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TAX CUT CONSIDERATIONS: A BRIEF REVIEW

Remarks of M. Monroe Kimbrel, President of The American Bankers Association, at a Dinner Honoring Him, Piedmont Driving Club, Atlanta, Georgia, Tuesday Evening, November 13, 1962. Mr. Kimbrel is chairman of the board, First National Bank, Thomson, Georgia. Dinner host was Charles E. Thwaite, Jr., chairman of the board, The Trust Company of Georgia, Atlanta.

Within less than two months the 88th Congress of the United States will be convening. That Congress will face the task of grappling with some of the most difficult economic challenges which the country has faced in the postwar period. In my judgment, the manner in which these are met by the Congress, and by the Administration, will have far-reaching consequences for the economic security of our nation. For this reason, it is encumbent on each of us to examine the issues as thoroughly as we know how, and to express our views as clearly and explicitly as we can manage.

One of the most complex economic questions, and perhaps the most significant one, with which the new Congress must come to grips is that of adopting financial policies which are consistent with the need for maintaining an adequate rate of expansion in our domestic economy. Regardless of their political persuasion or the nature of their economic biases, virtually all observers are agreed that the United States, if it is to provide sufficient job opportunities for its growing labor force, must act to improve on the economic performance which we have registered in recent years.

Undoubtedly, there are several areas in which the Federal Government may take action to foster a more favorable rate of long-term economic expansion. Nevertheless, attention in recent months has centered on the question of a broad tax cut, and the President has promised that he will submit a tax-reduction proposal

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when the new Congress convenes. This promise was made before the onset of the recent Cuban crisis, but spokesmen for the Administration indicate that Cold War developments have not changed the President's intention of including tax-rate reduction in the legislative program to be submitted in January.

In considering the President's proposal, the first question to be resolved is whether tax reduction is the right medicine for the signs of sluggishness evidenced by our economy in recent years. If we can agree--and I think there is general agreement on this point--that the economy stands in need of at least moderate stimulus, the issue narrows down to what stimulus should be applied. Specifically, the question is whether tax reduction should be preferred over heavier federal spending or easier credit policies. In my judgment, the answer to this question should be "yes."

There are several reasons behind this answer, but the basic one is that neither easier credit policy nor heavier federal spending would be successful, in the long run, in improving on our current rate of economic growth. The combination of increased spending and easier money could contribute to a short-term acceleration in economic output and fuller utilization of our economic resources. Of this there is little doubt. But would such policies add to the longer-range growth potential of our economy? I think not.

In fact, such policies could be seriously damaging to our long-term growth prospects. There is mounting evidence that the persistent advance in federal expenditures has served as a major deterrent to economic growth in this country. Therefore, the suggestion that a sluggish growth rate should be corrected by still further increases in federal spending strikes me as being particularly inappropriate. Such a solution, it seems to me, would not be unlike the injection of a drug into a patient already suffering from previous excessive doses.

If we are to shape federal financial policies in the months ahead with the deliberate objective of enhancing our potential for long-term expansion in employment, output, and over-all growth, then our policy actions must have distinct long-range implications. What is needed is not just a policy to promote expansion on a temporary basis, but rather policies which will foster an environment in which the growth-inducing qualities inherent in a free-enterprise economy permanently may be unleashed.

Now, as always, the process of economic growth requires the existence of incentives--incentives for investment, for innovation, for risk-taking, and for production. The strength of these incentives is of fundamental importance in influencing the rate of economic growth. If these incentives are weakened unduly by the existence of excessive tax rates, the process of economic growth inevitably suffers. In my judgment, it is so suffering now.

Taxation is only one of the factors affecting the strength of private incentive for investment and enterprise. Yet it is a major factor, and it is a factor which is subject to our direct and immediate control. A properly structured reduction in tax rates at this time would contribute significantly to the strengthening of private incentive, on which the rate of economic growth is so heavily dependent, and would represent a major step toward improving the climate for economic growth.

The question inevitably is raised as to whether we can afford a major tax cut at this time--particularly in the light of prospects for a sizable budget deficit in the 1963 fiscal year. The answer to this question, it seems to me, is also yes--provided the tax cut is properly timed and accompanied by strict control over federal spending.

Some observers have refused to endorse the proposal for a tax cut unless it is accompanied by an equivalent reduction in federal spending. I sympathize with the sentiments underlying this view, but I cannot fail to point out that it falls somewhat short of a realistic approach to a vital question of public policy. Moreover, this view also seems to be based on the assumption that the relationship

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between federal revenues and tax rates is far more rigid than actually is the case. Even with fixed tax rates, federal revenues tend to show substantial gains as the economy follows its upward growth trend.

Over the past decade, these gains have averaged more than $3-billion a year. Consequently, a major reduction in federal taxes, scheduled to take effect gradually over a period of from three to five years, need occasion no significant reduction in federal revenues at all. In other words, losses of revenue from tax reductions would be roughly offset by the gains which normally accrue as a result of expanding production and incomes. If federal spending can be held constant, therefore, there need be no substantial change in the government's fiscal position as a result of a tax cut. This suggests clearly that we can afford a major tax cut if we can succeed in holding the line against increased federal outlays.

There is an element of wishful thinking in the notion that by resisting a tax cut not accompanied by reductions in federal spending, we are acting in the interest of fiscal soundness. Under current and prospective economic conditions, it is difficult to believe that gradual increases in federal revenues would be allowed to result in an improved budget position. With expansive economic policies being emphasized, the odds are clearly that federal spending would rise by at least as much as, and probably more than, the increased revenues accompanying economic growth. If this is true, it is reasonable to conclude that the budget impact of providing an expansive economic influence through tax reduction while holding spending constant is likely to be as small as--and probably would be smaller than--a policy of increased federal spending with tax rates held unchanged. Even if the budget impact of the alternative policies were roughly the same, the course of tax reduction offers clear-cut long-term advantages which would not flow from increased federal spending.

I conclude, therefore, that tax reduction is not only a desirable objective of public policy at this time, but also that major reductions in rates

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can be implemented within the bounds of fiscal prudence. This will require that rate reductions be "phased in" over a number of years, and that federal spending be held constant over a protracted period. Consequently, I am hopeful that the President's proposal will make clear a determination to prevent further increases in federal spending, and that the details of his recommended tax reductions will be designed to strengthen growth-producing incentives.

Needless to say, final comments must be reserved until the details of the tax proposal are made public and the Administration's budget recommendations are submitted. For clearly, the ability of a tax reduction to contribute to sustained economic expansion depends upon the character and scope of the reductions; and the advisability of enacting tax reductions must be related to the prospects for effective and resolute expenditure control.

A second major economic question confronting the nation--and a question which has profound implications for federal financial policies--is the continuing problem of deficits in our balance of international payments. Much progress already has been made toward reducing the size of these deficits, but more will be required before the nation can rest comfortably. Efforts to secure additional progress must be made on a number of fronts.

Surely, one of the most important ways of bolstering our international financial position is by increasing our competitiveness in international markets. This requires, among other things, a strengthening of incentives for cost-cutting investment in new plant and equipment and the adoption of more efficient production techniques. This year's tax legislation providing for an investment credit represented a significant step in the right direction, but that legislation does not obviate the need for a thorough and broader strengthening of over-all economic incentives.

The competition which we face in international markets has become progressively more intense over the past decade, and there is no reason to expect any respite. The gradual elimination of tariff walls between the Common Market countries has had a significant impact on the ability of American producers to compete in these markets, and the progressive economic integration of the European economy suggests that we have not seen the end of these difficulties, either. As a device for alleviating the competitive handicaps to which we have been exposed in the European market by the progress of European economic integration, the Trade Expansion Act of 1962 was both necessary and desirable. Nevertheless, we should not deceive ourselves by thinking that, by itself, it assures us of markets which we previously have served.

In the final analysis, developments in our international competitive position will depend upon the strength, vigor, and soundness of our domestic economy. It is for this reason that, when we consider the urgency of policies for promoting a healthy rate of economic growth, we must think in terms of dual responsibilities: domestic responsibilities for ensuring the existence of adequate job opportunities to accommodate an expanding labor force; and international responsibilities for the preservation of an internationally competitive economy which will warrant confidence in the dollar and assure the continued success of the international payments mechanism which it supports. In my comments this evening on the question of a tax cut, I have been mindful of these responsibilities.

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