

As a businessman—certainly we heard a great deal last year about the overall problems of corporate liquidity or to put it in commonplace terms, the need to have credit and to have it readily available.

When they wanted to go to the bank and borrow and their business was good they did not want to be turned down because there was not any credit available there.

The Congressional Record is full of comment about the unavailability or the tightness of credit or the excessively high interest rates that were of concern.

Similarly I think a businessman wants to think of his customers as confident. He is worried always about his market.

That raises the question, is the kind of an economy that will come about as a result of this program that is before you, both the taxing part and the expenditure control part, designed to give confidence to purchasers from business whether they be consumers or other businesses.

Then we have to think of ourselves as home buyers. You have to think of the young family that wants to borrow money and take on a mortgage and assume an obligation for 20 or 30 years to provide a home.

Now, both the availability of credit and the interest rates that would have to be paid are of great concern to that individual and that family.

Now, finally those that are elderly, who live on a fixed income, who are on relief, who are very poor, who have limited resources that are not readily expandible. They are not even taxed by and large, the great body of the elderly and the retired and the poor.

But inflation is an indirect form of taxation and therefore their interest in this tax bill it seems to me is a very positive and direct one.

Now, this is the best I can do. I am not skilled in relating to constituents why this is necessary but I think if you can get them to look at themselves as citizens in all these other capacities rather than just looking out here how much more is going to be taken out of my paycheck, that is the only way that we can bring this home to the American people as to the necessity and desirability of it.

Now of one thing I am sure, that if this tax bill is not passed and you have a situation and next year in which the economy gets out of control and gets badly overheated and interest rates go beyond the very high levels that they are now, and you have the kind of shutoff of availability of credit, for example, in housing and in small business and to the farmer whose very life blood is credit, there is going to be a great deal of question about why we did not do something in the fall of 1967 about this situation.

Mr. GILBERT. Would you think that if you increase taxes at this point you are going to be taking a great deal of money out of the hands of the consumer?

Secretary FOWLER. Taking not a great deal but some; yes.

Mr. GILBERT. Would you not think that would have an adverse effect on retail trade?

Secretary FOWLER. It will have the effect we think, and this is a matter of judgment, of keeping the steady increase in the volume of purchasing at levels that can be satisfied by the productive capacity of the economy and avoiding the price inflation that would otherwise be likely to occur if the volume of that market grew excessively.

Mr. GILBERT. I heard the testimony and I have read that the warehouses are now empty or about to be emptied. Don't you think that would put a brake on the purchasing of this merchandise for the warehouse if you were going to have this tax increase?

Mr. ACKLEY. That I covered in some detail yesterday and also in response to some questions this morning.

Certainly there was an excessive buildup of inventory last year, but a great deal of that correction is already behind us.

Certainly, as far as distributors are concerned, both retailer and wholesalers, inventories are now back in normal relationship to their sales. So that we are not concerned at this point about the danger of the excessive overhang of inventories.

Mr. GILBERT. A fellow who has a retail business is certainly concerned about it, if he is going to see a drop off in his income.

Mr. ACKLEY. As I suggested, the level of retail inventories is quite back to normal by any reasonable standard. As the retailer sells more he is now going to have to replace it by ordering more from his suppliers. All we are talking about is slowing down the otherwise potentially too rapid growth of his sales so that his growing orders to his suppliers can be accommodated out of the productive resources that we have.

Mr. GILBERT. I am sorry, I just do not follow that argument. Maybe I am a little dense.

Mr. ACKLEY. The fact is that our economy is a most productive one and its productivity—its ability to turn out goods and services—is growing all the time.

But there are limits to our ability to produce an ever-increasing stock of goods for consumers and businesses and governments. What we are concerned with is the possibility, the very dangerous possibility, that with the extra stimulus from the Federal budget the growth of demand for goods and services will push against our ability to supply them, create the inflationary pressures and high-interest rates that we have seen.

We are trying to avoid that situation. The fact is that if the Government has to take more out of the economy to supply the men in Vietnam that reduces the growth in production available for the civilian economy. You have to keep the flow of consumer purchasing power in proportion to the available supplies of goods. That is what this is about.

Mr. GILBERT. You face a breakdown in the civilian economy.

Secretary FOWLER. Congressman Gilbert, let me see if I can put it to you in this light.

In the Korean war I happened to have been concerned with the mobilization process as Director of Defense Mobilization for some time and prior to that the Defense Production Administration. I was also with the War Production Board in World War II.

Now, in those periods, we to some extent relied upon monetary and fiscal policy but at that time we relied primarily upon the imposition of direct controls on the economy which took the form of allocations and priorities and indeed consumer rationing in World War II and direct wage controls, direct price controls and credit controls. You could not borrow money for this or that, or you were limited directly in the use of credit.

In the Korean war we did not have actual rationing but we had pretty substantial use of those same instruments. Now in this particular situation we are trying to do without them.

The retailer that you are speaking of, if he is old enough to remember the situation in World War II and the Korean war, the real question for him is whether he wants the economy stabilized during this period by a combination of fiscal and monetary policy or whether he is willing to take his chances on either inflation, roaring inflation, or a return to some kind of control mechanism.

We believe by and large the alternatives of the using of the fiscal and monetary policies is the one that is best for the American economy and that the American people will prefer it, particularly those whose memories are long enough to remember those other periods.

Mr. GILBERT. It is not because of any shortage of goods that you are trying to prevent the producing of more goods, is that right?

Secretary FOWLER. We are trying to keep employment and the use of plant and the creation of additional plant in some kind of reasonable relationship with the demand through these fiscal and monetary measures.

Mr. GILBERT. I have no further questions.

The CHAIRMAN. Mr. Betts.

Mr. BETTS. I do not have any questions but I did want to make a couple of comments. Maybe I will be laboring the point.

The concern I have here is that I just don't find anything I can really come to grips with.

I notice you use the words "expenditure control." I would be much more comforted if you used the words "significant expenditure reduction."

Secretary FOWLER. Could I give an example of the two.

I think with the pay raise I am talking about expenditure control. In cutting out some of the items in the budget that Mr. Schultze is talking about that is expenditure reduction. One is controlling an increase to a moderate pace, 4½ percent rather than 8 percent, and the other is an actual elimination of an activity.

Mr. BETTS. What I am getting at is that it just seems to me if this war in Vietnam is serious enough to warrant a 10-percent surtax on the American people, it is really serious enough to cut where it hurts. As Mr. Curtis said, "go after some of the sacred cows."

For example, I hear general statements about these expenditure cuts but nothing that seems to be bold enough to really excite me. For instance, I am advised there is \$10 billion unexpended in the foreign aid account.

Secretary FOWLER. How much?

Mr. BETTS. \$10 billion.

Mr. SCHULTZE. That sounds high. I will have a number in a moment.

Mr. BETTS. In the pipeline. I may be off a few billion dollars.

Mr. SCHULTZE. There are substantial amounts primarily. We have to distinguish on this between moneys which have been made available by the Congress and not obligated or contracts let—that is relatively small—and moneys which have been made available by the Congress and contracts let and goods under order. The latter is the big part of the unexpended balance.

Mr. BETTS. That does not impress me. I will tell you why.

I understand that when Secretary Rusk was before the Appropriations Subcommittee he said that these funds could be shifted and changed by the Department to other purposes than originally intended.

If there is \$10 billion accumulated it seems to me we could easily suspend foreign aid for 1, 2, or 3 years and use the money that is in the pipeline.

Mr. SCHULTZE. Again, after the moneys have been appropriated by the Congress but before contracts are let they can be shifted around.

Of course, once you sign contracts and make commitments, then you can't shift them around. Now the total amount you are talking about, the amount in AID for economic assistance, which was available but not contracted for, was \$800 million.

Mr. BETTS. Could these be the same kind of contracts you were talking to Mr. Curtis about this morning that could be terminated?

Mr. SCHULTZE. I must confess I am not familiar with the particular penalty clauses. I am sure there are probably legal means to terminate them.

Mr. BETTS. Coming from an agricultural area and at a time when we are talking about shortage of food supplies it just seems to me that all the worn out agricultural programs could be phased out. I am just throwing that out. It is a tremendously important area. It would not hurt to explore it.

I am not convinced that we have to have a \$5 billion space program appropriation. It seems to me if we are at war certainly that can be cut down at least \$2 billion.

Mr. SCHULTZE. In my statement and in later questioning I did indicate that in terms of expenditure reductions or deferring worthwhile projects until later, just not going ahead with them now, we are aiming to reduce by \$2 billion or more.

That is going to mean, and it is bound to mean, that there are a number of areas or desirable programs we are simply going to have to cut back.

In that sense I agree with you. That is the whole point. We are not anxious to do this any more than we are anxious to raise taxes. This is painful but we are going to do it.

Mr. BETTS. That is encouraging.

It seems to me it should be done. It would be impressive to me if you said you were recommending a \$2 billion cut in the space program, were recommending a phaseout of the agricultural programs, and were going to suspend the foreign aid program for 2 or 3 years.

A constituent of mine called me this morning about a Headstart program. He told me that out of \$138,000 that had been allotted to this particular Headstart program, \$75,000 was for administrative purposes in a local office and the teachers were paid \$560 a month for four and a half hours a day teaching.

I am not blaming you, Mr. Ackley, or the Secretary of the Treasury but I am just throwing that out as an example of some of the areas that are just right for cutting and cutting where it hurts because it is important.

Until somebody shows me where we are going to cut, and specifically how much we are going to cut, I am not going to be impressed with a general statement we are going to try to cut \$2 billion.

We on this side have been talking about that for a long time and have been outvoted. It looks like this is the day of reckoning.

Mr. SCHULTZE. May I make two points.

First, you will recall that last year we indicated we were going to cut, defer, delay, and postpone expenditures. I did come back to this committee—and it is incorporated in the record of the debt limit hearings in January—with about a 20-page list specifically showing item by item what we had done.

We are going to cut. But in order to get started, rather than proposing appropriation amendments and rescissions in the midst of an appropriation process, which is well along, and keeping Congress here for another 6 months, we have decided to take the appropriation bills as they come through in final form and cut from there.

Hopefully the Congress will cut some also. But then, between what the Congress cuts and what we can get at later, we will take this money out. As the appropriations come up item by item—we have set up specific machinery to do it and they are now being reviewed—all the appropriations that have come through are being reviewed for targets the agencies have to cut to.

Mr. BETTS. I wish it had been started last January when the tax cut came up.

Now we are in a jam over this salary increase of Government employees. The message came from the President recommending a salary increase.

Mr. SCHULTZE. Yes, sir; we are still recommending it.

Mr. BETTS. When these recommendations are made, pressures build up and things get out of control.

Mr. SCHULTZE. Again, Mr. Betts, I realize we disagree on some of this but we are trying to walk a middle ground. It is necessary to keep, hold and maintain Federal employees who do their jobs well. We can't let them fall behind. So we did send up a pay increase and that pay increase was a 4½-percent increase.

What we are now asking is for the Congress not to go beyond that. We are trying to walk a middle line here and be responsible in terms of attracting Federal employees who do a good job, and it is necessary to pay them an appropriate amount.

On the other hand, we do not want to see the Congress add to the proposal. The bill now being considered in the Post Office and Civil Service Committee would go well beyond that proposal.

Mr. BETTS. I understand. I commend you for the position you have taken up until now. I think we should have been aware of the risk we run when we try to take the middle ground. It would have been better to send up a message recommending 2 percent.

Mr. SCHULTZE. I am beginning to think, Mr. Betts, you may be right.

For a number of years the pay proposals caused a hassle between the executive and the Congress every year. So, we decided to go on the principle of comparability.

Now we have not achieved that. We are trying to achieve it. In a way you are right. What happens is that we send up a pay message which is based on that principle and then we argue from there on up. So maybe you have a point.

Mr. BETTS. It just seems to me that if this is serious, and you say it is, then this is the time to have a get tough policy on expenditure reduction. I see no indication of that in your presentation.

The CHAIRMAN. Mr. Vanik.

Mr. VANIK. Mr. Chairman, I see that Secretary Fowler has had to leave for another appointment, so I shall propound my questions to Assistant Secretary Surrey.

The CHAIRMAN. Very well.

Mr. VANIK. Mr. Chairman, I consider tax justice one of the hallmarks of good civilization. I think that there is a definite relationship between the underdeveloped countries of the world and those that have a more equitable tax structure.

The people of my district will rebel at any kind of tax increase, but they will rebel more about things that throw them out of line. They complain about cases they read where people with large amounts of income escape taxation.

In your opinion, does the surcharge tax method have any effect upon our search for tax equity?

Mr. SURREY. It has this effect. If one is looking for a method of increasing taxes on a temporary basis, that is as fair and equitable as possible considering the existing structure, then the surcharge method accomplishes that result.

That was the finding of the Subcommittee on Fiscal Policy of the Joint Economic Committee. If, on the other hand, you ask, does the surcharge method in and of itself do anything to cure what some people will call defects, depending on one's particular point of view, then the answer would have to be no.

On the other hand, as the Secretary indicated in his statement, the matter of structural defects in the law which should be corrected on a permanent basis, corrected for all time, is something that he thought certainly should be dealt with and indicated the President was sending a message up to that subject later in the session. The Secretary indicated that the subject matter was so different that the two should be dealt with at different times.

Mr. VANIK. If we adopt the surtax, does this expand or contract the advantage of income tax deduction or exemption to those who enjoy these privileges? Does it widen the gap?

Mr. SURREY. I think it about leaves the system essentially where it is today.

Mr. VANIK. Those people with exempt income or with good deductions are better off and the rest of the people are paying more. Is that logical?

Mr. SURREY. To the extent that the tax rates have been slightly increased it would do that.

Mr. VANIK. I would like to ask if it is possible to determine how much personal income in dollars avoids taxation through the exempt income route? Do you have any idea on that?

Mr. SURREY. I think we would have to submit it for the record.

Mr. VANIK. Break it down any way you like.

Mr. SURREY. I think we would have to submit it for the record. By exempt income, I gather you are not talking about that amount which is relieved of tax because of personal exemptions or matters of that nature.

Mr. VANIK. I think if the figures were available, it would be helpful in all categories—those people who are exempt because of low income and those who are exempt because they have a special kind of income. Also give us some idea as to the amount of exemption related to the kind of income.

I might add that I hope that would include the foreign tax credit and some other types of investment that are made which give people special benefit. I would like to also ask, does your office have any figures as to the total amount of income that avoids taxation because of the exemption on State and local bonds? Do you have that figure?

Mr. SURREY. Yes, we will put that figure in the record.

(The following information was received by the committee:)

Billions

Assuming no change in realization of gains the additional revenue from:	
Changing the holding period for a long-term capital gain from 6 months to a year would be.....	\$0.4
Eliminating the preferential rates on capital gains would be.....	5.0
Assuming no change in level of mining activities or other industry changes removing percentage depletion would increase revenues by.....	1.5

Millions

Amount of tax exempt interest reported by corporations in 1963.....	1,456
Amount of Western Hemisphere trade deductions reported by corporations in 1963.....	250

INTEREST ON STATE AND LOCAL GOVERNMENT BONDS, 1962

Money income class	Number of consumer units Dec. 1962 (millions)	Percentage of consumer units with tax-exempt interest	Average tax-exempt interest ¹	Percentage of tax-exempt interest received by each income group
0 to \$3,000 ²	16.3	(³)	\$1	4
\$3,000 to \$5,000.....	11.4	(³)	(³)	(³)
\$5,000 to \$7,500.....	12.2	(³)	(³)	1
\$7,500 to \$10,000.....	9.0	1	4	8
\$10,000 to \$15,000.....	6.2	(³)	1	1
\$15,000 to \$25,000.....	2.0	2	16	7
\$25,000 to \$50,000.....	.5	6	129	15
\$50,000 to \$100,000.....	.2	22	1,185	42
\$100,000 and over ⁴	(³)	66	2,356	22
Total.....	57.9	(³)	8	100

¹ Average is for all consumer units in the income class, including those with no tax-exempt interest.

² Includes units with deficits.

³ Less than 50,000 or 0.5 percent or 50 cents.

⁴ There were 27,174 tax returns in 1962 with adjusted gross incomes over \$100,000.

Source: Federal Reserve Board, unpublished data from consumer survey.

Detailed breakdown of certain items included in personal income but not in adjusted gross income¹

	<i>Billions</i>
2(d) Other types of income included in personal income but not in adjusted gross income-----	\$14.1
(1) Inventory valuation adjustment, non-farm, non-corporate business-----	.4
(2) Change in farm inventories in excess of tax return data-----	.9
(3) Tax-exempt military pay and allowances-----	2.3
(4) Excess of interest accrued over interest paid on United States savings bonds-----	.6
(5) Tax-exempt interest income-----	.6
(6) Property income received by fiduciaries, but not distributed to beneficiaries-----	2.6
(7) Property income received by nonprofit institutions-----	1.4
(8) Excluded sick pay-----	.4
(9) Excluded dividends-----	.9
(10) Excluded business expenses-----	2.6
(11) Excluded moving expenses-----	.1
(12) Excluded contributions to retirement plans by self-employed-----	0
(13) Bad debt adjustment-----	.8
(14) Depletion and oil well drilling adjustment-----	.2
(15) Gain on sale of livestock, timber and real estate-----	1.1

¹ Source: Unpublished data from the Office of Business Economics, Department of Commerce. Includes all components of personal income not in adjusted gross income except transfer payments, other labor income, and imputed income.

Derivation of the individual income tax base from Department of Commerce estimates of personal income, 1965¹

	<i>Billions</i>
1. Personal income-----	\$535.1
2. Portion of personal income not included in adjusted gross income-----	100.1
(a) Transfer payments (except military retirement pay)-----	38.3
(b) Other labor income (except director's fees)-----	18.2
(c) Imputed income ² -----	29.5
(d) Other types of personal income ³ -----	14.1
3. Portion of adjusted gross income not included in personal income-----	31.3
(a) Employee and self-employed contributions for social insurance ⁴ -----	13.2
(b) Net gain from sale of capital assets-----	10.0
(c) Other types of income ⁵ -----	8.1
4. Total adjustments for conceptual differences (2)-(3)-----	68.8
5. Estimated adjusted gross income of taxable and nontaxable individuals-----	466.3
6. Deduct: Non-taxable and non-reported adjusted gross income-----	57.0
7. Equals: Adjusted gross income of taxable individuals-----	409.3
8. Deduct: Deductions of taxable individuals-----	63.1
(a) Standard deductions-----	15.7
(b) Itemized deductions-----	47.4

Footnotes at end of table, p. 197.

Derivation of the individual income tax base from Department of Commerce estimates of personal income, 1965¹—Continued

	<i>Billions</i>
9. Equals: Net income of taxable individuals.....	\$346.2
10. Deduct: Personal exemptions of taxable individuals.....	91.9
11. Equals: Taxable income of individuals.....	254.3

Source: United States Department of Commerce, Office of Business Economics and United States Treasury Department.

¹ Items (1) through (5) were obtained from the Office of Business Economics, Department of Commerce, based on 1966 personal income estimates. A table incorporating 1967 revisions of the personal income estimates is expected to be published in the near future. Items (7) through (11) will appear in the Internal Revenue Service publication, Statistics of Income, 1965, Individual Income Tax Returns.

² Noncash items such as imputed interest and rental value of owner-occupied homes.

³ Includes inventory items, interest accruals on United States savings bonds, interest on State and local obligations, depletions allowances, income of tax-exempt organizations, income retained by fiduciaries, tax-exempt military pay and allowances, as well as allowable exclusions for sick pay, dividends, business and moving expenses, etc.

⁴ Employee contributions for social security, railroad retirement, Government pensions, etc.

⁵ Includes taxable pensions and annuities, net operating loss deduction and miscellaneous sources of income.

Mr. VANIK. Are your records in such a condition that you can tell us, for example, how many people hold a hundred thousand dollars of such bonds, how many would hold \$10,000 or less, how many would hold \$500,000 of such bonds or over a million dollars?

Mr. SURREY. I don't think our records would show that because the holding of tax-exempt bonds is not reported on tax returns. We would make estimates based upon whatever other general information we have and we could have a figure on the overall amount of interest that is involved and its impact on the tax system.

Mr. VANIK. Then today you would not be able to tell us whether any taxpayers or how many taxpayers would compare to the case of the Dodge widow who had \$5 million of annual income tax free? You could not tell us anything about that?

Mr. SURREY. We could not tell you with that precision; no. We will try to see if we have anything on that based on State income tax returns. We will check on that.

Mr. VANIK. Is there not some way that your office should be looking into these areas? I can see the special reasons for having tax-exempt bonds. I am not questioning that. But perhaps we have come to a time when we ought to put a ceiling limit on the amount of such tax-free income that any one individual taxpayer can have. Otherwise, it puts that taxpayer in a completely special class.

I think if we are going to sell our people on a tax increase, and I believe we must, we have to show that we are making some reasonable effort to develop a greater degree of justice in our tax system. If some people can make \$5 or \$10 million a year and pay not a penny in taxes, certainly something is wrong and ought to be corrected before we enact any new taxes on our people.

Mr. SURREY. The Secretary went into that point.

Mr. VANIK. I don't recall he went into this point.

Mr. SURREY. I think he did. He basically agreed with the need for tax reform. He said tax reforms is a job that very much needs to be done.

Mr. VANIK. I heard that. Yes; he said that.

Mr. SURREY. That is the same thing.

Mr. VANIK. You see, at this very moment we are talking about a tax bill and the people of America have a tax consciousness right now that has never been more acute. They are paying more in local taxes, they are paying higher sales taxes. Now we are coming with a prospective surtax, and they are alarmed. They are at this moment concerned not with a promise about some reform but about some achievement.

I think we ought to be taking steps in this direction in order to meet this argument, in order to sell, in order to make it possible for the taxpayers to accept the surcharge at this time.

Mr. SURREY. I think the Secretary in effect really did indicate very strongly in his statement that the President will be sending a message proposing comprehensive tax reform later in this session. That is the first step.

I would assume the second step is in his words, "I hope your committee will be giving its consideration to the President's reform recommendations in the months ahead."

Mr. VANIK. I have been awaiting some of these reforms since I came to Congress some 13 years ago. We have been a long time getting around to it. I feel that this is an appropriate time.

Certainly I think before we can act intelligently upon the surcharge issue we ought to have some concern about the untaxed income of America. It relates to this problem.

The President said if you have another or better method, think it up, produce it. I think we ought to try to meet that challenge. We can't do it without the cooperation of your office giving us these figures, which I think are essential in our determination.

As I take it, you will provide an estimate of the aggregate amount of tax-exempt income through tax-free bonds and you will endeavor to in some way or another indicate how they are held from whatever sources you have.

It seems to me that it would be almost appropriate to add on the tax return a line for "any other income which you believe not subject to tax." This would be a great relief to many taxpayers who have income they may not be sure about. It seems to me that would serve a very useful purpose.

If a taxpayer reported this, it might clear the doubts in his own mind and at the same time provide your office with very valuable information concerning the extent and the amount of untaxed income in America.

There may be other areas of taxation that you do not know about and that your office has not awareness of. I think maybe we ought to have some way of characterizing and tracking down these areas of untaxed income if your office will do that.

While you are at it, I would appreciate the record providing the amount of money that might be raised in taxes, the revenue gain, if we were to make capital gains a 1-year capital gains period instead of 6 months. There is a lot of reason to consider that.

I think we might also have some estimate by your office as to what such a capital gains tax might produce by way of added revenue plus some idea as to what might be gained or what is lost through the various depletion allowances or investments abroad. I think to round out the package we might also have in the record the amount of revenue we lose on the stock option device. I think it is terribly unfair to permit some taxpayers to pay taxes on their compensation at capital gains rates instead of ordinary rates like all the rest of us. I think if these things were in the record, it might pave the way and provide us with information that we ought to have in connection with this bill and with the proposal for tax reform which the President says you are working on.

Mr. SURREY. We will put these in the record to the best of our ability. (See p. 195.)

Mr. VANIK. Thank you very much.

The CHAIRMAN. Mr. Broyhill.

Mr. BROYHILL. First of all I would like to direct a parliamentary inquiry to the Chair.

In view of the fact that our opposition has proposed a surcharge, a lot of Members of the Congress are going to be retired by their constituents if they vote for this bill. My question is, Mr. Chairman, would an amendment be germane that would permit liberalization of the congressional retirement system?

The CHAIRMAN. The gentleman has stated a parliamentary inquiry, but would he permit the Chair to take this under advisement and not rule on it right now?

Mr. BROYHILL. Mr. Schultze, it seems like the Federal employees have been the whipping boy here on cutting expenditures. I will admit that I am somewhat prejudiced insofar as their welfare is concerned.

I think this is representative government. But I am wondering if we can in the final analysis actually economize as much as we think we are economizing in that particular area by not providing salary increases comparable to some of the positions in private industry.

I know that there is an increase in the cost of Government employment, but I don't think we can avoid it. I think the mere fact that we have the increase in the cost of living, that we have expanded the Government services and increased the number of employees, that within itself is causing an increased cost. I don't see how we can possibly economize by refusing to pay our employees what similar people in private industry are receiving. I don't think any business or industry could do that.

We hear that every time a proposal comes up for an increase in pay of Federal employees, a half billion dollars, billion dollars, or \$2 billion, yet we could not avoid the increase. We may have postponed it for 6 months. We may have changed the percentage one or two points. But the reason why we have to have the pay increase is because of the increase in cost of living, not because it may be politically expedient to put through a pay increase.

Mr. SCHULTZE. Mr. Broyhill, as you know, what we have done this year—by we, I mean the administration—is to submit a pay bill which, on a scheduled basis over 3 years, brings Federal employees up to so-called comparability, based on the BLS surveys of what private industry workers in equivalent occupations, and so forth, are earning.

Now, this is an attempt to balance the considerations that you indicated, which are certainly real considerations. As I indicated to Mr. Betts, we have to take those into account—to balance pay considerations on the one hand, with our fiscal requirements and fiscal needs, on the other. This is why we submitted, and I realize there is a controversy over it, what we thought was a fair and reasonable increase with a specific point in the bill relating to the next 2 years so that over the 3-year period we would get to the comparability standard of the Salary Reform Act.

What we are asking the Congress is to stay with that recommendation in view of the fiscal problems which are facing us. It seems to me this is a responsible and reasonable course to pursue. In view of the fact that we are coming up here to ask the American taxpayer for additional taxes, at the same time we have come forward with a reasonable but not excessive pay increase.

Mr. BROYHILL. I believe that we can save a great deal more money by a little better management control of the personnel structure and making certain that there is adequate work for the employees. Then we can effect the economies that we are talking about.

Mr. SCHULTZE. Mr. Broyhill, in a Federal Government with 2.9, almost 3 million, employees, far be it from me to say that in every part of the Government that we have effective personnel management. Obviously we don't.

At the same time we can point to impressive accomplishments in department after department in terms of productivity, in terms of getting more work out of the same number of employees, or in terms of workloads increasing faster than the number of employees.

We are at great pains, and I can't say always successfully, in case after case to do this. For example, to take one which is close to home, the Bureau of Accounts in the Treasury has a record of productivity increases which can't be matched, I think, by private business going.

The Veterans' Administration Life Insurance Office, the Social Security Administration, I can go right down the line. We obviously can have a lot more improvement. I am sure you can point to cases where we have a lot to do.

Mr. BROYHILL. I would like to pass on what employees have told me over the period of the last 15 years.

Now the three-step proposal, would that in your opinion bring the Federal employee up to comparability?

Mr. SCHULTZE. It is calculated to do that, yes, sir.

Mr. BROYHILL. Are you stating that they are not up to comparability at this point and that the 4½ percent this year—

Mr. SCHULTZE. Primarily in the upper grades. If you look at the lower grades—I must admit it is very disturbing to me, disturbing although understandable—the fact that it is the upper grades that the gap between private pay and Federal pay is the largest, but all the pressure for the increases, as you know, Mr. Broyhill, comes at the lower grades. I don't think before this committee I need to go into that too much further, but it is a disturbing fact.

Nevertheless, you are correct that particularly in the grades above 7, 9, and 11, there is a gap, but we have a proposal and we have submitted that to Congress to close that gap. We have closed it a good bit in the last 4 years, but still some remains.

Mr. BROYHILL. I agree over a period of years on a couple of occasions we did decompress it somewhat but that was politically unpopular because we were granting an increase to the higher grades. I don't think I am a hostile member, as far as you folks are concerned and as far as this proposed tax increase is concerned. I have said on many previous occasions that I don't see how we can stand a \$28 to \$30 billion deficit. We have just got to do something about it. I thought the Secretary of Treasury made a very fine statement and the four points he made as to why we could not afford a \$28 to \$29 billion deficit were very sound.

I think he can add a fifth point, and that is fairness to future generations. Why should we pass on the cost of our problems today to them? But I have been somewhat alarmed, frankly, by the response of my constituents. I have received more letters, and this is only part of them, in opposition to the proposal than I believe on any other matter in my 15 years in Congress. It is spontaneous.

I directed the parliamentary inquiry at the chairman, facetiously, of course, due to the fact that we are getting some resistance from the people we represent.

Here is an excerpt from one of these letters which emphasizes what I was directing at the chairman:

DEAR MR. BROYHILL: I am glad to oppose the President's tax surcharge. I would resent paying an increased tax necessitated by an irresponsible President and irresolute Congress. While I feel that your own record is a good one, I quite frankly don't feel that I can give my support or vote to any Member of Congress who passes this tax legislation. As I understand, Congress is designed to reflect the will of the majority of the citizens. I hope it won't be necessary to elect an entirely new Congress to accomplish this.

Here is another letter signed by five different people with five different addresses. They are all in the same neighborhood. No, there are a couple in Alexandria.

We are very much opposed to the proposed tax rise. As of now we are scarcely making ends meet. Most of us work a five-day week, some of us work a six-day week. We have no extra money to rob Peter to pay Paul.

To us it is feasible to arrange for recipients of welfare checks to earn their keep. This would also tend to relieve the taxpayer. There is no excuse for the able-bodied man or woman to live off the income of others. This would serve a two-fold purpose. People who work eight hours day or night are too tired to go out looking for trouble.

These letters run right along in that line. I find that the opposition to a tax increase is not the lack of regard for the inflation problem, Mr. Surrey, and the other points that the Secretary made earlier, although that particular aspect is difficult to explain to a lot of people. They are not indifferent to fiscal responsibility.

Their resentment all through these letters is toward needless programs, what they consider are needless programs and wasteful programs.

The Secretary pointed out that there was going to be a \$7½ billion cut in expenditures along with the \$7½-billion surcharge, and this was most encouraging. But I might add the explanation Mr. Schultze has given has not been completely acceptable to members of the committee. We cannot quite gather from what you have stated, Mr. Schultze, that this does result in a direct cut in the spending that these people are talking about. They can't see that these cuts are actually being made.

There is nothing that you have stated so far that covers the area that President Johnson is talking about. When he went on television and talked about riots, he made a very fine statement for the first 5 or 10 minutes that riots should not be tolerated. But then he turned around and vented his spleen at Congress for not voting more of the programs.

Now he was, in effect, saying that Congress was not spending enough money or appropriating enough money or was not liberal enough in enacting some of these programs that would curb the riots. These are the programs that my people are talking about, programs that are being conducted over here in Washington right now, ones where they employ former convicts and agitators, people who go out and harass the police, giving them positions of great responsibility and high pay. These are things that people resent.

I believe if you come forth with items where you would be making cuts in those areas, and I realize when you say \$20 billion in an area where cuts could be made, I don't think we have to cut \$7½ billion, I think the mere fact that we were cutting back and not rewarding these people for not going to work, I think this would gain the support of the people we represent.

Mr. SCHULTZE. Could I make several points with respect to that?

First, you are quite right, you can't take \$21 billion and take \$7½ out of that. I have said before, in terms of a specific number, that we are aiming to get \$2 billion out of that.

Point No. 2, of course you are aware that this committee itself has been looking at the whole welfare system, and one of the items as I understand it—I am not fully familiar with the committee's bill, but I believe there is a major emphasis on work and training for welfare cases which I think is really the direction in which to go.

Third, and I am sure we will disagree to some extent on the emphasis here, but it seems to me in terms of riots and in terms of the problems in our cities one has to take an approach, as the President has done, which is a blend, on the one hand, of firmness and, on the other hand, realizing that there are some serious problems to which we must give attention.

I think what we are facing now is a very difficult problem of balancing out our fiscal requirements on the one hand, and thereby the need for expenditure cuts, with a careful attempt on our part to place those cuts in the lower priority programs. You and I may disagree on what some of those lower priority programs are. But our aim here is to balance off, on the one hand, what we want to do in terms of the problems that the American people are faced with, the specific problems in the cities, and, on the other hand, the inflation problem that we are faced with.

It is a difficult thing to do, but we are going to do it.

Finally, it seems to me with respect to the particular program you are referring to in the District of Columbia, it is not my bailiwick, but I think one has to think about the fact it is a lot better to have people doing constructive work in a situation where they can do constructive work than to have them footloose and creating more trouble.

Mr. BROYHILL. There is no question along that line. I think the reason for that, Mr. Schultze, is that here is possible the primary difference in the philosophy. That is the Republicans are not as com-

passionate or not as tolerant or as concerned about the welfare of the poor or downtrodden as the members of the other party.

Mr. CONABLE. Will the gentleman yield? That is his own interpretation of the Republican's position.

Mr. BROYHILL. That is not my interpretation. That is what is charged by the other side. But it is not the real difference between the two parties. Our differences are on the question of fiscal responsibility, what is the role of the Federal Government in trying to solve these problems. I think it is important that we try to bring up these matters when we discuss the tax increase that the American people are objecting to. I am getting letters also, I will admit, urging increases in some of these programs. I think we need more help from the President and the administration in proposing cuts in some of these programs. They should let the American people themselves know that there is a great deal of waste going on in them. I just received the other day a report from the Alexandria Chamber of Commerce on a survey of their members.

The first 32 employers, members of the chamber, who returned the questionnaire reported they had over 240 jobs available in the city of Alexandria. Twenty-five of them were in the city of Alexandria government itself. Twenty in the Virginia Electric & Power Co. These people were complaining because they could not get people to fill the jobs.

When I made that announcement yesterday on the floor of the House we got some calls from the Office of Economic Opportunity saying the jobs were in Alexandria and the people in Washington can't get over to the suburbs to fill the jobs. I have asked the board of trade for the same type of survey because we know there are jobs in Washington that are going begging. My question at that point, Mr. Ackley, is if we could get more attention directed to the jobs and get the people who are now living on Federal welfare to take these jobs, not only would it reduce the cost of the welfare program and poverty program, but would it also not increase the gross national product?

Mr. ACKLEY. There is no question about that, Mr. Broyhill. As the President has frequently expressed it, our responsibility ought to be to get the people who are taxeaters into the category of taxpayers.

A whole range of programs has, of course, been developed to try to train people and to get them ready to fill productive jobs. The problem is not entirely that of training. Obviously there are some problems of motivation as well. Some people just don't want to work. Certainly your objective and mine would not differ at all in terms of the desirability, from an economic standpoint, social standpoint, and every other, of trying to get people who are not working on the job wherever they are capable of doing it. There certainly are many people who simply don't have the requisite skills to fill the jobs that are open.

The whole business of trying to measure the total number of job vacancies is a very difficult one and the Department of Labor has been struggling with it for a long time. I think there is the prospect if adequate budgetary funds were made available for a comprehensive continuing survey of job vacancies it would be useful not only in terms of the placement activities of the Bureau of Employment Security but also as a measure of the pressures on the economy. We would support very much an improvement of our job vacancy data.

Mr. BROYHILL. I do believe that if we could have more evidence of the fact that the administration does intend to make cuts in many areas that we have discussed it would be a lot easier for some of us who would like to support this bill to support it and not have to allow for any liberalization of the congressional retirement system.

Now, I have one more question.

Mr. SURREY, do you know offhand or does any member of your staff know offhand whether the SNCC organization, is a tax exempt organization or tax exempt foundation?

Mr. SURREY. I do not know offhand. I would have to check that.

Mr. BROYHILL. The reason I asked the question is that there was an article in the Washington Post this morning written by Mr. Jack Nelson of the Los Angeles Times which reported that a two-page article in the latest bimonthly publication, of the SNCC organization on the Palestine problem was a condemnation of the U.S. policy. "The article accused the U.S. Government of working with Zionist groups 'to support Israel so that America may have a toehold in that strategic Middle East location, thereby helping white America to control and exploit the rich oil deposits of the Arab nations.' " The article included photographs of alleged atrocities against Arabs back in 1956 as well as the recent uprising or conflict. It was just a general article in condemnation of American policy and the country of Israel.

The program director of the Students Non-violent Coordinating Committee acknowledged that the source of some of this material was Arab embassies. I think this is a serious situation because if the organization is disseminating foreign propaganda certainly it should be required to register under the Foreign Aid Registration Act, and certainly it should not be receiving contributions which would be considered tax deductible. I would appreciate if you would find out whether they are receiving it and whether in view of this action they should continue to receive it under present law.

Mr. SURREY. I will check into that, Mr. Broyhill. (See p. 210.)

The CHAIRMAN. Mr. Conable.

Mr. CONABLE. Mr. Chairman, you have been very patient. I will be perfectly happy—

The CHAIRMAN. Let me say to you, you have been very patient.

Mr. CONABLE. I will be perfectly happy to have my questions answered for the record if the question of time is such that it should be that way.

My first question is to Dr. Ackley. Somebody told me once, I don't know who he was, but presumably he was wiser than I am, that a corporate income tax is in effect one of the hidden taxes, to a substantial extent particularly in time of cost pressure. An increased cost of doing business is implicit in an increased corporate tax. In such a situation the corporate income tax is probably passed on to the consumer. Has there been any analysis in the light of the present economic situation as to what extent the 10-percent corporate surtax will simply wind up as additional tax against the individual citizen of America, adding to the impact of the individual income tax surtax?

Mr. ACKLEY. This is a question on which economists have been long divided and on which it is extremely difficult to get evidence. There are theories of taxation which do imply that at least in the long run some part of the corporate income tax is shifted forward in the form

of prices. Attempts to measure this or to determine it have been on the whole, I guess, inconclusive. I think most tax theorists, and perhaps Secretary Surrey could comment on this, will agree that in the short run very little of the corporate income tax is shifted forward.

Mr. CONABLE. Is it not more likely to be shifted if it is a general tax than it might be if it were as a result of a tax reform, such thing as the 7-percent investment tax credit, which has an unequal impact on corporations in competition with each other, depending on their capital structure?

Again, income tax, surtax, for corporations is one that afflicts all businesses alike. May I ask what percentage of the business of this country is done by corporations? Are there any statistics available in this respect? Certainly that has some impact on the extent to which this corporate surtax is passed on?

Mr. ACKLEY. I am sure there are such statistics. I am not sure I can give them to you by memory. It certainly is a very large fraction of the business, certainly in manufacturing. Much less so in services and agriculture and so on. But we can furnish for the record the percentage in each of the main areas.

Mr. CONABLE. I am concerned about this because part of the testimony we have had here has been that the inflation under which the country has been suffering in recent years has been at least in substantial part due to a cost squeeze and not necessarily to an overabundance of money. If we are in a period of reduced margins, and the first quarter's corporate returns indicate that, then it makes it all the more likely that the corporate surtax is going to be passed on to the individual, does it not?

Mr. ACKLEY. Again I think I would insist that in the short run, there is very little evidence that an increase in the corporate income tax, particularly a temporary increase, would in fact directly raise prices.

Mr. CONABLE. Any statistics you can give on that I would appreciate. I am interested in the economics of it. I am new here in the group and somewhat naive about economics.

Mr. ACKLEY. Roughly two-thirds of the private gross national product is produced in corporate business.

(The following table was received by the committee:)

RELATION OF CORPORATE GNP TO TOTAL AND PRIVATE GNP

[Dollar amounts in billions]

Period	Total GNP	Private GNP ¹	Corpo- rate GNP ²	Percent which corporate GNP is of—	
				Total GNP	Private GNP
1963.....	\$590.5	\$532.4	\$335.0	56.7	62.9
1964.....	632.4	569.4	361.3	57.1	63.5
1965.....	683.9	616.1	392.5	57.4	63.7
1966.....	743.3	666.7	429.6	57.8	64.4
1967: 1st half ³	770.7	687.4	443.2	57.5	64.5

¹ Private GNP is total GNP less compensation of general Government employees.

² Corporate GNP is the gross value added by all corporations.

³ Seasonally adjusted annual rates.

Source: Department of Commerce.

Mr. CONABLE. Here is another question I believe will be yours, Dr. Ackley. You will recall we had some rather shocking statistics on the percentage increase in private bond issues and municipal bond issues in the first half of 1967 over 1966. Those statistics by themselves look rather alarming.

May I ask you, was 1966 a bad year?

Mr. ACKLEY. No, as I recall—

Mr. CONABLE. Was it a typical year?

Mr. ACKLEY. Let us see if we can get some statistics on that. Is your question related to the volume of corporate securities offered in 1966? It showed a very substantial increase, over \$2 billion over 1965. Gross proceeds of corporate securities offered for cash were just under \$16 billion in 1965 and \$18.1 billion in 1966.

Mr. CONABLE. Has there been an increase in a fairly straight line or at least a regular progression in corporate offerings in the past recent years?

Mr. ACKLEY. There have been fluctuations, fluctuations primarily in the offering of common stocks. If we take bonds and notes—

Mr. CONABLE. The issuance of common stock bears only an indirect relation to the interest rate, does it not?

Mr. ACKLEY. Certainly 1966 appears to have been a record year in most respects in terms of offerings of corporate and State and local securities, so that the further increase in 1967 is above an already very high figure.

Mr. CONABLE. I wanted to be sure about that because we were talking about a percentage increase over 1966. We did not know whether 1966 was a big year or not.

Perhaps this is for Mr. Schultze. We have been talking about deficits ranging between \$16 billion and \$28 billion. We are talking about the net deficit at the end of the year, are we not?

Mr. SCHULTZE. The deficit for the full year.

Mr. CONABLE. In other words, in a typical year if we are talking about a \$28 billion deficit we have as of April or May in that year a \$38 billion deficit, do we not?

Mr. SCHULTZE. No, sir; I don't quite follow that. I am sorry.

Mr. CONABLE. Don't we have wide seasonal variations in the deficit, to the extent of \$10 billion?

Mr. SCHULTZE. My recollection is that what normally happens in terms of the debt increase is that you get most of it in the first half of the year. Let me consult on that for a moment—I'm told there is normally a surplus of about \$7 billion in the last 3 months of the fiscal year.

The CHAIRMAN. If you will yield to me, Mr. Conable, bear in mind that the peak in the fiscal year 1967 was set at \$336 billion as the limit. The \$358 billion on top of the \$336, you see, would serve to take care of a peak sometime during the fiscal year of \$358 billion. Would that be \$22 billion peak or what? I don't know. That is what the Secretary said he was going to help us on a little bit.

Mr. SCHULTZE. The last 3 months of the fiscal year you would get a reduction of about \$7 billion in the debt.

Mr. CONABLE. I want to know what we are talking about. We are not talking about the debt ceiling, we are talking about the deficit. Now, if you will refer to the monthly statement of receipts and ex-

penditures of the U.S. Government, at the end of May the deficit was \$18 billion. As of the end of the year the estimated deficit was \$9.7 billion. Now, when we are talking about deficits here aren't we talking about the deficit as of the end of that particular fiscal year?

Mr. SCHULTZE. That is correct.

Mr. CONABLE. In other words, the Government is going to have to have a borrowing authority, if the deficit is going to be \$28 billion, to cover \$38 billion in effect or some increment above \$28 billion in any event. If we are talking about a \$16 to \$18 billion deficit, in effect we are also talking about a borrowing authority of \$10 billion above that.

Mr. SCHULTZE. You are quite correct and the debt limit itself takes that into account. As you recall, in setting it both for 1968 and quite explicitly in fiscal 1969, there is a \$7 billion swing that is allowed past the end of the year.

Mr. CONABLE. I don't want us to be misled in thinking we are just talking about the figure that is involved at the end of the fiscal year. We are talking about a borrowing authority substantially above that.

Mr. SCHULTZE. By borrowing authority you mean debt limit?

Mr. CONABLE. Yes.

Mr. SCHULTZE. As the Secretary of the Treasury indicated earlier this afternoon, with the deficit in the range of \$14 to \$18 billion that we have been talking about there would be no problem with the debt limit. He was hesitant to give a very specific figure as to what precise number would trigger off the problem, but it would not be a number within that range because the debt limit takes account of the seasonal swing.

Mr. CONABLE. We are talking about a total effect on the economy then which could be substantially greater than the actual deficit.

Mr. SCHULTZE. Let me elucidate on that a bit—at least talk about it. I think you have to distinguish between the deficit for the year as a whole, which, to the extent it adds to the debt, has to be financed on out into the future unless you have surpluses later, and a temporary swing which can be financed out of tax anticipation certificates or short-term borrowing.

While you are right in getting at the entire financial picture, your point deals mainly with the seasonal swing in the debt.

Mr. CONABLE. At least we are going to have to go into the short-term market to that extent?

Mr. SCHULTZE. That is right.

Mr. CONABLE. Those are my questions, Mr. Chairman. I am interested in any information that might indicate further how much of the corporate surtax is going to be paid by the individual citizen eventually. It may be something that you just can't get. It may be a matter of theory. If the theory is incorrect—

Mr. SCHULTZE. The theory can't be incorrect, there are so many of them. One of them has to be right.

Mr. CONABLE. It appears to be incorrect to Dr. Ackley's thinking anyway because he says in the short term it is not going to be passed on to any substantial extent.

Mr. ACKLEY. Could I comment briefly on this seasonal question to which you referred. Unfortunately we do not have a seasonally adjusted administrative budget. We do have a seasonally adjusted national income budget which I think is the most significant measure

of the pressures on the economy. Without the tax increase that seasonally adjusted deficit would be increasing throughout this year with the tax increase it would be not only greatly lower but would be trending downward. In my statement I suggested, with the tax increase and with significant control of the growth of expenditures, that by the end of the fiscal year the deficit on national income account might be down in the order of \$3 to \$5 billion.

Mr. Bush?

Mr. BUSH. I have no questions, Mr. Chairman.

Mr. VANIK. Mr. Chairman?

The CHAIRMAN. Mr. Vanik?

Mr. VANIK. I have one other question following up the question I had of Mr. Surrey. I would like to know what the reaction of the Internal Revenue Service and your Treasury would be if there were another space on the income tax return which would simply say "other income which the taxpayer considers exempt from taxation." Now, if this were placed on the tax return it would be the kind of place for the taxpayer to report his exempt income and also to clear himself with the Internal Revenue Service. In other words, if there is any doubt in his mind he can take his exemption and put it there. That would notify the Internal Revenue Service that the taxpayers considered certain income as exempt. It would also give the Treasury and the Internal Revenue Service a very accurate way of determining the amount of income which is considered exempt.

The taxpayer would have an advantage in that it would release him from the danger of fraud for failing to disclose such income if it were a borderline issue. It seems to me it might increase revenues. It also might tell us the extent to which taxpayers are not paying income taxes on their earnings.

I have just one other point, Mr. Chairman.

Mr. CONABLE. Mr. Chairman, may I ask also, does the committee have any record of people who are going to be testifying later? Are we going to have a substantial number of people from the private sector? I must say my friends at home are saying to me that business is not as good as all that at this point. I hope we are going to have some comparison of what the business community actually thinks of the present state of our economy after which we can then consult further with administration spokesmen.

The CHAIRMAN. As the gentleman knows, the time for requests to be heard was fixed as at the close of business today. So far today I understand that we have 20 organizations and individuals who are requesting an opportunity to be heard on this matter.

Mr. CONABLE. Are they representative of among other things than the business community?

The CHAIRMAN. Yes, business, labor, other segments of the economy. But it is a limited number; 20.

Mr. CONABLE. It is always distressing, Mr. Chairman, to find how tremendously reliant we in the legislative branch are on what the executive branch wants to tell us. I think the record shows that sometimes the executive branch does not tell us everything they know. They do not misrepresent the facts; they simply do not tell us all they know. I am hoping we will have some opportunity for probing the economy beyond the specific problems that the executive branch has brought to our attention in seeking a tax increase.

The CHAIRMAN. We do not normally invite specific people to testify. We ordinarily have enough who request appearance without our having to invite them. In this instance we so far only have about 20 organizations who have expressed a desire to appear before the committee.

Secretary Fowler, in his statement, said, "The tax reform message will require more deliberate consideration since it involves proposals for permanent structural changes and some redistribution of tax burdens in the interest of a fair sharing of the load." This is what I object to. The Secretary further stated "Its basic objective is not to raise revenue but to correct a number of inequities and abuses in our tax system." It seem to me our objective should be to do both things, to correct inequities reaction of revenue because in correcting the inequities I think we can come up with a greater contribution for Federal taxation than we now receive from many sources. I certainly hope some effort will be made to do both things, to provide for greater revenues, at the same time that we endeavor to correct inequities.

Mr. SURREY. Maybe that was misunderstood, Mr. Vanik.

Mr. VANIK. That is the only way I can read it.

Mr. SURREY. Certainly some of the recommendations would raise more revenue.

Mr. VANIK. The basic objective, it seems to me, should be to raise revenue.

Mr. SURREY. Some of the recommendations would correct inequities where taxpayers may be paying more than their fair share today. The revenue so raised would offset those cases in which taxpayers or groups of taxpayers are paying more than their fair share.

Now, the committee will have an opportunity to consider whether the revenue raised from those provisions which tighten up the law should be used to go into the general budget as increased revenues or should be used, as this statement suggests, to take care of those situations in which certain groups of taxpayers are bearing more than their fair share of the revenue.

Mr. VANIK. I think the word "not" should be removed. I think we should try to do both things.

Mr. SURREY. I think an opportunity will be given the committee to consider whether provisions that tighten up and increase the tax on those groups who are not paying their fair share should be used in turn to ameliorate the situations of those who are paying more than their fair share.

Mr. VANIK. Thank you.

The CHAIRMAN. Earlier we had suggested that if the Secretary would produce a bill carrying out the recommendations that it would appear in the record. I will suggest if there is no objection that it appear immediately following the Secretary of the Treasury's opening statement and that it be followed by the technical explanation which has also been prepared by the Treasury Department. Is there any objection? (See p. 32.)

Mr. Surrey, let me ask you a little bit about the bill, itself. We have talked about everything except the bill. As I understand, the bill imposes a temporary surtax on both individuals and corporate income tax liabilities at an annual rate of 10 percent, that it raises from 70 percent to 80 percent the percentage of its estimated tax which the corporation may pay by installment without incurring a penalty. Sec-

tion 4 eliminates over a 5-year period the \$100,000 estimated tax exemption which presently determines whether or not a corporation has to make these advance payments.

And then section 5 suspends the schedule for the reduction of the excise taxes on passenger automobiles and telephone services during the period of the temporary surcharge. Is that a brief description of the five provisions?

Mr. SURREY. Yes, sir.

Mr. Chairman, may I just interpolate something here.

Congressman Broyhill asked me a question whether SNCC had a ruling which permitted contributions to it to be deductible. We just checked with the Internal Revenue Service and there is no such ruling. There is no ruling permitting contributions to SNCC to be tax deductible.

As to whether the organization itself has a ruling as an exempt organization we would have to check the field office because those rulings are issued in the field and not in Washington.

But there is no ruling that would permit a person making a contribution to it to secure a tax deduction.

Mr. BROYHILL. The person contributing cannot make a deduction?

Mr. SURREY. We checked and we know of no such ruling.

Mr. VANIK. On that same point I heard a broadcast this morning of H. L. Hunt Industries. It was a political broadcast.

Is that tax exempt? It is a program called Life Line.

Mr. SURREY. I would have to check. I think that is under consideration.

This is the substance of the bill, Mr. Chairman.

The CHAIRMAN. Actually this is not a surcharge so far as the individual is concerned of 10 percent over and above what his tax is under existing law? It is not just a 10-percent additional, is it?

Mr. SURREY. For the year 1967—

The CHAIRMAN. I am talking about the full year. Don't get into 1967. You have your low-income provision. I want you to explain just how it works. You have been referring to the fact that an individual with \$5,000 income does not have to pay a surtax. Tell me how it works.

Mr. SURREY. The bill itself says that every individual would have his tax increased in 1967 by 2½ percent, in 1968 by 10 percent. Then there is a specific low-income exemption which says that this increase shall not apply if the tax does not exceed \$290 in the case of a joint return and \$145 in the case of a single individual.

The CHAIRMAN. Because that would be the tax that would apply to the man who has a wife and two children, with \$5,000 of gross income. Is that right?

Mr. SURREY. Yes.

The CHAIRMAN. That is exactly the amount of tax in the case of the man who has the four exemptions including his own and who uses the standard deduction.

Now with \$295 of tax does he pay 10 percent more?

Mr. SURREY. He pays 10 percent more.

The CHAIRMAN. Even if it is \$291?

Mr. SURREY. Yes, sir.

The CHAIRMAN. Mr. Surrey, you know that we don't legislate that kind of proposal in this committee. How would we straighten that out?

We don't penalize a fellow just because he happens to pay \$1 more taxes than somebody else does by charging him \$29 more.

Mr. SURREY. We do in this sense. There are about 15 million taxable returns using the so-called optional tax table. Those people under \$5,000 if they want the standard deduction they must use these tables. These tables are so constructed that they are based upon the midpoint of the bracket. The brackets are \$50 wide.

If your income increases by \$1 under these tables your tax can jump up by \$9, \$10, or \$12.

The CHAIRMAN. I understand all of that.

Mr. SURREY. And people have been filing this way for years.

The CHAIRMAN. But not by \$29.

Mr. SURREY. Not by \$29, which is the maximum for a married person. But up to \$12, and it has been done for years and apparently no one has objected to it.

The CHAIRMAN. By the time we get around to wanting it, you had better be devolving some kind of notch arrangement, don't you think?

Mr. SURREY. For the year 1967 the notch of course is much lower than \$29.

The CHAIRMAN. Maybe we can get by without a notch in 1967 but maybe we can have a notch in 1968.

Mr. SURREY. That is something we can explore with the committee if they want to explore it.

The CHAIRMAN. You can begin to think about it.

Tell me about some of the other provisions insofar as they deal with the individual person. Is that the only thing we have to bear in mind on the low-income exemption?

Mr. SURREY. I think so.

The CHAIRMAN. Do you have any complications with respect to the tax base on which the surcharge is computed?

Mr. SURREY. The only point there that is taken account of is that we thought that the committee would want to keep the present value of the retirement income credit and consequently we did make an adjustment for that.

People having the retirement income credit would not lose their treatment compared with social security. This retirement income credit as you know creates a great many complications. This is another one that has to be added to the story of the difficulties of the retirement income credit. But as long as we have it this is something we had to take account of.

The CHAIRMAN. What have you done with respect to the retirement income credit itself?

Mr. SURREY. We said that the tax would be imposed on the tax liability after reduction by the retirement income credit. That will leave people having retirement income credit in the same relative position as those who have their social security income excluded.

The CHAIRMAN. You have some type of optional tax table provision?

Mr. SURREY. The Secretary is given in the draft we submitted to you the authority to determine and require the use of tables incorporating the tax imposed by this measure if he feels that is the best way of handling it on the tax return.

The CHAIRMAN. Is he permitted to round upward and downward?

Mr. SURREY. He is permitted to round upward and downward so that you don't have odd cents in the table.

The CHAIRMAN. You have rounded up to the next full dollar?

Mr. SURREY. That is right.

We will discuss this in executive session with the committee and indicate how we plan to do it but presumably we would incorporate the tax increase in the optional table.

The CHAIRMAN. You have not made up your mind as to how that should be done yet?

Mr. SURREY. It is our feeling this should be done but that is a matter we will have to discuss with the committee.

The CHAIRMAN. How do you handle the estimated tax?

Mr. SURREY. In the case of the estimated tax, with respect to the estimated tax for individuals we simply said that any increase that shall affect the estimated tax for individuals presumably would affect it in January of next year.

But the estimated tax would have to be increased accordingly along the lines of the increase in tax liability.

The CHAIRMAN. That would apply to corporations as well.

Mr. SURREY. Yes.

The CHAIRMAN. In making these estimates have you prepared tables to show what the total impact is of the adjustment in the payment from 70 to 80 percent on an estimated basis plus the imposition of the 10-percent surcharge?

Mr. SURREY. Yes.

The CHAIRMAN. Do you have any corporations at any level paying more than 100 percent of their tax liability in any calendar year?

Mr. SURREY. We would, as we do now, in other words, corporations are now finishing up the major acceleration started earlier.

The CHAIRMAN. You know what we have done. We have been very, very careful to prevent a percentage increase that might result in over a 100-percent of the tax liability being incurred in any one year.

Mr. SURREY. I think for the great mass of corporations that figure will drop even under these changes, considering various prior types of speedups.

The CHAIRMAN. It has an effect on the cash flow of course and if they don't have any cash, it forces them to have to borrow more money.

Mr. SURREY. Thinking for a moment about raising that 70 percent figure to 80 percent; on the average, corporations appear now to be using about 82 percent.

The CHAIRMAN. You mean they are actually paying on the basis of 82 percent of their liability?

Mr. SURREY. On an estimated tax basis.

The CHAIRMAN. Even though they are only required to pay on 70 percent?

Mr. SURREY. Yes. Some corporations will be between 70 and 80 but a great many corporations are already above 80 percent, just voluntarily. So that it is hard to get a table that will cover everybody.

Those corporations that are between 70 and 80 would have to go up. But those who are already above 80 would not have to make any change.

The CHAIRMAN. You know this committee has always refused to require corporations with less than \$100,000 of tax liability to be put

in the position of paying on the basis of estimates. Is this the same provision that was before the committee last year in that respect? Does it go all the way down to zero of tax liability over a 5-year period?

Mr. SURREY. I am not so sure this has been suggested before.

The CHAIRMAN. Or do you go all the way to zero?

Mr. SURREY. Forty dollars, the same as individuals. This is designed to put corporations on the same basis.

The CHAIRMAN. I understand that. I understand the theory of it. I think you know that I was one of the first in getting corporations to pay currently as their liabilities developed in the course of a taxable year, just like individuals, but we stopped at \$100,000 of tax liability.

Now if you go to \$40 you have how many corporations?

Mr. SURREY. We have a total number of taxpaying corporations of 700,000.

The CHAIRMAN. How many of that 700,000 have tax liabilities over \$100,000?

Mr. SURREY. Sixteen thousand.

The CHAIRMAN. The balance of them then are below the \$100,000?

Mr. SURREY. Which indicates some pretty sizable corporations from the standpoint of sales and so on are below \$100,000 tax liability.

The CHAIRMAN. Yes.

The very biggest corporations have happened in a taxable year to have a low tax liability. It is not based on the size of the corporation. I understand that.

Be sure now when you come to the executive session of the committee that you have tables which clearly reflect the total impact of the combination of these proposals. When we require them to pay more and pay it sooner, they also will be paying 5 percent more in 1967 because it would take effect the first of July.

They will be paying 10 percent more in 1968. But then as you step down and enlarge upon their requirement for payments, making them pick up a part of the tax, not only what was due in the past year but due in the present year, you will find, as we found earlier in considering this matter, that we were placing an excessive drain upon their capital flow.

You remember we reduced the Treasury's request at that time to more nearly what we thought was midway between what we wanted to do and what we thought was the fair thing to do.

Mr. SURREY. We will have those tables, Mr. Chairman.

The CHAIRMAN. Tell me about this business about the Western Hemisphere trade corporation that you brought into this hearing.

Mr. SURREY. The Western Hemisphere trade corporation has a present law to assist them under which their tax rate is supposed to be 14 percentage points below the regular rate of tax. This relationship is maintained.

The CHAIRMAN. Are we not increasing the tax on those?

Mr. SURREY. We are maintaining the existing relationship that they have.

The CHAIRMAN. You are leaving them unaffected by the surtax?

Mr. SURREY. Their rate has to go up. It can't go up 10 percent exactly because we still want to leave them 14 percentage points below the higher rate.

The CHAIRMAN. Are you charging them 10 percent surcharge or not?

Mr. SURREY. We are taking 14 points off the new corporate rate in effect.

The CHAIRMAN. These types of corporations have always paid 14 points less as a tax rate. If the corporation had to pay 52 percent, these corporations pay 14 points less or 38 percent, they have always been given preferential treatment. I don't know why you have to have an exclusion for them here. Why is it that they, like any other corporation, cannot figure their tax and then pay 10 percent more?

Mr. SURREY. That would give them a greater advantage than they have today.

The CHAIRMAN. Would it?

Mr. SURREY. Yes.

The CHAIRMAN. You are hitting them harder then? I misunderstood then.

Mr. SURREY. If you just increased their tax 10 percent it would give them a greater advantage than they have today.

The CHAIRMAN. You take care of the point. I was fearful that you had not taken care of it.

Mr. SURREY. We will study the suggestion, Mr. Chairman.

The CHAIRMAN. What about the minimum distribution by foreign subsidiaries, how do you treat those?

Mr. SURREY. The minimum distribution table is a table that indicates what percentage of distribution certain foreign subsidiaries have to make so that they will not have to pay the so-called subpart F.

The CHAIRMAN. If this is to go through by October 1, we have to begin thinking now about these technical points. I want you to get you mind on these points and not wait until we get into executive session.

Mr. SURREY. We have used a table for minimum distribution that was applicable when the corporate rate was 52 percent.

The CHAIRMAN. You have maintained the comparability.

Mr. SURREY. That is right.

The CHAIRMAN. What period of time do you say these corporations with \$100,000 or less of tax would have to adjust to an 80-percent estimated payment?

Mr. SURREY. The suggestion is that it be done over 5 years, 20 percent a year.

The CHAIRMAN. Beginning when?

Mr. SURREY. Beginning in the year 1968, calendar 1968.

The CHAIRMAN. With respect to calendar year 1968?

Mr. SURREY. Yes. For a calendar year corporation it would be the estimate for that year.

The CHAIRMAN. Do you follow the same general pattern in the estimating and payment of the tax in the case of these corporations that presently applies in the case of those subjected to the requirement today? Is there any difference or are they treated in all respect just as though they had tax liability above \$100,000 today?

Mr. SURREY. I believe so, Mr. Chairman, because this provision also applies to those corporations presently over \$100,000 in tax who are

excluding their first \$100,000. Consequently the same rules would apply to both.

The CHAIRMAN. At present we allow a corporation with tax liability of more than \$100,000 to exclude the first \$100,000 and then to pay on an estimated basis on that amount in excess of \$100,000 because we exclude those of \$100,000 or less.

Just how is that changed in the law? Take that \$100,000 away from the \$16,000 today that have the privilege of excluding it so that their estimates will be affected not only by the 70 to 80 but by the additional inclusion of the \$100,000 of tax liability excluded.

Mr. SURREY. What we say is that with respect to the first year which is 1968 you can exclude 80 percent of \$100,000.

The CHAIRMAN. You go down by 20 percent.

Mr. SURREY. That is right. The next year you can exclude 60 percent.

The CHAIRMAN. That is done, too, to minimize the combined effect?

Mr. SURREY. That is right. Also to smooth out the adjustment over 5 years.

The CHAIRMAN. What do you get in total over the 5-year period of additional advance payments through this process?

Mr. SURREY. From the gradual elimination of the \$100,000 tax exclusion we would get \$400 million a year.

The CHAIRMAN. For each of the 5 years?

Mr. SURREY. For each of the 5 years.

The CHAIRMAN. Actually then it would be about a \$2 billion pick-up over the 5 years.

Mr. SURREY. Yes, sir.

The CHAIRMAN. And then in the case now of the passenger automobile tax what you are doing is eliminating the April 1, 1968, date for the drop and what date are you putting in?

Mr. SURREY. We are putting in June 30, 1969. Congressman Bush corrected us; our draft had June 30. That is an amendment we agreed to.

The CHAIRMAN. Now with respect to communications services, you changed that April 1 to the same date?

Mr. SURREY. The same thing, June 30, 1969.

The CHAIRMAN. Is that effective also by the same provision that applies to the 10-percent surcharge?

In the event the Vietnam hostilities conclude at an earlier date it is an earlier date?

Mr. SURREY. No; the draft we submitted just has the definite date, July 1, 1969. It does not have a different termination date.

The CHAIRMAN. In other words, the termination of the Vietnam situation applies only to your 10-percent surcharge?

Mr. SURREY. No; even the 10-percent surcharge is on a definite basis.

The CHAIRMAN. You mean if the Vietnam situation should conclude within 6 months after this is done that these rates would still continue until the termination date?

Mr. SURREY. We had assumed that any changes prompted by the duration of the Vietnam hostilities would be reflected in new substantive legislation.

The CHAIRMAN. It would require an amendment to the bill that you submitted to carry out the exact intention that has been expressed

here at the table that these taxes last for a definite period of time up to June 30, 1969, or the end of hostilities, whichever comes earlier? Is that what you are saying?

Mr. SURREY. Earlier or later I guess.

The CHAIRMAN. I thought that is what the President had said in his message.

Mr. SURREY. I think the President said that this should be for a definite period of time to June 1969.

Now if Vietnam hostilities cease earlier or later, the 1969 date would have to be reexamined in the light of the situation with respect to Vietnam.

The CHAIRMAN. Are you just getting us in a position in the Ways and Means Committee to have more legislative responsibility here by putting this termination date in anyway?

We stopped having to extend all these taxes on an annual basis which we went through for a long time. Can we make it December 31, when Congress won't be in session and be certain then that it is temporary?

Mr. SURREY. I am not sure whether that would buy absolute certainty.

The CHAIRMAN. You are not?

Mr. SURREY. No.

The CHAIRMAN. You evidently look at it something like I do. There is no such thing as a temporary tax.

Mr. SURREY. There is no such thing as absolute certainty.

The CHAIRMAN. I think that covers the questions I had in mind.

Do you have any questions, Mr. Conable?

Mr. CONABLE. No. I just want to say one of the difficulties with having a contingent termination date is that it would be very difficult to determine when an undeclared war involving several parties actually ends.

We would be in trouble if we simply said the termination of this war without having a definite date.

The CHAIRMAN. I know from the information that has gone out it might not last as long as this date, that this tax might terminate earlier. That is the impression I got.

Maybe I am the only one that did.

Mr. SCHULTZE. The nearest thing I know to a kind of specific statement on that was in the state of the Union message with respect to the 6-percent when the President stated——

The CHAIRMAN. You mean I am that far behind?

Mr. SCHULTZE. That is right.

He explicitly said:

I will promptly recommend an earlier termination date if reduction in these (unusual Vietnam) expenditures permit it.

Mr. CONABLE. I have one other comment.

Your open mind on this legislation has been widely heralded and universally acclaimed. I trust all the concern with the details of enactment does not constitute any foreclosing of your options in any way.

The CHAIRMAN. No, I am just trying to expedite the consideration of it.

Without objection the committee will adjourn on this subject matter and reconvene at 10 o'clock on Monday morning, the 21st of August.

(Whereupon, at 5:40 p.m., the committee adjourned, to reconvene at 10 a.m., Monday, August 21, 1967.)

PRESIDENT'S 1967 TAX PROPOSALS

MONDAY, AUGUST 21, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to notice, in the committee room, Longworth House Office Building, Hon. Wilbur D. Mills (chairman of the committee) presiding.

The CHAIRMAN. The committee will please be in order.

Our first witness this morning is the president of the National Association of Manufacturers, Mr. Gullander. We will ask you to identify yourself first by giving us your name and capacity in which you appear for the record.

STATEMENT OF W. P. GULLANDER, PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. GULLANDER. Mr. Chairman, I am W. P. Gullander, the president of the National Association of Manufacturers. I am here to speak on their behalf with respect to the proposed tax bill.

The CHAIRMAN. We are pleased to have you with us this morning, Mr. Gullander, and you are recognized, sir.

Mr. GULLANDER. The economic effect of the 1964 income tax changes well demonstrated that over the long run maximum economic growth and maximum tax receipts result from moderate income tax rates which encourage expansion and risk taking.

Because of this, I find myself in a rather uncomfortable position, as I am certain this committee does, in discussing the need for a temporary tax increase.

No one can view the present fiscal situation with any degree of satisfaction. And the best that can be said for the alternatives that seem to be available for correcting it is that some are likely to be less damaging to the economy than are others.

Nevertheless, the problem must be faced, and it is my hope that I can contribute something that will be useful to you. In doing so, I have the guidance of a statement prepared by the NAM Taxation Committee, expressing its views on "Government Action in the Current Fiscal Crisis." This was carefully considered and unanimously endorsed by the committee at its meeting on July 11, and I emphasize the date July 11. It was prompted by concern with much the same problems as were brought up by the President in his message to Congress on August 3.

The full text of the taxation committee's statement is appended to my testimony and I ask that it be included in the record of these hearings.

The CHAIRMAN. Without objection, it will be.

Mr. GULLANDER. We see no reason to doubt the administration's estimate that, in the absence of a vigorous effort to correct it, the Federal deficit will be approximately \$29 billion in this fiscal year. And we see no reason to challenge the administration's assertion that a deficit of this size would produce a "ruinous" spiral of inflation, lead to a shortage of credit and high interest rates that would severely cripple business activity, and damage further our international balance of payments. These are essentially the same conclusions as were reached in the NAM Taxation Committee statement of July 11.

We wish, however, that the President had given more attention, in his message, to the factors responsible for the present crisis. The growth in nondefense spending over the last few years has contributed at least as much to the crisis as has the Vietnam war.

I know that much of this may sound like "water over the dam," and that your immediate concern is how best to deal with the crisis that is before us. The bulk of my remarks today will be suggestions for dealing with this immediate problem. But we must also given attention to what led to this situation. Unless we make plans for avoiding a continuation of recent fiscal trends, we may find that any temporary tax increase will become a permanent part of the revenue system.

OBJECTIVES

Clearly the prospective deficit of \$29 billion is economically intolerable and must be reduced substantially. However, a tax increase that would wholly eliminate the prospective deficit in fiscal 1968 would be equally intolerable.

It would require, for example, an income tax surcharge of about 50 percent to accomplish this. It is hard to say which would give the worse shock to the economy—the large deficit or the tax increase needed to eliminate it.

Reduction in expenditures offers a far sounder method of reducing the deficit and we had hoped that this would occur to an extent that a tax increase would be unnecessary. We fear, however, that the time is past when the problem for fiscal 1968 can be handled entirely in that way, although this is a time when efforts in that direction should be redoubled.

It follows that a program for dealing with the fiscal crisis in the current year must be in the nature of a compromise. It should involve a substantial reduction in spending, a temporary tax increase and, unfortunately, acceptance of a sizable deficit remaining after these measures have been taken.

The administration has suggested that the objective be a reduction in the budget deficit for fiscal 1968 from the prospective \$29 billion to a range between \$14 and \$18 billion. If fiscal policy is to be planned with any sense of perspective, Congress will need to have some such goal before it.

It is not that anyone can regard such a deficit with satisfaction. And certainly repeated deficits of that magnitude stretching into the future would have ruinously inflationary effects. But we must deal first with the problem of fiscal 1968 under the circumstances that exist, whether we like them or not.

EXPENDITURE REDUCTION

The program presented in the President's message contains, in his words, "two essential elements." These are "expenditure restraint" and "tax measures to increase our revenues." Your committee's direct concern is with the latter, but it can hardly be discussed until we have some idea of what can be accomplished in reducing Government spending.

Although the President endorses restraint in spending as an essential element in his program, his message contains little that would be helpful to Congress in carrying out such an effort. He offers only two specific suggestions: Elimination of \$1 billion of the proposed Federal pay raise, and restoring authorization of \$2 billion in sales of participation certificates. Beyond this he refers only to the "steps that Congress and the Executive can and should take to control expenditures."

It is important that the President take a major leadership role in developing the means to implement what he recognizes as an essential element in his program.

I will return later to this subject of Government economy with a suggestion as to how it may be achieved. For the moment we may note that a massive effort along these lines is absolutely essential. The President himself points out that \$1 billion of expenditure is equivalent to the revenue yield of a 2-percent surcharge coming directly out of the pockets of the American taxpayer.

REVENUE INCREASES

The President's recommendations for increasing Federal revenues are, of course, the part of his program which most directly concerns your committee.

A temporary surcharge of the same percentage on individual and corporate income taxes is the most equitable and least disruptive way of raising additional revenue for meeting a temporary need. I would like to repeat that sentence. A temporary surcharge of the same percentage on individual and corporate income taxes is the most equitable and least disruptive way of raising additional revenue for meeting a temporary need.

The NAM Taxation Committee, in its July 11 statement, recommended that:

Any tax increase should take the form of a one-year surcharge of a common fixed percentage on all net liabilities for personal and corporate income taxes.

We would, however, raise questions about some of the specifics of the President's proposals.

First, the surcharge legislation should cover a term of 1 year rather than 2 as proposed by the President and should be made effective on the same date for corporations and individuals.

Frankly, what we fear is that the longer this source of revenue remains available, the more likely the Federal Government is to become dependent on it. Instead of its being a means of getting through a temporary emergency, a longer term could be the means of its becoming a permanent necessity for meeting the cost of continuing spending programs. In other words, we see a danger that this new

source of revenue could reduce the pressure for regaining control over spending trends.

Second, the surcharge should apply to all income tax brackets. We may grant that it is undesirable to ask persons of comparatively modest income to pay additional taxes but it is equally undesirable to ask anyone to pay additional taxes. If, at present, taxpayers pay a proper share of the present tax total, it would seem that they should pay their proportionate share of any surcharge.

The most important question is whether it will be necessary to impose a surcharge at a rate as high as the proposed 10 percent. In fiscal 1968, each reduction in expenditures of approximately \$600 million would have the same effect on the deficit as 1 percentage point of the surcharge. The terms of this tradeoff seem sufficiently attractive to compel a maximum effort to cut Federal spending.

A rough calculation reveals that a cut of somewhat less than \$1 billion in expenditures, together with an expansion of the surcharge base by including all taxpayers, would make it possible to reduce the proposed surcharge by 2 percentage points and as mentioned above, each additional expenditure reduction of \$600 million would make it possible to reduce the rate by another percentage point.

It should be emphasized that a 10-percent surcharge on corporate tax liabilities would mean that the effective rate on all but the smallest corporations would be higher than it had been prior to the 1964 tax reduction.

SPEEDUP OF CORPORATE TAX COLLECTIONS

Particularly in the last 2 years, American corporations have been subjected to an acceleration of tax payments which has much the same practical effect on them as a surcharge on their current tax liabilities. The President has proposed two measures which would further speed up corporate tax collections in 1968. He would raise from 70 percent to 80 percent the basis on which corporations make current payments on their estimated tax liabilities. He would also eliminate, over a 5-year period, the exemption of the first \$100,000 of tax liability from the requirement for current payment. This form of tax acceleration would hit small enterprises especially hard.

We recommend that you do not take such action. As already mentioned, it is the equivalent of a surcharge during the transition period. Consider the case of a corporation which paid 70 percent of its tax liability for calendar 1967 in that year—leaving 30 percent to be paid in 1968—and then also had to pay 80 percent of its 1968 tax liability in 1968. In effect, it would have to pay an extra 10 percent of a year's tax in calendar 1968. This would be a serious burden to be placed on top of the surcharge you are considering.

The burden would be even more serious for many small corporations. A corporation whose tax liability remains consistently below the \$100,000 margin would, over the next 5 years, have to pay almost 6 years' taxes. Thus, in effect, you would be subjecting them to a surcharge of 16 percent on top of any surcharge Congress may legislate.

The argument has been made that since proprietors of unincorporated enterprises already pay their taxes on a current basis it is only fair to subject small corporations to the same treatment. But this argument misses the point. The extra burden on the small corporations

would be the result, not of their being on a pay-as-you-go basis, but of the transitional problem of getting on a pay-as-you-go basis.

There would have to be a period during which the small corporations would pay more than 1 year's tax in each year. There was a similar transitional problem for small proprietors when individual taxpayers were first placed on a pay-as-you-go basis in 1944. You will recall that Congress resolved the difficulty by a broad stroke—three-quarters of the 1943 tax liabilities of individuals were simply wiped off the books. But no one has proposed a similar tax forgiveness for small corporations if and when their payments are made current.

For 1964 through 1967 the overall speedup of corporate tax payments, exclusive of social security, will amount to at least \$12 billion under existing legislation. As many authorities have noted, the resulting squeeze on corporate cash resources has contributed to upward pressures on interest rates and tightness in the credit markets. An additional speedup would only aggravate these conditions.

CORPORATE TAX LIABILITY

The administration has recommended applying the surcharge to corporate tax liabilities before allowance of the investment credit and foreign tax credit. The only fair method would be to apply any surcharge to net tax liabilities after allowance of credits.

After all, the various credits and adjustments that are made in the calculation of final tax liability were all adopted by Congress for good and sufficient reason. If a tax surcharge must be enacted, we see no justification for the dilution of any such benefits to the taxpayer by applying the surcharge to the liability calculated before taking them into account.

The procedure provided in the administration's tax bill would result in a surcharge of more than 10 percent—in some cases much more—on tax liability as presently calculated. For instance, a corporation with an investment tax credit of the 50 percent maximum on its gross tax liability would have its tax increased by 20 percent instead of 10 percent. Failure to allow deduction of the foreign tax credit would result in many cases in even greater distortion. If it is your intention to collect increased revenue by a surcharge applied evenly to everybody, we do not see why such a provision should be included.

It is our belief that the most appropriate form of tax increase for meeting temporary needs would be a "bottom line" surcharge. By this we mean an additional tax calculated on the last line of the return, by applying a fixed percentage to tax liability as calculated according to existing law. Any other procedure distorts the pattern of relationships among taxpayers.

RELATIONSHIP OF THE CORPORATE AND INDIVIDUAL SURCHARGE RATES

During discussions both before and after the President's message, the suggestion has frequently been made that the surcharge rate to be applied to individuals should be somewhat less than the surcharge rate to be applied to corporations. I do not know the extent to which this will be given serious consideration by your committee, but in any case, I would like to make some comments.

In the interest of equity there is no justification for imposing a heavier percentage surcharge on corporations than on individuals. Both the tax history since 1964, and the impact on profits of the recent economic slowdown, suggest that, if anything, there should be greater reluctance to raise corporate taxes than individuals' taxes.

At the time of the 1964 tax cut, the reduction was proportionately much less for corporations than for individuals. The great bulk of corporate profits had previously been taxed at 52 percent and this was reduced in two steps to 48 percent—somewhat less than an 8-percent reduction. By comparison, the tax reduction provided for individuals averaged close to 20 percent.

I am not suggesting that you reconsider a decision made in 1964. But you should give thought to what will happen if every time there is opportunity for a tax cut, corporations are given less than a proportionate share and, every time there is need for a tax increase, corporations are burdened with more than a proportionate share.

This would mean that any kind of tax change would lead to a greater share of the burden being assigned to corporations. This is one reason we believe you should reject proposals for imposing a higher surcharge rate on corporations than on individuals.

Furthermore, since 1964, the nominal reduction in corporate tax rates has effectively been wiped out by the acceleration of corporate tax collections. This point is sometimes misunderstood, since it is regarded solely as a matter of the timing of taxpayments, rather than of the magnitude of the tax burden.

However, the additional amounts which had to be paid because of the speedup have been a real drain on corporations in just the same sense that they have been real revenue to the Treasury. In fact, in calendar 1967 without a surcharge, large corporations are paying a considerably higher cash tax rate, including the impact of the speedup, than they did in 1963.

While most business has yet to receive any actual cash benefits from the nominal reduction in the corporate tax rate enacted in 1964, individuals, by contrast, obtained their benefits promptly on schedule. Now, if the tax cut must partially be reversed, it would hardly seem appropriate to apply a heavier tax surcharge to corporations than to individuals.

A final reason for this conclusion lies in the statistical record of what has happened to various kinds of income during the economic slowdown of 1967. In the first half of this year, corporate profits were 6 percent below their level of a year earlier, whereas, personal incomes were 7 percent higher.

Corporate profit margins have been declining since the first quarter of 1966. It would not make much sense to apply a higher tax surcharge to this element of income than to others. As our taxation committee, in its statement of July 11 stressed:

Any tax increase should be of such character as to do minimum damage to business profitability and business confidence, since these factors are so vital in determining the general level of employment and economic activity.

Of course, one argument we have heard for making corporations pay a heavier surcharge rate than individuals is the claim that corporations received a tax break earlier this year when the suspension of the investment credit was terminated. This is surely a specious argument.

Congress action simply restored what practically everyone conceded to be a normal, natural, and permanent part of the tax system.

Admittedly, there was one slight advantage gained by business in the investment credit restoration—advancement of the date that the credit could be applied to a larger proportion of tax liability. But this represented a very small plus compared to the minus of the suspension itself.

In sum, we urge most earnestly that you resist all efforts to impose a higher surcharge rate on corporations than on individuals.

ORGANIZING FOR GOVERNMENT ECONOMY

This completes the suggestions I have to offer on how to meet the fiscal crisis which faces the country here and now. Please understand that the most I would claim is that this is the least damaging program for dealing with the situation we are in.

I would be remiss, however, if I did not add some comments dealing with longer range aspects of the fiscal problem. We should all be devoting thought not only to the problem of getting through this critical period, but to the questions of why we are in a fiscal crisis and how we can avoid it in the future.

It is clear that we cannot blame present fiscal difficulties solely, or even mainly, on the Vietnam war. Between fiscal 1964 and 1968, according to the President's January estimates, cash outlays for defense will have risen 41 percent whereas cash outlays for other purposes will have risen 45 percent.

This growth in expenditures is far beyond what can be supported by the normal growth in revenues. If it continues, tax increases will not be temporary but chronic necessities. We will have reversed the decision we thought we had made in 1964 in favor of growth in the private economy as against growth in Government.

If this is to be avoided, we must develop a firm determination to curtail growth in Government spending. And, what is a lot more difficult, we must develop an effective method of carrying out such a decision.

Consider the present situation. The President's message advocates both "a revenue increase" and "tight expenditure control." The proposal for a revenue increase is immediately taken up by the Ways and Means Committee which is responsible for studying it and carrying it to the point of appropriate action.

But there is no similar body to which a proposal for "rigid expenditure control" is referred for public study and action. The result is that needs for increased revenue are handled promptly but the same cannot be said for expenditure control.

In this context, I would like to read a portion of the statement adopted by our taxation committee at its July 11 meeting on the subject of expenditure control:

(1) Congress and the Administration should immediately a program for reducing federal expenditures and controlling their future growth. This program should have the following characteristics:

(a) It should be carefully planned and organized. The same kind of detailed planning should be applied to achieve economy as is now applied to developing proposals that involve spending more money.

(b) Specific responsibility for the program should be assigned to definite persons in the Administration and to definite members of Congress. Without such an

assignment, efforts to achieve economy might amount to no more than pious declarations.

(c) The program should have the short-run objective of reducing the deficit in fiscal 1968, so as to avoid or minimize the need for a tax increase.

(d) The program should also have the long-run objective of regaining control over the growth of spending in the future. This would require consideration of changes in substantive legislation, as well as appropriations. This long-run effort would be necessary to ensure that any tax increase enacted in 1967 or 1968 would be only temporary and would not be used to support a permanently higher level of spending.

The concept incorporated in H.R. 10520 introduced by Chairman Mills on June 5, 1967, merits support as part of a long-range program to control federal spending. It would establish a Government Program Evaluation Commission comprised of private citizens whose duties it would be to evaluate existing federal programs and make recommendations to the President and to the Congress as to their effectiveness, whether they should be continued, and their relative priority. Without a high-level coordinated effort of this nature, proliferation of federal programs can be expected to continue unabated.

We know that the need for Government economy is well recognized among Members of the Congress. But unless an effective means can be devised for translating this into action, there is a danger that any temporary tax increase would become permanent.

The relevancy of Government spending to revenue measures has been recognized by this committee on many occasions. Section 1 of the Revenue Act of 1964 came from your committee and was enacted with a declaration of national policy aimed at curtailing the growth of Government spending—

To further the objective of obtaining balanced budgets in the near future, Congress by this action, recognizes the importance of taking all reasonable means to restrain government spending and urges the President to declare his accord with this objective.

We hope that Congress, in considering a tax increase this time rather than a tax cut, will reiterate that statement in even firmer tones.

That is the end of my statement, Mr. Chairman.

(The statement referred to follows:)

STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS TAXATION COMMITTEE

GOVERNMENT ACTION IN THE CURRENT FISCAL CRISIS

The present state of the American economy in general, and the fiscal situation of the federal government in particular, make this a period of extreme difficulty in the formulation of tax policy. An increase in taxation could delay and impede a resumption of economic growth after the present business slowdown. Profits have been on a downslide since a year ago, and there has been some impairment of business confidence. A tax increase might make these tendencies worse. But the large federal deficit which appears likely in the absence of a tax increase would also have severely damaging effects on the economy.

The reason the country finds itself in this unpleasant dilemma is its earlier failure to exercise control over the growth of federal spending. Non-defense spending has been rising at a faster rate than the revenue yielded by the existing tax system. This continuous growth of non-defense spending is the heart of the nation's present fiscal problems. Any program for dealing with these problems must have as its keystone a concerted and carefully planned effort to regain control over non-defense spending.

The immediate situation is that we are threatened with a fiscal 1968 federal deficit which, in the opinion of reliable authorities, may go close to \$30 billion. The necessity for funding a deficit of this magnitude would place severe strains on the nation's credit resources, and raise interest rates to a level which would make it extremely difficult for the private economy to provide capital, particularly in such fields as housing, state and local construction, and business in-

vestment. Alternatively, if the Federal Reserve System were to expand the credit base so as to accommodate funding so large a deficit at low interest rates, the nation would be subjected to powerful inflationary pressures.

The most desirable method of dealing with this problem, of course, would be to eliminate or greatly reduce the threatened 1968 deficit by a cut in expenditures. To control inflation, expenditure reduction is more effective than tax increases which may be passed on in part in higher prices. Without extensive evaluation of programs, Congress and the Administration may, however, be limited at this time in their ability to accomplish an adequate reduction in non-defense spending for fiscal 1968 since much of the spending is a result of substantive legislation passed in earlier years. If this turns out to be the case, an increase in taxation might be considered as "the least of the evils."

There is an inherent danger, however, in using a tax increase as a corrective for an excessive deficit. A tax increase might so reduce the pressures for spending reduction, that its end-effect could be to increase expenditures over what they otherwise would have been, rather than to reduce the deficit below what it otherwise would have been. Whatever is done in the present fiscal crisis must guard against such a tendency.

At the present juncture, anything that is done, and anything that is not done, involves its own set of risks. But decisions have to be made, and the NAM Taxation Committee recommends the following program for government action during the present fiscal crisis:

(1) Congress and the Administration should immediately undertake a program for reducing federal expenditures and controlling their future growth. This program should have the following characteristics:

(a) It should be carefully planned and organized. The same kind of detailed planning should be applied to achieve economy as is now applied to developing proposals that involve spending more money.

(b) Specific responsibility for the program should be assigned to definite persons in the Administration and to definite members of Congress. Without such an assignment, efforts to achieve economy might amount to no more than pious declarations.

(c) The program should have the short-run objective of reducing the deficit in fiscal 1968, so as to avoid or minimize the need for a tax increase.

(d) The program should also have the long-run objective of regaining control over the growth of spending in the future. This would require consideration of changes in substantive legislation, as well as appropriations. This long-run effort would be necessary to ensure that any tax increase enacted in 1967 or 1968 would be only temporary, and would not be used to support a permanently higher level or spending. The concept incorporated in H.R. 10520 introduced by Chairman Mills on June 5, 1967 merits support as part of a long-range program to control federal spending. It would establish a Government Program Evaluation Commission comprised of private citizens whose duties it would be to evaluate existing federal programs and make recommendations to the President and to the Congress as to their effectiveness, whether they should be continued, and their relative priority. Without a high-level coordinated effort of this nature, proliferation of federal programs can be expected to continue unabated.

(2) If, after such an economy effort it appears that the nation is nevertheless threatened with the probability of a deficit in fiscal 1968 so large as to be potentially damaging to the economy, Congress may be impelled to enact a tax increase. If a tax increase is enacted by Congress, it should be designed in accordance with the following principles:

(a) Any tax increase should be clearly labeled "temporary" and should provide for its own termination at the end of one year. A tax increase for any longer period would reduce the pressures for government economy, and is therefore undesirable.

(b) Any tax increase should be of such character as to do minimum damage to business profitability and business confidence, since these factors are so vital in determining the general level of employment and economic activity. For example, any further speedup of corporate tax collections, especially one which is concentrated on small business, should be avoided at this time. Past speedup of such collections has impaired the cash resources of business for meeting its needs for current operations and expansion.

(c) Decision as to the dollar amount of any tax increase must of necessity be a compromise. It should be sufficient to reduce the deficit substan-

tially, but not so great as to impair the economy. We should not try to make up by a rise in taxes that part of the deficit which results from the present economic slowdown. Such a course would be self-defeating.

(d) During the period of any temporary tax increase, no fundamental changes in the tax structure should be made.

(e) Any tax increase should take the form of a one-year surcharge of a common fixed percentage on all net liabilities for personal and corporate income taxes.

(3) In undertaking such a program, Congress should make a firm declaration of its intention to halt the excessive growth of federal spending and to be guided, in both appropriations and substantive legislation, by that objective. This will help create confidence that any tax increase if enacted will in fact be temporary, and thus minimize its adverse impact on the economy. The absence of assurance on this point would create the fear that such a tax increase is only the first of a series.

At the time of its enactment, the 1964 tax reduction was hailed as a clear indication that henceforth the Nation would seek to grow by expansion of the private economy rather than by expansion of government. The NAM Taxation Committee is convinced that this is still the wish of the American people. The program recommended above is designed to get us back on that track as quickly as possible.

If the economy continues to maintain its growth trend of the 1960's, the over-all gain of federal revenues should approach \$8-\$10 billion per year. There are many indications that this revenue gain may be appropriated for expansion of existing programs and adoption of new programs. Taxpayers, who bear the cost of government and to whom the government turns when revenue emergencies arise, should insist that in the disposition of the expected revenue gain, absolute priority be accorded to tax rate reduction when the present emergency is over.

The CHAIRMAN. We thank you, Mr. Gullander. Are there any questions of Mr. Gullander?

Mr. BYRNES. Mr. Chairman.

The CHAIRMAN. Mr. Byrnes.

Mr. BYRNES. I want to compliment you on a very fine statement, Mr. Gullander. There is one thing that concerns me. You point out that we must be determined to curtail Government spending. If we provide a tax increase without the assurance of Government spending being cut, don't we remove the pressure that a deficit exerts toward expenditure control?

Mr. GULLANDER. Mr. Byrnes, I think we cover that in the sense that we recommend you have only a 1-year tax increase, which leaves the pressure. Second, we are influenced by the magnitude of the deficit which would have an inflationary effect.

And third, part of the pressure on Congress to spend more money than it has comes from people back home and a tax increase would have the effect of at least of making your constituents realize that if you overspend it starts hurting their pocketbook and not just the person buying Government bonds.

Mr. BYRNES. I think you point up the dilemma that some of us face. Unfortunately there are some individuals who are not concerned about the \$29 billion deficit. Assume we reduce the deficit to \$22 billion by a \$7-billion tax increase. Since the \$29 billion doesn't seem to bother some people, they may advocate moving right back up to \$29 billion again.

Mr. GULLANDER. Hasn't the administration, however, put its name on the line here in saying to the American public, "You give me \$7½ billion in increased revenue and we will find \$7½ billion to cut out of the expenditure side"?

Now, the administration is going to have to be judged on the basis of whether that is achieved.

Mr. BYRNES. We thought that was what the Secretary was suggesting. He did suggest prior to his appearance before the committee that 25 percent of the deficit would be eliminated by a tax increase and another 25 percent by expenditure cuts—for a total of 50 percent. But when he appeared before the committee, the billion-dollar potential pay increase above the administration's recommendation was really the only reduction of expenditures that was pinpointed.

He talked about needing authorization to sell \$2 billion of participation certificates instead of general bonds, but to me that doesn't really cut your expenditure level. It shifts your bookkeeping. While we have heard talk about a need for retrenchment from those who are the moving force in many of these spending programs, the specifics of any reductions haven't been provided. I wonder if the specifics won't fail to materialize if these individuals see \$7 billion more in revenue coming along.

Mr. GULLANDER. This was one of the very serious concerns of our committee before they came up with the statement and this was debated at great length and it was the size of the budget and the economic effect anticipated from the budget that caused great concern.

Another consideration, Mr. Byrnes, it seems to me is that if you curtail expenditures merely to hold down the deficit this is not going to be very influential on people who don't know what a deficit is, anyway, or aren't concerned about the \$29 billion, but if you put it in the frame of reference as we did in our statement that for every \$1 billion of curtailed expenditures you are going to reduce this percentage tax increase by 2 percentage points this hits home pretty clearly.

It seems to me if we can get the American public to recognize every time \$600 million is cut out of the expenditure side you can consider a temporary tax rate of 1 percentage point less, that puts more pressure on Congress as well as the administration than merely a statement that if you spend more money you are going to have a bigger deficit.

Mr. BYRNES. That presupposes, it seems to me, that you are still going to have a deficit of in the neighborhood of \$20 or \$22 billion. When you talk about reducing expenditures a billion dollars you are speaking in relatively small terms in the face of a \$29 billion deficit.

I would rather think in terms of the economic consequences of a deficit of this size in order to reduce the deficit to within manageable proportions. If we talk only of balancing a potential tax increase with expenditure cuts, we are not going to go very far down the line.

Mr. GULLANDER. The point I was trying to make is the President asked for 10 percentage points surcharge. He is also asking for a major expenditure reduction. To the extent you get added expenditure reduction and Congress can force that expenditure reduction, it cuts the 10 percentage points down to 8, or 6, or whatever the figure ought to be.

Mr. Byrnes, as I say, I am uncomfortable sitting here talking about a tax increase. I am much more comfortable talking about a tax decrease. We said we thought we had to be financially responsible and that the \$29 billion deficit is intolerable. You have to increase your revenue at least on a temporary basis along with expenditure reduction and one is just as vital as the other.

I would agree that the expenditure reduction is more vital than a tax increase because in effect that has a greater impact on improving

our economic circumstances, and we learned in 1964 as the economy grows Mr. Fowler's revenue grows as well.

Mr. BYRNES. I keep wondering whether or not the deficit that we have today may be the tool that will force some expenditure restraints. I worry about eliminating the restraint of the deficit on spending by providing more revenue which in turn reduces the deficit. That is one of the problems that bothers me.

I think we are in a mess any way we look at it.

Mr. GULLANDER. That is right.

Mr. BYRNES. How we got out of this mess is a problem. Until there is a real determination to use all the tools available, we can't solve our problems. I get a feeling that the administration wants to pay lip service to one tool: namely, expenditure reductions, while acting on the other tool: namely, a tax increase. I am not sure that we would end up any better off, if we limit ourselves in that way. We might end up worse off.

Mr. GULLANDER. I am sure my statement did not imply that we only talk about a tax increase.

Mr. BYRNES. That is right.

Mr. GULLANDER. Part of the problem is recognizing what is the \$29 billion. The American public doesn't know. I was in your State 8 days ago and spoke to a group of college presidents and I said, "Let me tell you what \$29 billion is. It is \$110 million every working day and it is a million dollars every 4 minutes." That is what \$29 billion is.

The solution to today's fiscal crisis would be more acceptable, including a substantial deficit in 1968, if we knew we were going to have a surplus in 1969 or if our house was going to be in order in 1970. We had a \$12 billion deficit under the Eisenhower administration which in terms of today's dollar would be much more, but the following year we had a small surplus so the long-term impact on our economy was not very great.

If we follow this deficit with a deficit in 1969 and 1970 are we going to be able to stand the impact?

In other words, we have to get this thing under control. But I don't think we can wait just to get spending under control. On a 12-month basis I think the American public is prepared to say, "We will chip in part of this with a tax increase but we expect our representatives, the people who make up this Government, to find ways to reduce spending."

It is no more or less than the corporation board of directors who tells its president, "You have to cut your costs or we are going to go out of business," and that is virtually the situation we are faced with.

Mr. BYRNES. The fundamental impetus toward expenditures reduction and the shift in attitude toward spending must, in the first instance, come from the administration. As of this moment in the proceedings, I haven't become convinced that they are as sincere about cutting back on the expenditure side as they seem to be with respect to the need for a tax increase. That is the problem that I see.

If I was convinced of an equal determination in both these roles then I would have much less difficulty as far as this bill is concerned.

Mr. GULLANDER. Mr. Byrnes, I think the responsibility is held in three laps. One is the administration you already mentioned. I think one is every Member of Congress and every constituent of that Member

of Congress back home. I have made speeches from coast to coast in which I have said, "You have to ask your Congressman for reduced expenditures, but you have to be willing to say so even if it hurts Wisconsin, or Florida, or wherever you may be from."

So the responsibility is held by all three segments of our society.

Mr. BYRNES. I certainly agree, and it is not an easy role, but I think we know where the basic stimulation for most of these programs comes in the first instance. Of course it all gets back to the people in the final analysis. If people insist on a certain course I think normally you find the Congress responsive.

Mr. GULLANDER. It is the leadtime.

Mr. BYRNES. And the executive also responds, but I don't know that the people have shown complete willingness to do without some of the governmental benefits. Of course you have to do without if you are going to cut back Government spending.

Mr. GULLANDER. Of course a temporary tax increase that they feel on April 15 may convince them that they have a bigger stake in this problem than they have had in the past.

Mr. BYRNES. That is a point that certainly may strengthen the case for a tax increase. Thank you very much.

Mr. GULLANDER. Yes, sir.

The CHAIRMAN. Mr. Burke.

Mr. BURKE. On page 6 you make note of the fact that:

A ten percent surcharge on corporate tax liabilities would mean that the effective rate on all but the smallest corporations would be higher than it had been prior to the 1964 tax reduction.

How does your association feel about just restoring the former tax, restoring the cut that has been made from 52 down to 48 percent, and putting it back up to 52 percent?

Mr. GULLANDER. I think we made our point clear here when we said that the surtax should be the same fixed rate for individuals and corporations as well. If you are going to do that then you would go to an eight and a third percent increase and we are saying if you go that direction then that should apply to individuals as well.

I think the President having asked for 6 percent initially has led most Americans to believe that the tax increase would be in the neighborhood of 6 percent rather than the 10 percent he is now talking about, but if you moved the route that you are talking about that would be an eight and a third percent increase and if you moved in that direction then the personal income tax rate should also go up eight and a third percent.

Mr. BURKE. I think there will be a reluctance on the part of many Members of Congress to raise anyone's taxes, whether it is corporations or individuals, higher than it was prior to the cut. I would like to get some indication from you on how you would feel about having a 52 percent tax instead of the 10-percent surcharge.

Mr. GULLANDER. A 52-percent tax, of course, is the equivalent of an eight and a third percent surtax. I think it important psychologically, if for no other reason, and also from an administrative standpoint, that we do this as a surtax, not as a change in rates because at the end everybody makes his calculation and he knows, "This is the price I am paying because I didn't insist on lower Government spending."

It should be the same for corporations as well as individuals.

Mr. BURKE. There is a question here about what contributed to the deficit. I think we have to be a little bit honest about it that Congress did enact over \$16 billion in tax cuts between the corporations, large and small, the individual income tax, the 7-percent investment tax credit, and the repeal of most of the excise taxes. Despite the fact that some of our friends are talking about the mess we are in, there has been a bonus to the taxpayers during the past 4 years.

Mr. GULLANDER. One of the economic facts of life we learned as a result of the 1964 tax decrease was when you put more stimulus to invest and to expand and to run risks in business, you expand the economy and actually this Government got greater revenue in the form of taxes under the lower rates than I think it would have gotten under the higher rates, so making a mathematical calculation in saying what the income tax take would have been at a 52-percent rate rather than the 48-percent rate is purely that, just a mathematical calculation. It is not in keeping with the facts because the economy would not have moved and rolled forward as rapidly as it did under a 52-percent tax as it did under the 48-percent tax rate.

You ask Mr. Fowler and he will give you the same answer.

Mr. BURKE. It might be possible to secure an increase in revenue by reducing the taxes instead of increasing them.

Mr. GULLANDER. Looking ahead to 1969, 1970, 1971, if we get some control over Government spending and restore the tax rates to what they are today, you should have enough growth in the economy to produce added Federal revenue to eliminate the deficit in a very few years; but if we start boosting higher and higher tax rates in order to balance the budget and just keep on spending more money you are never going to get this thing in balance because you will slow down the growth of the economy.

It is really the same problem that a manufacturer has who can maybe make more money selling his product at 15 cents a unit than at 20 cents a unit because of the added volume he gets and the reduction in costs he achieves.

Mr. BURKE. Thank you.

The CHAIRMAN. Mr. Schneebeli.

Mr. SCHNEEBELI. Mr. Gullander, the automotive industry is faced with a problem in a couple of weeks in the labor area and we hear some dire predictions that it is going to be a long and costly strike.

Now, in the event that this strike eventuates and lasts more than 3 or 4 weeks and causes a severe economic dislocation, what would be the recommendation of your association relative to the surcharge?

Would it change its attitude in the event there was a long strike and dislocation? Would that have any influence?

Mr. GULLANDER. Let me say I think you have to anticipate if that doesn't happen something else will very likely happen so it will have a bearing. Hitting your specific question, I think this has a great bearing on what tax rate you apply.

As we said, we think you should have a surtax, but it should be at a rate which will not slow down the economy. What you are talking about would justify a move not in the direction of 10 percent, but in the direction of 6 percent because it would have less effect on the economy in total.

Mr. SCHNEEBELI. You think the surcharge should be less in the event we have some economic dislocations of the type I have described.

Mr. GULLANDER. I think the surtax should be low enough so you could absorb that kind of deal.

Mr. SCHNEEBELI. Or do you think it should be totally deferred?

Mr. GULLANDER. This is another question as far as the effective date of the surtax, and I think the thing that is more important than the economic dislocation is you have a very practical problem for those who use electronic computers to pay their people and the performance of the computers.

The programing is a long-time proposition and I have serious doubts that any date prior to January 1 would be enough time for these corporations to even program into their payroll structure a change in withholding taxes.

Mr. SCHNEEBELI. You are recommending a deferment until January 1 for corporations.

Mr. GULLANDER. I am referring to the practical side and practical time from an administrative standpoint in which it could be accomplished and which in a sense covers your point as well.

Mr. SCHNEEBELI. And a strike of any long duration would have an effect you think on the implementation of this legislation.

Mr. GULLANDER. I think it would, particularly the size of it.

Mr. SCHNEEBELI. Thank you.

The CHAIRMAN. Any further questions? Mr. Gilbert.

Mr. GILBERT. Sir, I listened very attentively and you talked about a reduction in the budget. Are you referring to domestic spending?

Mr. GULLANDER. This problem of getting spending under control in the Government is basically no different than getting spending under control in a corporation and getting your costs under control. It is a question of weighing your income and your expenditure and there isn't any department, and there isn't any area, and there isn't any product that shouldn't be examined in the corporate situation to determine how you cut your costs, how you reduce your expenditures.

This applies to Government in all aspects. We don't believe that you should curtail the financial needs of Vietnam and not provide the essentials of what they need. But I am sure in the administration, the Defense Department as well as every other department, there is room for economies, not in less effectiveness, not in less support for our troops on the frontline, but in the administration, and bearing in mind that Vietnam is a relatively small percentage of the total defense expenditures. So I think the Defense Department should be examined just as closely as any others, not at the sacrifice of our problem in Vietnam, but to assure greater efficiency.

The President has talked about perhaps needing another \$4 billion in defense. I think this should be looked at very, very carefully. The easiest money to save is the money you plan to spend and haven't yet spent. The hardest money to save is money you are already spending and you must cut back.

I think they should all be examined.

Mr. GILBERT. What always seems to excite people is that Government should be operated on an efficient basis as a corporation. Now, I don't think you can equate the private sector, the corporation, and a

Government operation. One very obviously is a nonprofit organization for the so-called benefit of the people of the entire country.

Mr. GULLANDER. But you asked where the cuts should be made and I said I think you should examine all of them, and the priorities have to be determined by this body, your fellow Congressmen, and by the administration.

Mr. GILBERT. Of course you realize you have these tremendous problems within our large cities and even our smaller cities. I don't think you would suggest that we cut back on these domestic programs to help these cities.

Mr. GULLANDER. Let me say this: That we have two responsibilities to these cities. One is to solve the immediate problem and the other is to make sure that we don't start an inflationary spiral which will damage the citizens who are living in these center core cities more than anybody else. So in an attempt to cure what the problem is today let's make sure we don't create a worse problem for those very same people in the future.

Mr. GILBERT. How do you feel that we are going to create a bigger problem for these people? Are we going to cut back on their spending of the moneys they need to rebuild these cities?

Mr. GULLANDER. The inflationary spiral would increase the cost of everything they have to buy and reduce their ability to spread their income adequately.

Mr. GILBERT. We still have to spend money to rebuild these cities no matter how you are going to cut it, no matter how you are going to slice it. The mayor's conference just in the meeting the other day said that millions and billions would have to be spent to get rid of our slums and ghettos.

Mr. GULLANDER. We have to recognize we have three levels of government: local, State, and the Federal Government, and it is the responsibility of everybody. We also have to recognize that this is a responsibility of the citizens of the United States and they can't push the whole burden off onto government and the people themselves have to become involved and not lean more heavily on government, and this includes industry and industry management which is moving in this direction.

In other words, what results for the administration and this Congress is a question of priorities. If you want to spend it on the urban problem, then you better examine more carefully other legislation and cancel some obligations.

Mr. GILBERT. In other words, you disagree with President Johnson that our economy is healthy enough to both spend for the war in Vietnam and for our domestic spending.

Mr. GULLANDER. I think we have to learn that when we look at a new African nation we see a very elementary society and we recognize very readily there is a limit to what that society can do for itself and everybody can understand it.

The same applies to the United States. We are a tremendously huge society, a great big economic machine, but there is a limitation as to what you can do and it requires priorities. We say in the administration of an African country, "You ought to spend your money on agriculture rather than for your presidential palace," or for some other government activity. We have to make those priority choices here as citizens and recognize that this country can't do everything.

Ultimately it is because the country grows every year. You have to lay out priorities every year. That is why we are getting behind a million dollars every 4 minutes, because we said we can do more than than we can do.

If you increase taxes you slow down the economy and we don't benefit, anyway, if you slow it down with a surtax that is too excessive.

Mr. GILBERT. Wouldn't you think then we should eliminate the surcharge for the people in the low brackets rather than your statement that everybody be taxed?

Mr. GULLANDER. There are two aspects to this. One is at the time of the tax reduction in 1964 the people in lower brackets got about a 35-percent reduction in taxes, and I think this was fine. Corporations got about 8 percent and the people in upper brackets got less.

It averaged out to about 20 percent for individuals. If the tax structure as it exists today is an equitable one, then the surtax should apply to everybody so everybody continues to bear his proportionate share of taxes.

The other consideration is, as I mentioned before, there are 16 million people who ought to recognize through their pocketbook that if the Government is going to do all these things someone is going to have to pay for it.

If you say we can do all these things then you must realize they cannot be done within a balanced budget and you can't go very far with a \$28-billion deficit. To eliminate the deficit by a tax increase you would have to have a 50-percent tax increase. If you have a 50-percent surtax you could have people paying more taxes than they have income, and this would destroy the economy, as you all recognize.

We are obviously trying to do more than we can afford because it would require an increase in taxes of 50 percent to pay our way.

Mr. GILBERT. Thank you, sir.

The CHAIRMAN. Any further questions? Mr. Conable.

Mr. CONABLE. Mr. Gullander, we hear there is some conflict in economic theory, at least according to Dr. Gardner Ackley who was here last week, about the extent to which it is necessary for corporations in periods of fairly tight profit margins, or at least declining profit margins, to pass on a corporate surtax to the individual consumers in the country.

With about 75 percent of the goods and services in the country being furnished by corporations, isn't it likely that a corporate surtax is going to go to augment the burden on the individual workingman who is also having to pay an individual surtax? Do you have any idea to what extent the corporate surtax is going to be passed on in the present state of our economy?

Mr. GULLANDER. The answer to your last question I am afraid has to be no, but I can discuss it a bit. This is going to vary by product, by company, by markets.

Mr. CONABLE. But it is a general surtax.

Mr. GULLANDER. This is right.

Mr. CONABLE. It affects all corporations. Therefore, the competitive factor is not going to be the same as it might be with the—

Mr. GULLANDER. It isn't a surtax on the Japanese, and the Germans, and French, and in the textile industry, for example, we have substantial imports and in steel we have substantial imports. This

tax is not going to be levied in those foreign countries and therefore in those areas I doubt very much there is capacity to pass it on.

In specialities you maybe don't have competition, but in the basic product we have foreign competition and there they are going to be at a disadvantage, yes. In some other product in which you may be the primary producer and be the world leader you may be able to pass it all off. In some others you will find fractions in between.

You also find of course the fact that the marketplace is selective in what it does and as the individual consumer faces higher prices he has to make more selections, to establish priorities of what isn't he going to buy.

If he starts picking on your product you are not going to pass on that tax because you are worse off losing the business than you are by paying the tax, so in your taxed box of Wheaties or whatever, you are not going to pass it on.

There are products which are basically sundries. I am talking about a package of gum or a soft drink which tends to have a fixed price, and you have to find some way of eliminating that price squeeze until you get a jump in price.

So some of those will not move ahead.

Mr. CONABLE. Then I take it it would be your conclusion as well as Dr. Ackley's that there would be substantial absorption by the corporate profits of this additional cost of doing business. Is that correct?

Mr. GULLANDER. Yes, I do.

Mr. CONABLE. Thank you.

The CHAIRMAN. Any further questions?

Mr. GULLANDER. May I add to that, however, if the money market gets tighter and tighter because of this huge inflation to be financed by borrowing, corporate profit is going to be reduced and we are going to be paying a higher price for the money we are borrowing if you didn't have a surtax.

Mr. CONABLE. The corporations are going to have to continue to make profits and in the long run, of course, anything that increases the cost of doing business is going to have to be paid for by those people who use the goods and services of the corporations, isn't it?

Mr. GULLANDER. If the market will absorb it.

Mr. CONABLE. We are talking about, then, only the short run and when you it will not be passed on to any substantial degree in all probability—

Mr. GULLANDER. Short run, but a different period of time for every segment.

Mr. CONABLE. Yes.

The CHAIRMAN. Mr. Bush.

Mr. BUSH. Mr. Gullander, one quick question. Did your group come out with any specific list of cuts? I looked at your statement, and if you were the President and you were asked to cut domestic spending immediately, do you have a list of things that would add up to a substantial cut that you could detail for us and by department and by agency?

Mr. GULLANDER. I do not, and you may ask the question as to why I do not. Because I am not the President. To again refer to a corporate situation, the board of directors is unhappy with respect to the profit performance of the corporation for which it is responsible. It does

not tell the president, "You have to do this, this, this, and this." They will tell the president, "You have to get your costs down. You have to get your expenses down and you go out and find out how to do it."

The president of the corporation has all the facts to permit him to know where he can cut, where he can cut R. & D., where he can make changes to cut costs, and so forth. The only one in the country who has this available to him is the President of the United States.

You know the budget as well as I do, the voluminous size, and this requires a staff of a substantial number of people and strict orders as to what to do, including some arbitrary things only the President can do, plus the fact that Congress can put substantial pressure on him, but for an outsider to tell specifically where to cut, this is not a realistic approach to the problem.

Mr. BUSH. I am not sure I would agree with that. I think we need some help around here on cutting spending. I agree with your thesis, but I think we need some specific suggestions in this regard because it is one thing to criticize.

I find I make the same speech at home that you made, but I find the increasing pressure of people telling me, "OK, where would you cut?" And I think it would be helpful if your group had some recommendations and I am sure different members do. They can be put out in a rather general form just to give us some direction because I think we are going to have to come up with some specific suggestions if we really want to force the President to cut spending, which I frankly would like to see done.

Mr. GULLANDER. Only the department heads who are reporting to the President can really identify where to curtail the spending. If the President gives an assignment to each department head as to what he has to cut, the President can't tell where to cut. He can tell them in total as to what to cut, but as to where they must tell him and Congress must examine.

You must examine your agricultural program, all your programs, to determine whether or not this is the place to cut. It is a question of priorities and the American public have elected Members of Congress to make those priorities and they have elected the administration to make those priorities.

Mr. BUSH. No further questions.

Mrs. GRIFFITHS. Mr. Chairman.

The CHAIRMAN. Mrs. Griffiths.

Mrs. GRIFFITHS. I would like to say, Mr. Gullander, that really the Federal Government isn't like a corporation at all. There is no comparison. The Federal Government doesn't have a balance sheet. It doesn't have to make a profit. The Federal Government doesn't even have a memory. So that there is no real way in which it can handle with judgment the naming of priorities.

Now, I have been trying to get people on the other side of the aisle for some time to name priorities and say which things they would cut out, but I know that the mere suggestion of cutting out items and putting them in a list would cost millions of votes to anyone who named them, so that it isn't really that simple.

Mr. GULLANDER. That is why I said the responsibility is also on the constituents as well as Congress and the administration.

Mrs. GRIFFITHS. That is right; and even constituents like you.

Mr. GULLANDER. I agree. At least this constituent came forward and said we have to have a tax increase and we don't like it.

Mrs. GRIFFITHS. For instance, I had a man come into my office on Friday. He wanted to sell computer parts to the Government. He wanted the Government to purchase not from one blueprint the whole computer, but to buy them in parts, the main part and the peripheral parts and he showed me it would be cheaper, and I agree with him.

I used to purchase. But in place of that the Defense Department or GSA is buying computers by sending out to one or two contractors the request. Those contractors draw the blueprints, so what do you do? You buy their computers. If you suggested, and I am going to make the suggestion, that we buy these computers part by part at least one company in this country is going to be madder than a hornet.

Mr. GULLANDER. I have been in purchasing in my lifetime as well and some of my suppliers got mad at me, too. You have to get used to that.

Mrs. GRIFFITHS. This is a simple example of something that would save millions and yet is not being suggested. But supposing you started suggesting, well, we will cut out these dams, roads, this and that, and so forth and so on. It would become mighty unpopular, so that you have to have a general understanding throughout the country and it doesn't contribute to that understanding, in my opinion, for anybody to say that the Federal Government is just like a corporation.

Mr. GULLANDER. I didn't say it was like a corporation. I said the management problem is similar. When you have to curtail expenditures the responsibility must rest with management and in a corporation if you have to curtail expenditures the responsibility must rest with management. That is the only comparison I made.

Mrs. GRIFFITHS. But even that is not exactly right because management in a corporation in many cases owns enough stock in that corporation to vote itself into management no matter what, but I tell you we don't own that kind of stock in this corporation.

There is somebody else to vote.

Mr. GULLANDER. As I said to Mr. Byrnes, I have gone from coast to coast I forget how many times preaching the gospel that the people at home in Michigan, among other places, must write to you and say cut this even though it hurts Ann Arbor, even though it hurts Big Rapids where I was born.

Mrs. GRIFFITHS. They haven't been telling me where to cut out anything that helps Michigan because I haven't had a single letter like that.

Mr. GULLANDER. What is rougher than a \$29-billion deficit, a million dollars every 4 minutes?

Mrs. GRIFFITHS. But nobody ever writes me and says cut this even if it hurts Detroit.

Mr. GULLANDER. That may give them a greater responsibility.

Mrs. GRIFFITHS. They all write now and say send the money just to Detroit.

Mr. GULLANDER. That is one of the advantages of a surtax, it lets the people in Detroit find out that they must pay at least some part of it.

Mrs. GRIFFITHS. They are all mad about the surtax.

Mr. GULLANDER. I am too, but I think to be responsible you have to support it.

Mrs. GRIFFITHS. Thank you.

The CHAIRMAN. Any further questions of Mr. Gullander?

If not, Mr. Gullander, we again thank you for bringing to the committee your views and those of your organization. We appreciate your responses to our questions.

Mr. GULLANDER. Thank you, Mr. Chairman.

The CHAIRMAN. Captain Bullen of the National Federation of Independent Business. Mr. Bullen, we will ask you to identify yourself for our record by giving us your name and capacity in which you appear.

**STATEMENT OF GEORGE S. BULLEN, LEGISLATIVE DIRECTOR,
NATIONAL FEDERATION OF INDEPENDENT BUSINESS; ACCOMPANIED BY JEROME GULAN, CONGRESSIONAL LIAISON**

Mr. BULLEN. Mr. Chairman, I am George S. Bullen, legislative director of the National Federation of Independent Business. I have with me my assistant, Mr. Jerome Gulan.

The CHAIRMAN. Glad to have you with us, sir. Do you have copies of your statement available for us?

Mr. BULLEN. Yes, I gave them to the office when I came in, 120 copies.

The CHAIRMAN. It is here. Go right ahead, sir.

Mr. BULLEN. Mr. Chairman, I want to thank you for inviting the National Federation of Independent Business to testify before this committee on a matter which we feel is of the greatest importance to the small business community of this Nation.

The National Federation of Independent Business, founded 24 years ago, now represents more than 239,000 independents.

This means that approximately one out of every 20 small businessmen in the country is a Federation member. Our membership is representative of all facets of the business spectrum including retailing, wholesaling, manufacturing, and the service trades. A check of membership percentages in each category shows that the composition of the Federation is within a few percentage points of the composition of the Nation's entire small business community.

Therefore, we feel that we can reasonably say that the views expressed by our members can be taken as a valid cross section of the views of the 4.7 million enterprises comprising the small business community.

A few months ago we polled our nationwide membership on the question of a tax increase, asking their opinion on what was at that time the administration's current proposal; namely, a 6-percent surcharge on corporate and individual taxes. Our members voted overwhelmingly against the idea, with a majority of 90 percent expressing their opposition.

For your information we have included the question, showing arguments for and against, just as it was put to our members. You can see that only 9 percent were in favor, 90 percent opposed, while 1 percent expressed no opinion.

To save the committee's time, Mr. Chairman, I will omit reading the arguments, but I ask that they be included in the statement.

The CHAIRMAN. All right.

(The information referred to follows:)

The Mandate

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That Our Nation Remains the Land of Opportunity By Giving Small Business Fair Consideration



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① ARE YOU FOR OR AGAINST Congress increasing the Federal income tax on corporations and individuals by adding a 6 per cent surtax, effective July 1?

For example, a taxpayer owing \$1,000 would add \$60 (6%) to his regular tax bill. This increase would last 2 years. After that, the cost of the new tax would be \$5,000 a year for people with income of \$1,500 or less would be exempt from the new tax.

BEFORE VOTING ISSUES . . . READ THESE EXPLANATIONS:

1. **Argument for the proposal:** Proponents say the added revenue is needed to hold our budget deficit within prudent limits and to give our country and our fighting men the help they need in this hour of trial. Problems of the cities, air and water pollution, education, crime, social security, the aged, the poor, cannot be postponed or neglected because of a war that drains our country of its manpower and resources. This nation is prosperous enough to tighten its belt and release a relatively few dollars per person to insure that all Americans receive the support they need.

1. **Argument against the proposal:** Opponents say it is impossible to have a "guns and butter" budget, when the cost of both commodities is so expensive. We must support our troops. However, there is a limit on how much the taxpayer can stand. It is clear that a better way to pay for the war would be to eliminate some of the wasteful, domestic non-defense spending programs and not ask for an additional \$270 million for the poverty program, as the President did. Besides, leading economists agree that now is not the time for a tax increase certain to have a further depressing effect on our already slower growing economy.

	FOR	AGAINST	NO VOTE
1. Fed'l income tax increase of 6 per cent surtax on corps. and individuals	9%	90%	1%

Mr. BULLEN. We do not feel that this strong opposition to a tax increase on the part of the small business community should in any way be misconstrued or labeled a "lack of patriotism." We do feel that it is an honest expression of economic reality as seen by this country's small businessmen. They have not been convinced that we can enjoy a guns-and-butter economy.

Nor does their vote against a tax increase constitute an outlook of fiscal irresponsibility. Believe me, gentlemen, when I say that the local businessman is among the first to realize the pitfalls and economic chaos resulting from inflationary trends.

When the prime interest rate rises to 6 percent, it is the small businessman who must pay 7, or 8 percent, or more.

The President, in his August 3 message, predicts dire consequences if this tax increase is not approved. Among his predictions are spiraling inflation, higher interests rates, and tight money.

Mr. Chairman, the federation submits that the business community is already experiencing these problems. We hear daily of increasing payroll costs, higher wages, greater fringe benefits, high interest rates, and general tight money situations. Minimum wages continue to be driven upward, not by market conditions, but by social pressures and the dictates of organized labor.

As the trend continues, we see a slowing economy, rising inventories, a slowup in collections, increasing automation resulting in lesser employment. As a matter of fact, unemployment among the lesser skilled, the youths, the handicapped and the aged seems to rise proportionately with rising business costs.

That corporate profits are already declining is not news to the administration. Although we have barely gotten into fiscal 1968, the administration has admitted that these lower corporate profits will be yielding \$1.3 billion less in tax revenues than had been anticipated 6 months before.

Surely adding a 10-percent surtax to taxes already paid by corporations, both large and small, is hardly the way to stimulate a vigorous business outlook and could well prove disastrous should business decide to reduce productivity and employment—thus resulting in still lower corporate profits and an even smaller tax yield.

We believe that the administration must first win the confidence of the small business community and the Nation by severely reducing nonessential expenditures before it can expect to ask for and receive wholehearted support in a venture such as is proposed in the President's tax message.

Unless some drastic measures are taken to curtail nondefense spending, the small business community will not be convinced.

So long as Federal tax dollars are being spent on the war on poverty to establish tax free cooperatives which compete with existing business, they will not be convinced.

So long as priorities have not been assigned to the war in Vietnam, antipoverty, space, air, and water pollution, slum clearance, and foreign aid, they will not be convinced.

Mr. Chairman, the members of the National Federation of Independent Business have made it abundantly clear that they are opposed to this proposed surtax. We feel that the crux of their opposition lies in the fact that they are firmly convinced that our economy will not support both a guns and butter doctrine on an equal basis.

Therefore, we recommend:

(1) The Congress insist that the administration first follow through with its promises to reduce nondefense spending. Actual cuts rather than the promises or assurances are necessary.

(2) That some reasonable prognosis be given as to the duration and cost of our Vietnam commitment. Current estimates seems to be running as high as 10 or 20 years, with annual defense expenditures already in excess of \$75 billion.

(3) The Congress not approve any tax increase until after a reasonable period (6 to 12 months) in order to allow the administration to show its ability to drastically reduce nondefense spending and to prove the effectiveness of such cuts on the budget deficit.

That concludes my statement, Mr. Chairman.

The CHAIRMAN. We thank you, Mr. Bullen. Are there any questions of Mr. Bullen?

If not, we thank you, sir, for bringing to us the views of your organization.

Mr. BULLEN. Thank you, sir.

The CHAIRMAN. Mr. Seghers, you have been before the committee in the past on several occasions, but for this record will you again identify yourself.

STATEMENT OF PAUL D. SEGHERS, PRESIDENT, INSTITUTE ON U.S. TAXATION OF FOREIGN INCOME

Mr. SEGHERS. My name is Paul D. Seghers. I am president of the Institute on U.S. Taxation of Foreign Income. We are here to oppose the Treasury's proposal to impose the 10-percent surtax in such a way as, in effect, to deny a portion of the foreign tax credit allowable under existing law.

The Treasury states that the 10-percent surtax is to be imposed on the amount of tax computed without allowance of any investment credit or foreign tax credit to which a taxpayer is entitled under existing law.

The effect of this Treasury plan would be to reduce by 10 percent the presently allowable investment credit and foreign tax credit.

We cannot believe that your committee would approve this device for imposing a discriminatory tax increase of more than 10 percent on the tax bills of U.S. manufacturers and others exporting U.S. products and bringing into the United States income from abroad.

The discriminatory result of the Treasury's plan may be illustrated as follows:

Manufacturer A makes no plant investments and brings in no foreign income during 1968.

Manufacturer B makes plant investments and brings into the United States income from sales of its U.S. products abroad in 1968, resulting in allowable investment and foreign tax credits totaling \$40,000.

If, under existing law, each would pay an income tax of \$100,000, the Treasury's plan would require manufacturer A to pay, in addition to its income tax, a surtax of \$10,000; and manufacturer B to pay a surtax of \$14,000, or 40 percent more than manufacturer A.

The Treasury cannot deny that this would be the dollar result of its plan.

Let me interject here and say this. That if a manufacturer is paying \$14,000 more and his tax has been increased \$14,000 over the \$100,000 he would pay under existing law and you tell him you are only taxing him 10 percent he will tell you you are a darn liar. That isn't 10 percent.

That is a 14-percent tax increase or 40 percent more than his competitor who is selling domestically only would pay.

If the surtax is to be imposed for only a year or two, it would be an incentive to taxpayers to postpone plant improvements and the receipt of income from abroad. These results surely are not desired by your committee or the Congress.

OUR RECOMMENDATION

If there is to be a 10-percent surtax it should be exactly that: 10 percent added to the amount of tax otherwise payable under existing law—neither more nor less.

There are many other discriminatory tax burdens which the Treasury has been successful in imposing on U.S. manufacturers selling their products abroad, and thereby further aggravating the annual deficit in our balance of payments.

However, we recognize that this is not the occasion to discuss the need for tax reform in this area. At this time we only ask the committee not to impose further income tax penalties on U.S. exports and on the bringing home of income from abroad.

I hope that this has made the matter clear and no amount of words can change the fact that the Treasury proposal would increase the tax bill of many taxpayers over the existing law by more than 10 percent, sometimes as high as 20, 25 percent higher than their present tax bill in typical cases.

I have made my statement. I hope that if anyone has any questions that you will ask.

The CHAIRMAN. Are there any questions of Mr. Seghers?

Mr. Seghers, we thank you, sir, for coming to the committee.

Mr. SEGHERS. Thank you.

The CHAIRMAN. Mr. Kust. Mr. Kust, you too have been before the committee before but for this record we will ask you to again identify yourself.

STATEMENT OF LEONARD KUST, VICE PRESIDENT AND GENERAL TAX COUNSEL, WESTINGHOUSE ELECTRIC CORP.

Mr. KUST. Mr. Chairman and members of the committee, my name is Leonard Kust. I am vice president and general tax counsel of Westinghouse Electric Corp.

The CHAIRMAN. We are glad to have you with us, sir, and you are recognized.

Mr. KUST. Thank you. I appear to present the views of my company on the tax surcharge proposed in President Johnson's message on the state of the budget and the economy delivered to Congress on August 3, 1967.

The surcharge is proposed as a means of combating inflationary pressures on the economy, checking the rise in interest rates, relieving the tightness of money and averting an unequal and unjust distribution of the cost of the war in Vietnam.

We are not in a position at Westinghouse to judge the state of the budget as presented by the President, but if the President and the Congress are unable to reduce expenditures we agree that the projected deficit without a tax increase is potentially dangerous for the economy.

If taxes have to be increased, we want to be sure that the Congress has before it and takes into account considerations which we feel are germane and important to the decision as to how and when taxes should be increased.

PRESENT ACTION SHOULD NOT NEGATE RESTORATION OF INVESTMENT
CREDIT

We approve of the action taken by the administration and the Congress earlier this year in restoring the investment credit. This timely action, by stimulating modernization and expansion of capacity, will help to avert inflation. We commend the administration and the Congress for this action and urge that no action be taken now which would negate the beneficial effects of the restoration of the investment credit.

PRESENT ACTION SHOULD NOT BE TAKEN IN THE PERSPECTIVE OF OTHER
ACTIONS ALREADY TAKEN

Consideration of appropriate action at this time must also be placed in the perspective of other actions already taken affecting the tax payments of corporations in 1966 and 1967.

CORPORATIONS PAID ADDITIONAL TAXES OF \$4 BILLION IN 1966
AND \$7 BILLION IN 1967

As a result of the acceleration of estimated payments under the 1964 Revenue Act, the Tax Adjustment Act of 1966, and the administrative acceleration in 1966 of the payment date for withheld taxes, corporations have paid to the Federal Government in the fiscal year 1966 \$4 billion in additional taxes, about 15 percent of their taxes otherwise payable.

In the fiscal year 1967 these actions increased corporate tax payments by \$7 billion. Had this increase for 1967 taken the form of a temporary increase in the corporate income tax rate the effect on the cash flow of corporations should have been precisely the same, but to produce the same increase in tax payments the corporate rate would have had to be increased to about 60 percent from the prevailing rate of 48 percent.

If such an increase in the corporate tax rate had been enacted I think most people would agree that corporations were making a disproportionate contribution to increased fiscal needs. Corporations have made this contribution, unfortunately, for purposes of general recognition, in an obscured and less visible way than through a rate increase. But it has produced an identical reduction of the cash of corporations.

Considered in another way, the \$7 billion increase in the fiscal year

1967 represented increases of about 23 percent in the tax payments of corporations for that year, measured against total income tax payments of corporations of about \$30 billion.

Again, one must be impressed by the magnitude of the contribution which corporations have already made to increased fiscal needs.

BY CONTRAST INDIVIDUAL TAX PAYMENTS WERE INCREASED BY
\$1 BILLION IN 1966 AND \$1.3 BILLION IN 1967

By contrast, the restoration of excise taxes on automobiles and telephones and the increase in individual withholding and estimated tax payments increased individual tax payments by about \$1 billion in the fiscal year 1966 and about \$1.3 billion in the fiscal year 1967, an increase of only 2 percent, measured against total individual tax payments of about \$60 billion.

DISPROPORTION IN THE TAX BURDENS OF CORPORATIONS AND OF
INDIVIDUALS HAS DEVELOPED

At the time of the 1964 tax reductions the administration made a great point of demonstrating that the action taken was a balanced package in that it reduced individual income taxes by approximately 20 percent and, while the corporate rate reduction by itself was considerably less, adding the effects of the 1962 investment credit and depreciation liberalization, corporate taxes were also reduced by approximately 19 percent.

This, however, failed to take into account that corporations were required to speed up tax payments which increased their payments by approximately 10 percent a year through 1970. The further speed-up under the 1966 law compressed that annual increase into the fiscal year 1966 and 1967, which, with the speedup of withheld tax payments, resulted in a tax increase; that is, in tax payments, in 1966 of 15 percent and in 1967, as already indicated, of 23 percent.

Temporary suspension of the investment credit and accelerated depreciation further increased corporate taxes in 1967.

In view of what has transpired, it seems clear that the administration's apparent recognition of the desirability of balance in its actions affecting the tax burdens of corporations and individuals has nevertheless not prevented a very substantial imbalance from in fact developing. The heavy hand of additional tax burdens which has already been laid on corporations must be kept in mind in deciding on the nature of new tax increases.

ECONOMIC CONSEQUENCES OF THE INCREASED CORPORATE TAX BURDENS

The disproportion in the distribution of the burden of the additional taxes required by the Government in the last 2 fiscal years to finance the increasing costs of the Vietnam war and domestic programs must be judged not only by the lack of proportion and equity involved but by its economic consequences.

The President's call for increased taxes has as a major objective the avoidance of higher interest rates and tighter money. I think it is reasonably clear that the acceleration of tax payments of corporations in 1966 and 1967 has been very substantially translated into

additional borrowing, which has put pressure on interest rates and on the money market.

There is an excellent article in the July-August 1967 issue of the Harvard Business Review which analyzes in depth the effect of acceleration of tax payments on corporate liquidity and corporate borrowing. With your permission, Mr. Chairman, I would like to submit a copy of this article for the record.

The CHAIRMAN. Without objection it will be included at the conclusion of your remarks.

Mr. KUST. In our own case at Westinghouse the speedup of tax payments depleted our cash in 1966 and in 1967 by \$70 million at a time when it was already necessary for us to borrow money to finance modernization and expansion of facilities. It seems perfectly clear that had these additional tax payments not been extracted from us we could have reduced our borrowing by the same \$70 million.

Given the present state of cash shortages in corporations, any tax increases or further payment speedups will almost certainly be very substantially reflected in additional borrowing, thus, further increasing pressure on interest rates and the availability of money.

If, on the other hand, increased tax burdens on corporations should be reflected in decreased investment rather than increased borrowing, the purpose of averting inflation by tax increases would not in the end be achieved.

Expansion and modernization of productive capacity as the basic foundation for increasing productivity to support the prosperity of the Nation and the growing commitments of Government is, in final analysis, the best protection against inflation.

It seems clear that the speedup of corporate tax payments in 1966 and 1967 now presents a problem. It created a temporary bulge in revenues which we find must now be made up from other sources. It depleted corporations of cash so that they are now less able to absorb a new tax increase without borrowing or curtailing investment, both of which ran counter to the desired objective of reducing the pressure on interest rates and on price levels in general.

ANY SURCHARGE ON CORPORATIONS AND ON INDIVIDUALS SHOULD BE
EFFECTIVE JANUARY 1, 1968

I do not have the courage to say that given this history, taxes on corporations should not now be increased. Whatever economic wisdom may suggest, political realism would seem to dictate that if individual taxes are to be increased, corporate taxes must also be increased. But certainly they should be increased no more and no earlier.

In any event, it seems to us wholly unjust and economically unwise to compound the imbalance that has already been created by imposing the surcharge retroactively on corporations and prospectively on individuals. If Congress deems a surcharge necessary, the effective date for individuals and corporations should be the same. Given the present continuing uncertainty in the economy, that date, in our judgment, should not be earlier than January 1, 1968.

Thank you.

(The information referred to follows:)

[From Harvard Business Review, July–August 1967]

THINKING AHEAD—TAX SPEEDUPS AND CORPORATE LIQUIDITY, BY JOSEPH E. MILES

Acceleration of corporate income tax, Social Security, and employee withholding payments is squeezing business

FOREWORD

U.S. corporations have exhaustively examined the implications of the changes that have been made in their tax rates and base and in provisions for writing off capital investments. But they have paid too little attention, the author says, to the present and potential effects of the acceleration of tax payments which President Kennedy began and President Johnson is continuing. Dr. Miles is Vice President and Investment Counselor of Lionel D. Edie & Company, a New York investment and economic consulting firm, and is a member of the New York bar.

Acceleration of various direct federal taxes will provide an estimated increase in revenue of \$22 billion to \$23 billion when it is completed. Additionally, Social Security taxes have been increased about \$6.5 billion in the last two years, and even larger increases are in the offing. The impact of some of these tax changes is fairly certain; others are uncertain and conjectural at this point. Some will dampen the economy; others will stimulate it.

One thing is apparent: it isn't the same world as before, and thinking will have to change. This tax speedup has had and will continue to have an important effect on the structure of the business environment, including corporate cash flow, competition, customers' purchasing habits, the level and life of receivables, and the level of demand.

Yet, because structural changes do not lend themselves to normal business forecasting or corporate routines, many of these tax-induced changes have not been anticipated by corporate executives.

This analysis concerns itself primarily with the changes in payment dates on certain taxes and the several increases in Social Security tax rates. (The businessman presumably is familiar with the highly advertised reductions in tax rates for individuals and corporations in 1964 and 1965, the indirect corporate tax reductions represented by shortened depreciable lines in 1962, and the 7% investment credit instituted first in 1962.) I shall stress the substance of these changes and not the form in which they were passed by Congress or have been proposed by the Administration.

The conclusions stated herein are made with the proviso "all other things being equal." This is done not to protect me from bearing the weight of my errors but to underscore the probability that these results will give rise to offsetting or softening federal legislation.

Changes in the tax rates and tax base are understood rather easily. More difficult to grasp is the speedup of payments. President Johnson accelerated the payment dates on a number of taxes without changing rates. The attitude of many persons, including many corporate officers, to acceleration has been: We owe it anyway, we pay it a little earlier, so what?

For a better understanding of acceleration, let us examine an extreme case. Assume that all taxes are due on December 31 of each year. Then they are accelerated and become payable January 1. There is no increase in the rates; the same amount of taxes are due and paid in each year. But only the naive would say that to pay 100% of all taxes for two years in two days is not an increase. Acceleration is in effect a temporary tax increase during the period of speedup.

One failing of those who do not view acceleration as a temporary tax increase is that they misunderstand two accounting terms, namely, *reserved* and *funded*. Consider federal corporate income taxes. A tax liability arises whenever a corporation shows a profit. Before acceleration, payment of this liability lagged an average of seven to eight months behind the period in which it arose. A corporation generally did not put money aside to pay taxes as the tax liability was incurred. True, the amount of the liability was *reserved* on its books, but it was not *funded*. Taxes were paid—and still are paid—from current cash flow and current profits, and not from yesterday's cash and profits.

The U.S. corporation operates on cash flow. Accounting conventions tell us that taxes should be charged to the period giving rise to their liability—usually, in practice, the fiscal quarter—but they do not tell us when they are or should be paid.

U.S. corporate treasurers are not fools, with taxes due, on average, seven or eight months after their liability arises, they tell themselves, "Why fund the money? Analyze cash flow and make sure cash will be available to pay taxes when they fall due, but don't put money aside for this in Treasury bills or commercial paper at 4% to 6%. Put that money in the business at 10%, 15%, or 25%."

CORPORATE TAX ACCELERATION

There have been two recent rounds of acceleration of corporate income taxes. I shall examine them in chronological order.

JFK round

President Kennedy reduced corporate tax rates, but he stepped up the payment dates. Prior to this, larger corporations paid somewhat under half their income tax in the latter half of the tax year during which the liability arose and paid the greater part in the first half of the following year.

The unilaterally imposed quid pro quo for the cut in rates was a gradual move to a modified pay-as-you-go basis by 1971. This was accomplished by having corporations begin paying their federal income taxes in the quarter in which the liability arose.

This acceleration had varying effects on the corporate taxpayer depending on his size and, more particularly, on his growth rate.

EXHIBIT I.—EFFECTIVE FEDERAL CORPORATE INCOME TAX RATES (CASH TAX RATES)

[In percent]

Year	Zero growth	5 percent growth	10 percent growth	15 percent growth
1963.....	52.00	50.45	49.05	47.76
1964.....	52.00	50.45	49.05	47.76
1965.....	51.38	49.93	48.61	47.44
1966.....	51.60	50.30	49.13	48.06
1967.....	51.60	50.48	49.46	48.53
1968.....	51.60	50.65	49.46	49.00
1969.....	50.16	49.38	48.68	48.05
1970.....	50.16	49.49	48.85	48.31
1971.....	48.00	47.43	46.91	46.43

Effective federal corporate income tax rates under acceleration are shown in *Exhibit I* for various corporate earnings growth rates. (Hereafter, these will be termed "cash tax rates," meaning income taxes *paid* during the year divided by taxable earnings during that year. This measure of the actual tax burden on cash flow is better than pairing tax accruals with current earnings.)

The exhibit shows the combined effect on taxable income of the "reduction" in rates and of the speedup. It should be noted that taxable income as used here is not what a corporation shows in its annual report to shareholders, but what it includes in its tax return.

In making payments on their estimated federal income tax liability, corporations currently do not incur any penalty for underpayment if they pay a minimum of 70% of the actual liability. The exhibit assumes that corporations make payments at a 75% level of actual liability, building in a 5% margin for error (75% is also the figure used by the Council of Economic Advisers for this purpose).

Exhibit I indicates that there has been no reduction in the actual burden of corporate income tax payments as measured against taxable corporate income. The direct tax reduction (the cut in rates) was indirectly repealed for a period of seven years by means of acceleration of payments.

At the same time that acceleration went into effect, however, corporate income taxes were reduced by means of the second phase of the 7% investment credit. The exhibit does not take into consideration the effect of the 7% credit. This is deliberate so as to isolate acceleration and show its unfavorable effects.

LBJ round: President Johnson has refined JFK's tactic of increasing the tax take without increasing the tax rate. Instead of getting to a pay-as-you-go basis by 1971, corporations now must be paid up by July 1, 1967. The impact was greater in fiscal 1967 (federal) than in 1966.

The government estimated the new speedup would increase corporate tax payments in fiscal 1966 by an additional \$1 billion and in fiscal 1967 by \$3.2 billion (since changed to \$4 billion). This is on top of the JFK round of acceleration, which added about \$2 billion in fiscal 1966 and \$2 billion-plus in fiscal 1967. These increases also were concentrated in the latter half of the fiscal year, i.e., the first half of the calendar year.

Exhibit I indicates that the cash tax rate increased in 1966 and again in 1967 under the JFK round of acceleration. So the LBJ round came at a time when the cash tax rate was already scheduled to rise an average three fourths of one percentage point.

The Johnson Administration has requested two further rounds of speedups. Heretofore the first \$100,000 of corporate tax liability was due the following year and was not included in the estimates subject to quarterly payment. The President proposes to place these payments on a pay-as-you-go basis by 1972. The cost, primarily to smaller corporations, will be \$800 million a year for five years, starting in 1968.

Corporations currently filing estimated tax returns are required to pay 70% of their actual tax liability. LBJ proposes to increase the 70% minimum to 80%. Assuming that corporations include the same 5% safety margin, they will pay 85% of their estimated taxes starting June 15, 1968. The Administration estimates this as worth \$1.6 billion, but a more accurate figure would be \$2.4 billion, with \$1.8 billion falling due in 1968 and the remainder in 1969.

OTHER PAYMENTS SPED UP

President Johnson accelerated the remittance of Social Security and individual income taxes withheld by employers by having them remit such taxes faster and more frequently.

Prior to June 20, 1966 employers remitted in the middle of each month the accrued liability for the previous month. Since that date employers whose withholding of employees' income and Social Security payments plus the employer's share of the Social Security tax, totaled \$4,000 per month or more have been required to remit these taxes twice a month. Furthermore, the grace period was reduced from 15 days after the close of the accounting period to only 3.

Instead of having use of these funds for an average of 3½ weeks, employers now have them only half a week. The acceleration brought the federal government an additional \$1.5 billion to \$2 billion, as affected employers remitted 12½ months of withholding and Social Security taxes in a 12-month period.

On February 1, 1967 the \$4,000 minimum was dropped to \$2,500, forcing even smaller employers to accelerate these payments. As a rough rule of thumb, companies with 30 to 50 employees have been affected by the 1967 acceleration. Federal receipts probably increased by \$200 million to \$250 million.

The Treasury has announced plans to extend the semimonthly remittance system to much smaller employers. This is expected to be effective by the end of 1967 and will cover companies whose withholding and Social Security tax liabilities total as little as \$100 per month.

FUNDING THE LIABILITY

Some corporations, it appears, continued to view each of the various tax accelerations as merely payment of a debt—rather than as a one-time increase—until the Johnson rounds made their impact felt.

At any rate, many companies have now begun to fund tax accelerations with capital (debt, convertible issues, and common stock), and will continue to do so. Some, of course, have had plenty of cash and cash items on hand and merely dipped into these.

But cash has been in shorter supply. The buildup in inventories during 1966, the money squeeze on the banks, a slowdown in corporate profits, and the considerably higher Social Security tax rates since January 1, 1966 have accelerated the shrinkage of corporate liquidity. Capital expenditure programs have eaten into cash reserves as well, and many corporations now raising money did not think they would have to do so until 1968, 1969, or 1970.

Those corporations that attempt to pay the accelerated taxes from cash flow will lose competitive position, especially if they tighten inventories and receivables.

The tax speedup has squeezed, and will continue to squeeze, profit margins and per-share earnings. Corporations funding these liabilities find that overhead costs are higher, reflecting the carrying charges of the debt—which is not backed by an earning asset. To some extent corporations have been forced to pay higher interest rates because funding of taxes has caused their credit rating to deteriorate. Funding of accelerated taxes with common stock directly reduces per-share earnings.

LIKELY IMPLICATIONS

Acceleration of the various corporate taxes will add up to \$20 billion by the time the proposed round is over. This total consists of: the JFK round through 1967, \$7 billion; the LBJ acceleration of corporate income taxes in 1966–1967, \$5 billion; acceleration of withholding and Social Security taxes, \$2 billion; and the proposed acceleration of corporate income taxes, \$6.5 billion.

The consequences of funding obligations are not the only effects on businesses. There are others, some of a short-run nature and some more far-reaching.

Who will pay

The burden has fallen and will continue to rest almost entirely on larger corporations. Naturally, they must pay their own accelerations. Also they will have to carry part of the acceleration burden of smaller—especially privately owned—corporations, which usually have a difficult time raising money.

The tax speedups eventually will take upwards of an additional \$4 billion from the smaller companies. They do not have it and will “borrow” it from larger corporations by paying their bills more slowly, demanding more credit and longer terms, and requiring the larger corporations to carry their inventories. The larger companies' accounts receivables will rise. Those companies that will not or cannot grant more liberal credit terms will be at a competitive disadvantage.

Medium-sized companies

The per-share earnings growth of medium-sized companies will probably slow down. The burden of their own accelerated tax payments, as well as the indirect assumption of the burden of smaller companies, will force them to raise capital. Considering their size and the nature of the securities markets, financings on their part are likely to be either convertible debentures or common stock.

In either event, future earnings growth will be diluted on a per-share basis, leading to slower market appreciation of the stock and erosion in price/earnings multiples.

The slowdown in 1967 profits

Although a slowdown in corporate profits in 1967 is reducing the total tax bill, it is squeezing cash positions even more. The greater the drop in profits, the higher the corporate cash tax rate and the more the squeeze. An approximation of the impact can be obtained by reading *Exhibit I* from right to left. For a company whose earnings growth is declining from 10% in 1966 to zero in 1967, the cash tax rate increases from 49.13% to 51.60%.

Further funding

Although corporate tax acceleration will drop from an estimated \$6.5 billion in 1967 to \$2.6 billion in 1968 and \$1.4 billion in 1969, the tax-induced incremental demand for funds will still remain at a high level. Funding of this additional amount, plus \$800 million per annum in 1970–1972, will continue to exert some pressure on the money and bond markets.

Corporate cash flow

I have pointed out that acceleration is equivalent to a temporary tax increase. One of the proposed speedups, the increase in payments of estimated taxes from 70% to 80%, is a permanent one. The resulting tax increase, however, will offset only a small part of the eventual decline in the cash tax rate, as can be seen in *Exhibit II*.

The exhibit draws comparisons with 1963, the last year before reductions in the tax rate and acceleration. A 5% margin for error is included in each estimate.

After acceleration is completed, the reduction in the corporate tax rate reduces actual corporate income tax payments by an estimated \$2.4 billion a year (assuming a 5% growth rate in pretax profits). Raising the estimated payments from 70% to 80% reinstates \$200 million of the cut.

EXHIBIT II.—EFFECT OF INCREASING ESTIMATED TAX PAYMENTS

(In percent)

	Zone growth	5 percent growth	10 percent growth	15 percent growth
1963.....	52.00	50.45	49.05	47.76
75 percent estimate.....	48.00	47.74	46.91	46.43
85 percent estimate.....	48.00	47.66	47.35	47.06

The increase in estimated payments from 70% to 80% primarily affects large corporations. One might suppose that with lower cash tax payments eventually, the burden on the large companies of indirectly carrying the tax acceleration for the small companies is short-lived. This is not true, however. The cash tax rate will not decline until 1970—and not until 1971 if the Administration should increase the minimum on payment of estimated corporate taxes to 90% (which is a real possibility).

Furthermore, companies that have about \$1,000,000 of pretax income also will feel acceleration of payments on the first \$100,000 of their tax liability directly. For a company that size, such a speedup is equivalent to an increase in the tax rates of 1.5% during the period of acceleration.

Standby credit

Corporations will depend on banks for lines of credit to a greater extent than in the past. They must do this, or keep a larger cash balance against contingencies, for several reasons.

Almost all corporate income taxes will be due at the time the liability is incurred. Heretofore, when taxes were due 6 to 15 months after the liability arose, it was easier to predict requirements. Predicting the next quarter's earnings is often most difficult; and, with the minimum amount due rising from 70% to at least 80%, there would be even less leeway for error in estimated earnings.

More important, because future acceleration will squeeze the smaller corporations more and more, forcing greater assumption of receivables and inventories by larger corporations, the latter must bear much of the burden of periodic disruptions in the manufacturing process no matter where they develop. Since many of these problems cannot be forecast in advance, standby bank credit is the easiest and least expensive way to guard against such contingencies.

With corporate income tax payments more current, federal fiscal and monetary action should have a more immediate effect on corporate behavior during cyclical upswings. If greater use of bank credit develops, the monetary authorities will be in an even stronger position to dampen excesses or spur lagging demand for bank loans.

Mergers on rise

Mergers will be more frequent in the future, especially those involving smaller companies. These companies have felt only one round of acceleration—that on withholding and Social Security. The really big one will start January 1, 1968. As they feel this squeeze, and when they cannot borrow, they will be more inclined to sell out. Smaller utility and telephone companies will be particularly vulnerable.

Medium-sized companies will also be squeezed. Those that are not financially strong enough to absorb the burden of higher inventories and receivables forced on them by the effect of acceleration on smaller companies will either lose position or merge.

Shift in tax payments

Before the speedups, larger corporations paid 62% or 63% of their income tax bills in the first half of the year. The JFK and LBJ rounds of acceleration were concentrated in the first half of the year, increasing the percentage of the tax bill paid by larger corporations in the first half to about 66% in 1967.

With the completion of these speedups and the proposed increase in payment of estimated taxes, however, larger corporations will be paying about 57.5% of their tax bill in the first half and 42.5% in the second half. (Smaller corporations were paying upwards of 100% of their tax bill in the first half; by 1972 they too will be paying 57.5% in the first half and 42.5% in the second half.)

This means that corporations will borrow more in the second half of the year (specifically, on September 15 and December 15) and less in the first half than they did before.

Cyclical companies

A corporation whose operations are cyclical will not be as financially pinched during business declines as it was in the past, because of the lag in tax payments. The decrease in the rates will also alleviate the cash squeeze. Prior to 1964 a downturn in pretax profits of 15% increased the cash tax rate to 57.7% in the year of the profit decline. After acceleration is over, a 15% downturn will result in a 49.3% cash tax rate.

Conversely, during an upswing a cyclical company will not be able to use the lag in tax payments to finance itself as readily as it did in the past. If a company had been in a zero growth period and then registered a 15% increase in pretax earnings, its cash tax rate would have declined from 52.00% to 47.76% prior to acceleration. After acceleration, however, the same circumstances will cause a decline in the cash tax rate from 48.00% to 47.06%.

Growth companies

The faster the growth in earnings enjoyed by a company, the less the decline in cash tax rate accomplished by the cut in rates and acceleration. The cash tax rate will decline from 52.00% to 48.00% for a zero growth company, from 50.45% to 47.66% for a 5% growth company, and from 47.76% to 47.06% for a company with a 15% growth rate.

Furthermore, the speedup of corporate income tax payments imposes a greater incremental tax burden on the company with faster growth. For example, under the JFK round the average cash tax rate over the period of acceleration declined from 52.00% to 51.21% for a zero growth company and increased from 47.76% to 48.15% for a 15% growth company. The LBJ round was again more oppressive on faster growing companies.

An increase in payment of estimated taxes to 90% will offset virtually the entire remaining reduction in cash tax rate for the 15% growth company.

Local governments

State and municipal governments have discovered the advantages of acceleration. Several government units have upped their tax take in this way—New York State and New York City, to name two—and others probably will follow.

EFFECTS ON TAXPAYERS

Senior management of a company, and especially marketing executives, should be aware of changes in the consumer's federal tax burden and in his "cash flow" as affected by withholding.

Social Security

Increases in both the rate and the base for Social Security taxes took place in 1966. Assuming the about half the estimated \$6 billion boost effective then was paid by employees, \$3 billion was removed from their disposable income. To this should be added the \$300 million acceleration of Social Security taxes assessed in 1966 against self-employed individuals.

During 1966 Social Security benefit payments increased by \$4.8 billion. The net effect was an increase in disposable income of \$1.5 billion. The groups paying more and the groups receiving more do not have the same consumption mix, however, and the effect on a particular company varies according to the markets it serves.

The Administration has proposed increases in both Social Security benefits and taxes. As of this writing it is impossible to say exactly what the changes will be; but for the purposes of this analysis, I have assumed that the increases will be enacted as proposed. Even if they are not, the trend is evident, and sooner or later the package will be passed in some similar form.

Increased benefits became effective July 1, 1967; increased rates will be imposed on July 1, 1968. Thus there is a "plus" effect this year and a "minus" effect next year.

Social Security tax payments will go up in 1968, 1969, 1971, 1973, and 1974 (with minor increases thereafter). The rises will have different effects. The 1968, 1971, and 1974 boosts are in the base: in 1968, from \$6,600 to \$7,800; in 1971, to \$9,000; and in 1974, to \$10,800. The 1969 and 1973 increases are in the rate, from 4.4% to 5%, and then to 5.55%. The rate increases are the more regressive.

We will experience a number of step-ups in rates and base over the next eight years. All will have adverse impacts upon spending—how much depends on whether the increase is in the rate or the base. Granted, there will also be step-ups in benefits, but they will come largely in different time periods.

The scale-up in benefits in the lower income brackets is keyed to \$50 jumps in average monthly covered income, whereas in the upper income brackets the scale-up in benefits is keyed to \$100 jumps in income.

By more than doubling the base, the Johnson Administration is shifting the cost of Medicare to those in the \$6,000 to \$10,800 income range. Their eventual benefits from Medicare probably will not be much higher under the proposed changes, but their relative share of the costs of the plan will, in some instances, more than double.

Tax withholding

The changes in income tax withholding rates for individuals effected in 1966 were originally estimated to remove approximately \$1.2 billion (annual rate) from disposable income. Recently, the estimate was raised to \$1.5 billion.

The most significant immediate result for our purposes here is the fact that the individual earning more than \$7,500 and owning his own home was substantially over-withheld last year.

The federal government was aware of this and provided that such a taxpayer could reduce his 1967 withholding rate by claiming a portion of the excess itemized deductions in his 1967 withholding, so long as they average 18% or more.

The net effect is that some homeowners whose incomes range from \$7,500 up now have a lower withholding rate and are receiving, or have received, a substantial refund on 1966 taxes. It is to be expected that some of them will put the "windfall" into savings. But many will use it to buy durable goods, especially if they decided against purchasing "big ticket" items last year, when their paychecks were smaller because of over-withholding. While an accurate figure for the size of the refund is not available, a fair guess is \$2 billion.

Furthermore, this is not a one-time item. Hereafter, the middle-income homeowner will be over-withheld and receive a refund the following year, through probably not as big a one as this year. In past years many of these individuals made the final payment on their income taxes on or before April 15. Now they will be receiving refunds instead at about the same time of the year. It is not inconceivable that this will alter seasonal purchasing patterns.

On the negative side, taxes of lower income individuals will be withheld at almost exactly the rate of accrual of their tax liability. Thus they will be receiving much smaller refunds than in the past. (This would be offset, however, by the massive increase in Social Security benefits proposed for July 1, 1967.) And the minimum that self-employed individuals and those with substantial investment or "unearned" income have to pay on their estimated income tax liabilities was increased from 70% to 80%.

EXHIBIT III. COMBINED SOCIAL SECURITY AND INCOME TAX BURDEN AS A PERCENT OF TOTAL INCOME

Income level	1961	1963	1965	1966	1967	1968	1969	1971	1973	1974
\$5,000.....	11.4	11.9	9.3	10.0	10.2	10.2	10.8	10.8	11.4	11.4
\$7,500.....	12.6	12.9	10.5	11.9	12.1	12.6	13.2	13.2	13.8	13.8
\$10,000.....	14.1	14.4	11.9	13.0	13.1	13.6	14.1	14.7	15.2	15.7
\$15,000.....	16.3	16.4	13.8	14.5	14.6	14.9	15.2	15.6	16.0	16.6
\$20,000.....	18.3	18.4	15.4	15.9	16.0	16.3	16.5	16.8	17.0	17.5

Note.—Assumptions: The taxpayer is married, and he has 2 children. The 10 percent standard deduction is taken for the \$5,000 income group and an allowance for 15 percent in itemized deductions is made for the other groups.

Combined burden

To the consumer, a tax is a tax, regardless of whether it is called an income tax or a Social Security tax. An increase or decrease in one or the other alters his net cash income and changes his attitude toward buying goods and services. The trend of the combined income and Social Security tax burden is shown in *Exhibit III* for individuals at several earnings levels, with the proposed increases in Social Security taxes factored in.

The relative regressiveness of Social Security taxes is shown by the change in combined tax burden from 1961 to 1963, when Social Security taxes were increased. The decline in the combined burden from 1963 to 1965 reflects the two-stage reduction in rates in 1964 and 1965. The total burden moves up most sharply from 1965 to 1969 for lower-middle income taxpayers; their income tax reductions of 1964 and 1965 will have been wiped out by 1969.

The schedule indicates a reduction in individual income taxes with some emphasis on the middle-income group. The reduction probably will be in a combination of lower rates, particularly in the lower and medium brackets, and changes in the dollar amount of exemptions and/or the standard deduction.

An interesting sidelight here is the "cash flow" pattern of the individual taxpayer. Now that withholding rates on individuals are more closely approximating actual tax liabilities and the Social Security base is increasing over the years, the amount of the salary check will be constant during the year for most taxpayers. Once the Social Security base is increased to \$10,800, considerably fewer taxpayers will enjoy the step-up in cash flow accompanying full payment of Social Security taxes.

An even cash flow throughout the year smacks somewhat of a planned budget. Will this tend to increase purchasing on the installment plan by those earning between \$6,600 and \$10,800—i.e., those individuals most affected by the increased Social Security rate and base?

CONCLUDING NOTE

Changes in tax rates and payment dates for corporations and consumers have had and will continue to have material influence on the business environment. Acceleration of taxes amounts to an estimated \$22 billion to \$23 billion, which alone would warrant attention. Because so much of the effect is structural, and because business, when making plans, does not normally concern itself with structural changes, many businessmen will not be aware of them until after they have occurred. Businessmen with foresight, however, will have an opportunity to improve their competitive position.

The CHAIRMAN. Mr. Kust, we thank you sir for bringing to the committee your views. Any questions? Mr. Schneebeli.

Mr. SCHNEEBELI. Corporations and the business community have been borrowing very heavily in the market in the first 6 to 8 months of this year. You seem to infer that much of the borrowing was brought on by the corporate speedup payments.

Would you give us any indications of what percentage to your mind of the corporate borrowing this year was caused by the increased accelerated payments? Was there a substantial amount?

Mr. KUST. Well, I would have no way of directing Congress to figure, but Secretary Fowler in his statement indicated that corporate borrowing had increased by about \$13½ billion, I believe is the figure that he used, in the first half of 1967.

The additional corporate payments that were made in the fiscal year 1967 were in fact made on April 15 and on June 15. This is when the speedups were effective.

Well, this additional amount that was paid by corporations in total was \$5 billion, and I don't think you can say that \$5 billion of the \$13½ billion borrowing is to be attributed to the speedup, but I don't think there is any doubt at all that a very substantial part of the \$13½ billion is attributable to the fact that the corporations had to hand over \$5 billion that was in excess of a normal year's tax payment and this created pressure on cash resources necessitating borrowing.

Mr. SCHNEEBELI. Despite this accelerated payment which caused Westinghouse to pay \$70 million in 2 years, the Federal revenue was still less than they anticipated, wasn't it? In fiscal 1967, the total Federal revenue was a lot less than anticipated despite the speedup.

Mr. KUST. I think the speedup of course was taken into account in the original projections. The speedups were certainly there and have remained there, but what they have had to revise their projections on or the results for the year 1967 was because of the declining corporate profits which were caused by tax payments.

Mr. SCHNEEBELI. That \$70 million reflected what percentage of your normal tax picture in those 2 years? How much additional was it?

Mr. KUST. Our normal tax payments have been on the order of \$100 to \$120 million, so in 2 years—

Mr. SCHNEEBELI. \$240 million.

Mr. KUST. \$240 million; \$70 million out of \$240 million, almost a third.

Mr. SCHNEEBELI. A 30-percent increase in taxation?

Mr. KUST. I am just calculating this now. I think I could give you a more precise figure, but it would be on that order, certainly over 20 percent.

Mr. SCHNEEBELI. It is in the order of 30-percent increase in payments. I am surprised it was that high. I didn't realize that.

Mr. KUST. The figure that I quoted is that for all corporations in the fiscal year 1967 the increase was 23 percent above a normal year's tax payment.

Mr. SCHNEEBELI. And how long forward will this go now with the anticipated proposal made by the Treasury of furthering this acceleration of tax payments?

Mr. KUST. That will affect corporations with income tax payments under \$100,000 for 5 years.

Mr. SCHNEEBELI. For 5 years?

Mr. KUST. And of course the magnitude is not nearly as great as the speedups that have already taken place.

Mr. SCHNEEBELI. I would like to ask you what percentage might that be.

Mr. KUST. I think the administration estimated \$300 million in the next fiscal year, that is, so this would be for 5 years, but it is on that order.

Mr. SCHNEEBELI. What are corporation profits this year? \$60 billion?

Mr. KUST. Corporation profits are estimated at about \$80 billion, but tax payments are just over \$30 billion.

Mr. SCHNEEBELI. Thank you.

The CHAIRMAN. Any further questions?

If not, Mr. Kust, we again thank you, sir, for your testimony.

Mr. KUST. Thank you.

The CHAIRMAN. That completes the calendar for today.

Without objection the committee will adjourn until 10 o'clock in the morning.

(Whereupon, at 11:30 a.m., the committee adjourned to reconvene at 10 a.m., Tuesday, August 22, 1967.)

PRESIDENT'S 1967 TAX PROPOSALS

TUESDAY, AUGUST 22, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to notice, in the committee room, Longworth House Office Building, Hon. Wilbur D. Mills (chairman of the committee) presiding.

The CHAIRMAN. The committee will please be in order.

Is our colleague from New York, Mr. Tenzer, in the room?

Our first witness this morning will be Mr. Walker Winter, accompanied by Dr. Madden and Mr. Statham. We welcome you back to the committee this morning in a different capacity from that which you once had. I don't know whether the members of the committee are aware of it or not, but Mr. Winter served as a member of the staff of the Joint Committee on Internal Revenue Taxation some years ago.

STATEMENT OF WALKER WINTER, VICE PRESIDENT, CHAMBER OF COMMERCE OF THE UNITED STATES, AND CHAIRMAN, TAXATION COMMITTEE; ACCOMPANIED BY DR. CARL H. MADDEN, CHIEF ECONOMIST, AND ROBERT R. STATHAM, TAXATION AND FINANCE MANAGER

Mr. WINTER. It is certainly very kind of you to remember, Mr. Chairman.

The CHAIRMAN. We are pleased to have you with us. Please identify yourself for our record and give us the names of those at the table with you.

Mr. WINTER. Thank you, sir. My name is Walker Winter. I am a vice president of the Chamber of Commerce of the United States of America and chairman of its taxation committee. I am also a partner in the Chicago law firm of Ross, Hardies, O'Keefe, Babcock, McDugald and Parsons.

I am accompanied by Dr. Carl H. Madden, on my right, chief economist of the national chamber, and by Robert R. Statham, taxation and finance manager of the chamber.

Mr. Chairman, the national chamber is grateful for this opportunity to present its views on the President's tax proposals as outlined in his message of August 3, 1967. The proposals have been the subject of constant study since that date by businessmen and business economists.

The chamber appreciates the position of the administration in seeking a tax increase at this time. It believes, however, that the economic evidence presently available does not indicate that the business resur-

gence which the administration foresees will occur so soon, nor in the magnitude suggested by the tax surcharge proposal.

It is for this reason that Dr. Madden is with me today in order to answer any questions members of the committee may have as to the way the business economists view the current economic situation.

The national chamber favors deferring a tax increase until it is substantially more certain than now that there will be a major upturn in the economy and inflationary pressures are more apparent. We believe it would be ill-advised to attempt to raise revenues by a tax rate increase when such a rate increase might well result in an actual reduction in revenues.

UNRELIABILITY OF ECONOMIC FORECASTS

The administration's economic forecasting in past has not been such as to inspire confidence in considering so delicate a question as a tax increase. The Council of Economic Advisers' forecast last fall of a continued investment boom is a case in point.

The resulting proposal to suspend the investment tax credit and accelerated depreciation allowances, we believe, was ill-advised and we so testified at that time. The suspension came at a time when the economy was actually in the midst of a readjustment, involving a sharp decline in housing construction, a substantial rise in the consumer savings rate, and a sizable pileup of business inventories.

The economic case for the surcharge proposal, as we understand it, rests on the correctness of the official forecast of economic activity in the near term. A crucial question, therefore, is whether the current rise in the economy is strong enough to withstand a tax increase. We believe additional time and study are needed before this can be determined.

TIMING OF AN INCREASE

Timing is of critical importance. Here, the record since the Vietnam escalation in mid-1965 does not justify optimism that the timing of fiscal policy moves recommended by the administration can be accepted without question.

Last January, as the economy was slowing down, the administration assured the Nation that a just-right budget deficit of \$8 billion required a surcharge increase by midyear of no more and no less than 6 percent to prevent inflation.

But even as the 6-percent tax proposal was being considered by the Joint Economic Committee, economic conditions showed that the investment tax credit should be reinstated.

In our judgment, administration economists, again, have not accurately judged the timing and impact of a tax proposal on economic events. Business economists though generally conceding that, if the economy is in for a real upsurge in the coming months a tax increase might be needed, generally have held to the view that the expansion in the economy will be slower coming and less ebullient than the administration has contended.

As we understand it, even the economists principally responsible for the 1964 Revenue Act rate reductions have not endorsed the present tax increase proposals.

Administration economists, in calling for a tax increase, have failed in our judgment to take sufficiently into account the rise in output capacity. Production has risen and the fruits of the investment spending boom of 1963-65 should result, if not impeded, in steady additions to productive capacity. Administration economists have also failed, in our judgment, to take into account the elasticity of the labor force which the overall unemployment rate does not reflect.

Finally, and most basically, they have overlooked the damaging effect of a tax increase on consumer and business psychology.

The case has not been made that a tax hike is needed to avoid what the President has called the clear and present danger of "brutally higher interest rates and tight money." The conditions for credit markets in 1968 are in the views of the business economists, likely to be quite different from conditions in 1966.

This year's expansionary monetary policy has increased the liquidity of banks and other financial institutions. The first-half expansion in the Nation's money supply at a 6-percent annual rate, and of bank credit at an even faster 11-percent annual rate, has restored liquidity and brought short term rates to well below last year's peaks.

Treasury use of tax anticipation certificates can tap this liquidity, and a rise, to some extent, in short-term rates would be helpful for balance-of-payments reasons without threatening to precipitate another drainage of funds from savings and loan associations into market instruments as happened last year. Dr. Madden can comment on this in more detail if the committee wishes.

The proposal for a tax increase cannot be justified as simply a war-time measure. The deficit projected results from both nondefense and defense expenditures. Nondefense expenditures have been increasing as fast, or faster than, defense expenditures. From fiscal year 1963 through fiscal year 1967, nondefense expenditures rose from \$39.8 to \$55 billion or 38 percent. Defense expenditures rose from \$52.8 to \$70.7 billion, or 34 percent.

TAXPAYERS ARE WILLING TO FACE FISCAL BURDENS IF NEEDED

Taxpayers have always shown their willingness to face fiscal burdens where the need has been demonstrated. But taxpayers have grown cautious of a stop-go economic policy. Their skepticism of Great Society programs has grown this summer in the wake of riots in the cities. No amount of Federal spending can solve all of our problems immediately. Some programs may have to wait until we are again at peace in Vietnam. Priorities must be established.

If the taxpayers are going to bear an increased tax burden, they have the right somewhere in this discussion to ask also about future tax rate reduction. Burdened by increasing State and local taxes, they are now being asked to bear higher Federal taxes.

Can the country ever hope to live within its revenues? Is it not somehow possible, long-range, to manage on the tax revenues which can be produced under the 1964 rate schedule in an expanding economy? Cannot, perhaps, some hope be held out to taxpayers that we can get back on the road to tax rate reductions—the road we saw ahead of us in 1964?

The national chamber supported the tax rate reductions of 1964 in the face of substantial criticism—for example, the charge by Senator Byrd, then chairman of the Senate Finance Committee, that the chamber wasn't being fiscally responsible in supporting this action.

We supported the reduction proposals because we thought they provided the shortest road to a balanced budget through increased revenues. Certainly, as to the revenues, our faith was vindicated. Revenues rose from \$86.4 billion in 1963 to \$115.8 billion in 1967.

However, a change in administration policy then followed. Business and taxpayers in general were warned about a "fiscal drag" of billions of dollars. Immediately spending programs were devised to anticipate this "fiscal drag." Increased revenues have not kept pace with the new spending programs, and the programs have not been curtailed, despite the increase in defense needs.

Business, in general, is not persuaded that any future tax revenue increase will not immediately be swallowed up by new spending programs—by new demands for Government services.

We are told we have reached a crisis. To meet the crisis, it is proposed to impose upon taxpayers a burden of a \$7.4 billion tax hike in fiscal year 1968 and approximately \$9 billion in calendar year 1968.

But the crisis is apparently not serious enough for the administration to do more than reduce spending by possibly \$2 billion in the civilian area, maybe \$2 billion in the defense area, sell \$2 billion in participation certificates, and try to head off another \$1 billion in additional pay boosts. The chamber of commerce believes that if the situation is as serious as the administration contends, and we believe it is, real and immediate major cuts in nonmilitary spending should be effected.

SPENDING REDUCTION

The Nation is faced with a potential administrative budget deficit of possibly \$29 billion. This assumes no tax increase. The deficit potentially is greater than for any other year since World War II.

The rise of expenditures is a matter that the administration, with the assistance of the Congress, can control, if the will is present. Earlier in the year, there was a logical solution: Cut Federal spending. The same solution is still there, though the ameliorative impact will be lessened.

In January, when the President first asked for a surtax, the national chamber declared:

Reduction of spending for nondefense purposes—in the maximum amount commensurate with effective and efficient operation of the government—should be the first consideration. For the period of the present military stringency all less essential or new spending programs should be decelerated or postponed.

At the time, neither the administration nor the Congress appeared to be so inclined. In fact, despite many warning signals, there have been too few examples of fiscal restraint.

It is time to call a halt to prolific spending. It is up to the administration to reduce unnecessary or less-essential programs, and to defer spending where possible. Priorities must be established. Many worthwhile programs may have to be deferred.

The budget can and must be reduced. Emphatically, we do not agree that only limited amounts, mostly in the nondefense area, are subject to reduction. Literally, all Federal programs should be subjected to

close examination. Some of the choices for cutting back may not be simple, but faced with the alternatives, such decisions must be made.

Action in this respect is absolutely essential. It should be taken with a firm hand. Somehow, spending can be reduced more than the \$4 billion the administration has suggested it will recommend for cutting or possible postponement.

The national chamber urges the Congress to give prompt consideration to legislation introduced by Chairman Mills which would establish a bipartisan Government Program Evaluation Commission. Positive and forward thinking, this proposal definitely will point us in the direction we should take.

The Commission would (1) make a complete evaluation of Federal programs—old and new, (2) determine the effectiveness of such programs—in terms of present and projected costs, (3) determine whether these programs should—or should not—be continued, and (4) determine the relative priority a program should receive—in the allocation of Federal funds. The enactment of H.R. 10520 holds great promise. It can be the guide to significant savings and a better allocation of resources.

PROPOSED LEGISLATION

Mr. Chairman, we would like to make certain recommendations for changes in the proposed tax increase legislation, if it is determined that an increase is necessary.

What is being proposed without question discriminates against business conducted in corporate form. It is the position of the national chamber that any tax increase should be borne in like manner by individuals and corporations.

Individuals and corporations should be required to pay the same percentage surcharge. Any tax increase should become effective on the same date for both, and there should be no retroactivity. A retroactive feature would have the effect of disrupting corporate planning at a time when many corporations have reduced profits.

Formerly, corporations could absorb retroactive taxes. But the acceleration of corporate income tax payments, which was instituted by various enactments starting in 1950, has greatly reduced the flexibility of corporations to absorb unanticipated tax payments of a retroactive nature.

Further with respect to acceleration, under the administration's proposal there would be an elimination over a 5-year period of the \$100,000 exemption for estimated tax payments. There would also be an increase from 70 to 80 percent that a corporation's estimated tax for a given taxable year must bear to its final liability.

Such a speedup of corporate tax payments will yield only a temporary one-time fiscal gain in Government tax revenue. We are very concerned about the effect this will have on small businesses. It will have the impact of siphoning off their working capital.

The effect of this action would be to require corporations to keep large cash balances on hand to guard against contingencies, or to be readily able to resort to borrowing. For some small corporate businesses this might not be possible.

The increase from 70 to 80 percent with regard to the imposition of the penalty for underpayment of estimated tax also poses problems.

It is suggested that this would put corporations on the same footing as individuals. It should be pointed out that corporations often have a more difficult time in estimating their earnings than do individuals.

The individual more often has salary and other income which can be estimated with greater certainty. Corporations generally are on the accrual method of accounting and report income before cash is received with which to pay taxes.

In order to protect itself, the corporation in estimating its tax must assume some margin of error in order not to have to pay the 6-percent penalty. By increasing the 70 to 80 percent, there would be less tolerance for error, and consequently it can be expected that more corporations will find themselves subject to the 6-percent penalty for underpayment of the estimated tax.

We suggest, therefore, that if the change is to be made from 70 to 80 percent, the law should at least provide that the present nondeductible for 6-percent penalty for underestimation in the future paid by corporations be deductible as interest.

Also, assuming a change from 70 to 80 percent, it is probable that more corporations will overestimate their taxes. By overestimating, a corporation under present law could lose the use of a considerable amount of capital, until a refund could be obtained.

Presently, it is necessary to wait until the filing of the final return to obtain a refund. We believe that provisions should be made to permit a refund for overpayment of estimated tax to be obtained prior to the filing of the final return.

Mr. Chairman, we have not addressed ourselves in this statement to whether the surcharge, if it is determined that there must be one, should be computed before or after the investment tax credit or the foreign tax credit.

We do not have a specific recommendation in this regard. We appreciate that to most taxpayers the imposition of the surcharge after subtracting the credits is preferred. Other taxpayers would prefer it otherwise. We are also aware of the balance-of-payments implications of the foreign tax question.

With regard to the proposal to postpone the reduction of the excise taxes on automobiles and telephone service, if a tax increase is ultimately deemed necessary, the chamber will not oppose such a postponement. We say this with reluctance. These taxes are discriminatory. Both the businesses affected and the taxpayers bearing their burden have the right to know when these reductions are actually to be made. They have the right to be given a firm date when these taxes will be reduced or will expire.

SUMMARY

Mr. Chairman, the position of the national chamber may be summarized as follows:

First, we recognize the probability of a major Federal deficit. However, we are not convinced that current economic conditions justify a tax increase at this time. We urge holding in abeyance the enactment of any increase until the Congress can be more certain of a major economic upturn accompanied by inflationary pressures of the nature predicted by the administration.

If, in fact, an economic boom is not forthcoming, a tax increase would be self-defeating.

Second, during the intervening period, immediate major and meaningful cuts in spending should be made. The administration must establish meaningful and realistic standards of priority to govern Federal spending. Congress must assist in these efforts.

Third, in the event a tax increase is determined necessary, it should apply to individuals and corporations at the same surcharge rate at the same effective date and without retroactive effect.

Fourth, the chamber opposes the proposed acceleration of corporate tax payments, particularly for corporations paying \$100,000 or less in annual taxes.

Fifth, if a tax increase is judged necessary, the chamber will not oppose the postponement of excise tax reductions on automobiles and telephone service. However, any legislation deferring the scheduled reductions of these taxes should have a firm expiration date.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Winter. We appreciate your bringing to us the views of the Chamber of Commerce of the United States. Mr. Landrum.

Mr. LANDRUM. Mr. Winter, I note your statement here as I have noted in most of the statements brought to the committee, and in most of the statements coming to my attention from people who are concerned about this problem who do not appear before the committee, that the first thing we should do is to have a reduction in nonessential Federal expenditures.

With that I am in complete agreement. In my judgment I think every member of this committee is in complete agreement, but I get sort of vexed with people like yourself and others in responsible places who are knowledgeable and possess quite some degree of expertise in this field saying reduce Federal expenditures, nonessential Federal expenditures, and that is as far as you go.

You don't ever come up with what it is we can reduce. Then when we start reducing on programs that affect people back home in the Nation we find the local chamber of commerce, the leaders there, making determined fights to have programs for water and sewage expansion, for highway expansion and improvement, and so forth. We have the leaders in education and all levels of government asking for increases and continuation of these expenditures.

Then we come along and find the doctors and the nurses and the people concerned about health, and they want the health expenditures continued. They want funds for matching to build hospitals. They want all that continued. As a matter of fact, it seems to me—the way I read these things—is that nonessential means that which does not affect me.

Now, what I would like to have from people like you is not just a statement to cut nonessential expenditures, but some recommendations as to where these cuts can take place and then we will begin to get to work, when we have the support from people like you.

Mr. WINTER. If I may respond to that, Mr. Chairman, I do not have a satisfactory answer to your question, one that satisfies me or one that will satisfy you. Our position certainly is that where we

start is with the \$4 billion in cuts that the Director of the Budget has indicated may be possible.

Through the balance of this session I think that as the different appropriations bills are considered every effort should be made where possible to effect cuts as I know efforts are being made at this time. That doesn't carry us very far.

We have hope that through the type of commission which Chairman Mills has proposed to be established we can get a sense of direction. We think that the administration has to provide a change in direction and a better sense of direction here in this area and establish priorities. I recognize your point.

If the money is there the people are going to want it. There is going to be a demand for increased service. If I may make one other point, I would like if I may to provide for the record—I don't have it now—the specific proposals we made earlier this year for cuts in expenditures when we were faced with a budget deficit of perhaps \$8 billion.

That has to be reexamined and certainly our chamber committees are going to reexamine it. That is the best answer I can give you.

Mr. LANDRUM. Where are those specifics?

Mr. WINTER. I don't have them with me.

Mr. LANDRUM. Last night I read a very fine statement by the New York Chamber of Commerce Committee on Taxation. They sent down a statement to Chairman Mills to be included in the record which I concluded, after reading, was a very, very fine statement and it had in it a proposal of one-for-one. Applied that would mean one dollar of reduction in nonessential expenditures for each dollar of taxes we finally have to lay on top of what we have, if we do enact a surtax bill.

But nowhere in that statement could I find any suggestion about where one of these dollars would come from. They give us the formula and tell us how to apply it. That is simple enough.

But the problem is much more complex than that.

Now, if you possess, and I say "you" advisedly, meaning the chamber, the expertise that you have the reputation of possessing, then I think it is high time the U.S. Chamber of Commerce, and the State chamber of commerce, and all these other people that come in here saying cut, tell us where we can cut and get away with it. I am in favor of it. I am ready to start cutting and have been.

Mr. WINTER. I think there would be perhaps two responses to that. I think what we can reflect is simply the feeling of the business community and no matter how many meetings I have gone to over the years the same plea is there, "I have been burned; I hurt." Maybe the businessman doesn't know how to rectify that situation, but we have to look to Congress for that and particularly for guidance from the administration for that.

Mr. LANDRUM. Let me ask you this: How much of the appropriation for elementary and secondary education from the Federal level would you cut out?

Mr. WINTER. I do not have those figures. I'm sorry.

Mr. LANDRUM. Would you cut any of it?

Mr. WINTER. We did make proposals for that. If I may, I can supply that for the record, but I did not work on that particular project.

(The information referred to follows:)

NATIONAL CHAMBER CALLS FOR \$5 BILLION SPENDING CUT

The Board of Directors of the National Chamber has called on Congress to cut at least \$5 billion from the Administration's request for \$144 billion in new spending authority for Fiscal 1968.

Noting that the Administration's 1968 budget requests mark an all-time high in Federal expenditures, the Board observed:

"While much of the increase is attributed to Viet Nam costs, increased spending is proposed for practically every other area of Federal activity as well. It is especially imperative, in this period of enlarged military outlays, that we trim other costs—by eliminating nonessentials, and postponing less essential programs."

FOLLOWS STUDY

The Board action followed an in-depth study and report on the 1968 budget by the Chamber's Government Operations and Expenditures Committee.

The Committee this year concentrated its examination on a limited number of important Government programs.

In carrying out this approach, the National Chamber enlisted the assistance of specialists in those areas selected for in-depth review. In addition, Chamber committees held special budget review sessions and an *ad hoc* Joint Task Force considered the Foreign Assistance program.

As a result of this scrutiny, the experts found, for example, that at least \$2.1 billion could be cut in six programs *alone* without impairing national needs. These included foreign aid, the poverty program, rural electrification, public health grants, education subsidies, and urban grant and loan programs.

In addition, the Board urged that Congress make a critical review of *all* spending programs, and based on the detailed information available to it, make cuts wherever programs can be dispensed with, deferred or delayed without harm to the national interest.

Said the Board statement:

"Recent Senate hearings produced an abundance of evidence of waste and ineffectiveness of costly Federal programs intended to help State and local governments.

"Many programs have been cited by Members of Congress as requiring careful scrutiny in an effort to reduce spending. For example, they have raised such questions as:

- Should the Federal Government finance research and development activities growing at a half a billion dollars a year, and reaching \$17 billion in fiscal 1968?
- Should we continue to spend over \$5 billion a year on the space program?
- Should a billion dollar pay raise for civilian and military employees be granted, notwithstanding the huge war costs and mounting Federal deficits?"

The Board noted that judicious pruning, while not easy, is important.

"The right decisions are not easy to make. But our economic well-being demands that they be made by Congress—and supported by the public—in time of war."

CUTS CAN BE MADE

The examination of several important programs made by the National Chamber refutes the idea that the budget is a barebones budget that cannot be cut.

The study revealed *examples* of possible reductions. Among them are these:

Office of Economic Opportunity (poverty programs)

Budget request.....	\$2, 042, 500, 000
Recommended reduction.....	354, 000, 000

The major programs designed to combat poverty continue to be characterized by the lack of reliable operational data. Conflicting costs-per-enrollee reports and unsupported claims of achievements create a credibility gap which with one or two exceptions, makes it impossible to reach an informed judgment as to whether the programs should be expanded, curtailed or discontinued.

Until such time as more reliable information is available any expansion of Job Corps, Neighborhood Youth Corps or the VISTA programs cannot be justified. Accordingly, the Chamber recommends that 1968 obligational authority for these activities be held at present levels.

The Administration has requested \$470 million for the Head Start program and plans to allocate \$135 million of this amount for "follow-up programs" in the early primary grades. The Chamber recommends an increased appropriation for regular Head Start programs. No funds, however, should be made available for the proposed follow-up activities because money for such a program is already provided for in the Elementary and Secondary Education Appropriation.

Even though Head Start has enjoyed some success, the National Chamber continues to recommend that the educational activities authorized under the Economic Opportunity Act of 1964 should be transferred to the Office of Education of the Department of Health, Education, and Welfare.

The Special Impact program, otherwise known as the Javits-Kennedy program, was created by an amendment to the Economic Opportunity Act in the last session of Congress. OED still has not written the administration guidelines for the program and the legislative purpose appears rather amorphous. Therefore, it would be advisable to be cautious in allocating funds to this program until its performance can be evaluated.

Rural Electrification Administration

Budget request: Loan Authorizations for Electrification Program...	\$314, 000, 000
Recommended reduction.....	150, 000, 000

The electrification program of REA continues to grow despite the fact that the original goal of electrifying farms has been substantially completed. Rural electrification cooperatives are using Federal loans at a subsidized interest rate of 2% to re-loan to their consumers for the purpose of financing the installation of electrical wiring on premises and the purchase and installation of electrical and plumbing appliances and equipment. The subsidized interest rate available to these cooperatives gives them an unwarranted competitive advantage over privately financed financial institutions.

The reduction recommended here would help return the program to a level sufficient for any remaining rural electrification needs in keeping with the intent of the Act.

Economic Assistance (foreign aid program)

Budget request.....	\$2, 530, 420, 000
Recommended reduction.....	70, 305, 000

Economic assistance activities should, in general, not be expanded. Exceptions may be justified regarding amounts required for Viet Nam supporting assistance, development loans and technical cooperation and development grants.

A reduction of \$70.3 million applied uniformly will hold all other activities to fiscal year 1967 levels.

Public Health Service

Budget request.....	\$2, 922, 687, 000
Recommended reduction.....	300, 000, 000

The budget estimate for the Public Health Service indicates an increase of \$315 million over the current year. The record of appropriations granted to the Public Health Service over recent years shows an average annual increase of \$250 million in new spending authority. The record also shows that over the period from fiscal year 1962 through fiscal year 1968 appropriations exceed actual expenditures by an average of almost \$500 million per year. In fact, it is estimated that in each of the fiscal years 1966, 1967, and 1968 appropriations will exceed expenditures by well over \$600 million. This constitutes a tremendous backlog of spending authority.

In a recent study of the National Institutes of Health made by a distinguished committee of American citizens headed by Dean E. Wooldridge, the committee reported to the President that NIH has an important organizational need to strengthen its capacity for long-range planning for determining the optimum utilization of its funds.

The backlog of funds accumulating in the Public Health Service could very well lead to grants and other expenditures for extremely low priority projects. Under these circumstances, an overall reduction of the Public Health Service budget of at least \$300 million should be made.

Office of Education

Budget request-----	\$4, 054, 670, 000
Recommended reduction-----	527, 000, 000

There is increasing evidence that the tremendous up-surge in Federal spending on education resulting from programs enacted by the 89th Congress is causing administrative and management problems at all levels of government that have yet to be solved. Likewise, the on-rush of new education and training programs is creating a considerable drain on the Nation's supply of skilled educators and administrators. This is leading to wasteful expenditures and ineffective programs. The time has come to make a thorough evaluation of existing programs to ascertain their effectiveness and the ability of the Nation to man them with the kind of qualified personnel needed. We therefore recommend reductions of \$260,000,000 in the budget requests for elementary and secondary educational activities.

The Chamber recommends that none of the \$35,000,000 requested for the National Teachers Corps be approved. The program is not needed, and even if it were, qualified staff is simply not available.

The "temporary" program of Federal assistance for operating as well as constructing schools in areas overburdened by the children of Federal employees has drifted along for 16 years, with periodic proposals to the Congress to make the program more equitable and justifiable. Presidents Eisenhower, Kennedy and Johnson have repeatedly recommended a reexamination of this program to limit it to truly "overburdened" school districts, but without avail. The 89th Congress authorized such research, and the Office of Education duly expended appropriated funds therefor in contract with the Stanford Research Institute, to provide objective bases for returning this program to its original purposes. These recommendations were duly forwarded to the Congress by the Administration, along with appropriately reduced budget requests for FY 1967. The 89th Congress ignored both the research findings and the budget recommendations, thus conceding that this program is more pork barrel than educational in its justification. We strongly recommend a further review of this program by the 90th Congress, with a view to amend P.L. 815 and 874 in accordance with the research evidence already purchased by tax funds. Such action could reduce this program by \$232,000,000.

Urban grant-in-aid and loan programs

Budget request-----	\$1, 897, 850, 000
Recommended reduction-----	700, 000, 000

The HUD budget for 1968 proposes the expansion of a number of grant-in-aid and loan programs. These programs include Grants for Neighborhood Facilities, Urban Renewal, Urban Planning Grants, Metropolitan Development Incentive Grants, Open Space Land Programs, Grants for Basic Water and Sewer Facilities, Grants to Aid Advance Acquisition of Land, Public Works Planning Fund, Comprehensive City Demonstration Programs, Urban Research and Technology, Low Income Housing Demonstration Programs, and Rent Supplements. The record of these programs makes their expansion at this time seriously questionable. The programs are not new. They have had many years in which to prove their effectiveness. The record to date indicates they have not been successful in achieving their primary objectives.

Evidence in support of this has been and is being compiled by the Subcommittee on Executive Reorganization, headed by Senator Abraham Ribicoff. This evidence has led Senator Ribicoff to say: "The fact is that the job is not being done. And you can go on and list these programs from now until tomorrow and still the job is not being done." Senator Ribicoff, after pointing out that we had spent \$96 billion on our cities in the last ten years, went on to say that some of these Federal programs were causing the nation to slip further and further behind. Similar evidence relating to the confusion and duplication of Federal programs for cities is being accumulated by investigations conducted by Senator Muskie and his Subcommittee on Intergovernmental Relations.

The increasing recognition of the ineffectiveness of programs such as those listed above is becoming a major issue. To a large extent, this issue is behind current efforts to design new approaches to solving urban problems—approaches such as revenue sharing, block grants, and quasi public-private approaches. Senate Majority Leader Mansfield has also called for a really thorough evaluation of where the Nation stands with some of these programs. On the basis of this widespread concern, it is highly justified to refrain from expanding these

programs until the Nation can review them and, hopefully, design new courses of action for solving community problems. For this reason, the above budget reduction is recommended. This would permit most of these programs to meet anticipated current obligations while, at the same time, keep them from expanding in a direction that, as is increasingly becoming clear, is not in the Nation's best interest.

Mr. LANDRUM. New York State, for example, increased its criteria for measuring entitlement to medicaid for a family of four to \$6,000 after taxes and busfare and so forth, and some of the representatives from that area are complaining that it costs that State \$100 million for us to do that.

Would you say cut some in that field?

Mr. WINTER. If I may, Congressman, may I defer to Dr. Madden, the economist.

Mr. LANDRUM. The economist has the answer?

Dr. MADDEN. Sir, I think you are making a strong argument for Chairman Mills' program evaluation commission. I think that you have outlined with some eloquence the complicated problem facing the Congress, namely, that in the public interest and in the national interest it is clear to every taxpayer who faces increasing taxes at the State and local as well as the Federal level that some new definition of priorities for Government action needs to be defined, but at the same time these same people representing the interests of their geographical district recognize the value of some desired and desirable Government spending.

Therefore, it seems to me that you are making a very strong argument for the appointment, the establishment, of a highly respected commission representing all areas of American life which would advise the Congress by careful studies, as the bill proposes, so that you would not have this problem that you describe of being of two minds about cutting spending.

Mr. LANDRUM. That would be just great and over the long run I think might prove extremely beneficial to Members of Congress and fruitful for the economy of the country, but we have this problem now, August 1967, and there seems to be some concern that we get rid of it before October.

I don't know whether we shall or not. It would take that long to get a commission such as you suggest selected, and then I imagine it would take them a few days to make the study, wouldn't it?

Dr. MADDEN. Yes, sir.

Mr. LANDRUM. So in the long run, yes; it is good. I would like to see some specifics now from organizations such as yours, the National Association of Manufacturers, the local State chambers of commerce, the National Education Association, and the various other organizations that are concerned and interested in receiving the fruits of a Federal source.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Schneebeli.

Mr. SCHNEEBELI. Mr. Winter, you mentioned that Dr. Madden is with you to discuss with the committee the way the business economists view the current economic situation which apparently is different from the evaluation given by Dr. Gardner Ackley, the White House economist.

Would you develop that theme to a degree of why you disagree with the presentation given the committee earlier?

Dr. MADDEN. Yes, I would be glad to. Briefly the difference of view rests on two factors, the timing of the upturn in the economy, how fast it is coming, and, second, how strong it will be in the private sector in forthcoming months.

With regard to timing, it has been the position of the average business economist throughout 1967 that the inventory readjustment would take somewhat longer, a quarter or two longer, than the administration suggested in the Council of Economic Advisers economic report to the President.

Second, there is the view among business economists that business investment spending is likely to rise slower than the administration's economists suggest or imply. They don't state specifically, but suggest or imply, and the reason for this in the eyes of business economists is that profits have declined during this rolling readjustment of the first half of this year and this decline in profits when combined with rising unit labor costs in many industries is likely to produce more caution on the part of business decisionmakers in the field of business investment spending than the administration suggests.

Mr. SCHNEEBELI. Dr. Madden, I think the administration said that the business resurgence would be quite vibrant during the third and fourth quarters of this year. We are almost finished with two-thirds of the third quarter and is there any evidence of any substantial rise during July and August that would indicate support for their thesis?

Dr. MADDEN. In my judgment there are indications that the upturn is beginning, but these indications are not as strong as the administration suggests and implies.

Mr. SCHNEEBELI. And how much slower do you think this resurgence is than has been explained to us by the administration? They say the third and fourth quarter. What are you referring to in your interpretation of this resurgence, the fourth quarter, the first quarter of next year or what specifically?

Dr. MADDEN. Well, I think this is the area of uncertainty which this committee should probe with great care and I don't profess to have a specific and ironclad answer to that question, but I would say that there is some doubt in my mind as to what the effect is going to be on consumer intentions to buy of the proposed 10-percent surcharge itself.

I question how that will affect consumer confidence in retail sales of business, first. Number two, I question the impact on business investment spending plans of the surcharge proposal itself. I believe that housing is going to be rising slower than anticipated because of the return of interest rates to the high levels, a 45-year record level of last year in the housing market.

Therefore, I can only say that in my judgment there is a question whether this upturn may not move slower than the administration suggests and less strongly.

Mr. SCHNEEBELI. Well, let's grant that it may be nebulous at the present time. Is it apt to be a little more clear by October 1?

Dr. MADDEN. I think that it is apt to be more clear, yes, by October 1 at the time of the traditional fall season in business which may extend a little beyond October 1, but certainly we will know more on October 1 about this than we know now. There is no question.

Mr. SCHNEEBELI. That would be a climate in which to decide this than at the present time.

Dr. MADDEN. It would be a better time, yes.

Mr. SCHNEEBELI. That is all. Thank you.

Mr. ULLMAN. Mr. Chairman.

The CHAIRMAN. Mr. Ullman.

Mr. ULLMAN. Mr. Winter, I get a little bit discouraged with what I call gooneybird economics. You know the story about the bird that flies backwards because he would rather see where he has been than where he is going.

This committee unfortunately can't indulge in that kind of economics. In your statement you have indicated that you want to wait until it is substantially more certain than now that there will be a major upturn in the economy and inflationary pressures are more apparent.

Just last week we had some new figures from the Department of Commerce. There has been a rather startling and major shift in the economic climate of the country. Almost every indicator that we have been given during this past 10 days indicates a strong upsurge in the economy.

If we are going to try and run this country on the basis of what happened 6 months or a year ago (because to be 100-percent certain that is what you would have to do) I think we would be in a pretty sorry mess.

That is the kind of thing that leads to major recessions, major ups and downs, that could be disastrous to the total economy.

Mr. WINTER. I believe Dr. Madden will want to expand but the point I do want to make is that if a tax increase is placed in effect and if in fact the result is similar to the downturn in 1959 where the revenues dropped off so badly, then what is the alternative?

I think we are in real difficulty but I would like Dr. Madden to respond if that would be satisfactory.

Dr. MADDEN. I certainly agree with you if one accepts your premises. However, let me read to you from the editorial in Business Week of August 19, on page 158:

As for timing the situation is even less clear. Moreover, the economy has not yet regained its full momentum after the slowdown in the first half of the year. Industrial output is lower than it was a year ago. Factories are operating at only 83 percent of capacity as compared with over 90 percent a year ago. The average work week has been shortening almost continuously since last fall. Consumers have been saving a relatively high proportion of incomes. With this sort of slack in the economy there is a strong argument for allowing the business upswing to gain more speed before clamping on new restraints.

The figures that you refer to of last week, personal income figures and unemployment figures, naturally are going to rise at the end of a half year of rolling readjustment and it is typical of the beginning of such an upturn in the annals of business cycle history that the upturn in the figures when it first comes is larger than it is later as the upturn develops, larger in percentage amount, so while some indicators have risen, the question before this committee it seems to me is the very question of how to evaluate the timing of the upturn and the speed of it, and there is in the judgment of competent observers some question as to the strength and the speed of this upturn and, of course, it is the administration's responsibility to make the case for their position.

Our view is this case has not been made.

Mr. ULLMAN. In view of the fact that interest rates now are pushing through the ceiling—they are about at the same level as they were last September when we were in a real financial crisis—and add to that the fact that you are starting with that level of interest rates, add to that the prospect of a \$29 billion deficit, what in the world do you think is going to happen to the money market if we allow the country to get into that kind of a deficit position?

Dr. MADDEN. This again is the question which I think this committee should probe with great care. It is a serious question and an important question, but it is not a question which is likely to be resolved exactly as it appears on the surface.

For one thing, the year 1968 in the credit markets is not likely to be similar to the year 1966. In 1966 there is no question about there being a near financial crisis because of the large demand for funds in all sectors of the market and for all maturities in the face of a highly restrictive Federal Reserve policy.

In August of 1966 there was a near financial crisis in New York money markets. However, since the fall of 1966, and more particularly in the spring of 1967, the Federal Reserve System has pursued an aggressively easy monetary policy just confirmed by a press report of the Federal Open Market Committee's meeting in May, in this morning's newspaper.

As a result of this aggressively easy monetary policy which has seen the money supply rise by an annual rate of 6 percent a year and bank credit by 11 percent a year, we now have corporations, banks, and other financial institutions rebuilding their liquidity and, as they rebuild their liquidity, short-term interest rates have fallen and only recently show any signs at all of rising again.

Now, the Treasury is facing \$15 billion worth of financing, or was facing at the beginning of this fiscal year \$15 billion worth of financing, in the last half of this calendar year, but comments from the bond markets suggest that because of the liquidity position of banks and corporations this \$15 billion financing is, in their terms, not awesome and, although it will certainly be larger than last year by 50 percent, in this particular period it is not outside the experience of the money market for this very half of the year we are now talking about.

Now, 40 percent of the large borrowings that have been made in the first half of this year by corporations, according to Securities and Exchange Commission data, have been made for the purpose of repaying bank loans.

Corporate treasurers having been stung by last year's financial near crisis are rebuilding their liquidity positions in order to avoid the kind of shock that they felt as a result of last year's experience, and so it is not clear that in 1968 we need to repeat the experience of 1966.

It is not even clear that in 1968 the demand for borrowings by corporations will necessarily be as strong as it is this year, because there is this indication that some of the borrowing, an important part of the borrowing by corporations this year has been anticipatory and has been for the purpose of repaying bank debt, rebuilding liquidity, and reducing to some degree the dependence of the corporations on the banking system.

Mr. ULLMAN. On that point, isn't it a fact that there is a much heavier picture of corporate borrowing this year than there was last year?

Dr. MADDEN. Exactly; and I am saying that this heavier corporate borrowing has been effected this year in anticipation of this deficit which we are faced with and it is not necessarily for the purpose of expanding plant and equipment facilities.

Rather, it is to restore the liquidity, the cash position of the corporations and therefore it does not necessarily follow from this high demand that in 1968 the corporations will have a similarly high demand for money and therefore the total demand for money in 1968 may not be as high as the administration has implied that it will when it compares 1968 flatly with 1966.

Mr. ULLMAN. Is there any letup of business borrowing in the markets today? All I see is an acceleration. Your argument might make some sense to me if I saw any indication whatsoever that there was any downturn, but it isn't there.

Now, you talk about the business profits dropping. Certainly they dropped. But where are they? Are you saying today they are at a low figure compared to 3 or 4 or 5 years ago?

The only time in recent years that profits were higher was last year. If you take the peak off of last year they are almost at an all-time high and yet you are saying that business is in a marginal condition.

I have never seen business in a healthier condition than it is today, looking at the total picture.

Dr. MADDEN. I think you are absolutely right in saying that business is in a healthy condition today. It is certainly true that we have had a remarkable prosperity for which I think the Nation should be thankful; but I do not believe that is the issue that is before this committee.

The issue that is before this committee is whether business investment is going to increase next year and whether if it does this will produce a large demand for funds in the money markets, and I am saying our position is that this is a questionable assertion that this committee should pursue in some depth before it accepts the position that there necessarily is going to be this increase.

For example, profits have declined by 7 percent in the first half of his year. Unit labor costs are rising. It is very unusual for businesses to expand their plant and equipment spending in the face of profits that have declined and unit labor costs that are rising. Authorities such as Geoffrey Moore, the research director of the National Bureau of Economic Research, in a recent Wall Street Journal article point out that this is the case, that historically this is unusual.

So there is a question whether business is going to expand its investment spending next year and therefore there is a question whether the demand for money in 1968 will be as strong as the administration economists assert that it will be.

Mr. ULLMAN. The question that this committee is going to have to face, and this Congress, is which is the most acceptable alternative facing the country today. The easy thing to do would be to sit on the status quo and wait until there were some certain answers.

Unfortunately in this business there aren't any certain answers. We have to look 6 months ahead rather than 6 months behind, and

the alternative danger would be the inflationary pressures building up as they did last year; inflationary pressures growing to the point that we would be threatened with another serious financial crisis and cost-of-living increase that might very well be disastrous to the economy.

That is the prospect that we have to face.

Now, you have come out, as I understand it, flatly in opposition to the tax increase. Is that right, Mr. Winter?

Mr. WINTER. At this time, until we get more indication of what the swing of the economy is; yes.

Mr. ULLMAN. You realize that this could take 6 months. If we don't act now, if we put it off until next January, then we are talking about a July 1 increase.

In my judgment and for what it is worth I think that the tax increase that we will impose or should impose would be effective on January 1 rather than retroactive. I think there is some basis for that.

Now, what would be your judgment on that?

Mr. WINTER. I think my judgment would be that if there is to be a tax increase January 1 would be the time. I think later this year there should be a better indication whether you are going to give a green light and go ahead with the tax increase in some measure or whether the indicators indicate that this should not be done.

No, I don't think this can wait until next spring or summer or something like that. I think the decision has to be made later this term.

Mr. ULLMAN. Now, Mr. Winter, you compare 1963 with 1967 with respect to expenditures. You are ignoring the expenditures of this year, fiscal 1968, which are already apparent, in which we are facing a \$10 billion increase in defense expenditures.

You heard the President and the Secretary say that they estimate \$4 billion additional defense expenditures this year.

Mr. WINTER. That is correct.

Mr. ULLMAN. With an \$80 billion defense expenditure and \$15 billion for interest we will spend \$95 billion for defense and interest alone. With respect to expenditures, every responsible person that we have had before this committee has indicated that you might cut expenditures in the domestic area by \$4 to \$5 billion at the most.

I think it would be drastic. I think we would have chambers of commerce all over the country coming in and objecting if we cut this budget by \$5 billion.

But when you are looking at a \$29 billion deficit and can reduce domestic spending by only \$5 billion you are talking about a \$24 billion deficit. Are you, the representatives of the Chamber of Commerce of the United States, coming here and telling us that we should allow a \$24 billion deficit to stand without taking some action by this tax committee.

Mr. WINTER. If the alternative is a tax increase which would result in a lessening of revenues we are not helping the deficit situation.

Mr. ULLMAN. Mr. Winter, the business community could hardly be healthier today. The pressures are building up. Are you telling me that the economy is so weak that a 10 percent increase in taxes might throw us into a recession?

Mr. WINTER. In our judgment it would be prudent to wait a while before you make a decision to impose a tax increase. Let's see what the psychological impact of this proposal is before we go ahead. Beyond

that I am not an economist. I simply rely and have to rely on the economists that we have working with us.

But that is our judgment.

Mr. ULLMAN. Let me just say that I am rather shocked that the chamber of commerce of this country with business as strong as it is, about as high a prosperity as we have ever had in the Nation, is saying that we should take a \$25 billion deficit rather than try to pay as we go. With the people of America making more than they have ever made in the history of the country, with business at almost an alltime high in prosperity that we should follow a policy of deficit spending, it is saying that we should take a \$25 billion deficit rather than trying to pay our way.

I am shocked that the chamber of commerce would take that position.

Dr. MADDEN. I think you are misstating the chamber's position, sir. I think the chamber is saying in this period when Government expenditures have been rising at a record pace throughout a period of unprecedented business prosperity and at a time when taxpayers are paying more in taxes at the Federal, State and local level, it is time for the Congress of the United States to pay attention to the priorities for Federal spending and not tolerate a deficit of \$24 billion when spending can be cut.

Mr. ULLMAN. Mr. Landrum attempted to get some priorities from you. We try to get some priorities from everybody. But you just shift the buck. You won't face up to the issue. We have to. All I am saying is that the best brains that we have had, the people who do face up to the problem, have said we might cut \$5 billion of Federal spending in the domestic area.

I am willing to face up to that, even though, as I said before, your chambers of commerce all over the country are going to scream to high heaven if we cut that much.

Where are you going to make the cuts? You are refusing to face up to that responsibility.

I am rather shocked at the testimony of the chamber.

Dr. MADDEN. Well, in business when a budget has to be cut it is cut.

The CHAIRMAN. Mr. Collier.

Mr. COLLIER. I think we ought to get the record straight here, and you correct me if I am wrong. Was it not late in February of this year that the chamber sent to Members of Congress—I don't know how many—I was one of those who received it—a very detailed report, whether I agreed or disagreed in some or part of the instances, marking where these cuts would be made.

Mr. WINTER. That is correct. As I indicated earlier, we can provide that for the record.

Mr. COLLIER. So I am at somewhat of a loss here with this colloquy that deals with nonspecifics. They were specific.

Mr. WINTER. What we did this year was a little different than we have done before. We looked into certain specific areas to see how much we thought could be cut.

This is when we were faced with an \$8 billion deficit, and our result was a recommendation of about, as I recall it, a \$2 billion specific cut and we thought an overall \$5 billion cut could be made.

Other groups have indicated about the same. I couldn't go into any more detail on that now because, as I say, we are faced with a \$29 billion instead of a \$8 billion deficit. I think we would want to look a great deal further and we certainly will as fast as we can, but again I say I don't have an answer that satisfies me or that will satisfy someone else as to what cuts can be made.

I sat through the colloquy between Mr. Curtis and the Director of the Budget the other day when Mr. Curtis was trying to get a pinpointing of whether cuts couldn't be made in a particular area, and it is one of the most difficult problems to try to pinpoint that, I know, and I think if the Congress doesn't have the facts to work this out, develop it, that the answer is a Commission that can be appointed that can take the time and focus upon spending programs.

Now, maybe we can only cut what the Director of the Budget said, \$4 billion this year. If that is all we can do, that is a start. We will see what the indicators are a couple of months from now and see what has to be done.

If something has to be done the chamber isn't going to be in opposition to it, but we think at this time our position should be withhold action, go slow, and take a look. Don't take precipitous action in this area.

Mr. COLLIER. Significant, too, is the fact that when those reports came in the Congress had acted upon one deficiency appropriation bill of \$11.9 billion and had only one other appropriation bill. Today we have passed 10 of the 13 appropriation bills and consequently this apparently late desire on the part of some to say where do we cut spending comes, I would say, a little bit belated.

We had a multimillion-dollar space bill that, desirable as it may be that we explore space, certainly at a time when we have priority demands there should have been sought a means in this area where we could cut back.

I just don't buy some of the conversation here today of my colleagues because there is little word that was brought into the conversation, the colloquy here earlier, that we saw some of the indicators 2 and 3 years ago. So I say that if the bird was looking ahead then it had developed an advance case of glaucoma because we knew the direction we were heading and there were Members of this Congress who at that time said that we were heading to just the situation we are in today. So I too am shocked, I might say to my friend from Oregon, that we haven't faced up to this problem as we should have in those areas that did not demand priority. I for one, while I appreciate the recommendations from any source as any legislator does in dealing with these problems, can also see areas myself where we could have cut back. Yet look, if you will, at the 10 appropriation bills we have passed since that time.

Mr. WINTER. In January, as I indicated on page 5 of our statement, we made about as strong a plea as we could for a reduction in the nondefense spending. We thought it was called for. We have seen little result from that.

Mr. COLLIER. And it is going to be very interesting to see whether the little birds that are looking ahead when the next budget comes up here will have an understanding of the economic and fiscal plight into which we find ourselves today.

That is all I have.

The CHAIRMAN. Mr. Herlong.

Mr. HERLONG. Along the lines the gentleman from Oregon was discussing, you have stated here that we will admit that we will be faced with a tremendous deficit this year. We here have to deal in terms of alternatives.

We either have the deficit of \$29 billion or we don't spend as much money. I think most of you recognize that the money that we are spending today is money that has been appropriated in prior years and how much we cut these appropriations bills this year is going to have very little effect on the size of that deficit, isn't that correct?

Mr. WINTER. That is correct, yes.

Mr. HERLONG. We are in effect talking about cutting at this point and I am in favor of cutting—goodness knows my record shows it—but we are really locking the barn after the horse is stolen. We are dealing with a lot of homely analogies here today, and I say we are locking the barn after the horse is stolen.

I don't want a tax increase. I don't want it at all. I don't want a tax increase at all, but I prefer it to the alternative consequences. I don't like getting old either, but I certainly prefer that to the alternative, and I think that we are going to be just as dead if we go into the money market for \$29 billion as we would be dead physically if we didn't get any older.

Mr. WINTER. That may be the alternative which would be a tax increase. We appreciate that. We think that the time is ripe for a start by a commission or the administration to indicate priorities for spending programs.

Yes, they might have to take a few years, but as I say, one principal concern we have is that if you have a tax increase, if it in fact results in additional revenue, we think all of that is going out in new spending programs. This is not to say that there aren't many programs that could be devised that are extremely important, but you can't do everything all at once. That is our position.

If the ultimate decision is that there has to be a tax increase, that obviously is it, the alternatives are what? The alternatives are certainly worse.

Mr. HERLONG. I think the Secretary of the Treasury agrees with you that if this money in additional tax revenue is spent on nonessential spending that it will be highly inflationary. He stated that all along. We don't want to do that, and I don't know any control, however, that we in this committee can have over that.

What we have to do is face the facts that we have, that we have this deficit and hope that the people downtown will establish priorities of spending. The President has said that he is going to do some vetoing if we will uphold him. He indicated the other day if we would hold the line on the increases in the salaries of the Government employees and the postal workers that he would back us up in it, but very few people in the Congress have said that they would vote to uphold a veto.

Mr. WINTER. I think the initiative has to come there because, as you say, and I readily agree, on a geographic basis you have the demands. I saw a book the other day about so big on Federal money and programs available. It only took a few years to develop this rather radical change, or rather substantial change, let me say.

I think the responsibility should be there. It is pretty hard to do.

Mr. HERLONG. The only thing that we could do in this committee is to find some method in my judgment to keep from having to go into the money market for \$29 billion at this time. We have to do whatever it takes. We hope that the people downtown will do their part.

Mr. WINTER. Correct.

The CHAIRMAN. Mr. Broyhill.

Mr. BROYHILL. Dr. Madden, have you ever heard of the expression in the investment business known as last money in and first money out?

Dr. MADDEN. Yes; I have.

Mr. BROYHILL. There have been a lot of questions here as to where we should make these cuts in expenditures. That is such a difficult thing to do. Yes; it is politically difficult, but why wouldn't it be a practical approach in the absence of this bipartisan commission that the chairman has proposed to cut the programs which were most recently inaugurated?

Now, this would be the type of program that has not yet become a way of life in the country or a part of a tradition, which makes it extremely difficult to terminate, but such programs as the war on poverty which has only been in existence long enough for us to know that it is a wasteful ineffective program.

We may even decide to cut the education program. Of course we are all for education. We know that is a rather sacred field as far as cutting expenditures is concerned, but we have been in the elementary and secondary field for just a few months. This is a field that has been traditionally left up to the States and the local communities.

We are talking about a temporary tax increase if that word temporary means anything. I have said before that there is nothing more permanent than a temporary tax increase and a temporary building, built in Washington during the war, but if we are sincere about a temporary tax increase then why can't we have a temporary cut in these programs which were most recently inaugurated?

That is, in the absence of a more sophisticated type of system of cutting back expenditures, just cut the programs most recently put into being; and, furthermore, stop the totally new programs.

We are being admonished constantly by the President because we don't go along with him in creating multibillion-dollar new programs. It has been proposed that we spend billions of dollars in additional funds to eliminate the so-called ghettos, the things that cause the riots in this country. The President was on the television the other day criticizing those who started the riots, a very fine job. Then he turns around and blames it on the Congress because we hadn't spent enough money to get rid of the so-called slums.

We were condemned for voting down this \$40 billion rat bill when there were already three programs in existence that can do the job if administered properly.

So I don't see anything so difficult about finding places to cut spending. I know it is a difficult question for you gentlemen to answer because you are going to step on somebody's toes when you begin to list these various programs. It seems to me that the least dangerous way of cutting back on spending, and we are going to hurt somebody—we are going to have to tighten our belt and it is not going to be politically

popular—but the least destructive way of cutting back is to cut back the programs most recently proposed.

Do you gentlemen agree?

Mr. WINTER. I think as indicated in the statement here that our approach would be that the priorities must be established. I am not entirely sure that the latest programs are the ones that more readily can be cut. There may be earlier ones that perhaps have far less importance and ought to go first.

This, as I understand it, is what the Commission would do. They would evaluate different programs, not just the new ones but the ones, as I say, that have been in for a long time that carry the annual appropriations, an evaluation and establishment of priorities.

I am not sure that this LIFO method is really the answer. It depends upon the degree of priority. If the economy won't stand a tax increase, then obviously I think that something like that would have to come to avoid any more extreme measures.

Mr. BROYHILL. I would appreciate any recommendations or suggestions from the Chamber of Commerce of the United States as to where specifically these expenditures can be cut, but in the absence of a recommendation I am going to take my own initiative in voting for the cuts and voting down the programs and it will amount to at least \$4 to \$5 billion that we have been talking about.

One of the main reasons given by the Treasury as to why this surcharge should be enacted is to lessen the dangers of increased interest rates and tight money. Yet a couple of witnesses yesterday, Mr. Gullander from the National Association of Manufacturers and Mr. Kust of Westinghouse, indicated that the accelerated payments of estimated corporate taxes cause corporations to go into the money market and that contributed to the tight money market and high interest rates as much as Treasury borrowing.

Do you agree?

Mr. WINTER. Yes; and the elimination of \$100,000 will have an impact, too.

Dr. MADDEN. I quite agree. It will simply add to the total borrowing that will be needed if corporations have to borrow for this purpose and any additional borrowing will put pressure on the supply of credit, so I think the point is correct.

How large a magnitude is involved is a question I couldn't answer without study.

Mr. BROYHILL. If this surcharge goes into effect as proposed by the Treasury it would mean about \$400 million additional taxes by accelerating the payments that the corporations pay from 70 to 80 percent and \$400 million by eliminating from the estimated tax payment the \$100,000 exemption, and that would mean what amount in surcharges for corporations; \$1 or \$2 billion, is it?

Mr. WINTER. I think about \$2 billion is correct.

Mr. BROYHILL. Would the additional taxes, accelerated payments or surcharge, be passed on in the way of cutting back dividends to stockholders, or will the result be more borrowing by the corporations to replace the funds lost out of the treasury?

Dr. MADDEN. Whether the corporations would borrow or not would depend on their cash position. Whether the corporations would pass on the tax increases or the additional cost resulting from the accelera-

tion is another question which depends on how strong the demand for the products of these corporations is.

If the demand for their products is sufficiently strong, then prices will rise and they can recover the cost of the tax increase. If the demand for their products is not sufficiently strong, then the only thing that can happen is that profits will fall.

Mr. BROYHILL. Then you don't know for certain yet whether this surcharge will necessitate additional borrowing on the part of corporations?

Dr. MADDEN. Insofar as it constitutes an increase in costs of a corporation it certainly seems reasonable to think it would increase the need for borrowing, but it is impossible to estimate how much.

Mr. WINTER. Cash certainly is required to pay taxes and adding 10 percent to the tax bill would certainly involve additional money.

Dr. MADDEN. Certainly.

Mr. BROYHILL. Thank you.

The CHAIRMAN. Any further questions? Mr. Battin.

Mr. BATTIN. Mr. Chairman, I think maybe the West must be famous for birds. We have the gooneybird economic theory and out where I come from we have a baffle bird. He is one that continually changes his course of flight and nobody knows where he is, but nine times out of 10 he gets lost and doesn't know where he is either.

I was amazed to watch the President's Chairman of his Economic Advisers sit before us and go into great detail on economic indicators reflecting the past and projecting the future and based upon these make the recommendation that there be the 10-percent surtax. I am a little bit curious as to how we as a committee or the Congress or the business community, having built up through the years a rather substantial storehouse of information on trends and economic conditions, would ever assume that we could just go forward without ever looking back to see where we have been or what might happen under given circumstances and conditions.

I think the indicators that were presented to us the first day of these hearings and the ones that have been presented since don't give any clear indication of what might happen in the next two, three, or even four quarters.

Would you agree with that?

Mr. WINTER. Two, three, or four quarters?

Mr. BATTIN. Ahead.

Mr. WINTER. Well, I don't know that I projected that far. Certainly the projections at that time indeed to me did not indicate that the case had been made out for action now.

Dr. MADDEN. I read Mr. Ackley's statement. It seemed to me that Mr. Ackley did not in his statement formulate propositions about the future, the next three or four quarters, that were very accurate or specific. He stated that the economy was going in for a very strong rise, but he confessed that he could not quantify the timing or the speed of that rise, and that is exactly the issue before this committee, in my judgment.

Insofar as the tax surcharge bill is an economic measure it rests upon the judgment about the impact of the tax on the economy, so you are quite right the way in which economists attempt to forecast economic

conditions is by surveys of intentions to buy on the part of consumers and of businessmen.

You, of course, have the plans of the Federal Government over the next fiscal year. They have, however, in the past proved inaccurate in part, as, for example, the estimate of revenues was inaccurate to the tune of \$7 billion.

Mr. BATTIN. I would like to interrupt you there. Again this is a problem of projection. The budget was based upon estimated revenues. Because of circumstances that year those revenues were not realized, netting a deficit in the budget beyond what had been anticipated, but now the point is that Mr. Ackley made what I thought was rather a startling assumption and I would like to have your opinion.

He said, assuming that there would be no major labor strikes or problems in the economy in calendar year 1967, then certain things would happen. With all the contracts that are up I find it rather difficult to believe that there will not be any major labor problems in the economy.

Would you care to comment?

Dr. MADDEN. I would agree with you thoroughly on this point and it is one of the very important reasons for caution on this committee's part in making this highly delicate and extremely important decision. The reports from the automobile industry suggest that progress toward a settlement there has not been as fast as might be hoped.

I believe, if my memory serves me, that about 7 million workers this year are subject to wage settlement considerations. The pattern for these wage settlements set as early as the airline mechanics strike in 1966 is unquestionably going to be above the rate of productivity advance in industry, particularly as a result of the readjustment in the first half of this year, so you have a source of cost-push inflation, potential inflation, here that would not necessarily be reached by the tax decision of this committee at all, but that would affect the consumer's attitude toward purchases.

I would like to mention in this connection an article that appears in U.S. News & World Report for August 28, 1967, on page 31 called, "The Case of the Vanishing Pay Raise."

One example that this magazine gives is a family of four getting \$7,500 a year with a pay raise of \$375. It lists the proposed increase in Federal income tax at \$147, proposed increase in social security tax at \$40, the increase in State and local taxes at \$31 average, for a total tax increase of \$218 this year, leaving out of the pay raise \$157, and then, based on U.S. News & World Report's estimate of price rises that might result from labor settlements in excess of productivity, \$181, so that the family's net loss with this pay raise of \$375 is \$24 for the year.

We have had this discussion about priorities. Each of us, of course, is a consumer, but most of us, many of us, are taxpayers, and taxpayers according to reports are becoming more and more dissatisfied generally with the judgment of priorities that lead to the taxes we have to pay, so I think this is a consideration that stems from this automobile and other wage settlement considerations, the problem of what is going to be the impact of these wage settlements on prices and in turn what is going to be the impact of these wage settlements on consumer intentions to buy and therefore on the economy.

Mr. BATTIN. Generally in this connection we had before the committee a while back a request to suspend the investment tax credit. The economy was heating up too fast in the opinion of many and this could cause some serious consequences.

The investment tax credit was suspended. Then later, earlier this year, we were asked to reinstate the tax credit because the economy was becoming sluggish and was not producing the anticipated revenue.

Now in the committee today we are talking about a 10-percent temporary proposed surtax. I asked this of Mr. Ackley and received his opinion or his expression, but I am not so sure that there aren't some who would use the tax laws as a means of regulating the expansion or the reduction of our economy.

Would you care to comment on that?

Dr. MADDEN. I think there is no question at all that there is a highly influential group of economists who would indeed use the tax laws to regulate the economy in preference to changes in expenditures in the Federal Government. These men argue that expenditure totals should be set by some judgment of the value of the program and that then tax rates should be changed frequently in order to adjust the deficit or surplus to economic conditions.

Indeed, as you well know, these people propose to remove the responsibility for individual tax changes from the committees of the Congress and lodge it in the arms of the President of the United States who would make these decisions at his own discretion within a broad guideline.

Mr. BATTIN. I have just perhaps one other comment and it goes to questions that have gone to witnesses, none of whom so far has been an elected Member of Congress, as to where cuts should be made.

I always had the feeling that the people in the district that I represent elected me to make those decisions. If I make the wrong one then they have a choice every 2 years as to what they are going to do about it, but surely what you might think is a good cut in your own mind and in your own feeling about any given program might not agree with mine. I would suggest to the members of the committee that today and during the balance of this week on the floor of the House they have a great opportunity to make some cuts with the NASA appropriation bill up and the authorization for foreign aid.

We have a real chance to aid the President in every way possible to bring down spending in line with his target, and I promise you as one that I won't shirk my responsibility.

Thank you very much.

The CHAIRMAN. Any further questions? Mr. Watts.

Mr. WATTS. I have listened with a great deal of interest to some of the questions that have been propounded here. I am inclined to agree that it would be wonderful, as Mr. Landrum suggested and Mr. Ullman suggested, if you could come in with some proposals as to where the cuts ought to be made.

I know you did come in with a program in the early part of the year. Of course, I don't want to leave the final decision up to you or to any other group.

Mr. WINTER. We appreciate that.

Mr. WATTS. I know where you all want it cut and I know where labor organizations would cut. I know where farmers would cut. While

I am perfectly willing to accept all of your recommendations, I am going to have to agree with Mr. Battin that the final decision has to be made here and in the Congress because if we allow you alone to decide where the cuts are going to be made I know they are going to be made from a selfish standpoint.

If we allow the labor unions alone to make them, they are going to be made from a selfish standpoint. If we allow the farmers alone to make them, they are going to be made from a selfish standpoint, or, whatever the group, it is certainly not going to recommend any cuts where it is going to get hurt particularly.

In other words, I found out years ago when I had been in Congress a short time that everybody in the country is for economy except on his and "his'n," and so while I might be willing to accept your recommendations to be evaluated, I do agree that I wouldn't want you to have the final say about it because I think I know what would happen. I do think, however, when you come in here and talk about cuts you ought to have been prepared to have brought back with you that list that you sent out in the earlier part of the year and go over it again and review what has happened in the interim.

It is easy to talk about a great big cut and a little hard to do something about it. You know how it goes—when you get to talking about a cut, and then you have 50 Governors and 50 States, the mayors and boards, councils of every city, the county judges and the fiscal courts of all counties, and 85 percent of the people in the country, by telephone, letter, telegraph and personal visit, constantly haranguing each Member of Congress for more and more and more money. It is very seldom you get a letter that wants less.

Once in a while you do, but most of them want more. I have often felt that maybe Congress has done a right responsible job in not answering all the requests, because if we had met every demand for money made on us, while there may be some existing bad financial condition, we would by this time have been over the brink. So when you do come in—while it would have been nice if you could have had your specific suggestions today—I don't merely want to consider your suggestions alone. I want to get everybody's and weigh each one.

I didn't ask you a question. I preached a sermon. Thank you.

MR. WINTER. I think in the time ahead, too, we must recognize that there will be perhaps after Vietnam—I don't know when—more and more requests from the States for some form of revenue sharing and that is going to have to have a great deal of study.

I don't know what the ultimate outcome of that will be. We have just been through a very tedious procedure in Illinois trying to raise taxes, and I can tell you it is very difficult. It is difficult on the Federal level.

THE CHAIRMAN. That is one thing you don't have to remind us of, Mr. Curtis.

MR. CURTIS. Mr. Chairman. I want to thank these witnesses for appearing and giving this committee the benefit of their studies and evaluations. I think one of our basic problems here is a fundamental difference in economic philosophy between the new economics, as practiced by this administration, and the economics of people like myself. The administration has been following the theory of moving the economy forward through increasing aggregate demand, through creating Federal deficits, if necessary. This is what I call the new economics.

With Dr. Heller a few years ago and members of his school, one of our problems was the absence of any concern about deficits, and the President's school of new economists still say you don't have to worry about the Federal debt because it is a less percentage of gross national product and so on.

I am leading up to the point that we have reached a critical situation where the administration, as shown by its policies and its witnesses' presentation, and as Mr. Ullman has ably stated, obviously just doesn't believe there is anything fundamentally wrong in the deficit itself because they keep talking about "where-would-you cut?" rather than why is a balanced budget necessary.

I think you stated, Mr. Madden, that when business finds that they have to balance their budget they just balance it. The difference lies in the fact that the President doesn't think balancing the budget or even approaching a balanced budget is economically necessary. This is a perfectly respectable position, but let the President admit it.

I spent last week trying to go over in detail with the Director of the Budget Bureau items where the budget could be cut. Very clearly it can be. The difference lies in the fact that the administration's fiscal experts don't share this concern.

Now I am coming to a basic point that I want to pose here. We can just sit here on this committee, and Congress and the executive can just do nothing. If so, I can assure President Johnson there will be a \$7 billion cut in his expenditures in fiscal 1968 of a projected \$144 billion; at least \$7 billion.

It will be a meat-axe cut. It will be the cut imposed by inflation. Last month the consumer price index went up 0.4. If the consumer price index (the measure of inflation) goes up five points, there we have the \$7 billion. That comes out of the hide of the lowest income groups in our society, out of the welfare programs and out of the guts of defense in Vietnam.

As I understand the administration's theory behind the tax increase, they think that increasing the tax rate will minimize these inflationary forces, but I know no economist who doubts that the inflation that we are experiencing right now, as registered in the consumer price index, is cost-push inflation.

This isn't demand inflation. The falloff in industrial production demonstrates this isn't demand inflation. This is cost push. And if it is cost push we can have the unique combination of inflation and recession. In fact, we have had inflation and have reached this downturn.

You can have less revenues at a higher tax rate. It is the deficit that is going to increase, I would say, this cost push just as much even if it is financed by a tax increase because at least the corporate tax becomes a part of cost and is passed on, as it has to be, to the consumer in increased prices.

We have already increased costs through the payroll tax, and social security tax if that goes through. It may be a necessary expenditure, but, nonetheless, this becomes a cost item. Interest rates are part of the cost push, and here there is a very serious situation. The administration puts that aside and says nothing can be done about the interest rates we are paying, an increase of \$2 billion from 1966 to projected 1968, from \$12 billion to \$14 billion.

One-half of that is from the increased debt, it is true; but the other half is from increased interest rates. The Secretary of the Treasury

under my interrogation recognized that we could have saved money on interest rates by removing the 4¼-percent ceiling on long-term bonds because for the past 2 years we have had to finance the rollover of this debt entirely in the short-term area, which has increased the cost to the Government. This is certainly not one of these items that is uncontrollable.

I would say we are paying about a billion dollars more than we need to in interest rates due to this kind of foolishness. The Democratic leaders of this Congress won't adhere to the Treasury's request to give them flexibility in this area. One request they made which I thought had real merit.

Mr. ULLMAN. Would the gentleman yield?

Mr. CURTIS. Sure I will yield.

Mr. ULLMAN. The problem, Mr. Curtis, and the reason that your statement isn't right, is the fact that the short-term rates have been so much lower than the long-term rates during the past 2 years and they are still lower than the long-term rates. When you are talking about shifting to long terms now you are talking about shifting into the higher interest rate bracket rather than the low bracket.

Mr. CURTIS. We are paying considerably more than 4¼ percent for interest, but the main point is that it gives flexibility so that you can keep your short-term rates lower. Short-term rates indeed should be much lower than long-term rates. But when the Federal Government had to go into the money market, as it did last year, for \$175 billion just to finance the rollover of the Federal debt, when we find that about 50 percent of the Federal debt is now in maturities of 1 year or less, and the average maturity is now below 4 years, 3 years and some months, we begin to see this picture. This also aggravates the money market for the private sector.

However, this administration has refused to take any leadership in this area. Now let's get to this business of where you would cut that was passed back to you and has been passed back to me by the administration witnesses.

Mr. Mills has made a fine proposal for a commission, but I would observe this. The President if he would and agreed with this theory could call this kind of commission together right now from the leaders of the Congress. The answer is he doesn't agree with this theory.

I urged early this year a rescission bill. It isn't quite true that the appropriation bills of this particular session have no bearing on the expenditure level. They have a bearing, but it is perfectly true the carryover balances of powers to spend granted by previous Congresses go to make up what the expenditure level for this fiscal year can be and the President has it in his power right now to cut back at least \$10 or \$15 billion on these expenditure levels. But notably, and I am going to repeat it, symbolically the President has abandoned the role of turning off the lights in the White House and he used that role as symbolism.

I am not attacking the President when I point out that this symbolism has disappeared. Instead in time of war in Vietnam and war in the cities, if it can be called that, the President symbolizes a nation that can go on as if there were peace everywhere; live as usual; take your weekends.

Congress can adjourn on Thursdays, of course, as we have been all year, going for a 2-week recess around Labor Day. This is the kind of symbolism that the people see and then wonder, "What is this asking us to put in more money through increased taxes."

There is no leadership in the Executive. The Executive in this area has said he can't do anything about expenditure cuts.

Well, he can, and the reason he hasn't is that he just doesn't care to. President Eisenhower, when they first set up the space program, looked upon it as requiring a level of expenditure of \$1.8 billion projected into the future. The limitation was the number of scientists and engineers in the society, not money.

We have been hitting it at over a \$5 billion level. You can pay a person the salary of a scientist and call him a scientist, but that doesn't make him one. You can call a person an engineer and pay him the salary of an engineer, but that doesn't make him one. This program of \$5.3 billion in space is clearly an area where it could be cut back and improved and in these times certainly needs cutting back.

On the defense of Western Europe, great military leaders like President Eisenhower and others have called upon this administration to cut back on a \$2 to \$3 billion expenditure. This administration won't even discuss it, but here is an area where clearly we could cut back in defense.

Another is atomic energy. I am going down the list again. The defense budget itself, just because it has the name of Vietnam on it, doesn't mean that it isn't hiding vast waste. Our Joint Economic Subcommittee this year pointed out the manner in which Secretary of Defense McNamara had made a mockery out of the terms advertised bid and competitive bidding, and the way in which money could be spent more wisely there.

I have a bill in to cut approximately \$2 billion in agriculture. Secretary Freeman says it is a bill presented by a city Congressman. Well, I don't happen to be a city Congressman, but it is the result of years of work of the Joint Economic Committee where we have been trying to study this field of agricultural economics and my work as a member of the delegation in Geneva and in our GATT conferences. The American Farm Bureau I am happy to say has supported this approach, but, no, this administration keeps on with their agriculture program again as if things were normal. It is a bad program. It is bad for commercial agriculture. It is adding at least \$2 billion to these expenditure budgets that, note, don't need to be added.

To get into the business of the use of personnel by the administration, one never hears about productivity increases when it comes to the work of the Federal Government. It is just a continued increase of employees with very little real work done on the job of reclassifying skills and relating wage rates to skills.

Also there is the manner in which the administration rammed through without study the military manpower program based on the draft, which is about as expensive and poor a manpower program as we have.

You go down the list and you don't even have to touch the war on poverty to get at least \$10 billion, \$15 billion out of this budget.

Mr. Chairman, for the record the expenditure levels of this Federal Government in fiscal 1960 were \$77 billion. The testimony last week

by the Director of the Budget indicated it might be \$144 billion for fiscal 1968. We were not a poor country or a country overlooking the needs of our people in 1960. I want to call attention to a couple of other things.

President Kennedy, I remember, in 1960 campaigned saying we have to double the amount we are spending on education in our society in the next decade. My response was why was he asking us to slow down? We almost tripled the amount from 1950 to 1960.

I can tell you that we have slowed down, because Federal money not wisely spent can drive out private and local money, reduce effort, and this is what we are seeing. At least we should look at this area. In foreign aid and other areas, spending ought to be cut back from a total figure of \$5.1 billion to what the Clay Commission recommended, about \$1.8 billion. I say this, as one who favors the theory of foreign aid because you can have the Curtis corollary to Gresham's law operating, namely, that Government money will drive out private. We see it in the Alliance for Progress, where the misuse of Government investment has actually not increased private investment, either from the developing society itself, or from American private investment. So there is such a thing as going beyond the point of diminishing returns in expenditure policy and this certainly is the issue before this committee.

We can go beyond the point of diminishing return in tax policy. The chairman, himself, of this committee, on the floor during the debt ceiling debate, raised the question whether increasing rates would actually produce more revenue. Our tax rates are still too high. We could embark on a program for 20 years of reducing Federal income tax rates if we held our expenditures and increased our revenues through the expansion of the tax base.

These are the issues as I see it. I think your testimony has been on the point. The reason I have, in effect, testified here was in light of the cross-examination of Mr. Ullman. He restated the administration's case quite accurately, in my opinion. I think it is a poor case. I think it is founded on misconceptions of proper fiscal and economic policy, but I certainly want to zero in on this business of cutting back expenditures.

It is the correct course to take. It can be done. Mr. Mills' proposal can be adopted, but cutting expenditures doesn't have to wait for that. If the President believed this he could start exercising leadership today along these lines, and Congress could just heave a sigh of relief and support him on it and get this budget deficit down to about \$10 or \$15 billion.

I think we are going to have to have a deficit of that size. In dealing with a deficit of that size, it makes sense to talk in terms of what we might do to finance some of it through increased taxes and not have it all go into the Federal Reserve or into the money market. But until the administration agrees with this, I don't think it makes any difference how you finance a \$30 billion deficit.

The economic consequences and the damage are so great and the burden it is going to put in this cost-push inflationary area is such that we are going to have the meat ax cut of inflation.

Thank you, Mr. Chairman.

The CHAIRMAN. Any further questions?

If not, we thank you, gentlemen.

Mr. WINTER. Thank you.

The CHAIRMAN. Our colleague from New York, Mr. Tenzer, is now in the room. We are pleased to have you with us this morning, Mr. Tenzer, and you are recognized, sir.

STATEMENT OF HON. HERBERT TENZER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. TENZER. Thank you, Mr. Chairman and gentlemen. Mr. Chairman, I appreciate this opportunity to appear and testify before you and the other distinguished members of the Ways and Means Committee, on the President's 10-percent tax surcharge proposal.

I will also outline my own suggestion for an alternative to raise the same amount of revenue or, should you so decide, to raise twice the amount sought by the administration without costing more taxpayers any more than the President has proposed.

At the outset let me say that I oppose the President's proposal for a surcharge in its present form. I will continue to oppose it unless it includes provisions to tax the untaxed.

By what I mean, the surcharge or equivalent should apply to those whose income is derived from depletion, depreciation, capital gains, and other loopholes and tax-sheltered income, so long as the surcharge remains in effect.

By this suggestion I am not proposing a broad change in our tax laws at this time. While a comprehensive reform of our tax laws is long overdue. I realize that this desirable result will require separate study by this committee.

To accomplish this I have introduced in the House, House Joint Resolution 454 to establish a Commission on Unequal Taxation. The Commission would be charged with the responsibility to review the entire tax structure—the existing inequities—the tax loopholes—and would make recommendations to the Congress designed to equitably distribute the tax burden.

Prior to my election to the Congress in November 1964, I was the senior partner of a New York law firm. I have been a practicing attorney for 38 years. During this period I served as chairman and a director of a number of business corporations and of three commercial banks. I have also had extensive experience and investments in real estate.

While I have had a wide experience in law, business, banking, and real estate, I am not a tax expert or an economist.

I do know that the generally accepted theory of taxation in America is that money to be used in the service of all the citizens is justly raised by taxation; that a tax which does not apply equitably upon all or which, applying equitably upon all, is used for the benefit of a few, is unjust.

In his first annual message to the Congress on December 2, 1817, President James Monroe said:

To impose taxes when the public exigencies require them is an obligation of the most sacred character, especially with a free people.

If "taxation without representation is tyranny," then representation without taxation is scandalous.

Let me cite examples of what I consider as scandalous. The Internal Revenue Service has informed me that in calendar 1964, there were 35 individual returns filed with adjusted gross incomes of \$500,000 and over, and on which no Federal income tax was paid. These returns represented a total adjusted gross income of \$75.2 million.

The Internal Revenue Service also informed me that in the same year, 24,084 individuals filed tax returns with adjusted gross incomes in excess of \$10,000 and paid no taxes. The combined adjusted gross income of these individuals was \$523,515,000.

I have here, Mr. Chairman, a letter from the Office of the Secretary of the Treasury under date of August 22, 1967, signed by Samuel M. Jones, Deputy Assistant to the Secretary, in which these figures are confirmed.

The CHAIRMAN. Do you want to make it a part of the record?

Mr. TENZER. I would like to make it a part of the record at this point.

The CHAIRMAN. Without objection it will be included in the record. (The letter referred to follows:)

OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, D.C., August 22, 1967.

HON. HERBERT TENZER,
House of Representatives,
Washington, D.C.

DEAR MR. TENZER: In reply to your request for information pertaining to the number of non-taxable income tax returns showing adjusted gross incomes in excess of \$10,000, I am providing the information you requested for the year 1964, which is the most recent year for which statistics are available.

In 1964, 24,084 non-taxable income tax returns with adjusted incomes over \$10,000 were filed with the Internal Revenue Service. The total adjusted gross income of these non-taxable returns was \$523,515,000.

A table explaining the above is attached.

Very truly yours,

SAMUEL M. JONES,
Deputy Assistant to the Secretary.

Mr. TENZER. Thank you. It is equally scandalous that certain corporations enjoy unusual special privileges under our tax laws, while most corporations pay at the rate of 48 percent.

One example of the special privileges to which I refer, is that extended to the oil companies.

In 1964 the U.S. income taxes of the 22 largest oil companies when taken together reveal these interesting statistics:

Year 1964 (combined)

Gross profit.....	\$5, 179, 036, 000
Federal tax (4 percent of gross).....	240, 529, 000
Foreign, some State tax (20 percent of gross).....	1, 064, 383, 000
Income after tax (74 percent of gross).....	3, 873, 836, 000

It is shocking that the largest oil companies pay a smaller percentage of their net incomes in taxes than small businessmen, workers and farmers. The man in the lowset tax bracket pays 14 percent of his net income in taxes, while the figures I just mentioned showed that the Federal tax of these 22 companies was 4 percent.

I have read the testimony of Secretary of the Treasury Henry H. Fowler; of Assistant Secretary of the Treasury Stanley S. Surrey; and of Chairman Gardner Ackley, Council of Economic Advisers and others who testified last week before this committee. They presented

the problem of a \$29 billion deficit facing the administration. They explained how they plan to borrow 50 percent, cut 25 percent, and tax 25 percent, to meet the deficit.

I have read their analyses of the needs for additional tax revenues. I may even agree with their fears about inflation. However, I cannot understand why they have overlooked, as a source of revenue, those who pay no taxes at all and those who do not pay an equitable share of the tax burden.

The Secretary of the Treasury in his testimony on page 37 of his prepared statement said as follows:

I want to make quite clear that the choice of the surcharge form to meet a temporary need by no means implies a turning away from the need for achieving important permanent structural changes in the tax system.

Indeed, as the President stated in his Economic Message, he will be sending a message proposing comprehensive tax reform later in this Session.

Both in timing and objectives, however, tax reform should be distinguished from the present temporary surcharge recommendation. The surcharge is needed now for revenue. Expeditious action is essential if it is to achieve its purpose. It is a temporary measure and not a permanent part of our revenue structure. The central issues for Congressional concern are the size of the needed increase and its timing.

The Tax Reform Message will require more deliberate consideration since it involves proposals for permanent structural changes and some redistribution of tax burdens in the interest of a fairer sharing of the load. Its basic objective is not to raise revenue but to correct a number of inequities and abuses in our tax system. Tax reform is a job that very much needs to be done. I hope your committee will be giving its consideration to the President's reform recommendations in the months ahead.

However, I am not speaking now of overall tax reform. I am addressing myself to the present needs and how best to meet them.

I do not agree with the Secretary of the Treasury that we must wait for a tax reform message until after the tax surcharge is disposed of. We have had promises of tax reform before.

The Democratic platform of 1940 contained the following declaration. "To encourage investment in productive enterprise, the tax-exempt privileges of future Federal, State, and local bonds should be removed."

The Democratic platform of 1948 said, and I quote—"We shall endeavor to remove tax inequities and to continue to reduce the public debt." The Republican platform of 1952—"A thorough revision and codification of the present hodge-podge of internal revenue laws," requires attention.

And finally, the late President John F. Kennedy in his special message to the Congress on taxation, April 20, 1961, said;

While it is essential that the Congress receive at this time this Administration's proposals for urgent and obvious tax adjustments needed to fulfill the aims listed above, time has not permitted the comprehensive review necessary for a tax structure which is so complicated and so critically important to so many people. This message is but a first though urgent step along the road to constructive reform . . .

Moreover, special provisions have developed into an increasing source of preferential treatment to various groups. Whenever one taxpayer is permitted to pay less, someone else must be asked to pay more. . . .

It will be a major aim of our tax reform program to reverse this process, by broadening the tax base and reconsidering the rate structure. The result should be a tax system that is more equitable, more efficient and more conducive to economic growth. . . .

I would urge the President not to wait with his tax reform message. The taxpayers who are already paying their share want to know what this administration intends to do about those who by tax avoidance procedures, do not pay their equitable share of the tax burdens.

They want to know now.

The President should send his tax reform proposal to the Congress without delay. Such action will create an air of confidence in the minds of the taxpayers. It will serve to encourage them in giving objective consideration to the Nation's budgetary needs. They will better understand what the President's advisers are saying.

The proposal which I am making today stems from the fact that I want everyone to share in the Nation's mounting tax burden. I want everyone to contribute to the Nation's obligations at home and abroad.

Mr. Chairman and gentlemen of this committee, last Thursday I introduced H.R. 12445, a bill to impose a minimum income tax on certain individuals and corporations with substantial incomes. My proposed bill has the following features:

(1) Taxpayers with less than \$10,000 in actual income will be exempt.

(2) A minimum income tax to apply across the board so as to reach all tax loopholes and tax-sheltered income, income from tax exempt securities, nontaxed capital gains, excess of percentage over cost depletion and real estate depreciation income.

The thrust of my proposal is to tax the untaxed by having them pay a minimum income tax of 10 percent, to remain in effect only so long as the President's surcharge tax remains in effect.

I have carefully considered this proposal to establish fairness and equitable treatment among all individuals and corporations.

I am not wedded to the text of my bill but to the equity behind the principle. If the principle is accepted, then I am certain that the distinguished chairman and members of the House Ways and Means Committee and their tax experts will amend the bill to correct its deficiencies and omissions.

One of the individuals who paid no tax in 1964 had an adjusted gross income of \$5 million. Under the President's proposal he would not contribute to the cost of running the Government because no matter how you look at it, 10 percent of zero is still zero.

I want those with substantial incomes who pay no taxes to contribute their just share of fighting the war in Vietnam; fighting the war on poverty, and the battle to clean up and rid the riot potential cities of slum areas. I want them to pay an equitable share of the burden of providing education, medical facilities, and building our highways, the benefits from which they share with their fellow citizens.

H.R. 12445 (Tenzer bill) is not a tax reform measure. It does not single out any particular tax loophole for reform. It simply requires a minimum contribution to the Nation's tax burden through a minimum income tax applied to all income—without regard to exemptions, deductions or other special privileges set forth in the Internal Revenue Code.

I fully realize that tax reform cannot be accomplished overnight; however, the time to start is now. A complete overhaul of our tax laws is urgently needed and will be of long-term benefit to our Nation.

With the President's tax surcharge proposal intended to raise only 25 percent of the \$29 billion deficit, it seems only fair, reasonable, and equitable that every taxpayer, individual or corporate, should pay something toward the tax revenue needed to prevent unbridled inflation.

Unofficial Treasury Department estimates confirm that my proposal will produce about \$7 billion in additional revenue. By spreading the tax burden to those who were previously untaxed, other taxpayers will be assured that the surcharge is only temporary.

My proposal can be used as an alternative or as an amendment to the President's surcharge proposal.

Under the President's tax surcharge proposal, the law and fixed-income taxpayer, one who earns less than \$5,000, is exempt. He may, however, be adversely affected if the budgetary cuts of \$7½ billion extend to the basic human needs which he requires to sustain himself and his family.

The additional tax revenues which my proposal will produce, together with the President's surcharge, will provide sufficient funds to safeguard against budgetary cuts in the areas of human needs such as health, education, and housing.

I have already stated to the President, in person and in writing, that I will oppose the surcharge in the absence of some sharing of the tax burden by the untaxed and those who have taken advantage of various tax shelters, legal though these actions may have been.

For the long term a complete overhaul of our tax laws is necessary. My proposal will answer the question for the short term and indicate to the taxpayer who will be called upon to pay the surcharge that others of their fellow citizens are not escaping their proportionate share of running the Government.

Let the tax and economic experts of this distinguished committee draft a proposal which will equitably distribute the tax burden required by the fiscal 1968 budget.

If a just and equitable revenue proposal is desired, then our policy should be, "Everybody pays or nobody pays."

The CHAIRMAN. Mr. Tenzer, we thank you, sir, for coming to the committee to discuss your idea with us. Any questions of Mr. Tenzer? Mr. Curtis.

Mr. CURTIS. Simply this, Mr. Tenzer. I welcome your support to get a tax reform bill before this committee. There are many areas that I felt we need to move in on. I would make the observation, though, that I doubt if a tax reform bill is going to end up with as much net revenue for the Government.

We may get some additional revenue, but some of the taxes or rather the return that you referred to that are paid on taxes need a little further explanation.

Some that you mention I particularly recognize are those that pay no tax because they give all their money to charities. I think our charities are fairly well established as to what the money goes for. Maybe we ought to revise it. Personally, I think if money is spent in this area it is true that it doesn't come to the Federal Government, but it doesn't go to these individuals either.

The same thing when you mention big-city problems. Another big area where the people do not pay taxes are those who buy municipal

bonds, but they are men and women who, of course, are trying to get the most return for their money and they could get a much higher rate of return from other forms of investment. They choose the lesser amounts they can derive from municipal bonds because of its tax-exempt feature. But if your reform were to be enacted, and eliminate that feature, you would be shutting off the source of the financing of schools, sewers, and community facilities. The very expenditures that we are seeking to encourage would involve much higher rates of interest and probably a lot of these projects would go by the board.

I only point this out because there is this point that our laws are not as inequitable as they might seem although I again share with you the awareness of the need to look at these areas constantly and I think we do need to look.

I hope a bill will get before us and we will zero in on some of these areas, including the ones I mentioned.

Mr. TENZER. May I comment on that, Mr. Curtis?

Mr. CURTIS. Yes. I just want to raise the red flag that I don't think you are going to find the juicy sources of revenue that can be derived from closing up inequitable loopholes. Yes, sir.

Mr. TENZER. I wish you would have said red light instead of red flag but I think I know what you mean. One of the statements you made was about the man who gives all to charity.

Mr. CURTIS. Yes, that is right.

Mr. TENZER. Of course, you know that is not the usual case; it is the exception to the rule rather than the practice.

Mr. CURTIS. Yes, but the \$5 million you mentioned in your statement is why I mentioned it.

Mr. TENZER. There are others, and I would like to offer for the record a statement from the Library of Congress quoting the Internal Revenue Service about the 35 individuals with \$500,000 adjusted gross income or more in 1964.

(The information referred to follows:)

THE LIBRARY OF CONGRESS,
LEGISLATIVE REFERENCE SERVICE,
Washington, D.C., January 13, 1967.

From: Economics Division.

Subject: Nontaxed incomes of more than \$500,000.

The Internal Revenue Service has informed us that in calendar 1964, there were 35 individual returns filed with adjusted gross incomes of \$500,000 and over, and on which no Federal income tax was paid. These returns represented a total adjusted gross income of \$75.2 million. A breakdown of the income characteristics of these returns follows:

	Number of returns	Thousands of dollars
Salaries and wages.....	19	1, 145
Business or profession income:		
Net profit.....	12	14
Loss.....	8	3, 050
Farm income:		
Net profit.....	1	27
Loss.....	8	838
Partnership income:		
Net profit.....	4	24
Loss.....	17	2, 625
Sales of capital assets:		
Gain.....	29	21, 063
Loss.....	0	0
Sales of depreciable property:		
Gain.....	6	24
Loss.....	0	0
Sales of other property:		
Gain.....	0	0
Loss.....	3	72
Dividends.....	32	57, 609
Interest.....	33	2, 577
Pensions and annuities.....	6	74
Net income from rents.....	8	59
Net loss from rents.....	13	193
Royalties:		
Gain.....	3	7
Loss.....	1	8
Net income from other sources.....	0	1, 430

Source: Statistics Division, Internal Revenue Service.

IRS indicated that, in general, the most probable factors accounting for this income being non-taxable are tax credits and itemized deductions, especially large contributions.

For greater detail on this issue, a copy of Philip Stern's, *The Great Treasury Raid*, is also enclosed. See especially Chapter 1.

PAUL F. PRESTON,
Analyst in Public Finance.

Mr. CURTIS. Sure.

Mr. TENZER. Let me say this. First of all, my own income, which is partly sheltered by real estate depreciation and capital gains, will be taxed considerably more under my bill than under the President's surcharge proposal, so I am not talking about soaking the rich. I am talking about taxing myself as well. I give substantial amounts to charity, but the foundation provision of the tax laws was originally intended to serve a useful purpose. It has been perverted by some and we ought to look into it in depth and we ought to correct the defects in the system.

Mr. CURTIS. I agree with that.

Mr. TENZER. The second point you make was about municipal bonds. I told the President that I had an individual visit me 3 weeks ago over a weekend. This is a man whom I represented over 20 years ago when he and his brother sold the business. He invested all of his proceeds in the sale after paying capital gains tax in tax-exempt securities.

Last year he had \$170,000 of income, all tax exempt. He came to me to complain about the war in Vietnam and about the riots in our cities and I asked him, "Joe,"—his name isn't Joe—but, "Joe, how much did you pay toward replacing the hardware this Government lost in Vietnam? How much did you pay to improve conditions in the slums of our riot-potential cities?" and he said, "None."

I said, "Well, I am going to propose a bill that is going to make you pay some," and this good friend of mine said, "How much?"

I said, "At least 10 percent."

He said, "So that means that I would have to pay \$17,000, I would gladly pay. Nobody asked me."

I don't want to eliminate provisions relating to municipal bond income. I don't want to eliminate the tax-exempt bond procedures. When you are asking me to tell my constituent who has to pay \$1,000 in taxes, "I want you to pay \$100 more to meet the current budget, to meet the exigencies and the needs of our country," I want to turn around to him and say that that man who had the \$170,000 income is going to pay \$17,000. Everyone should pay something. That is all I want to accomplish.

Mr. CURTIS. The point is that I think he may not realize it, but he actually is paying something. If he had invested in other forms of investment he would probably be earning, say, \$400,000 instead of \$170,000. He has foregone this.

Mr. TENZER. But that was his choice.

Mr. CURTIS. I understand it, but I am simply saying that the net result was that the \$130,000 in effect went to the cities of this country to assist them in building these community projects.

Now let me point out—

Mr. TENZER. It will still go for that, Mr. Curtis. Under my proposal it will still go to them. It will not detract one bit.

Mr. CURTIS. I am simply posing the economic problem. I again agree with you that these things need to be looked into. One other thing, because I find this is so frequently misunderstood.

The Federal Government under the 16th amendment does not have the power to tax return of capital. We didn't put depreciation laws and depletion laws in there out of choice, but the Constitution forbids us to tax return of capital.

Now, it is true that I think we need to look at the way we measure return on capital and depletion and depreciation, but let's don't oversimplify it; or real estate depreciation you mentioned, because in one sense through inflation we actually have been imposing a tax on return of investment to our people, a return of capital investment, so this needs looking into, I must emphasize, but I don't think you are going to find these sources of revenue that you anticipate because these have not been written completely irrationally.

Mr. TENZER. May I comment on that, Mr. Curtis?

Mr. CURTIS. Sure.

Mr. TENZER. In H.R. 12445 which has been referred to this committee on page 3, section 4, it says:

An amount equal to the amount by which the allowance under Section 167 relating to depreciation for real property for the taxable year was greater than it would have been under the straight line method of depreciation when applied to such property for the taxable year.

Mr. CURTIS. But you can never get more than 100 percent back, sir, and that is the point. This is just getting it back earlier.

Mr. TENZER. But may I call to your attention, Mr. Curtis, that there are provisions under our tax laws today under which you get back more than 100 percent.

Mr. CURTIS. I think this 7 percent is wrong and I oppose it and said so at the time.

Mr. TENZER. Besides the 7 percent.

Mr. CURTIS. This was the administration's reform.

Mr. TENZER. Besides the 7 percent.

Mr. CURTIS. I don't know how that—

Mr. TENZER. Let me give you a simple example. You buy a Cadillac car for \$6,000 and depreciate 25 percent a year for 4 years. You have gotten 100 percent back. You sell the Cadillac car for \$2,000 and pay a capital gains tax on it.

The question is, Should the capital gains tax under circumstances when you received 100 percent of your capital back be only 25 percent? Let me give you another example in real estate.

Mr. CURTIS. Wait a second. I want to say there you are raising another question which is an important one, but a different one. You are now talking about the different treatment of ordinary income from capital gains and here I think we do need to do some work, but again it is a different principle.

The CHAIRMAN. Just a minute now. On that particular point, Mr. Tenzer, we have corrected that situation at least—the example of the Cadillac you gave. Mr. Vanik.

Mr. VANIK. I just want to say that I think our colleague from New York has made some very worthy recommendations, and I concur in the need for tax reform. But I would like to direct your attention to the fact that the President's recommendation for tax reform specifically said that it wouldn't be primarily directed toward raising increased amounts of revenue, but that it would be directed toward making adjustments that are not discriminatory.

I think the President should be urged to try to raise some revenue with his tax reform proposals, and I certainly solicit the support of my colleague from New York in encouraging the President to come up with that kind of a recommendation because I concur that we can raise a substantial amount of tax revenue by tax reform.

I might point out that in addition to those commonly known as escape routes which the gentleman has suggested there are many others that are unknown to many of the members of this committee. They haven't yet been made public. We don't make a practice here of looking at tax returns.

I think we should look at specimen unidentified tax returns to find out new and unusual and extraordinary devices that are not commonly known. I think that we would probably double our estimates of revenue lost if we were to use this approach to raising revenues in the tax program.

Mr. TENZER. Let me say to my distinguished colleague that I believe that it would be much easier for this committee, the distinguished chairman and members, to get the information than what I experienced in trying to gather data to study this problem. But I also would like to

say that if there is the danger of inflation and I am prepared to accept the thesis presented by the distinguished economists who addressed this committee that there is danger of inflation—then I think the President's direction should be to seek additional revenues and to cut the deficit and cut the items necessary to prevent and avoid an unnecessary inflationary spiral.

Mr. VANIK. Thank you.

The CHAIRMAN. Mr. Collier.

Mr. COLLIER. One question. I didn't read H.R. 12445 and consequently from what you say here you say taxpayers with less than \$10,000 will be exempt from your proposal.

Mr. TENZER. Yes, they would pay their normal tax.

Mr. COLLIER. They would pay their normal tax.

Mr. TENZER. Yes. They might be subject to the surcharge, but if they paid a minimum tax on all of this income that they enjoy from these four sources, which would be 10 percent as a minimum, if they are paying more than that by their regular return they would not be subject to this tax at all.

The main thrust of my approach, and I think you will be able to revise it and fashion it to meet the needs, is to see that the man with an income of a million dollars, with the \$200,000, with the \$400,000 income, who pays nothing, should pay a minimum of 10 percent.

Mr. COLLIER. Under normal conditions I recognize that your statement in that regard is very clear. Let me ask you though in the light of your response to my previous question, just one other question. Are you not suggesting then under this proposal of yours that the single man making \$10,000 a year income is in no better position to pay a tax than a married man with four children who is making \$11,000?

Mr. TENZER. He wouldn't be subject to it either when he takes his deductions.

Mr. COLLIER. Then I misunderstood you originally. Maybe we ought to go back and get that straight. You say that the taxpayers with less than \$10,000 in actual income would be exempt.

Now going that far, and you responded to my question, then I must repeat that the man who is making \$12,000 a year who has four children or five children would then according to your theory be in a better position to make a contribution than the single taxpayer with \$10,000.

Mr. TENZER. No, the man with the four children would have six deductions and the single man wouldn't have those deductions.

Mr. COLLIER. But you say actual income. I only accepted it in that verbiage.

Mr. TENZER. Adjusted gross income.

Mr. COLLIER. Now that throws a whole new light. In other words, a taxpayer with less than \$10,000 of taxable income would be exempt.

Mr. TENZER. \$10,000 of adjusted gross income plus the four categories set forth in my bill.

Mr. COLLIER. With all of these crying needs you are speaking about.

Mr. TENZER. Yes.

Mr. COLLIER. That is all.

Mr. TENZER. That is adjusted gross income. If you are shocked by that let me say again that you should be visibly moved by the fact that there were 24,084 income tax returns with adjusted gross incomes over \$10,000 filed in 1964, all of whom paid no tax.

Mr. COLLIER. I am, but I am merely pursuing this on the basis of the underlying purpose of your bill and that is equity and ability to pay. I am shocked about the other part too, but I just had a double stock with this \$10,000 limit.

Mr. TENZER. Those under \$10,000 would be paying their adequate share of the tax burden by a normal tax return which they would be required to file.

Mr. COLLIER. Regardless of family status, dependency, and so forth?

Mr. TENZER. With all the deductions that they would be entitled to, they are already paying their equitable share.

The CHAIRMAN. Mr. Bush.

Mr. BUSH. Mr. Chairman, I have several questions, but what is the time? We don't have much time.

The CHAIRMAN. We had our second bells.

Mr. BUSH. Just briefly, I wonder if the gentleman has figured the inflationary consequences of this tax proposal as it relates to corporations. It seems to me that as I read it if you add the \$7.5 billion set from the surcharge and he is talking about another \$7.5, most of which comes from corporations, you are really talking about doubling the corporate tax here.

Mr. TENZER. Let me say that a 10 percent minimum tax which I propose, I am informed by unofficial Treasury Department sources, would yield \$7 billion. It would be \$5 billion plus from individuals, and only \$1 billion plus from corporations. A 5 percent minimum tax would yield \$1.5 billion from individuals, and \$100 million from corporations. The total amount of taxes collected last year: 1966 taxes paid by corporations was \$30 billion. Taxes paid by individuals was \$61 billion.

Mr. BUSH. Mr. Chairman, as I said I had several other questions but one of them is as it relates to the oil industry because I believe the statement only covers part of the story. The oil industry does pay its fair share of the taxes and I don't think we have time to develop this here but I just didn't want the record to go unchallenged.

I would be glad to continue this discussion with the gentleman at some other time but I don't want this statement to go unchallenged as to an industry that is vitally important to this country. I just regret we don't have time to continue this right now.

Mr. TENZER. I think all industry is important to this country. It is just a matter of degree but I will be glad to file, as an exhibit, with the permission of the chairman a statement showing the United States income tax of the 22 largest oil companies for 1962, 1963, and 1964 which shows the gross profit of \$5,179,000,000 and Federal tax paid of only \$240 million whereas they paid to foreign governments and some States \$1,064,000,000.

(The exhibit referred to follows:)

REPORT FROM WASHINGTON, CONGRESSMAN HERBERT TENZER, 5TH CONGRESSIONAL DISTRICT, NEW YORK

[From the Congressional Record of Jan. 26, 1967]

H.R. 3803 SEEKS TO REDUCE THE OIL DEPLETION ALLOWANCE

Mr. TENZER. Mr. Speaker, on January 25, 1967, I introduced H.R. 3803, a bill to reduce the oil depletion allowance from 27½ percent to 20 percent at the rate of 2½ percent annually over a 3-year period.

The bill also requires the Secretary of the Treasury to reduce the tax allowance by an additional 50 percent whenever he finds that a substantial part of the tax savings has been used to finance mergers with or to purchase companies in unrelated fields.

Our Federal budget is increasing and our local village, town, city, county, and State budgets are likewise increasing—often to an even greater degree. Plugging the tax loopholes is our way to equalize the tax burdens among the Nation's taxpayers, corporate as well as individuals.

The special privileges under our present tax laws to the oil companies are inequitable and require all other corporations and individuals to carry a greater share of the tax burden than they should be carrying.

It is shocking that the largest oil companies pay a smaller percentage of their net incomes in taxes than small businessmen, workers, and farmers. The man in the lowest tax bracket pays 14 percent of his net income in taxes while in 1965 the 20 largest oil companies paid an average of 6.3 percent of their net incomes in Federal taxes. These companies had a combined net income of more than \$5.7 billion, yet paid only \$360 million in taxes.

U.S. INCOME TAXES OF 22 LARGEST OIL REFINERS (1962-64)¹

	Rank in size	Year	Gross profit	Federal tax	Percent	Foreign, some States' tax	Percent	Income after tax	Percent of gross
Standard (New Jersey).....		1962	1,271,903,000	8,000,000	0.6	423,000,000	33	804,903,000	66
		1963	1,584,469,000	69,000,000	4.3	496,000,000	31	1,019,469,000	64
		1964	1,628,555,000	29,000,000	1.7	549,000,000	33	1,050,555,000	64
Texaco.....		1962	546,371,000	13,000,000	2.3	51,700,000	9	484,671,000	88
		1963	615,768,000	10,250,000	1.6	58,830,000	12	545,668,000	88
		1964	680,761,000	5,500,000	0.8	77,900,000	11	577,361,000	87
Gulf.....		1962	488,351,000	19,389,000	3.9	128,871,000	26	340,091,000	70
		1963	540,065,000	30,870,000	5.7	137,842,000	25	371,353,000	68
		1964	607,343,000	52,443,000	8.6	159,781,000	26	395,118,000	65
Socony Mobil.....		1962	379,339,000	8,300,000	2.1	128,700,000	33	242,339,000	63
		1963	437,352,000	23,000,000	5.2	142,500,000	32	271,852,000	62
		1964	464,660,000	27,700,000	5.9	164,800,000	30	294,160,000	63
Standard (California).....		1962	348,181,000	5,800,000	1.6	28,600,000	8	313,781,000	90
		1963	356,568,000	2,900,000	0.8	31,600,000	8	322,068,000	90
		1964	393,188,000	8,300,000	2.1	39,600,000	10	345,288,000	87
Shell.....		1962	173,555,000	7,200,000	4.1	8,680,000	5	157,675,000	91
		1963	211,575,000	19,100,000	9.0	12,623,000	5	179,852,000	85
		1964	213,575,000	2,800,000	1.3	12,585,000	5	198,190,000	92
Standard (Indiana).....		1962	168,843,000	3,105,000	1.8	3,381,000	2	162,420,000	96
		1963	208,022,000	22,182,000	10.6	2,748,000	1	183,092,000	88
		1964	204,817,000	8,486,000	4.1	1,480,000	0.7	194,851,000	95
Phillips.....		1962	158,320,000	48,000,000	30.3	3,365,000	2	106,955,000	67
		1963	160,954,000	52,000,000	26.2	3,491,000	2	105,463,000	65
		1964	152,197,000	32,229,000	22.2	4,950,000	3	115,018,000	74
Cities Service.....		1962	84,143,000	20,773,000	24.7	3,183,000	3	60,185,000	71
		1963	101,976,000	20,188,000	21.4	4,285,000	4	77,505,000	74
		1964	113,405,000	27,925,000	24.7	9,677,000	8	84,513,000	74
Continental.....		1962	73,477,000	1,065,000	1.4	3,335,000	5	69,077,000	94
		1963	99,665,000	9,143,000	9.2	3,157,000	3	87,365,000	88
		1964	112,009,000	8,725,000	7.7	3,175,000	2	100,109,000	89
Sun.....		1962	66,395,000	2,200,000	0	13,400,000	20	53,195,000	80
		1963	79,976,000	1,300,000	1.9	17,460,000	22	61,216,000	77
		1964	88,577,000	2,400,000	2.7	17,670,000	20	68,507,000	77
Union.....		1962	59,421,000	8,000,000	13.5	5,500,000	9	45,921,000	77
		1963	73,028,000	13,100,000	17.7	6,000,000	8	53,928,000	74
		1964	87,564,000	13,300,000	15.2	7,200,000	8	67,064,000	77
Standard (Ohio).....		1962	37,235,000	9,275,000	25.0	3,738,000	10	24,222,000	6
		1963	54,008,000	15,225,000	28.1	4,896,000	9	33,887,000	62
		1964	70,252,000	21,150,000	30.2	5,334,000	7	43,768,000	62

See footnotes at end of table.

U.S. INCOME TAXES OF 22 LARGEST OIL REFINERS (1962-64)¹—Continued

Rank in size	Year	Gross profit	Federal tax	Percent	Foreign, some States' tax	Percent	Income after tax	Percent of gross
Sinclair.....	1962	57,936,000	0	0	10,586,000	18	47,350,000	83
	1963	71,036,000	1,200,000	0	9,532,000	13	62,704,000	88
	1964	66,444,000	2,119,000	0	10,531,000	15	58,736,000	88
Marathon.....	1962	35,894,000	2,200,000	0	205,000	1.5	37,889,000	105
	1963	50,058,000	(3)	0	933,000	1.8	49,125,000	98
	1964	63,220,000	(3)	0	2,844,000	4.4	60,376,000	95
Atlantic.....	1962	61,110,000	0	0	14,844,000	24	46,266,000	75
	1963	56,747,000	0	0	12,734,000	22	44,013,000	77
	1964	61,081,000	0	0	14,005,000	22	47,076,000	77
Tidewater.....	1962	35,191,000	228,000	0.6	2,387,000	6	32,576,000	93
	1963	42,795,000	563,000	0	3,384,000	8	39,474,000	92
	1964	40,508,000	377,000	13.7	4,426,000	11	35,705,000	63
Ashland.....	1962	24,324,000	6,201,000	25.8	2,799,000	11	15,324,000	64
	1963	28,769,000	10,556,000	37.7	2,104,000	3	18,109,000	65
	1964	36,385,000	9,672,000	26.8	2,977,000	8	23,735,000	65
Sunray.....	1962	41,203,000	3,850,000	9.3	1,152,000	2.8	36,201,000	85
	1963	49,727,000	6,533,000	13.3	1,328,000	2.7	41,866,000	85
	1964	29,357,000	2,711,000	0	1,290,000	3.6	35,182,000	100
Pure.....	1962	27,680,000	2,246,000	0	1,276,000	4	28,950,000	107
	1963	28,582,000	2,212,000	0	27,000	.01	29,767,000	106
	1964	32,282,000	600,000	0	164,000	.5	31,518,000	98
Skelly.....	1962	22,674,000	1,260,000	5.7	250,000	1	21,164,000	96
	1963	27,479,000	3,025,000	7.7	275,000	4	24,179,000	89
	1964	26,601,000	785,000	1.2	275,000	2	25,551,000	98
Richfield.....	1962	36,615,000	6,000,000	16.6	0	0	30,615,000	83
	1963	29,767,000	1,300,000	4.4	773,000	2.6	27,894,000	94
	1964	26,255,000	2,629,000	0	5,429,000	20.8	21,455,000	82
Total.....	1962	4,198,161,000	164,500,000	4	838,891,000	20	3,194,770,000	76
	1963	4,908,386,000	246,660,000	5	950,540,000	19	3,649,846,000	74
	1964	5,179,036,000	240,529,000	4	1,064,383,000	20	3,873,836,000	74

¹ Compiled from records of the U.S. Securities and Exchange Commission by the staff of "The Gasoline Letter." Warning—this table is part of the Mar. 21, 1966 issue of "The Gasoline Letter" and may not be reproduced by any means—including office copying equipment—without prior written permission of the publisher. Violation of copyright is a Federal offense carrying penalties from \$500 to \$2,500.

² Cr.

³ Marathon is the only large oil company that has been able to conceal its domestic income taxes in the Securities and Exchange Commission files. We phoned Girard Jetton, Marathon's tax chief and asked the U.S. figure, but he said it's a secret. Since the firm probably doesn't want to keep secret the smallness of its foreign taxes, it's assumed the U.S. tax is small and all of Marathon's income taxes are listed here as foreign.

Mr. BUSH. And I suggest to the gentleman that this is only part of the story and what I would like to suggest if we had time to develop it is that if you look at the First National City Bank record of corporations and their tax burdens, their overall tax burdens related to their assets, for example, the oil industry bears its share and we can't develop this in 5 minutes but I would be happy to continue the discussion at a later date.

The CHAIRMAN. Mr. Tenzer, we thank you, sir, for coming to the committee and without objection the committee will reconvene at 2 o'clock this afternoon.

Mr. TENZER. Thank you very much, Mr. Chairman.

(Whereupon, at 12:32 p.m., the committee recessed to reconvene at 2 p.m., the same day.)

AFTER RECESS

(The committee reconvened at 2 p.m., Hon. Al Ullman, presiding.)

Mr. ULLMAN. The committee will come to order.

Our next witness is Mr. John C. Davidson.

We are happy to have you before the committee, Mr. Davidson. We will welcome your counsel on this matter.

Will you please identify yourself for the record and proceed as you see fit.

STATEMENT OF JOHN C. DAVIDSON, PRESIDENT, TAX COUNCIL

Mr. DAVIDSON. Thank you, Mr. Chairman. I am John C. Davidson, president of the Tax Council.

I appreciate the privilege of appearing in these hearings in behalf of the Tax Council. The council is a business-supported organization concerned primarily with encouraging a tax philosophy and structure in harmony with the economics of progress.

The second paragraph is directed to Mr. Mills primarily, Mr. Chairman, but I will read it because I like this paragraph, if I may.

To begin with, Mr. Chairman, may I say we are most mindful and appreciative that the grim fiscal facts of 1967 have not deterred you and your colleagues on this committee, the Secretary of the Treasury, and other top policy people, from reaffirming the goal of more and repetitive tax reduction from revenue growth at the earliest possible date.

To summarize this statement, our views on the current problem are:

First, in the interest of resuming strong and sound economic growth with its yield of new and better jobs, corporations should not be asked to take on a new tax burden which is any larger relatively than is imposed on individuals or, more specifically—

(a) the rate of a temporary surcharge should be the same for corporations as for individuals,

(b) the effective date of a temporary surcharge should be the same for corporations as for individuals,

(c) a temporary surcharge should be applied only to the final corporate tax bills; that is, after the foreign tax and investment credits have been given effect,

(d) there should not be at this time any further speedup of corporation tax payment, either by increasing the percentage of current payment for liabilities in excess of \$100,000, or by beginning to require current payment for liabilities up to \$100,000.

Second, a temporary surcharge as enacted should be at a considerably lesser rate than the 10 percent proposed by the President.

Third, a moderate temporary surcharge effective at an early date could be more useful in restraining a new inflation than a larger surcharge effective at a later date, and would be easier for the economy to digest.

Fourth, as a rough guide, it would seem that the executive branch and the Congress should seek to achieve expenditure reduction—beyond the items mentioned by Budget Director Schultze last week—in the range of the revenues provided by a moderate surcharge.

DISCUSSION

To some, it might seem that the views I express are special pleading for corporations, but such is not the case. These views are special pleading to keep the way open for a resumption of strong growth which is the only means for constant addition to the total of high quality jobs in the private economy.

Because the President's tax proposals would add more to corporate than to individual tax bills at this time, and because there are some who voice a desire to go further than the President, it has seemed important to me to give attention to some fundamental aspects of this problem.

The fiscal and economic facts presented to you last week by administration spokesmen clearly indicates that the kind of tax increase needed at this time is one which would, because of excess public demand already present, restrain a growing total demand from catapulting us into inflation while we get back on the track of high level growth. Except as a later result of a new wave of unabated inflation, there was no indication of any fear of excesses developing in business investment spending. To the contrary, the view seemed to be that this spending would continue on its present plateau for a time, in contrast to the sharp rises expected in personal income and sales. It was conceded that enactment of the program as presented actually would reduce business investment spending by about \$1 billion over the last two quarters of this year. If a similar reduction were repeated in the following 6 months, this critical area of spending would be back to approximately the level of 1966.

The major source of new funds to finance business expansion is retained earnings; that is, profits after tax less dividends. Profits provide the inducement as well as the major means for business expansion. Strong economic growth inevitably is paced by good and rising profits. Total corporate profits showed a little improvement in the second quarter, but the annual rate is still about \$3 billion behind that for all of 1966 and \$5 billion behind the peak rate in the fourth quarter of 1966. While there is an underlying expectation of improvement in profits as the increase in growth of incomes and sales takes place, heavy wage settlements hang over the marketplace and we may be facing a situation in which something has to give.

Regardless of what may be the trend in profits and business investment spending in the short term, I believe the last thing which should concern us at this stage is fear of too much growth of productive facilities over the years ahead. When question is raised about a return to the surging trend of a year ago, it generally is in the context of an assumption that the actual rate of expansion in facilities was too large for the economy to absorb. Yet, no one claims that we have excess capacity today in the sense that this condition existed after the capital goods boom of 1955-57. When we look at the present balance in industrial facilities, and recognize how quickly rates of utilization could move up to pressure-point levels, it is evident that we did not overbuild in 1966. Thus, it would seem the fundamental problem last year was not that the expansion rate was too great in physical terms, but that this rate outran our ability to finance it. As we look ahead, I believe we must consider that the problem is not likely to be one of spending too rapidly for business expansion, but is much more likely to be the absence of available financing adequate to support a growth trend which would be most beneficial for the economy.

Any investment in new plant and equipment, whether to modernize or expand, creates better jobs. The question is whether a given expansion in overall investment and growth is strong enough to also create an addition to the total number of jobs. What has happened in the manufacturing sector of the economy since World War II illustrates the importance of strength in economic expansion to net job creation.

You may recall that, after the war, economists and labor force statisticians generally thought we would never return to the peak level of manufacturing employment, 17.6 million workers in 1943. However, the 17 million level was exceeded again in 1953, 1956, 1957, and 1964, although the totals stayed below the wartime peak. That peak was exceeded for the first time when the total moved up to 18 million in 1965, but it is interesting to note that the unemployment rate did not drop below 4 percent until manufacturing employment went sailing past 19 million in 1966.

The relation between the growth of jobs and the growth in production may be simply stated. Other factors being equal, the number of jobs will decline when the percentage increase in productivity exceeds the percentage increase in total output; will stay about the same when productivity and output gains are about the same; but will increase in step as output moves up beyond productivity gains. We need all the productivity we can get because this is the only means for advancing the value of work and underwriting wage increases without inflation. But, to provide more and better jobs, we also need a significantly higher rate of growth in total output. We can expect this condition to be normal hereafter only if profits are adequate and investment funds are available to induce and sustain vigorous expansion in productive facilities.

EQUAL TREATMENT FOR CORPORATIONS

My foregoing remarks explain our belief that the rate of surcharge, and its effective date, should be the same for corporations as for individuals. I will add further comment here only with respect to the base of the surcharge and further speedup in corporation taxes.

With respect to the tax base, the application of the surtax to corporate tax bills before the foreign tax and investment credits would, in effect, penalize the corporations which are doing the most, in the first instance, to ease the balance-of-payments problem by bringing home income from foreign investments and, in the second, to move us back to an expansion trend in productive facilities which will sustain strong economic growth and provide a bounty of more and better jobs.

With respect to further tax speedup, the new proposals come on top of acceleration in payments and remittances which since 1964 has subjected the larger corporations to an additional tax of some \$14 billion—the equivalent of a surcharge in the range of 50 percent of 1 year's tax bill. An increase from 70 to 80 percent in the requirement for current payment on tax liabilities in excess of \$100,000 would for the transition year have the effect of a 10-percent surcharge.

With respect to the proposal to inaugurate a 5-year program for putting tax liabilities under \$100,000 on a current basis, the result would be the equivalent of a 16-percent surcharge in each of the years for companies whose liabilities do not exceed that figure.

It seems inappropriate that speedup in the corporate area should be justified by reference to current payment of individual tax because of the large forgiveness of tax when the latter was introduced. The importance of retained earnings to new investment and job creation is fully as great for the small firms as for the large ones, and it is a well known fact that smaller corporations have greater difficulty in raising money from banks and other outside sources. In addition, for many small firms, especially in manufacturing and in research and technology, it is difficult to project an annual rate of profit from a current rate because the inflow of new business is not steady. To handle new business as it comes along, such firms must attempt to hold together their forces of skilled and technological workers even though this means recurring red ink in slow periods. There is serious question, therefore, whether there ever will be a good time to apply speedup to small firms, but certainly that time is not now.

A LESSER RATE OF TEMPORARY SURCHARGE

The second overall view stated in the summary is that the temporary surcharge as enacted should be at a considerably lesser rate than the 10 percent proposed by the President in his August program. The evident reasons for this view are the hazard of applying too great a dose of new tax restraint to the private economy at this time, and the contemporary preference for a much greater effort to reduce and control in the expenditure area. If it be thought that a moderate surcharge might be too little even if not enacted too late, there are two further considerations which bear on the size of the job to be done.

The first is that a significant part of the current deficit, perhaps as much as \$6 billion to \$7 billion, will be financed internally within the Government, primarily by use of a surplus in the current accumulation of trust funds. This consideration affords no reason for complacency about the ultimate size of the deficit, but it does bear directly

on both inflationary consequences and on the amount of Government competition with private users of credit for available supplies.

The second consideration is that even a moderate temporary surcharge would be of substantial significance as regards release of credit for private use. As an indication of the magnitudes here, the average annual increase in business borrowings from banks for the 5 years ending with 1966 was somewhat over \$5 billion, or roughly the annual yield expected from a 6-percent surcharge.

EFFECTIVE DATE

Mindful of the view that the President's program was sent up too late to permit enactment of a surcharge to be fully implemented by October 1, and believing that his entire program even if justified would be entirely too much to process to enactment in such a short period of time, I yet have not been able to escape the conclusion that if a temporary tax increase is needed, and we believe it is, then the need is current and not prospective. We think the President's program asks too much of taxpayers, first in the extra burden which would be placed on corporations, and second in the rate of surcharge, but we do believe the facts presented to you by Secretary Fowler and Chairman Ackley indicate the need for quick action on a moderate and uniform surcharge. However, we believe the scheduled termination date should be December 31, 1968, instead of June 30, 1969, as proposed by the President.

Expedited enactment of a temporary surcharge would begin the transfer of income from the private to the public sector when the Federal deficit is running at its highest rate, and before demand in the private economy has reached an inflationary level. The old adage "A stitch in time saves nine" is apt as regards both timing and size of a surcharge.

EXPENDITURE REDUCTION

The President's program indicates a range of tolerance for a deficit in the administrative budget from \$18 billion down in the current fiscal year, and his tax program as a whole is designed to close most of the gap between the potential and this tolerable level of deficit. In our opinion, a much greater burden should be placed on expenditure reduction and control. It does seem logical that quick action in moving a moderate surcharge toward enactment would make more evident the major job that remains to be done as regards expenditure reduction and control. As a rough guide, it seems the Congress and the executive branch together should find ways and means of reducing expenditures to roughly approximate the amount of new revenues coming from a tax increase—beyond the items mentioned in the testimony presented by Budget Director Schultze last week.

Among other virtues, a balanced program of a moderate temporary surcharge with matching reduction and control of expenditures would provide the best assurance that we will get on with the job of using revenue growth to reduce taxes at the earliest possible time.

In conclusion, Mr. Chairman, may I make a general observation?

CONCLUSION

In the business world, we think it important that corporations be good citizens in every respect including payment of taxes. Recognizing that some temporary increase in taxes is needed, at this time, we, therefore, feel that corporations should pay their share. At the same time, we hope it will not be overlooked that corporations are run by people, are owned by people, exist only to serve people, and thus in the broad sense are people. The first law of taxation in our time could well be that people cannot escape the burden of taxation by shunting payment and collection responsibility to corporations. In the final analysis, only people pay taxes, and only people suffer the consequences when taxes are unwisely levied or increased or continued beyond the time of necessity.

Mr. ULLMAN. Thank you, Mr. Davidson.

Are there any questions?

The CHAIRMAN. I just want to apologize to Mr. Davidson for not being here at the beginning of his statement. But I have gone back and read it. We appreciate your appearance here this afternoon.

Mr. ULLMAN (presiding). I want to get your position clear.

With respect to the surcharge portion of the President's proposal do you support that part of the proposal?

Mr. DAVIDSON. We think the tax increase is necessary and the surcharge is a proper technique but it should be a lower rate than the President has proposed.

Mr. ULLMAN. Suppose we don't enact it until, say, November 15?

Mr. DAVIDSON. I don't think the passage of time would provide a reason to increase the rate. I happen to agree if it were done quicker it would be more effective.

Mr. ULLMAN. Do you think we might make it retroactive to July 1?

Mr. DAVIDSON. The present program does not propose it—except October 1. I don't think you could enact it in November and make it effective back to July 1.

Mr. ULLMAN. When should we make it effective?

Mr. DAVIDSON. I think it should be done effective October 1 at a moderate rate. In view of the entire program I think it would be more beneficial.

Mr. ULLMAN. Thank you.

We appreciate having your testimony, Mr. Davidson. You have been very helpful.

Mr. DAVIDSON. Thank you, Mr. Chairman.

Mr. ULLMAN. The next witness is Mr. Kenneth G. Heisler.

Mr. Heisler, we welcome you before the committee. We will ask you to identify yourself and your colleague for the record.

You may proceed as you see fit.

**STATEMENT OF KENNETH G. HEISLER, EXECUTIVE DIRECTOR,
THE NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS;
ACCOMPANIED BY WILLIAM F. McKENNA, GENERAL COUNSEL**

Mr. HEISLER. Thank you, Mr. Chairman.

My name is Kenneth G. Heisler, executive director of the National League of Insured Savings Associations. This is a nationwide trade association serving the savings and loan industry.

I have with me William F. McKenna, who is general counsel of our organization.

Mr. ULLMAN. We welcome you before our committee, Mr. McKenna.

Mr. McKENNA. Thank you, Mr. Chairman.

Mr. HEISLER. I am appearing before you today to present testimony in support of President Johnson's recommendation that the Internal Revenue Code of 1954 be amended to increase taxes. The amendment would impose a 10 percent surcharge on individual Federal income tax liability, to become effective on October 1, 1967, and a 10 percent surcharge on corporate Federal income tax liability, to become effective as of July 1, 1967. It would also speed up collection of corporate taxes and continue certain excise taxes at current rates.

In his message to Congress on August 3, the President noted that without a tax increase and tight control of Federal expenditures, a large deficit could be anticipated for the fiscal year ending June 30, 1968.

Among the probable adverse effects of such a deficit, he listed "brutally higher interest rates and tight money which would cripple the home builder and home buyer, as well as the businessman." He noted that interest rates have already turned up sharply despite the relatively easy money policy being followed by the Federal Reserve System.

In the consideration of this legislation, we must clearly recognize that we are faced with a condition, not a theory. The Federal Government is confronted with the prospect of a deficit of unconscionable proportion. Estimates of this fiscal year's deficit range around \$29 billion. Even in an economy as dynamic and diverse as ours, a deficit of this size cannot be tolerated.

A firm, straightforward attempt has to be made to bring the financial affairs of the Federal Government within prudent and digestible fiscal housekeeping tolerances. In view of the budgetary conditions that confront the Congress, there are no reasonable alternatives to (1) an increase in income taxes, and (2) a reduction in spending on non-defense programs.

Action upon both fronts is required and necessary. Recourse solely to an increase in taxes would be insufficient to attain the objectives desired, unwise as a matter of public policy, and inequitable to the taxpaying public.

As is well known to every member of this committee, the thrift and home financing business underwent a painful belt-tightening ordeal last year. It was not of our choice or of our making. We are not anxious to have our 1966 experience repeated to the same degree of severity.

Nonetheless, we went through the ordeal and made the adjustments that had to be done, I can assure this committee that the most objective observers of the American social, political, economic, and financial scenes would agree that the thrift and home financing business bore an unduly disproportionate share of the burden in 1966.

Thrift institutions basically depend for economic life on the spread between what they pay for money in the form of dividends on savings accounts and what they receive from investing that money in home mortgages.

By supervisory and tax policy, savings and loan associations are narrowly confined in the type of investments they may select. Their main investments must be channeled into home mortgages. This type of investment is long term in nature and limited in the rate of interest return. When the dividend rates a savings and loan association must economically pay in order to attract savings funds too closely approach the various usury rates fixed by State laws for interest on mortgage loans, the investment flow from savings and loan associations used to originate real estate mortgages decline. Homebuilding and transfer of homeownership suffer.

Such a situation is far less likely to occur if the Federal Government raises more of the funds it needs by means of an increase in taxes. To the extent it does so, the necessity of Federal Government borrowing in the public market decreases, thus removing one of the upward pressures on interest rates. The interest rate structure then may hopefully be expected to remain on a lower plateau in a range that can be met by savings and loan association in offering dividend rates on savings that will continue to attract the account holders' dollars.

One further restraint to tax income to the Federal Treasury should be mentioned at this time. The present definition of a domestic building and loan association in the Internal Revenue Code of 1954 lists in detail the portfolio limits of investments an association may hold and still qualify as an association for Federal income tax purposes.

The net effect of the definition is to prevent an association from making any type of lawful investment that would forfeit its status as a domestic building and loan association. Therefore, the definition does not result in any increase in taxes flowing to the Treasury that could otherwise occur if a savings and loan association were free to make the investment without forfeiting its status as an association.

Savings and loan associations are chartered under the laws of 50 different States as well as under Federal charters. As might be expected, the investments they are authorized to make vary with laws of their incorporating jurisdictions. The national league has suggested that all savings and loan associations, whether federally or State-chartered, that have their savings accounts insured by the Federal Savings and Loan Insurance Corporation be automatically defined as bona fide domestic building and loan associations for Federal tax purposes.

These institutions would then be in a position to make investments authorized by law that would produce more tax dollars for the Federal Treasury than is now the case. At an appropriate time, we hope this committee will give consideration to this suggestion.

In any event, the tax proposals made by the President will go far toward producing an appropriate balance between monetary policy and fiscal policy, thereby enabling the savings and loan industry to attract the savings funds required to continued to finance homebuilding and homeownership in the United States. The national league urges adoption of the President's tax proposals.

Thank you for giving us the opportunity to present these views.

Mr. ULLMAN. Thank you, Mr. Heisler.

Are there questions of Mr. Heisler?

I am a little concerned about your advocacy of a broadening of the definition. What is your situation today with respect to adequate money supply to handle homebuilding needs?

Mr. HEISLER. Our situation has improved in the last few months from the situation that existed in 1966 and in the first quarter of 1967 due to higher interest rates in other areas that our shareholders were using for investment.

Mr. ULLMAN. Do you have adequate money to meet the demand now?

Mr. HEISLER. I suppose there is never adequate money to take care of home building and home financing in the United States in the sense that it could be extended to marginal areas. We are approaching an adequate amount I would say.

Mr. ULLMAN. What is the trend? Is your situation getting better on a week-by-week basis or getting worse?

Mr. HEISLER. Getting better; getting much better.

Mr. ULLMAN. The problem as I see it is that if we broaden the definition and allow you to go into other kinds of loans, the homebuilding industry, itself, might very well suffer.

Mr. HEISLER. I feel that the extent to which savings and loans would go into other areas would be gaged by conditions at the time. If there was overbuilding and oversupply of housing, then they would be able to get into other forms of investment. Since the savings and loan institutions are specialists in the home financing field can never see them getting out of that as a primary form of investment as long as they were able to make home mortgage loans. But it would better enable them in times of stringency to tide themselves over and pay a little higher rate of return to their investors so that they would continue to have these funds in bad times and in good times. I would feel that in the future we will have high and low interest rates, they will be variable from time to time.

Mr. ULLMAN. Thank you very much, Mr. Heisler. We appreciate having you before our committee.

Our next witness is Mr. Raymond Hoffman; we welcome you before the committee.

Will you please identify yourself and your colleagues for the record.

You may proceed as you see fit.

STATEMENT OF RAYMOND A. HOFFMAN, ILLINOIS STATE CHAMBER OF COMMERCE; ACCOMPANIED BY NORMAN J. BEATTY, MANAGER, TAX DEPARTMENT

Mr. HOFFMAN. My name is Raymond A. Hoffman. I am a partner in Price Waterhouse & Co.—a firm of certified public accountants—and a former chairman of the Federal Taxation Committee of the Illinois State Chamber of Commerce. I am accompanied by Norman J. Beatty, manager of the chamber's tax department.

Mr. ULLMAN. Mr. Beatty, we welcome you before the committee.

Mr. BEATTY. Thank you, Mr. Chairman.

Mr. HOFFMAN. This statement is presented on behalf of the Illinois State Chamber of Commerce, a statewide organization with a membership of more than 19,600 businessmen in 478 communities in every part of the State of Illinois. The members are engaged in virtually every type of business and range from the self-employed to those associated with some of the Nation's largest corporations.

The recommendations set forth in this statement were prepared by a special subcommittee and approved by the chamber's Federal taxation committee of 90 members.

The Illinois State Chamber of Commerce has long supported fiscal responsibility, a balanced Federal budget, reductions in Federal spending, and reform of the Federal tax structure. For many years, the most basic reform we have advocated has been a reduction in Federal income tax rates to reduce their stifling effect on business.

Excessive borrowing as well as excessive tax rates can have adverse effects on the state of our economy. In this context, the Illinois State Chamber of Commerce has adopted the following statement of policy.

In view of the situation in Vietnam, extensive disorders throughout the country, and the need to maintain an effective deterrent force to prevent worldwide aggression, the Illinois State Chamber of Commerce feels that a state of emergency exists in regard to Government financing and that all programs of Federal spending, whether domestic or foreign, defense or space, must be reviewed and reevaluated in the light of existing demands on Government and the current state of our economy and that more realistic priorities should be established to determine which expenditures will be eliminated, reduced, or delayed. We feel that no sound tax adjustments can be considered in the absence of such a comprehensive review.

The costs of Government must be financed, but they also must be controlled.

Thus, we suggest that any additional tax revenues should be not greater than the amount cut from proposed Federal spending and that any tax increase should be temporary and nondiscriminatory.

This statement has not been prepared by a group of analysts or economists. The chamber's Federal taxation committee is composed of independent businessmen, financial officers of large- and medium-sized corporations, tax administrators, and professional men dealing regularly with tax problems. Thus, it is a statement of businessmen from Illinois. Not wishing to be naive, however, this statement was checked with a number of economists associated with business and financial institutions in our State, and we found that it had their unqualified support.

ADDITIONAL TAX REVENUES SHOULD AT LEAST BE MATCHED BY REDUCTIONS IN PROPOSED FEDERAL SPENDING

We are well aware that various estimates indicate that Federal spending might exceed anticipated revenues in the current fiscal year by as much as \$25 to \$30 billion and that to finance a sum of this magnitude through borrowing could well cause excessive inflation and a restriction of credit that would stifle the economy.

In finding ways to reduce this gap between spending and revenues, we feel that the first priority should be a reduction in spending. In an attempt to quantify the relationship between reduction in spending and an increase in revenues, we feel that the amount of reduction in spending should at least equal, and preferable exceed, any tax increase. You are aware of many plans and suggestions as to how and where Federal spending can be reduced, such as the detailed

proposal by the Council of State Chambers of Commerce to eliminate approximately \$5½ billion in spending.

We feel the fact that the United States is engaged in a war has not been fully taken into account in our governmental spending patterns. During World War II and the Korean conflict, there was forthright curtailment of governmental functions. While the current conflict may not require equally drastic restraints, some of the priorities established then may provide a guide to appropriate action under the present emergency.

ANY TAX INCREASE SHOULD BE TEMPORARY AND NONDISCRIMINATORY

A surcharge tax is appropriate only if it is to meet a temporary emergency. It has the advantage of permitting an increase in revenues with a minimum of delay; however, such a surcharge is not the answer to every need for additional revenue, and does not eliminate the need for continuous study and review of the Internal Revenue Code to improve the basic tax structure.

Should it be determined that an emergency tax measure of this type is necessary, it should be nondiscriminatory and not attempt to indirectly change the proportion of sharing the Federal tax burden.

Under the current proposal there is discrimination against business corporations in two regards: First, the use of an earlier effective date than for individuals; and, second, the initiation of a program to further accelerate Federal income tax payments by corporations.

A temporary tax of an emergency nature is not an appropriate device to reassess and redefine the degree of graduation in our tax structure. It can be argued that there is too much or too little graduation in our present system of individual income tax rates or that graduation occurs in the wrong part of the rate schedule. If current concepts of equity dictate changes in the degree of graduation, they should be made carefully on a more or less permanent basis. Such a temporary reassessment of relative equities is proposed in exempting from the surcharge individuals—other than estates and trusts—whose income does not exceed that generally covered by the first two brackets of taxable income. If an emergency exists which justifies a tax surcharge, the responsibility for meeting such an emergency should be shared proportionally by all taxpayers.

We sincerely appreciate the opportunity to present these views, and again emphasize that this testimony in behalf of the Illinois State Chamber of Commerce is an attempt to communicate to you the viewpoints of businessmen in Illinois. I am not an economist, nor is Mr. Beatty, but in the context of our experience we would be pleased to answer any questions that you may have.

Mr. ULLMAN. Thank you very much, Mr. Hoffman. You have brought an interesting point of view to the committee.

Are there questions of Mr. Hoffman?

Thank you very much, Mr. Hoffman.

The committee will stand adjourned until 10 a.m. tomorrow morning.

(Whereupon, at 2:40 p.m. the committee adjourned, to reconvene at 10 a.m., Wednesday, August 23, 1967.)



PRESIDENT'S 1967 TAX PROPOSALS

WEDNESDAY, AUGUST 23, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to notice, in the committee room, Longworth House Office Building, Hon. Wilbur D. Mills (chairman of the committee) presiding.

The CHAIRMAN. The committee will please be in order.

We have as our first witness this morning Mr. George Meany, president of the American Federation of Labor & Congress of Industrial Organizations.

Mr. Meany, you have been with us on many occasions in the past when we have had knotty problems before us. We appreciate your coming back on this occasion to give us the benefit of your views and those of the organization you represent. You are recognized, sir.

STATEMENT OF GEORGE MEANY, PRESIDENT, AMERICAN FEDERATION OF LABOR & CONGRESS OF INDUSTRIAL ORGANIZATIONS; ACCOMPANIED BY ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION; AND NATHANIEL GOLDFINGER, DIRECTOR, DEPARTMENT OF RESEARCH

Mr. MEANY. Thank you, Mr. Chairman. My name is George Meany. I am president of the AFL-CIO and I am appearing here on behalf of that organization.

At the outset, I would like to summarize our views on these issues.

We are fully in accord with the President's concept that a temporary war tax is needed. It is our view that the American public generally—not just the Armed Forces—should share the sacrifice involved in the war in Vietnam. Moreover, we believe that increased tax revenue is needed—in view of the large prospective budget deficit and problems of financing that deficit—to lessen the danger of tight money and very high interest rates, which would depress the socially important home-building industry and related industries.

However, we are firmly opposed to the administration's major recommendations of how to increase taxes. It is our conviction that equality of sacrifice should be based on ability to sacrifice. The required temporary tax increase must be fair and equitable.

Certainly some sectors of our economy can afford far more in tax increases than others. But the administration's proposals recognize the principle of ability to pay only to a minor degree.

We believe that the temporary surtax rate on corporations should be at least twice as great as on individuals. Low-income taxpayers should be exempt from any surtax and the temporary tax increase on other income groups should be based on ability to pay.

We recommend some degree of taxation of excluded income; those large sums that are not now subject to taxation, such as interest on State and local bonds, the excluded half of capital gains and depletion allowances.

Moreover, we urge you to give careful consideration to a substantial increase in the maximum tax rate of 25 percent on capital gains from the sale of property.

In our opinion, Mr. Chairman, the war tax you are now considering must be fully keyed to ability to pay.

We are aware that some people have suggested cutting or halting vital domestic programs as an alternative to a temporary tax increase. If put into effect, such suggestions could be disastrous and we unalterably oppose them.

We are convinced that America can meet the Nation's obligations in Vietnam, while making progress toward solving its domestic problems. Forward strides on the homefront are essential to the preservation of our free society. America has the human and material resources to achieve both an honorable settlement of the war in Vietnam and a strengthened social order at home.

A TEMPORARY TAX INCREASE IS NEEDED

This Nation, Mr. Chairman, could easily finance a greatly expanded domestic program, within the present tax structure, were it not for the war in Vietnam. It is the added cost of men and material for that war which makes a temporary tax increase necessary.

Such tax increase is a war tax—necessitated by the sharp rise, within the past 2 years, in the size of our Armed Forces and in military expenditures. This tax rise envisions a degree of sacrifice by the American public, not only our fighting men.

A tax increase in a war period is not strange to the American people. Although no American hails a tax increase on his income, we have willingly paid increased taxes for the defense of freedom in earlier years. I have confidence in the good sense of the American people to believe that we will do so again, at present.

The need for a temporary tax increase rests on sound economic, as well as moral grounds. National defense expenditures have risen \$20.5 billion between fiscal year 1965 and the year that ended June 30, 1967. They are rising at present. In this fiscal year, defense spending is expected to rise another \$5 billion to \$9 billion and perhaps more.

Mainly as a result of these rising military expenditures—coupled with the effects on tax revenue of the recent economic slowdown, due to last year's tight money—the budget deficit is increasing. The administrative budget deficit in fiscal year 1967 was about \$10 billion—substantially greater than the modest deficits of the previous 2 years. Now, this deficit looks like it is rising to \$20 billion to \$25 billion or more in the year ending June 30, 1968.

It is not the existence of a budget deficit which troubles us, Mr. Chairman. With remaining problems of unemployment and underem-

ployment, the Federal Government should be placing somewhat greater amounts of money into the economy's spending stream than it takes out.

It is the size and sharp rise of the deficit—and the financing of a large deficit—that does trouble us. I believe it troubles most Members of the Congress, as well.

In fact, anticipation of the Government's financing of a large deficit has already affected the money market and interest rates. Many corporations have floated new bond issues in recent months, in an attempt to beat the expected tightening of the money supply and very high interest rates.

In the process, interest rates have been rising. The average mortgage rate on FHA insured new homes rose to 6.4 percent in June, for example. The rate on triple-A corporate bonds, in mid-July, was nearly 5.6 percent—higher than last September, when money was very tight.

Mr. Chairman, I am no expert in these matters. However, I see many signs of the economy moving up moderately and, hopefully, the pace will be picking up a bit in the months ahead. One does not have to be an expert to know that rising economic activities mean some increase in private borrowing, as businesses finance the expansion.

If the financing of the Government's large deficit, in the coming year, is superimposed on this situation, money will probably tighten and interest rates will rise to new heights.

We saw the effects of the Federal Reserve Board's tight-money and high-interest-rate policies last year. Homebuilding went into a deep recession, despite the need for a sharp increase in new and rehabilitated housing. Related industries, such as lumber and furniture, went into a slump.

Tight money and very high interest rates, in the year ahead, will probably achieve similar results again. The social goal of more and better housing would be thrown for a loss. The economic pickup would be unbalanced, with one sector of the economy depressed. Countless numbers of people would pay the price for such development—consumers, small businesses, farmers, State and local governments that need to borrow money, as well as workers in affected industries.

Therefore, Mr. Chairman, we believe that a tax increase is needed to reduce the amount of the Government's deficit that will have to be financed in the money market.

We do not agree at all with the proposition that the tax increase is required to prevent a classical inflation in the next several months with shortages of goods, manpower, plants, and machines. Manufacturing industries are now operating at about 85 percent of their capacity, the workweek has been cut down in the past year, there is remaining unemployment and underemployment.

Moreover, the labor force is expanding rapidly and new plants and machines are being installed. It would take a very sharp and continuing boost of business activity—much sharper than expected in the next several months.

If a tax increase is adopted, the overall pace of the economic upturn will probably be slightly slower than otherwise. However, the economic advance would be more balanced and it would be more widely shared among the various industries.

The dangers of tight money, very high interest rates, and an unbalanced economic advance are real and tangible. A tax increase is needed to reduce these dangers and to provide our Armed Forces in Vietnam with as much of the best equipment as they need to achieve an honorable settlement of the conflict.

THE SURTAX RATE ON CORPORATIONS SHOULD BE SUBSTANTIALLY GREATER
THAN FOR INDIVIDUALS

The record clearly indicates, Mr. Chairman, that the surtax rate on corporations should be much greater than on individuals. There is no justification for applying the same surtax rate on both corporations and families, as the administration proposes.

Only within the past several months, the Congress restored, at the administration's request, the 7-percent tax credit on business investment in new equipment. This early restoration was also more lavish than the original credit.

The restored 7-percent tax credit is worth about \$2 billion to corporations over a full year. It is the equivalent of a \$2 billion tax cut on corporate income.

However, this special action to reduce corporate taxes was not accompanied by any action, whatsoever, to reduce taxes on American families.

We are fully aware, Mr. Chairman, of the talk about declining profits and a profit squeeze. Corporate profits did decline a bit toward the end of last year and in early 1967, as business activity leveled off. However, the decline was small and it was from very great heights. In addition, profits are rising again, with the economic pickup.

Let us look at the record of rising incomes for various groups in the economy between 1960 and the first half of 1967:

Corporate profits after payments of taxes skyrocketed 74½ percent.

Dividend payments to stockholders soared almost 69½ percent.

Total wage and salary payments to all employees in the entire economy increased only 54 percent—reflecting increased employment as well as the wage and salary gains of individual workers.

Total after-tax personal income in the entire economy rose merely 53 percent.

Weekly after-tax take-home pay of a factory worker, with three dependents increased only 24 percent—and, in terms of buying power, merely 11 percent.

That is the record of the past 6½ years, Mr. Chairman, even after accounting for the temporary and small profit decline of the recent past. Profits have skyrocketed—moving up, far out of line with workers' wages. In addition, corporations received a special tax cut only a few months ago.

In light of this clear record, we urge the committee to recommend a surtax rate on corporations at least twice as great as on individuals. A 6-percent surtax on individuals should be accompanied by a 12- or 15-percent surtax on corporate tax liabilities. Or an 8 percent surtax rate on individuals should be coupled with a 16 or 20 percent rate on corporations. The surtax rate on corporations should be at least 20 percent if the surtax rate on personal income is 10 percent.

Over a full year, such surtax rates on corporate tax liabilities would raise the following approximate amounts:

Surtax rate on corporations and approximate additional revenue:

- 12 percent, \$4 billion.
- 15 percent, \$5 billion.
- 16 percent, \$5.3 billion.
- 20 percent, \$6.6 billion.

THE SURTAX ON INDIVIDUAL INCOME SHOULD BE FULLY BASED ON ABILITY
TO PAY

The administration has proposed a flat 10-percent surcharge on the total tax liabilities of all personal income taxpayers with taxable incomes above \$2,000 for joint returns and \$1,000 for single individual returns.

In effect, this means no surcharge on a family of four with a gross income of \$5,000 or less, but the application of the same 10 percent surtax rate on the total tax liabilities of all such families whose incomes are \$5,001 and more.

This proposal recognizes ability to pay to a degree—by exempting lower-income taxpayers from the surtax. However, this proposal is unfair and inequitable to middle- and moderate-income taxpayers.

For example, under the administration's proposal, a family of four with a taxable income of \$1,999—gross income of about \$4,990—would pay its regular tax of \$290. It would pay no surcharge. Another family of four with a taxable income of \$2,001—gross income of slightly over \$5,000—would be required to pay its regular tax of slightly over \$290 plus the 10 percent surtax, or \$29. For the extra \$2 of taxable income, it would be required to pay \$29 in additional taxes. This is clearly unfair.

Moreover, this proposal also fails to give sufficient recognition to the ability to pay principle as one moves up the income scale. Families with incomes of \$6,000 or \$10,000 would pay the same 10-percent surcharge on their total tax liabilities as families with incomes of over \$1 million.

In addition, the proposal also fails to recognize that the after-tax weekly take-home pay of most groups of wage and salary earners has increased only slightly in the past 2 years. The weekly take-home pay of the average factory worker, with three dependents, was \$100.39 in June—only 62 cents per week greater than in June 1966 and \$3.40 per week above June 1965.

Simple application of the 10-percent surtax rate to the total tax liabilities of all four-person families with gross incomes above \$5,000 would wash out this average factory worker's gain in weekly take-home pay during the past year and one-quarter of his take-home pay improvement over the past 2 years. A somewhat similar situation would apply to most large groups of wage and salary earners.

So, Mr. Chairman, we reiterate our belief that the surtax on individuals must be based fully on ability to pay.

Therefore we recommend the following proposal, which we urge you to adopt:

Each family filing a joint return would subtract \$300 from its tax liability and apply the surtax rate to the remainder. Therefore, lower-

income families—such as four-person families with gross incomes below \$5,000—would be exempt from the surcharge.

A family with a tax liability of \$301, would apply the surtax rate to \$1 instead of to the full \$301 amount. Another family, with a liability of \$700 would apply the surtax rate to \$400.

Each single individual taxpayer would similarly deduct \$150 from his tax liability before applying the surtax. The effect would be similar to what I have just described for families filing joint returns.

All taxpayers, except those with low incomes, would pay the same surtax rate. However, with the deduction of \$300 for joint returns and \$150 for single individual taxpayers, the burden of the surtax would be much more equitably based on ability to pay.

Let us take the example of an 8-percent surtax on a family of four. At a gross income of \$5,000 or less, there would be no surcharge. At \$6,000, the surcharge would be \$12 or 2.6 percent of the regular tax liability. At \$10,000, the surcharge would be \$65 or 5.8 percent of the regular tax. The surcharge would reach 7.2 percent of the tax liability, or \$229, at \$20,000 of gross income.

SURCHARGE ON FAMILY OF 4

Gross income	Present tax	8-percent surtax after \$300 deduction from tax liability	Surcharge as percent of present tax
\$5,000	\$290	0	0
6,000	450	\$12	2.6
10,000	1,114	65	5.8
15,000	2,062	141	6.8
20,000	3,160	229	7.2

Note: See apps. I, II, and III for detail.

If this much fairer and more equitable method of applying a temporary surtax on personal income is adopted, the following approximate amounts of money could be raised over a full year:

Surtax rate and approximate additional revenue:

6 percent, \$2.8 billion.

8 percent, \$3.9 billion.

10 percent, \$4.9 billion.

We urge you to adopt this method of raising additional revenue from the individual income tax, combined with a corporate surtax rate that is at least twice as great as the rate on personal incomes.

THE ABILITY-TO-PAY PRINCIPLE REQUIRES TAXATION OF EXCLUDED INCOME

Tax loopholes of special privilege for wealthy families and corporations are numerous and notorious.

In 1964, for example, 482 tax returns reported adjusted gross incomes of \$1 million or more—after excluding interest from State and local bonds, half of capital gains, and so on. Yet, 19 of these millionaires paid no tax at all on their 1964 incomes—not 1 single cent.

Personal capital gains from the sale of stock, real estate, and other property are in the neighborhood of \$20 to \$24 billion per year in recent years. However, only half of these profits are even listed as income, subject to taxation. The top tax rate on personal capital gains is very special—it is 25 percent. In addition, the story is closely similar for the approximately \$7 to \$8 billion of capital gains of corporations.

Double depreciation writeoffs of new buildings are wonderful if you are lucky enough to be a real estate investor—or an outrage, if you are an average citizen. These tax-free cash-returns adds up to great fortunes. After the major writeoffs are taken, in 7 or 8 years, the building is sold and the top tax rate on the profit is 25 percent.

Yet this is not the end. The new owner of the used building writes off the price he paid for it at $1\frac{1}{2}$ times the average rate. The process goes on and on and the public pays the price in inflated land costs, high rents, and lost revenue to the Federal Government.

Fortune magazine once described a typical real estate situation, involving a Manhattan skyscraper. On a $\$2\frac{1}{2}$ million investment, the happy investor made $\$3.3$ million in after-tax profit after only 5 years.

In his book on Federal taxes, Philip Stern reports the following developments in 1960:

Eight New York real estate corporations amassed a total of $\$18,766,200$ in cash available for distribution to their shareholders. They paid not one penny of income tax.

When this $\$18,766,200$ was distributed, few of their shareholders paid even a penny of income tax on it.

Despite this cash accumulation of nearly $\$19$ million, these eight companies were able to report to Internal Revenue losses, for tax purposes, totalling $\$3,186,269$.

I shall not go on with any more of such details, Mr. Chairman. You are considering a temporary war tax. This is not the time for structural tax reform, with detailed consideration of each loophole. In this connection, we were glad to learn that the administration intends to present its proposals on tax loopholes later this year.

However, Mr. Chairman, we believe that this is the right time—when you are considering a war tax—to include some degree of Federal taxation on the great amounts of cash-returns that are now excluded from income reported for tax purposes.

Major categories of such excluded income are: half of capital gains, income from tax exempt State and local bonds, and depletion allowances. These excluded categories of income add up to something like $\$13$ to $\$14$ billion for individuals and families and to about $\$9$ to $\$10$ billion for corporations.

To permit such huge categories of income to go untaxed while the Government is imposing a special war tax, would be utterly unfair and inequitable.

Therefore, Mr. Chairman, we suggest that once a figure is determined for the surtax rate, that a tax of that exact figure be imposed on excluded income in these three categories, after a generous deduction.

On the personal income side, we propose that the taxpayer list his income from these three categories, deduct a generous $\$10,000$ and apply the same tax rate as the surtax on the remainder, if any.

With a deduction of $\$10,000$ per tax return, moderate-income taxpayers would be exempted from the tax on excluded income. Moreover, the tax rate would be much lower than the regular tax rates. Yet a significant portion of excluded income would be subjected to some taxation and additional Federal revenue would be raised at a time when it is needed.

On the corporate side, we recommend a similar listing of those categories of excluded income, a very generous deduction of $\$25,000$ and application of the same tax rate as the surtax to the remainder.

The deduction of as much as \$25,000 would exclude small corporations, and most medium-sized corporations, as well, from this tax. However, it would subject the excluded income of wealthier corporations to a low tax rate—much lower than the 48 percent on reported income. At least part of the revenue potential of excluded income would be tapped.

This proposal seems to us to be simple, clear, and direct. It is not structural reform of the detailed problems in our tax system. But it would raise additional revenue, as part of a war tax, by applying a degree of taxation to the large sums that are now excluded from the income tax.

On personal income, such taxation, at a 6-percent rate, could raise approximately \$350 million. An 8-percent rate could raise about \$475 million and a 10-percent rate, something in the neighborhood of \$600 million.

As for corporate income, a 12-percent tax rate on excluded income, along these lines, could bring about \$800 million of additional revenue and a 20-percent rate, approximately \$1.3 billion.

Approximate revenue potential of taxing excluded income:

Personal income tax:

6 percent, \$350 million.

8 percent, \$475 million.

10 percent, \$600 million.

Corporate income tax:

12 percent, \$800 million.

15 percent, \$975 million.

16 percent, \$1.1 billion.

20 percent, \$1.3 billion.

These estimates, Mr. Chairman, are not precise. However, they roughly indicate the substantial amount of revenue that could be raised by placing a small tax, after a generous deduction, on these categories of excluded income. It seems to us that taxation of excluded income should be an integral part of a temporary war tax, if it is to be fair and equitable.

In addition, Mr. Chairman, we urge you to give careful consideration to a substantial increase in the 25-percent maximum tax rate on capital gains. This special rate is unfair—particularly when the Congress is adopting a temporary tax increase to raise additional Federal revenue to help finance a war.

In conclusion, let me repeat, we are firmly convinced that a temporary war tax is needed. Such tax increase, however, must be fully keyed to the principle of ability to pay.

I have tried, Mr. Chairman, to give you, as briefly and carefully as I can, a number of fair and equitable methods to achieve the President's objective of raising additional revenue. These alternatives to the administration's proposals are also practical and sound. They would raise from about \$8 billion to approximately \$13.4 billion of additional Federal revenue over the course of a year. (See apps. IV, V, and VI for detail.)

We urge you to give these AFL-CIO recommendations your careful consideration during the committee's deliberations in the coming weeks. Thank you.

The CHAIRMAN. Without objection, Mr. Meany, the material appended to your statement will be made a part of the record at this point.

(The material referred to follows:)

APPENDIX I

AFL-CIO PROPOSAL: 6-PERCENT SURTAX—FAMILY OF 4 (INCOME FROM WAGES AND SALARIES)

Gross income	Present tax ¹	AFL-CIO proposal ²	Surtax as percent of present tax
\$3,000			
\$4,000	\$140		
\$5,000	290		
\$6,000	450	\$9	2.0
\$7,000	596	18	3.0
\$8,000	772	28	3.6
\$9,000	943	39	4.1
\$10,000	1,114	49	4.4
\$11,000	1,285	59	4.6
\$12,000	1,468	70	4.8
\$15,000	2,062	106	5.1
\$18,000	2,710	145	5.4
\$20,000	3,160	172	5.6
\$25,000	4,412	247	5.7
\$30,000	5,876	335	5.7
\$40,000	9,332	542	5.8

¹ In addition to \$2,400 in personal exemptions, family is assumed to have personal deductions of \$600 or 10 percent of gross income, whichever is larger.

² AFL-CIO proposal calculated as 6 percent of present tax after subtraction of \$300 from present tax.

APPENDIX II

AFL-CIO PROPOSAL: 8-PERCENT SURTAX—FAMILY OF 4 (INCOME FROM WAGES AND SALARIES)

Gross income	Present tax ¹	AFL-CIO proposal ²	Surtax as percent of present tax
\$3,000			
\$4,000	\$140		
\$5,000	290		
\$6,000	450	\$12	2.6
\$7,000	596	24	4.0
\$8,000	772	38	4.9
\$9,000	943	51	5.4
\$10,000	1,114	65	5.8
\$11,000	1,285	79	6.1
\$12,000	1,468	93	6.3
\$15,000	2,062	141	6.8
\$18,000	2,710	193	7.1
\$20,000	3,160	229	7.2
\$25,000	4,412	329	7.4
\$30,000	5,876	446	7.6
\$40,000	9,332	723	7.7

¹ In addition to \$2,400 in personal exemptions, family is assumed to have personal deductions of \$600 or 10 percent of gross income, whichever is larger.

² AFL-CIO proposal calculated as 8 percent of present tax after subtraction of \$300 from present tax.

APPENDIX III

AFL-CIO PROPOSAL: 10-PERCENT SURTAX—FAMILY OF 4 (INCOME FROM WAGES AND SALARIES)

Gross income	Present tax ¹	AFL-CIO surtax proposal ²	Proposed surtax as percent of present tax
\$3,000.....			
\$4,000.....	\$140		
\$5,000.....	290		
\$6,000.....	450	\$15	3.3
\$7,000.....	596	30	5.0
\$8,000.....	772	47	6.1
\$9,000.....	943	64	6.8
\$10,000.....	1,114	81	7.3
\$11,000.....	1,285	99	7.7
\$12,000.....	1,468	117	8.0
\$15,000.....	2,062	176	8.5
\$18,000.....	2,710	241	8.9
\$20,000.....	3,160	286	9.1
\$25,000.....	4,412	411	9.3
\$30,000.....	5,876	558	9.5
\$40,000.....	9,332	903	9.7

¹ In addition to \$2,400 in personal exemptions, family is assumed to have personal deductions of \$600 or 10 percent of gross income, whichever is larger.

² AFL-CIO proposal calculated as 10 percent of present tax after subtraction of \$300 from present tax.

APPENDIX IV

Approximate amount of additional revenue—Alternative A

Tax	Additional revenue
Individual income tax: 6-percent surtax (AFL-CIO proposal) ..	\$2, 800, 000, 000
Corporate income tax:	
12-percent surtax.....	4, 000, 000, 000
15-percent surtax.....	5, 000, 000, 000
Excluded income:	
6 percent on personal income.....	350, 000, 000
12 percent on corporate income.....	800, 000, 000
15 percent on corporate income.....	975, 000, 000

(NOTE.—Total, about \$8,000,000,000 to \$9,100,000,000.)

APPENDIX V

Approximate amount of additional revenue—Alternative B

Tax	Additional revenue
Individual income tax: 8-percent surtax (AFL-CIO proposal) ..	\$3, 900, 000, 000
Corporate income tax:	
16-percent surtax.....	5, 300, 000, 000
20-percent surtax.....	6, 600, 000, 000
Excluded income:	
8 percent on personal income.....	475, 000, 000
16 percent on corporate income.....	1, 100, 000, 000
20 percent on corporate income.....	1, 300, 000, 000

(NOTE.—Total, about \$10,800,000,000 to \$12,300,000,000.)

APPENDIX VI

Approximate amount of additional revenue—Alternative C

Tax	Additional revenue
Individual income tax: 10-percent surtax (AFL-CIO proposal) ..	\$4, 900, 000, 000
Corporate income tax: 20-percent surtax.....	6, 600, 000, 000
Excluded income:	
10 percent on personal income.....	600, 000, 000
20 percent on corporate income.....	1, 300, 000, 000

(NOTE.—Total, about \$13,400,000,000.)

The CHAIRMAN. We appreciate your bringing to the committee this discussion of your views. Any questions of Mr. Meany? Mr. Curtis.

Mr. CURTIS. Mr. Meany, there is one point of economics in your statement here on page 4. I think I agree with the point you make there. You say:

We do not agree, at all, with the proposition that the tax increase is required to prevent a classical inflation in the next several months with shortages of goods, manpower, plants, and machines.

I think I share that view with you, but what I see lying behind the inflation we are presently experiencing—the Consumer Price Index went up 0.4 last month and the previous 2 months 0.7—is what the economists refer to as cost-push inflation.

Would you agree that that is the kind of inflation that we are threatened with and actually have right now and have to consider in discussing this Federal deficit?

Mr. MEANY. No, I don't think that is any great threat and I think, as far as the classical inflation, that we have learned over the years that that is no threat at all.

Mr. CURTIS. Well, classical inflation is demand inflation. As I say, as I look at these indicators I don't think that demand inflation is the thing we need to worry about, but we certainly are having inflation right now that is affecting your people very much in the Consumer Price Index and it affected them last year.

This is one of the bases for your wage demands in the negotiations now underway.

Now, I think that we are going to experience a great deal more of this cost-push inflation resulting from this Federal deficit and our handling of it. If the inflation were to amount to as much as 5 percent this year—if it goes at 0.4 a month we would be getting there—we will have a meat ax cut of all Federal expenditures of \$7 billion. That is, a cut in defense, poverty programs, and everything else. You will also have your union workers and other wage earners experiencing a similar cut in real purchasing power. I am calling attention to this because you don't direct attention to the kind of inflation which seems to be with us right now.

Mr. MEANY. Well, of course we don't feel that that is a serious threat at this time.

Mr. CURTIS. Well, it exists. The 0.4 increase in the Consumer Price Index just last month isn't fiction. Now, how does that affect your people? This comes to another question. I think most economists agree that the corporate tax is essentially a consumer tax. The corporation is going to have to pass that tax on in the price of goods and services.

If this is true, then your suggestions here would aggravate the cost-push kind of inflation that we have right now.

Mr. MEANY. Well, you feel that any increase would be passed on to the consumer? Isn't it possible that the profits could be reduced a little or that the stockholders might get a little less?

Mr. CURTIS. There is that possibility, Mr. Meany. This has been a debate for years between economists, but I prefaced my remarks by saying I think the agreement is getting to be pretty general that the corporate tax is essentially a consumer tax. The bulk of it is passed

on in the increased price of goods and services, leading to the situation we have today.

Mr. MEANY. If you carry that sort of reasoning to its logical conclusion we shouldn't have any tax on corporations at all.

Mr. CURTIS. Oh, no; I think we should.

Mr. MEANY. Oh, you do.

Mr. CURTIS. Oh, yes.

Mr. MEANY. But don't you think prices would come down if we didn't have a tax on corporations?

Mr. CURTIS. Oh, that is true, but I just think there is a place for what amounts to a general sales tax at the Federal level, even if we do it through the corporate tax. To some extent, I think, there is an element of this that probably does get to the stockholders, the investors, but then this comes to another point on page 5.

You point out that profits have skyrocketed, but we have to relate profits going up to money invested, because the amount of capital that has been invested in our society has skyrocketed.

Mr. MEANY. You mean profits that were plowed back in?

Mr. CURTIS. Partly, and partly new money, but plowing back in has been some of it. However, the thing that I think we have to relate profits to is the amount of equity investment, and the amount of capital invested has been at a greater rate than the profits, causing a decline in percentage of return per dollar invested over a period of years.

It is now climbing back again, but this I think we have to concern ourselves with. Well, I just wanted to examine those points with you a bit to see what you might say. One other thing.

On page 3 you say:

We saw the effects of the Federal Reserve Board's tight money and high interest rate policies last year.

Actually an examination of the money situation indicates—it is very interesting—that we did not have tight money then. At the same time we were having these high increase in interest rates, the monetary policy seemed to be one of relative monetary ease, which is a further complication.

Mr. MEANY. Certainly not, Mr. Curtis, in the construction industry.

Mr. CURTIS. It is true the money that left did go out of savings and loans and created a very serious problem, a bottleneck problem. One of the disturbing things to me has been the fact that we did have what would be called relative monetary ease at the same time we had these high interest rates, which I think to a large degree came from the Federal Government's fiscal policies, not the Federal Reserve.

Some economists said they were trying to put all the pressure on monetary policy to try to stop the inflationary forces instead of at that time using increased taxes as a possibility.

Now, it wasn't myself, but that was the dialog at the time. You don't recommend apparently what others seem to recommend, cutting back on Federal expenditures in other than Vietnam war areas. I say that because I think there is some possibility of cutting back defense as well as nondefense. You don't think that is a necessary ingredient to this problem?

Mr. MEANY. No; I think I make it clear there that I think we can pay for the Vietnam war without giving up the very important social

side of the Federal Government's program which I think is terrifically important.

Mr. CURTIS. I wasn't necessarily including that because I notice whenever people like myself do suggest we should cut back in other than Vietnam war expenses they immediately say, "Well, you mean education or poverty."

Well, let's just set them aside.

Mr. MEANY. What do you mean?

Mr. CURTIS. I mean, for example, foreign aid. I mean, for example, agriculture. We are talking in terms of billions, each one of those I have mentioned. Don't you see any reason for cutting back here?

Mr. MEANY. That leads to a question of the overall national policy. Can we afford to cut back as a nation in foreign aid? Can we afford to abandon the so-called space race?

Mr. CURTIS. You are right, it is a question of establishing priorities and that is why I raised the question.

I think the greatest priority that faces us is solving this fiscal problem because, as I say, if we do nothing about cutting the size of the deficit—and I don't care whether we finance the deficit through increased taxes, through new debt, or through selling off capital assets—I think we are going to have a meat axe cut in every one of these programs, including poverty, education, and defense in Vietnam, through inflation. If the inflation continues at its present rate it would mean a \$7 billion cut out of a \$144 billion expenditure program. I would argue that what you are saying is right, that we have to consider these on a priority basis, but let's put in as one of the priorities the solution of the fiscal problem.

That is why I say that I think it is necessary to cut back in some of these areas. Many of them you and I probably would agree that we hate to cut, but on a priority basis we need to, at least for a year or two.

However, you don't recommend anything of this nature, of establishing expenditure priorities with the object in mind of reducing the expenditures from \$144 billion.

Mr. MEANY. I would like to point out, Mr. Curtis, that we are dealing with a measure proposed by the administration which is a temporary tax increase. We are not dealing with the whole question of the monetary policy and these other things that you mentioned and I don't know why you think there is certain great significance because I don't specifically recommend cuts in the space or foreign aid.

Mr. CURTIS. Simply this: That any fiscal problem has two sides. One is revenue. The other is expenditures. And if you can cut your expenditures, then you don't have to tax the people additional amounts. Maybe you still do, but that is why I raised the question of whether or not you felt that cutting expenditures might be preferable to increasing taxes.

Mr. MEANY. Well, I think I am for cutting any nonessential expenditures, but certainly the programs you mentioned I don't think are in the nonessential class.

Mr. CURTIS. Well, in other words, contrasting the \$144 billion expenditure level of this administration with a \$77 billion level in 1960, you don't regard anything in the \$144 billion as less important in the

scale of priorities than the fiscal problem that we are confronted with.

Mr. MEANY. I think that a great many things have happened since 1960 that we better take into consideration.

Mr. CURTIS. We were doing pretty well in 1960, but it is very interesting that you think that the things that have happened since 1960 justify a Federal expenditure level of \$144 million in contrast to a \$77 billion level of the Federal Government.

After all, we are talking about a total society, not just what the Federal Government does, but what does the total society do in education, health, welfare and so on.

Mr. MEANY. We didn't have any education expenditures of the Federal Government to amount to anything in 1960.

Mr. CURTIS. We sure did. We were spending more, I might say, per capita in those days than we are now.

Mr. MEANY. I don't think.

Mr. CURTIS. Well, this is a question to be examined.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Ullman.

Mr. ULLMAN. I want to commend you, Mr. Meany, for what I consider a responsible paper with constructive alternatives, and obviously you have done a lot of work on it. You are in a position somewhat like that of a Member of Congress. You represent a lot of people, a lot of taxpayers, and what you are recommending is that the people that you represent, many millions of people, will have to dig into their pockets and pay some more taxes, and that I consider is statesmanship and I commend you for it.

Now, I presume the reason that you are doing that is because you have looked at the alternatives. Is that right?

Mr. MEANY. Yes.

Mr. ULLMAN. And the main alternative you are concerned about is the alternative of the high interest rates and the tight-money situation.

Mr. MEANY. Which would come from a large Federal deficit.

Mr. ULLMAN. That is right. Now, you have gone into the tax structure. I think you would be realistic enough to see the difficulties of trying to include tax revision procedures in this bill.

Mr. MEANY. No, I make that clear that I don't think we should try to get into the question of tax reform, which we have a great interest in, but I do point out you can get a little more money here without enacting tax reform at this time.

In other words, you can get a little out of these present tax-exempt areas.

Mr. ULLMAN. Thank you.

The CHAIRMAN. Any further questions? If not, Mr. Meany, we thank you, sir, for coming to the committee.

Mr. MEANY. Thank you, Mr. Chairman.

(For telegram from Uniformed Firemen's Association, in support of Mr. Meany's statement, see p. 746.)

The CHAIRMAN. Mr. Wright and Mr. Fefferman. Mr. Wright, if you will identify yourself and Mr. Fefferman for the record we shall be glad to recognize you, sir.

**STATEMENT OF KENNETH M. WRIGHT, VICE PRESIDENT AND
CHIEF ECONOMIST, LIFE INSURANCE ASSOCIATION OF AMERICA,
AND ARTHUR S. FEFFERMAN, DIRECTOR, ECONOMIC ANALYSIS,
AMERICAN LIFE CONVENTION**

Mr. WRIGHT. My name is Kenneth M. Wright and I am vice president and chief economist of the Life Insurance Association of America. I am accompanied by Arthur S. Fefferman, director of economic analysis of the American Life Convention.

Our two associations have an aggregate membership of 349 life insurance companies accounting for approximately 92 percent of the life insurance in force in the United States. These companies also hold over 99 percent of the reserves of insured pension plans in the United States.

The prospect of the projected \$29 billion budget deficit in fiscal year 1968 is a matter of deep concern to the life insurance business and to millions of its policyholders, beneficiaries, and pensioners. Rising Federal expenditures in both the military and nondefense areas, together with lowered estimates of projected tax receipts, point to a budgetary situation that threatens to go out of control.

A Federal budget deficit of the magnitude now projected could produce serious inflationary consequences for the American public, by adding to the already visible trends toward higher prices, wages, and costs in the economy.

Moreover, the amount of Treasury borrowing needed to finance such a massive deficit would accentuate the pressures toward higher interest rates, by placing heavier burdens upon financial markets that are already facing record private demands for funds.

Under these circumstances, the life insurance business believes it is imperative for the Congress to take fiscal action at the earliest possible time to hold back the strong pressures toward higher interest rates and rising price levels that would result from a Federal budget deficit as large as \$29 billion.

The life insurance business agrees with the philosophy expressed in the President's budget message on the inflationary dangers of a \$29 billion budget deficit:

The Nation could face a return of strong inflationary pressures and an intensified wage-price spiral—which could rob the poor, the elderly, the millions with fixed incomes. We would lose our opportunity to make progress this year toward one of our most urgent objectives: price stability.

We have already witnessed strong tendencies toward higher price levels, stemming from the combined impetus of an expanding private economy and rising Federal expenditures, including military spending.

In spite of the severe credit shortage which developed in the summer and fall of last year, which had the effect of slowing economic expansion in the first half of 1967, inflationary pressures toward higher wages, costs, and price levels still persist.

A \$29 billion Federal deficit, in our view, would produce upward pressures on price levels, with wide-ranging consequences, not only in fiscal 1968 but in the years ahead. Because of its uneven impact upon

different economic groups, and especially on those living on pensions or fixed incomes, inflation has been rightly described as "the cruelest tax of all."

In addition to the hardships that inflation would work upon the domestic economy, rising price levels would lead to further deterioration in our balance of payments by worsening our competitive position in world trading markets.

In considering a program of fiscal actions to reduce the impending deficit, we would urge the Congress to use a balanced approach, with close attention both to the level of nondefense spending and to the amount of increased taxation that will be needed.

In his budget message of August 3, the President has stated that he is "directing each department and agency head to review every one of his programs, to identify reductions which can be made and to report to the Director of the Budget in detail on the actions he is taking to put those reductions into effect."

We are hopeful that such a review can achieve significant results, and would urge the Congress to likewise consider the pressing need for cutbacks in the expenditure programs that are currently pending, in the recognition that the inflationary implications of the prospective budget deficit arise from the high level of Federal expenditures and not just from the shortfall of tax revenues.

We fully recognize that spending reductions are not easily achieved. However, judicious trimming of less essential programs, along with postponement of public works outlays that are not critical in a high-employment economy, should permit a substantial decrease in fiscal 1968 spending totals.

Furthermore, the announcement of specific programs for expense reductions would be of material help in dampening speculative activity based on anticipated inflation, even if the normal operation of budgetary, legislative, and administrative procedures might mean that much of the savings would not be evident until future budgets.

The life insurance business believes that a tax increase is an unavoidable necessity at this time, and that a temporary uniform surcharge on both corporate and individual income taxes is an appropriate approach under present circumstances.

We would urge the Congress, in reviewing the administration's tax proposals, to consider the following points:

1. Legislative action on a tax increase should be prompt, in order to correct the present revenue imbalance and also to remove uncertainties in the business community and the financial markets as to the nature and extent of the tax increase.

2. While we have no way to evaluate a surcharge of 10 percent, as against some other percentage, the general magnitude of the proposed tax increase—that is \$7½ billion in fiscal 1968—appears to be suitable in the present situation, so long as such an increase can be accompanied by reductions in Federal expenditures.

3. In the interest of fiscal equity, it would be desirable for the surcharge to take effect at the same time and at the same percentage rate, for both corporations and individuals, and at the earliest prospective date.

4. The form of the tax increase should be temporary in nature in order to avoid adverse effects on long-term business planning, and should not be used as a basis for increased Government spending.

5. The application of the temporary surcharge should be kept simple and uniform, without the introduction of exemptions or complexities which aim at structural tax reforms.

For example, the proposal to exempt individual taxpayers with incomes falling entirely in the two lowest brackets would conflict with the basic principle that tax burdens should be shared by a broad base of the American public, especially when revenues are needed to cover outlays for the national defense.

Furthermore, this exemption would depart from the principle that all people pay the same tax rate on the same bracket of income, and would introduce a structural change in our tax system which should not be attempted in an emergency tax measure not without extensive debate.

A major objective of the proposed tax increase and spending cuts is to reduce pressures upon an already overburdened capital market. Failure to reduce the \$29 billion deficit now in prospect could lead to spiraling interest rates.

The life insurance business believes that early action to correct the budgetary situation is necessary to avoid a recurrence of the extremely tight financial situation which developed in the summer and fall of 1966.

However, it does not appear likely that the proposed tax increase would bring an actual decline in the present high levels of long-term interest rates, in view of the heavy demands that are in prospect for private long-term financing. Early implementation of the administration's budget proposals would alleviate upward pressures on interest rates by reducing the Treasury's fiscal 1968 borrowing needs to more tolerable amounts.

At the same time, it should be pointed out that two features of the administration's tax proposals, though they would trim the administrative budget deficit, would not relieve total borrowing pressures in the capital market by the full dollar amounts involved.

First, the proposal to restore authority to issue \$2 billion in participation certificates would merely substitute such issues for an equal amount of regular Treasury borrowing, with no reduction in total demands in the financial markets.

Second, further acceleration of corporate tax payments would cut into business working capital by an estimated \$800 million. However, corporations would seek to restore their working capital by increasing their demands on the long-term capital market. This response would shift pressure onto the corporate bond market and away from the short-term market where the Treasury would otherwise borrow.

To summarize briefly, it is our view that a temporary uniform surcharge on both corporations and individuals is an unavoidable necessity to bring the Federal budget under control. Prompt action is also needed to simultaneously reduce Federal expenditures and hold down the deficit in order to lower Treasury demands upon the money and capital markets and curb inflationary tendencies in the economy.

Thank you, sir.

The CHAIRMAN. Thank you, Mr. Wright and Mr. Fefferman, for coming to the committee and giving us these views that you have expressed.

Are there any questions of these gentlemen?

Mr. SCHNEEBELI. Mr. Chairman.

The CHAIRMAN. Mr. Schneebeli.

Mr. SCHNEEBELI. Mr. Wright, in your capacity as an economist I am asking this question. What is your appraisal of which way the economy is trending? We have conflicting testimony that it is going sideways, it is going up with vigor, and so forth. What do you think about which way the economy is going to be going in the next couple of quarters, because this of course will have influence on the committee's decision?

Mr. WRIGHT. We thought about this question and this would be our view on the matter. First of all, there is a choice to be faced. Looking ahead it is always difficult to see exactly the trend of the economy, but the choice lies between cutting back on Federal pressures and the Federal deficit that stimulates the economy as against allowing such very sizable deficits and demand pressures to run the risk of inflation.

Mr. SCHNEEBELI. We recognize this alternative, but, nevertheless, we would like to have some confidence in the fact that the additional taxes are going to be based on a rising economy which is better able to take it and we would not like to think that the taxes would cause a temporary recession because the economy isn't healthy enough to take a tax increase.

Do you have any analysis of this?

Mr. WRIGHT. Yes. Let me approach that in this fashion. While the economy has been rising less rapidly, it is still rising. A good deal of the slowing process has occurred in the inventory field where adjustments were called for. In the view of a great many economists these adjustments in inventories are now largely behind us and that portion of drag on the economy may not be such a large factor in the next two quarters, the third and fourth quarters.

Therefore, our appraisal would be that the economy is essentially healthy and strong. This has been our background in thinking that a tax increase of the magnitude proposed would not tip us into a downturn for the total economy.

Let me also point out that if the full proposal of the President is implemented we would still be left with a budget deficit of \$14 to \$18 billion, which itself is one of the largest deficits we have had for the entire postwar period and a very strong continuing expansionary influence on the economy even at that reduced level.

Mr. SCHNEEBELI. Would you say the economy is going upward in the third and fourth quarters? We are already about two-thirds through the third quarter. There doesn't seem to be any robust increase that I can see.

Mr. WRIGHT. There have been some significant upturns in a number of key areas. I can cite the turn up in industrial production. Housing starts have moved up very strongly. Personal income is continuing to rise strongly. Order backlogs are up in the latest reports. I think that we may now be facing a situation in which easier money, which began some 8 or 9 months ago, is beginning to show quite an effect from the turnaround of last summer and fall, plus the fact that the inventory adjustments are now not as great a drag as they had been.

Mr. SCHNEEBELI. Thank you very much.

The CHAIRMAN. Any further questions? Mr. Battin.

Mr. BATTIN. Several times in your statement you quoted from the President's message to us on August 3. One of the things he said in his message, and the reason I ask this question, is that you throughout your statement emphasize the necessity to couple an increase in taxes with a reduction in Federal spending. I quote the President's message:

All actions we take to reduce Federal spending must—and will—be carefully and compassionately weighed. For we cannot turn our backs on great programs that have been begun, with such promise, in the last 3½ years.

I am wondering, based upon the state of legislation at this point in Congress, with the unrest that exists in the country, with the talk about a Marshall plan for the cities of the country, whether you want us to believe that there will be a corresponding reduction in Federal spending?

Mr. WRIGHT. I know this is a difficult problem and our feeling is that this lies within the province of the Congress and the administration to decide which areas shall receive priority. But I believe that the administration has expressed confidence that there are areas that can be cut, and I have seen many congressional statements that in specific programs further cutbacks would be possible.

I think this is a matter of setting priorities. I cannot urge upon you specific areas that should be eliminated or cut, but I think in the postponement and deferment of those things that are not so pressing a good deal could be achieved in budgetary savings.

Mr. BATTIN. Another area is one that was discussed earlier in the week. Do you think being faced with a \$29 billion deficit would have any, let's call it, pressure on the Executive to hold down spending without any tax increase?

Mr. WRIGHT. You mean in the absence of a tax increase?

Mr. BATTIN. Yes, just being faced with a \$29 billion deficit.

Mr. WRIGHT. I think it is bringing that pressure to bear right now.

Mr. BATTIN. And you follow the papers as closely as Members of Congress do?

Mr. WRIGHT. That's right.

Mr. BATTIN. Do you ever see what happens when a cut is made on Capitol Hill of any requested expenditure? I can just think of the other day when the other body made a very sizable cut in foreign aid. The President took the airwaves that night to condemn that body for what he considered a temporary setback. I don't share, I guess, with you the feeling that the administration will, in fact, even come close to dollar-for-dollar savings or even less than that, a three for one, reduction in nonvital expenditures, and this is what gives me great cause for alarm because I think the tax increase without the reduction is doing nothing more than financing the continuation of the present level of spending.

Mr. HERLONG. Will the gentleman yield at that point?

Mr. BATTIN. Yes.

Mr. HERLONG. And this cut that they made over there would have no effect on this year's spending at all because they have over \$9 billion in the pipeline that is already obligated?

Mr. BATTIN. That is right.

Mr. HERLONG. Then it would have no effect. Yet he asked for more to go into the pipeline at a time like this.

Mr. BATTIN. As we sit here and listen to those of you who come before us and give us your conscientious opinion it becomes a little difficult then for us to have to make the decision, to weigh the evidence coming from here and down the street. I don't know just what to do.

Thank you very much.

The CHAIRMAN. Mr. Herlong.

Mr. HERLONG. On yesterday afternoon the White House called me in connection with this foreign aid bill that is now before the House and asked me if I would go along against making any cuts in this bill, and I said, "Now, I am trying to get your tax bill increase passed and I don't see how you can talk out of both sides of your mouth at one time. You are asking me to vote to spend more on foreign aid than the Senate has voted, and at the same time you want us to increase the burden of people in this country in taxes. Then the next minute you tell us you are going to cut down on unnecessary expenditures."

I assume that they consider this as not an unnecessary expenditure, but it won't affect their program any at all if they don't appropriate a nickel in foreign aid this year, and we are trying to hold down on these things. I told them, "I don't see how you can, in good conscience, ask me to vote for more at the same time you are asking me to vote for a tax-increase program."

The CHAIRMAN. Any further questions? If not, we thank you, Mr. Wright and Mr. Fefferman.

Mr. WRIGHT. Thank you, sir.

The CHAIRMAN. Mr. Hall. Mr. Hall, we appreciate having you back with the committee again to discuss this very serious problem. If you will identify yourself for this particular record we shall be glad to recognize you, sir.

STATEMENT OF E. S. HALL, CHIEF ENGINEER AND SECRETARY, FREEDOM INC.

Mr. HALL. Mr. Chairman, my name is E. S. Hall. I am chief engineer and secretary of Freedom Inc., Farmington, Conn.

The President's surtax message:

Without a tax increase and tight expenditure control, the deficit could exceed \$28 billion. * * * If left untended, this deficit could cause * * * ruinous inflation.

Inflation, strikes, riots, Communist guerrilla, "wars of liberation" in Cuba, Vietnam, Watts, Chicago, Cleveland, Newark, Detroit—can America be saved?

The 10-percent surtax is simple. Figure out your income tax and add 10 percent. Made even simpler by omitting lower income exemption and corporate speedup, it still might collect \$6 billion. But that's not half enough to stop inflation, the dishonest tax that steals the value of our dollars.

Congress has the power to levy and collect taxes, to pay the debts, to borrow money, to coin money, regulate the value thereof, and of foreign coin.

Congress has the power to manage money in a way that would keep the free-market price level stable. Contracts would be valid, and the same pay would buy the same or better living, year after year. Cash, savings bonds, insurance, social security and the like would be worth as much tomorrow as they were yesterday.

We could save and invest with confidence in the future of the dollar. Government could continue to honor its 1935 commitment to buy gold from, or sell gold to, foreign governments and their central banks at \$35 an ounce. Dollars would continue to supplement gold as the international money and good-as-gold capital reserves supporting other currencies and accepted in trade within and between the nations of the world.

Congress has the power to maintain free-market price stability, whatever the rate of unemployment or economic growth. Congress has the power; all it needs is know-how and the will to act. There are no legislative panaceas. Our one best hope is a bill to remove the cause of the entire disease.

What is the cause of price inflation? Why do prices rise? Because too few are unemployed? Because too many are receiving too-high incomes? Because prosperity is "overheated"? Not primarily. The "new" economists are mistaken. They have managed to extend prosperity 7 years by deficit spending—that is more than the "old" economists have done by balancing the budget—but economist or not, anyone familiar with elementary algebra knows that—

the number of DOLLARS spent

the number of units of COMMODITIES paid for = average commodity PRICE

and that when Government—by deficit spending of credit created by banks as they "monetize" the bonds—inflates the numerator, dollars, faster than business increases the denominator, commodities, the value of the fraction, price, rises.

Money inflation is the primary cause of price inflation. Inflation doesn't just happen; it is a crime committed primarily by Government.

Government's responsibility is to adopt the monetary and fiscal policies that will raise the numerator, dollars, at the same rate that business raises the denominator, commodities, to keep the value of the fraction, price, stable.

The Federal Reserve, by market operations with Government securities, and by adjusting reserve requirements and interest rates, has been governing the quantity of bank credit, raising or lowering the quantity of dollars in the market. These monetary measures depend on human judgment, not infallible; they may do more harm than good.

The administration and Congress, gazing into economic crystal balls, have been trying to raise or cut taxes to cool or heat prosperity, to restrain or promote economic growth, and always to reduce unemployment.

These fiscal measures, too, depend on human judgment, not infallible. What we need is an automatic fiscal governor responsive to price trends, to make the free-market price level stabilize itself. How would you design it?

Government commits the crime—inflation by excessive deficit spending—because our income-tax law, the Internal Revenue Code of 1954, as amended, is inadequate. Thousands of pages, an incredible monstrosity, yet it doesn't even collect enough revenue to prevent inflation. Mr. Chairman and members, our country's in an inflated jam. Only you can save it. Introduce and act on the freedom tax bill.

A bill to provide a simple alternative to the complex Internal Revenue Code letting taxpayers elect which way they pay; to tax the national income—broadest tax base insures lowest rate—the rate adjusted automatically to collect the revenue to maintain free-market price stability; and to untax social security and provide total security.

More specifically, a bill to let employers elect to make employees their limited partners and withhold an incentive tax on profit, salaries, and wages, instead of existing income and payroll taxes, and pay the balance of profit or the loss, partly in cash dividends declared as usual and partly in business property ownership credited, or charged if a loss, to the partners in amounts proportional to their respective amounts of money invested—book value—and year's pay. Comparisons made from annual reports show that, in a profitable business, whether you are an employer, an owner of business property, or an employee, the personal owner of yourself, a part of business personnel, you will get your part of profit and may pay a higher tax, yet you will get a take-home raise. No strikes.

To adjust the tax rate automatically in response to price trends, and issue limited amounts of new currency—U.S. notes—to balance the budget, reduce the debt, and restore and then maintain the buying power of the dollar and free-market price stability. No need to "borrow" money. Cut spending up to \$5 billion interest on the bank-held debt.

To let the needy change from partial to total security; adequate cash aid added to their other incomes, if any, to enable them to buy food, clothing, and shelter, plus payment of all their medical bills, locally administered by social workers and the clergy, and paid directly from income tax revenue. No accounting overhead. Lowest cost. Free-market medical care. Total security.

The fighting in Vietnam can stop Communists but it cannot stop communism; it is not possible to shoot or bomb an idea. No amount of bombing and killing Communists can convince them they are wrong and induce them to quit their "wars of liberation." A right idea could. As Victor Hugo put it, "No army is as powerful as an idea whose time has come."

Give us the freedom tax law. Under it we can set an example of strikeless and steadily growing prosperity. Communists and other Socialists will be left without a mission, left with no "wage slaves" to "liberate," left with nothing "left" to fight for. The war in Vietnam and other "wars of liberation" all the way from Havana and Watts to Newark, Detroit, Washington will subside. We can stop bombing, withdraw our troops, cut defense spending \$20 billion in fiscal 1968, and lead the world toward peace.

The CHAIRMAN. Mr. Hall, we thank you, sir, for again coming to the committee and giving us the benefit of your thinking. Are there any questions of Mr. Hall?

Thank you, sir.

Mr. HALL. Thank you. (For additional statement submitted by Mr. Hall see p. 833.)

The CHAIRMAN. Mr. Hicks? Is Mr. Hicks present, Mr. W. B. Hicks, Jr., executive secretary of the Liberty Lobby? Mr. Hicks is not present?

Mr. Crehore? Mr. Crehore, if you will give us your name, address, and capacity in which you appear for the record we shall be glad to recognize you, sir.

STATEMENT OF JOHN DAVENPORT CREHORE, WASHINGTON, D.C.

MR. CREHORE. Mr. Chairman and other members of the committee, my name is John Davenport Crehore. I am a voter in New Hampshire, residing temporarily at 3824 Porter Street NW., Washington, D.C.

I appear as a private citizen, a student of the socioeconomy, with no affiliations, and representing no one but myself.

SUMMARY

I speak in support of the President's recommendations for increased taxation. Severe cutting of the budget would be truer wisdom than increasing taxes to support its extravagance, but I approve of increased taxation because the budget will not be cut to an economically safe level, and because anyway it will be politically wiser to incur the public's displeasure at increased taxation than to stir its rage at lowered doles.

In summary my recommendations are the following. I am sorry they do not accord with modern doctrine. However, you will find that for the most part they fit the classical sociological and economic concepts, although lack of time for detail may leave this claim unproved.

TELEPHONE SERVICE

I urge maintenance of the telephone excise at 10 percent for the period of budgetary imbalance; really poor people don't have telephones.

AUTOMOBILE TAX

I would restore the excise on automobile pleasure cars to 10 percent, applying this also to their tires; and I would increase the Federal tax on gasoline somewhat. Statistically a new car lasts 15 years. Five out of eight million new cars are bought to replace cars which could be kept in service for less than the budget of a new car. Ergo, most new cars are luxuries—status symbols.

Our country's financial stringency is more threatening than is generally acknowledged; the Government should pinpoint surtaxation on free spenders so long as it won't balance its budget.

POSTAGE RATES

I would retain the 5-cent first-class rate, and raise lower-class rates on actual weight of advertising material enclosed, increasing present post office differentials.

ADVERTISING ON AIRWAVES

For revenue, and to avoid further disadvantaging of printed media, I urge taxation of advertising broadcast over public air channels, on the assertion of public ownership, entailing supervisory expense.

FOREIGN PROPAGANDA

I suggest cessation of free distribution of foreign propaganda. Reasons: Budgetary economy; defense against brainwashing of the populace.

POST OFFICE ACCOUNTING

I urge that strictly standard corporation accounting methods be applied to the operations of the Post Office Department. This would segregate many costs properly chargeable to other governmental entities or enterprises, and would enable the Congress to determine, among other things, fair rates of postage for each class of mail.

A SOCIOECONOMIC TAX ON ALCOHOL AND TOBACCO

I urge increases in taxation upon alcohol and tobacco to the limits presently feasible, with progressive increases periodically into the far future—this program to be kept in conformity with the whole Government's ability to cope with bootlegging. Proceeds: for highway casualties and cancer.

FNMA TRUST PARTICIPATION CERTIFICATES

I suggest that "the" \$2 billion of these participation certificates hanging over the market be sold as quickly as convenient. As a sociologist I concur in the administration's insistence that there is psychopolitical advantage in every lowering of the visible deficit. And as an ex-Wall Street banker I approve the operation which these participation certificates are presumed to implement; namely, borrowing at wholesale to lend at retail—to small businessmen and homebuilders. The fact that Fannie Mae is not operated in the anticipated manner should not cause it to be hindered in the functions it can be made to perform as was intended, unless its prompt liquidation is anticipated.

RETAIL SALES TAX

I now respectfully submit for the judgment of the committee a tax plan in which I visualize many benefits, including the saving of \$700 million per annum to add to the President's item of \$800 million in interest saved, through the collection of one-half the Federal tax revenue on practically a daily remittance basis.

This plan, by substituting retail sales taxation for income taxation in the lowest brackets, releases 20 million families from income tax, happily restoring to their pay envelopes the 20 percent now being withheld. It also hands them exemption coupons with which to pay part of the new sales tax. It pays off their State sales tax for them directly to their State treasurer. And it offers many more big and little rewards, all very simply administered, and very likely to be of great political advantage to the party sponsoring the plan.

FIGURES HEREIN ARE TENTATIVE

It should be kept foremost in mind throughout this fragmentary outline that every figure cited is tentative. The plan is so flexible that wide variations in percentages, et cetera, will not spoil it but will determine whether application of it will raise, lower, or leave unchanged the total tax revenue. I shall use for illustration the figures I use in my accompanying booklet, "National Sales Tax—A Workable Plan," obtainable through bookstores countrywide.

TWENTY MILLION FAMILIES RELEASED FROM INCOME TAX

The releasing of 20 million families from income tax is accomplished by increasing personal exemption from \$600 to \$1,500—\$6,000 for an average family. The revenue thus missed is collected in a sales tax of 20 percent on the broadest feasible base of retail sales, and on some other sales to ultimate consumers.

The poor are spared through issuance, presumably twice a year to all persons, of monthly ration coupons with total cashable value in a year of \$100. This is comparable with the actual value of the \$600 income tax exemption.

AVOIDING CONFLICT WITH PRESENT TAX SYSTEMS

The problem of avoiding conflict with State sales tax systems is solved by payment to every State of a portion of the national sales tax. The portion must be the same for every State. So it will probably be the figure called for for reimbursement of the State with highest sales tax, for refraining from collecting it—say 5 percent—one-fourth—out of the Federal 20 percent, leaving 15 percent for the U.S. Treasury, say \$60 billion net.

State bureaucracies need not be disturbed; they may be given the Federal sales tax to collect—for a fee.

NO CONFLICT WITH FEDERAL INCOME TAX

Let it be noted that nothing in my plan conflicts with the income tax system. My only contact with it is in raising personal exemption to make room for sales tax at the bottom of the scale, and in adjusting the income tax rates somewhat in the remaining brackets to ease the impact of the basic 20-percent sales tax.

POLITICAL ADVANTAGE

The difficulty in comparing the two systems will hide any changes in real impact at any level, and thus will make it difficult for opponents to accuse the Treasury of putting the whole burden onto "the rich"—even if it does so, as expected.

I'm sure this plan of mine could be built into immense political capital for the party sponsoring it. We know the public is frantic at the prospect of less cash in pay envelopes next year. One point that can be loudly touted is that this sales tax per se will not raise taxes for anybody one penny; it will be funded for the worker by the money now being withheld from him as income tax, 10 to 20 percent of his earnings. Restored to the weekly pay envelope, this will give a big psychological boost to morale. Psychopolitical.

CONSERVATIVE TAX PLANS

Political scouts are uncovering millions of conservatives in business and the professions who aren't bothering to argue with the reigning liberals, but who will defiantly vote against liberal doctrine in 1968. This Crehore tax plan should certainly attract these sound economists, with its foot in the door against the confiscatory income tax system.

Vide the increasing weight and number of schemes like the Baker-Herlong plan, liberty amendment, State sharing of Federal income tax, et cetera. If my plan should ever be worked on in consultation with myself an uncountable number of advantages inherent in it would be developed. The booklet describes many more than I have named here—both economic and sociological.

ACKNOWLEDGMENT

I thank the committee for the invitation to speak; and I hope I may be asked a few questions testing my plan for availability. (For additional material submitted by Mr. Crehore see p. 795.)

The CHAIRMAN. Thank you for coming, Mr. Crehore.

Mr. Hicks is now present. Mr. Hicks, come forward please.

Mr. Hicks, if you will identify yourself for our record by giving us your name, address, and capacity in which you appear we shall be glad to recognize you, sir.

STATEMENT OF W. B. HICKS, JR., EXECUTIVE SECRETARY, LIBERTY LOBBY

Mr. HICKS. My name is W. B. Hicks, Jr., executive secretary of the Liberty Lobby, 132 Third Street SE., Washington, D.C.

The CHAIRMAN. Glad to have you, Mr. Hicks, and you are recognized.

Mr. HICKS. Mr. Chairman and members of the committee, I am W. B. Hicks, Jr., executive secretary of Liberty Lobby. I am here to present the views of our 11,000-member board of policy, on behalf of the 170,000 subscribers to our monthly legislative report, Liberty Letter.

Mr. Chairman, Liberty Lobby is opposed to these proposals. Our board of policy voted overwhelmingly to advocate lower taxes, both in 1966 and in 1967. We feel that our position against a tax increase reflects the general attitude of the American people, as well.

This is not a mere instinctive reaction, either. There are good, sound reasons why the Congress should not raise taxes. The main reason, we believe, is that a tax increase would have inflationary effects that could trigger the very chain of events that the President described so well in his message containing these proposals: Strong inflationary pressures, intensified wage-price spiral, spiraling interest rates, tight money, and recession in the housing industry.

It seems clear to us that the economic advisers who are calling for an increase in taxes are searching for an easy way out of the tight spot we are in as a result of 30-odd years of error. They seem to have grabbed onto an old, standard formula that describes what inflation is, and by approaching it in a new direction, they hope to solve the inflation problem.

You know what the equation is, of course; the one that says: "Inflation is the result of an increase in the supply of money and credit relative to the increase in production of goods and services."

Now, the new approach is, that they hope to lay a tax on the supply of money and credit, and thereby the magic of algebra will reduce the rate of inflation.

It won't work that way. The reason it won't work that way is a simple one: Whatever tax you attempt to apply to the supply of money and credit is inevitably going to be shifted right onto the half of the equa-

tion called "production of goods and services" and instead of decreasing inflation, the result is increasing inflation.

What happens when we apply our income tax increase? Obviously, some taxpayers have but one place to obtain the money to pay the new tax: They spend less—for awhile. Then they decide to press for more pay to cover the increased taxes, plus a little extra to cover the higher prices which come with the inflation. They have then managed to shift the burden of the taxes from the "spending" money onto the "production" money, except for that portion which the producer himself can put into his price structure, as added inflation.

Other taxpayers—those with savings—follow a different procedure. They simply dip into their savings to pay the extra tax. Or they buy a little less insurance next year. Either way, they have placed the tax increase directly against the "production" money of the economy, because it is these savings accounts and insurance policies that provide the "production" capital for the economy.

Eventually, nearly all of the tax increase falls onto the capital money supply, the "production of goods and services." The remainder goes into inflation, in either of two ways: (1) Prices are raised as the market will allow, and (2) interest rates rise, as the supply of production money is reduced.

Proponents of the tax increase sometimes say that interest rates will rise if taxes are not increased. The fact is, that if taxes are increased, interest rates will rise as a result.

The events just projected will depend on what the Government does with the tax money it collects. If it should use the money to pay off Government debt outstanding, it would be a case of returning the money to the same part of the economy from which it came: The capital savings, or "production" money flow. In that case, the effect on the economy would be zero.

But we know that this is not what the Government wants to do. On the contrary, the Government is not paying off debt, but expanding it. It is not putting anything into useful production of goods and services, it is spending; using up; consuming.

It is consuming at a rate never before equaled by all the governments of the world put together. It is even creating a whole new class of nonproductive spenders. Our President has added over half a million additional employees to the Government payroll, and their major service is to channel Government expenditures to additional millions of recipients of taxpayers' funds who are themselves nonproductive spenders.

It is proposed to spend an additional \$3 billion providing make-work jobs for idle hands in the riot-scarred cities. Perhaps this effort will prove to be socially productive, but in terms of economics, it will not produce goods and services that people want, and are willing to pay for. No, it will simply add that much more "spending" money to the inflationary flow.

Our Government does not save; it does not invest; it does not produce. It consumes. And it wastes.

In the channel at the North Vietnamese Port of Haiphong is a huge, irreplaceable dredging machine. It works 24 hours a day, keeping the channel free of the mud that threatens to clog up the channel. A single

well-placed bomb could wreck that dredge, and within weeks, the mud would close off the main source of enemy supplies in Vietnam.

Instead, our Government throws away hundreds of millions of dollars in planes and bombs on secondary, piddling targets like empty barracks buildings, and the most important, cheapest target of all is declared "off limits."

So the Government that wants to spend and spend has only one choice. Take it out in taxes and continued inflation. But inflation means high prices. High prices, high taxes, and high ratings on the Gallup Poll just don't go together. The limit has been reached.

It appears to Liberty Lobby that the big spenders are between a rock and a hard place. They might as well face it. The spending will stop, anyway. It might as well be here, it might as well be now. The representative of the people who is first to recognize the new state of affairs and call for the halt voluntarily will be recognized as the friend of the people.

We hope that this committee will reject the proposed tax increase. That would be right for the committee, right for the administration, and right for the people.

Thank you.

The CHAIRMAN. Mr. Hicks, we thank you, sir, for coming to the committee and giving us the views of yourself and your group. Are there any questions of Mr. Hicks?

If not, sir, we thank you again.

Mr. HICKS. Thank you.

The CHAIRMAN. That completes the calendar for today and without objection the committee will adjourn until 10 o'clock in the morning.

(Whereupon, at 11:52 a.m., the committee adjourned to reconvene at 10 a.m., Thursday, August 24, 1967.)

PRESIDENT'S 1967 TAX PROPOSALS

THURSDAY, AUGUST 24, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to notice, in the committee room, Longworth House Office Building, Hon. Wilbur D. Mills (chairman of the committee) presiding.

The CHAIRMAN. The committee will please be in order.

Our first witness this morning is our distinguished colleague from Texas, chairman of the Banking and Currency Committee of the House, Mr. Patman. We appreciate having you with us and you are recognized.

STATEMENT OF HON. WRIGHT PATMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. PATMAN. Thank you, Mr. Chairman. I appreciate the opportunity of appearing before your committee. I shall be as brief as possible.

However, I will do my best.

The proposed 10-percent surcharge which is under consideration will be an empty gesture unless something concrete is done about interest rates. In fact, the President's tax increase would not have been necessary had the Federal Reserve Board performed its duties in the public interest. Unless the Federal Reserve is forced to cooperate with the Federal Government we will almost certainly face the necessity of an even higher tax increase next year.

The last interest rate increase caused by the Federal Reserve, which is still having its effects, whether intended or not, will have a devastating effect on certain financial institutions that are vital to the welfare of this country.

I refer, among others, to the savings and loans, the mutual savings banks, and the credit unions. The increase of 37½ percent imposed by the Federal Reserve Board on December 6, 1965 was a devastating blow to these institutions, and unless direct action by the Federal Reserve to lower interest rates begins immediately, these institutions will be forced to suffer more.

In addition to these three institutions being hurt and injured—and some of them destroyed—by the increases, it will cause further disruption the homebuilding industry and make the building of homes more difficult because interest rates will force the charges to be so high that it will discourage homebuilding, as it has in the past.

In addition to that it will force Government rates up for all levels of government.

Now, all this presuming that the Federal Reserve will continue to ignore its own duties and keep on imposing higher and higher interest rates. The Federal Reserve has a responsibility, but they have not performed their duties in accordance with their responsibilities.

I think, however, the Congress has the greatest responsibility. Congress has ignored this issue too long, so that now we are right on the brink of devastation for much of our economy because of these high interest rates.

If the Federal Reserve cannot be brought back into line as it should to perform for the public interest instead of the private financial interests, I think the Congress should consider liquidating the Federal Reserve.

In the original Federal Reserve Act the process of liquidation is set out as to what will happen if the banks are liquidated, and the law makes it very plain that our first obligation will be to pay the banks back involuntary investment—it is not stock, although they call it stock—to pay back to the banks that involuntary investment which is about \$570 million now, and after we do that and meet the other obligations the remainder belongs to the Government. If we are compelled to liquidate the Federal Reserve System the Government would profit by at least \$65 billion—\$65 billion—which could be paid on the national debt and would put us, of course, in a much better position than we are in right now.

Now, this proposed tax surcharge could really be called the Federal Reserve tax of 1967. A substantial part of the money raised through the surcharge must go to pay added interest cost resulting from the December 6, 1965, action of the Federal Reserve.

Let me quote from the testimony of Charles L. Schultze, the Director of the Bureau of the Budget, before your committee on January 30, 1967:

We estimate that the increasing shortage of credit funds and rising interest rates experienced last year are adding approximately \$3 billion to the Federal budget for fiscal year 1967 as a whole.

This \$3 billion was estimated January 30 and since that time interest costs have continued to climb, so we know that Mr. Schultze's estimate was indeed a very conservative one. The \$3 billion mentioned by Mr. Schultze represents only the increase from the December 1965, Federal Reserve action. It does not take into account the tremendous increase in interest rates since President Truman left office in 1952.

May I invite your attention, Mr. Chairman, to the fact that I have compiled some figures, obtained from the Federal Reserve, and the Treasury, and the Comptroller of the Currency, and the FDIC, so there is no doubt about the authenticity of the information that I furnish.

These figures show that for 14 years, from 1939 through 1952, interest rates were very low. You know, back in 1940 I was before this committee and I advocated, along with former Senator Robert L. Owen, to pay for the cost of the war, of the part that we could not raise money for otherwise after we had sold all the bonds we could sell, and we had taxed all we could tax, and then the money had to be manufactured, that the Federal Reserve manufacture the money, as it has a right to do, make the loans to the Government without interest,

and we would pay it back $2\frac{1}{2}$ percent a year over a 40-year period. That is my proposal now. We can do that.

Now, of course the committee didn't see fit to recommend that, but for some reason the Federal Reserve Board resolved not to let the interest rates go above $2\frac{1}{2}$ percent and from 1939—at that time it had been $2\frac{1}{2}$ percent—and never after that did the interest rates go above $2\frac{1}{2}$ percent until the end of the Truman administration in 1952, in fact, until the beginning of the Eisenhower administration, in 1953.

The Eisenhower administration floated two substantial bond issues, one of them $2\frac{3}{8}$ percent and one of them $2\frac{1}{2}$ percent, which proves conclusively that the interest rate was delivered at $2\frac{1}{2}$ percent and below, so it can be done. Those 14 years, 1939–1952, were the roughest years in the history of any country on earth—inflation, deflation, wars, shooting away a quarter of a billion dollars, a half billion dollars, a day on the battlefields sometimes. We had ruinous inflation facing us; we had a terrible depression; we had long lines of hungry people and we had over 10 million unemployed during part of that time, so if the Federal Reserve Board can keep interest rates at $2\frac{1}{2}$ percent and less during a 14-year period as rough as that one they can do it any time and, of course, we all know they can do it any time. That is what they are there for. They have the power to do it and they can do it, but by reason of their failure to do it our interest burden today on the national debt alone is \$14.2 billion.

Now, \$6.7 billion of that is absolutely excessive. It is exorbitant. But we are having to pay that extra interest on the public debt because of the action of the Federal Reserve Board.

Now, the same proposal that I had back then I have now, to finance the Government's part of the war cost by the Federal Reserve.

Now, you can't call that unorthodox unless you call the Federal Reserve unorthodox. You know, for many years at one time the Treasury could borrow money from the Federal Reserve directly at the request of the Secretary of the Treasury under terms fixed by him, but after World War II was over this was changed.

Now the law reads that the Treasury could still borrow up to \$5 billion directly from the Federal Reserve. They did it not very long ago, a few months ago. It is being done right now, so it is the same principle as I am advocating right now to save the ruinous cost of the war.

For every billion dollars we borrow, Mr. Chairman, eventually we will pay back \$2 billion like it is being run right now. We will pay back \$2 billion. Every schoolhouse that is built for a million dollars we will have to pay \$2 billion. This is ruining our country. The people can't stand that indefinitely.

Our country just can't take it. The truth is we have two governments here in Washington. One government is presided over by elected people like ourselves and the President of the United States who is elected. But the other government is a banker's government operated through the Federal Reserve. They are ruining the banking affairs, and they are running in conflict. We don't control them.

You know, Mr. Eisenhower told Mr. Martin the Federal Reserve was independent and he believed that. Of course it is not independent under the law. There is no law granting them independence. It was never proposed in Congress that they be independent. It was never dis-

cussed. No one thought they were independent, but Mr. Eisenhower told Mr. Martin that they were, and when Mr. Kennedy and Mr. Johnson came in and the Fed was proposing to increase interest rates 37½ percent on December 6, 1965, Mr. Johnson, the President, said, "Now, I want to talk to you gentlemen about that. That is going too far. We can't afford that."

And so Mr. Martin and others had an appointment to go to Johnson City to see the President. They went down there, but the President found out when they got there that what they were going to talk about they had already done in a secret session 2 days before that. Mr. Martin defied the President of the United States.

Now, that is the first time that they ever had a direct conflict, a direct confrontation, where the Federal Reserve just told the President of the United States that he would not prevail, that they would prevail.

Now, of course the fault is that the Congress didn't protect the President, didn't give him the power to go to the mat with the Federal Reserve. He is elected by the people. They are not elected. They in effect have lifetime jobs and if they increase interest rates to where it ruins the country nobody can punish them. They are outside of the law so far as any punishment is concerned.

The Members of Congress should have this responsibility just like the Constitution says. I have been here over a period of time when Congress was tested, and Congress will come nearer staying by the people against inflation than any group you can find in America, certainly in a better way than the people who are selfishly interested when they can raise interest and collect the interest rates themselves.

You know, that is a position that no person should be in. The people who set interest rates in this country and determine the supply of money should be dedicated public servants, preferably elected by the people, at least have the responsibility to preside over it.

Who is the Federal Reserve under? They don't claim to be under anybody; just themselves. They are operating in a different government, a banker's government entirely, and I think something should be done about that or we are going to have disastrous consequences by reason of it.

Now, on the yield of the interest rates after the 14 years that I told you about, there is another 14-year period just subsequent to that that I also have the figures for, and without objection, Mr. Chairman, I would like to insert this in the record.

The CHAIRMAN. Without objection they will be included.
(The information referred to follows:)

Yields on long-term Government bonds 1939 to present

[Percent per annum]

	<i>Yield</i>
1939-----	2.36
1940-----	2.21
1941-----	1.95
1942-----	2.46
1943-----	2.47
1944-----	2.48
1945-----	2.37
1946-----	2.19
1947-----	2.25
1948-----	2.44
1949-----	2.31
1950-----	2.32
1951-----	2.57
1952-----	2.68
1953-----	2.94
1954-----	2.56
1955-----	2.84
1956-----	3.08
1957-----	3.47
1958-----	3.43
1959-----	4.08
1960-----	4.02
1961-----	3.90
1962-----	3.95
1963-----	4.00
1964-----	4.15
1965-----	4.12
1966-----	4.65
Average for 14-year period (1939-52)-----	2.36
Average for 14-year period (1953-66)-----	3.65

Mr. PATMAN. And from 1953 to 1966 I have the interest rates here during the next 14 years. Interest rates were 50 percent higher just on Government rates alone.

Now, a lot of people think that so-called market forces fix interest rates. Well, to some extent that is true, but on our large Government debt, interest rates are fixed by the Federal Reserve. There is no free market in Government bonds.

Now, if our Government bond indebtedness was something like \$50 billion, possibly the free market forces would operate, but not when the public debt is as big as it is today. I have asked Mr. Eccles that question when he was Chairman; I asked presidents of the Federal Reserve banks that question; and I asked Mr. Martin that question,

and not one of them has ever said in a huge national debt that there is a free market in Government bonds.

There can't be. The interest rate is fixed by the Federal Reserve bank itself. This is something that no one can dispute.

The cost of servicing the national debt is advancing faster now than we will ever be able to catch up with it by passing tax laws. We just can't do it. The Federal Reserve is of course operating in a way just like Robin Hood acted except in reverse.

Robin Hood, it is said, would take from the rich and give to the poor. The Federal Reserve, however, takes from the poor and gives to the rich. The Congress of course is responsible for this and should do something about it. The Federal Reserve Bank of New York runs the Federal Reserve System. These other banks are just like branches. They have no power to amount to anything. They have about 20,000 people working in the Federal Reserve System but the bank of New York runs the show entirely.

None of these other 11 district banks can even make a condition statement unless the Federal Reserve Bank of New York first gives them the information. They have all the information.

The other 11 Federal Reserve banks don't have any, so it is run by the New York bank. And of course it is supposed to be under the Federal Reserve Board, or, to be more correct, it is the open market committee, and the open market committee is composed of the seven members of the Board and 12 presidents of Federal Reserve banks.

Those 19 fellows get around the table and fix the supply of money and determine interest rates.

Now, who are these 12? We will take the one in New York. He is just like all the other 11. He is elected by the directors in that bank. Who are the directors in that bank? Six of them are elected by the banks themselves, by the banks in that Federal Reserve district. They elect six of them and those six can run the entire show. The other three are appointed by the Federal Reserve Board, and they are not only in a minority position, but they must have had tested banking experience or the Federal Reserve Board cannot appoint them on that Board.

So, in effect, you have nine bankers running that Federal Reserve Bank of New York. It is the same way in all the other banks. The bankers have the majority of the directors and with this tested bank experience they have in effect a hundred percent of them now.

High interest rates, Mr. Chairman, should concern this committee a lot and I know it does. I know the members of this committee are conscientious and sincere and will do what is best in the public interest, but I invite your attention to the fact that the small businessman is going more and more out of the picture.

Over the years we have tried to help him. We have arranged to get loans made to the small businessmen up to an amount that would not let them get into a big business to compete with large business but can compete among themselves. We furnish them a little money to do that, but there is no source of funds for big money.

You know, there are a lot of mergers going on and a lot of good people are being displaced, people who have knowledge and ability, and they can go into a business and be in competition with some big concern that is charging too much to the consumers now, but they have no source of funds to go to. They have all been wiped out.

The RFC was the last. It helped a lot of pretty good size concerns, but they have been wiped off the face of the earth and now every one of these big boys you will find, people interested in all the different industries, manufacturing industry and others, all over the Nation on these boards.

It is not possible for an independent group to get substantial money from that source to go into business in competition with a big concern. If they could that would help the consumers because it would give us lower prices.

The Federal Reserve should assume its responsibility and fix lower and lower rates instead of higher and higher rates. They are going higher all the time.

Mr. Chairman, I am available and I will be glad to try to answer any question that is posed, but I do want to seriously insist that of all times this is one time we have to do something about interest rates. It is absolutely ruining our country. We are paying \$14 billion plus every year since William McChesney Martin went into that position in 1951, paying \$14 billion a year every year since, \$211 billion excess interest, exorbitant interest, in addition to what our country has proven should have been paid and what was done in the hardest times during the existence of the United States of America.

If we don't do that we should liquidate the Federal Reserve System.

Thank you very much, Mr. Chairman, for the opportunity of appearing before you gentlemen and I would appreciate any consideration that you give this matter. My suggestion is strictly in the public interest. Some people say that I am carrying on a vendetta with the Federal Reserve. Of course that is just an excuse. It is not a reason. I have nothing against the Federal Reserve or any person in the Federal Reserve. They have certainly done me no wrong as far as I know, but they have done a great wrong to the public interest, and that is what I am trying to represent, just the public interest. I don't have it in for anybody.

The CHAIRMAN. Any questions? Mr. Burke.

Mr. BURKE. Mr. Patman, I think you have pointed out a real serious problem here in the Nation when we realize that the Federal Reserve is exacting \$14 billion a year in interest.

Mr. PATMAN. Excess actually.

Mr. BURKE. And I recall when Mr. Martin was testifying before this committee I asked him if it wasn't possible for the Federal Reserve to exert a little patriotic effort and reduce that charge to the Federal Government.

With all the people in this country who are being asked to pay an additional 10 percent surtax as well as corporations, I think the Federal Reserve will have to come to some understanding with the people of America. Fourteen billion dollars a year is too much to exact from the pockets of the taxpayers of this country, and, while I do not agree with everything that you have said, I do agree with you on his part that \$14 billion is an exorbitant interest rate to be taking out of the Government. In a period of 20 years it will practically equal the present public debt, and the question is how long can the taxpayers of this country afford the luxury of this \$14 billion debt that they are paying to the Federal Reserve System.

I think that there are steps that the Federal Reserve could take to reduce this interest charge.

Mr. PATMAN. Mr. Chairman, may I extend my remarks and insert the bill that I have offered in connection with this, and I would like to have consideration of the subject in connection with this tax bill that you have right now.

(The bill referred to follows:)

H.R. 12250

A bill to provide for the issuance of nonnegotiable United States bonds to finance certain defense expenditures for the duration of the hostilities in Vietnam, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. The Secretary of the Treasury may issue to Federal Reserve banks nonnegotiable, non-interest-bearing bonds the principal of which shall be repayable in annual installments equal to 2½ per centum of their face value. The principal amount of such bonds issued by the Secretary in any fiscal year shall not exceed the amount by which national defense expenditures for that fiscal year are greater than such expenditures for fiscal 1965. The provisions of section 14(b) of the Federal Reserve Act (12 U.S.C. 355) shall not apply to any obligations issued by authority of this Act. The authority provided by this Act expires upon the determination by the President that the United States is no longer engaged in hostilities to protect the independence of the Republic of South Vietnam.

Mr. PATMAN. And may I answer briefly what the gentleman from Massachusetts said.

The banks are not responding to the public interest in this war because when we were escalating the war; that is, when they raised the interest rates 37½ percent, and now they don't want to make loans to deserving students and we need their skills at reasonable rates.

They would permit loans to be made to them at 6 percent interest, but the banks for all practical purposes have gone on strike against the students and they are demanding rates now that would come up to an effective 15 percent before they will get into this campaign and that is wrong. They are not responding to the public interest.

It is the bank's duty to work in the public interest. They are getting the use of the Government credit free. What more could you let them have?

In addition to this you have heard about these arms shipments and sales to foreign countries and that the Export-Import Bank was persuaded by the administration to make some of those loans. You know why they did? Mr. McNamara said that the big banks would make these loans; they wanted to make the loans. But when it came time for them to make them they refused to make them.

And you know the reasons they gave? They wanted to make loans to people who would keep compensating balances with them.

Of course that gives them a higher interest rate and they wanted higher rates than the Government would give. That is the reason they refused to make those loans and that is the reason the Export-Import Bank had to come into the picture and help protect the security of this country by making those loans.

So there are two cases just recently where the banks have absolutely fallen down on trying to protect the public interest.

The CHAIRMAN. Any further questions?

If not, Mr. Patman, again we thank you.

Mr. PATMAN. Thank you very much.

The CHAIRMAN. Mr. Wilde? Mr. Wilde, you have been before the committee before. We have always profited from listening to you.

We appreciate your coming back. If you will identify yourself for the purposes of this record by giving us your name and capacity in which you appear we will be glad to recognize you.

STATEMENT OF FRAZAR B. WILDE, CHAIRMAN, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. WILDE. Mr. Chairman, my name is Frazar B. Wilde. I am Chairman of the Committee for Economic Development; also chairman emeritus of the Connecticut General Life Insurance Co. I should like to file with the committee a statement of position on the proposed tax increase and to confine myself to some comments consistent with that statement if that is agreeable.

The CHAIRMAN. Without objection your statement will be included in the record and you are recognized to proceed in your own way.

(The statement referred to follows:)

STATEMENT OF FRAZAR B. WILDE, CHAIRMAN, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. Chairman, my name is Frazar B. Wilde. I am Chairman of the Committee for Economic Development, as well as Chairman of CED's Subcommittee on Fiscal-Monetary and Debt Management Policy. It is a privilege to appear before this Committee to give you the results of our studies as they apply to the President's proposal for expenditure restraint and a temporary tax increase.

Almost continuous study over a period of twenty years has led us to conclude that the Federal Government through its taxing and expenditure decisions could help maintain a healthy economy by following what we refer to as a "stabilizing budget policy." This policy is designed to balance the demands of the public and private sectors with our capacity to produce at stable prices, and to provide incentives and means for increasing productive capacity. The main characteristics of this "stabilizing budget policy," which aims not only at economic stability but also economic growth and efficiency, are:

That it should aim for a budget surplus to be used for debt retirement under conditions of high employment. This is important because the surplus would add to the funds available for private investment, thereby easing the pressures on monetary policy and promoting steady economic growth. The present budget will produce a very large deficit.

That the impact of the budget should vary with the condition of the economy as a whole, being more expansive when the economy is depressed and more restrictive when the economy is booming or inflationary. The present budget clearly does not do this.

That the over-all impact of the budget on the economy should not, when combined with appropriate monetary and other policies, be so restrictive as to make attainment of high employment unlikely or be so expansive as to lead to persistent inflation. The impact of the present budget will be inflationary.

A "stabilizing budget policy" is achieved when *the government sets its expenditure programs and tax rates so they would yield a moderate surplus under conditions of high employment and price stability.* It is independent of conditions at any particular time and it does not depend on correctly forecasting the future trend of the economy. But it does require attention to the surplus or deficit that would result at high employment.

A policy that would yield a budget surplus under conditions of high employment will not actually yield a stable surplus in a fluctuating economy. The surplus will be larger in inflationary booms. In such booms the surplus can be applied to debt reduction. It can supply funds for investment and in that way it can ease the strain on money and capital markets. But there will be a deficit when economic activity is much below the high employment level. Financing the deficit will use funds that are not in demand under those conditions and in that way it can sustain income. These swings will occur automatically with variations in national income and employment because they are accompanied by variations of tax revenues and certain expenditures, such as unemployment compensation.

Except in extreme cases of inflation and recession, we believe these automatic swings are the budget's major contribution to economic stability. The deficit now facing us is so large that it is far outside the range of any stabilizing swings which would occur automatically.

Deliberate correction of the imbalance in the Federal budget is the chief tool that is now available for restoring the condition of growth at stable prices.

We have argued in earlier CED policy statements for agreement in advance between the President and both houses of Congress on a method for quickly enacting temporary changes in tax rates as a way of stopping a recession and promoting recovery or holding back excess demand and averting inflation. This would require devising some means for putting the tax change quickly into effect and for assuring its termination.

Time will be wasted in searching for an agreement between the Executive and Legislative branches of government on continuing authority for the Executive to practice a discretionary fiscal policy. For this reason, in a statement issued last December, "A Stabilizing Federal Budget for 1967," CED expressed its preference for a temporary across-the-board tax increase for the calendar year 1967 to the extent necessary to produce the desired balance in the Federal budget. We repeat that recommendation for fiscal 1968 as well.

In our December 1966 statement we acknowledged that the outlook for the economy in 1967 was uncertain. At the moment there is not much difference of opinion among the experts as to the economic outlook for the remainder of 1967 and calendar year 1968. Most economic indicators point to rising economic activity. Moreover, unlike the previous fiscal year, the Federal budget for fiscal 1968 is projected to have a \$15 billion deficit on National Income and Product Account. We are especially anxious that the government does not pursue policies which heighten the chance that total demand—both public and private—will exceed our capacity to produce at stable prices and thereby add to inflation.

We regard inflation as highly undesirable because it erodes the value of long-run, money-fixed obligations, which are so important in our economy. It poses serious hardships for the weaker groups in our society, the older retired people, for example. But it also has a substantial effect on all those who are presently accumulating fixed claims for their ultimate retirement income. Since pension plans comprise a part of compensation for a large portion of the population, the impact of inflation on our economy is widespread.

In addition to its socially destabilizing effects, inflation introduces a disruptive element into our economic life. Anticipation of price increases tends to accelerate both inventory accumulation and expenditures for plant and equipment. Business firms, faced with the prospect of price increases, tend to pursue policies which only accentuate the demand pressures which cause inflation. These actions result in a rate of expenditures which cannot be sustained over long periods. Thus one of the most pernicious effects of inflation is that it tends to accentuate instability in the form of price increases, bigger increases in demand at times when capacity is over-loaded, and sharper declines in demand and output and employment when the speculative character of the demands is realized and the inventory and plant and equipment accumulation cannot be sustained. Rapid inflation brings the worst of both possibilities—accelerating price increases followed by substantial declines in output and employment.

With the economy operating near the peak of its capacity in human resources and efficient plants, it is especially important that the Federal Government examine its spending plans with extreme care. As we said in our statement in December, "This Committee believes that holding down the rate of government expenditure growth would be preferable to raising taxes as a way of achieving the necessary surplus; temporary tax increases tend to remain in effect and the revenues they generate tend to be absorbed in permanent spending programs."

To realize those reductions in spending which are possible, the President must exercise restraint in his recommendations and the Congress must exercise similar restraint in its authorizations. In addition, the President should be free to use his discretion over the timing and amount of expenditures which are controllable by him under law.

A review of economic developments since the acceleration of military activity in Vietnam may be useful to understand our arguments in favor of an increase in taxes and a reduction in expenditures.

The rise in the military demand upon the national economy associated with the Vietnam War began in the middle of 1965. By the first quarter of 1967 the value of resources being devoted to military purposes had increased about 40 per cent above the rate of early 1965; part of this increase resulted from rising prices.

The rise of military production came in an economy whose total output was rising rapidly, so that while the value of defense production rose by about 40 per cent, it rose by only about 26 per cent as a proportion of total output.

The defense build-up was superimposed on an economy in which there was some slack, but not very much, and the slack was already being reduced by the expansion then under way. The defense build-up immediately accentuated inflationary tendencies which were already in evidence. The increased production and incomes resulting from the defense expansion caused further expansion of private investment in plant and equipment and in consumption expenditures. Even though real output continued to rise at a substantial rate—5.9 per cent from the second quarter of 1965 to the second quarter of 1966—it could not keep up with the acceleration of spending, and the rate of price increase jumped.

The absorption of resources for defense was not so large as to slow down significantly the rate of growth of the supply of non-defense goods and services. However, the real output available for non-defense use could not grow as rapidly as non-defense demands were growing, especially as these demands were being stimulated by the defense program itself. Some of the demands could not be met in full, and this raised a problem of priorities—of which demands should be met and which should not. This problem was not met explicitly and positively, at least at first. It was met negatively. The failure to take steps to restrain consumption and government non-defense expenditures made it almost inevitable that real investment and net exports (the excess of U.S. exports of goods and services over U.S. imports) would be squeezed down. The impact on net exports came first, partly because the booming, inflating U.S. economy sucked in more imports and partly because the Vietnam operations themselves increased overseas expenditures.

In the second half of 1965 total private fixed investment—in business plant and equipment and in residential structures—continued the rise that had been under way before the Vietnam build-up began. However, after the first quarter of 1966, investment ran into a growing insufficiency of savings, which was later accentuated by the absorption of part of the savings to finance a growing government deficit. The pressure of investment demand against the supply of savings available for private investment caused interest rates to rise. Higher interest rates restrained total investment, but some kinds of investment were held back more than others. Between the first quarter of '66 and the first quarter of '67, total fixed investment (excluding inventory) declined from \$94.5 billion to \$90.2 billion (1958 prices, annual rates) and from 14.9 per cent to 13.8 per cent of the real final product. But until the first quarter of 1967 this decline was entirely concentrated in residential construction which fell from \$22.3 billion to \$16.8 billion. Other fixed investment, mainly business plant and equipment expenditures, rose both absolutely and relative to available output throughout 1966. While wage and other cost increases were a factor, the larger part of this decline in construction resulted from the greater sensitivity of residential construction to interest rate increases and from the institutional structure of the financial system, which tended to divert funds from housing as savings become scarcer. In the fall of last year the government made an attempt to shift part of the impact of the shortage of savings on to plant and equipment expenditures by suspending the tax credit for business investment. Partly because of this, but partly also because profits had levelled out and for other reasons, business investment declined in the first quarter of 1967. Indeed, the prospective rate of growth of private investment was so reduced that the government restored the investment credit in the spring of 1967.

In sum, it may be said that while the Vietnam effort was not so large as to cause any severe hardship in real terms in the domestic economy, the consequences of the policy actions and inactions of the build-up period up to early 1967 were a degree of inflation and a concentration of the real impacts on fixed investment and on net exports. Obviously, these impacts were not desirable.

On any reasonable assessment of the growth of public and private demands for output in the remainder of 1967 and 1968, the supply of saving available to finance private investment after financing a Federal deficit of about \$15 billion will leave little room for increases in private investment from current levels. The competition of a large Federal deficit with rising demands for saving to finance private investment will tend to make interest rates high and this will have the effect of holding down private investment.

In the first half of 1967, however, monetary and credit developments have been very expansive. Federal Reserve credit has expanded at a 15 per cent rate per annum since December 1966 in contrast with a 10 per cent annual rate from 1964

to 1966; total member bank reserves have increased at a 10 per cent rate since December compared with a 4 per cent average annual rate in 1964 to 1966; the money supply has increased at an annual rate of 7 per cent since December 1966 compared with a 4 per cent rate in the period 1964 to 1966. Despite these expansive influences the enormous demands for credit swollen by the huge Federal deficit have pushed long-term interest rates to the levels attained in the summer of 1966.

Thus the lack of sufficient restraint in the Federal budget has resulted in the worst of several circumstances—interest rates are back at their historical highs, and the saving necessary to finance the private investment which will expand our capacity to produce is being absorbed by a huge Federal deficit. Furthermore, the recent rapid increases in bank credit and the money supply point to the prospect of subsequent excess demands relative to our capacity to produce.

All of these circumstances call for a concerted effort to reduce Federal expenditures and for an increase in taxes. It is for these reasons that we support a substantial tax increase.

In supporting a tax increase, we are aware that all economic projections are uncertain. At the currently high level of total private demand, the more stimulating the fiscal and monetary policies we pursue, the larger is the chance that it will fall short.

The costs of excessive demands are clear and substantial. Pressures for wage increases are already strong and will only be increased by further rises in prices. Monetary policy has been strained to the extreme in late 1966 and it would be unwise to take actions which raise the possibility of the need for another very restrictive monetary policy in late 1967. The balance of payments position of the United States would also be adversely affected by a renewal of inflationary pressures. If prices continue to rise, exports will be diminished, and, with delivery times lengthening for domestically produced goods, imports will once again grow sharply. Cost increase, i.e. wage increases, price increases or interest rate increases, become institutionalized as a permanent part of the economic structure. For all these reasons excessive demands leading to renewed price inflation in 1967 and 1968 would be most detrimental to both our short-run and long-run objectives.

There are undesirable consequences of a level of Federal spending and taxing which results in insufficient aggregate demands, and CED has consistently recognized this—most recently by supporting the tax cut of 1964. An obvious and undesirable consequence would be unemployment. In addition, the profitability of investment would decline, adversely affecting investment and our capacity to grow. If later it appeared that total demand was rising less than is now widely anticipated, the depressing effects of insufficient demand could be offset by prompt actions to reduce taxes, to move toward greater monetary ease, and to restore currently deferred but desirable public expenditures.

Thus the damages from a too expensive fiscal policy would be substantial while at the moment the risks of potential under-utilization are small, in large part because of our ability to respond. This strongly suggests that the appropriate fiscal policy for 1967 and 1968 is one which exposes us to only a very small chance that total demands will exceed our capacity to produce at stable prices.

It is such a balancing of risks which leads us to recommend:

(1) a substantial reduction in presently projected government expenditures; and (2) an across-the-board tax increase of the simplest character that makes no changes in the fundamental tax structure.

The swing of the Federal budget from a surplus at an annual rate of nearly \$3 billion in the first half of 1966 to a budget deficit at an annual rate of \$13 billion in the first half of 1967 represented a fiscal stimulus which we have not experienced since the Korean War. If the deficit is maintained at its current rate we run the risks of excess demands and price inflation. But to attempt to redress the balance by taking actions to achieve a moderate surplus in 1968 would overly expose the economy to the risks of recession. It is our firm conviction, however, that over longer periods the path of fiscal prudence is to pursue the often enunciated CED budget rule of setting expenditures and revenues so that at high employment we attain a budget surplus of some \$3 billion.

Mr. WILDE. To appear before this distinguished committee with a recommendation for a tax increase is an unpleasant duty. The present corporate and personal income taxes are too high for the best growth and success of our society. Reform in the tax structure may be needed,

but, unfortunately, our present fiscal condition, growing Federal debt, and the need for prompt temporary action make it unwise and impossible to consider any important changes in our basic tax structure.

We should recall as a matter of record that our economic history shows clearly that in the long run the economy is more efficient and more productive with tax cuts and a lower tax structure than we now have to bear.

The reason that the economy is more efficient with lower taxes is no mystery. Our society is made dynamic through the profit motive. If individuals and businesses are allowed to retain a larger percentage of the reward for their skills and the use of capital, the whole society benefits. It is just as fundamental and just as simple as that.

Let us remind ourselves that tax cuts have proved the way to more employment and growth. This was first demonstrated in the twenties. Failure in 1957 and 1958 to make a tax cut was one of the reasons for our slow rate of progress. The reduction in taxes in 1964 was an important reason for the development that followed. To argue that we should return to a high tax basis because we once had one is bad reasoning.

Why does CED recommend a tax increase in the face of this history? We do it in the context of a present fiscal and monetary situation which is compelling despite the harm that high taxes do in the long run. Since the winter of 1965-66 our country has had high employment.

Various CED studies since 1947 have concluded that under such conditions the Federal budget should produce a surplus and not a deficit. Again, under the given conditions by far the better choice is reduction in expenditures rather than a tax increase. Neither action has been taken.

CED recommended in December 1966 that if the administration and the Congress could not find a way to reduce or postpone expenditures, the unpleasant choice of a temporary tax increase should be made. The tax increase was recommended strongly on a temporary basis with an early terminal date. It was urged that the tax increase be of the simplest character with no changes in the fundamental structure. This action was not taken, and as a result much harm has been done to the economy, especially to the price structure.

A tax increase promptly enacted cannot do all the things we need in terms of avoiding further damage to the country. A tax increase may not restrain inflation unless other measures are taken.

We are confronted with wage and other cost increases of great dimensions. A tax increase will not guarantee that we will have lower interest rates for the reason that today's interest rates are influenced by the inflationary threat and liquidity preferences and not solely by the supply of and demand for money in the current market.

In other words, interest rates, while basically reflecting supply and demand, reflect the deterioration which is possible in the future buying power of money. The relative shortage of mortgage money reflects this as well as the serious increase in land prices and the wage demands of the building trades, all of which are handicapping housing development.

A temporary tax increase may help but will not solve the problem of the country's balance of payments. Other things must be done.

With this catalog of limited gains, why should we advocate a tax increase? We should do it for three reasons.

(1) It will make whatever deficit we have to handle less than it would otherwise be. This is particularly true if we are courageous in the restraint of expenditures.

In the President's message to the Congress on fiscal problems he cited expenditure restraint as the No. 1 item. The Congress is the body that controls purse strings. There are no public expenditures until final action by the Congress.

Congress has the power to modify or change legislation on the books. Congress today has a serious responsibility. The public at large, as distinguished from certain pressure groups, expects that it will respond in a way which will affect the overall problems of all of our citizens.

(2) It would be an act of discipline which our democratic society needs to impose upon itself. While this is an intangible, it is of great consequence. We have for some years now accepted the new economics theory that annual balancing of the budget is unrealistic and even undesirable. It has been the consensus that over time there should be balance and under CED theory some surplus. Unlimited increases in the public debt are not accepted even by most of the disciples of the new economics.

(3) By showing ourselves and the rest of the world that we have the character to impose an unpopular tax increase, we will do much to maintain economic soundness in our affairs and help preserve world faith in our dollar.

It may and should help us face up to our other problems, namely, the establishment of expenditure restraint and determination of priorities as long as we have the war in Vietnam. We are undertaking tremendous responsibilities not only in Vietnam but in the rest of the world. We are struggling with important domestic programs.

We have to make choices because our economy cannot do all things for all people at this point in time. There are areas of relative priority. These we should determine and act accordingly.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Wilde, we do appreciate your comments on the matter before the committee. We appreciate your coming to the committee, Mr. Schneedebeli.

Mr. SCHNEEBELI. Mr. Wilde, I always appreciate so much getting your testimony. I think your logic is very impressive.

A specific question. In the event the 10-percent surtax was approved what time interval would transpire before it would have much effect on either inflation or the tight money market? How long would it have to be in effect to be of any value?

Mr. WILDE. You are asking about the timelag, so called?

Mr. SCHNEEBELI. Yes, sir. What is your interpretation of the time lag that would ensue before it could be effective?

Mr. WILDE. Well, to repeat, Mr. Congressman, we have two matters to influence the price structures. One is expense reduction, which could be started at almost any time, and the second one is the impact of withdrawing from the spending stream the 10 percent from individual taxpayers.

It probably starts in part pretty soon because people anticipate and buy so many things on time that they might refrain from doing that, so it could start within a relatively short time from the enactment of a 10-percent increase.

The full impact of it will depend on how much is canceled out by wage increases and other activities, but it would carry on for as long as the law was in effect.

However, the exact measure of this pressure I wouldn't be a good enough statistician to be specific about.

Mr. SCHNEEBELI. Would it take 3 months? 6 months?

Mr. WILDE. I think so.

Mr. SCHNEEBELI. You make a statement here on the bottom of page 3 under (2):

We have for some years now accepted the new economics theory that annual balancing of the budget is unrealistic and even undesirable.

Whom do you mean by "we"? Not CED certainly?

Mr. WILDE. Well, the "we" in this case refers to two groups, specifically CED, and broader than that. There is almost a majority of some dimensions in this country among the economists because most of them adopt the Keynesian approach philosophically. They differ in degree.

I did mean CED and a somewhat broader group.

Mr. SCHNEEBELI. Are you stressing "annual" rather than "cyclical"?

Mr. WILDE. Yes.

Mr. SCHNEEBELI. You believe in a cyclical balancing of the budget don't you?

Mr. WILDE. Yes; we do.

Mr. SCHNEEBELI. I am afraid that one sentence might be misinterpreted, but you do believe in a cyclical balance and even a surplus.

Mr. WILDE. I do very much.

Mr. SCHNEEBELI. I do too. Being from New England I would have suspected that you would too.

Mr. WILDE. It is more than that. It is really fundamental. I don't think you can spend yourself through deficits with perpetual success in our kind of a society.

Mr. SCHNEEBELI. Thank you very much.

The CHAIRMAN. Mr. Conable.

Mr. CONABLE. Mr. Wilde, earlier you were here and heard the testimony of our colleague, Mr. Patman, and I don't want to put you on the spot about it, but do you feel the market does or doesn't affect interest rates? I wonder if you could give us more of your views on that. In your business you have been very much concerned with interest rates I am sure.

Mr. WILDE. The interest rate dialog is a very complicated one. The distinguished Congressman from Texas has a certain theory about it. I would wonder very much whether it reflected the solid facts of life.

The idea that man has the power through any institutional instrument—ours happens to be the Federal Reserve System—that you can produce through an institution all the money you need for all the expansion that you want to have at a given point of time isn't borne out by history and it doesn't stand up in fundamental analysis.

The ability to run a capitalistic society successfully arises out of the production of wealth and the saving of some of it for useful purposes. In the meantime you can generate the so-called paper money credit through the operations of the Federal Reserve to help ease strains, but you can't carry it too far.

If you go too far your money becomes suspect not only by yourself but around the world and, as I have pointed out here, the present interest rates of 6 percent plus represent partly the cost of money and partly a hedge against deterioration in the value of that money.

This is why money rates are so high in the rest of the world, because they have a more inflationary situation than we do. Here is Europe, an old and strong area in resources, but by their own practices in the past they have an interest rate structure for long-term money that runs around 8 percent today. Yet they are strong countries, but they have been guilty of inflationary excesses, and the public doesn't want to lend money long and nothing that a central bank can do can change this fundamental fact. There are lots of people in this country who think that this is a manmade result to have higher interest rates and a scheme generated by self-seeking bankers and other financial institutions. It is not as simple as that.

The CHAIRMAN. Mr. Bush.

Mr. BUSH. Mr. Wilde, yesterday Mr. Meany testified before the committee. I am not sure whether you are familiar with his testimony but there was a good deal in the paper on it.

Did you have a chance to read any of that?

Mr. WILDE. I read the highlights, Congressman, of Mr. Meany's testimony in the paper this morning.

Mr. BUSH. My question was what would you say is the major point of difference between what the CED recommends and his testimony yesterday?

Mr. WILDE. Probably the major difference is the theory, which I deplore and regret, that some people have, apparently including Mr. Meany—I am quite surprised—that you can raise taxes in our type of society to very high levels and accomplish economic progress, reduction of deficits, and the payment of your bills currently. All the studies show that the higher brackets produce a minimum amount of money and in the actual operation of high taxes, whether they are corporate or personal, you get a diminishing return and a lowering of efficiency in our kind of society, and nobody ought to realize it better than the labor folks because they only have to look across the seas and see a great country like England where socialistic theories and taxation, have pushed this nation to a weakened condition.

Our tax structure, as I have testified, is too high now for peacetime, but to try to push it up still further isn't good economics and it isn't good public policy. It isn't even fair.

Those who contribute the most even in these strange times should have something more, and when you increase personal taxation to more than 50 percent you have a bad psychology and you have an inefficient kind of society with people standing around trying to find ways to beat the tax law rather than to pay their taxes or produce more for the country's good.

Mr. BUSH. Thank you.

The CHAIRMAN. Any further questions? Mr. Curtis.

Mr. CURTIS. Thank you, Mr. Chairman. I want to apologize for not having been present when you made your statement, Mr. Wilde. I have had a chance to read it. I was pleased to note the recommendation that you have is twofold—one, substantial reduction in presently projected Government expenditures, and, two, and across-the-board tax increase.

What I am afraid this committee and the Congress is faced with is an administration that wants only a part of that package. They want a tax increase, but don't want to do anything about reducing expenditures.

What would be your judgment if we were presented with a situation where there were no substantial expenditure decreases? Do you think a tax increase would be beneficial?

Mr. WILDE. Well, I would have to deplore the situation, and as I read the President's message he said this fiscal program starts with expenditure restraint.

Mr. CURTIS. He says it in words, but when it comes to figures it just isn't true. He gave us a figure of \$135 billion in expenditures for fiscal 1968 in the January budget message. The testimony of the Secretary of the Treasury and Director of the Budget before us when we went into it reveals that that figure now is probably around \$144 billion, so he may talk one way, but this is not expenditure restraint.

It is the reverse. In 6 months they revise their expenditure estimates for fiscal 1968 from \$135 billion to \$144 billion.

The question with these figures which show no reductions in expenditures, but actual increases, is what would a tax increase do? Would that be beneficial?

Mr. WILDE. Well, it is obvious that if there isn't expenditure restraint the deficit would be larger and hence the tax increase would be less effective, but it will do some good for the reasons that I have outlined in my short comments here.

Mr. CURTIS. That is what I was getting at. I wonder if it does any good to increase taxes. I will put it this way. I was pleased to note—at least I think I note this—that you were saying the size of the deficit itself creates the basic problem.

Am I paraphrasing your statement correctly?

Mr. WILDE. Yes.

Mr. CURTIS. And I agree with that. Then the question is, let's say, it is a \$30 billion deficit. You can finance a deficit three different ways in any combination—sale of capital assets, increase tax revenues, or debt financing—but it seems to me that with a deficit the size of \$30 billion, the very size is going to create damage, however you finance it.

In fact, I can't quite see what difference it makes whether you have a tax increase as part of the financing mix. I think the damage through the sheer size is going to outweigh any consideration like that. At least I pose that for your comment.

Mr. WILDE. Well, this is an old question that has been raised in many categories, including personal conduct. This is in a very large theater. I still think that it would be desirable to have a tax increase, producing \$5, \$6, \$7, or \$8 billion, even if we didn't do what our duty clearly calls for, but it is arguable.

Mr. CURTIS. I am not talking about duties. I am trying to keep the discussion in the area of economics and concentration what the effect of a deficit that large would be.

Now I notice an assumption in your statement that the increase in the tax rates will increase revenues. This is another thing that the committee has been trying to look into.

Given the economic climate we have, given the tax rates—and I share your view that they already are too high—will increasing the

rates actually increase revenues, or might increasing the rates produce an economic downturn whereby we would end up with less revenue? What about that?

Mr. WILDE. This is a fair question which has been posed in the dialog and in the press. There is a very strong consensus that the forces for forward motion cannot be slowed down importantly by a 10 percent or other tax increase.

Mr. CURTIS. You think there is a consensus on that? I was not aware of any. I know there are some who argue that, but I also heard others who argue differently.

Mr. WILDE. All of the economic forces tend to suggest that we will go forward even if we have a tax increase.

It may slow it down, but the reason that CED talks about short-term changes is not fine tuning, but we talk about a 1-year program, for example, so that it has to be debated before the end of 1 year. It can be taken up, of course, by the Congress earlier.

Mr. CURTIS. Let me direct one more line of questioning. Is it the theory of the CED that increasing the tax rate would assist in holding down inflationary forces? Is that one of your theories?

Mr. WILDE. We feel it would be a contributor to restraint of inflation, but not a complete answer.

Mr. CURTIS. Well, let me pose this question then, as I posed it to Mr. Meany: It gets back to what I understand the position is of those who question the advisability of the tax increase. We are experiencing inflation right now. In the last month, the CPI went up 0.4. It has gone up 0.3 and 0.3 before that. Most people that I have listened to identify this as cost push inflation, not demand.

Now if this is the kind of inflation that we have and with the forces that are already in existence, and we superimpose this deficit on top of it, isn't it entirely possible that a tax increase, which would add to cost, would strengthen the inflationary forces, or at most only have a neutral effect?

Mr. WILDE. Well, obviously if all of the cost increases which come along are going to be passed on, if nobody is willing to accept the problems of the country today, you will have a cost-push inflation no matter if you do have a generous—and we do have a very generous—monetary policy.

Mr. CURTIS. Yes.

Mr. WILDE. In fact, may I say something on that?

Mr. CURTIS. Certainly.

Mr. WILDE. In my formal statement you will find figures showing the tremendous increase in the monetary supply which the Federal Reserve has permitted and encouraged in 6 months. It is bigger than anything we have had in years. It is really spectacular.

Mr. CURTIS. I know that and this is the very point I made to Mr. Meany yesterday where he talked about a tight money policy, and I said the figures reveal just the opposite, just as you are presenting. This again points out that this isn't a demand-type inflation.

In fact, one of the things with this economic slowdown is that utilization of plant capacity has gone down, so again I think the economic problem that faces this committee is what does a tax increase do to a cost push type of inflation.

The administration has argued for a tax increase to dampen what

would be actually a demand-type inflation, which doesn't seem to be the issue. As I understand, some economists have said that they don't think that a tax increase is the proper medicine.

Mr. WILDE. Well, of course, Congressman, as you know, finally somebody has to buy something and this is done through money and credit, so if they have less money and credit to buy something, then the cost push will not be as influential, but it will be there.

Mr. CURTIS. But the remarkable thing to me in our economy is the development of discretionary purchasing power. The economists now are following that and measuring it. This is a unique thing, I would say. It is something new in economic concepts. Our previous theories of economics, as I understand, were based on an economy of scarcity.

We are moving into a different kind of situation and I would say discretionary income is a pretty good indication of this, so it may be that people will buy in spite of these things.

On the other hand, they may not. Savings rates increased notably in the past year or so. I suppose they could increase more. I don't know.

Well, I wanted to examine some of these things with you because I certainly appreciate the great work your organization does and your willingness to come before this committee and give us the benefit of your judgment.

The CHAIRMAN. Thank you, Mr. Wilde, for coming to the committee again.

Mr. WILDE. Thank you, Mr. Chairman and gentlemen.

The CHAIRMAN. Mr. Bryant. Mr. Bryant, we will ask you to please identify yourself for the record by giving us your name and capacity in which you appear.

STATEMENT OF F. LEONARD BRYANT, MANUFACTURING CHEMISTS ASSOCIATION; ACCOMPANIED BY JAMES MORTON, DIRECTOR OF GOVERNMENTAL RELATIONS; MICHAEL PANCINI, MEMBER, TAX POLICY COMMITTEE; AND RAPHAEL SHERFY, COUNSEL TO TAX POLICY COMMITTEE

Mr. BRYANT. Thank you, Mr. Chairman and members of the committee. My name is F. Leonard Bryant. I am chairman of the board of directors of Hooker Chemical Corp. I am appearing before you today in my capacity as a representative of the Manufacturing Chemists Association (MCA), a nonprofit trade association with 185 U.S. member corporations, large and small, which account for more than 90 percent of the Nation's chemical productive capacity.

The American chemical industry contributes \$39 billion to the gross national product and employs nearly 1 million workers.

With your permission, I have with me today a few associates. On my right Mr. Morton, director of governmental relations for MCA; on my left Mr. Pancini, a member of the tax policy committee of MCA; and Mr. Sherfy, who is counsel to the tax policy committee.

The CHAIRMAN. We are pleased to have you gentlemen here with Mr. Bryant. Mr. Bryant, you are recognized.

Mr. BRYANT. Thank you, sir. We appreciate the opportunity to address you today. I will follow pretty generally the prepared statement

which was submitted to your committee yesterday with a few remarks in places for clarification.

Our association has given careful consideration to the administration's tax proposals made by President Johnson on August 3, 1967. In brief, our recommendations, which will be discussed in detail are as follows:

(a) The administration should make a substantial effort to effect a percentage reduction in nondefense spending equivalent to the percentage of surcharge imposed on the public. This should be done as a corollary measure recognizing the Government's responsibilities as well as the private citizen's, in bearing the cost of war and in lessening the danger of inflation.

(b) Any surcharge should have a definite termination date, be kept as low as possible, and should apply equally to individual and corporate tax liabilities.

(c) The effective date of a surcharge should be January 1, 1968.

(d) A surcharge should be applicable to net tax liabilities after allowance of the 7-percent investment credit and foreign tax credits.

(e) No change should be made in the present estimated tax requirements of corporations, and accordingly the following Presidential proposals should be rejected:

(1) Elimination of the exemption of the first \$100,000 of corporate tax liability from the requirements of payment on quarterly estimated basis.

(2) Increasing from 70 to 80 percent the amount of the estimated tax which must be paid in installments during the taxable year.

Current economic conditions have had a significant adverse effect upon corporate earnings during the first half of 1967. A recent survey of 528 corporations published by the Wall Street Journal on July 28 disclosed that after-tax profits in the first quarter fell 6.4 percent, and those in the second quarter fell 8.1 percent, below the amounts reported in 1966.

In the case of our own industry, the chemical industry, first-quarter earnings as reported by the Department of Commerce were \$786 million for 1967 as compared to \$847 million in 1966. This represents a decline of 7.2 percent for the first quarter of 1967 from the first quarter of 1966.

The figures for the second quarter for chemicals and allied products are not available but from all indications, this decline in earnings was greater in the second quarter than in the first quarter.

While we realize that in recent days statistics released by the Government indicate that an upturn has started in the economy, we do not believe that it has yet commenced in the chemical industry. We have just not seen the upturn in the chemical industry.

Recently the top executives from 13 firms producing chemicals, drugs, and cosmetics met with Government officials, including Secretary of Commerce Alexander Trowbridge. They informed Mr. Trowbridge that they did not see any immediate evidence of an economic upturn.

Furthermore, we believe that even though the economic uncertainties are resolved in the fourth quarter on a favorable basis, it is highly unlikely that corporate earnings for the full year 1967 will attain their 1966 levels, especially in our own industry.

Substantial increases in State and local taxes, together with a probable increase in the social security tax, will further reduce corporate earnings and cash reserves in the future.

At the same time we are acutely aware of the sacrifices being made by our servicemen on the battlefields of Vietnam. It is essential that our Armed Forces be provided with all resources which are necessary to bring that conflict to an honorable and just conclusion within the shortest possible period of time.

Similarly, we recognize that certain prior financial commitments, such as those for interest on the national debt and for previously approved projects, cannot be eliminated from present budgets.

These commitments, of necessity, create limiting factors on the ability of the administration to curtail spending.

Nevertheless, it must be recognized that in recent years nondefense expenditures have risen at an alarming rate, and Government civilian employment has substantially increased in the past 3 years. This spending fueled the inflationary fires at a time when industry and labor were being asked to practice restraint.

In view of these factors, before any tax increase can be justified, it is incumbent upon both the administration and Congress to scrutinize meticulously current appropriation requests and expenditures in order to eliminate waste and to hold down expenses wherever feasible.

In this connection we applaud the administration's announced efforts to eliminate \$2 billion of expenditures from the nondefense portion of the budget.

However, we do not feel that this action goes far enough. As we indicated earlier, the administration should make a substantial effort to effect a percentage reduction in nondefense spending equivalent to the percentage of surcharge imposed on the public.

Without specifically terminating some of the projects which have been determined essential on a long-range basis, efforts should be made to extend or defer such projects over an additional period of time in order to draw out, and thus reduce, current expenditures.

President Johnson's message of August 3 and the testimony of the administration's representatives last week indicate the dangers inherent in creating deficits of the magnitude stated therein. However, the President's proposal for a 10-percent surcharge recognized that a substantial portion of the deficit will remain with us despite the proposed increase in taxes.

Our association is keenly aware of the inflationary effect that substantial deficits might have on the economy and fully endorses all efforts directed toward its reduction. It fully recognizes that serious attempts at curtailments of expenditures probably will not be adequate to eliminate deficits of the magnitude which the President has predicted and that increased taxation is unhappily necessary.

Thus, the Manufacturing Chemists Association would like to take this opportunity to endorse the President's proposal for a surcharge with the following suggested modifications:

1. Any surcharge enacted should be of limited duration with a definite termination date.

The economic improvement following the enactment of the tax reductions contained in the Revenue Act of 1964 provides substantial evidence of the economic benefits flowing from lower taxes.

The adverse results which followed the suspension of the investment credit also indicate the severe economic effects which can occur as the result of a change in tax policies.

In view of these lessons, it is essential that any surcharge which is enacted provide a specific termination date so that long-range planning for economic growth and progress may proceed in an unhampered manner.

Accordingly, we support the recommendations of those who previously appeared before you and believe that a 1-year period for the surcharge merits serious consideration.

2. The rate of surcharge must be kept as low as possible.

It is reasonable to expect that a surcharge of 10 percent will have a depressing effect on the economy. To the extent that serious efforts are made to reduce governmental expenditures, the benefits of such reductions should be applied to the goal of maintaining the surcharge at the lowest possible level.

The new tax burden should be consistent with our national goals of financial responsibility and yet continued economic growth.

3. The surcharge should be applied equally to individual and corporate taxpayers.

The availability of resources with which to pay the cost of the surcharge dictates that its imposition on corporations should not be greater than that imposed on individuals.

The recent burdens placed on corporations at State and local levels, coupled with increased payroll tax burdens and speedups of estimated taxpayments, has caused a severe drain on corporate working capital.

At present, while individual savings are increasing, it has become necessary for more and more corporations to resort to borrowings to provide working capital necessary to the continued operation of their businesses. To provide a disproportionate burden on corporations could result in severe economic dislocations and should be avoided.

There is no doubt that fairness requires that the proposed surcharge should apply equally to both corporations and individuals. In other words, tax liabilities of both groups should be affected uniformly. Based upon the tables provided by the Treasury Department in its press release of August 4, it is evident that the proposed surcharge—if enacted at the 10-percent level—would reduce the tax benefits of individuals provided in the Revenue Act of 1964 by approximately half.

Providing for a similar surcharge for corporations, however, has the effect of wiping out completely the reduction afforded under the Revenue Act of 1964.

4. The effective date should be January 1, 1968.

If this proposed surcharge is enacted, it should be effective only prospectively and should not be effective before January 1, 1968, for both individual and corporate taxpayers.

This effective date would permit taxpayers to make orderly plans for the future, taking into account only prospective tax increases. We do not believe that a retroactive tax increase of 10 percent is fair. The postponement would minimize the possibility of additional tax burdens depressing the economy before a full recovery from the economic deterioration of the first half of this year.

It is our belief that the key to the success of the Government's fiscal program is its timing, and that premature action or over-reaction could knock the economy on its back before it is firmly on its feet.

5. A surcharge should be applicable to net tax liabilities after allowance of the 7-percent investment credit and foreign tax credits.

Any surcharge should be applied to net tax liabilities, after 7-percent investment tax credits and foreign tax credits. We believe this is necessary in order that all taxpayers bear a uniform and proportional increase in their U.S. tax burden.

Congress enacted numerous tax provisions to provide relief from burdensome taxation or to promote economic or social objectives.

In some instances, such relief has taken the form of a tax credit, while in other instances it has been classified as a deduction. A surcharge against gross tax liabilities would reduce the effect of this relief thoughtfully provided by tax credits.

A surcharge based upon a gross tax would partially nullify benefits intended to be granted by the 7-percent investment tax credit to corporations making additions to plant and equipment. The reasons expressed for the early reinstatement of that credit, and which were so carefully considered by your committee earlier this year, are equally applicable to the necessity for the application of any surcharge on a net tax liability basis after allowance for such credits.

Also, for example, dividends received from certain foreign corporations must, under current law, be grossed up by the amount of foreign taxes applicable thereto (thus creating additional taxable income) and a related foreign tax credit is allowed against the domestic corporation's U.S. income tax liability.

Alternatively, a taxpayer may elect to take a deduction for foreign taxes rather than utilize the credit. To apply a surcharge based upon the additional dividend income required to be reported and, at the same time, prohibit the foreign tax credit from reducing the surtax base, would result in a gross inequity, thus converting the surcharge into a disguised tax upon foreign income.

A surcharge applied before allowance of foreign tax credits and investment credits also creates the inequitable situation of increasing certain taxpayers U.S. taxes in an amount in excess of the surcharge percentage applied against other taxpayers.

For example, a corporation with a tax liability before credits of \$100 (before surcharge) and a foreign tax credit of \$20 is liable for U.S. taxation of \$80. The application of a surcharge of \$10 to the \$100 increases the liability of \$110. Reduction of such amount by the foreign tax credits of \$20 leaves a U.S. tax liability of \$90 which represents not a 10-percent increase, but a 12½-percent increase in the U.S. burden.

Further, certain domestic corporations are required to pay U.S. income tax on subpart F income or upon minimum distributions from their controlled foreign corporations (elected to minimize the burdensome provisions of subpart F).

Since these additional taxes have already placed such companies at a disadvantage with foreign-controlled competitors, any surcharge which is imposed upon this type of income, without allowance for foreign tax credits, would result in a further deterioration of the competitive positions of those U.S. companies with foreign operations.

During the 1960's the United States has been plagued by a continuing deficit in its balance of payments despite various actions taken by the Government to reverse this situation. While it has been recognized that in the long run U.S. private investment abroad has had a substantial positive effect on the balance of payments, enactment of a surcharge before allowance of foreign tax credits will have an additional depressing effect on the balance of payments.

We are of the opinion that imposition of this temporary surcharge might well result in a reduction in the amount of foreign dividends being remitted to the United States, thus having an immediate adverse effect on the balance of payments.

6. No change should be made in the present estimated tax requirements of corporations.

The administration's proposal to accelerate payment of estimated taxes should not be approved. If enacted in conjunction with a surcharge, it will cause an additional strain upon corporate cash resources, having a possible adverse effect on the economic condition of the country.

Unlike individual taxpayers, most corporations utilize the accrual basis of accounting and are already required to pay taxes prior to the collection of the receivables which created the tax liability. The previous enactments which presently require corporations to pay estimated taxes on a current basis were inequitable in this respect and resulted in extensive corporate borrowings.

The present \$100,000 exemption and the 70 percent requirement alleviates, to some degree, the inequity of paying the tax before cash from the sales transaction is realized. These provisions must be continued in the law.

To even a greater extent, the smaller members of MCA will find the proposed changes extremely burdensome. Some of these smaller businesses lack the resources required to secure extended bank loans to fund increased tax prepayments before realization of cash.

In the event that you do decide to change the 70 percent requirement to 80 percent, we have attached for your consideration, a proposed amendment, with an explanatory note, which would permit the taxpayer to more readily comply with the new requirement. This would be accomplished by liberalizing the annualization relief provision.

On behalf of the Manufacturing Chemists Association, I wish to thank you for the opportunity you gave me to make this presentation, and I urge that serious consideration be given to the recommendations we have made.

I would be glad, sir, to answer any questions and my associates would be glad to help if we can be helpful in any further way.

The CHAIRMAN. Thank you, Mr. Bryant. Without objection the material appended to your statement will appear in the record at this point.

(The information referred to follows:)

ATTACHMENT TO STATEMENT OF MANUFACTURING CHEMISTS ASSOCIATION
CONCERNING PROPOSED AMENDMENT TO SECTION 6655

Among the proposed amendments to the Internal Revenue Code made by the President in conjunction with a recommended surcharge on income tax was an increase from 70% to 80% of the amount of the corporate tax to be paid in estimated tax installments if no penalty is to be imposed. Presumably, § 26655

(d) (3) would also be amended so that a taxpayer relying on this exception in order to avoid penalty would have to pay an amount equal to 80%, rather than 70% of the tax computed by annualizing the taxable income for the appropriate period of the taxable year.

In a period of rising corporate income, a corporate taxpayer can be assured of avoiding a penalty either by basing his estimated tax on the tax paid for the preceding year or on the facts shown on the corporate return for the preceding year with the tax computed at the rates of the current year. In a period of declining profits, however, where the profits for the current taxable year are virtually impossible to estimate, a taxpayer can adequately protect itself from penalty only by relying on § 6655(d) (3). If it does so, its first installment must be determined by annualizing its taxable income for the first three months and paying $\frac{1}{4}$ of 70% thereof. Thus, the taxpayer has a period of 15 days from the close of its first quarter to prepare its accounting statements, to translate book income into taxable income and to compute its available investment credits and foreign tax credits. Since it is virtually impossible to do this with accuracy in so short a period of time, a taxpayer will generally make the best possible rough estimate which time allows and pay an amount equal to substantially more than $\frac{1}{4}$ of the 70% of the tax based on this estimate to be on the safe side. In the event that the taxpayer is now to be required to pay 80% of the estimated tax, the problem becomes much more difficult.

Consequently, it is recommended that if the 70% requirement is increased to 80%, an additional amendment be made to provisions of § 6655(d) (3) (A) which will permit the taxpayer, which finds it impossible to determine its taxable income accurately within the 15 day period between the end of its accounting period and the due date for its estimated tax payment, to make its computation based on the annualized income as at the end of the month prior to the month preceding the due date. In other words, § 6655(d) (3) (A) should be amended to read as follows:

"(3) (A) An amount equal to 80 percent of the tax for the taxable year computed by placing on an annualized basis the taxable income—

"(i) for the first 2 month or for the first 3 months of the taxable year, in the case of the installment required to be paid in the 4th month.

"(ii) for the first 3 months or for the first 4 months or for the first 5 months of the taxable year, in the case of the installment required to be paid in the 6th month.

"(iii) for the first 6 months or for the first 7 months or for the first 8 months of the taxable years in the case of the installment required to be paid in the 9th month, and

"(iv) for the first 9 months or for the first 10 months or for the first 11 months of the taxable year, in the case of the installment required to be paid in the 12th month of the taxable year.

"(B) For purposes of this paragraph, the taxable income shall be placed on an annualized basis by—

"(i) multiplying by 12 the taxable income referred to in subparagraph (A) and

"(ii) dividing the resulting amount by the number of months in the taxable years (2, 3, 4, 5, 6, 7, 8, 9, 10, or 11, as the case may be) referred to in subparagraph (A)."

The CHAIRMAN. Are there any questions of Mr. Bryant? Mr. Conable.

Mr. CONABLE. Mr. Bryant, I would like to welcome you here to Washington and give you a special greeting from one who also comes from western New York. We heard yesterday from Mr. Meany and he proposed that the surtax on corporations be substantially higher than on individuals.

Now, we have read a lot in the paper about how the surtax is going to be equal on both corporations and individuals, and yet you pointed out some things that are going to increase tax costs for corporations beyond the surtax level.

I wondered if the MCA has made any analysis of exactly what percentage increase in surtaxes the President's proposal would actually bring about? That would be something in excess of 10 percent, wouldn't

it, because of the speedup, because of the manner of handling of the credits, and so forth?

Mr. BRYANT. Without taking into account the speedup, which is really another subject and has affected our cash flow over the last few years, as you know, taking account simply of the suggestion of the President that this be calculated on the gross tax and not on the bottom line, in effect, of the return as the Manufacturing Chemists Association has recommended they did survey what would have happened in 1966 in a number of companies if the tax had been calculated that way and it varied from 11 percent up to nearly 14 percent, probably ranging from 12½ to 13 percent, as I cited in the example I gave.

This is particularly unfortunate with respect to the foreign tax credits in that the companies that will be penalized the worst by this provision actually are the ones providing the most foreign dividends back in this country and therefore making the maximum contribution to our balance-of-payments problem.

Mr. CONABLE. Mr. Bryant, I have another question. You referred to the depressed conditions in your industry and also the profit problems you have had and the falling off of profits. The result is your margins I suppose are considerably narrower than they were a couple of years ago.

Do you have any estimate at all as to the extent to which this corporate surtax is likely to be passed on to the consumers?

Mr. BRYANT. Mr. Conable, this is very hard to answer categorically because of course it would depend on the nature of the product involved and the nature of the industry, business which was selling. The competition will determine whether it can or not.

Mr. CONABLE. Certainly you have a good deal more foreign competition than other industries, which would have some effect.

Mr. BRYANT. This is a major effect today because really the competition is intensifying for the chemical industry today and the competition has been reflected in the reduced earnings that you have read about in the papers, and some of our problem in the industry has been greatly stepped up foreign competition, which of course will be further stepped up as the effect of the Kennedy round begins to be felt.

So that even though chemical companies domestically would like to do something to attempt to, at least partially, retain their margins, they will find, especially in commodities, which are the big volumes and therefore will account for most of the business, that it will be very difficult to do so I believe.

There may be some specialty situations where there may be price increases passed on, but in my judgment a very minor amount of it will be recovered by the chemical industries.

Mr. CONABLE. In higher prices?

Mr. BRYANT. In higher prices, yes, sir.

Mr. CONABLE. In other words, this is a corporate tax and not just a hidden tax on the consumer?

Mr. BRYANT. Yes.

Mr. CONABLE. Ultimately it is going to come out of the consumer, but at least for short term it is going to be paid by the corporations themselves.

Mr. BRYANT. This would be my judgment, yes, sir.

The CHAIRMAN. Any further questions?

Thank you again, Mr. Bryant.

Mr. BRYANT. Thank you, sir.

The CHAIRMAN. Mr. Ferguson, Mr. Ferguson, we welcome anybody who would be the president of a Fighting Taxpayers Association. It sounds like a very aggressive group. Please identify yourself for this record and we will be glad to recognize you.

STATEMENT OF COURTLAND D. FERGUSON, PRESIDENT, FIGHTING TAXPAYERS ASSOCIATION

Mr. FERGUSON. Thank you very much, Mr. Chairman. A group of Fighting Taxpayers Associations was formed recently because we became very seriously concerned about the increases in taxes as levied by the Government. I am president of the Fighting Taxpayers Association. I am also president of the Courtland D. Ferguson, Inc., an advertising agency. We have had offices in the National Press Building since 1932.

The Fighting Taxpayers Association has no paid employees. We are strictly a group of people seriously concerned about taxes.

The CHAIRMAN. Why don't you have a seat?

Mr. FERGUSON. Thank you, sir.

The CHAIRMAN. We are glad to have you with us and you are recognized, sir.

Mr. FERGUSON. Thank you. As president of the Fighting Taxpayers Association, I am here today to speak a word for the faceless American, the American taxpayer who has become merely a number in our computerized society.

Briefly, we should like to attempt to bring him back into focus, the man who works for a living, the man who has a family to support, the man who wants to feed and clothe them and give them decent living surroundings, the man who wants to take care of his family properly and educate his children.

This faceless American is now caught up in the throes of taxation heaped upon him by all different levels of government. Government has now become a giant octopus that has this man caught in its tentacles. The squeeze is on. Taxes from the Federal Government, social security taxes, sales taxes of all kinds, real estate taxes—think of any kind of a tax man can possibly devise today, and the American taxpayer is paying for it.

At some point, you take so much money away from the average working man in taxes that he does not have enough left to properly take care of his own family. We oppose this 10 percent surtax because we think that point has been reached. We feel it is time for Government to seek some other solution instead of piling more taxes upon the individual citizens.

For instance, Maryland has just doubled its income tax on the average working person by enacting a 2- to 5-percent-graduated-income tax and an arbitrary piggyback tax of 20 percent, which in Baltimore City is actually 50 percent.

This year, in Maryland, a man earning \$10,000 per year, with a wife and two children, with this proposed increased Federal income tax, increased social security tax, increased Maryland income tax, will have approximately \$2,000 taken right out of his paycheck before he ever sees it. When you add all of the sales taxes, real estate property tax, and miscellaneous taxes, direct and indirect, open and hidden, it is esti-

mated that a man earning \$10,000 a year will actually have only \$7,000 a year left to support his family.

When you consider that the average working person in the United States will pay 30 percent or more in taxes, we maintain that the time has come to stop increasing taxes at all levels of government. We have a Federal income tax. Now, this 10-percent surtax is actually a tax on the Federal income tax.

In the State of Maryland, we have a State income tax. In making out the Maryland income tax return, we cannot deduct our Federal income tax, and will not be able to deduct the 10-percent surtax. Consequently, in Maryland, we will have a tax on a tax on a tax.

Many people are misled about taxes on business and feel that corporations pay all the taxes on business. In most cases the corporations do not have the money to pay additional taxes on business and taxes on business are usually treated as an additional cost of doing business and passed on to the individual consumer, which means that the individual really pays those taxes too.

The high-tax road ahead can lead only to communism. It is easy enough to be complacent and say, "It can't happen here." But complacency is only a tranquilizer that clouds the view of the dangers ahead.

Communism can happen here and it will happen here if Federal Government, State, county, and city continue to increase taxes and take away from the average working person substance with which to support his own family. Communism will happen here when we reach the point where taxes are so high that Government has to take all the money a man earns and divide it up. Communism will happen here if we continue to bleed ourselves here at home financially, and abroad militarily.

We are living in a national LSD economy. It's crazy. We cannot continue forever to be both the benefactor of the world and the protector of the world and maintain the American way of life at home.

If an individual borrowed money last year, paid interest on it, gave it away, borrowed money this year, paid interest on it while continuing to pay interest on the money he borrowed the previous year, and gave it away—and kept that up, year after year, everybody would say he was crazy, and his relatives would claim he was incompetent to handle his own financial affairs and have him put away.

And yet the U.S. Government has followed this practice for years, and it just doesn't work.

We should abolish foreign aid; we should stop giving away what we haven't got. The net result is bad, anyway. It makes no sense at all to bleed the average taxpayer, borrow money, pay interest on it, to give foreign aid to communistic puppets like Nasser of Egypt—or to give foreign aid to Communist countries, or to give foreign aid to countries that are making money by shipping supplies to North Vietnam.

In retrospect, our foreign policy has not been good. We fought two wars, gave endless billions of dollars to France, and we got De Gaulle. If we were attacked today, who would be our allies? Who would fight for us and with us, regardless of the foreign wars we have fought and the endless billions of dollars that have been given away abroad?

In our LSD economy of today, the average taxpayer is beset, bewitched, bothered, and bewildered. When the Government talks about a possible deficit of \$29 billion, the average man just can't figure out

what is going on, but he knows something is wrong, he knows that something should be done about it.

This 10 percent surtax is no cure for a \$29 billion deficit. We had better attack the disease itself rather than apply a poultice. The disease is spending what we haven't got.

We propose the following for this committee's consideration and for the consideration of the Congress of the United States.

First, that a committee be appointed to make an extensive in-depth study of taxes in the United States today, as they fall upon the taxpayer from all directions in all levels of government, to learn just what the average taxpayer is paying in total taxes, to learn what is left for him to support his own family, to learn how far that money will go in support of his family. Let's learn the whole score for the future.

Second, that this committee make a great effort to do away with the concept of deficit spending as a national way of life in America.

Third, that foreign aid be abolished until such time as we can pay for it out of current tax receipts rather than out of borrowed money. Let's stop giving away what we haven't got.

Fourth, that definite action be taken on the reduction of Government spending. It has been talked about for years, but now the time has come to do it.

Fifth, that we stop shadowboxing in Vietnam and fight the war to win or get out. It seems as though \$2 billion per month and more than 500,000 young Americans is too much of a price to pay for a land that is 10,000 miles away, where we are not even sure what the people themselves actually want, where we may get the same result if we win the war as we got in China.

Sixth. As military expenditures have reached such gigantic proportions, it is logical to assume that there is great waste in multibillion-dollar purchases made during the year by the Defense Department.

Therefore, we recommend that the Congress appoint a standing Watchdog Committee, similar to the Truman Committee, that will carry on a constant search for waste in military spending.

Seventh. As the Federal Government has gotten so big, we recommend that a second standing Watchdog Committee be appointed to survey and study the regular civilian departments of the Government, to keep them from mushrooming in the number of employees and expenditures, from year to year.

Eighth. We recommend that a third standing Watchdog Committee be appointed to watch over the entire welfare operation, and to endeavor to see that welfare is not made a lazy man's paradise, but only real help for the needy, that the man who is able to work and where a job is available that he is qualified to fill, that he be made to work for a living as the average taxpayer is working for his living.

Ninth. We recommend that a special committee be appointed to study tax loopholes that may be enjoyed by special organizations, foundations, or groups of investors in special fields, to make sure that each and every one in this country pays his fair share of the taxes—that there are no tax-exempt profit-producing businesses of any kind, favoring any one special group of citizens.

It has been truly said, "The power to tax is the power to destroy." Our organization is founded upon the basic premise that we should fight to hold the line on taxes because we feel this is the only way to preserve the family life of America, to insure the future of freedom in

this country, to guarantee us that we will not continue to travel the high tax road to communism.

We invite you gentlemen of this committee and the Congress of the United States to join us in this fight. Thank you very much.

The CHAIRMAN. Thank you, Mr. Ferguson. Are there any questions? Thank you very much.

Mr. BETTS. I might just say you are a good fighter.

Mr. FERGUSON. Thank you very much, sir.

The CHAIRMAN. Mr. Mendenhall. Mr. Mendenhall, if you will identify yourself for our record by giving us your name, address, and capacity in which you appear, we will be glad to recognize you.

STATEMENT OF JOHN MENDENHALL, PARTNER, AND DIRECTOR OF TAXES, ARTHUR ANDERSEN & CO.

Mr. MENDENHALL. Mr. Chairman and gentleman, my name is John Mendenhall. I am a partner in, and director of taxes for, Arthur Anderson & Co., an international firm of certified public accountants, with home office at 69 West Washington, Chicago, Ill.

The CHAIRMAN. Thank you, sir, for coming, and you are recognized.

Mr. MENDENHALL. With your permission, I would like to submit a written statement for the record and to cover here only its major points.

The CHAIRMAN. Without objection that will be included in the record.

(The statement referred to follows:)

STATEMENT OF JOHN MENDENHALL, PARTNER, AND DIRECTOR OF TAXES, ARTHUR ANDERSON & Co.

Mr. Chairman and gentlemen, it is a privilege to be able to appear before the members of this Committee today in order to protest one provision of the recently proposed tax legislation. My name is John Mendenhall, and I am a partner in, and Director of Taxes for Arthur Anderson & Co., an international firm of Certified Public Accountants.

SUMMARY

I protest the provision that appears as Section 4 of the Treasury Department draft of the legislation and which proposes to eliminate, over a period of five years, the \$100,000 "floor" under which estimation and prepayment of corporate income taxes is not required. I protest for the following reasons:

(1) The proposal is inconsistent with the policy that led to the original adoption of the \$100,000 floor in 1954.

(2) It will be extremely difficult and expensive for small corporations to file declarations of estimated tax and make prepayments.

(3) The penalty for underpayment of estimated tax is an unnecessarily harsh remedy for an honest mistake.

(4) Smaller corporations will find it expensive to use the "escape clauses" which are more useful to larger corporations.

I am here primarily for two reasons. First, I respectfully protest this provision on behalf of my firm's many corporate clients with annual income taxes of less than \$100,000. Secondly, I am here on behalf of my firm itself. Because many of our smaller corporation clients would have to seek our advice on this matter frequently throughout the year, it would be a severe demand on the time of our own professional personnel. The time involved, as well as the cost incurred, would be disproportionate to the importance of the problem.

Actually I am here on behalf of almost all U.S. taxpaying corporations, at least a group representing probably from 80% to 85%. This is the group that is affected by Section 4 of the Treasury's draft. The Statistics of Income for

Corporation Income Tax returns for 1962 published by the Internal Revenue Service shows that almost 600,000 corporation income tax returns reflecting tax liabilities were filed for that year. Of this number, slightly more than 487,000, or 81%, showed a combined normal tax and surtax under \$25,000. Undoubtedly, these figures and percentages have changed since 1962, but I'm sure that it is still a fair statement that a very large number of corporations have annual corporate income tax liabilities of less than \$25,000 and that an even larger number have annual corporate income tax liabilities of less than \$100,000.

INCONSISTENT WITH PRIOR POLICY

The \$100,000 dividing line appeared first in the Internal Revenue Code of 1954, along with the introduction of the system of prepayments for corporations. The report of the Senate Finance Committee issued in connection with the adoption of the new Code (S. Rep. No. 1622, beginning at page 137) contains the following language on page 139: "... with the \$50,000 exemption in the House bill, the declaration system would leave unaffected 390,000 corporations. It would affect, however, 35,000 corporations, accounting for about ninety percent of the corporate tax liabilities. Your Committee's action will exempt an additional 15,000 corporations from the declaration and advance payment requirements. The remaining 20,000 corporations, however, account for about 85% of corporate income tax liabilities ..."

This language was written to explain the action of the Senate Finance Committee in increasing the proposed level for exemption from corporate declarations and prepayments from the \$50,000 originally proposed by the House of Representatives to \$100,000. Thus, at that time, 405,000 corporations out of 425,000 were deliberately exempted from the requirement of filing Declarations of Estimated Tax and making prepayments. The exemption made good sense, of course, because of the picture on the other side of the coin. The 20,000 corporations who were left subject to the declaration and prepayment requirement accounted for more than 85% of the total corporate income tax.

Assuming that these figures and statistics have remained approximately correct, the proposal under consideration takes this shape. You are being asked to approve legislation which would compel over 400,000 corporations to file annual Declarations of Estimated Tax, many undoubtedly requiring also periodic quarterly revisions, solely to *accelerate* the payment of corporate income tax that probably represents less than ten percent of the total corporate income taxes. This will not produce payment of taxes otherwise uncollectible. It calls only for prepayment. The prescription cannot be renewed. This will increase Government revenues only once, with the effect spread over the five years following enactment. The only statement on this subject in the President's message combines the revenue effect of this proposal with the proposal that the penalty level for estimated taxes be raised from 70% to 80% and estimated \$800 million in additional revenues for Fiscal 1968, somewhat more in subsequent years. In any case, once the change is fully effective, assuming no violent fluctuations in overall corporate income or tax rates, collections should revert to normal, but hundreds of thousands of corporations would be left with the recurring annual problem of filing Declarations of Estimated Tax. The cure hardly seems worth the damage to the patient resulting from side effects.

The adoption in 1954 of the \$100,000 exemption figure was not accidental. It represented the result of a deliberate policy of relieving thousands of corporations from a burdensome obligation that produced only a single non-recurring collection benefit to the Government. The Senate Finance Committee Report referred to previously contains some further language explaining the purposes of the provision:

"The House bill exempts from the required Declaration of Estimated Tax and the new tax-payment schedule corporations whose yearly tax liability cannot reasonably be expected to exceed \$50,000. Moreover, it limits the current payment requirements to that portion of the tax liability in excess of \$50,000. This exemption, which is designed to restrict the application of the new system to a comparatively large group of corporations, has been increased by your Committee ..."

BURDEN ON SMALLER CORPORATIONS

Gentlemen, it would be extremely difficult and expensive for smaller corporations, those with income tax liabilities of \$100,000 all the way down to \$40, to comply with the provisions requiring Declarations of Estimated Tax and cur-

rent prepayments. Few of them have experienced tax personnel on their pay-rolls, nor do they have the budget experts to provide the necessary information even if they did have the tax experts. I can tell you from our own experience that it is difficult enough for large corporations to estimate their incomes almost a year in advance but at least they have trained budget, tax and accounting employees. In fact, it is difficult enough for most businessmen to have income tax returns prepared and filed *after* the end of the year, for any corporation, large or small, without having their attention distracted by a Government requirement that they enter the forecasting field, instead of concentrating on the need to make profits. The ease of collecting prepayments, from the Government standpoint, should not be allowed to obscure the corporate taxpayer's practical problems with the estimation procedure.

EXCESSIVE PENALTY FOR UNDERESTIMATION

If this burden is imposed upon the small corporation, the penalty for lack of skill is unnecessarily severe. A poor shot results in an underpayment which causes more than shame for poor marksmanship. This unsteady hand produces a sharply defined penalty of 6% for the period of the underpayment—not a 6% deductible interest charge for an inadvertent "loan" from a gracious Government, but a nondeductible penalty more like a 12% simple interest charge. A 6% nondeductible penalty for an honest mistake in estimating something that often is simply impossible to estimate with any accuracy seems to me harsh and severe.

HARD TO AVOID PENALTY

Some will say that there is no need to worry about a penalty, even though unnecessarily harsh, since the statutory pattern of estimation offers several ways to avoid penalties, escape clauses, if you will. For example, no penalties will apply, even if the entire target is missed, and not just the bulls-eye, if the estimated tax paid is at least as large as the actual tax for the prior year. As a practical matter, however, this is small comfort to the businessman whose corporate purse is slim and who cannot afford to overpay estimated tax just to avoid a possible penalty. His company needs every possible dollar of working capital in order to produce an ultimate profit for the year, a goal also necessary for any permanent benefit to the Government. There is hardly any advantage to the Government in unnecessarily stripping him of working capital during the year only to find that the corporation has been unable to make a profit for the year. This results only in eventual refund of tax prematurely collected. The other major so-called "escape clause" involves predicting the corporate tax within, as proposed, 80% of the final actual tax and this is equally unrealistic for many smaller corporations. All escape clauses have the disadvantage of requiring the taxpayer to prove his way out of danger.

Perhaps the proposed extension of the estimation requirement to smaller corporations will be defended on the ground that it already applies to the individual proprietor who is unincorporated. This may be logical to some, but to me it is an application of what I would call the doctrine of "shared misery." If B is in a sinking boat, should we take A out of his sound ship and put him into the leaky boat so that both may perish in happy uniformity?

There were good reasons for the \$50,000 floor originally proposed in 1954. The Senate Finance Committee was sufficiently impressed with them to increase the floor to \$100,000 where it has remained ever since. The reason is simple and the same today, even using the language of 1954, "... to prevent the hardships which might otherwise be imposed on corporations which are uncertain as to what their income during the taxable year will be." To impose a recurring annual burden on several hundred thousand corporations in order to accelerate, temporarily, the collection of a very small percentage of the total corporate income tax just doesn't seem sensible. I urge you not to extend, to hundreds of thousands of corporations, the rule that they must estimate their income within prescribed limits and pay their income taxes in advance. The result would be to raise the crystal ball and the soothsayer to an undeserved importance and to distract many businessmen from their real occupation which is to create the real earnings upon which income taxes ultimately must be based.

Thank you.

Mr. MENDENHALL. It is a privilege to be able to appear before the members of this committee today in order to protest one provision of the recently proposed tax legislation.

I protest the provision which proposes to eliminate over a period of 5 years the \$100,000 floor under which prepayments of corporate income taxes is not required.

I protest for the following reasons:

(1) The proposal is inconsistent with the policy that lead to the original adoption of the \$100,000 floor in 1954.

(2) It will be extremely difficult and expensive for smaller corporations to make such estimated payments.

(3) The penalty for underpayment of estimated tax is an unnecessarily harsh remedy for an honest mistake.

(4) Smaller corporations will find it expensive to use the "escape clauses" which are more useful to large corporations.

I respectfully protest this provision on behalf of my firm's many corporate clients with annual income taxes of less than \$100,000.

Secondly, I protest on behalf of my firm itself. Because many of our smaller corporate clients would have to seek our advice on this matter frequently throughout the year, it would be a severe demand on the time of our professional personnel. The time involved, as well as the cost incurred, would be disproportionate to the importance of the problem.

We know that regarding individual taxes vast sums of revenue come from the lower income tax groups. However, with corporations we know that a rather small portion of the total corporate tax collections comes from corporations paying under \$100,000 in tax.

All but a small percent of corporate tax revenue comes from the rather small number of corporations showing a tax liability of over \$100,000.

In other words, the number of corporations earning under \$100,000 is amazingly high and these smaller corporations owe a very small portion of the corporate tax collections.

In 1954 Congress carefully considered these facts. At that time Congress decided on the \$100,000 floor rather than a \$50,000 floor, which was considered. The \$100,000 floor placed only 20,000 corporations under the estimated tax system and did not bother the other 405,000 tax paying corporations.

Nevertheless, these larger 20,000 corporations subjected to the system paid 85 percent of the total corporate tax. Congress concluded that the difficulties which would have been incurred by the other 405,000 smaller corporations under the prepayment system exceeded the benefits of accelerating Treasury receipts.

Although my statement submitted for the record contains some statistics on this point, the Treasury and your own staff will undoubtedly have more current information for you to show that these distribution proportions are still substantially accurate.

Unfortunately, the administration's revenue estimates on their bill to date combined this \$100,000 matter with the effect of moving the 70 percent escape clause to 80 percent. So the proposal under consideration takes this shape: You are being asked to approve legislation which would compel over 400,000 corporations to file annual "Declaration of Estimated Tax," many undoubtedly requiring also periodic quarterly revisions, solely to accelerate the payment of corporate income tax that undoubtedly represents a small percent of the total corporate income tax.

That will not produce payment of taxes otherwise uncollectable. It only calls for prepayment. The prescription cannot be renewed. This increase in Government revenue occurs only once, with the effect spread over 5 years following enactment. Once the change becomes fully effective, assuming no violent fluctuations in overall corporate income tax rates or in corporate income, collections should revert to normal, but hundreds of thousands of corporations would be left with the recurring annual problem of filing "Declaration of Estimated Tax."

The cure hardly seems worth the damage to the patient resulting from side effects.

Gentlemen, it would be extremely difficult and expensive for smaller corporations, those with income tax liabilities of \$100,000 all the way down to \$40, to comply with the provisions requiring current prepayments. Few of them have experienced tax personnel on their payroll, nor do they have budget experts to provide the necessary information.

I can tell you from our own experience that it is difficult enough for large corporations to estimate their income almost a year in advance, but at least they have trained budget, tax, and accounting employees.

In fact, it is difficult enough for most businessmen to have their income tax returns prepared and filed after the end of the year without having their attention distracted by a Government requirement that they enter the forecasting field, instead of concentrating on the need to make profits.

The ease of collecting prepayments from the Government's standpoint should not be allowed to obscure the corporate taxpayer's practical problems with estimating procedures. If this burden is to be imposed on small corporations, the penalty for lack of skill is unnecessarily severe. A poor shot results in underpayment which causes more than shame for poor marksman ship.

This unsteady hand produces a sharply defined penalty of 6 percent for the period of underpayment, not a 6-percent deductible interest charge for an inadvertent loan from a gracious government, but a non-deductible penalty more like a 12-percent simple interest charge.

A 6-percent nondeductible penalty for an honest mistake in estimating something that is often simply impossible to estimate with any accuracy seems to me harsh and severe.

Some will say that there is no need to worry about the penalty, even though unnecessarily harsh, since the statutory pattern of estimation offers several ways to avoid penalties, escape clauses, if you will. For example, no penalties will apply, even if the entire target is missed, and not just the bull's-eye, if the estimated tax paid is at least as large as the actual tax for the prior year.

As a practical matter, however, this is small comfort to the businessman whose corporate purse is slim and who cannot afford to overpay estimated tax simply to avoid a possible penalty.

His company needs every possible dollar of working capital in order to produce an ultimate profit for the year, a goal also necessary for any permanent benefit to the Government. There is hardly any advantage to the Government in unnecessarily stripping him of working capital during the year only to find that the corporation has been unable to make a profit during the year.

This results only in eventual refund of tax prematurely collected. The other major escape clause involves predicting the corporate tax,

within, as proposed, 80 percent of final actual tax, and this is equally unrealistic for many smaller corporations.

Perhaps the proposed extension of the estimation requirement to smaller corporations will be defended on the ground that it already applies to individual proprietors who are unincorporated. This may be logic to some, but to me it is an application of what you might call the doctrine of shared misery.

If B is in a sinking boat should we take A out of his sound ship and put him in the leaky boat so that they may both perish in happy uniformity?

Two wrongs never make a right.

The reasons for maintaining the \$100,000 floor are as valid today as in 1954, when Congress carefully considered this very point. In 1954 the committee reports stated that the floor was set "to prevent the hardships which might otherwise be imposed on corporations which are uncertain as to what their income during the taxable year will be."

To impose a recurring annual burden on several hundred thousand corporations in order to accelerate temporarily the collection of a very small percentage of the total corporate income tax just doesn't seem sensible. The result would be to raise the crystal ball and the sooth-sayer to an undeserved importance and to distract many businessmen from their real occupation, which is to create the real earnings upon which income taxes are ultimately based.

I hope that our Nation's fiscal situation is not so desperately on a hand-to-mouth basis as to force this burdensome acceleration procedure on small businessmen.

Thank you.

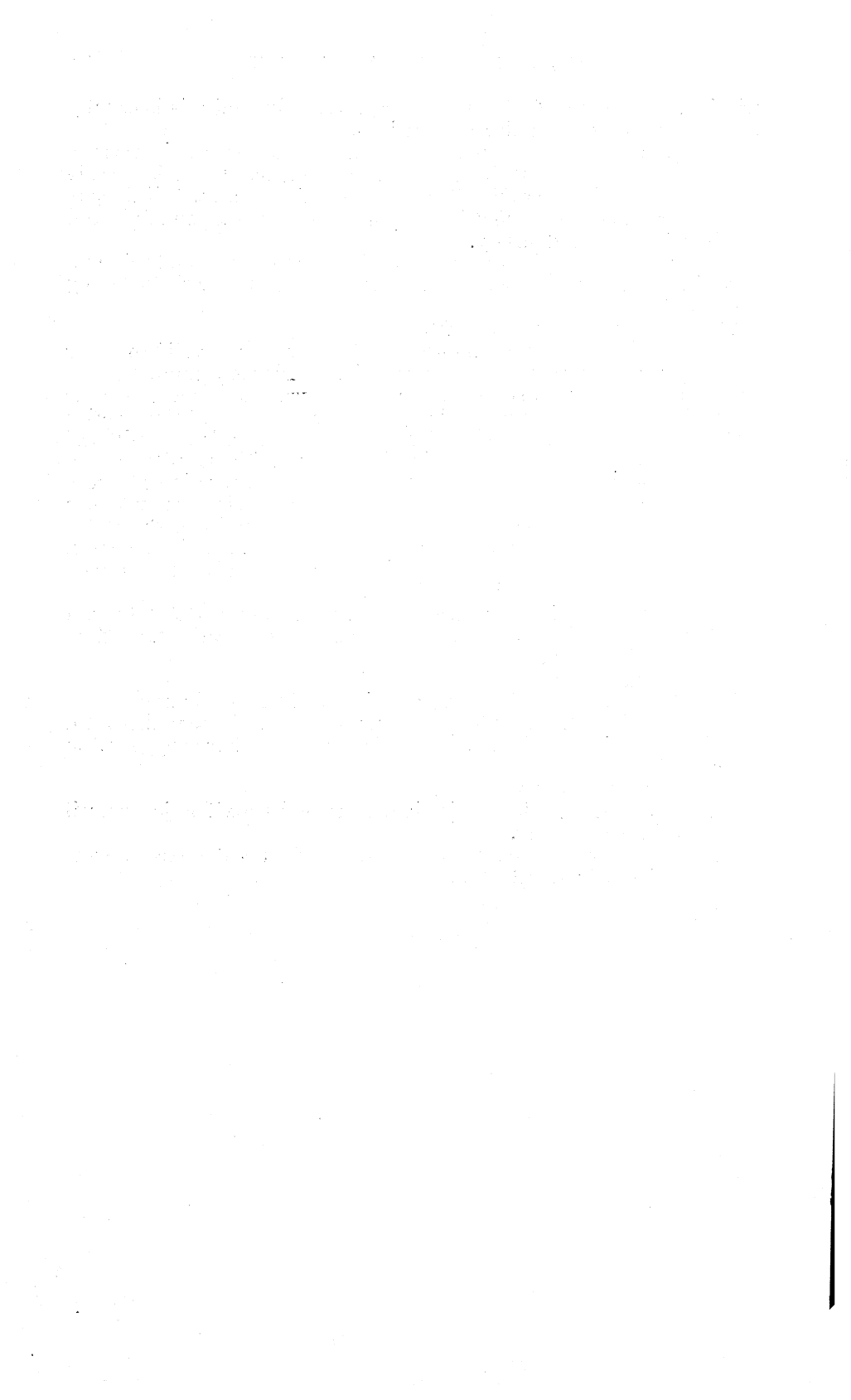
The CHAIRMAN. Are there any questions of Mr. Mendenhall?

We appreciate, Mr. Mendenhall, your coming to the committee and certainly we will take into consideration what you have suggested in the way of amendment.

Mr. MENDENHALL. Thank you.

The CHAIRMAN. Without objection, the committee will adjourn until 10 o'clock in the morning.

(Whereupon, at 11:47 a.m., the committee adjourned to reconvene at 10 a.m., Friday, August 25, 1967.)



PRESIDENT'S 1967 TAX PROPOSALS

FRIDAY, AUGUST 25, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to notice, in the committee room, Longworth House Office Building, Hon. Wilbur D. Mills (chairman of the committee) presiding.

The CHAIRMAN. The committee will please be in order.

Our first witness this morning is Mr. Clarence M. Tarr. Mr. Tarr, please come forward. You have been before the committee on occasions in the past, but for this record will you again identify yourself by giving us your name and capacity in which you appear.

STATEMENT OF CLARENCE M. TARR, PRESIDENT, NATIONAL ASSOCIATION OF RETIRED CIVIL EMPLOYEES; ACCOMPANIED BY LUTHER MILLER, FIRST VICE PRESIDENT; AND JOHN A. OVERHOLT, GENERAL COUNSEL

Mr. TARR. Thank you, Mr. Chairman. My name is Clarence M. Tarr and I am president of the National Association of Retired Civil Employees. I am accompanied by Mr. Luther Miller on my right, first vice president of the association and Mr. John A. Overholt, general counsel.

The CHAIRMAN. We appreciate having you, Mr. Tarr, and you other gentlemen, before the committee this morning.

Mr. TARR. Our association has more than 133,000 members, principally retired civil employees of the United States but including also some of their dependents and survivors, and widows of employees who died in the service.

We have more than 1,000 chapters throughout the United States. We speak for more than 500,000 retired Federal employees and more than 250,000 dependents and survivors of former Federal employees.

We are also concerned with the welfare of millions of other elderly retired citizens who must eke out a precarious existence with incomes only a fraction of those received by persons in their productive years. We speak in favor of the objectives of the President's proposals but urge amendments necessary to the welfare of retired citizens.

INFLATION

We note that one of the primary purposes of the President's plan is to restrain inflation which is the greatest problem of our older people trying to get by on meager pensions and annuities. By official records,

inflation has forced up the cost of living at the rate of 3 percent per year for the past 2 years, and we know from experience that the prices of things needed most by older people are going up at an even faster rate.

In our civil service retirement system, we have a provision for an automatic annuity increase to match increases of 3 percent or more in the consumer price index, but by the time we get one increase, we are almost due for the next.

The annuity increase is always about a year later than the increase in the cost of living.

Furthermore, the Consumer Price Index was designed to cover average prices paid by a "worker" and his family whose needs are somewhat different from those of a retired individual and his family.

One item will illustrate the difference. Drugs, medicines, and medical services and supplies are more necessary for elderly persons than for workers' families, and costs of medical care have shown the greatest increases in recent years. As a result, our people find that annuity adjustments to compensate for increases in the cost of living are both too little and too late.

DISCRIMINATION IN INCOME TAX LAWS

For these reasons our people are for any down-to-earth program that will halt inflation. At the same time, many of our people are burdened by the present discrimination against retired Federal employees, retired municipal employees, retired teachers and others by the present Federal income tax laws.

We have pointed out to this committee on numerous occasions that it is manifestly unfair to exempt retirement income under some systems from Federal income taxes while refusing to exempt retirement income under other systems.

The most striking example is the exemption of social security and railroad retirement annuities from tax while imposing the tax on the annuities of retired Federal workers, retired municipal employees, and retired schoolteachers.

In 1954, this discrimination was partially alleviated by a retirement income credit of \$1,200, which was the amount of the maximum tax-free individual benefit under social security, although less than the corresponding amount under railroad retirement. Later, when the maximum annual individual benefit under social security was increased to \$1,524, the retirement income credit was promptly increased to \$1,524.

Furthermore, in 1964, the retirement income credit was extended to married couples over 65 years of age to compare with the combined tax-free social security income of a similar couple. This gave a couple over 65 years of age a retirement income credit of \$2,286.

RETIREMENT INCOME CREDIT

Social security benefits were increased substantially in 1965, but there was no corresponding increase in the retirement income credit. Still greater increases are pending as the result of the House approval of H.R. 12080, now pending in the Senate.

Furthermore, the income base was increased in 1965, and a further increase in this base is pending in H.R. 12080. As a result of these increases, the retirement income credit should be correspondingly increased to \$1,800 for an individual and \$2,700 for a couple in 1967, with a further increase in 1968 to match increases resulting from H.R. 12080.

MEDICAL REDUCTIONS

We have another serious tax problem. Through the year 1966, we were permitted to claim as exemptions on our Federal income tax returns practically all of our medical and dental expenses, which was very important for persons who have to pay out large sums of money for medical care. This was drastically changed by an incidental provision of the law authorizing medicare, and now we find severe limits to the amount of medical expenses we can claim as deductions.

It is true that medicare helps with many of our medical problems, but we have many members who do not share its benefits. You will recall that most Federal employees who retired since July 1, 1960, were specifically excluded from medicare benefits but were not excluded from the change in income tax deductions.

Also, there are a great many others who have medical expenses which were not helped by medicare, as for example, the persons who have tremendous outlays for prescription drugs and medicines. These are the people most hurt by the new restrictions on medical deductions.

SUMMARY

Our members are loyal Americans who have demonstrated their devotion by long careers of public service prior to retirement. They are still loyal Americans willing to bear whatever just burden they must assume for the benefit of their country. If an increase in Federal taxes is best for the country, they will offer up their fair share.

In all justice, we should not have to pay more. And so we insist that as full citizens of this land we should not have our taxes increased without first eliminating the present discrimination against us in Federal income tax laws, and restoring to us the medical deductions so necessary to persons in our stage of life.

Therefore, we ask that any bill reported out by your committee include a provision to increase the retirement income credit to equal tax-free social security income, and to restore the unlimited medical deductions for persons over 65 years of age.

Mr. Chairman, we thank you for this opportunity to appear and present our views in this manner, and I will endeavor to answer any questions you or other members of the committee may have.

Thank you.

The CHAIRMAN. Mr. Tarr, we again thank you for bringing to the committee the views of yourself and the organization you represent. Are there any questions of Mr. Tarr? We thank you, sir.

Mr. TARR. Thank you very much.

The CHAIRMAN. Mr. Donald W. Jackson. Mr. Jackson, if you will give us your name and capacity in which you appear for the record we will be glad to recognize you, sir.

**STATEMENT OF DONALD W. JACKSON, EXECUTIVE SECRETARY,
TENNESSEE TAXPAYERS ASSOCIATION, INC., AND MEMBER,
POLICY COMMITTEE, NATIONAL TAXPAYERS CONFERENCE**

Mr. JACKSON. Donald W. Jackson, Nashville, Tenn. I am representing the National Taxpayers Conference, which is an organization composed of taxpayers' associations throughout the country.

The CHAIRMAN. We appreciate having you with us, Mr. Jackson, and I guess you observed that you have a Congressman from your district on this committee. We are very proud of him.

Mr. JACKSON. We are very proud of him too, Mr. Chairman. We think he is doing a fine job here.

The CHAIRMAN. He is. You are recognized, sir.

Mr. JACKSON. I am appearing before this committee today not only as executive secretary of the Tennessee Taxpayers Association, but primarily as the spokesman for the executives of a number of similar citizen-research organizations in various States, comprising the National Taxpayers Conference.

My statement has been concurred in by the executives of those statewide organizations who are listed on the last page of the material I believe you have before you.

Mr. Chairman, this committee is considering proposals which are designed to increase Federal revenues in the current fiscal year by an estimated \$7.4 billion. The bulk of this increase—\$6.3 billion—is to be raised through the proposed 10-percent surcharge on the tax liabilities of individuals and corporations.

The decisions taken by this committee on these proposals will inevitably hold vital implications for the future fiscal policy and direction of the Nation. It is in this context that I would like to present to the committee the views of those for whom I appear here today.

The tax increase proposals are presented to the Congress and the Nation with the argument that they are an integral part of a balanced fiscal program, needed to finance the Vietnam war and maintain a relatively stable economy—that is to say, tax increases balanced with expenditure restraint to hold a budget deficit (and thus a further increase in the national debt) to what are referred to as “manageable” proportions.

There are some who would contest this description of or justification for these tax increase proposals. Our view of the Government's current expenditure policies leads to a contrary conclusion—that this program may instead be characterized by imbalance, leaning too heavily on tax increases and not enough on stern and firm control and reduction of nonessential, nondefense Federal spending.

SIZE AND SCOPE OF THE TAX BURDEN

The burden upon the taxpayer is already extremely heavy, despite some tax reduction in recent years. According to figures recently published by the Tax Foundation, Inc., total taxes collected by all levels of government in the fiscal year 1967 amounted to about \$3,300 per American family, with Federal tax collections accounting for almost 70 percent of that amount. By comparison, a little more than a decade ago, in 1956, the total taxes collected per family amounted to about \$1,897.

It should be noted here too, that the proposed 10-percent surtax on individual and corporate tax liabilities will come on top of another rise in the increasingly burdensome social security tax which the House of Representatives has already approved and which seems certain of early enactment.

There have been many tax increases by State governments during the past year. Several States have increased sales and income tax rates. Examples include Ohio, Minnesota, West Virginia, and California. In my own State of Tennessee, the Taxpayers Association supported Governor Ellington and the legislature in a proposal to increase corporation income taxes by 25 percent. The tax rate was increased from 4 to 5 percent on net earnings of corporations.

Other tax increases were made on gasoline, tobacco, alcoholic beverages, and so forth. I cite this to make two points: (1) the taxpayers' associations of this Nation are willing to support taxes when needed, but they also want evidence of restraint on spending programs, and (2) the tax burden on the taxpayer is growing as a result of actions taken by State legislatures.

We do not believe that the Congress and the Executive have exhausted every conceivable avenue to reduce and limit nonessential spending. This is due at least in part to our failure to live up to the declaration contained in section I of the tax reduction act of 1964, expressing a clear preference for the continued application of expenditure restraints.

There is but little comfort to be derived from the fact that the 10-percent surtax is proposed on a "temporary" basis. The fact that it is proposed at all, and that the tax package also includes proposals to postpone scheduled reductions in the automobile and telephone service excises, should be a sufficient reminder that where taxes are concerned anything is possible—and that while tax increases may be described as "temporary," tax reductions also are sometimes temporary.

CONTROL OF FEDERAL SPENDING SHOULD HAVE FIRST PRIORITY

It may be that in the final analysis the Vietnam war requirements will make some tax increase necessary. It is our contention, however, that any such decision should be preceded by the most vigorous efforts to control and reduce Federal spending, so as to make tax increases at this time unnecessary.

Thus we concur in the position taken recently by the distinguished chairman of the Joint Economic Committee, Senator Proxmire of Wisconsin, when he stated:

Congress should cut spending before it undertakes a tax increase. If the Government has to allocate more of the national resources to defense purposes, we should cut down on the Government's other claims on resources. Why should the Government go on consuming more than ever when it asks the private sector to consume less?

It is not carping criticism to suggest that we have failed at the national level to establish a system of reasonable expenditure priorities. Federal programs proliferate and expand in both scope and cost. While it is recognized that expenditure control is not the primary responsibility of this committee, it is surely not unrelated to the issues raised by the pending tax increase proposals.

As your distinguished chairman himself recently declared:

All too little has been said about expenditure control and in my judgment, insufficient attention has been paid to it. It is, in fact, one of the most influential factors of all in the shaping of tax policy, whether many like to admit it or not.

I have recently heard it reported that between fiscal 1956 and 1967 more than 100 new Federal programs (or major expansions of existing programs) were initiated, and that the cumulative costs of these programs to date, including the amounts requested for the current year, totals a startling \$85 billion.

A more specific example of the growth tendencies of Federal activities may be provided by pointing to nine new programs established as recently as fiscal 1963; the first year cost of these programs was only \$241 million, but through fiscal 1968 these programs will have generated expenditures of \$3¾ billion.

All reasonable persons must recognize that as our population increases and as our society becomes more complex the demands for public services—and therefore spending—increase. There are indeed no limits upon the desires of our people or demands upon Government, but as your chairman, Representative Mills, also suggested recently:

This, however, does not justify the perpetuation of programs that have already proved to be unsound or have outlived their former usefulness, and it does not mean that any and every new program must be accepted lock, stock, and barrel no matter how worthy or high sounding its objective may be. It does not mean that we must tolerate ill-conceived experiments which could pass a rudimentary cost-benefit test only if the benefits are measured in such ambiguous terms as "prestige."

Calls for expenditure restraint have been heard on many sides in recent months. Indeed it is interesting to note the emphasis upon this in the testimony of the Budget Director and other officials before this committee last week.

However, examination of the budgetary actions taken to date—and indeed the official acknowledgments that we may be facing a budgetary deficit in the \$29 to \$30 billion range—hardly suggests that such demands have as yet been translated into meaningful results.

While action on fiscal 1968 appropriations and other spending authorizations is far from completed, tabulations appearing in the Congressional Record and elsewhere indicate that in the appropriation bills thus far acted upon by the House, reductions of slightly more than \$3 billion have been made. About \$1.3 billion of this was in Defense Department requests.

While his totals differ somewhat, it was interesting to note the Budget Director's testimony to the effect that the reductions made to date in the nondefense money measures actually would reduce fiscal 1968 spending by only \$660 million, and that even these reductions would be largely offset by other actions requiring increased expenditures this year.

It appears, therefore, that there is a clear need for more vigorous action in restrain Federal spending, on the part of both Congress and the Executive.

EXPENDITURE POLICY DURING KOREAN WAR

A major argument for the tax increase is that it is required because of the increasing costs of the Vietnam war. On this point, it is of inter-

est to compare present expenditure policy with that followed in the somewhat similar period of the Korean war years.

In fiscal 1950, national defense spending totaled \$13 billion, while Federal expenditures for nondefense purposes (excluding interest) totaled \$20.8 billion. By fiscal 1952 defense expenditures, reflecting Korean war costs, had risen to almost \$44 billion. Over the same period nondefense spending actually was reduced by nearly one-fourth, to less than \$16 billion.

The comparable totals for the Vietnam war years, to date, tell a far different story. Defense spending has increased from \$52.8 billion in fiscal 1963 to \$70.7 billion for the fiscal year 1967. But nondefense expenditures on a comparable basis also have increased—by more than one-third—from less than \$30 billion in 1963 to \$41.5 billion in 1967.

SUMMARY

The tax burden continues to increase in spite of the Tax Reduction Act of 1964. An increase in social security taxes seems rather certain, and State and local governments are raising many types of taxes, including personal income, corporate income, and sales taxes.

It may be that in the final analysis the Vietnam war requirements will make some tax increase necessary. It is our contention, however, that any such decision should be preceded by the most vigorous efforts to control and reduce Federal spending.

During the Korean war, nondefense spending was reduced by nearly one-fourth. On the other hand, during the Vietnam war years, to date, nondefense spending has increased by more than one-third.

Mr. Chairman and members of the committee, I appreciate very much to have the opportunity to have presented these views to you today on behalf of the Tennessee Taxpayers Association as well as similar research organizations in 16 other States.

I would be glad to answer any questions.

The CHAIRMAN. Without objection, Mr. Jackson, we will include the list of the organizations in the other States which join you in this statement.

(The information referred to follows:)

This statement is presented on behalf of the following organizations. Each has specifically endorsed the comments included in this presentation.

Tennessee Taxpayers Association.
North Carolina Citizens Association.
Public Expenditure Survey of Wisconsin.
Nebraska Tax Research Council.
Washington State Research Council.
Missouri Public Expenditure Survey.
Montana Taxpayers Association.
Taxpayers Federation of Illinois.
Associated Taxpayers of Idaho.
Oregon Tax Research.
Utah Taxpayers Association.
Citizens Public Expenditure Survey of New York.
Ohio Public Expenditure Council.
New Jersey Taxpayers Association.
Colorado Public Expenditure Council.
Connecticut Public Expenditure Council.

The above statewide organizations maintain research staffs for the purpose of making recommendations to Federal, State, and local officials on tax and spending policies. Each organization—council, survey, federation, or association—represents interested taxpayers.

Mr. JACKSON. Yes, sir.

The CHAIRMAN. We appreciate your bringing these views to the committee this morning.

Mr. FULTON. Mr. Chairman.

The CHAIRMAN. Mr. Fulton.

Mr. FULTON. I would just like to express my personal appreciation to my good friend Don Jackson for giving us his time and the benefit of his vast knowledge with reference to taxation.

Don, we are certainly pleased to have you.

Mr. JACKSON. Thank you.

The CHAIRMAN. Any further statements or questions?

If not, we thank you, Mr. Jackson, again.

Mr. JACKSON. Thank you.

The CHAIRMAN. Mr. William Jackman. Mr. Jackman, you have been before the committee on other occasions in the past. We welcome you back, but for purposes of this record will you identify yourself.

STATEMENT OF WILLIAM JACKMAN, PRESIDENT, INVESTORS LEAGUE, INC.

Mr. JACKMAN. Thank you, sir. My name is William Jackman. I am president of the Investors League, a nonprofit, nonpartisan organization with thousands of individual investors from every State in the Union. Our officers are located at 84 Fifth Avenue, New York, N.Y.

The CHAIRMAN. You are recognized, Mr. Jackman.

Mr. JACKMAN. Mr. Chairman and distinguished members of your committee I wish to thank you for the privilege of presenting to you our views on the President's proposals to increase corporate and individual income taxes now before you for consideration.

The President asks for an individual and corporate income tax surcharge of 10 percent starting on October 1, 1967 for individuals and July 1, 1967 for corporations. These surcharges would be temporary and expire in June 1969. He also asks for an extension of automobile and telephone excise taxes.

The principle reasons given by the administration for these recommendations are to head off inflation and soaring interest rates.

The proceeds of \$7.4 billion presumably would be used to reduce the 1968 Federal budget deficit now estimated at \$29 billion (instead of the \$8 billions estimated at the beginning of the year.)

PROPOSALS WOULD BE INEFFECTIVE

Gentlemen, it is our opinion, that these tax increases are unnecessary at this time and would prove ineffective. The only way to put our Government's financial house in order would be to drastically curtail non-defense Federal spending programs and to defer other ones now under consideration.

Every businessman knows that high taxes, just like high wages, are inflationary. They represent costs of doing business, and these increased costs, when they exceed increased production, must be passed along in higher prices to the consumer.

As regards higher interest rates, excessive Government debt competes for the people's savings and naturally forces up interest rates. This is exactly what has been happening in recent years. In the long

run, interest rates are controlled by the laws of supply and demand, and not by Government fiat.

CUT FEDERAL SPENDING

Since 1960 the U.S. population has grown by only 10 percent. In the same period, the personnel comprising the civilian bureaucracy of the Federal Government has grown by 25 percent; the cost of Government payrolls, including military, has grown by 75 percent; the total of all Government spending has grown by 83 percent; nondefense expenditures of the Federal Government are up 97 percent.

It is obvious that the only sensible step toward curbing inflation and huge deficits, is to cut Federal spending.

There is a bill, S. 538 passed by the Senate in May, now pending before the House. It provides for creation of a Joint Committee on the Budget. It should be passed in our opinion.

A NEW COMMISSION NEEDED

A more fundamental, additional approach to expenditure control is envisioned in a proposal by the distinguished chairman of this committee, Congressman Wilbur D. Mills. His bill, H.R. 10520 would create a 12-member bipartisan Government Program Evaluation Commission, its members drawn from private life, to examine all Federal programs and activities, old, new and projected, and assign priorities among them.

The yardstick would be "the fundamental needs and vital objectives of the Nation." The Commission would ask of each program: What is its effectiveness in terms of present and future costs? Should it be continued? If so, at what level of funding?

A companion Senate bill, S. 2032, has been introduced by Senator William Proxmire, Democrat, of Wisconsin, chairman of the Joint Economic Committee. He calls the idea "a fresh look" at Government expenditures, needed to instruct Congress and the President as to how much should be appropriated in a given fiscal year for each Federal activity.

The rationale of expenditure control was outlined by your chairman, Representative Mills in a speech in late May, before he introduced H.R. 10520. Among his points: After taxes were reduced in 1964, it appeared that the rate of Federal spending had moderated.

But in September 1965, the spending rate rose quickly and this year, if certain contingencies occur, the Nation is faced with the prospect of a possible fiscal year 1968 budget deficit of nearly \$30 billion—the largest since World War II.

Though urgent defense costs account for part of the spending rise, nondefense costs also have risen and this is where controls must be applied. First-year costs of a new program are only part of the story; of more concern is what future costs will be 5, 10, even 15 years ahead.

As these rise, they can impose a straitjacket on tax policy and endanger the desired goal of spending controls coupled with regular, frequent and significant reductions in tax rates which will free the private economy to help solve problems which many people are urging that the Government solve directly.

Therefore, priorities must be set on nondefense programs.

EXCISE TAX REVISION

The administration proposals to extend excise taxes on automobiles and telephone services are likewise inflationary. The Federal Communications Commission is trying to reduce telephone rates. Why not let the temporary Korean war excise taxes expire? The same thing applies to automobile excise taxes. Threatened strikes and other factors are going to force up automobile prices. Continuation of the excise tax will force prices even higher.

If there is to be an excise tax, which might be a saving grace if applied fairly, it should be a very low rate applied equally to all industry at the manufacturer's level, with the possible exception of food and drug industries.

The President estimates that extension of scheduled reductions in telephone and automobile excise taxes would provide additional Federal revenues of \$300 millions for fiscal 1968 and over \$2 billions in 1969. The \$2 billion figure for 1969 seems to us to be a highly questionable estimate.

A SOURCE OF NEW REVENUES

It would be much more simple to collect such additional revenues by a simple tax reduction. This could be done promptly by enacting H.R. 8146, a bill introduced on April 6, 1967, by one of your committee members, James B. Utt. This bill provides for a 50 percent reduction in the maximum tax rate on long-term capital gains, from 25 percent to 12½ percent.

Dependable surveys indicate that if this bill were enacted, the Treasury would receive nearly \$700 million more than under present rates. If these surveys were updated, they would indicate that the Treasury's increased revenues from this source would be even greater.

TIMING WRONG

The timing of the President's tax increase proposal seems all wrong. We can as yet see no indication of a big business boom. Ask the steel and auto boys. These are basic industries. Labor uncertainties in the near future are alarming to these industries and could well result in a slump, certainly not a boom.

CONSIDER THE STOCKHOLDER

Under the President's proposals, the individual who is a stockholder will be hit double since a 10 percent surcharge on the present 48 percent corporate rate will raise that rate to 52.8 percent or more than it was before the reduction of the old 52 percent rate. The individual will then bear that bite on any dividend distributions.

Because so much of personal income is in the lower tax brackets, a relatively small but constant increase in each of the percentages in the several graduated brackets, say by 2 percentage points, might well produce more tax revenue than the higher-sounding 10 percent surcharge.

Because inflation is best checked by a tax that reduces consumer income and that bears least heavily upon income likely to be invested, the flat increase in the scale of rates would seem more appropriate economically than the 10-percent surcharge at this time.

There is talk of making tax surcharges larger for corporations than for individuals. Just remember that, taxwise, there is no such thing as a "corporation." Corporations are only millions of people pooling their invested savings together. The corporate income tax is one of the Treasury's major sources of income. They are paid only out of profits at a rate of 48 percent.

The remaining earnings distributed to individual stockholders are then taxed at rates from 14 percent to 70 percent. It is obvious that if the Treasury wants more income, they should go all out to encourage business expansion and creation of even greater profits. Whenever government attacks profits, it is simply attacking itself.

As Senator William Proxmire crisply summarizes:

The crux of my opposition to the President's 10 percent surtax proposal is that it is dead certain to retard this Nation's economic growth.

Gentlemen, our entire Federal tax system must be overhauled. It has become a hodge-podge mess. Its policies must be established and controlled by Congress, and not by the executive branch or its bureaus who are only presumed to enforce our laws and not to make them.

In your tax thinking, gentlemen, just remember one other thing. There are over 24 million American investor-shareowners whose savings provide the jobs for our workers in industry and produce under our free enterprise profit system, the goods and services that have given this Nation the highest standard of living in this world.

And remember one other thing. This system is called "capitalism." Karl Marx, in his "Communist Manifesto," stated that the surest way to destroy capitalism was to impose a heavy progressive income tax and an even higher inheritance tax. We have already gone too far down this road.

Gentlemen, yours is a monumental task. God help you.

Thank you so much.

The CHAIRMAN. Thank you, Mr. Jackman. We appreciate your bringing to us your views this morning.

Are there any questions of Mr. Jackman?

We thank you, sir.

Mr. JACKMAN. Thank you.

The CHAIRMAN. Mr. Mitchell. Mr. Mitchell, if you will for our record identify yourself by giving us your name and capacity in which you appear we will be glad to recognize you.

STATEMENT OF C. R. MITCHELL, CHAIRMAN, LEGISLATIVE COMMITTEE, U.S. SAVINGS & LOAN LEAGUE; ACCOMPANIED BY STEPHEN SLIPHER, LEGISLATIVE DIRECTOR

Mr. MITCHELL. Thank you, sir. My name is C. R. Mitchell. I am president of the First Federal Savings and Loan Association in Kansas City, Mo. I am also legislative chairman of the Legislative Committee of the U.S. Savings and Loan League.¹

¹ The United States Savings & Loan League has a membership of 5,100 savings and loan associations, representing over 95 percent of the assets of the savings and loan business. League membership includes all types of associations—Federal and State chartered, insured and uninsured, stock and mutual. The principal officers are Otto Preisler, president, Chicago, Ill.; Hans Gehrke, Jr., vice president, Detroit, Mich.; C. R. Mitchell, legislative chairman, Kansas City, Mo.; Norman Strunk, executive vice president, Chicago, Ill.; and Stephen Slipher, legislative director, Washington, D.C. League headquarters is at 221 North LaSalle St., Chicago, Ill.; and the Washington office is maintained at 425 13th St. NW., Washington, D.C.

The CHAIRMAN. Mr. Mitchell, you are recognized.

Mr. MITCHELL. Mr. Chairman, I have with me this morning Mr. Stephen Slipher, legislative director of the U.S. Savings and Loan League.

The CHAIRMAN. We are glad to have you with us, Mr. Slipher, as well.

Mr. SLIPHER. Thank you, sir.

The CHAIRMAN. You are recognized, Mr. Mitchell.

Mr. MITCHELL. Mr. Chairman, we appear before this committee in general support of the administration's proposal for a surcharge on personal and corporate income taxes. Basically, we want to express our concern about the prospect of a \$25 to \$30 billion Federal deficit in the coming year which could well be the result if corporate and personal income taxes are not increased in the near future. We share the view of Secretary Fowler that a deficit in the area of \$25 to \$30 billion would be intolerable.

Our interest in the tax legislation before this committee stems from the interrelationship of tax policy upon the credit markets in the American economy, in general, and the real estate mortgage market, in particular.

Certainly, the developments of the past 2 years make it crystal clear that Federal spending and tax policies determine to a large extent whether the housing industry and the home buyers of America will share proportionately in the supply of credit available in the American economy.

Two years ago, in mid-1965, the decision was made to escalate the American military effort in Vietnam and the credit markets and, most notably, the mortgage market have been in a general state of uncertainty since that time. As the Members of Congress remember, the strong uptrend in the private sector of the economy in the second half of 1965 produced obvious inflationary measures and a pattern of rising prices, higher wages, and increased costs of goods of all types.

As a first step to counteract inflationary forces, the Board of Governors of the Federal Reserve System boosted the discount rates from 4 percent to 4½ percent and interest rates allowable on time deposits from 4½ percent to 5½ percent in December, 1965.

When this and prohibited steps failed to slow excessive and inflationary demands for credit, the Board of Governors 6 months later took steps to tighten the supply of money and credit available in the economy. The result was the tight money crisis in the late summer of 1966 and the highest short term and long term interest rates in over 40 years.

We said then and we are of the same opinion today that high interest rates and tight money, alone, fall short of an adequate program to combat inflation.

We said then and we are of the same opinion today that added emphasis on fiscal policies, including higher taxes and reduced spending, though temporarily uncomfortable, is vitally needed when the country is burdened with costly military operations.

We said then and we are of the same opinion today that virtually complete reliance on monetary restraints to fight inflation places an unfair and uneven burden upon the homebuilding industry and upon American home buyers.