home pay from a tax cut is indistinguishable for the vast majority of wage earners from the additional take-home pay due to an increase in wages.)

This addition to consumer spending would increase employment and incomes, leading to further rounds of spending. Moreover, the improvement in sales expectations would have effects of its own on business expenditures. It would, in the first place, probably reverse the decline in inventory investment; second, it would also promote additional fixed investment. Together, the effects on consumer and business spending could well provide the stimulus needed for a rapid advance to full employment provided the tax cut is large enough.

I do not not agree with the view that a tax cut should be delayed until after a recession has begun. The weakness of investment in the last few years is a reflection of the slow growth of demand and the continuation of excess capacity. There is substantial danger that businessmen will come to regard a slack economy as a normal state of affairs.

Under these circumstances, our economic recoveries will become even more disappointing than they have been in the last two cycles and our rate of growth will become chronically depressed. A prompt tax cut would very quickly be translated into higher business sales and break these bearish expectations.

Since the economy is already $30 billion below potential and the prospects are that it will lose ground in the months ahead, strong medicine is needed to overcome the effect of the disappointing performance in recent years. Even if it is assumed that the tax reduction will have a substantial direct effect on business spending, a cut of at least $10 billion would be required to close the gap between actual and potential output. In arriving at this judgment, I assume that the effect of the tax cut would not be offset in whole or in part by expenditure reduction. If expenditures were reduced, the size of the tax cut needed to reach full employment would increase by more than the cut in expenditure.

I believe that what the economy needs is a permanent reduction in tax rates, because it is now clear that the present rates choke off expansions long before high employment is reached. However, consideration of a permanent change in tax rates would trigger off a national debate that could not possibly be completed in this congressional session.

Moreover, any permanent revision in the rate structure should be carefully adapted to the tax reform program scheduled for congressional consideration next year. For this reason, I would suggest the enactment of an equal percentage-point cut in individual and corporate income tax rates effective October 1 for a year or 15 months, with the understanding that these rates would be superseded by a new rate structure which would be included in next year's tax reform bill.

A reduction of one point in all individual income tax rates would cost $2 billion a year; the same reduction in the corporate rate would cost $0.5 billion. Accordingly, a 4-point reduction in the individual and corporate rates would amount to a total reduction of $10 billion at an annual rate; of this, $8 billion would go to individuals and the remaining $2 billion to corporations.