury Estimated Revenue Losses," are the reduction in revenues that would occur in these years at certain levels of GNP, assuming that you had the tax cut compared to not having the tax cut, holding the income levels constant.

The bottom line are the actual change in receipts from one year to the next. The actual change in receipts were also estimated by the Treasury Department-- maybe we did not always get it just right, but in those years, the Administration did estimate that receipts would go up each year. Even if you look at this year's budget, we estimated that we would have a tax cut with a fiscal year impact of $14 billion. That was the mid-session budget review. That is the fiscal year impact of the tax cut that the Administration has proposed, and we also estimated at the same time that fiscal year '79 receipts would be higher than fiscal year '78 receipts.

So, on the one hand, you are comparing, do receipts go up because of general growth in the economy? The Administration expects that they will, even if you pass the tax cut. Previous Administrations on previous tax cuts believed that receipts would tend to go up from year to year and estimated those effects.

On the other hand, we said that receipts would be lower than they would otherwise have been. One is comparing the impact of the tax cut from a trendline of receipts, what receipts would otherwise have been. The other one is comparing the change in receipts from year to year, taking the previous year as your base.

Senator Roth. If you would yield for a questionk you said "what otherwise would have been." You are not talking about the impact that the tax has. You assume that there would be the same growth.

Mr. Sunley. I am saying it is static.

Senator Roth. I do not think a lot of people understand.

Mr. Sunley. I understand. That is an important point, Mr.

Roth. These estimates in the past have always been done at certain levels of income, GNP, personal income, corporate profits. What would be the impact of changing the tax law holding those income levels constant, and we estimated that would be lower.

But, at the same time, we have estimated that receipts would grow compared to the previous year.

The two estimates are not inconsistent with each other; they are made on different bases, and I think they are both relevant.

Senator Matsunaga. Then of course, Mr. Chairman, if I may pursue what Senator Roth earlier stated, that the feedback will depend a lot on where the tax cut is, as was pointed out by Senator Roth, unless there is an area in which they will stimulate business, that is business expansion. If tax cuts will not do that, then your estimates of feedback are to be used.

On the other hand, we must remember unless we make cuts in the area of the individual spender that unless there is the demand, then there is no sense in stimulating business; business and increased investment without demand would not, in any sense, improve the economy.

These are the things that need to be discussed as we go on. Many of the economists have pointed this out.

Senator Roth. If the Senator would yield at this point, because he makes a very important point, it seems to me of critical importance in this year, as we provide tax cuts for businesses, that the House has provided -- they are very significant cuts -- in my judgment, it is equally important that they be combined with a significant, across-the-board tax cut for the individual. That, in turn, on the low end of the economic scale could help provide some of the demand that Senator Matsunaga is talking about. On the higher level, it will help provide more savings and more punch to the economy.

So I think that your point is well taken.

Senator Matsunaga. The point that I am trying to make is that unless we provide for compensation of inflation and increased Social Security taxes into the pockets of the consumer, no matter how much we try to stimulate business at the other end we will still be in trouble.

But coming back to the Treasury, the point that I was trying to make, that these are the considerations which need to be figured by the Treasury and make these forecasts with this type of tax, what feedback can we expect with the other type of tax cut, what type of feedback can we expect?

These, of course would be -- figures such as these -- would be very helpful to us in making our determination as to where the tax cuts fall.

The Chairman. The point that occurs to me out of all of this, looking at this chart, it may well be that a careful, thoughtful study -- and I would make the point, Mr. Sunley, you were not around in the Treasury in '69, were you?

Mr. Sunley. I was.

The Chairman. Were you the guy who made the decision over there that the capital gains increase not be counted? If you are the guy keeping the books, you do not have to take the blame for what the decision was.

Quite apart from all of that, it seems to me as though that we have a right that these figures be annualized on this basis. Could it be that merely moving an effective rate of capital gains taxation from 13 percent out to 15 percent, or 15.9 percent, moving that effective tax rate up three points, we might have picked up no net gain in revenue, we might have actually lost billions of dollars, tens of billions of dollars of economic activity that would have been in the nation's interest.

If that is the case, we ought to try to study some of that with that thoughtfully in mind.

I am not here to point the finger of scorn. I think I voted for every bit of it, either after it was amended, after it was put in the bill, or in the process of putting it there. If we had been in an area where our tax decisions had been counter-productive, we ought to have the honesty and the courage to try to correct it for the future.

We have covered that subject pretty well.

Why do we not let Mr. Shapiro move us in the direction that he had in mind.

Mr. Stern. Mr. Chairman, if I may mention one thing, when the Committee took up the countercyclical revenue sharing bill, we neglected to mention that you would need to file a budget waiver resolution because it is a bill that authorizes expenditures and it is being reported after May 15th of the year. So we would suggest that the Committee report out a resolution requesting a budget waiver.

The Chairman. All in favor of reporting out the waiver requested say aye?

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

The Chairman. The ayes have it.

Mr. Shapiro. I thought it would be of a help to the Committee if we took a few minutes and talked very broadly about the provisions in the House bill and put it into perspective and see where the allocations of revenues were.

The Chairman. What are you looking at?

Mr. Shapiro. The pamphlet headed, "Description of H.R. 1311 as passed by the House." This is the pamphlet. It is being distributed right now, for those of you who may not have it.

This has a short summary and a long recitation. The short summary begins on page 3, and it is only a few pages. I will just highlight some of it.

The Chairman. What page?

Mr. Shapiro. Page 3.

Senator Hansen. Page 3?

Mr. Shapiro. Page 3 of the summary.

Let me point out at the outset, however, that the House bill has four major areas. The first one is individual income tax reductions. The second one deals with tax shelter provisions. The third area includes the business tax reductions. The fourth area includes the capital gains provisions.

Those are the four main areas: individual, tax shelter, business and capital gains. On page 3 is the summary of the individual income tax areas. That particular one, the first provision is a tax reduction and extensions.--

What it provides is essentially a 6 percent widening of brackets and certain rate cuts in addition to that.

Also, previously as you know, previously we had a standard deduction. Today it is called a zero bracket amount. The reason for that, the taxpayers no longer subtract that standard deduction off their tax return. The standard deduction was put into the tax tables, and what that means, what used to be the standard deduction, the $2200 standard deduction for single returns, the first bracket for single returns, zero to $2200 is a zero tax, and that is why we now refer to that first bracket as a zero bracket. That is referred to it as ZEBRA.

For these purposes, I will refer to it as the standard deduction because it has the same effect.

Under present law, the standard deduction is $2,200 for single persons and $3,200 for married couples filing joint returns. That has been increased $100 for single returns from $2,200 to $2,300 and it has been increased $200 for joint returns, that is from $3,200 to $3,400.

Senator Curtis. Is that standard deduction for all taxpayers?

Mr. Shapiro. Those who elect to take the standard deduction. Those who do not itemize their deductions.

Senator Curtis. I see.

Mr. Shapiro. Item B in the House bill deals with the personal exemption and general tax credit. As you will recall, the present law has the temporary tax cuts that we have been referring to, and that is a credit, and every taxpayer gets to elect either to take a $35 credit per each personal exemption the taxpayer has or, alternatively, they can elect to take a credit of 2 percent on their taxable income up to $9,000.

So, as you could appreciate, a single person would elect -- if a single person has $9,000, they would elect the second alternative, which would give them a credit of $180 and a $35 credit. But someone who may have five or six dependents, however, would elect to take the personal exemption credit alternative.

This is a credit, dollar per dollar, offset against the taxes. The decision that provided the credit was made by the

Congress and this Committee in view of the fact that it was temporary, instead of making rate deductions, you decided to have a credit that could be virtually seen on the tax return and, once that credit was determined, it would just come right off the return and you would not make any other rate adjustments.

The decision has now been made, by the Administration and by the House and essentially by this Committee in its budget request -- I think it was contemplated to make that temporary credit permanent, meaning this: you can just add that to the tax cuts in view of the fact that you have the tax cut, to have some simplicity and make some adjustment. The House converted that credit into an increased personal exemption.

In other words, ~~instead of having a $750~~ personal exemption and also a credit that was temporary, the fact that the credit was made permanent, the House provided a $250 increase in the personal exemption and that would take it from $750 up to $1,000.

The effect of that is, for any taxpayer that has a $35 credit, looking at the $35 credit, they are made whole, meaning that the lowest end, in that 14 percent bracket, 14 percent of the $35 credit equals $250.

No one who is then taking the alternative of the $35 credit gets hurt by the increase. Those who are in higher brackets, of course, get a benefit. Those who use the 2 percent of the first $9,000 of that alternative do get, to some extent, a lesser benefit of this bill, because they use some of that conversion, depending on their other rate cuts.

In some of the tables, we will point that out, as to those that are tax increases and the reason for it. Looking at the $35 alternative, it nets out exactly on that $250 increase up to a $1,000 personal exemption.

The third part of the House bill, item C here, current income credit to individuals, that was a temporary provision that was provided in 1975 and extended each year. That was made permanent, so it is now a permanent earned income credit that is a 10 percent credit up to the first $4,000 of earned income and there is a phase-out between $4,000 and $8,000 so that the taxpayers who have income over $8,000 could not get the earned income credit.

In addition, the House made several minor modifications to make the earned income credit work better, more for administrative purposes. Both the tax base or the tax service --

Senator Dole. They did not change the refundability, did they?

Mr. Shapiro. No, it is still a refundable credit.

Item D in the House bill deals with certain itemized deduction provisions that the House made. The House repealed the gas tax reduction, as you know. That is part of the energy bill and the House dealt with the energy bill as well.

Item 2 --

Senator Curtis. What is the effective date of these?

Mr. Shapiro. All of the individual tax reductions are effective January 1, 1979. The itemized deduction changes are effective then, too.

Senator Hansen. Mr. Chairman, if Senator Curtis would yield, I remember -- I have forgotten what year, Mr. Shapiro, but one year I think we passed about four and a half pages of effective dates. I would hope that we did not get into that same kind of a situation again, because I had a letter from a constituent of mine in Wyoming whose husband had to have a leg amputated and, before they made the decision as to whether they should sell a ranch or try to lease it, they then referred to the present, existing law and, with the help of their accountant and lawyer they determined it would be best to sell the ranch. Obviously, they could not run it with her husband's having only one leg.

So they sold that ranch and then we changed the tax laws and changed the effective dates, and they got stuck with a $31,000 extra tax and it just about wiped that poor couple out. And I hope that we do not do that sort of thing again, so that there could be some uniformity on effective dates. I should think that it might be very helpful.

Mr. Shapiro. Senator Hansen, the bill you have reference to is the 1976 Tax Reform. What happened, the House passed the bill in 1975 and either made the provisions effective on the day that the Ways and Means Committee made the decision or made it effective on a prospective basis beginning in 1976 that was prospective from the House action. The Senate Finance Committee and the Senate did not take the bill out until 1976. The Conference did not complete action until near the end. The bill was passed October 4th.

You, in the Senate Finance Committee, went through a great many provisions that were in that House-passed bill on your own and you did not make the effective date decisions at that time that required the staff at the end to put a table together of every single provision showing you the House effective dates and looking at the budget restraints that required certain budgetary concerns. And you effectively made decisions on the sheets ~~of paper that had effective dates that~~ were incorporated later.

Then, in the conference you had the House bill effective date and the Senate bill effective dates and most of the problems that occurred because of taking retroactive dates which, if I recall correctly, the Senate dates -- at least the dates the Finance Committee enacted or prospective to the following year.

The problem is, your budgetary problems with the budgetary resolution in conference, and at the end, you had to meet within a certain level, and you adjusted dates adjusting some of the House dates because of budgetary needs, and that required some retroactive dates which, as you recall, beginning in this conference, in that case, the sick pay, for example, Section 911 and a few others -- we had to postpone the effective date because of the retroactive effect in those areas.

That, I think, was the budgetary restraints that caused many of the problems in the conference.

Senator Hansen. I appreciate that it is a complicated and difficult thing to resolve. If a change in tax law that does not affect adversely a taxpayer, I do not think we are going to have the problem. But when it turns around the other way, then I do submit that it is pretty darned unfair, particularly to older people -- and I certainly was touched deeply by this poor lady who just got wiped out.

Mr. Shapiro. I just want to briefly give the background in 1976 and give you some reasons why it occurred.

Let me point out, if my recollection is correct, there are no provisions in the House-passed bill that are retroactive -- in fact, all of them are prospective: January 1 of next year. So I do not think that that would cause any problems in this particular bill.

The only provisions that have an effective date, the capital gain, the treatment with respect to sale of residence made effective -- that is the date the Ways and Means Committee acted. There are no adverse retroactive dates in the House-passed bill.

Senator Curtis. In the conference, a decision was made to make everything that was going out of the Treasury prospective and everything that was coming in retroactive to the 1st of January, even though we were making these decisions in November and December. It was done because the Budget Committee was breathing down our necks.

Mr. Shapiro. You have a responsibility that you should raise $2 billion from the tax reform bill. The only way for that fiscal year, whihch was ending -- if you made these provisions prospective, you would not have met that budgetary limitation, so you had to pick up some of the House dates in order to meet that limitation.

I think Senator Curtis is correct that generally if it was to the benefit, it was to the benefit, it was prospective. If it would pick up revenue to meet the budgetary requirement, that you made it retroactive. Most decisions were along those lines.

Continuing on page 3, itemizing deductions, the House repealed the gas tax deduction.

In the area of political contributions, there is both a deduction and a credit. The House repealed the deduction and continued the present law credit for political contributions.

In the area of medical expenses, the House made several modifications. On balance, it could not pick up revenue. It was intended to provide some simplification to some extent.

Under present law, you get a deduction for one-half of your medical premiums, up to $150. Even a taxpayer who does not meet the 3 percent floor that is provided for medical expenses can, in any event, take $150 premium deduction.

The House repealed that.

Also in the House bill, present law provides a 1 percent floor that has to be met for medicines and drugs. The House eliminated that floor, which meant that you added the medicine and drugs to the 3 percent. You have to add all of that in. But, in doing so, the House limited it to only prescription drugs, except insulin. You could not get it on any medicine or drugs.

That resulted in that the medical expense deduction now, you can take all your medical premiums, all your medical expenses generally, including prescription drugs and insulin, and you can take a deduction for that only to the extent of the excess of your medical expenses above the 3 percent floor of your adjusted gross income.

The next item, individual, is unemployment compensation. The House bill taxes unemployment compensation to the extent that that income, plus other income, exceeds $20,000 in the case of single people and $25,000 for married couples, with a phased-in effect.

The next provision on page 4 is dealing with deferred compensation, cafeteria plans and profit-sharing plans dealing with certain problems that came out as a result of the Internal Revenue Service rulings or problems left over from ERISA or regulations that deal with deferred type compensation plans in general.

Going on to page 5, the second section of the House bill which deals with tax shelter provisions, there are two areas in that bill. The first one is extending the anti-risk provision across the board.

As you recall, in 1976, you provided a rule for adverse that deals with areas such as farming, oil and gas, motion pictures and equipment leasing. What that deals with is essentially non-recourse loans, so you would not be able to take any deductions on these activities unless you were at risk, meaning that you were personally liable.

If you have a nonrecourse loan on which the taxpayer is not personally liable, they do not get any deductions. The House bill extends that to cover all activities, not just these four that were listed in the '76 Act, but it does not apply to real estate.

In addition, the provision was expanded to cover certain closely-held corporations and more entities than are covered under the present law.

Senator Dole. We will have an opportunity to delete that later on?

Mr. Shapiro. All the provisions in the House bill are completely before this Committee for action.

The next part is the partnership provision. The concern that was raised in the House, with auditing problems in certain tax shelter areas, that some do not report and/or when they do, there is not time for the IRS audit.

The House provided penalties to the extent that if the partnership papers are not filed on time and continue the statue of limitations only with respect to partnership items when they are filed late, and to allow the Internal Revenue Service to audit these so-called tax shelter partnerships, but limited to thoe partnerships in which you file for SEC quarterly requirements legislation.

It is intended to cover the larger tax shelter partnerships.

The next category in the bill is Title III on page 5 which are the business tax reductions. The first is the corporate rate reductions.

As you know, in present law, the corporate rate has a 20 percent tax on the first $25,000 of income and a 22 percent tax rate on income between $25,000 and $50,000 and then a 48 percent tax on all corporate income above $50,000.

The House bill provided graduated rates which will provide a 17 percent rate on the first $25,000 instead of 20 percent under law, and the second $25,000, between $25,000 and $50,000, the present law has a 22 percent rate. The House bill has a 20 percent rate.

Then the House added two additional brackets. As I indicated, present law has a 48 percent rate on all income above $50,000. The House bill provides that income above $50,000 and $75,000 will be taxed at the 30 percent rate rather than 48 percent in the present law.

Corporate income between $75,000 and $100,000 which presently has a rate of 48 percent, the House bill would have a 40 percent rate and then, in all corporate income above $100,000, the House bill would have a rate of 46 percent.

The next category of the bill is category D, the investment credit modifications. As you know, the present investment credit is a 10 percent rate. That is to expire at the end of 1980. The House bill makes the 10 percent rate permanent.

In addition, there are other modifications such as the limitation on the extension of the credit. You cannot take it above $25,000 except on one-half of your income.

The House bill phases the limitation over a four-year basis. You go to a 90 percnet limitation. What this means is that you can offset the investment credit against more of the tax liability.

Also, the investment credit was expanded to study certain rehabilitation structures. Under present law, the investment credit only applies to plant and equipment and the House bill would cover structures, but only to rehabilitation expenditures and general industrial and commercial buildings.

The Chairman. Let me ask this question of the Committee. What would the Committee like to do about this?

The hour is 12:00 o'clock. There is a vote going on, a roll call vote in the Senate. Have we planned an afternoon session here this afternoon?

Mr. Stern. My thought was that you would not have---

afternoon sessions, at least for the first few days.

The Chairman. You are not planning an afternoon session?

Mr. Stern. No.

The Chairman. You were planning to explain the bill this morning?

Mr. Shapiro. Almost all of it is finished. If you want to break now, we can just pick up with the littler stuff tomorrow and start going through the individual provisions. All the staff material for that area has been distributed to the Committee members.

The Chairman. It helps to get some business done, and it also helps to vote on some things as we go along.

It helps with attendance, and it also helps to get some things done. So let me just alert the Committee that tomorrow that I would like to vote on this earned income item. I am going to suggest that the earned income should be 10 percent, up to $6,000 and then it should be phased out sharply and that that should not be available to anyone who was on welfare.

This would start out to be an idea to keep people off the welfare, not to put them on it, and if you couple the earned income with the effective jobs credit as proposed elsewhere in the bill, I would think that we could use this to move people off the welfare. It should not be used as an additional welfare item. It should be used to help move people into the mainstream, not into dependency.

If you moved it up to $600 and then phased it out much more sharply, and also make it a matter of negative withholding, I think that you have got that. That is something that I think we could vote on tomorrow.

Would that not give us a better balance in the bill than we have now, if we look at the criticism of the bill?

Mr. Shapiro. One of the concerns expressed was that not enough of the tax reductions are at the low and low-middle income levels. The earned income credit suggests that you are suggesting we put $1.8 billion into the low income level and essentially make them whole for any Social Security tax increase or inflation tax increase that would be imposed upon them.

The Chairman. Senator Dole?

Senator Dole. Maybe in addition we could take up an amendment for an extra exemption for totally disabled, which I plan to offer and, which I might add, in the Roper poll as it was explained to us, it is one additional exemption that American people accept by a 78 percent margin.

The Chairman. What would the cost of that be?

Mr. Shapiro. We have an estimate. I am not sure I have it right here, but we have made an estimate on that.

Senator Hansen. What time will we start tomorrow morning?

The Chairman. It is schedule for 10:00 o'clock.

Senator Roth. Mr. Chairman, just to enable us to plan, what do you think? We would complete going over the House bill?

The Chairman. I would think that we would continue to discuss the matter tomorrow, that it always seems to me that if we can act on one or two of these big items as we go along, it helps with attendance.

It also gives our people in the media an opportunity to at least have something to show for their time and problem of sitting in on these sessions.

Senator Roth. What I was raising, would you expect we would be offering amendments beyond those you are discussing today, those two amendments?

The Chairman. I would just think that in the area that we are going over -- as I indicated, I want to bring up this particular item. ~~We could vote on some others, too.~~

If you vote on one or two as we go along, and also explaining the bill, and then we will go back on other amendments.

The Committee stands in recess.

(Thereupon, at 12:00 noon, the Committee recessed, to reconvene at 10:00 a.m. on Friday, September 8, 1978.)

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