CONGRESSMAN'S REPORT

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May 3, 1963

Taxes and Spending V
The President and Henry Ford -- An Old Idea Revived

Forty years ago Henry Ford proved, to the amazement of the business community, that you can sometimes increase profits by reducing prices. This year President Kennedy is asking Congress to try something similar -- to increase long-run federal revenues by reducing taxes. While much debate and uncertainty lies ahead, I'm convinced that, with prompting from both management and labor, the Congress will pass some kind of tax cut this year. General support for the idea has come from the U.S. Chamber of Commerce, AFL-CIO and many other sectors of our economy, as well as leaders of both political parties, including Governor Rockefeller.

In four recent newsletters I have explored our present tax structure, recent history of the federal budget, the conflict over "big spending", and responsible ways of reducing federal expenditures. All of this time the House Ways and Means Committee has been studying the President's proposed tax program; in a few more weeks it is expected the Committee will report out what will become the Revenue Act of 1963. Now, in this report, I want to summarize the President's proposals and what he seeks to accomplish with them.

WHOSE TAXES WILL BE REDUCED?

If enacted, the President's proposals would bring lower taxes on the current incomes of nearly all individuals and corporations. The cuts for 1963 would look something like this:

	Under Present Law Would Pay Taxes Of	Under Proposal Would Pay	Thus Government Would Lose and Taxpayers Keep
Individuals	$48.6 billion	$45.8 billion	$2.8 billion
Corporations	$24.1 billion	$23.8 billion	.3 billion

However, this would only be the beginning. Additional reductions would take effect in 1964 and 1965 as follows:

	Total Tax Reduction 1963	Total Tax Reduction 1964	Total Tax Reduction

Individuals	$2.8 billion	$8.3 billion	$11.0 billion
Corporations	.3 billion	1.2 billion	2.5 billion
Total tax cut	$3.1 billion	$9.5 billion	$13.5 billion

EFFECT ON INDIVIDUALS

The combined effect of the rate cuts and reforms proposed by the President would be an average 18% tax reduction for all individual taxpayers. Greatest reductions would be in the lower income brackets -- as high as 40% for those earning less than $3,000 per year, as low as 9% for those with incomes over $50,000.

Here are three typical examples showing how the tax cuts would work out in the next three years for a married couple with two children.

	Tax under 1962 law	Proposed for 1963	Proposed for 1964	Proposed for 1965
If their income is $3, 000	$60	$55	$15	$14
If their income is $7, 500	$877	$823	$716	$663
If their income is $15, 000	$2,486	$2,365	$2,202	$2,076

EFFECT ON CORPORATIONS

For corporations, the tax rate reductions would average nearly 11%. Largest reductions would go to corporations in the lower tax brackets -- as high as 27% for companies earning less than $25,000, as little as 10% for those earning more than $1 million annually. At the end of the three-year reduction program the highest corporate rate would be 47%, down from the present 52%.

Here are some typical examples of taxes under the proposed changes:

	Tax under 1962 law	Proposed for 1963	Proposed for 1964	Proposed for 1965
Corporation earning $25,000	$7,500	$5,500	$5,500	$5,500
Corporation earning $50,000	$20,500	$18,500	$18,000	$17,250
Corporation earning $1 million	$514,500	$512,500	$493,000	$463,750

'RECAPTURING' PART OF THE REVENUE LOSS

We have noted that the government would lose in revenues under this plan $3.1 billion the first year, $9.5 billion the second year and $13.5 billion the third and succeeding years. However, experts are agreed that the net loss to the government would be substantially less than these figures. There are two reasons:

1) The proposed "reforms" included in the President's plan would bring in new revenue from some taxpayers by closing certain "loopholes".

2) The extra money taxpayers would have left after paying their taxes would enable them to spend more for goods and services, stimulating business sales and resulting in a "feedback" of tax revenues from higher profits and earnings.

A LOOK AT THE REFORMS

The reforms are of two kinds: "loophole openers", which grant additional deductions and exemptions to relieve special hardships or encourage business growth; and "loophole closers" which bring in new revenue by broadening the tax base and eliminating unfair special preferences. (Note: These terms are used as convenient tags, and not to suggest that either the "closers" or "openers" are necessarily bad.) The "closers" would bring in more new revenue than would be lost by the "openers." None of these reforms would apply to 1963 income. In 1964 and succeeding years the net gain of "closers" over "openers " would be $3.3 billion. Subtracting this amount from the revenue losses indicated above reveals a net loss to the government of $3. 1 billion for 1963, $6.2 billion for 1964, and $10.2 billion for 1965 and succeeding years.

Important "loophole openers" include a proposal to permit low-bracket taxpayers to increase their "standard deductions" (for taxes, charitable contributions, etc.), provide taxpayers over 65 years of age a $300 credit against taxes otherwise due, and allow deductions for research and development activity.

Among the "loophole closers" are proposals to limit charitable and other deductions to that amount in excess of 5% of the taxpayers' adjusted gross income, repeal special tax treatment for dividend income, and extend the minimum holding period necessary to qualify for long-term capital gains treatment from the present six months to one year.

TWO KINDS OF 'FEEDBACK'

There are really two different kinds of "feedback" effects from a tax cut of this kind. The plan anticipates that, in time, these will bring larger revenues from lower tax rates (the Henry Ford theory discussed earlier.) They are:

1) <u>The immediate, direct "feedback"</u>. Here is a simplified example: A carpenter paid taxes in 1962 of $400. With tax cuts he pays $320 for 1963. With this $80 he buys his wife a new vacuum cleaner. The retailer's profit on the sale is $20, and the manufacturer's profit is $15. Thus the retailer has a larger income and pays $7 more in taxes. The manufacturer, with his larger income, pays $5 more in taxes. With his $13 of additional net income the retailer buys a pair of shoes. With his $10 of additional net income, the manufacturer orders material to add one unit of production. In turn, the shoe merchant and the supplier of vacuum cleaner parts have larger income and pay more taxes. Out of this series of transactions the government "recaptures" perhaps $20 of its $80 "loss."

2) <u>The long-range revenue gain from greater economic growth</u>. It is agreed by bankers, economists and such political figures as President Kennedy and Governor Rockefeller that tax reduction would stimulate demand for goods and facilitate needed expansion of plant and equipment. Employment would increase, incomes would be larger, and the government ultimately would collect more taxes from the larger and more prosperous economy that resulted. This can be illustrated by an example:

> Today personal income totals $440 billion, corporate income $51 billion; this tax base yields <u>$68 billion</u> in federal revenue. With a tax cut personal income could rise to $540 billion, corporate income to $60 billion. Even under the lower rates this new tax base would yield <u>$75 billion</u> in revenue, <u>a net gain of 10%</u>. Conceivably we might do even better than that.

THE '62 TAX CUTS FOR BUSINESS -- A STRONG ARGUMENT

For an administration supposedly anti-business, the Kennedy Administration has already given business more tax relief than at any time since World War II. Last year the Congress, at the President's urging, enacted a 7% investment credit designed to give business a $1.1 billion tax cut for purposes of expansion. In addition, new, liberalized depreciation allowances were ordered, increasing the business tax cut to $3.6 billion. According to the Wall Street journal this tax incentive already is having an effect. It is estimated that plant expansion will be increased $3 - 4 billion this year, or 8 to 10% over previous expansion plans. All of this expansion is creating jobs and putting men to work, and it may partly explain the big drop in unemployment noted last month.

If this relatively small tax cut for business has actually caused this surprising pick-up in business activity, it is not difficult to imagine what a general tax cut of the kind proposed by the President might accomplish.

WILL THE SIXTIES FINALLY SOAR?

All of us have been disappointed by the sluggishness of our economy in the first three years of what was billed as the "Soaring Sixties." However, in the last few weeks a strange and happy development appears to be taking place. Instead of an oncoming recession, which was widely predicted, business is beginning to "take off."

For example, the Kiplinger Washington Letter reports the following encouraging facts:

* Plant and equipment spending is soaring to a new high of $40 billion or more this year.
* Machinery orders are growing.
* Construction is starting to brighten.
* Home builders are expanding their plans.
* Retail sales are up, ahead of forecasts.
* Autos are on the way to a 7-million-car year.
* Inventories of raw materials are being built up at a faster pace at all levels.

Similarly, U. S. News and World Report informs its readers of a business trend that is "strongly upward" and adds, "If taxes are cut, effective next January 1, the upward trend will get added push, and will continue longer. * Significantly, the magazine predicts personal income will reach $473 billion and corporate profits $55 billion by this time next year, even without a tax cut. These advances would go far toward realizing the three-year goals cited above.

Some economists say this brighter picture is partly the result of anticipation of tax reduction; if that is so, we already have an indication of what a tax cut can do. In any case, authorities agree the tax cut itself will brighten the picture even more.

YES, BUT W-H-E-N WILL WE BALANCE THE BUDGET?

I believe this country can't forever continue a policy of deficit spending, planned or unplanned. There are three ways to balance the budget:

1) Drastic spending cuts. For reasons discussed in my prior reports one must realistically conclude that this course won't be taken, regardless of whether liberals or conservatives are in power. The realities are such that even the modest $5 billion spending cut I have proposed looks doubtful. Furthermore -- and this is especially important -- there is serious danger that such efforts at budget-balancing right now might put the brakes on our presently bright economic upturn and bring on a new stagnation. Many economists believe the big spending cuts of 1957 accomplished precisely this unhappy result, causing our worst post-war recession in 1958.

2) Raising taxes to the level of spending. This isn't going to happen. Nearly everyone is afraid of the effect this might have.

3) The "Henry Ford" approach. If this approach is taken, and we combine it with a cautious and prudent attitude toward present and new spending programs, we should be able to balance the budget without drastic cuts in spending, which might imperil both our economy and our defense effort.

The President and the bankers and economists who advise him have chosen the third course as the one offering the least danger and the soundest, long range promise. Realistically, I believe they have chosen the only approach that is a live possibility today.

HOW LARGE IS THE FEDERAL DEBT?

The federal debt is something which I view with concern and caution, but ability to carry debt depends on one's income. No one would suggest that the federal government's "line of credit" should be limited to that of a private person or even a giant corporation like General Motors. Obviously the federal government can afford to carry more debt than a state or even a combination of many states. What, then, is the level at which the debt becomes excessive or dangerous?

Homely examples can be misleading, but I believe it might be helpful to compare recent changes in the federal debt with comparable changes in the debt of a private person. The present federal debt of $303 billion is 52% of our $578 billion annual income (Gross National Product). This is similar to the position of a man who earns $10,000 per year and owes a total of $5,200 on his house, automobile and personal belongings. I don't know many $10,000-a-year men who owe that little.

Now let's go back to 1946. In that year our debt was $269 billion against an annual income of $211 billion. On the same basis our $10,000-a-year man would have been carrying a debt of $4,616 on a 1946 income of $3,650. Thus, even though he had added about $600 to his indebtedness, we would have to say he was decidedly better off today. The same is true with the federal government.

WHAT'S REALLY BEST FOR THE COUNTRY?

I have tried to present on these pages the President's case for a substantial tax cut, but you are entitled to ask, "How do you stand, and how will you vote?"

Generally, I have misgivings about deficit-financing of this kind; it squarely contradicts the kind of fundamental family-type economics I learned in my youth. As readers of these reports will recall, I have sponsored legislation which would establish flexible tax rates and compel balanced budgets over every four-year period.

But few legislators, and even fewer economists, support my proposals; when the vote comes, my choice will doubtless be between (a) continuing our present tax schedule and (b) adopting the kind of tax-cut bill eventually produced by the Ways and Means Committee. My decision will rest on the content of that bill and the case the Committee makes for it.

Regardless of my vote, I predict passage of a tax-cut bill this year. New generations sometimes prove that new theories will work. By an interesting coincidence Henry Ford II is one of the new-generation business leaders urging our new-generation President to take this course. For the sake of the country's future, I hope they are right.