FEDERAL REVENUES AND TAX CHANGES

The current economic situation and the prospective economic developments, just reviewed, make it clear that the economy can "take" a tax increase without endangering prosperity—indeed, that a tax increase is necessary to restrain an otherwise excessive economic advance which could generate strong inflationary pressures.

Under these circumstances the tax increase would clearly yield more revenues—not less, as some have contended. It could yield less only if it threw the economy into a recession, so that the effect of the higher tax rates was more than offset by a reduction in the tax base.

There surely have been times when that could be the effect of a tax increase. The proposition that—in a weak economy—higher tax rates can produce less revenues rather than more is, of course, the counterpart of the proposition that—in such an economy—a tax reduction can increase Federal revenues by stiulating a strong economic advance.

If our economic situation today were that of 1962 and 1963—or of the 5 or 6 previous years—we should indeed again be considering a tax cut rather than a tax increase. In late 1962 and 1963, unemployment was high, utilization of plant capacity was low even though new investment was adding only very slowly to capacity, prices were under no pressure, and the prevailing business sentiment was that the weak economic expansion that had begun in early 1961 had about run its course. Under those conditions a tax cut could and did put idle resources to work and expand the revenue base dramatically.

But that is not the situation of the economy in 1967 or its outlook for 1968. We are operating at or below 4 percent unemployment and, with a tax increase, we will continue to make full use of our resources.

Under these circumstances, fiscal restraint will slow down the growth of demand, to keep it within the growth of our ability to produce. This is precisely why we want it. But it will only slow it down not turn it around.

Under today's conditions, a tax increase will yield substantially larger, not smaller, revenues. The higher tax rates will be applicable to an expanding tax base. The revenue estimates which the Secretary of the Treasury has given you take account of that prospect.

Without a tax increase, the tax base would, of course, expand even more rapidly. But the extra expansion would consist mainly of higher prices for the same volume of production. Federal revenues would rise, but the real purchasing power of those revenues would not. The extra revenues would be paid in inflated currency, its value impaired by rising prices for what the Federal Government buys.

Without a tax increase, the cruel and unequal bite of tight money and high interest rates would impose some restraint on the growth of demand and the inflation of money incomes. But the additional revenues generated by that kind of restraint would not flow to the Government. Rather, they would ffow to those who have money to lend.

We must not forget that—whenever the economy is operating at or close to full use of its productive resources—increased Government expenditures cannot fail to be paid for by a slower growth of real income in the private economy. Extra production to meet the needs of the Government must necessarily be matched by lower production to meet private needs.