MONTHLY TAX FEATURES

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Tax Foundation, Inc.

50 Rockefeller Plaza ☐ New York, New York 10020 ☐ 212-582-0880 ☐ Volume 20, Number 10, December 1976

400 Hear Senator Long on Tax Outlook

The recipient of this year's Tax Foundation Distinguished Public Service Award, Senator Russell Long of Louisiana, told 423 guests at the Foundation's 39th annual dinner he personally favors "about a $15 billion further tax cut."

The cuts would be divided "about one-third as a refund against the 1976 taxes to get the money in people's hands immediately, about one-third of it as a reduction in withholding rates, and about one-third of it in such things as further increase in the investment tax credit to stimulate more investments and to encourage industrial expansion."

President-elect Carter is not at this time planning to ask for a fuller tax cut, "but it's my judgment," said the chairman of the Senate Finance Committee, that he would be wise to do so."

The new President is going to seek to build a bridge of cooperation and understanding with the business community. "I can't guarantee that," said the Senator, "but I believe that he's a smart man and a wise man and I think he will."

The Honorable Russell B. Long, U.S. Senator, Louisiana, addressed the 39th annual Tax Foundation dinner, December 1. He is shown wearing the gold medal Distinguished Public Service Award presented to him by Chairman Willard F. Rockwell, Jr.

Senator Long's citation was read by Tax Foundation's Chairman Willard F. Rockwell, Jr. The gold medal is inscribed: "For extraordinary and diligent service to the people of the United States in guiding the nation's fiscal policy..."

Congress, said Senator Long, is going to have to take a very serious look at the proposal to integrate the individual and the corporate income tax to eliminate double taxation of dividends. But it's a very expensive proposition, he added, "so I can't really promise you that we'll be able to enact it. If we can afford it, then I think that it would be a very thoroughly desirable tax reform."

Commenting on the energy crisis, the Senator said: "We can have energy independence. You can have all the energy you want. Only one condition: you have to pay for it... To me the most honest way is to pay for it right out in the open with the product under the free enterprise system."

Conference Searches for Wise Tax Revision

It is possible by wise tax revision, said Raymond J. Saulnier, Professor Emeritus, Columbia University, to contribute to the desirable ends we all want to achieve—higher growth, more self-supporting jobs, reduced unemployment and reduced inflation.

If we didn't believe we could achieve those things by means of tax revision, we wouldn't be here this morning, he added.

Thus opened the 28th National Conference of Tax Foundation, "Federal Budget Policy, Employment, and Inflation," December 1. Professor Saulnier was chairman of the morning session. Other speakers included two more professors of economics, two economists from the private sector, two bureaucrats, a congressman, a tax counsel, and the president of Tax Foundation.

Most agreed that unemployment is a most serious problem, that to deal with it effectively more capital investment is needed, and that to provide investment capital, tax revision is needed. But there were many recommendations about what revisions are needed and how to get them.

The new Federal budget process was praised. Britain, where 60 percent of GNP is in government programs, was cited as a horrible example of central planning.

In general government interference in the economy was decried and relief for taxpayers to save and invest was

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Conference Speakers Search...

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called for. Speakers agreed that a reduction in corporate income taxes was a good idea both in economic terms and politically. But there was disagreement in how and whether personal income tax rates could be reduced. And the effects of tax cuts on government spending, debt, inflation, and stimulation of the economy were considered debatable.

The outlook for revision of two-tier taxation of corporate income was considered fairly good. Simplification of the tax code was discussed in some detail. It was agreed that Congress would do what it had to do in political terms and that therefore the voters would control any attempt to use taxation to regulate the economy. Voters, it was stated, take a short-term and personal view of proposed solutions to their problems.

A capsule review of each of the presentations follows. The full verbatim text of the proceedings will be published in January and will be mailed to all those who attended.

The 'Full Employment Budget' How Good A Guide to Public Policy?

The result of stiffer taxes on investment will be less investment and less effort. By sapping the strength of the private economy, the relative strength of government would rise dramatically.

That is the serious concern of Alan Reynolds, vice president of the First National Bank of Chicago.

Fiscal theories like full employment budgeting—in other words, "budgeting as though deficits were really surpluses" —can only yield a continually growing debt and an onerous tax burden to service that debt. Britain, he pointed out, provides a classic example of the truth that treasuries cannot print wealth and central banks cannot print jobs.

Such theories grouped under the heading, "the new economics," are not borne out by history. In 1946, for example, a $60 billion reduction of Federal spending was followed by a vigorous boom. In 1948 a combination of tax cuts and higher spending was followed by a sharp recession. The Coolidge Administration managed to combine a 3.5 percent average unemployment rate with a 0.5 percent inflation rate, he reminded participants.

Full employment budget theory cannot explain periods in which unemployment and inflation are both high.

"I favor massive cuts in taxes during recessions and equivalent cuts in Federal spending during booms... It would put the government Leviathan on a diet getting both sides of the budget down to the point where the private sector would have some room to breathe," he declared.

"The economy's long-run real growth depends on the quantity and quality of labor and capital, which in turn depends on the after-tax real rewards to productive activity," said economist Reynolds.

The full-employment budget concept focuses on the hypothetical surplus or deficit a given tax and expenditure program would produce if the economy were operating at full potential, generally defined as four or five percent unemployment. "Too large" a full-employment surplus, relative to private demand, will be restrictive, according to the theory, and "too small" a surplus will cause inflation. In fact, however, the appropriate size of the surplus depends upon other government policies and economic circumstances which affect private demand. It is now widely recognized that the tradeoff of inflation against unemployment is a far more complicated process than it was thought to be when the full employment budget theory was conceived.

The Long-Run Implications of Short-Term Federal Budget Policy

The Carter Administration will face a difficult choice with regard to tax cuts. A tax rebate could be paid to everyone and the effect on aggregate demand and output would be trivial. Or a reduction in rates paid by high income people, corporations and other employers would be a courageous surprise but could substantially increase employment and output.

There is little likelihood of any such surprise, according to William Niskanen, Ford Motor Company economist. That's because Congressmen do not have personal incentive, consistent with being re-elected, to write good tax law.

As Aristotle observed, most people obey necessity rather than argument, and punishments rather than the sense of what is noble. "Good law is a public good; that is why it is so scarce," observed the Ford economist.

The problem derives from the voters, most of whom recognize the direct effects of a law more clearly than the indirect effects, particularly if the indirect effects are delayed. Further, most voters are relatively unconcerned about the effects of a law on others.

On the question of government spending Mr. Niskanen disagrees with Alan Reynolds' notion that tax cuts might lower government expenditures. The Ford economist noted that one of the primary political discoveries of recent years is the low apparent political cost of deficit financing. The rate of growth of Federal spending was unusually high, he pointed out, in the years following the general reduction in tax rates in 1954, 1964, and 1970.

Perspectives on Future Federal Tax Revision

Laurence N. Woodworth, chief of staff of the Congressional Joint Committee on Taxation, reviewed the likelihood of a long list of unfinished tax business being considered by the new Congress. The impression he left, as expressed by Chairman Saulnier, was that there is nothing in the tax system that is not to be under consideration.

First, said Dr. Woodworth, the issue of a temporary tax cut will face the Congress. The figure often mentioned of $15 billion is a good likelihood as to its size if there is to be one. But he doubted whether such cuts would concentrate primarily on the high marginal rates, as Mr. Niskanen had suggested.

Discussion is more likely to center on whether a rebate or a tax reduction is most apt to be spent by the individual. Efforts to encourage investments by business would amount to no more than half the tax cut package.

There will be increased emphasis on tax simplification in the period ahead.

"There is very substantial Congressional interest in the general area of capital formation, and first and foremost in this area I would say is the question of double taxation," the committee chief declared. Committee members are concerned both from the standpoint of equity and about the preference that the present system gives to debt financing over equity financing. But ways of dealing with this all cost a great deal of money and there are a number of very difficult technical problems and a lot of hard work needs to be done. Whether suggested tradeoffs will be satisfactory to business is a good question.

OPENING SESSION*—Morning panelists are given rules of procedure by (standing) Chairman Raymond J. Saulnier. Seated left to right are William A. Niskanen, Jr., Alan Reynolds, and Laurence N. Woodworth.*

PM SESSION*—Chairman Emmett A. Murphy hands a written question from the audience to Congressman Clarence J. Brown. Professor George M. von Furstenberg looks on while Professor Martin S. Feldstein stands by for another question.*

The Needed Disciplines In Federal Budget Policy

Samuel M. Cohn struck a hopeful note following a pleasant luncheon.

The veteran of 28 annual Federal budgets which grew during his tenure as a senior career official in the Executive Office of the President from $40 billion to $400 billion, said he believes the new Congressional budget process, which has now been through its first year of operation, has succeeded far beyond his own expectation.

He suggested that Federal budget formulation and execution be accompanied by:

- Consistency and clarity of political and budgetary objectives
- Skilled and careful staff analyses
- Able and experienced managers at all levels
- Realistic expectation of what can be accomplished, plus institutionalized "sunset" reviews
- Mutual trust and confidence with more "sunshine" or public disclosure among the principal actors in the annual budgetary drama
- Voluntary commitment to prudence and restraint as required in the public interest.

Mr. Cohn was introduced by Tax Foundation President Thomas Macioce, who presented to him an illuminated scroll commemorating "your many well-deserved honors which you have received over the years for your service, your achievements, and the knowledge you have imparted to so many others about the needed disciplines in Federal budget policy."

The scroll noted that Mr. Cohn is usually referred to as "Mr. Budget," because of his almost legendary knowledge of budget details and his quick grasp of the issues, and his success in educating the several OMB Directors under whom he served, as well as members of Congress and others. He is presently vice president, Robert W. Nathan Associates, Inc.

In introducing the afternoon panel of speakers, Chairman Emmett A. Murphy of the Standard Oil Company of California, noted that it took 186 years for the spending level of the Federal government to reach $100 billion. That was in 1962. By 1971 it had reached $200 billion. Four years later it was $300 billion. Two years later, in fiscal 1977, we are projecting $400 billion as the annual rate.

An informed public, he said, is our best insurance against fiscal irresponsibility at all levels of government. This program is a part of the continuing Tax Foundation educational process.

"The Board of Trustees of the Tax Foundation, its officers and the Advisory Council are entitled to our admiration and support for their accomplishments in carrying out its purposes," said Mr. Murphy.

"In knowledge and informed constructive action lies the hope for the future of our republic."

The Unemployment Caused By Unemployment Insurance

Professor Martin Feldstein of Harvard raised the important question of the contributions made to unemployment by our inefficient unemployment insurance system. The system creates a substantial incentive to be unemployed, he believes.

Between 1973 and 1976 unemployment insurance benefits paid by the states rose from $5 billion to $18 billion. The taxes required to finance these benefits are more than a third of the entire Federal corporate income tax. And ultimately, said the Harvard economist, these high taxes are paid primarily by workers in the form of lower wages and higher prices.

The system, he pointed out, has two bad incentive features. First, for those who are already unemployed, it greatly reduces and often almost eliminates the cost of increasing the period of unemployment. A typical unemployed worker in Massachusetts receives two thirds or more of lost net income and in some cases may receive more by being unemployed than by returning to work.

And second, the current system raises the net compensation to the employee relative to the cost to the employer for all types of unsteady work, thus providing both employers and employees with the incentive to organize production in a way that increases the level of unemployment.

The method of experience rating under which employers now contribute to their state's unemployment insurance fund on the basis of the unemployment experience of their own previous employees is ineffective, Professor Feldstein demonstrated. The rating system tends to perpetuate repeated periods of layoff because many firms with high layoff rates already face the maximum tax rate. An increase in layoffs causes no increase in tax payments. In New York some 60 percent of all benefits were related to firms paying the maximum tax.

As a result the system may be contributing 1.25 percent to the permanent rate of unemployment adding more than a million people to the number of unemployed.

The remedies for these two adverse incentives said Professor Feldstein, are first, to tax unemployment insurance like all other forms of compensation, and second, to strengthen the experience rating by raising the maximum tax rate that is paid by employers with high layoff rates.

If we don't, "it will not be possible to bring the unemployment rate below 5 or 5½ percent and hold it there without inducing an accelerating rate of inflation."

The Rhetoric of Tax 'Reform'

In a scholarly analysis of the effects of inflation in aggravating existing distortions in the Federal income tax system, Professor George von Furstenberg of Indiana University pointed to interest as "the one major item containing an entirely disproportionate inflation kicker."

Examining various types of income, he illustrated how in many cases the distorting effects of inflation exist, but approximately cancel one another out, except for interest.

"It is regrettable indeed," Professor von Furstenberg concluded, "that our tax system should be one of the factors making for continuing inflation just because it fails to allow that what is represented as interest under inflationary conditions... in fact... consists of real interest and an inflation premium." The latter, he pointed out, represents neither taxable income nor deductible expense in any real sense.

Economic Planning and Employment

Unemployment is one of our most serious problems, we all agree, said Congressman Clarence J. Brown of Ohio. But the solution is not central government economic planning.

That would only "screw up our national economy."

We have in our economy over 14 million separate business firms gathering and distributing millions of types of materials and products according to a complex interaction of relative cost of production, quality, variety of products, market preferences and so on. "Only the self-regulating free market which performs this calculus of interaction minute by minute can cope with this situation accurately, fairly, and on a national or worldwide scale," the congressman said.

But when the government tried even so limited a plan as the wage and price controls of 1971-1973, "terrible shortages and pent up inflationary pressure came as a result. The experiment was clearly a major contribution toward our recent recession."

"It will take time for business, racked by past and present government intervention and fearful of more, to regain the investment confidence needed to really return to full employment."

What's needed is sharply increased supply of capital per worker. The stock of fixed capital per worker declined in the past decade from an average of $55,000 to less than $41,000.

"Unless there is some kind of a turn around, we can never hope to attain the full employment by 1980."

Here is his list of approaches to solving the problem:

Further reduction in corporate income tax rates.

Elimination of double taxation of corporate income and stockholder dividends.

Liberalization of depreciation allowances to increase the allowances and put them on a current dollar basis.

Further liberalization of the investment credit making it a permanent part of our tax code.

More favorable treatment of net operating losses.

Tax incentives for personal savings either through a general personal income tax cut or special savings exemptions.

Clarence Brown was elected to Congress in 1965. He is ranking Republican member of the House-Senate Joint Economic Committee. Back home in Urbana, Ohio, he is an editor and publisher.

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