LEAD TIME AND CONTRACYCLICAL TAX POLICY*

In the preceding *Review* we discussed the implications of lead time for one instrument of contracyclical policy, manipulation (suspension and restoration) of the investment credit.[1] We did not, however, discuss its implications for the manipulation of personal and corporate income taxes. This is the subject of the present inquiry. Specifically, we propose to consider the bearing of lead time on the choice of instruments for contracyclical tax action.

By contracyclical tax action, we refer to *ad hoc* measures taken in response to current or immediately anticipated economic conditions. It is true that budgeting is done nowadays on assumptions as to economic conditions during the forthcoming fiscal year, and that in this sense some degree of contracyclical action may be implied in the budget proposals. But since these are submitted six months before the beginning of the year covered, they are necessarily based on tenuous and remote estimates and do not constitute *ad hoc* action in the sense used here. Only when current or proximate conditions are deemed to call for contracyclical tax measures at the time the budget is enacted do we have such action as a part of the regular fiscal routine. Otherwise it calls for special legislation.

Since we are dealing with *ad hoc* tax action, it may be superfluous to observe that we are not concerned with the automatic compensatory effects of the tax structure itself, reflecting the "built-in stabilizers." (Owing to the progressivity of the personal income tax, and the volatility of corporate profits, federal revenues tend to rise relative to national income during economic expansions and to decline relatively in contractions.) These stabilizers are very powerful, and serve greatly to reduce the need for special action, but they do not always suffice to obviate it. In any case, they are taken for granted here.

1. Contracyclical Tax Action in the Postwar Period

Before we launch on the main discussion, it may be worthwhile, by way of background, to sketch in a few words the record of special contracyclical tax action since World War II.

During the four completed postwar business cycles, 1946–49, 1949–54, 1954–58, and 1958–61 (measuring from lows), there appear to have been no tax increases for the purpose of restraining booms[2] and (with one possible exception) no reductions for the purpose of combating recessions.[3] Some of the tax changes turned out to be timely for stabilization policy, some untimely, but they were motivated predominantly, if not wholly, by other considerations. Their cyclical effects were largely incidental and haphazard.

After a careful review of *antirecession* fiscal policy in these four cycles, Lewis comments as follows:

". . . [I]t is frequently difficult—sometimes impossible—to decide definitely whether or not the motive in particular actions was primarily to counter recession. But, insofar as a distinction is possible, those actions which appear to have been primarily counterrecessionary have been on the expenditure side of the budget."[4]

As for the present cycle, still incomplete, the story is considerably different. Thanks in part to the growing acceptance of the idea of compensatory fiscal policy, in part to the intensive efforts of the Kennedy Administration to popularize the expanded version of that policy now known as the New Economics,

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[1] "The Investment Credit as an Economic Control Device," *Capital Goods Review* No. 67, September 1966.

[2] The Korean war taxes may possibly be construed as restraints on an *anticipated* boom, but are more realistically considered noncyclical in nature.

[3] The possible exception is the reduction of excise taxes in 1954, described by Lewis as a measure "for which the recession was a frequently advanced but not the only argument." Wilfred Lewis, Jr., *Federal Fiscal Policy in the Postwar Recessions*, p. 18. The Brookings Institution, 1962.

[4] *Ibid.*