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1963 JOINT ECONOMIC REPORT

REPORT

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

ON THE

JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

WITH

MINORITY AND OTHER VIEWS

MARCH 14, 1963.—Ordered to be printed

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MARCH 14, 1963.—Ordered to be printed

Mr. DOUGLAS, from the Joint Economic Committee, submitted the following

REPORT

together with

MINORITY AND OTHER VIEWS

REPORT OF THE JOINT ECONOMIC COMMITTEE ON THE JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

[Pursuant to sec. 5(a) of Public Law 304, 79th Cong.]

THE CONDITION OF THE ECONOMY

The economy has registered significant gains over the last 2 years. However, during the past year the rate of economic expansion has slowed while the economy was still substantially short of full employment. This has not been exclusively a short-run cyclical development. Rather, the symptoms are those of chronically inadequate demand. Since the mid-1950's there has been a persistent tendency for the rate of use of labor and capital to be a little lower at the peak of each successive cyclical expansion.

Unemployment averaged about 4.2 percent at the 1957 peak, about 5.2 percent at the 1961 peak, and about 5.6 percent over the last 13 months. Furthermore, the unemployment rate, seasonally adjusted, has equaled or exceeded 5 percent of the civilian labor force in every month but one since 1957, averaging 5.9 percent for the last 63 months—a period of more than 5 years. This is about 50 percent above the interim goal of a 4 percent unemployment rate. When allowance is made for the loss of employment through involuntary part-time work due to slack demand, the unemployment rate for these 5 years averaged about 7 percent.

In addition, the labor force has tended to rise more slowly than expected so that it has been about 500,000 to 800,000 below the long-run trends based on increases in the number of people of working age, their distribution by age and sex, and trends in the rates of participation in the labor force.[1]

The Nation for 5 years has been experiencing a widening gap between total demand and potential output. Demand rose to about 2 percent above potential output in late 1955 and, although demand continued to rise thereafter for 2 years, the rise was less rapid than the accelerated rise in the Nation's potential output. Demand, therefore, was 3 percent under potential at the cyclical peak in 1957. At the next cyclical peak in 1960, actual output was about 6 percent below potential, and the percentage of slack so far has not fallen below this. In fact, the ratio of actual to potential output has been stable or drifting slowly downward since the fourth quarter of 1961.

This chronic slack has tended to hold down prices, consumption, investment, savings, employment, and output. For example, prices of raw materials fell by about 5 percent in the recent recovery in contrast to the usual increase. The fall in stock prices in 1962 is also in sharp contrast to the substantial increases usually appearing in cyclical expansions.

Only in the field of services and some types of construction have prices remained strong or rising. In these two areas the possibility of upward bias in present price indexes is substantial. First, there is the difficulty of measuring quality changes. Second, in services, rising prices reflect mainly rising wages and other incomes necessary to attract labor and capital into these growing parts of the economy and away from previously higher paid goods-producing industries. Third, in both services and construction, statistical adjustments for increased productivity are either minimal or nonexistent. In short, in those areas where the facts are reasonably clear, prices have been weak. In other areas where prices have shown a contrary tendency, there is reason to believe that this is either a statistical illusion or a belated adjustment to price rises that took place some years ago in other parts of the economy.

REASONS FOR ECONOMIC SLACK

Role of taxes

Several explanations have been offered for the deflationary tendencies of recent years. A growing consensus, however, has developed that one of the most important factors has been the tendency of Federal, State, and local tax structures to exert too powerful a braking effect on the economy when demand is rising.

In general, State and local taxes tend to fall largely on consumption or on private incomes usually devoted largely to consumption. Only a minor part of these taxes, probably no more than 5 to 10 percent, falls on either savings or investment.

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[1] Joint Economic Committee, hearings on "State of the Economy and Policies for Full Employment," 87th Cong., 2d sess., testimony and discussion of Ewan Clague, Commissioner of Labor Statistics, U.S. Department of Labor, pp. 735-774. Also see Mr. Clague's testimony before the Joint Economic Committee in hearings, "January 1961 Economic Report of the President and the Economic Situation and Outlook," 87th Cong., 1st sess., pp. 23 ff.

At the Federal level, tax policies since 1941 have been continuously adapted to what were viewed correctly (until recent years) as inflationary conditions. Taxes were adopted in an atmosphere of excess demand, of almost constant pressure on productive resources, and of excess liquidity sufficient to have generated a runaway inflation. With the passage of time, Federal tax policies have become outdated and illadapted to present and prospective conditions. Probably as much as 70 to 90 percent of the Federal tax burden falls upon consumption, and from 10 to 30 percent upon savings. Reasonable men may come to different conclusions about the precise numbers. It is clear, however, that Federal taxes, reinforced by the persistent rise in State and local expenditures and taxes, have tended to shift an increasing proportion of the combined Federal, State, and local tax burden onto consumption. This is the prescription for an anti-inflationary policy. It tends to encourage a significant rise in rates of savings, both average and marginal, and a reduction in the ratio of consumption and investment to the Nation's full employment output and incomes.

We need to remind ourselves how important it was in the wartime and early postwar years to maintain a strong anti-inflationary fiscal policy as a barrier to runaway inflation. Memories may now be dim, but in 1944 the Federal deficit amounted to one-fourth of the gross national product, while in the early postwar years the volume of deferred demands for consumer goods, capital goods, and government projects, not merely in the United States but in all the free world, was so overpowering that only the most careful guard against inflation could prevent disaster. The earliest hearings of this committee, 15 years ago, were on this very problem of inflation. Most of its activities over its first 5 to 10 years of service to the Congress directly or indirectly concerned the importance of guarding the Nation against inflation.

Internationally, the United States in those early years had an excess of liquidity and the rest of the world almost none, as indicated by the so-called dollar shortage and the dominance of the United States as holder of most of the world's gold supply. Economies around the world were disorganized, physical capital was substantially damaged by war, and productivity in these countries was lower relative to the United States than it had been before World War II.

But by the middle 1950's these underlying inflationary and expansionary forces had been largely eliminated in these countries. The United States had contributed to the restoration of the economies of Western Europe and Japan, to the redistribution of international liquidity and gold stocks, and hence to the convertibility of the currencies of other trading nations. We had extended military assistance to our allies; extended economic assistance to developing and newly emerging nations; rearmed at home; rebuilt most of our capital facilities, both public and private; and satisfied the deferred demand in this country for consumer goods and housing. As if this were not enough, between 1946 and 1957 the Nation reduced the average annual hours of work by about 7½ percent, including an increase of about 50 percent in the average length of annual vacations per employee.

These accomplishments resulted in the elimination of the vast deferred demands and excessive liquidity that had been so inflationary after World War II and during the Korean rearmament. Yet the only revisions in taxes from the mid-1950's to date were a rise of at least $8 billion to $10 billion per year in increased social security taxes—a regressive form of taxation—and the tax laws of 1954 and 1962. Both of these latter revisions tended in general to reduce Federal taxes falling mostly on incomes, personal and business, that were likely to be saved rather than on those that were likely to be promptly spent.

Thus, the dominant economic fact in recent years has been a steadily more oppressive burden upon the economy from Federal, State, and local tax policies which tended to discourage consumption and investment and to encourage savings. With the inflationary pressures conquered, the result has been to hold down demand so far below full employment output as to produce unemployment of labor and capital. It is indeed a tribute to the strength, vitality, and dynamism of the American economy that these oppressive burdens have so far failed to produce massive unemployment and financial collapse.

Role of structural changes

In stressing the now oppressive character of tax policies which once served a valid national purpose, it would be a mistake to overlook other developments that have also contributed in lesser degree to the Nation's problems of unemployment and idle capacity. The major problem is inadequate total demand, but the situation has been aggravated by some serious structural problems: immobility of labor and capital; workers without the training and experience for new job opportunities opening up in our economy; particular local areas in which, for one reason or the other, dynamic changes in technology and demand have left resources without profitable employment. But these structural problems are not new. They have been reported repeatedly by Government and private agencies for decades. These structural changes are a significant impediment to further noninflationary expansion of demand and output when unemployment is at or below 4 percent. But persistent unemployment of 5–7 percent reflects inadequate total demand—not these structural influences.[2]

Technological change has produced not only these structural imbalances, but also has reduced the costs of making adjustments. It now costs less relative to today's income levels for a worker to change his job or his location than was true 25 to 50 years ago. Similarly, costs to management in moving plant and equipment that would have been prohibitive some decades ago are today economically feasible due to improvements in technology. Nor does the matter end here. At one time, to shift a worker from one trained occupation to another would have involved several years of new training and experience before the worker could earn his way in the new trade. Skills and trades were highly specific, particularly in the mechanical pursuits. Today most skilled jobs have more of a common core of skill requirements, teaching techniques are better, and training programs can be designed that will permit shifts of workers within a shorter time period and at a cost which is feasible for society, the employer, and the worker to meet.

[2] Subcommittee on Economic Statistics: "Employment and Unemployment," a report to the Joint Economic Committee, 87th Cong., 2d sess., and "Higher Unemployment Rates, 1957–60: Structural Transformation or Inadequate Demand," 87th Cong., 1st sess.

While the major focus of policy this year—as the President has indicated in his messages to the Congress—is on the problem of taxes, we must not forget that the most successful tax policy cannot do the whole job. Public and private policies must also be designed to deal with the problems of structural rigidities and immobilities. For example, some programs proposed by the administration are intended to deal with the problem of young people with inadequate training. Tax policy revisions are important in creating an atmosphere in which adjustments of the system to full employment conditions are possible. Structural revisions are also important and necessary, however, if unemployment rates, below 4 percent, are to be achieved without inflationary consequences.

Role of monetary policy

Competent economists have testified before the committee that monetary policies must bear some of the share of the responsibility for the slowdown of recent years and the failure to restore full employment during two successive cyclical expansions. Undoubtedly, the overly restrictive monetary and debt-management policies of the winter of 1959–60 contributed to the 1960–61 downturn. The committee commented upon this point in earlier reports, particularly a year ago when we stated:

> First, Federal Reserve authorities have shown a stubborn propensity to tighten credit and force up interest rates during each recovery period, notwithstanding the fact that each recovery has begun from a higher plateau of interest rates (and a money supply relatively smaller) than the previous recovery. Interest rates have been trending upward again throughout the 1961 recovery. Although the upward movement, so far, has been at a comparatively gentle rate, there are indications that the monetary authorities are already impatient to have them resume their more accustomed pace.[3]

THE ECONOMY IN 1963

The evidence presented to the committee indicates that, at present, economists generally look for continuing moderate gains this year. Government purchases—Federal, State, and local combined—are expected to rise at about $2 billion per quarter. Business investment may average slightly above last year's level. Home construction should continue at about its fourth-quarter rate. Consumer purchases should continue to rise, in line with gains in disposable personal income generated by business and Government activity.

Economists differ as to how these factors will work out in terms of specific numbers. Even the most pessimistic experts expect gross national product this year to be about $565 billion, and even the most optimistic do not expect it to average more than perhaps $580 to $585 billion. The President's Economic Report and Budget are based on the assumption of a gross national product of about $578 billion for the calendar year 1963 (assuming his tax proposals are adopted), compared to about $554 billion in 1962.

At the very best, no significant reduction in unemployed labor or capital can be expected this year, even if the more optimistic experts

[3] Joint Economic Committee, Annual Report of the Joint Economic Committee on the January 1962 Economic Report of the President, 87th Cong., 2d sess., p. 8.

prove to be correct. Some rise in idle resources may occur, with unemployment exceeding 6 percent sometime during this year, even if taxes are reduced in accord with the President's program.

The prospects, therefore, indicate that if no action is taken on fiscal and other Government policies to remove the brakes which are restricting private economic activity, the Government's revenues again will be seriously impaired. Indeed, a renewed downturn this year in private economic activity would not be beyond the realm of possibility. If this occurs, the deficit in the Federal budget would mount beyond the most pessimistic expectations of the administration or its critics. Therefore, this year, short-run or cyclical and long-run growth considerations both call for immediate tax cuts and revisions together with complementary monetary and debt management policies.

Paths to full employment

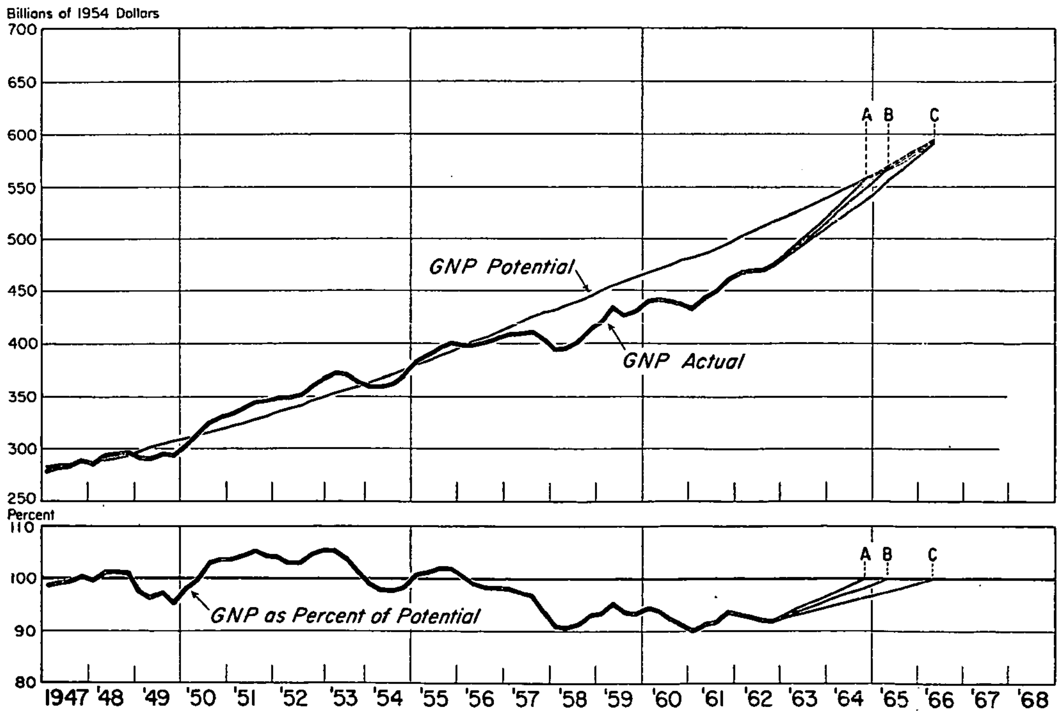
What is the magnitude and speed of the expansion necessary if the economy is to reach full employment in the foreseeable future? Chart I shows the comparative movements of actual and potential real gross national product. In the fourth quarter of 1962, demand was some 7 to 8 percent below the full employment output potential. Three paths from that point to full recovery are illustrated: "A" represents full recovery by the fourth quarter of 1964; "B" represents full recovery by the second quarter of 1965; and "C" represents full recovery by the second quarter of 1966. The first pattern "A", would require that gross national product rise by 8.3 percent per year over a 2-year period. The next, "B", would require an average rate of gain over 2½ years, of 7.4 percent per year. The third, and slowest pattern, "C", could be realized if the recovery averaged 6.5 percent per year over 3½ years.

Even the most rapid of these patterns, "A", would not be unrealistic if the proposed program of tax reduction and reform is adopted and is accompanied by appropriate monetary and debt management policies. Historically, output has tended to rise at a pace of between 8 and 13 percent per year during periods of recovery until the economy approaches full employment of labor and capital. At this point the rate of gain slows considerably, soon coming down to, or below, the long-term rate, or to between 1 and 4 percent per year. The only exception occurs when the economy, for some reason, reaches a cyclical peak and turns down before full employment of productive resources is reached. This happened in 1959–60. A similar slowdown short of full recovery seems to have been happening during the past year. Consequently, if the proposed fiscal program works—producing a normal recovery movement toward full employment—then from past experience it would be reasonable to expect a very high rate of gain in demand, and hence in output, until unemployment begins to approach 4 percent, and real GNP approaches potential GNP. This would be close to, if not faster than, the pattern labeled "A" on chart I.

Chart I

Actual and Potential Real Gross National Product,

Quarterly since 1947, at seasonally adjusted annual rates, and actual as percent of potential



Source: Department of Commerce and the Staff of the Joint Economic Committee.

Parenthetically, this analysis of recovery patterns implies that under the President's program the Federal budget on a national income account basis would tend toward balance by the end of calendar 1964. Historical precedent would be in favor of the budget (national income account basis) showing a surplus in fiscal 1966 and subsequent years unless: First, for reasons not contemplated under present budget policies, it becomes necessary to sharply raise Federal expenditures for national defense, international affairs, or space; or second, the economy experiences a renewed cyclical downturn. This latter development would prevent the Government from realizing the full revenues which the new tax structure would provide at full employment levels. If the tax program works as can reasonably be expected, however, a new cyclical downturn would not be likely to come soon enough to affect Federal receipts significantly before fiscal 1966 or later.

FISCAL POLICY

The fiscal policies of the Federal Government concern much more than the mere matter of financing those expenditures by the Government which are deemed desirable in the national interest. A two-way interaction occurs between the Federal budget and the private economy. Receipts and expenditures in part reflect changes in the general levels of private economic activity and also have a substantial influence on the level and rates of change of total output, employment, and purchasing power. We conclude:

Federal budget surpluses or deficits are unreliable as indicators of whether budget policies are expansionary or inflationary on the one hand, or are deflationary or repressive on the other.

Most people believe, as does this committee, that fiscal policies should be designed to produce regularly recurring surpluses during prosperous years so that the Federal debt can be reduced. Most people also believe that when the budget is balanced or shows a surplus the Federal Government is not contributing to an inflationary situation and that when it shows a deficit there is a definite contribution to inflation. In a word, surpluses are considered synonymously with fiscal restraint; exact balance with neutrality; and deficits with expansive or inflationary policies. This is not always correct.

Budget surpluses and deficits can arise from a wide variety of causes so that in some cases a budget surplus may occur when the Government is following a definitely expansive and even inflationary policy, while on the contrary, a deficit may reflect budget policies that are definitely deflationary in character. Since most people quite rightly are more worried at the moment about budget deficits than about budget surpluses it may be useful to point out that a budget deficit can arise under at least three different types of conditions:

First, expenditures and tax policies can be such that in the long run the budget will show an appropriate surplus in most years. But, in any one fiscal year, the economy, for some reason independent of fiscal policy, may experience a recession. Personal and business incomes then will fall and Federal revenues will be too low to balance the budget. This "passive," unplanned deficit would be the result of a temporary decline in private economic activity. If, in this circumstance, either expenditures are cut or taxes increased in an effort to balance the budget in the face of falling receipts, the recession would quickly spiral downward into a very large and prolonged depression. But, if the Government "sits tight" on the fiscal front and follows an expansionary monetary policy, the deficit should be minimized. With an early restoration of prosperous conditions, a surplus will be generated to make possible repayment of debt incurred in recession.

Second, the tax structure can be well designed but total expenditures too large for the revenue structure to finance, even at full employment levels. This is typically the case in wartime. Whenever this happens, the Government's budget will develop an inflationary deficit even at full employment. The obvious policy prescription for such a situation is to raise taxes and tighten monetary policy as severely as possible while exercising the utmost economy on the expenditure side. This was the set of policies recommended vigorously by this committee when the Korean emergency arose in mid-1950. We are still convinced that prescription was correct.

Third, a deficit can arise because the existing tax structure is too repressive on private activity. Taxes may yield, at full employment, such large revenues that the private economy simply cannot adjust to the stringent tax burdens on private incomes and expenditures. This is a chronic deflationary situation. Output, employment, and incomes will tend to fall short of full employment levels. Consequently, Government revenues will be inadequate. The budget will show a deficit as a result not of inadequate taxes or, necessarily, of excess expenditures (though expenditures could be excessive by standards of efficiency or social policy). Rather, the deficit results from the depressing effects of inappropriate tax policies on private economic activity.

This last set of conditions can be remedied only by a revision in the tax structure that reduces the repressive character of the tax law and/or reduces the amount of revenue raised at each level of total private incomes. A revision in tax structure and rates will produce more revenue in these circumstances as a result of improved economic conditions and can bring about a balanced budget or a surplus as quickly as the private economy can respond to the change of policy. Tax change in this case is the shortest and quickest way to a balanced budget and the elimination of deficits. In these circumstances, the surest and quickest way, therefore, to hold both deficits and the national debt to a minimum is to revise and reduce taxes.

Recent Federal deficits reflect fiscal policies which, on net balance, have tended to hold down expansion of the private economy.

Recent deficits are largely the result of excessive and repressive taxation. The economy could finance a higher level of Government expenditures if this were desirable for reasons of national security or social policy. But, the present structure of taxes is capable of producing, at full employment, revenues which would produce too large a surplus over recent and proposed levels of Federal Government expenditures. Furthermore, the tax structure itself tends to be deflationary, as indicated earlier in this report. Postponing action to correct the present deflationary fiscal policies will make the situation worse, not better. The debt will go up least, and budget deficits will be smallest and soonest eliminated, if there is now a broad and thorough-going revision of fiscal policy.

Of course it could be argued that the budget ought to be brought into balance by raising taxes or reducing expenditures by enough to eliminate the deficit of $9.2 billion in the fiscal year 1964 administrative budget. When questioned about this possibility the Director of the Bureau of the Budget estimated during our hearings that a rise in taxes of $20 billion would be necessary to balance the budget in fiscal 1964. Alternatively, expenditures would have to be reduced by at least $20 billion—and depending on the composition of the cuts, perhaps more. Such a large rise in taxes or cut in expenditures, he estimated, would increase unemployment by about 1½ million workers, and raise the unemployment rate to between 8½ and 9½ percent of the civilian labor force.

The unemployment resulting from such a reduction in Government expenditures would be more than the total employment of all individuals in the San Francisco-Oakland region, or the total number employed in Boston, Mass. The total unemployed from this type of Government expenditure reduction would be greater than all individuals presently employed in Detroit.

We are convinced that a reduction in Federal Government expenditures to the extent of $10 to $15 billion cannot be obtained without severely curbing the amount of Government services now provided. For example, the entire costs of operation and maintenance of the Department of Defense are less than $15 billion. Total research and development by the Department of Defense is about $7 billion. Total expenditures for natural resources are about $2.6 billion. Contemplated expenditures for commerce and transportation amount to slightly over $6.5 billion. The point which we make is that Government expenditures are basically beneficial to the Nation. Undoubtedly, some economies can be made in all of these areas, but a slash of major proportions would seriously reduce the level of services which the Nation now obtains from its Federal Government.

Recommendations

The President and his Council of Economic Advisers have produced an excellent report. They have indicated their best estimates concerning future economic trends and also recommended specific policies aimed at achievement of full employment and rapid economic growth. The Economic Report concentrates attention largely on tax reduction and reform. While we generally agree with their discussion, tax policies, while important, also must be coordinated with other policies designed to meet the basic economic problems. Thus our own recommendations cover not only the specific question of taxation but also other economic issues on which decisions should be made in the months ahead.

FISCAL POLICIES

We favor enactment as quickly as possible of reforms which will tend to broaden the tax base, reduce the complexity of the tax structure, reduce overlapping with State and local tax structures, and contribute to improved economic stability,

full employment, and economic growth. Tax reforms are essential. They involve many questions of equity and social policy in addition to the purely economic issues they raise.

The administration has wisely made reform of our complex, repressive, and often inequitable tax structure an integral part of its tax program for this session of Congress.[4] Obviously, reforms are needed and are always in order, as this committee has pointed out repeatedly. Opinions vary widely as to the tax changes that would be appropriate as parts of a tax reform program.[5]

It is important to recognize the distributional effects of the reforms which have been proposed by the administration. The proposed revisions tend largely to close loopholes that exist with respect to higher income individuals and corporations. The proposed tax reduction is largely proportional by income groups. However, almost all of the tax reductions which have been granted in recent years, specifically in 1954 (particularly the depreciation changes) and in 1962 through the investment credit and further depreciation revision, have been for the benefit of higher income groups and corporations. The changes in 1954 and 1962 probably involved net tax reduction to these groups of as much as $10 to $12 billion per year. On the other hand, social security taxes have been increased by at least $8 to $10 billion per year, and these fall almost entirely on lower income families.

Thus the reforms proposed currently tend, when considered in conjunction with the tax reduction proposals, to redistribute the balance by providing relatively greater net tax reduction for lower income groups. These reforms are essential because they are the sole source of the progression in the tax reduction proposed by the President.

The Congress should promptly enact a tax revision program in line with the general economic principles underlying the President's proposed tax program. In view of prospective expenditure programs and economic trends, this is the surest path to full employment and rapid economic growth; it is also the surest and quickest path to achievement of budget surpluses and debt retirement.

A reform of the Federal tax structure and a *reduction* in *tax rates* can result in a *rise* in *total Federal revenues* whenever Federal revenues take a substantial share of total incomes (gross national income,

[4] Senator Claiborne Pell: In any consideration of reform, serious consideration should be given to a sweeping simplification of the present tax rules. I would favor a framework in which all tax rates would be cut as low as possible along with a drastic reduction in exemptions and deductions, making allowance only for extreme hardship cases. To my mind, such a system would be of great benefit to the Nation because it would remove, in one sweep, the existing possibilities for nonpayment of tax, which result from the legal use of present loopholes or through outright evasion. Moreover, such a sweeping reform would make the tax system vastly simpler to administer and it would make it vastly easier for the individual taxpayer to comply. Business and personal financial decisions would be based more on the economics of the market place and less upon tax consequences. The entire economy—in addition to the Public Treasury—would benefit.

[5] Congressman Boggs believes tax reduction is sufficiently important to the Nation's economic growth that the President's tax reduction proposals should be separated from the tax reform recommendations. Tax reduction should be considered expeditiously by the Ways and Means Committee and the Congress; tax reforms can then be examined later. The tax reduction program should be—as the President recommended—across the board to all income groups, although adjustments may have to be made to reflect the fact that reforms will not be part of the tax reduction package. This position involves no commitment or judgment concerning the merits of the various reforms proposed by the administration, each of which must be considered in detail by the Ways and Means Committee and the Congress.

before deductions of depreciation), and at least one of the following conditions prevails: (1) Federal tax rates, in combination with substantive provisions defining the tax base, are so repressive of private economic activity that output and employment are held down below full employment rates; and/or (2) the tax system is geared to produce at full employment a surplus over expenditures too large for the private economy to accommodate within prevailing private habits of consumption, savings and investment.

These conditions have prevailed in the United States during recent years. The present tax structure was largely designed as a vigorously repressive component of a general anti-inflation policy. Hearings and reports of this committee between 1947 and 1953 testify to this emphasis. Furthermore, the anti-inflation character of Federal tax policies has been reinforced constantly by growing State and local tax burdens which fall heavily on consumption and lightly on savings.

The Federal Government is in a situation not unlike a private business firm. Total demand for a firm's product will change over time with fluctuations in general business conditions, even though the firm may maintain a constant price for its product. But the firm may discover that its aggregate profits over the business cycle still produce less than an adequate average rate of return on its capital. Under these conditions, a reduction in the price of its product may serve to increase the aggregate sales of its product by more than the accompanying rise in costs—especially as fixed, or overhead costs will be written off over a larger physical volume. Demand for the product (at the lower price) will continue to fluctuate with cyclical changes in business conditions. However, total sales and profits, at each point in the cycle, will now be greater than they would have been if the earlier higher price policy had been continued. Hence the average rate of return on capital will be higher.

The basic reason for supporting tax revision—including provisions to broaden the tax base and substantially reduce rates—is to eliminate deficits and realize the budget surpluses which a healthy economy is capable of producing. Such revision will free the private economy of the irrational restraint of a repressive Federal tax system, permitting a rapid rise toward full employment of labor and capital. This can even result in revenues substantially larger than under present taxes

The administration's tax program is designed, initially, to increase consumer demand. The first effect of tax reduction is to place more funds in the hands of individuals. Thus, a reduction in withholding rates will serve week by week, and month by month, to raise the take-home pay of those receiving wages and salaries. Probably about 93 cents out of every dollar of tax savings will be spent by taxpayers. The historical evidence seems overwhelming. Taxes were reduced in 1948 and, during the course of 1948 and 1949, personal consumption expenditures continued to rise even in the 1949 recession, while the ratio to disposable personal income averaged about 94 to 95 percent. Again, in 1954, tax reduction occurred, and a percentage of about 93 prevailed.

While some individuals may choose to save—at least in the short run—a larger than usual portion of their increased after-tax income, it certainly seems reasonable to presume that others will be encouraged by the permanent nature of the tax reduction to commit themselves for new durable consumer goods bought on credit. This latter will tend to increase the ratio of aggregate consumer outlays to disposable personal income.

But this is not the end of the story. For every buyer there must be a seller. Every additional dollar spent from tax savings is received by some business firm or individual in the form of increased gross income. What will happen to this additional income? Much of it will certainly be reflected in increased consumer demand. Some portion will be absorbed by business firms in the form of increased retained earnings.[6] Of the increased income, some portion will go to governments (Federal, State, and local) in the form of increased tax payments.[7] Individuals will have a substantial amount that will be reflected in a further increase in consumption expenditures. These consumption expenditures, in turn, create a new round of additional income. With each rotation of the funds, additional amounts are drawn off so that the residual additions to consumption are progressively less. They are, however, positive and add with each circuit through the economy some further increase in aggregate demand for goods and services.

This is the first basic form of stimulus to the economy which can be expected from tax reduction. It meets, directly, the problem of inadequate demand by increasing the cash flows to individuals who will increase their purchases from business. We estimate that the multiplier increase in total demand stemming from tax reduction will probably be in the order of 2¼ times the amount of the tax cut.[8]

Moreover, additional consumer demand will undoubtedly encourage businessmen to expand the amount of their investment in plant, equipment, and inventories. This expansion in investment also will generate additional income, and some of this income will be spent. As a consequence, tax reduction serves both to increase after-tax incomes directly, and also to raise incomes indirectly by encouraging investment activity.

The fact is that our automatic stabilizers have developed too much braking power. When the economy expands, total tax receipts increase more rapidly than incomes.[9] The result has been increased stability, but at lower and lower rates of output of the economy's labor and capital. Effective automatic stabilizers are vital to a healthy economy, but changes are now necessary in the tax structure to make these automatic stabilizers operate around a full employment rate of total output, rather than around a level reflecting substantial economic slack.

The majority of this committee is in favor of general tax reform. However, there is a question—both within the nation generally and within this committee—as to whether tax reform should be enacted simultaneously with tax reduction. In view of the fact that tax reforms may take considerable time to enact, Congress may decide to separate from the major tax package some of the

[6] But this will presumably influence nonconsumer decisions.
[7] These increased revenues at the State and local level may well be used to expand governmental services, providing an additional stimulative effect.
[8] See supplementary staff material, p. 45.
[9] This result reflects primarily the fact that marginal tax rates are higher than average tax rates under the existing Federal tax statutes. See Report of the Joint Economic Committee on the 1961 Economic Report of the President. Appendix "Staff Memorandum on the Relationship of the Federal Budget to Unemployment and to Economic Growth," 87th Cong., 1st sess., pp. 119–125.

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tax reduction and enact it quickly. If this becomes necessary, the tax reduction selected for quick enactment should concentrate the tax savings largely in the lower income brackets.

While we strongly support the legislative approach of retaining the President's program in one package, it may become necessary, in order to provide a powerful initial tax reduction in 1963, to separate one piece of the package and move it more expeditiously through the legislative process. We recommend, on economic grounds (i.e., maximizing the stimulative effect), that if this becomes necessary, the proposed tax reductions be such as to concentrate these first stage reductions largely in the lower income brackets. Such action would also be equitable since, as noted earlier, tax revisions since 1954 have benefited high income groups and corporations while raising taxes on lower income groups via higher social security taxes. Either a rise in the personal exemption or a change in the first bracket rate would fit this requirement.

If the proposed changes in the first bracket individual rate is the part selected for quick action, then this will benefit *all* taxpayers, since all taxpayers pay the first bracket rate. Thus, if the present first bracket were split and new rates of 14 and 16 percent were immediately applied to the present income ranges now subject to 20 percent, all taxpayers would obtain some tax benefit, with the maximum amount per taxpayer being $200 for all married couples with taxable income in excess of $4,000. At the same time the major relative advantages from such an approach will be felt by the lowest income groups. Hence, the initial economic stimulus from such an approach would be maximized.

This proposal could be fitted easily into the administration's set of recommendations, since the proposal merely accelerates one portion of the final recommendation. All the rest of the recommendations, including further rate reductions, could follow along the legislative path at a more leisurely rate, and obtain the same final results. This is a logical division since the other rate reductions affect the same taxpayers who currently benefit from many of the "loopholes" which will be closed by the proposed reforms.

This suggestion also accelerates the amount of tax reduction consistent with our recommendation below. The aggregate initial revenue loss from our approach might be about $6 billion in 1963, contrasted with the administration's recommendation for $2.8 billion. Of course, a much greater "feedback" of increased revenues at the lower rates could be expected as a result of the greater economic stimulus, so that the net revenue loss in fiscal 1964 might be quite small—in fact, possibly smaller than under the administration's more conservative approach.

A revenue loss of about $10 billion under the proposed tax program, spread over 3 years as recommended by the President, would be of about the right order of magnitude. But the proposed schedule is too slow. The largest part of the revenue loss (about $6 billion) should be concentrated in calendar 1963, with progressively smaller parts in succeeding fiscal years.

The President has recommended to the Congress that his $10 billion tax reduction program become effective over a 3-year period, beginning in calendar 1963 and ending in calendar 1965. This timing is indicated in table 1. The timing of the tax changes over the 3-year period can significantly affect the way in which the proposed program will influence the economy.

TABLE 1.—*Tax program revenue effects by years*

[In millions of dollars]

CALENDAR YEAR LIABILITIES

	1963	1964	1965
Individual:[1]			
Rate reductions	−2,760	−8,280	−11,040
Reforms		+2,330	+2,330
Total	−2,760	−5,950	−8,710
Corporations:			
Rate reductions	−330	−1,250	−2,560
Reforms		+200	+200
Acceleration of payments		+1,300	+1,500
Total	−330	+250	−860

PERCENTAGE OF TOTAL REDUCTION

	1963	1964	1965
Individual:[1]			
Rate reductions	25.0	75.0	100
Reforms		100.0	100
Total	31.7	68.3	100
Corporations:			
Rate reductions	12.9	48.8	100
Reforms		100.0	100
Acceleration of payments		86.7	100
Total	38.4	−29.0	100

[1] Exclude capital gains changes

Source: President's 1963 Tax Message, hearings before the Committee on Ways and Means, House of Representatives, 88th Cong., 1st sess., pt. 1, p. 63.

The current problem is to move from a position of low activity to a higher rate at which the economy will grow smoothly in line with longrun trends. It would seem appropriate, therefore, to schedule a substantial amount of the individual income tax reduction now when there is the greatest amount of unused resources. Additional tax reductions might then be tapered off as the economy moves closer to a higher full employment rate of activity. Small initial injections of tax reduction which become larger in later stages may serve to stimulate the economy at an accelerated rate. The effect of this approach could be to generate new cyclical fluctuations and perhaps a temporary inflation. The largest doses should be given when the patient is the sickest—not when he is almost well.

What time schedule has been proposed for the personal tax changes? About one-fourth of the proposed tax rate cuts for individuals would be made effective in calendar 1963; another one-half would become effective in 1964; and the final one-fourth in calendar 1965. If we include the effect on personal tax liabilities of both changes in rates and the proposed structural reforms, the net revenue loss would be spread almost evenly through the 3 calendar years: i.e., about 32 percent in calendar 1963; about 36 percent in calendar 1964; and about 32 percent in calendar 1965.

A greater initial tax reduction may serve to increase the fiscal 1964 deficit. There comes a time when economic realities should outweigh political considerations. The greatest likelihood of achieving the smallest possible accumulated budget deficits over the next 3 fiscal years and at the same time stabilizing the economy at the full employment longrun trend of output can be realized through substantial initial tax reduction in calendar 1963. We urge Congress to quickly enact tax legislation providing about $6 billion of revenue loss in the current calendar year 1963, and thereafter for progressively smaller amounts during calendar 1964 and 1965.

There is one qualification to our general conclusion. Corporate rate reduction is proposed in part on the grounds that it will benefit small business firms by increasing their after-tax retained earnings. For these small firms, almost their only source of funds for expansion is their retained earnings. We accept this justification in its entirety. Therefore, we support without qualification the proposal to reverse at once the present corporate normal and surtax rates of 30 and 22 percent.

The administration should amend its tax program to include reductions or eliminations of some present Federal excise taxes. Such changes should be promptly incorporated in pending tax legislation by the Congress.

We were disappointed to discover that no mention was made of reductions in excise taxes in the President's tax recommendations. The reduction of excises would be ideally suited to meet the objectives set out by the President in his tax message. These excises were generally enacted under wartime or inflationary conditions as a means of reducing consumption. Under present conditions of inadequate consumer demand, this justification for them is no longer valid. Obviously, we do not include in this category excises on alcohol, tobacco, or excises paid into trust funds to pay for specific public services, such as highways. We were impressed by the apparent unanimity among our witnesses and our own committee members that excise reduction and removal was appropriate in 1963.

There is unquestioned evidence to indicate that excise revenues are obtained in large part from low-income groups. Thus, a reduction in excises, when passed on in the form of price reductions, can benefit consumers even more than commensurate reductions in income taxes. From a stimulative standpoint alone, therefore, perhaps the strongest case for tax reduction can be made with respect to excise taxation. This is especially true since many of our present excises are imposed on goods that pass through several succeeding levels of processing and marketing. As a consequence, removal of excises may well result in reductions in final consumer prices by more than the amount of the excises. Furthermore, some of the present excises directly raise business costs—for example, excises on automobiles, business machinery, and telephone service—and thus affect final prices.

A more fundamental justification for excise reduction can also be made. Excises, by their very nature, serve to distort price relationships in the economy. Thus, they tamper with the efficient allocation of resources. Reduction or removal of selected excises, especially those imposed at the manufacturer and wholesale levels, could result in lower prices and a much more efficient provision of goods and services to meet the demands of the consuming and investing public.

A further reason for excise reduction concerns the efficient use of resources by the Federal Government. Administrative costs, both by taxpayers and by the Federal Government, are undoubtedly greater for excises than for income taxes. Reduction or removal of excises will thus reduce the costs of paying taxes and the costs of auditing taxes.

Administration policy has been to concentrate largely on tax reduction and reform to stimulate private spending, holding nondefense expenditures constant, and providing only for the most necessary increases for defense and space. This committee believes that economies could be found in some of the present spending programs and that from such savings greater emphasis could be given on the expenditures side of the budget to the great priorities of national need: Education, health, conservation, research and development, urban renewal, worker retraining, and area redevelopment, without increasing total expenditures.

The administration has placed almost total emphasis upon tax reduction as the means of stimulating the economy. In economic terms this emphasis by the administration reflects a decision that increases in aggregate demand within the private sector will yield greater benefits to the Nation than would be obtained if the tax moneys were used to finance increased Government expenditures. Reliance has, therefore, been placed upon the private economy rather than the Government to further the satisfaction of individual wants in the Nation. In general, we agree with this emphasis.

For years, this committee and other committees of the Congress, have pointed out numerous ways in which expenditures can be reduced through more efficient procurement and supply practices, elimination of duplication of activities, wider use of competitive bidding, cutting back old programs or activities no longer needed, and reductions in some of the numerous subsidies to private groups and industries. As one example, Secretary of Defense McNamara has already made substantial economies along the recommended lines. More could be done both in Defense and other departments and programs.[10]

No member of this committee would support increases in unnecessary Government expenditures which had as their sole justification an expansion of economic activity. This Nation has far too vast an array of unmet needs to justify using any resources in sterile make-work programs. Nor is there any excuse for inefficiency and waste in the use of tax dollars under either defense or nondefense programs. If additional Government expenditures yield no benefit to the Nation, they should not be made. The criterion, however, is much stiffer. Increased Government expenditures should not be made—even though they provide social benefits—if the benefits derived from the expenditures are less than those which would be obtained by commensurate expenditures in the private sector.

No simple comparison can be made of satisfactions obtained through private and public means. We believe primary reliance should be placed upon tax reduction. We believe also that some types of increased Government expenditures can provide a high rate of return to the Nation.

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[10] Senator Claiborne Pell: "With regard to our essential national security expenditures, I believe potential economies may be realized through a revamping of our civilian and military foreign aid programs. While these programs must be continued, the emphasis should be placed increasingly on education, technological training and on pilot projects. Such a policy could lead to a reduction in the size of programs."

Expenditure increases which can be justified on their own merits have the advantage that they may be concentrated in certain geographic or economic sectors of the Nation. For example, if depressed conditions occurred in a large city, a new Government contract that could be justified on other grounds would be of maximum economic benefit if it could be made to private firms in that city. Similarly, if a particular industry was suffering from a temporary reduction in demand and Government expenditures justifiable on other grounds can benefit this industry, such expenditures would have a maximum economic effect.

The administration has made a conscientious effort to hold down the increases in aggregate Government expenditures. However, the net economic effect of the 1964 budget will probably be moderately expansionary even without tax reduction. Spending for defense and space will be larger although, on balance, other expenditure requests have been held constant.

In addition to this general recognition of the expansionary nature of the proposed 1964 budget, there are expenditures which would yield a high social return in the form of contributions to future economic growth. These could be financed out of savings in present programs of the type outlined above so that there would be no net increase in expenditures. The result would come from some shift in priorities.

Public works

Needed public works are one of the primary ways in which the Federal Government contributes to economic growth, because these projects,as well as private investment, expand the ability of the total economy to produce goods and services in the future. It is unfortunate if these projects are curbed simply in order to obtain an aggregate budgetary figure which seems politically attractive. If public works can be justified on their merits, the Nation is worse off if these projects are not made. Moreover, at the present time when there are high levels of idle resources, these projects, if they meet the criterion we have indicated, will further serve to stimulate the economy. Finally, these projects have another advantage in that they can be concentrated in areas and industries which are currently depressed.

In the public works area, we are concerned about the geographical distribution of expenditures. Public works now are undertaken largely in areas where there is considerable land rather than a substantial number of people. Virtually three-fourths of our citizens live in urban areas that take up only 2 percent of the land. Public works with highest social priority are most likely to be needed in those areas where there are the greatest concentrations of population. Moreover, not only should the social returns be the highest, but also the economic returns, since it is in the areas of greatest population concentration that the most severe problems of unemployment exist.

Urban renewal

The Federal Government presently has a program under which urban renewal plans can be submitted by communities and, if appropriate, receive Federal support. This program could probably be both expanded and improved if the present law were expanded to permit the Federal Government to more actively assist communities in the preparation of potential urban renewal projects. Such promotion by the Federal Government could yield high returns without significant Federal expenditures. A vast need exists for private investment in urban redevelopment, but the Federal Government must aid in creating the opportunities for this private investment. Various estimates have been given that a dollar spent by the Government in directing urban improvement can stimulate between $2.50 and $3 of private investment.[11]

Education

We will not comment in this report on the specific legislative proposals dealing with the Federal Government in the area of education. However, we are concerned about the dominant place that education has in our longrun economic growth. We are also concerned about the tremendous needs that exist in the fields of education. Perhaps in no other field can a dollar of additional expenditures yield as high a longrun rate of return. It has been estimated, for example, that at least 40 percent of the economic growth during the postwar period is attributable to our expanding educational base. Additional Federal expenditures designed to assist State, local, and private agencies in meeting these needs should provide great benefits to the Nation in the years to come.

Health

The economic returns from improved health are probably of the same order of magnitude as improvements in education. In both cases, the needs are great and the benefits to the economy substantial. Without commenting upon specific legislative recommendations, we emphasize the importance of these expenditures.

Encouragement of private research and development

In addition to the development of physical plant and equipment through public works and the improvement in our human resources through expenditures for education and health, substantial gains in economic growth can be obtained through improvement in the state of technological knowledge. This is a threefold problem. First, we must give encouragement to inventors and innovators. Second, we must insure that increases in technical knowledge are widely disseminated. Technology develops in part from private sources. However, the Federal Government, especially through its military interest, significantly influences this development. More attention should be directed to the subject of dissemination of research results obtained in the first instance for the benefit of the Government.[12] Third, the large Government share of research and development activities has been administered in ways that have produced varying and uneven impacts on the economy.

MONETARY AND DEBT MANAGEMENT POLICIES

We do not agree with the Council of Economic Advisers that: "Monetary policy has remained favorable to economic expansion." [13] The widespread urge for supplementary fiscal action is evidence of the

[11] See "The Scope and Financing of Urban Renewal and Development," a statement by the Business Committee of the National Planning Association, June 1962.
[12] See, for example, the report by the Bureau of the Budget on "Government Contracting for Research and Development," Senate Subcommittee on Government Operations, 87th Cong., 2d sess., S. Doc. No. 94.
[13] Economic Report of the President, January 1963, p. 19.

general feeling that monetary policy has not been favorable enough to bring forth enough expansion. Since mid-1962 active consideration has, accordingly, been given by the executive departments, by Congress, and in public forums, to tax reduction and reform as necessary Federal moves for reducing unemployment and stimulating growth.

This shift in emphasis which has pushed fiscal policy to the forefront in current policy discussion in no way eases, however, the responsibility of the Federal Reserve authorities to do more than in the past to restore the desired growth pattern. Indeed, if there has ever been any uncertainty as to the force of the public mandate in calling upon the monetary authorities for stimulative measures, vigorously pursued, that uncertainty can no longer exist. The widespread demands for stimulative tax reductions are by the same token demands for stimulative monetary action. Monetary policy must now help fiscal policy to do the stimulative job which, unfortunately, the monetary authorities have not done. Similarly, in these circumstances debt management should be handled so as to reinforce expansionary fiscal policies.

We recommend that the monetary authorities follow a policy of assuring that the money supply expands in line with the rising needs of an expanding economy. Such a policy will reinforce the proposed fiscal policies and at the same time spare the Federal Reserve System their perennial explanations of why monetary policy is blameless in the face of a lagging economy.

The failure of monetary measures, unaided, to bring about a satisfactory reduction in unemployment and an improved rate of growth stems in part from the policies which have been pursued. Increases in money supply have been allowed to lag behind the growth of the economy. Another aspect of recent policy involves the alleged constraints imposed by the balance of payments.

The adverse effects on the economy, when emerging from recession, of a tax system which operates to impose a drag upon the economy by rolling up a disproportionately large tax "bite" out of the increased activity are being recognized in current tax discussions. On the monetary side, the economy has had to contend with a similar institutional drag. The "money supply" has been allowed to level off with each weakness in the economy but is not permitted to expand to appropriate new high levels as the economy struggles to come out of the downswings.

As the volume of transactions of goods and services grows, something like a similar expansion in the media of exchange is necessary. Under our banking system, this means an expansion of the volume of credit. The Federal Reserve System was expressly designed—and is expected—continually to adjust the money supply to the increasing needs of the economy. If an expansion in available reserves is not forthcoming, either the volume of transactions must be curtailed or the existing money supply called upon to do extra duty. But money conservation measures are not costless. They are likely to be used only when the needs of expanding trade strain the available means of settlement. The upward trend in the turnover of demand deposits, most rapid in years of monetary restraint, is thus an indication that the public has not been supplied with sufficient amounts of new money in relation to transactions and income.

The ratio of money supply, that is, currency in circulation together with demand deposits, to gross national product, has steadily declined since 1950 (table 2). At the end of 1954, when the distortions of the Korean war had been liquidated, the money supply amounted to 35.9 percent of gross national product. As recently as 1958 it was 31.1 percent, down more than 10 percent, while in 1962 it was down to 26.4 percent, a decline of more than one-fourth in the decade.

TABLE 2.—*Money supply, total liquid assets, and gross national product with comparisons*

[Amounts in billions of dollars; ratios expressed as percentages]

Period	Gross national product	Demand deposits adjusted and currency outside banks	Total liquid assets held by the public [1]	Ratio to gross national product	
				Money supply	Total liquid assets [1]
1951	329.0	119.2	281.0	36.2	82.6
1952	347.0	125.2	298.0	36.1	81.8
1953	365.4	128.3	311.5	35.1	85.6
1954	363.1	130.3	320.3	35.9	85.9
1955	397.5	134.4	332.5	33.8	81.3
1956	419.2	136.0	343.2	32.4	79.6
1957	442.8	136.7	356.0	30.9	80.3
1958	444.5	138.4	373.1	31.1	80.2
1959	482.8	142.3	393.9	29.6	80.5
1960	503.4	140.9	399.2	28.0	79.0
1961	518.7	143.2	424.6	27.6	78.2
1962	553.6	146.0	458.3	26.4	80.9

[1] December each year, seasonally adjusted.

Source: Federal Reserve System data.

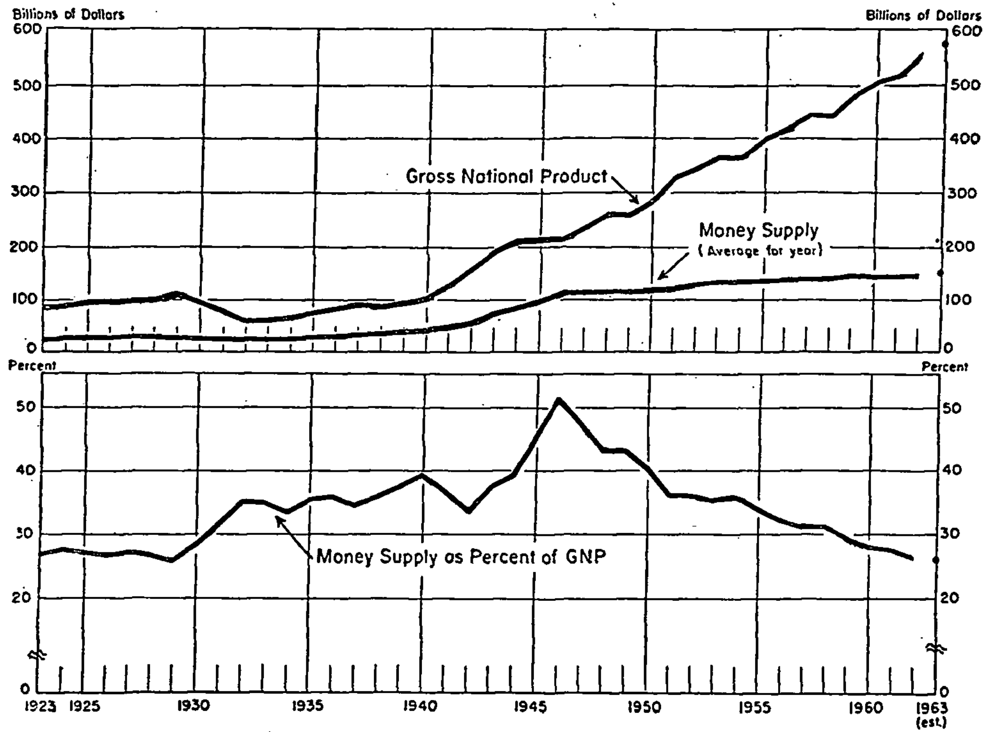
Stated another way, at the end of 1954 the money supply was called upon to support a gross national product 2.8 times its size. Eight years later it was being called upon to do one-third more; that is, the gross national product was 3.8 times the money supply.

If combined currency and demand deposits today had the same ratio to business activity as they did a decade ago, the money supply (demand deposits plus currency) would be over $200 billion instead of $146 billion. No one would suggest that the postwar lag in the money supply now dictates an immediate, or drastic, effort to catch up. Congress and the people have a right to insist, however, that in the decade ahead, the economy will not again have to make a 70-percent increase in gross national output of goods and services fit a 23-percent increase in money supply.

An expanded concept of money, including other so-called "liquid assets," is often used by the Board of Governors in its annual report discussions. The extent of the lagging financial means for carrying on business is less marked with this concept, but nonetheless real. Even when these other popular ways of holding substitute "money" balances are included, the liquid wherewithal for doing an enlarged volume business has been declining relatively. From 1954, after the Korean war, to 1961, total liquid assets held by the public have fallen from 85.9 percent to 78.2 percent of 1961 gross national product. It has been up somewhat in late 1962, returning to the 1957 levels.

CHART 2

Gross National Product, Money Supply and Ratio of Money Supply to GNP



Sources: Department of Commerce and Federal Reserve System.

Prepared by the Machinery and Allied Products Institute (See hearings, p. 782).

Recent evidence, coupled with the statement of the Chairman of the Board of Governors that some lessening of ease was decided upon in December 1962, shows that the authorities are already returning to the pattern which prevailed before this yearend increase in the ratio of liquid assets to gross national product.

We again recommend that the monetary authorities provide the basis for secular increases in the money supply as the economy grows, through open market purchases of longer term Federal securities, rather than by lowering reserve requirements.

We have in the past repeatedly recommended that the Federal Reserve provide the basis for an expanding money supply for our growing economy by open market purchases of longer term Federal securities. This policy gives the taxpayer a break through return to the Treasury of earnings of the Federal Reserve on such security holdings, instead of providing a free gift of earnings to the private banking system as occurs when expansion is provided through the lowering of reserve requirements. In addition, such open market purchases of longer term securities help the Treasury lengthen the debt, and tend to keep prices of longer term securities up and interest rates on these securities lower than would otherwise be the case. In turn, lower interest rates in the long end of the market tend to encourage investment, particularly in plant, equipment, and housing, which contributes to a higher rate of long-term economic growth. We can see no excuse for any other policy.

The monetary authorities have been going directly contrary to this committee's recommendation on this matter. They have reduced reserve requirements. The recent report of the Advisory Committee on Banking to the Comptroller of the Currency [14] indicates that further reductions in reserve requirements are under consideration. The Joint Economic Committee, therefore, requests that the monetary authorities advise this committee before taking any further actions which run contrary to this committee's repeated recommendation that secular increases in the money supply be provided through open market purchases of longer term Federal securities rather than by lowering reserve requirements.

We disapprove of the action of the Federal Reserve Open Market Committee in December 1962 when it moved to tighten monetary conditions. Tight money is not now needed either to fight inflation or to "protect the dollar."

The hope that monetary policy will aid, rather than hinder, fiscal measures was vitiated by the ready confession of the Chairman of the Board of Governors to this committee on February 1, 1963, under questioning: "I will say to you now that you are correct in your analysis that the Federal Reserve is pursuing a slightly less easy policy." [15] This statement was made in answer to a question as to whether policy had changed in December 1962 for the first time in 2½ years. The Chairman of the Board of Governors did not satisfactorily explain the

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[14] "National Banks and the Future," a report of the Advisory Committee on Banking to the Comptroller of the Currency, Sept. 17, 1962.

[15] Joint Economic Committee, hearings on January 1963 Economic Report of the President, 88th Cong., 1st sess., p. 348.

grounds for even a slight deliberate tightening of credit. The change of policy was confirmed and reasons for the action were set forth in the record of the Open Market Committee's actions for 1962 that was made available to the committee after the hearings in response to our request. The action still seems to us both perplexing and premature.

It is thoroughly irrational to tighten monetary conditions while business activity is unsatisfactory, unemployment is high, large amounts of our capacity are idle, and the price level is stable. We hope that, if Congress should enact tax reduction measures, the monetary authorities will demonstrate enough faith in the judgment of Congress to lend their active aid and cooperation well in advance of the need for financing a deficit. They should not wait idly by while a tight credit situation is allowed to develop because of rising business credit requirements in an economy striving to grow.

Not even the balance of payments argument about "protecting the dollar" provides excuse for tighter money and higher interest rates. The extensive hearings of our Subcommittee on International Exchange and Payments provided no evidence that differentials in interest rates between United States and foreign countries provide any substantial stimulus to capital outflows and hence to gold losses and a deficit in our balance of payments. Indeed, evidence points to many other factors, such as the needs of trade, and so forth, as being of far greater importance.

A distinguished Swiss economist, amplifying views expressed to the committee by other international witnesses, emphasized that—

> * * * In general, it must be recognized that international capital flows do not depend just on interest rates, but on interest rates plus the state of confidence in the currency concerned.
>
> If this confidence is high, a country may be able to sustain very low rates, thus Switzerland probably has about the lowest interest rates anywhere.
>
> If, on the other hand, this confidence is shaken, even rather high interest rates may be insufficient to stabilize capital flows. In fact, some of the money the United States has been losing in recent months was going to a country with even lower rates, that is, Switzerland. Conversely, Germany found in 1960–61 that low rates did not stop the influx of foreign money.[16]

Additional evidence against the overemphasis on differential interest rates lies in the relative smallness of recent differentials.[17] When the risks of foreign exchange are insured, rate differentials have at times been in favor of New York. In any case the advantage or disadvantage has been small and swinging back and forth, with major differences easily accounted for by the special circumstances, e.g., those involving Canadian exchange, which have tended to outweigh interest considerations.

Several empirical studies presented during the year likewise suggest that the needs of commerce for strategically placed working balances, tax considerations and other non-interest-rate factors are far more

[16] Hearings, "State of the Economy and Policies for Full Employment," op. cit., p. 386.
[17] Hearings, 1963 Economic Report of the President, op. cit., pp. 375–378.

likely to be primary forces behind short-term capital movements than are modest opportunities for interest arbitrage.[18]

The Nation has now been brought to the active consideration of tax reduction for economic stimulation. Even if such measures are adopted and succeed, we will nonetheless require domestic monetary expansion. Instead of continuing to rely upon an asserted need for relatively high interest rates, we think that trade expansion and other avenues offer the preferable approach to the serious balance-of-payments problem.

Raising interest rates for balance-of-payments reasons can also be ruled out because such action merely provides an opportunity for other countries to raise interest rates. A competitive race toward higher interest rates would not be in the interest of this country or of other economies abroad. In fact, with postwar inflationary pressures eliminated, the case for a somewhat lower structure of interest rates is overpowering. To the extent that international capital movements provide any basis for corrective action at this time, the appropriate remedy is to be found in a multilateral payments agreement of the type suggested later in this report. The alternative of stifling our economy through high interest rates is unconscionable.

The Federal Reserve must either be persuaded or compelled by law to institute a better and more timely system of reporting to the Congress and the public the actions taken by the Open Market Committee and the Board of Governors, together with the specific reasons for such actions.

The Federal Reserve is a direct servant of the Congress. It acts solely as the agent of Congress in carrying out its functions of controlling the supply of money. This power is given to Congress by the Constitution and the Federal Reserve authorities merely act for Congress under delegated powers. By both law and sound principle, the Board of Governors and the Open Market Committee must report their actions to Congress, together with their reasons for taking these actions. This information must be so explicit and clear that Congress can reasonably judge whether the monetary authorities have exercised the delegated monetary powers in accord with congressional instructions and in the national interest. The reports also must be timely, and hence should be submitted to Congress in time for their review by this committee in connection with its annual hearings on the President's Economic Reports; that is, by January 20.

The report of actions, and the reasons for actions taken, as is set forth in the Board of Governors annual report, have been notoriously inadequate, uninformative, and confusing, as this committee has noted in the past. We are quite disappointed to discover in the record of actions for 1962 no significant improvement in this respect.

The meeting of December 18, 1962, at which a change in policy took place is typical. A few phrases from that record are illustrative of the unsatisfactory character of the record. At this meeting it will be remembered that while the country was talking about the need to

[18] See paper by Philip W. Bell, "Private Capital Movements and the U.S. Balance of Payments," in "Factors Affecting the United States Balance of Payments," compilation of studies prepared for the Subcommittee on International Exchange and Payments of the Joint Economic Committee, 87th Cong., 2d sess., pp. 395–481, and subsequent hearings on "Outlook for U.S. Balance of Payments," p. 124.

See also statement of Robert F. Gemmill, "Interest Rates and Foreign Dollar Balances," in hearings on "State of the Economy and Policies for Full Employment," op. cit., pp. 975–981.

stimulate the economy by tax reductions, the Open Market Committee was deciding upon a contrary program of less monetary ease. From the report of the meetings we learn what everyone knew, that "evidence of solid additional achievement was still limited," or, to use the words of the directive, "recognizes the unsatisfactory level of domestic activity, the continuing underutilization of resources, and the absence of inflationary pressures." In spite of these preponderant considerations, clearly dictating no less "ease" in the money markets, that committee voted 7 to 5 for "maintaining a firmer tone in the money markets while continuing to provide moderate reserve expansion in the banking system." The contradiction in this portion of the directive calling at once for a "firmer tone" and "moderate expansion," confusing as it is, does not obscure the fact, as Chairman Martin told this committee in his oral testimony, that a new policy of less ease had been instituted.

The most disturbing aspect of the problem is the conclusion implied by their 1962 report, if we can accept it as a complete, clear, and accurate record. The confused nature of their annual report and the vague words of the so-called "directives" suggest that the monetary authorities themselves have hazy and unclear concepts of what they are trying to do. When one undertakes to give operational significance to such expressions as "somewhat" less ease, "moderate" expansion or similar differences, the confusion is not necessarily that of the observers but more probably that of the actors. We would prefer to think that this is not the case but the alternative is to believe that the authorities are unable to make an effective report on their policies. This matter remains a troublesome issue involving the relationship of Congress with one of its own agents.

Under present conditions of high unemployment and excess capacity, debt management should be handled so as generally to reinforce expansionary fiscal and monetary policies.

A Federal deficit of sizable proportions must be financed during 1963–64, regardless of whether action is taken to reduce taxes. Indeed, as we have earlier pointed out, the cumulative deficit to be financed over the next 3 fiscal years will be smaller if an effective tax reduction and reform program is adopted, than if no such action is taken.

Under present conditions of high unemployment and excess capacity, debt management must be handled in ways which generally reinforce the needed expansionary fiscal and monetary policies. Baseless fears of inflation or balance-of-payments considerations must not be allowed to constrain public debt operations occasioned by the transitional budget deficits.

These considerations dictate that "lengthening the debt" should be given less weight for a while. This is no occasion for large amounts of Treasury borrowing at long term, since this places the Treasury in competition with the demands of private businesses and individuals for investment funds. Furthermore, Treasury borrowing on short term under these conditions may actually aid the balance of payments by supporting domestic short-term interest rates while weakening long-term rates. To the extent that changes in short-term interest rates have any influence on international capital flows, such a policy would be all to the good.

On the other hand, there is no reason to pursue a policy of extreme shortening of the debt structure. To the extent that the Treasury enters the long end of the market, they should do so via the auction method of selling Government bonds. This is a policy we have urged repeatedly in the past. The Treasury is commended for its initial exploratory move in this direction, and for the success which attended the sale of the $250 million issue of bonds of 1988–93 on January 8, 1963. We recommend that the practice of offering longer and medium-term Treasury bonds at competitive bidding be employed regularly and be made an established part of debt management practices.

INTERNATIONAL POLICIES

The United States has for some years faced the problem of bringing its balance of payments under control in a manner consistent with its objectives of maximum employment and a more rapid rate of growth of the domestic economy. We reject the notion that the United States must raise domestic interest rates or follow restrictive fiscal policies—causing a low growth rate and high domestic unemployment—in order to solve the U.S. balance-of-payments problem. Indeed, the strength of the dollar ultimately depends on the strength and growth of the underlying U.S. economy.

The committee is of the conviction—shared by responsible authorities in Europe—that the United States must move rapidly toward maximum employment, production, and more rapid growth. Therefore, we recommend the following international economic policies:

The United States should promptly seek a payments *agreement among the leading industrial countries* to neutralize destabilizing short-term capital movements and to finance temporarily deficits *arising from more basic factors.*

A payments agreement which will prevent international capital movements from interfering with domestic policies for economic stability and growth is a matter of urgent national interest. To use high domestic interest rates to check or reverse capital outflows is wrong. Domestic high-interest rates simply increase unemployment and retard growth, thus compounding the balance-of-payments problem. To propose paying $30 to $40 billion per year in reduced incomes to American workers and investors to obtain a $2 to $3 billion per year reduction in the payments deficit is to reduce economic calculus to absurdity.

Aside from the lack of proportion in the argument, there is no reason to expect the policy to yield long-run success. The payments deficit and accompanying capital movements have not been cured by several years of high unemployment and slow growth, nor have analysts been able to produce reasonable proof of significant response of capital movements to moderate interest rate differentials.[19] Other factors, such as speculation, tax considerations, trade requirements, and rising direct investment abroad, appear to outweigh any possible interest rates effects.

[19] Contrary to widespread impressions, U.S. interest rates do not appear low compared to those in the other highly industrialized countries. Recently, for example, short-term rates in Switzerland, Belgium, Germany, and the Netherlands have tended to remain below the U.S. rates. Only in the United Kingdom, France, and Canada have rates been higher than in the United States. If forward cover is taken into account, the United Kingdom rate would be roughly the same as the U.S. rate.

Neither the IMF standby credit agreement negotiated in 1961 nor the variety of bilateral short-term currency support arrangements of the Treasury and the Federal Reserve meet the conditions for an adequate payments agreement. The conditions for a successful multilateral agreement were set forth over a year ago by our Subcommittee on International Exchange and Payments as follows:

> * * * The amount should be adequate, particularly in currencies other than the dollar and the pound. * * *
>
> Credits should be made promptly as needed. The size of the credit in relation to the deficit should, by agreement, be governed by the nature of the deficit: If the deficit is caused by "hot money," the bulk of the outflow should be financed by the credit; if the deficit is "structural" (i.e., of the type which requires correction through accelerated industrial modernization), credit might be granted to cover a significant fraction of the deficit over a period of several years; if, however, the deficit is caused by inflationary policies on the part of the deficit country, credit should be given for only a short period and only if the deficit country agrees to take adequate remedial measures.[20]

The United States should take the leadership in establishing a mechanism which can add to international reserves.

In the postwar era the principal source of expanded reserves needed to restore international monetary liquidity and meet the requirements of expanding world trade and payments was the export of gold and dollars from the United States. This arrangement will continue to work only as long as the United States provides an outflow of gold or other trading countries are willing to hold an increasing proportion of their reserves in the form of dollar balances.

In the long run a multilateral arrangement must be agreed upon for strengthening the world monetary system, and adding to world reserves as needed.

Such a plan should lessen dependence on gold as an international monetary reserve. This might be accomplished by any of several plans that have been proposed. We do not attempt here to prejudge which plan will turn out to be best after this matter has been given serious international consideration and study. We are convinced, however, that now is the time for the United States to take leadership in establishing such a mechanism for the orderly expansion of international reserves before an international liquidity crisis at some future time provides a much less propitious atmosphere in which to negotiate a workable long-term agreement.

The United States should promptly and vigorously bargain for a reduction of the Common Market external tariffs, and the Common Market should be requested to make an immediate unilateral reduction in its tariffs on a most-favored-nation basis pending completion of the negotiations.

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[20] Joint Economic Committee, report of the Subcommittee on International Exchange and Payments, "International Payments Imbalances and Need for Strengthening International Financial Arrangements," 87th Cong., 1st sess., p. 22.

Our best hope to developing a constructive solution to the persistent U.S. payments deficit is the development of policies to deal with the basic sources of the present deficit. The first step in dealing with the basic sources of our payments deficit is the development of policies to expand our overall export surplus.

Fortunately, an expansion in our export surplus can be achieved by the further removal of barriers to international trade. The first step is the removal of the barriers to American exports into the Common Market in Western Europe. These countries are among the most rapidly expanding in the entire world. Over the years ahead these nations will need to import more both because of their rapid growth and because they face inflationary pressures. The tendency for countries like West Germany, France, and other countries to continue accumulating gold and dollars rather than to spend more of their rising export income on imports, on capital investments in other countries, and on foreign aid, has been responsible for a large part of the free world's payments imbalance. If such surplus payments countries would allow goods from the United States and other countries to be sold more freely in their markets, their present fully employed resources of capital and manpower could be devoted to the most productive activities, including further domestic capital investment essential for their future growth.

Consequently, the United States should promptly and vigorously bargain for a reduction of the Common Market external tariffs. We should not procrastinate until sometime in 1964 to begin negotiations under the Trade Expansion Act of 1962. Action should be taken at once which would lead to negotiations as soon this year as is practicable under the act. In addition, the Common Market should be requested to make an immediate unilateral reduction in those tariffs on a most-favored-nation basis, pending completion of these negotiations. This is entirely equitable and called for in view of (1) the large contributions of the United States toward the economic reconstruction of Western Europe in the postwar period, and (2) the persistence of balance-of-payments surpluses in Western Europe which, if allowed to continue, threaten to disrupt the international currency systems, and bring on inflationary conditions within these countries.

Legislation should be enacted this year to broaden the 80-percent provision of the Trade Expansion Act so that it can be used whether or not the Common Market is enlarged.

When the 80-percent provision of the Trade Expansion Act was adopted, the administration assumed that the Common Market would be enlarged to include Great Britain and some other European countries. Through trade negotiations with such an enlarged Common Market, tariffs on such categories as coal, organic chemicals, transportation equipment, most kinds of machinery, photographic supplies, paints, cosmetics, miscellaneous chemical products, aircraft parts and equipment, as well as a variety of other products could have been reduced to zero. Through negotiations with the present Common Market, only the tariffs on goods falling within the categories of aircraft parts and equipment and margarine can be entirely eliminated. On most other nonagricultural commodities, reductions are limited to only 50 percent.

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The members of the EEC have been rapidly eliminating trade barriers among themselves. Once all internal barriers are eliminated, possibly by the end of 1966, a common tariff wall will be erected around all the member states applicable to nonmembers.

The members of the European Free Trade Association (EFTA) have also been eliminating internal trade barriers. However, they plan no common external tariff but the national tariffs of each member state will apply to nonmembers. If Britain had become a member of the Common Market, other EFTA countries might have followed.

The interplay between the establishment of a different external-internal tariff places all outsiders at a competitive disadvantage. Consequently, if no action is taken to extend the 80-percent provision, U.S. exporters will face significant tariff discrimination.

Reductions of 50 percent in the Common Market tariffs and those of the member countries of the European Free Trade Association may not be enough to maintain, much less to increase, our exports to these countries. This is necessarily so since we will, after 50-percent reductions, still have to cross tariff barriers while the member countries of the Common Market and EFTA will have tariff-free entry in their respective market areas. This disadvantage will place our exporters in a relatively adverse competitive position.

Since 15 percent of our farm income is derived from exports, a thorough study should be undertaken by our special representative for trade negotiations to determine whether or not the agricultural policies of the EEC are now or may be in the future in violation of the requirements of GATT, particularly article 24.

The recent exclusion of Great Britain from the Common Market creates additional fears concerning American agricultural exports to the Common Market. One of the primary reasons given for the French veto was that Britain would not be able to accept the recently adopted agricultural policies of the Common Market.

In January 1962 the EEC reached an agreement on the major features of a common agricultural policy to replace the different national systems of agricultural support of the member states. The new policy is based largely on a system of target prices and variable levies to be established by 1970. Many aspects of the program are still uncertain and have not yet been formulated by the member nations.

On July 30, 1962, national restrictions on imports of grain were replaced by variable levies. These levies were calculated to offset the differences between domestic market prices and the prices of foreign imports. The levies on imports from the other member countries are to be eliminated by 1970 when a single price system will come into effect throughout the entire Common Market. Moreover, restrictive import regulations were also adopted for poultry, eggs, and pork. Similar restrictive measures are in prospect for rice, dairy products, and other agricultural commodities. According to the Council of Economic Advisers—

> * * * The action program of the EEC Commission proposes as a goal that 90 percent of EEC agricultural

production be covered by common policy regulations of some kind. [21]

Article 24 of the General Agreements on Tariff and Trade (GATT) provides that external customs tariffs, including those on agricultural products, must "not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territory prior to the formation of such a union." In other words, if the agricultural policies of the Common Market are more restrictive today, or will be more restrictive in 1970 than the individual agricultural policies of the member nations in 1957, they may be in violation of article 24.

Regardless of the legality of EEC agricultural policy, the adoption of a protectionist agricultural policy would endanger not only agricultural exports but the liberal trading policies of the free world. The United States would be forced to retaliate against the Common Market if it adopts such a policy. This retaliation will probably be extended beyond the agricultural sector.

The United States must continue to negotiate on a most-favored-nation basis for ourselves and the whole free world, with special emphasis on access to the markets of highly industrialized countries for the products of the developing nations of the world. This policy rules out participation in discriminatory trade blocs by the United States.

The traditional policy of the United States has been to promote freer trade through tariff- and quota-reduction agreements, extending the benefits of a trade agreement with any one country to all other nations with which we maintain a reciprocal most-favored-nation policy. This policy has been highly successful in promoting an expansion of world trade to the mutual benefit of the United States and our trading partners in the free world. This policy should be continued. This does not mean, however, that the rich industrialized countries can obtain the benefits of trade barrier reductions without making appropriate contributions of their own. If, for example, the Common Market is unwilling to make significant reductions in its external barriers, then there is no obligation on this country to extend most-favored-nation treatment to these countries in connection with our trade agreements with other countries.

Those concerned with America's international trade policies should give particular attention to the problems of the developing nations of the world. Typically, these countries have urgent import needs and—with the exception of a few countries like Venezuela—meager foreign exchange reserves. They consistently use all of their export proceeds and foreign credits to keep imports at the highest possible level. The volume of their imports is determined not by restrictive trade practices, but by the amount of each area's exports plus net capital flow. As a result, it is not in the present interest of the United States to negotiate for lower tariffs or other concessions on consumer goods. Such concessions could only be obtained at the expense of more essential imports; for example, foodstuffs and capital goods. Only the further development of the economies of these countries will substantially increase U.S. exports.

[21] Economic Report of the President, January 1963, p. 112.

While our foreign-aid programs are of great importance in assisting these developing nations to solve their economic development problems, it is also true that access for their exports of tropical products and raw materials to the markets of the United States and the other highly industrialized trading nations is essential if these developing nations are to obtain the foreign exchange needed to finance their imports of capital. We should make every effort in the conduct of our own policies, as well as in the conduct of negotiations with other trading nations, to render assistance in this way to our less developed associates of the free world.

We reiterate with special emphasis the earlier recommendations of this committee and its subcommittees that the United States seek to persuade our Western European allies to carry a greater share of the burdens of the common defense of the free world and the provision of economic assistance to the developing nations. Considerations of equity reinforce the necessity of actions leading to the elimination of the deficit in our balance of payments.

The committee is not satisfied with the contributions being made toward mutual defense and economic aid by our Western European allies. If the rapidly growing, highly prosperous countries of Western Europe assumed a fair share of both these common obligations to the free world, a substantial part of the present imbalance in payments between the United States and Western Europe would be eliminated. The administration must, therefore, press more vigorously to secure such increased contributions from these allies.

NOTE.—Mr. Patman agrees generally with the tenor of the report but must reserve judgment on the specific recommendations because pressure of other congressional duties prevented his full participation in the hearings and committee deliberations. In addition, he would like to call attention to the able statement of the Honorable George W. Mitchell, member of the Board of Governors of the Federal Reserve System, who testified before the committee on February 1—in particular his presentation of the view that monetary policy could have done more to encourage economic expansion in 1962, his enlightening account of the very limited effectiveness of general monetary policy as a means of dealing with basic balance-of-payments problems, and his unusual, if not unique, willingness to advance a proposal for dealing directly with the flow of funds abroad.

NOTE.—Senator Fulbright reserves judgment as to the details of the type of tax reduction he would advocate should the tax reduction provisions of the President's proposals be separated from the so-called reform provisions. As to the excise tax reductions, he believes each of these should be considered on its merits.

INDIVIDUAL VIEWS OF SENATOR WILLIAM PROXMIRE TO THE MAJORITY REPORT OF THE JOINT ECONOMIC COMMITTEE

The Case Against a Tax Cut Now

OVERWHELMING DRIVE FOR TAX CUT

All Americans, of course, desire relief from the heavy burden of taxes they must bear to support our Government.

A tax cut now is powerfully supported by the President, leading business organizations, top labor groups, a heavy consensus of economists, and many of the most influential opinion-leading commentators.

TAX CUT NOT RESPONSIBLE

But I submit that tax reduction under the following conditions is not responsible in a period of relative prosperity in the economy:

1. The current deficit is expected to approach $9 billion.
2. The administration plans to ask for an initial increase in spending of about $4.5 billion. Based on past experience, Congress is more likely to increase than to decrease the President's initial spending proposals.
3. The national debt exceeds $300 billion. It is greater than the national debt of all other nations in the world combined. Service costs on the debt are already $10 billion.
4. The tax cut would increase the size of the deficit, the national debt, and the burden of servicing the debt.

TAX CUT SURE TO INCREASE DEFICIT AND NATIONAL DEBT

The easy assumption has been made by many administration witnesses that the tax cut, far from deepening the deficit, eventually would reduce it and, in fact, is the surest way to a balanced budget.

This is almost certainly wrong.

Calculations based on the whole sweep of witnesses appearing before the committee show that the longrun net loss of revenues flowing from the $10 billion tax cut would be between $1 and $6⅔ billion.[1]

[1] The most typical assumptions on the multiplier effect of the tax cut by witnesses before the committee were that it would be between 2 and 2½. In other words, that a $10 billion tax cut would increase the gross national product by $20 to $25 billion.

The consensus was clear that monetary restraint of the kind the Nation's money managers told the committee they expected to practice would reduce this multiplier. One monetary expert estimated that such a monetary policy would probably result in a multiplier of 1½, or a $15 billion increase in the gross national product from a $10 billion tax cut. All things considered, a multiplier of 2 or a $20 billion gross national product increase from a $10 billion tax cut would seem to be as reasonable a guess as any.

What would such an increase in the gross national product flowing from such a tax cut mean to ultimate Federal revenues?

Here again the expert witnesses differed. Dr. Arthur Burns of Columbia University, and former Chairman of the Council of Economic Advisers, estimated it would be about one-sixth. His estimate is confirmed by relating Federal tax revenues to the size of the gross national product. The relationship is about one-sixth.

On the basis of such an estimate, the net loss from a $10 billion tax cut allowing for a $3⅓ billion increase in revenues would be $6⅔ billion.

On the other hand the Council of Economic Advisers testified that the Federal tax recovery from increased gross national product is 30 percent. Even on this cheery basis, Government revenues would increase only $6 billion as a result of the $10 billion tax cut and the net loss would be $4 billion.

Even if we take the most optimistic multiplier assumptions of the Council: that the multiplier is 3 and that a $10 billion tax cut will increase the gross national product by $30 billion, and apply the optimistic Council 30-percent figure for Federal tax recovery, the total recovery of revenues would still be $9 billion and the net loss would be $1 billion. The Council has suggested that the multiplier may be somewhat higher than 2 because of induced investment through the so-called accelerator principle. They have, however, wisely refrained from estimating the quantity of this additional amount since, with the present high levels of excess capacity, it seems doubtful that any additional investment will be encouraged by the tax reduction.

The conclusion that the kind of sharp across-the-board tax reduction recommended by the President would result in an eventual as well as an immediate tax loss is borne out by economic analysis as well as by common sense.

ADMINISTRATION RELIES ON STIMULATION FROM DEFICIT

Argument by administration witnesses for a tax cut has been made primarily on the grounds that it would increase demand in the economy, and that with unemployment close to 6 percent and plant utilization at 82 percent, the economy needs a surging demand.

Indeed, most administration witnesses frankly see little difference in economic impact between a reduction in Federal taxes and an increase in Federal spending. Both, in their view, would increase demand. Both would do so by increasing the Federal deficit.

The theoretical result: As the deficit increases, the Government puts more into the economy in demand (spending) than it takes out in taxing.

DEFICITS HAVE NOT BROUGHT SOUND ECONOMIC GROWTH IN THE PAST

Will deficits in fact stimulate sound long-term growth? Our recent history has plenty to say about the answer to this question.

In the past 32 years this Nation has become thoroughly experienced in Federal deficits. Deficits have been a continuous way of life for our National Government almost throughout this period. These deficits have been so immense that the national debt has exploded twentyfold since 1930: from $16 billion to over $300 billion.

With this experience, this Nation should be expert on the stimulative effect of deficits on the economy. What has been the result?

Except in World War II when deficits were astronomical, there is no evidence that continuous deficits have promoted economic growth. The evidence is all to the contrary.

The biggest growth in peacetime Federal debt, for example, was in the decade of the thirties and in the period since 1957. The thirties period was characterized by disastrous economic stagnation and record unemployment, coinciding with 10 years of such heavy deficits that they would be equivalent to $20 billion annually today. From 1957 to date, Federal deficits have averaged a heavy $6 billion per year. And yet, economic growth has been the slow-moving despair of current economists during this very period.

Advocates of the deficit route point to the impressive economic progress in Europe during the past decade to support the deficit stimulus theory. The economic situation in European countries during the past 10 years is so vastly different from ours—particularly in terms of demand—that the comparison is not a valid one.

But even here what does the record show? The industrial star of Europe, Germany, enjoyed a mammoth 92-percent growth in industrial production in the 8 years between 1953 and 1961 (most recent year for which figures are available) compared to 20 percent in this country; but its deficit averaged 0.1 percent of GNP during this period compared to an average deficit of 0.4 percent of GNP in the United States. In terms of GNP, Germany had one-fourth the deficit and four times the growth of this country.

This is not to argue that deficits retard growth. It is to argue that in a $550 billion economy, even the $12 billion deficit programed by the administration is swamped by the impact of private economic forces.

DEFICIT FOR GROWTH: A RADICAL DEPARTURE

Until this year, 1963, the President had contended that deficits might be necessary public policy in periods of recession. But on the upturn of the cycle, the Federal Government should run a surplus and over the business cycle balance the budget.

But now we are asked to follow a radically new theory. The deliberate deepening of the deficit this year is not planned for the purpose of overcoming a recession. Indeed, the President talked of 22 months of uninterrupted recovery in his state of the Union message. The planned deficit is billed for the purpose of promoting long-term growth.

But sound long-term growth can no more be based on the deficit gimmick than on any other easy panacea. Growth of an individual, a family, or a nation depends on the hard, long work of many years, on the sacrifices and forbearance required for education, the gradual development of skills, and the painful processes of research.

The preeminent economic success of America has been based squarely on individual self-reliance, with minimum Government participation and maximum individual freedom and incentive. Indeed, the starkest economic difference in the world today is between the economic stagnation of Communist collective economies and the dynamism of free Western economies.

SOUND TAX CUT REQUIRES SPENDING CUT FIRST

All of this suggests that the right prescription should indeed be a tax cut to free the economy's productive force from the burden of Government taxes but unless Federal spending is reduced—at least to keep pace with the reduction in Federal taxes—the reduced burden is a mirage.

Tax reduction with increased Government spending gives the impression of a lighter Government burden. But the lessened tax burden when spending is increased is then quickly translated into higher prices and an evaporation of the increased purchasing power of the tax cut. The taxpayer's after-tax income may be higher. But his income buys no more.

The sure inflationary impact of a tax cut this year was freely conceded in the hearings by such an eminent authority as Professor Duesenberry of Harvard. No economist disputed it.

SPENDING CAN BE CUT

If a tax cut with increased spending is not the answer, can, as a matter of practical fact, spending be reduced or at least stabilized without sacrificing major goals of this Nation such as national defense, space exploration, and indeed the development of skills through education on which long-term growth must be based?

Can spending be wisely reduced? It can indeed.

Although the President implied that spending other than defense, space, and interest will remain the same in 1964 as in the current fiscal year, the fact is that this spending will increase by more than $2 billion.

DOMESTIC SPENDING TO CLIMB $2 BILLION THIS YEAR

This year's budget by various bookkeeping transactions conceals the real increase in spending in the domestic sector.

The reason the $2 billion increase doesn't show up is because the administration plans to sell $700 million of the cotton surplus, $423 million of Export-Import Bank holdings, $315 million of Federal National Mortgage Association and Federal Housing Authority mortgages, $300 million in Commodity Credit Corporation loans, $150 million in farm housing loans, and $150 million in college housing loans. This total of $2 billion of liquidated assets will be used to offset increased spending in almost every department of Government.

GOVERNMENT SALE OF HOME MORTGAGES SURE TO SLOW DOWN RECOVERY

The administration's announced intention of selling $315 million of Federal National Mortgage Association and Federal Housing Authority mortgages during the coming year is sure to tend to drive up interest rates for home buyers.

The Budget Director told the committee at the hearings that the general impact on interest rates would not be significant because in the absence of the sale of mortgages the administration would be required to sell other Federal securities (presumably Treasury securities) to finance the deficit.

But the impact of the sale of such a large amount of mortgages could be quite different from the effect of selling a similar amount of Treasury securities. Interest rates on Treasury securities have only a secondary effect on mortgage rates. Some Government experts have testified to the committee the effect is relatively unimportant.

There can be no question, however, that the sale of more than $300 million of home mortgages by the Government will have a definite tendency to drive up interest rates.

If interest rates on home mortgages do indeed rise, unemployment would be sure to increase.

The biggest cost in home buying is interest. A rise in mortgage interest rates will surely reduce home construction. Home construction contributes directly and heavily to employment. Any cutback in home starts would seriously retard economic recovery.

Government sale of $300 million of mortgages could significantly reduce whatever expansionary effect the tax cut might have on the economy.

BIG INCREASES IN GOVERNMENT PAYROLLS

Let us consider the surest index of expanded spending: The Defense Department is the only department of Government which will actually reduce the number of its employees in the coming fiscal year. Every other department, without exception, will increase its employees in the coming budget year. Here are a few examples: Agriculture by a whopping 5,000, or 4 percent; Treasury by 4,000, or 5 percent; Interior by 4,000, or 6 percent; Health, Education, and Welfare by 6,000, or 7½ percent; General Services Administration by 3,000, or 9 percent; Commerce by 3,500, or 11 percent; and Labor by 1,300 or 14 percent. All of these increases will come in a single year—next year.

Asked about this sharp increase in employees in the coming year when they appeared before the committee, the Secretary of Agriculture, the Secretary of the Treasury, the Secretary of Commerce, and others all told the committee the increase was the result of new programs the Congress had passed.

But the Secretary of Commerce was most revealing when asked to defend the huge 11 percent increase in 1 year in personnel in his department. He said that if he were given a free hand to reduce or eliminate old programs he could, in fact, reduce personnel by 10 percent and operate a better department.

The Secretary of Commerce wisely pointed to the failure of the administration and Congress alike to look with critical scrutiny to economy in old programs which have developed powerful bureaucratic and often special interest support but no longer serve our national interest.

EXTRAVAGANT SUBSIDIES TO SPECIAL INTERESTS

The explosive expansion of some of the older programs with the hell-bent support of special interest shows how extravagantly generous with the taxpayer's money Congress has become when it teams up with subsidy-seeking interests.

For instance, just since 1957 (to the coming year's 1964 budget), Federal spending for water transportation subsidy to shipbuilders has leaped from $365 to $677 million or 85 percent;[2] subsidies to privately owned commercial aviation have zoomed from $219 to $885 million, or fourfold; and promotion of business from $127 to $617 million, or an incredible fivefold.

Reducing entrenched, special-interest-supported spending is one of the toughest jobs of Government. It will become even tougher as "the establishment" persuades the Congress and the American people to accept the theory that larger Federal deficits fed alike by tax cuts and/or increased Government spending would lead to sound long-term growth.

But the theory is wrong. In fact, reduction of unjustified Government spending not only won't hurt economic expansion, it will help it. Wasteful Government spending diverts resources of skilled men and scarce material from constructive private uses. As the Government's massive purchasing power moves in, prices move up. The eventual burden on the taxpayer is sure and heavy.

SOME DOMESTIC SPENDING ESSENTIAL

This is not to say that all Government spending can only be an anchor that private enterprise must drag along—far from it. Spending that encourages manpower training, vocational education, industrial research, contributes to the very essence of a growing economy.

The tough job of Government is to adopt and advance the programs that will, in fact, advance the economy as well as to eradicate the programs that burden it.

There is no question in this Senator's mind, however, that in every phase of Government activity including defense and space, spending can be reduced an aggregate of billions below the President's requests, possibly to a level permitting a sound tax cut.

[2] These figures only include direct expenditure subsidies. In addition, the water transportation industry obtains substantial hidden subsidies in the form of preferential tax treatment.

ECONOMISTS FAIL TO PROVE TAX CUT WILL WORK

The case for the proposed tax cut, timed to coincide with both a present deficit and increased spending, and calculated to deepen the deficit, has not been made. It has not been made in these respects:

RECORD OF PREVIOUS TAX CUTS

1. The tax cut may have little or no stimulative effect on the economy. After only four of the nine tax cuts in the past 40 years did business significantly improve. There were times it actually got worse. This doesn't prove the so-called stimulative multiplier didn't appear; it does show it can be washed out by other factors. This would seem to be almost certain for the $2.7 billion net tax cut proposed for the first tax cut year in this $550 billion economy.

Even the ultimate $10 billion net tax cut would seem to be likely to be washed out. For this ultimate grand total would amount to less than 2 percent of the gross national product. During the thirties, deficits that averaged more than twice this—4 percent—of the GNP seemed to have little effect on economic growth.

MONETARY RESTRAINT WILL WEAKEN TAX CUT STIMULATION

2. Any substantial stimulative effect of the tax cut would almost certainly be sharply cut and perhaps even destroyed by the restraining effect of monetary policy. The country's top monetary authorities, the Secretary of the Treasury and the Chairman of the Federal Reserve Board, both told the committee that they expected interest rates would be likely to rise if the economy moved ahead in 1963 and 1964. In view of the monetary power of these gentlemen, it is almost a sure thing that this expectation will be translated into reality. Interest rates will go up. Monetary authorities have publicly indicated that they will raise interest rates on savings bonds to 4 percent within the next year.

Monetary authorities appearing before the committee, other than the Secretary of the Treasury and the Chairman of the Federal Reserve Board, universally agreed that rising interest rates would slow down economic expansion. Dr. Meltzer, of Carnegie Tech, argued that the stimulative effect (multiplier) of the tax cut would depend almost entirely on the degree of monetary tightness.

The virtual certainty of this monetary tightness will surely develop for two reasons; (*a*) a policy of raising interest rates is regarded as the prime weapon for diminishing the adverse effect of the tax cut on the balance of payments; (*b*) rising interest rates are accepted as the ready tool to try to forestall the inflationary effect of the tax cut.

The majority report, in my view, does an excellent job of describing the problems of monetary policy with which we will be concerned in the months to come. Moreover, it indicates clearly the weaknesses in some of the monetary policies followed during the last few years. I wish to be specifically on record in support of the monetary section of the majority report.

TIGHT MONETARY POLICY WILL NOT IMPROVE BALANCE-OF-PAYMENTS POSITION

Incidentally, the preponderance of evidence from the joint committee's hearings last August and this year suggests that interest rate differentials can have only secondary effects on the balance of payments through influencing capital flows. Haverford professor Philip Bell and Federal Reserve economist Robert Gemmill have made the only available studies of the effect of interest rate differentials on capital flows and they have found the effect is far less significant than speculation and of far lesser significance than previously supposed. Neither of these studies was contradicted by any other studies that were brought to the attention of the committee, although witnesses appearing before the committee were systematically challenged to show any evidence to contradict the Bell and Gemmill studies.

This means the Government's monetary policy will be restrictive, will tend to counteract any stimulative effect of the tax cut, largely because of a false assumption—now exploded—that interest rates must be higher in this country to stem capital flows from this country overseas.

As for using rising interest rates to forestall the inflationary effect of the tax cuts, the principal architect of this policy, Chairman William Martin of the Federal Reserve Board, himself indicated that the policy would have only moderate effect in restraining rising prices. And yet this policy of monetary restraint to raise interest rates is the widely accepted answer to whatever inflation may develop in the future: not reduced Government spending, not increased taxes. Both are regarded as politically impossible.

The basic economic design—increased Government spending and lower taxes to stimulate the economy and rising interest rates to stabilize prices—is likely to lead to a cruelly oppressive debt burden as rising deficits are matched by rising interest rates required to service the heavier national debt.

What is worse, it means an economywide restraining force, slowing down home building (where interest is the biggest cost), small business borrowing, and generally shifting a heavier burden to such debtor groups as farmers and consumers.

CASE FOR CORPORATE TAX CUT NOT MADE

3. The heaviest and most consistent support for the tax cut came from those who argued that it was necessary to stimulate investment. No witnesses contradicted the alleged wisdom of such a tax cut. Almost all argued it was desirable to promote economic growth in the economy.

And yet the case for such a tax cut this year seems to be even weaker than it has been in the recent past. Let us review the record:

In 1954 the Nation enjoyed its last major tax cut. It was generally agreed that the prime beneficiaries of that tax cut were corporations. That tax cut was said to have been designed to stimulate investment in view of both its individual impact (most of the benefits went to persons in investment income brackets) and its large corporate reduction.

Now, 9 years later, the Congress is asked to make another sizable corporate tax reduction. One distinguished Senator remarked as the committee hearing opened that the 1954 tax cut seems to have had a long-term adverse effect on the economy because it stimulated investment between 1955 and 1957 to such an extent that the economy has been characterized by idle investment facilities, overbuilt plant capacity, unemployment, and slow growth ever since.

Just last year investment was "stimulated" by two additional tax reductions. First, depreciation guidelines were revised to provide the equivalent of a $1.5 billion stimulant to investment—and relief to corporations.

Secondly, the investment credit was rifle shot into corporate taxation to provide a specific and high-powered stimulus to investment through a 7-percent tax credit for every dollar of investment made.

The argument for further stimulation by tax cut is feeble indeed in view of these facts: (1) the overwhelming preponderance of recent tax reduction on the side of stimulating investment; (2) cash earnings in 1961 exceeded investment by a record absolute amount of $18½ billion and a record of 62 percent; (3) although later figures are not available, cash earnings have been soaring since then while plant and equipment outlays have been about the same. The result: corporations have never been in a better cash position to invest in plant and equipment.

All the tax-incentive stimulation of the past seems to have done little to move business investment in plant and equipment ahead. In view of the recency of the 1962 corporate tax reductions, it would seem to be wiser to give these "investment stimulants" a chance to work rather than to hit again in a time of deficit spending with another "trickle down" investment tax cut.

MANY GROUPS HURT BY TAX CUT

Finally, there are many groups in the American society who would be hurt, not helped, by this tax cut.

FUTURE TAXPAYER BURDENED

The preeminent victim, of course, is the future taxpayer. As Dr. James Buchanan, chairman of the Economics Department of the University of Virginia, has written, the inevitable tendency of the politician is to spend for the present voter, reduce taxes for the present taxpayer, and mitigate the consequences by raising interest rates, thereby passing the whole burden to the future taxpayer. When Congress's economic experts on this committee, to whom Congress must look for advice, contend that such a policy is sound economics as well as effective short-run politics, the combination may be all but irresistible.

FARMER HIT

Secretary of Agriculture Orville Freeman testified for the tax cut but conceded that a substantial majority of America's farmers owe no income tax. Obviously for these farmers—who make a heavy investment of work, property, risk, and efficiency in their farms—the tax cut is meaningless. No one argues that America will buy or consume more food because of the tax cut. To the extent the tax cut sparks inflation and forces increased interest rates—and it seems certain to do both—the farmer is sure to be hit and hurt, and badly.

LITTLE BENEFIT TO UNEMPLOYED

Above all, this planned tax-cut deficit has been justified in the name of the unemployed. But the tough question that this Senator has encountered in talking to unemployed in Wisconsin is, "What good is a tax cut to an unemployed man with no income? He doesn't pay any taxes now. He doesn't need a tax cut. He needs a job."

An answer that the tax cut may stimulate the economy to provide more jobs is, as the previous analysis suggests, far from perfect.

It is especially ironic for the three groups which the Secretary of Labor told the committee form a disproportionately heavy part of the unemployed: the high school dropout; the unskilled; the minority groups. According to the testimony of the Secretary of Labor, each of these groups suffers not 6-percent unemployment but more than 12-percent unemployment.

Tax cuts will not begin to solve the problems of high school dropouts, unable to get jobs because of inadequate education and low or zero skills. Tax cuts will do little to knock down the prejudice barriers barring the minority groups from employment.

Few of the unskilled are likely to win jobs because of the tax cut. Their barrier is their lack of skill in an automating, technologically changing society. These people need training. A tax cut to solve their problem seems as heartless and stupid as Marie Antoinette's "Let 'em eat cake," for starving Parisians.

The unemployed in these groups will enjoy little benefit in income with a tax cut. They pay no Federal income tax; nor is it likely to help them get jobs.

To the extent the deficit drives up interest rates, these people who are likely to be debtors will suffer. To the extent the deficit drives up prices, they will all be hurt as consumers.

OLD PEOPLE HIT HARDEST

Of all groups in America, the hardest hit by this tax cut-sparked deficit will be the retired old people.

On February 15, 1963, the Treasury Department released a fact sheet showing that of the 18 million Americans 65 years old and over, 14½ million, or 80 percent, have such low incomes that they pay no Federal income tax now.

So 80 percent of the older people could not possibly receive any benefit from an income tax cut. Since the overwhelming majority of the 20 percent of oldsters who do pay income taxes pay very little, the benefit would in aggregate be very small indeed.

On the other hand, many of these older people are debtors. The rising interest rates which seem to be the certain concomitant of the income tax cut will come out of their already pitifully inadequate incomes. Rising prices—a likely companion of any Federal deficit stimulation of the economy—would likewise diminish what little they could buy with the income they have.

PROPOSED TAX CUT REGRESSIVE

Administration witnesses have contended that the proposed tax cut is a progressive one which will give low-income groups the greatest benefit. This is simply not true.

The following table shows the benefits to various economic groups from the personal income tax cuts—including the progressive reforms recommended by the administration. This table shows a precisely opposite effect from the table usually shown by the administration. This is because the administration table shows the percentage reduction of the income tax paid by persons in each income bracket. Because persons in high-income brackets of course pay higher income taxes, the administration table suggests the tax cut would be progressive.

Income	Federal income tax	Other taxes [1]	Total tax before cut	Total tax after cut	Percent reduction
$3,000	$60	$600	$660	$614	7
5,000	420	1,000	1,420	1,296	8
10,000	1,372	1,500	2,872	2,568	10
15,000	2,616	1,700	4,316	3,776	13
20,000	4,124	1,900	6,024	5,182	14

[1] Property (or imputed rent), sales, excise, auto, etc.

That the tax cut is, in fact, regressive, is demonstrated in the above table which shows the percentage reduction in all taxes paid that results from the administration recommendations. Because all Federal taxpayers pay heavy State and local taxes in addition to Federal taxes, this table shows a far more accurate picture of what actually happens to the taxpayer's total liability.

The impact of the President's tax proposal on various income groups was dramatically shown in a table submitted to the committee by Dr. Leon Keyserling. This table eloquently dramatizes the regressive effect of the proposed tax cut. The table follows:

President's proposed tax structure in 1965 compared with present structure (1962), at various tax levels (for married couple with 2 children)

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Taxable income level	Present tax [1]	Present income after tax	Proposed tax [2]	Proposed income after tax	Percent tax reduction	Percent increase in after-tax income	Percent tax to income	
							Present	Proposed
$3,000	$60	$2,940	0	$3,000	100.0	2.0	2.0	0
$5,000	420	4,580	$280	4,720	33.3	3.1	8.4	5.6
$7,500	877	6,623	663	6,837	24.4	3.2	11.7	8.8
$10,000	1,372	8,628	1,068	8,932	22.2	3.5	13.7	10.7
$15,000	2,486	12,514	2,076	12,924	16.5	3.3	16.6	13.8
$25,000	5,318	19,682	4,605	20,395	13.4	3.6	21.3	18.4
$35,000	9,037	25,963	7,814	27,186	13.5	4.7	25.8	22.3
$50,000	15,976	34,024	13,837	36,163	13.4	6.3	32.0	27.7
$100,000	44,724	55,276	38,542	61,458	13.8	11.2	44.7	38.5
$200,000	115,224	84,776	95,072	104,928	17.5	23.8	57.6	47.5

[1] Assuming 10 percent deduction for taxes, interest, contributions, medical, etc.

[2] Assuming President's proposal, as revised by Dillon's testimony, of $400 minimum deduction for married couple and $100 for each child; 10 percent for incomes between $6,000 and $10,000; $1,000 flat deduction between $10,000 and $20,000; and 5 percent deduction for $20,000 and up.

Actual slight deviations from these workable assumptions would not in the slightest change the general import of the analysis.

Because tens of millions of American adults earn so little income that they pay no Federal income taxes, it is obvious that a significant share of our citizens will get no benefit but will almost certainly have to pay higher interest rates because of the tax cut and, very possibly, higher prices.

TAX CUT WORSENS ADVERSE BALANCE OF PAYMENTS

Witnesses were systematically asked what effect the proposed tax cut would have on the balance of payments.

It was generally conceded that the tax cut would worsen our balance of payments because the main thrust of the cut is to increase demand in the consumer sector. This would mean that purchases of imports would rise sharply.

On the other hand, far from reducing American prices to enable us to sell more abroad and increase exports, this tax cut, as Professor Duesenberry properly pointed out in the hearings, will certainly, inevitably, tend to increase prices and reduce our exports.

So the proposed tax cut would worsen our balance of payments by (1) increasing imports and (2) decreasing exports.

HEAVY COST OF TAX CUT FAILURE

Administration witnesses argued that if the tax cut fails to stimulate the economy as advertised, little has been lost. This is emphatically not true. If this highly questionable gamble, this radical new departure from American fiscal policy, is adopted and fails, the consequences will be serious indeed.

(1) The already heavy national debt will be even more burdensome.

(2) Our present progressive income tax system will have been seriously jeopardized with little real political prospect of restoring it. It is hard to imagine a more difficult political task than increasing taxes back to their present rate once Congress cuts them. The alternative frankly advocated by Dr. Burns and other witnesses: a national sales tax. In the judgment of this Senator, this would be a first-class economic disaster as well as a gross injustice.

(3) Our antirecession ammunition (the real justification for a tax cut) will have been used up, leaving us far less equipped to cope with economic adversity.

(4) Our balance of payments will have been worsened both because imports will have been increased relative to exports and because the great American economy will have failed to respond to the prime economic prescription of its President and suffered a growing deficit.

(5) The most essential ingredient in economic success for a free nation—public confidence—will have been severely and needlessly damaged because of the failure of a highly advertised prime economic policy of our Government.

(6) The essential ingredient for discipline in Federal spending—that tax relief depends on spending reduction—will have been lost. This adverse consequence is even more sure to follow if the tax-cut prescription succeeds than if it fails.

And, in the long run, this may be the most serious threat of all in the tax-cut-for-a-deficit philosophy. For once the conviction takes hold that economic prosperity can be firmly based on deficit financing then the incentive to spending discipline will be lost and the trend to bigger and bigger government that is the consequence of unrestrained spending could become irresistible.

SUPPLEMENTARY STAFF MATERIALS

Operation of the Multiplier and Accelerator [1]

The primary reason for tax reduction is to stimulate the economy. This stimulus will occur in large part through the so-called multiplier and accelerator principles. These concepts have been discussed at great length in the economic literature, but little attempt has been made to quantify them.[2] This appendix is designed to summarize the concepts and to suggest some magnitudes that might be attached to the concepts.[3]

Multiplier

The multiplier deals with changes in consumption that may be expected from some initial change in economic conditions. The multiplier coefficient indicates that the change in final consumption will be the initial change in economic conditions multiplied by the coefficient. The original formula for the multiplier was $1/(1-\Delta C/\Delta Y)$ where $\Delta C/\Delta Y$ represents the percentage of additions to income which will be consumed. Thus, if 80 percent of additions to income will be consumed, the multiplier formula would indicate that the total increases in consumption would be five times the amount of the initial change.

The multiplier assumes that, as a result of increasing incomes—from tax reduction or any other source—individuals will spend more on consumer goods and services.[4] Therefore, in attempting to quantify the multiplier, it is necessary to look at past relationships between consumption and GNP.

Table I indicates the percentage of gross national product made up by consumption demand in the years 1954–62. This table suggests that the percentage relationship between aggregate consumption and GNP has remained fairly stable over the past 8 years.[5] Thus, aggregate consumption seems to remain at about 65 percent of GNP as the economy has grown over the years. The apparent stability of the aggregate relationship suggests that the annual increases in consumption have averaged about 65 percent of the increases in GNP. As

[1] By Roy E. Moor, assisted by Gregory Guroff.

[2] For some analytical references, see: R. F. Kahn, "The Relation of Home Investment to Unemployment," Economic Journal, June 1931; Gardner Ackley, Macroeconomic Theory (New York, 1961), pp. 340-343, 486-487; John M. Clark, "Business Acceleration and the Law of Demand: A Technical Factor in Economic Cycles," to be found in American Economic Association, Readings in Business Cycle Theory (Philadelphia, 1944), pp. 235-260; Evsey Domar, "Essays in the Theory of Economic Growth" (New York, 1957), pp. 90-91; William Fellner, "Trends and Cycles in Economic Activity" (New York, 1956), pp. 143, 309-319; Daniel Hamberg, "Economic Growth and Instability" (New York, 1956), pp. 216-218, 268-270; John P. Lewis, "Business Conditions Analysis" (New York, 1959), pp. 155-156, 497-501; Fritz Machlup, "Period Analysis and Multiplier Theory," article in American Economic Association, Readings in Business Cycle Theory (Philadelphia, 1944), pp. 203-234; Paul A. Samuelson, "Interactions Between the Multiplier Analysis and the Principles of Acceleration," article in American Economic Association, Readings in Business Cycle Theory (Philadelphia, 1944), pp. 261-270.

[3] This material is based generally on staff analysis plus the recent contributions of a number of our witnesses. See specifically material in the committee's hearings on the 1963 Economic Report of the President, (hereafter referred to as "hearings"), presented by Gerhard Colm, John Lintner, William Hellmuth, Neil Jacoby, James Duesenberry, and Lester Chandler.

[4] There is a further assumption in the usual multiplier presentation that everything else in the economy remains constant.

[5] Somewhat less stability would be shown if quarterly data were used, since yearly figures act to average intrayear moves. However, in terms of the relationships being examined here, annual data seem adequate.

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consumption goods,[7] this would mean an initial increase in aggregate demand of approximately $9.3 billion.

The initial increase in consumption will depend in part upon who receives the tax reduction. Material submitted for the annual hearings indicates that the additional amounts of consumption out of additional income vary substantially among income classes.[8] If tax reduction were concentrated entirely among low income groups, virtually 100 percent of the tax reduction might be spent. The 93-percent figure assumes that the distribution of the tax reduction is similar to the present distribution of incomes.

TABLE V.—*Hypothetical increase in consumption demand from 1-year tax cut*

[In billions of dollars]

Period	Tax reduction	Increases in GNP	Increases in nonpersonal income (22.5 percent of GNP)	Increases in personal income	Increases in personal tax (13 percent of personal income)	Increases in disposable incomes	Increases in personal savings (7 percent of DPI)	Increases in GNP
I	10.00	----------	----------	----------	----------	10.00	0.70	9.30
II	----------	9.30	2.09	7.21	0.94	6.27	.44	5.83
III	----------	5.83	1.31	4.52	.59	3.93	.27	3.66
IV	----------	3.66	.82	2.84	.37	2.47	.17	2.30
V	----------	2.30	.52	1.78	.23	1.55	.11	1.44
VI	----------	1.44	.32	1.12	.15	.97	.07	.90
VII	----------	.90	.20	.70	.09	.61	.04	.57
VIII	----------	.57	.13	.44	.06	.38	.03	.35
IX	----------	.35	.08	.27	.04	.23	.02	.21
X	----------	.21	.05	.16	.02	.14	.01	.13
XI	----------	.13	.03	.10	.01	.09	.	.
.	.	.	.	.	.	.	.	.
.	.	.	.	.	.	.	.	.
Approximate totals	----------	24.97	5.62	19.35	2.52	26.83	1.88	24.97

NOTE.—Assumes no change in (1) demand for imports; (2) private investment or Government expenditures; (3) distribution of income; and (4) effective tax rates after tax reduction.

The $9.3 billion represents the initial increase in GNP. This increase constitutes a rise in incomes to those who sell the consumption goods. Thus, if the various relationships described above held true, the increase in consumption from this $9.3 billion rise in incomes would be about $5.83 billion. These relationships are shown in table V. It indicates the amounts out of each increase in GNP which will go into various forms of income, including the incomes from increases in consumption demand. The bottom line in table V shows the aggregate increases in GNP of $24.97 billion and in various types of incomes as a result of the initial tax cut of $10 billion.[9]

[7] This assumption may somewhat understate the initial savings rate from Federal tax reduction, depending on who obtains the tax reduction. The average savings rate for the economy as a whole is lower by the inclusion of low income individuals who are not taxpayers. Rough calculations using material from the Michigan Survey Research Center (see hearings, p. 335) suggests that the initial savings rate for taxpayers would be about 10 percent. This would lower the final increase in gross national product to $24.13 billion.

[8] See material from Survey Research Center, the University of Michigan, hearings, p. 336.

[9] This table differs somewhat from that used in the hearings (see p. 19). The table in the hearings was for expositional purposes only and—while the percentages used can be supported—the relationships indicated in the above table seem more realistic. The results in the two tables are approximately the same.

One quantitative question on table V concerns the length of time involved in each of the periods. One way to estimate the length of each of these periods is to apply the statistics available concerning general turnover of money. In general, the money in our economy turns over about four times a year. This would suggest that if the entire $10 billion of tax reduction occurred in a lump sum at the beginning of a year, four increases in GNP could occur from the tax reduction in the year. Thus, each period would be about one-quarter of the year. However, since the $10 billion would normally be spread throughout a calendar year, the average tax reduction for the year would only be $5 billion. Hence, the stimulative effects of only the first two periods would be felt in 1 year.[10] One of our witnesses suggested that the tax reduction funds might change hands six or seven times within a year; that is, each period would be about 2 months in duration.[11]

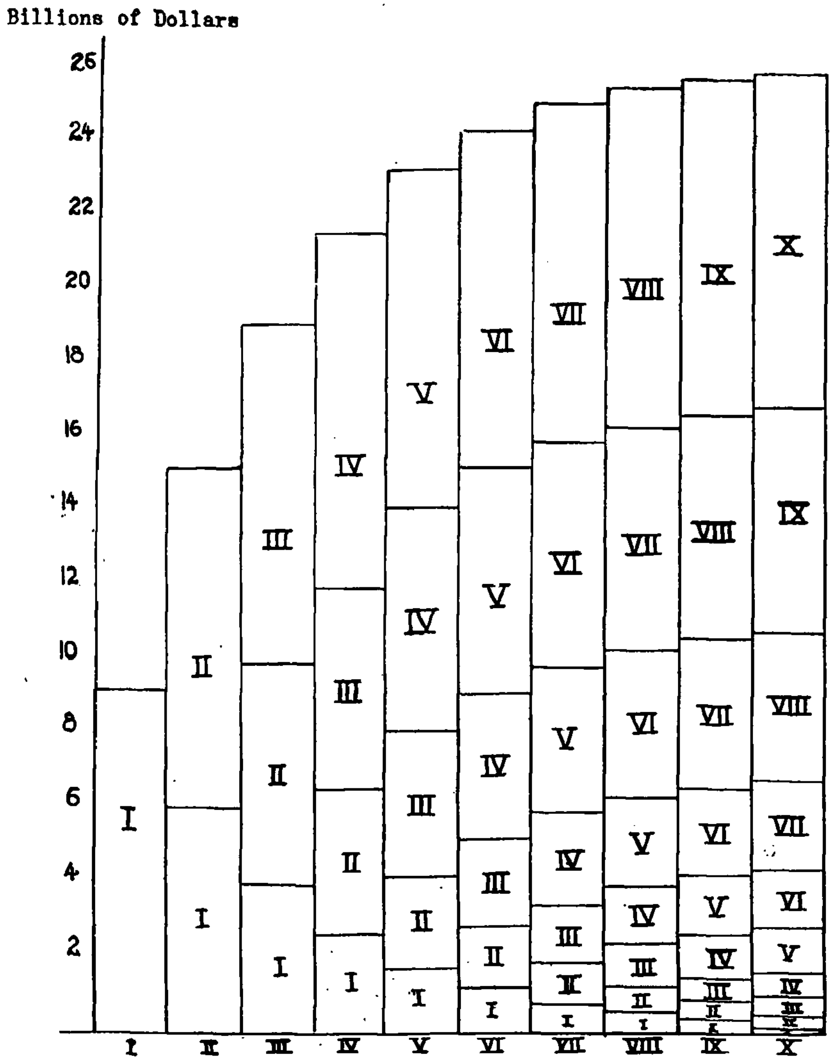
The tax reduction proposals currently being discussed involve permanent reductions rather than simply a 1-year reduction. The tax reduction described in table V is for 1 year only. If the 1-year reduction had been entirely in the form of a lump sum amount at the beginning of the first period, the initial increase in GNP over the pretax cut level would have been, as noted, $9.3 billion. In the second period, however, the increase in GNP over the pretax level would have only been $5.83 billion. Hence, GNP would eventually return to its pretax level. By contrast, with a permanent $10 billion tax reduction, the increases in GNP are additive. As a result, if $10 billion were given in a lump sum at the beginning of each period, the total increase in GNP in the second period would be the $9.3 billion stimulus from the second injection of $10 billion plus the $5.83 billion increase obtained in the second round from the first $10 billion injection.

This additive effect from a personal tax reduction is shown in chart 1. The rectangles marked with a "I" are the successive effects of the initial $10 billion tax reduction; the rectangles marked "II" are the successive effects of the second injection of $10 billion; and so on. As this chart indicates, GNP will reach a new level that is $24.97 billion higher than before the permanent tax reduction. This final result is simply the addition of the increases in GNP obtained from each of the preceding injections of $10 billion of tax reduction. It is the addition of all the items shown in the last column of table V.

[10] This conclusion is consistent with the estimate by the Council of Economic Advisers that about 50 percent of the stimulative effects of tax reduction would be felt in the first year.

[11] See Gerhard Colm's testimony, hearings, p. 477.

CHART 1.—Increases in GNP Permanent Tax Reduction



Accelerator

The accelerator relationship refers to the fact that some changes in investment will occur as a result of changes in aggregate demand. The accelerator analysis assumes that increases in consumption demand must be reflected in part by increases in the demand of firms for capital goods to meet the additional consumer wants. The multiplier implies that increases in final demand will be reflected by increases in demands for labor services. The accelerator concentrates on the effects of increased consumer demand on increased output of capital goods. This latter change is important, just as the multiplier, because a rise in demand for investment goods constitutes a source of additional income that can then be used in a multiplied way throughout the economy. Thus, an interaction occurs between the multiplier and accelerator.

Historical data do not provide any simple and consistent relationship between changes in aggregate demand and changes in investment. Investment seems to move concurrently with consumption, but the quantitative relationships vary. If a comparison is made of changes in investment and the aggregate amount of investment in the previous period, no consistent relationship appears. If the changes in investment relative to a base period investment are compared to changes in consumption, no statistical relationship is apparent. Thus, as our witnesses have pointed out, forecasting investment changes associated with changes in consumption represents a hazardous undertaking.

This difficulty is not surprising. Unlike the relationship between consumption and gross national product, which remains relatively constant, investment fluctuates more erratically for at least two reasons. First, the theoretical accelerator relationship only involves investment induced by consumption changes. But, clearly, many autonomous factors also influence part of the total changes in investment. These autonomous factors include interest rate changes, rates of innovation, the nature of shifts in consumer demands, the general state of optimism and pessimism, and many other factors. Second, even induced investment has a varying relationship to changes in other economic magnitudes. Investment tends to increase more than proportionately as the economy passes through recovery periods and into prosperous times and falls more than proportionately as the economy goes into recession periods.

Because of these difficulties, no claim of analytical or empirical precision is made for the following material. Rather, the attempt is merely to suggest how the accelerator might operate and to provide some rough calculations that may be suggestive of the possible magnitudes. The procedure has purposely been left simple, both for expositional reasons and because more complex relationships do not appear to provide greater precision with respect to future changes in investment. Some of the factors that have been bypassed include the changes in (1) cash flows, (2) prices, (3) Government outlays, (4) technological relations, and (5) psychological attitudes.

While no relationships apparently exist over time, one consistent relationship between investment and consumption does seem to occur at cyclical peaks. Table VI shows the ratio of investment to consumption in the four previous business cycle peaks.

TABLE VI.—*Relationship of investment to consumption at cyclical peaks (seasonally adjusted annual rates)*

[Dollar amounts in billions]

Cyclical peak	Consumption	Investment	Percent of investment to consumption
November 1948	$180.8	$43.9	24.3
July 1953	234.1	51.1	21.8
July 1957	288.3	66.7	23.1
May 1960	329.9	70.3	21.3

It would appear that a rough ratio of about 22.5 percent does occur during relatively prosperous periods. By comparison, the ratio of investment to consumption in the fourth quarter of 1962 was 20.9 percent.

For the following analysis, three assumptions are made: (1) tax reduction begins at a time when investment is 20.9 percent of consumption, (2) no lags occur in the reaction of investment to changes in consumption, and (3) after the full effects of the multiplier stemming from tax reduction have occurred, the peak relationship of investment to consumption will exist. With these assumptions, an accelerator effect can be computed which will indicate the changes in investment necessary with changes in consumption in order to obtain a relationship of 22.5 percent when the economy reaches a peak from the tax stimulus.[12]

Following this analysis, the investment induced by the initial increased consumption (or GNP) would be about \$12.4 billion.[13] Thus, the combined effect of the initial multiplier from the tax reduction, plus the accelerator, would equal about \$37.4 billion. Table VII shows the combined effects of the initial multiplier and the accelerator over time.

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[12] This approach assumes that all investment changes in the movement to the peak are induced by increased consumption.

[13] If at peak levels $I/C=.225$ and the multiplier for consumption operates as is expected, then: assume time $(t)=$ fourth quarter 1962, $\Delta C_t+\Delta I_t$ represent initial changes in consumption and investment.

$$GNP_t=G_t+C_t+I_t$$

then at the peak,

$$GNP\text{ peak}=G\text{ peak}+C_p+I_p$$

where

$$G_t=G_p$$

where

$$I_p=I_t+A\Delta I_t \qquad C_p=C_t+K\left(\frac{\Delta C_t}{.93}\right)$$

We know:

$$\frac{I_p}{C_p}=.225$$

thus:

$A=$accelerator
$K=$multiplier related to the original tax cut
$\left(\frac{\Delta C_t}{.93}\right)=$original tax cut

Thus:

$$\frac{A\Delta I_t+I_t}{K\left(\frac{\Delta C_t}{.93}\right)+C_t}=.225$$

and

$$\frac{I_t}{C_t}=.21$$

where

$t=$4th quarter 1962

$$K=\frac{\Delta GNP}{\frac{\Delta C_t}{.93}}$$ where ΔGNP equals the sum of the geometric progression of C_t: $\Sigma_i \Delta C_i a^i$

where

$a=.627$; See table V, thus

$$K=2.497$$

$$\frac{A\Delta I_t+I_t}{2.497\left(\frac{\Delta C_t}{.93}\right)+C_t}=.225$$

$$A\Delta I_t+I_t=.225\left(C_t+2.497\frac{\Delta C_t}{.93}\right)$$

$C_t=\$363.5$ billion
$I_t=\$75.0$ billion

and if we assume a \$10 billion tax cut at time (t), then $\Delta C_t=\$9.3$ billion. See table V.

substituting

$$A\Delta I_t=.225\ (363.5+24.97)-75.0$$
$$=12.40$$

$$\frac{A\Delta I_t}{K\left(\frac{\Delta C_t}{.93}\right)}=\frac{12.40}{24.97}=.4966$$

TABLE VII.—*Initial increases in gross national product from $10 billion tax cut*

[Billions of dollars]

Period	Increase in consumption	Increase in investment	Increase in GNP
I	9.30	4.62	13.92
II	5.83	2.90	8.73
III	3.66	1.82	5.48
IV	2.30	1.14	3.34
V	1.44	.72	2.16
VI	.90	.45	1.35
VII	.57	.28	.85
VIII	.35	.17	.42
IX	.21	.10	.31
X	.13	.06	.19
Approximate total	24.97	12.40	37.37

Table VII does not indicate the full economic effects of a permanent $10 billion tax reduction. As GNP rises the dollar significance of tax reduction increases because the tax reduction is provided through lower rates. The lower rates are now applied to greater aggregate incomes. Hence, the aggregate revenue reduction is greater in later years than in the first year of reduction.

Table VIII summarizes this factor. The table describes only the cumulative effects from permanent tax reduction. Thus, Government expenditures and other factors not affected by the tax reduction are held constant. The upper left-hand corner of the table indicates the seasonally adjusted annual rates of GNP, consumption, and investment in the fourth quarter of 1962. If a $10 billion tax reduction were initiated at the beginning of 1963, the multiplier effects of such a tax reduction are indicated in column 4. As described above, these multiplier effects will begin immediately to stimulate investment, as indicated in the last column in table VIII. Thus, in terms of seasonally adjusted annual rates, GNP, consumption, and investment will be larger in the first quarter of 1963. Since the tax rate reduction is permanent, subsequent stimuli to consumption will occur in ensuing periods and these will be steadily larger as the economy grows. These increases are indicated generally in the remaining columns in table VIII. It can be seen from this table that the increases in consumption and in investment tend to taper off at new levels. Thus, the new levels of GNP, consumption, and investment after the reduction in tax rates will be as indicated at the bottom of the first three columns of table VIII.

TABLE VIII.—*Hypothetical operation of combined multiplier-accelerator with increasing GNP (seasonally adjusted annual rates)*

[Billions of dollars]

Period	GNP	Consumption	Investment	Changes in consumption associated with tax cut in period: 1963 I	1963 II	1963 III	1963 IV	1964 I	1964 II	1964 III	1964 IV	Changes in investment
1962: IV	562.00	363.50	75.00	------	------	------	------	------	------	------	------	----------
1963: I	575.92	372.80	79.62	9.30	------	------	------	------	------	------	------	4.62
II	584.90	378.86	82.54	5.83	9.53	------	------	------	------	------	------	7.54
III	590.87	382.87	84.50	3.66	5.98	9.68	------	------	------	------	------	9.40
IV	594.48	385.89	85.59	2.30	3.75	6.07	9.77	------	------	------	------	10.59
1964: I	596.94	387.07	86.37	1.44	2.35	3.81	6.13	9.84	------	------	------	11.37
II	598.51	388.15	86.86	.90	1.47	2.39	3.84	6.17	9.88	------	------	11.86
III	599.71	388.97	87.24	.57	.92	1.50	2.41	3.87	6.20	9.90	------	12.24
IV	600.24	380.33	87.41	.35	.58	.94	1.51	2.43	3.89	6.21	9.92	12.41
.	.	.	.	.21	.36	.59	.95	1.52	2.44	3.89	6.22	----------
.	.	.	.	.13	.22	.37	.60	.95	1.53	2.44	3.90	----------
Approximate levels	601.46	390.18	87.78	------	------	------	------	------	------	------	------	12.78

Underlying assumptions:

$$GNP_t = G_e + C_t + I_t$$

where

$G_e = \$123.50$ billions
$C_t = C_e + \Delta C$
$I_t = I_e + \Delta I$

where

$I_e = \$75.00$ billions
$C_e = \$363.50$ billions

effective tax cut $(t_e) = .01779\ GNP_e$
$\Delta C_{t+1} = .627053 \Delta C_t$
If a peak exists at $t_e = \$10.70$ billions then

$\Delta C_e = \$26.68$ billions
$\Delta I_e = \$12.78$ billions

thus

$C_e = \$390.18$ billions
$I_e = \$87.78$ billions
$GNP_e = \$601.46$ billions

A question frequently asked with respect to this type of analysis is whether the stimulative effects expected from a tax reduction will provide sufficient revenues to more than offset the cost of the initial reduction. During recent periods of economic expansion the Government has generally taken about 36 percent of additions to GNP in taxes.[14] This percentage includes both increasing revenues from individual and corporate taxes. Because the stimulative effects described above are obtained through tax rate reductions, the 36-percent figure has been reduced to 30 percent for purposes of this analysis. Table IX indicates the anticipated revenue consequences to the Federal Government from tax reduction, if GNP increased as suggested in table VIII. In the fourth quarter of 1962 Federal revenues were estimated to be $108.9 billion at seasonally adjusted annual rates. Column 2 of table IX indicates how these revenues would fall simply because of the rate reductions. The last column in table IX indicates the total revenues after both the reductions and the increases due to expansion of the economic tax base.

[14] See 1961 Joint Economic Report, report of the Joint Economic Committee on the January 1961 Economic Report of the President, p. 87th Cong., 1st Sess., 119 ff.

TABLE IX.—*Changes in Federal revenues with tax cut and expanding gross national product*

[Billions of dollars]

Period	GNP	Federal revenues less tax cut	Total Federal revenues
1962: IV	562.00	108.90	108.90
1963: I	575.92	98.90	102.99
II	584.90	98.65	105.52
III	590.87	98.49	107.15
IV	594.48	98.39	108.12
1964: I	596.94	98.32	108.80
II	598.51	98.28	109.36
III	599.71	98.25	109.56
IV	600.24	98.23	109.70
Approximate levels	601.46	98.20	110.04

Several additional points should be made with respect to this general analysis. First, the increases in investment induced by tax reduction will themselves generate additional income and a multiplied effect should be associated with these additional incomes. This effect has not been quantified in this appendix.

Second, no attempt has been made to take account of changes in psychology resulting from the economic stimulus of the tax cut. To the extent that psychological attitudes toward consumption and investment are favorably affected by the general rise in activity, some relatively autonomous adjustments may occur in consumption and, more particularly, in investment. But these are impossible to quantify.

Third, this analysis has been based upon relationships expressed in current dollars. The historical material is largely drawn from periods when prices were not rising rapidly. No recognition has been given in this analysis to the possible consequences of bottlenecks, economies of scale, and other factors that may influence price changes in the future.

JOINT ECONOMIC COMMITTEE

MINORITY VIEWS

on the

1963 ANNUAL ECONOMIC REPORT OF THE PRESIDENT

MARCH 13, 1963

Submitted by:

Representative Thomas B. Curtis
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long as additional consumption is about 65 percent of additional GNP as the economy grows, then the aggregate percentage of GNP in consumption will remain at 65 percent.

TABLE I.—*Personal consumption expenditures related to GNP*

[Dollar amounts in billions]

Year	GNP	Personal consumption expenditures	Percent
1954	$363.1	$238.0	65.5
1955	397.5	256.9	64.6
1956	419.2	269.9	64.4
1957	442.8	285.2	64.4
1958	444.5	293.2	65.9
1959	482.7	313.5	64.9
1960	503.4	328.5	65.2
1961	518.7	338.1	65.2
1962 [1]	553.6	356.7	64.4

[1] Estimated.

Source: Economic Report, table C-1, p. 171.

What happens to the 35 percent of increased GNP which does not go into increased consumption? In a general way, this 35 percent can be divided into three components. First, businesses rather than individuals receive incomes from some portion of the increases in GNP. Thus, incomes will be obtained in the form of corporate retained earnings, depreciation, corporate taxes, and similar items.[6] Incomes received in these forms cannot be associated with increased personal consumption and, as noted above, the multiplier deals only with increases in consumption. Table II indicates the amounts and percentages of GNP which have gone into these nonpersonal forms of income in recent years. Since nonpersonal income rises more rapidly than GNP during expansion periods, the following material assumes that additions to nonpersonal income during the next few years will be about 22.5 percent of increases in GNP.

TABLE II.—*Nonpersonal income related to GNP*

[Dollar amounts in billions]

Year	GNP	Personal income	Nonpersonal income	Percent
1954	$363.1	$289.8	$73.3	20.2
1955	397.5	310.2	87.3	22.0
1956	419.2	332.9	86.3	20.6
1957	442.8	351.4	91.4	20.6
1958	444.5	360.3	84.2	18.9
1959	482.7	383.9	98.8	20.5
1960	503.4	400.8	102.6	20.4
1961	518.7	416.4	102.3	19.7
1962 [1]	553.6	440.5	113.1	20.4

[1] Estimated.

Source: Economic Report, tables C-1 and C-14, p. 171 and p. 188.

[6] This component of increases in GNP also includes a proportion of the amounts spent by individuals for increased imports, since these are reflected in the national income accounts by changes in some business profits, such as profits of banks engaging in international finance.

Second, not all of the increases in personal income are reflected in increased consumption. A portion of personal income is paid to Federal, State, and local governments in taxes. This amount obviously is not available for consumption. Table III indicates the amounts and percentage relationships of these taxes to personal income during the past 8 years. Since the general percentage relationship has been rising, the percentage of additions to personal income taken in taxes must have been higher than these general relationships. It is estimated here that about 16.5 percent of additions to personal income have been taken in taxes. However, a Federal tax cut will clearly reduce this percentage in the future, probably to about 13 percent.

TABLE III.—*Personal taxes related to personal income*

[Dollar amounts in billions]

Year	Personal income	Personal taxes	Percent
1954	$289.8	$32.9	11.4
1955	310.2	35.8	11.5
1956	332.9	40.0	12.0
1957	351.4	42.6	12.1
1958	360.3	42.4	11.8
1959	383.9	46.8	12.2
1960	400.8	51.4	12.8
1961	416.4	52.8	12.7
1962 [1]	440.5	57.8	13.1

[1] Estimated.

Source: Economic Report, table C-15, p. 190.

Third, of individuals' personal disposable income, some portion is saved, rather than consumed. This proportion has been relatively stable in recent years at around 7 percent, and the assumption is made here that the percentage saved from additions to disposable income will be about 7 percent.

TABLE IV.—*Personal savings related to disposable personal income*

[Dollar amounts in billions]

Year	Disposable personal income	Savings	Percent
1954	$256.9	$18.9	7.4
1955	274.4	17.5	6.4
1956	292.9	23.0	7.9
1957	308.8	23.6	7.6
1958	317.9	24.7	7.8
1959	337.1	23.6	7.0
1960	349.4	20.9	6.0
1961	363.6	25.6	7.0
1962 [1]	382.7	26.0	6.8

[1] Estimated.

Source: Economic Report, table C-15, p. 190.

If the Federal Government enacts an individual tax reduction with a loss of revenue of $10 billion in 1963, this amount would be felt by individuals in the form of increased disposable income. If 7 percent of this amount were saved and the remaining amount spent for

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MINORITY VIEWS

SUMMARY OF RECOMMENDATIONS

I. Tax recommendations: (*a*) Under stated conditions, support a permanent reduction in personal and corporate taxes; (*b*) suggest a 1-year cut of $7 to $8 billion as possibly appropriate; (*c*) favor greater incentives to save and invest; (*d*) suggest consideration be given to new methods of taxing growth income; (*e*) believe some structural reforms should be enacted in 1963; (*f*) question wisdom of enacting future tax cuts now; [1] (*g*) if administration continues to press for 3-year program, believe largest cut should come in first year; (*h*) must be accompanied by expenditure control, noninflationary financing of deficits, easing of the cost-price squeeze, and other measures vital to economic growth.[1]

II. Expenditure control: (*a*) Support temporary ceiling of $95 billion on Federal spending; [1] (*b*) Congress should establish Joint Committee on the Budget; (*c*) President should appoint an Advisory Commission on Federal Expenditures to study the following areas: (1) Establishment of spending priorities among Federal programs; (2) appraisal of Federal activities to determine those which retard economic growth; (3) improvement of Federal budgeting process; (4) examination of Government functions which could be better performed by private economy; (5) review of Federal responsibilities to determine which could be performed at State and local levels; (6) determination of proper level of user charges and other fees charged the public for special Government services; and (7) improvement in Government operations to increase efficiency.

III. Balance of payments: (*a*) Support greater efforts to "set our own house in order" as a means to eliminate our balance-of-payments deficit, putting less reliance on negotiation and the hope that other nations will change their conduct; (*b*) reject measures which would in any way restrict the convertibility of the dollar.

IV. Agriculture: (*a*) Recommend gradual reduction in price supports; (*b*) support efforts to develop new and improved uses for agricultural products; (*c*) urge setting up of soundly determined inventory objectives; (*d*) recommend against permitting growing of surplus crops on new reclamation and irrigation acres; (*e*) urge measures to assist the farm unemployed in moving into productive employment; and (*f*) recommend stopping Government subsidy of crops in one area in preference to another area.

V. Other recommendations:

A. Facilitating adjustment to technical change.—

1. *Education and training.*—(*a*) Broaden the Manpower Development and Training Act to include adult education courses in basic subjects; (*b*) expand Federal vocational and technical education programs; (*c*) coordinate Health, Education, Welfare's vocational education program and Labor's apprenticeship program; (*d*) review draft law provisions as they impede education and employment of young men; (*e*) amend Manpower Development and Training Act to authorize training of more young people, particularly "dropouts"; (*f*) eliminate incon-

[1] See Senator Javits' additional views.

sistency among Trade Expansion Act of 1962, the Area Redevelopment Act, the Manpower Development and Training Act, and unemployment insurance programs; (*g*) amend tax laws to permit tax deduction for education or training expenses and tax credit for individuals training in either academic or vocational subjects at the post-high school level; (*h*) provide incentives for companies to plan for technological changes by encouraging States to broaden merit ratings under unemployment insurance laws; (*i*) encourage States to permit individuals undergoing training or retraining to receive unemployment compensation up to normal amounts and limits; [1] (*j*) consider disqualifying from unemployment compensation workers who refuse referral to training without good cause.

2. *Mobility.*—(*a*) Amend tax laws to change definition of "home" to the place where a worker owns a home and maintains his family; (*b*) eliminate barriers to mobility caused by pensions and job rights; (*c*) pay subsistence or transportation allowances to unemployment insurance claimants who look for work in areas beyond a predetermined distance from their home; (*d*) allow tax relief for moving expenses involved in taking a new job.

3. *Job information and research activities.*—(*a*) Strengthen the U.S. Employment Service and private employment agencies; (*b*) establish a nationwide "early warning system" to allow preparation for technological job displacement; (*c*) favor establishment of a national clearinghouse of skills and job vacancies; (*d*) support permanent State programs for temporary extension of unemployment insurance.

B. Productivity.—(1) Encourage research and development activities in industries serving civilian markets; (2) create a National Productivity Council; (3) support tax deduction as a business expense of outlays for machinery and equipment; (4) review of depreciation schedules; (5) encourage profit sharing by employees; (6) encourage export expansion.

C. Antitrust.—Favor establishment of a Commission on Antitrust Laws to review U.S. laws and procedures as they affect growth, foreign economic policy, etc.

D. National emergency strikes.—Urge the administration to submit new legislation to deal with national emergency strikes.

E. Discrimination in employment and training.—Require faster progress in eliminating it, not only on the basis of race, but age as well.

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[1] See Senator Javits' additional views.

INTRODUCTION [1]

The American people have been told by spokesmen for this administration that 2 years ago, when it took over the reins of the Federal Government, we were in the "valley of recession." The rate of unemployment was 6.7 percent. We had a "slack" economy, and our annual rate of economic growth was unsatisfactory. Our favorable balance of exports over imports was not what it should be. Farmers were being forced off their farms because they were not receiving "full parity of income." We had a serious balance-of-payments deficit. And our gold supply was rapidly falling to an alarming level.

Now, after 2 years in office, during which it has had firm control over both Houses of the Congress, by its own definition the administration finds us back in a similar "valley of recession." Our rate of unemployment is 6.1 percent, notwithstanding the addition of over 186,000 more civilians to the Federal payroll [2] and an increase of over 192,000 in the armed services.[3] We are in the grip of "economic lethargy" (as the Chairman of the President's Council of Economic Advisers termed it). Our favorable balance of exports over imports declined in 1962 by over $700 million,[4] and discriminatory policies and actions of the Common Market against our agricultural exports (unaccompanied by effective action of this administration) sound an ominous warning for the future.[5]

Our balance-of-payments deficit was $2.2 billion in 1962 and would have been nearly $700 million larger had it not been for the accelerated repayment of debts owed us by certain foreign governments. Our gold supply has gone down an average of nearly $900 million in each of the last 2 years to a low as of March 4 of $15.8 billion, and the drain is continuing. With $12 billion of this needed to back up our currency, it is clear that this cannot continue much longer. Potential claims by foreigners against our gold stock amount to over $20

[1] These minority views are not in response to the majority report. The minority began writing its separate views as the committee's annual hearings closed on February 6. The majority began writing its report at the same time and completed and distributed to the minority its final draft on March 2. Since the minority views had to be completed by March 8, to have prepared these views on the basis of the majority report would have given us insufficient time to properly develop the case we wish to make. While agreeing with some conclusions and disagreeing with others in the majority report, we wish to commend the majority for the format of its presentation. It clearly poses the issues that must be dealt with in the debate now in progress on our Nation's economy. The careful reader will be able to distinguish between the majority opinion and our own, both as to the areas of agreement and disagreement.

[2] Seasonally adjusted, U.S. Department of Labor Monthly Report on the Labor Force, January 1961 and January 1963. It is significant that the number of employees in the U.S. Employment Service has increased from 272 at the end of fiscal 1961 to an estimated 330 at the end of fiscal 1963, with expenditures during the same period rising from $1,932,703 to an estimated $3,296,300.

[3] Ibid.

[4] The balance of merchandise exports over imports declined by $1.2 billion, but this was partially offset by an increase in balance on services.

[5] Eldon Griffiths, chief European correspondent for Newsweek magazine, recently wrote that the United States stands to lose more than 30 percent of all its exports to Europe if high Common Market tariffs against our agricultural exports are maintained. Prof. Lawrence B. Krause of Yale University, in a study prepared for the Subcommittee on International Exchange and Payments of the Joint Economic Committee, 87th Cong., 2d sess., stated (p. 126): "The near-term prospect for wheat imports into the Six from the United States are very poor and the complete loss of the market must be contemplated." Again (p. 128) he warns: "While in the very short run the value of U.S. exports of meat may increase to the EEC, the eventual loss of the entire market must be anticipated."

billion.[6] Senator Harry Byrd, Democrat of Virginia, chairman of the Senate Finance Committee, has warned that devaluation of the dollar might be the result. Prof. Paul Samuelson, one of the President's consultants on economics, recently suggested that the dollar may be *overvalued* and that our policy should be to "alter the parity of the dollar."

The Federal debt has increased nearly $14 billion,[7] the consumer price index has increased by over 2 percent, and general inflation has reduced the purchasing power of our people's money by $14 billion. This record hardly justifies the President's assertion that the past 2 years have brought the greatest record of price stability in the postwar period. At the same time, although there has been some rise in the standard of living, there are millions of less fortunate Americans whose standard of living has not improved or has actually worsened.

Our annual rate of economic growth has been a little over 3 percent—far short of the administration's goal of 5 percent.

There has been no real improvement in our basic industry—agriculture. Additional net income from farming rose in 1961. However, this was almost entirely attributable to land retirement payments received during 1961. In effect, farmers who received these payments merely accelerated income that would otherwise have been received in 1962 (from the sale of grain that would have been raised in 1961 on the retired land) into 1961. Similar acceleration of 1963 income into 1962 (in the case of farmers continuing in the land retirement program) merely replaced 1962 income which had been accelerated into 1961, so that net 1962 farm income remained at about the same level as 1961 income. It should be noted that net farm income rather than gross farm income is what counts when this basic industry's share of the net national income is considered.

From December 31, 1960, to December 31, 1962, the net book value of Commodity Credit Corporation stocks increased by $735 million.[8] During this period our farm population declined by 1,322,000 and the number of farms decreased by 260,900. Over 367,000 farm operators and farmworkers left the farm. Still, U.S. Department of Agriculture expenditures rose from $5.9 billion for fiscal year 1961 to an estimated $7.5 billion for fiscal year 1963, and the Department added over 16,000 employees to its payroll during the 2-year period ended December 31, 1962. Income per capita of farmers has risen slightly, but, as pointed out by the U.S. Department of Commerce, this is "due to the declining number of farms and farm population." [9]

Bringing agricultural production and consumption into reasonable balance and assuring farmers a fair share of the *net* national income by reducing the cost-price squeeze are fundamental objectives of our farm policy.

It is our position that any program of governmental action to improve the economy must be premised on the stable purchasing power of our money if it is to be meaningful. Inflation causes labor to de-

[6] Short-term liabilities to foreigners totaled $20.1 billion on Dec. 31, 1962. Of this amount, $12.2 billion was to official holders (e.g., foreign central banks) and $7.9 billion to private holders. In addition, short-term liabilities to international organizations totaled $4.9 billion. Source: Federal Reserve Bulletin, February 1963.

[7] From Dec. 31, 1960, to Dec. 31, 1962, the public debt of the Federal Government increased from $290.4 to $304 billion. Approval of the President's deficit budget for fiscal year 1964 will increase the debt an additional estimated $12 billion.

[8] Book value of surplus stocks of butter rose from $39.6 million on Dec. 31, 1960, to $207.1 million on Dec. 31, 1962. Soybean stocks went up from $10.6 to $87.4 million.

[9] Survey of Current Business, December 1962 (p. 24).

mand increased wages because it cannot make ends meet with the reduced purchasing power of its wages. Escalation clauses in labor-management contracts affecting thousands of workers automatically result in wage increases as the cost of living moves upward. Millions of our senior citizens living on retirement income and savings find that the reduced purchasing power of their money keeps them from an adequate diet and increases the cost of their medical and hospital care.

It is in this setting that we now proceed to evaluate the specific proposals of the administration and to advance our ideas for attaining the meaningful and sustained economic growth which the American people deserve.

The administration refuses to recognize that the United States today is experiencing the beginnings of an economic revolution that already is altering fundamentally the way our people live and work. Slowly and still dimly, the Nation—if not the administration—is beginning to perceive the nature and extent of this revolution and the magnitude of the social and economic problems it poses. We believe it is urgent to focus public attention on these problems—and the economic forces underlying them—and to begin a serious national discussion on the course we must take to solve them.

To this end we shall: (*a*) Diagnose the nature of our economic problems; (*b*) analyze the weaknesses of the administration's basic economic assumptions; (*c*) discuss the administration's tax and spending policies and recommend changes in them; (*d*) discuss the balance-of-payments problem and monetary policy; and (*e*) offer other appropriate recommendations.

A. NATURE OF OUR ECONOMIC PROBLEMS

In our view, the major domestic problem of the present decade is the adjustment required by the increasingly rapid pace of technological change in our society. In his testimony before the House Ways and Means Committee on February 8, 1963, Secretary of Labor W. Willard Wirtz spoke of "a revolution in the replacement of men by machines." This phenomenon is so rapid and profound that a word—automation—has been coined to describe it.

With each passing year, less and less labor is required to produce more of the products of our farms, mines, and factories. As relatively less labor is required to satisfy our basic material needs, more labor—but of a different kind—is called upon to satisfy the preferences that arise out of the desire for a better and fuller life for ourselves and our children.

That deep and pervasive changes are taking place in our economy is beyond dispute. They are reflected in part by the changing occupational structure of our labor force. For example, from 1950 to 1960, the number of all employed persons increased by 14.5 percent. At the same time, white-collar and service workers increased by about 26 percent; agricultural workers declined 41 percent; and manual workers increased by only 5.8 percent.

Rapid technological progress is essential to maintain our economic and military leadership and to provide a higher standard of living for our growing population. But it creates individual hardships and demands difficult and often painful personal and family adjustments.

Automation, for example, creates demands for new and higher skills, but it makes old skills obsolete. In the process, the person with no skill, or with an obsolete skill, or in an area other than where the new jobs are located, becomes increasingly subject to frequent and persistent periods of unemployment.

Rapidly advancing technology also results in new and improved industrial processes and, by creating demands for new products, changes patterns of consumption. Among other results, these developments make obsolete much of our capacity to produce existing products.

Our unemployment problem has been aggravated further by barriers to worker mobility, industrial migration, featherbedding on the part of both management and labor, foreign competition, multiple jobholding by individuals, the movement of workers away from the farm, inadequate attention to the rehabilitation of the physically and mentally handicapped, discrimination based on age, sex, race, and creed, weaknesses in our educational system, particularly in the area of vocational training, and a tax structure which discourages industrial expansion. Compounding the problems caused by the technological revolution and these other factors, we will soon face an explosion in the size of our labor force as the large number of babies born in the 1940's reaches working age.

Clearly the primary challenge of the 1960's is to ease and facilitate the adjustment of our people to these economic forces of change. Technological advances will provide opportunities for a fuller, more satisfying and freer life for all of our people. But it will take imagination and effort to insure that those lacking needed skills or experience, those who are poor in talent and those who suffer discrimination in employment share in the opportunities which these developments will provide. Failure to adjust will bring untold human suffering as well as blunt our efforts to achieve a higher level of sustained economic growth. This need to adjust was forcefully pointed out recently by Gosta Rehn, Director of Manpower and Social Affairs for the Organization for Economic Cooperation and Development, who said:

> New techniques are being developed and utilized at a very high rate. All this means that the changes in economic structure, to which States and individuals have to adapt, will be very great. The rapid acceptance of such changes as imply a reallocation of manpower and other productive resources toward the most efficient sectors is a precondition for maximum progress.[10]

We regret that the administration, while proclaiming a New Frontier, has not regarded with sufficient urgency the extent or depth of the adjustments facing us in the decade ahead. Even worse, it has either failed to grasp or has neglected the need to make the Nation more fully aware of them.

[10] The OECD Observer, Nov. 15, 1962.

B. CRITIQUE OF THE ADMINISTRATION'S BASIC ECONOMIC ASSUMPTIONS

The heart of the administration's economic program consists of efforts to increase consumer demand.[11] This would be done by a series of "planned" but "temporary" budget deficits, partly resulting from the proposed tax reduction. Basic to the administration's program is a belief in the efficacy of budget deficits as a remedy for our new economic problems, of which persistent and mounting unemployment and an apparent excess of industrial capacity are but surface symptoms. The administration apparently has abandoned the theory of balancing the budget over the business cycle. It now asserts that we must run deficits in good times and bad until some distant future when Federal revenues presumably—or hopefully—will catch up with increasing expenditures.

It is curious that, in spite of the failure of a series of large and steadily increasing budget deficits to stimulate a full recovery from the last cyclical downturn, the administration still retains its faith in the stimulative effect of "temporary" deficits.[12] Interestingly, the current upturn is the only one in the postwar period which has not developed a budget surplus.

The administration claims that deficits are "passive" if caused by a decline in economic activity. Passive deficits, the Council of Economic Advisers has said, do not provide stimulus; only deficits resulting from tax cuts or spending increases stimulate the economy.

If this were the case, the deficits of the past 2 years of cyclical upturn should have stimulated the economy since they were caused more by rapidly rising Federal spending than lagging revenues. Expenditures increased by $13 billion from fiscal 1961 through the estimates for fiscal 1963. At the same time, revenues were increasing by $8 billion. If revenues were lagging, it was only in relation to the sharp increases in Federal spending.

We think the administration overemphasizes the importance of fiscal measures to increase consumer demand. More relevant—and less costly in terms of budget impact—are those measures that would sharpen incentives to superior economic performance and thus produce the more vigorous expansion needed to reap the full benefits of the economic revolution now underway.

As for the thesis that the overall magnitude of the Federal budget deficit, per se, is a measure of governmental stimulus to the economy, it is useful to note an analysis of the relationship between the Federal budget (national income accounts basis) and economic activity included in a paper presented to the committee by George Terborgh, research director of the Machinery and Allied Products Institute.[13] Terborgh's analysis shows that there is no general pattern to support the theory that deficits are stimulative and surpluses repressive. In fact, in the postwar period, of 51 quarters with a rising gross national product, Terborgh found that 28 were associated with a Federal surplus, 23 with a deficit. Of 13 quarters with declining gross national product, 12 were associated with a deficit.

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[11] See Senator Javits' additional views.

[12] This theory was thoroughly discredited in the 1930's when huge budget deficits in relation to gross national product failed to "cure" the depression and reduce unemployment to an acceptable level. After running deficits from 1931 to 1940 totaling $28 billion (3.6 percent of total gross national product during this period), unemployment in 1940 was virtually the same (14.6 percent) as in 1931 (15.9 percent).

[13] Hearings before the Joint Economic Committee on the 1963 Economic Report of the President, pp. 773–785 (hereinafter referred to as "Hearings").

Because of the lag between the budget position and the response of the economy, Terborgh also compared the budget position with the gross national product 6 months later. On this basis, of 51 quarters with rising gross national product, 24 showed surpluses in the second quarter preceding and 27 showed deficits. Of 13 quarters with falling gross national product, 7 showed surpluses, 6 deficits. Terborgh ascribed the budget's apparent lack of economic impact to the offsetting effects of more powerful forces and to differences in the way deficits are financed. We shall discuss problems of debt management under section C, below.

Neither do the facts bear out the administration's contention that aggregate demand is lagging. From 1947 to 1962 personal consumption expenditures and total Government demand for goods and services averaged 84.5 percent of gross national product. In 1961 the figure was 85.9 percent and in 1962, 85.7 percent. During 1961 and 1962 new construction was about 8 percent of gross national product—or slightly higher than the postwar average. In its 1963 annual report (p. 15), the Council of Economic Advisers itself acknowledged that the failure of gross national product in 1962 to reach predicted levels was not caused by a shortfall of consumption.

What has fallen behind is the percentage of gross national product accounted for by producers' durable equipment. This averaged 6.1 percent for the entire postwar period, but stood at 4.9 percent in 1961 and 5.2 percent in 1962. We shall discuss causes of this decline in business investment later in these views.

An increase in aggregate demand may be helpful in attacking cyclical unemployment, but this is not the current problem. Our economy has moved in 24 months from the low point of the last cyclical downturn—which was relatively minor by postwar standards—and has now reached a new level of gross national product.

From the trough of the downturn in February 1961 through January 1963, industrial production increased 15.1 percent. Yet, reflecting the ability of relatively fewer men to produce more goods, nonfarm employment increased by less than 4 percent.

Although the Nation as a whole is prosperous, too many of our citizens are not sharing in this prosperity. Unemployment from February 1961 through February 1963 declined by only 500,000 (seasonally adjusted). In February, about 4.4 million persons (seasonally adjusted), or 6.1 percent of the civilian labor force, were still unemployed.

It appears that increases in aggregate demand are having less and less impact in reducing the level of unemployment. We are learning anew that an increase in the demand for commodities does not necessarily translate itself into increased demand for labor, or at least for the labor of the unemployed.

In large part, this reflects structural changes in the economy. The increasing importance of structural unemployment is clearly indicated by the fact that the average duration of unemployment in 1962 (14.7 weeks) was higher, except for 1 year, than at any time since the end of World War II, including during recession years.

In his testimony before the committee, Secretary Wirtz stressed the structural causes of the current unemployment by pointing out that there is no "single overall unemployment problem." [14] Rather, he said,

[14] Hearings, p. 196.

unemployment is concentrated largely among young people, racial minorities, and the unskilled. Secretary Wirtz added that we are going to have to start hitting at these problems "with rifles instead of with a shotgun." In other words, greater attention should be directed to linking remedies for unemployment to its specific causes.

Contrary to his advice to the committee, the Secretary then recommended the administration's shotgun approach of increasing consumer demand.

The extent to which obsolete capacity, as opposed to inadequate demand, may have been responsible for the low industrial operating rates of recent years is indicated by the heavy emphasis manufacturers have placed on modernizing their plant and facilities. The 15th McGraw-Hill survey of business plans for new plants and equipment showed that since 1958, manufacturing firms have devoted about 70 percent of their plant and equipment investment to replacement and modernization of obsolete facilities. The need to produce new and improved products more efficiently explains why the steel industry, although operating at an average of 71.8 percent of capacity from 1957 to 1960, at the same time spent over $5.5 billion on new plant and equipment. The modernization trend in industry is expected to continue at least through 1965. This fact reemphasizes the point made earlier that our major domestic problem is the adjustment of men to new technological conditions.

Even after this major program of modernization and replacement, 24 percent of our industrial plant predates 1945; about 40 percent of our manufacturing capacity predates the Korean war.

While these figures show that we still have much old capacity, McGraw-Hill cautioned that its survey may understate the level of obsolete facilities because it covers only the larger companies in an industry. It is likely that small- and medium-sized companies have not replaced obsolete and antiquated facilities to the same extent as the larger companies. In any event, while we do not know precisely how much of our unused capacity is obsolete, it seems reasonable that a large part falls into this category.

It is important to remember that excess capacity figures cited to show a lagging economy are averages for all industries. Generally, some industries are operating at or near their preferred rates, while others are operating well below the desired levels. In a dynamic economy both the size and shape of demand are constantly changing. When growth increases demand for products already being produced at capacity levels of existing plant, the mere existence of excess capacity in other industries is irrelevant. Furthermore, it should be clear that increased demand for the products of industries operating at capacity can lead to inflationary pressures even though the overall average indicates the existence of idle capacity.

The administration's general approach to economic issues is based on the assumption that our economy is stagnant, slack, and tired out. It assumes that our economic growth rate has slowed considerably and that there is a growing gap between actual and potential production.

We wish to make clear that the desirability of achieving a higher rate of economic growth is not at issue. A vigorous rate of sustained economic growth facilitates adjustment to the technological revolution. But we submit that the administration has incorrectly diagnosed our problem as one of stagnation. We have expressed our disagreement with its assumptions in our minority views to the 1961 and 1962 Annual Reports of the Joint Economic Committee. We wish to call attention to these views here and to state, only briefly, some of the reasons for our disagreement with the administration's basic assumptions.

One trouble with the gap theory is its use of gross national product as the indicator of economic growth. The gross national product is only one measure of economic activity. It does not fully measure true economic growth, by which we mean the attainment of a richer and fuller life for more of our citizens. Gross national product rises rapidly during a war, but no one would call this true economic growth. Indicators of true economic growth, such as increased leisure time, new and improved goods and services on the market, greater longevity, better health, greater opportunities for education and travel, are not reflected, or reflected only incompletely, in the gross national product. By these and other measures, our economy has scored impressive gains in growth in the past decade.

Even if we were to accept gross national product as a valid measure of economic growth, the techniques used by the administration to project our potential growth and thus to derive the magnitude of the gap are questionable. Walter W. Heller, Chairman of President Kennedy's Council of Economic Advisers, told the Joint Economic Committee in 1961 that the Council's estimates of the gap were "at best hazardous and uncertain." In the same vein, but while still serving as professor of economics at the University of Minnesota in 1959, Dr. Heller acknowledged before the House Ways and Means Committee that—

> * * * we need to recognize the limitations of our knowledge concerning the sources of growth and the precise methods of accelerating it.

Dr. Arthur Burns, president of the National Bureau of Economic Research and former Chairman of President Eisenhower's Council of Economic Advisers, has written two penetrating analyses of the Council's gap theory [15] in which he illuminates some of the hazards of "growthmanship." For example, by starting from different postwar years, but using the same logic and technique as the administration, one can measure potential and actual output and get results which differ significantly from those reached by the Council. In one case, the results showed a level of actual output above potential output.

Dr. Burns has also pointed out that since 1947 our economy has always operated below its potential, with the exception of the Korean war years and a few months in 1955. Under the Council's theory, therefore, aggregate demand was lagging even in the boom years of 1947 and 1956. If the Government had followed policies to close the "gap" then, Dr. Burns believes that the pace of inflation might have been very much faster, without appreciably lowering the average rate of unemployment or raising the average rate of economic growth over the entire postwar period.

[15] Congressional Record, Jan. 28, 1963, p. 1103; Apr. 27, 1961, p. A2885.

The gross national product analysis is a logical and statistical construct that has no real counterpart in a complex and dynamic economy based on decentralized free choice and initiative. Free enterprise means trial and error, change and adjustment. This is an inevitable aspect of effective economic performance and, in fact, of managerial decisions generally. There is no reason founded on convincing evidence to believe that the complex processes of any economy can work perpetually at an even pace or near some full employment or "potential" trend line.

The administration's gap theory and its insistence upon the idea that our growth rate has fallen significantly below past levels is, at best, a risky guide for policy. The administration must avoid the oversimplification which results from too great a fascination with the aggregates of the gross national product. It must examine the components of our dynamic economy to see, specifically, where the trouble lies.

As the Federal Statistics Users' Conference noted in a paper presented to the committee: [16]

> * * * There is a tendency on the part of some users both in and out of the Government to find easy mechanistic relationships among the components of the gross national product and to make easy assumptions about the effect of this or that possible public or private policy on the overall total GNP.
>
> Nothing could be more dangerous. There is no substitute for penetrating analysis of GNP in detail. The very popularity of GNP should cause us all to be concerned about changes taking place within the economy which are reflected in the components of GNP but which are slow to make an impact in the overall GNP figure.

The fact is that our economy, while beset with problems, is continuing its steady growth. Our diagnosis shows that we are suffering more from growing pains than tired blood.

As we emphasized earlier, this is not to say that we cannot and should not improve our rate of growth. But we cannot encourage faster growth and, at the same time, solve the problems arising from growth by applying a treatment more appropriate to stagnation or cyclical decline.

Our most fundamental criticism of the administration is that its failure to identify the real nature of our economic problems diverts the Nation's attention from them and thus delays a genuine solution.

We cannot afford to mark time much longer. Labor's call for a 35-hour week and for industrial sabbaticals, as well as the recent rash of serious labor disputes, make clear that uneasiness about basic changes in the economy are spreading. The administration must lead history, or it will find itself overtaken by it.

[16] Hearings, pp. 767–768.

C. THE ADMINISTRATION'S TAX PROGRAM

The President has sent to the Congress a program of individual and corporate income tax reduction and reform designed to improve our rate of economic growth and reduce the unemployment rate to 4 percent (a rate deemed by him to reflect "full employment").

We agree that our Federal tax structure discourages, rather than encourages, sound business and business expansion with its attendant employment opportunities. We support reform of our tax structure and rates, but we have several reservations about the administration's program:

1. Even if we grant the administration's assumptions that an increase in consumer demand is needed to take up the alleged slack in our economic performance, we have serious doubts that the administration's program would achieve this objective.

2. Our diagnosis of the Nation's economic problems leads to the conclusion that the administration's tax program misses the mark by failing to provide sufficient incentives for savings and investment.

3. The tax reduction program—coupled with the lack of restraint in spending which characterizes the administration and the Democratic Congress—would result in a series of large and prolonged budget deficits. These would create difficult problems of debt management, further increase the burden of interest payments on the public debt, probably lead to renewed inflationary pressures, and have an adverse effect on our persistent balance-of-payments and gold problems. Approval of the President's tax program should be contingent upon more vigorous steps to hold the line on expenditures, with the objective of bringing the budget into balance within the very near future.

We shall discuss each of these points in turn.

1. Inadequacies of administration tax program

We believe that the tax program, even while incurring heavy costs in terms of budget deficits, will fail to remove the tax impediments to growth in sufficient amounts to carry the economy to higher levels of sustained activity. Our reasoning is largely, although not exclusively, based on the 3-year stretch-out of the program, on the concentration of the largest and most constructive reductions in the second and third years, and on the excessive emphasis on stimulating consumption at the expense of improvements in our productive plant.

In his testimony before the committee, Dr. Heller conceded that the program would have been somewhat different if the administration lived by economics alone. A number of other witnesses who appeared before the committee expressed doubts about the effectiveness of the program. After 2 years of recovery, it is altogether possible that counterexpansionary forces might seriously offset any beneficial effects which could flow from the moderate and gradually applied tax reductions.

Whatever one's position on tax reduction, it cannot be justified on the basis of the multiplier theory—as the administration and the majority try to do. The serious problems connected with predicting the multiplier effects of tax cuts were stressed in a statement presented to the committee by the Department of Commerce. As the Department said:

> Theoretically the multiplier effects abstract from the numerous other forces which are operating in the economy at any given time. Additional expenditure brought about by a tax cut, for example, must be superimposed upon estimates of the net effect of these forces before a realistic appraisal can be made of the future behavior of the economy subsequent to changes in the tax laws. A tax cut which is too small or which is introduced at a time when the economy is leveling off or even beginning to turn down may not lead automatically to an increase in output. This is the reason why an examination of the past relations involving tax cuts or other multiplier-inducing actions on the subsequent behavior of output is so inconclusive. We find a variety of net effects arising from an expenditure which has multiplier effects; namely, output rising, leveling, and even turning down. To fully appraise such changes in the tax laws or other actions we would have to determine the most likely behavior of the economy in the absence of such changes. This is a difficult task.[17] [18]

There are additional reasons why the administration's program might not do what is expected of it. For example, the effect of tax reduction would be blunted if, contrary to the administration's expectations, consumers saved 1 or 2 percentage points more than 7 percent of total after-tax income. While recent experience indicates that consumers save about this amount of total after-tax income, the savings rate on marginal increases in income is probably greater than 7 percent. Moreover, the 7-percent assumption is related to all individuals in the economy. However, many lower income individuals—who bring the average rate down—do not pay taxes. Therefore, the savings rate among those who will obtain the tax reduction undoubtedly is higher than 7 percent.

The effects of the tax cut also would be largely offset if consumers used a significant part of their tax reduction to pay off existing debt. In addition, a large part of the tax reductions will be offset by the $2 billion increase in the social security payroll tax which has already taken effect this year and by those increases scheduled to take effect in the coming years. Increases in State and local taxes and increases in the consumer price index will further diminish the effect of tax cuts.[19]

An additional problem is posed by the method of financing the deficits which, in part, would result from the tax cut. These problems will be discussed in more detail below, but suffice it to say here that the problem of financing the additional debt could lead to an increase in interest rates and in the consumer price index that might deter private investment.

We doubt that the administration's fiscal program of moderate and gradually applied tax cuts accompanied by increases in spending will work. The chances of failure are compounded by the administration's almost total neglect of other important actions which are required by

[17] See additional views of Senator Miller.

[18] Hearings, p. 247.

[19] The Associated Press has estimated that State tax increases may total $2.5 billion as a result of action by State legislatures meeting this year.

the current economic situation. Some of these bear on the question of why there is a drop-off in business investment. Psychological factors, such as business confidence, and economic factors, such as the risk of the rate of return, weigh heavily on investment.

If the administration's program does fail, the Nation will be left with a high level of unemployment, a prolonged series of budget deficits, an increase in the economy's inflationary potential, aggravated problems of debt management, and a possible worsening of our balance of-payments and gold problems.

Secretary Dillon told the committee that it would not be a catastrophe if the administration's program failed. Perhaps not, but we wonder what the administration's policy recommendations would be in that event. Would it suggest that taxes be lowered even more? Or should taxes, in that instance, be raised? Or would we be compelled to sharply increase Federal spending? How large would the annual deficits be in that event? And how much would the national debt grow? Where would citizen and business confidence be then?

We regret to say that the administration's tax reduction program is neither fish nor fowl. Without offering substantial promise of doing what it sets out to do, it would intensify a large number of our existing economic problems and create new ones in the field of debt management. In no case should we adopt halfway measures which aggravate present problems and create new ones.

We believe that our diagnosis of the economy and our recommendations for overcoming the Nation's economic problems, both by incentive tax reduction and reform, as well as by other important measures offer the best choice of policy and should be adopted by the administration.

Our recommendations on the general principles that should govern a tax program for 1963 are as follows:

a. We strongly favor enactment of a permanent reduction in personal and corporate taxes accompanied by expenditure control, noninflationary debt financing, and additional actions to remove impediments to growth. (See sec. g, below.) One-half of the annual reduction should take effect in calendar 1963, with the full reduction taking effect in calendar 1964.

b. The precise size of the tax reduction required to substantially reduce impediments to growth without leading to increased inflation is not clear. However, we believe that it must be larger than the $2.7 billion net cut for 1963 proposed by the administration. An annual reduction of from $7 to $8 billion might be about right to do the job, but no firm judgment can be made until the question has been subjected to more searching examination by the Congress.[20]

c. While providing the largest amount of dollar reductions to individuals, we believe that a reform of tax rates to remove impediments to growth and job-creating investment—as contrasted to tax cut programs designed to inject mass purchasing power into the economy—should provide greater incentives to save and invest than does the administration bill. We explain our reasons for this position on pages 75–78 of these views.

d. Consideration should be given to a new approach to provide incentive taxation of growth income. Inasmuch as our objective is growth, many individuals and corporations would be greatly encour-

[20] See additional views of Senator Miller.

aged if, for example, the tax rates were cut with respect to the amount of the annual increase in their income over that of the previous year. Naturally safeguards would have to be written into such a plan to prevent avoidance of its policy through devices of whipsawing, artificial inventorying, and the like.[21]

e. Although rate reduction is the most important and needed tax reform, we believe at least some structural reforms should be included in the 1963 tax program. We will not take a position here on each of the administration's proposed structural reforms: some appear desirable; others, such as the 5-percent floor under deductions, would retard economic growth and injure our private free enterprise system.

f. We question the prudence of enacting tax cuts to take effect 2 or 3 years in the future. In a world characterized chiefly by change, events move too rapidly to recommend such a policy. Although our minds are not closed on this point, we believe enacting tax cuts on a year-to-year basis is the sounder course. Accordingly—depending upon the budgetary situation and the economic outlook—we believe Congress should consider making further rate reductions and structural reforms next year.

g. Should the administration continue to push for a 3-year program, we believe the largest cuts should be made in the first year, with successively smaller cuts in the last 2 years when, under the administration's theory, the economy should be expanding vigorously. We are in general accord with the majority on this point.

h. The tax program must meet the following conditions:

(1) Since any tax reduction will further deepen the large and increasing Federal budget deficits, the administration must take prompt and effective action—preferably along the lines of the recommendations on pages 84–85 of these views—to bring the rapidly rising level of expenditures under firm control in order to minimize the size of the 1964 deficit and attain budget balance in 1965 or, at the latest, 1966.[22]

(2) The administration must provide convincing assurances that it will finance the 1964 budget deficit in such a way as not to increase significantly the inflationary potential in the economy.

(3) The administration must begin immediately to take some of those other actions—as suggested in section F of these views—which are necessary if we are to reach full employment, restore vigor to our economy, and balance the Federal budget.

We believe a bold, balanced, and comprehensive economic program such as we have outlined here offers the best hope of achieving the goals which all Americans share—without exposing the Nation to the serious economic risks of the administration's program.

2. Encouraging savings and investment

Improving our rate of sustained economic growth depends upon an expansion and improvement of our productive capacity and an increase in our productivity. These advances can in great measure be attained through a greater development of our human resources. In part, however, they depend on stepped-up private investment. We are concerned that the administration's proposals do not go far enough in this key area of removing the impediments to expansion of private investment.

[21] See additional views of Senator Miller, which outline his plan for incentive taxation of growth income.
[22] See Senator Javits' additional views.

In its 1963 report, the Council of Economic Advisers recognized that the failure of gross national product to reach the level predicted for 1962 was caused by "the failure of expenditures other than consumption to rise as far as had been expected. * * * The error, then," the Council said, "was in the area of business investment."[23]

According to Dr. Burns, the reason for recent weakness in this area can be found in the uncertainty and hesitation which has characterized business expectations of the future. This hesitation and uncertainty, he said, has been caused basically by the steady erosion of profit margins and our continuing balance-of-payments deficits and the resulting uneasiness about the strength of the dollar.

Too much attention has been directed to the point that aggregate profit increases have been the highest in our history. Since sales and investment have increased at a greater rate, however, the ratio of profits to sales and investment has been declining.

The profits squeeze has particular relevance to the lag in business investment. Profits after taxes per dollar of sales for all manufacturing corporations fell from an average of 6.3 cents in 1947–51 to 4.8 cents in 1952–56, and to 4.5 cents in 1957–61. Annual rate of profit after taxes on stockholder's equity dropped from an average of 14.1 percent in 1947–51 to 10.9 percent in 1952–56, and to 9.4 percent in the 1957–61 period. Corporate profits after taxes as a percentage of corporate sales show a similar decline.

According to a Department of Commerce study released November 27, 1962, the share of total corporate output returned to capital in the form of profits declined by 25 percent from 1948 to 1962. Further, while corporate tax liabilities were doubling over the period, after-tax profits rose only 25 percent. It is no surprise that Secretary of Commerce Luther Hodges told the committee on January 30 that investment expenditures were lower than expected in 1962 because of "limited profit opportunities."[24]

Although the Council agrees that the problem lies in the area of plant and equipment expenditures, it argues that business investment is restrained because of excess plant capacity. As already noted, we believe that most of this excess capacity is obsolete or produces goods for which there is no consumer preference, and in no event is all of it usable.[25]

Neil Jacoby, dean of the Graduate School of Business Administration, University of California, told the committee—

> * * * the opportunities for stimulating investment in an advanced economy with dynamic technology by offering strong incentives are greater now than they have ever been in the past. It would be unfortunate to forgo them because of illusions of "excess" capacity.[26]

As Gabriel Hauge has pointed out, idle capacity, where it represents high cost or obsolescent facilities, is more a consequence of inadequate investment than a cause. In his testimony, Dr. Burns pointed out that the historical record shows that even after prolonged or severe depressions, when idle capacity was larger than in 1961, business investment has typically rebounded sharply when a resurgence of business confidence ushered in economic recovery.

[23] 1963 Economic Report of the President, p. 15.
[24] Hearings, p. 238.
[25] See Senator Javits' additional views.
[26] Hearings, p. 541.

Moreover, even if we were to grant the administration's primary assumption that our problem is one of inadequate aggregate demand, it would still seem more appropriate to increase aggregate demand in the first instance in the investment sector. Increases in investment demand not only raise aggregate demand: they also raise the ability of the economy to satisfy the aggregate demand.

Specifically, how do we differ with the administration's program as it relates to incentives to save and invest?

The essential source of funds for accelerated investment must be private savings. The administration's combined program of tax reduction and reform—as the majority clearly indicates—is designed almost entirely to promote additional consumer purchasing power on the assumption that it will be translated into consumer demand. Such concentration might reduce the aggregate savings rate in the economy. Yet, it would seem far more appropriate that in an expanding economy, savings rates should increase in order to facilitate the rising investment requirements appropriate to an advancing economy.

The administration's tax reduction proposals, if taken by themselves, appear to benefit the middle and higher income groups, which ordinarily provide the principal savings necessary to finance economic growth. But the administration's program proposes to take away most, if not all, of these benefits to middle and higher income groups through its so-called "tax reform measures." These tax increase proposals apparently have as their purpose the offsetting and elimination of a large part of the advertised benefits implied by the tax reduction features of the program.

The most outstanding example of this illusory approach is the proposed 5-percent limitation on itemized deductions. The Congress has deemed it appropriate in years past to provide specific deductions designed to reflect certain types of costs which individuals incur. In large part, the justification for these itemized deductions has been to promote certain economic goals. Interestingly enough, these goals have generally been associated with economic growth in the private sector.

For example, the deduction for interest expenses serves to aid homeowners. The deduction for charitable contributions permits private assistance to charities in lieu of increased Government domination of these charities. The deduction for State and local taxes serves to strengthen these governments by protecting their revenue sources. The medical deduction tends to aid individuals in meeting medical expenses and, thereby, raises the general level of health services in the Nation.

All of these goals would be adversely affected by the proposed 5-percent limitation. Moreover, this recommendation—more than any other—would serve to wipe out or reduce the tax benefits that might otherwise come from rate reductions.

Consistent with the objectives of increased availability of savings in the economy, greater emphasis should have been provided in the administration's program on corporate and noncorporate business tax reductions.

Under the administration's program, large business corporations would receive only a nominal cut in tax rates from 52 to 50 percent of net income after January 1, 1964. Another 3-percent cut is proposed to take effect on January 1, 1965. In the meantime, the proposed 5-year acceleration in corporate tax payments to the Treasury would largely offset the effects of the rate reductions until 1969.

In order to more effectively remove impediments to growth and provide new jobs, we believe, as we have indicated earlier, that the President's tax program should provide earlier and larger tax rate reductions on corporate incomes, as well as substantial reductions for individuals.

A substantial and reasonably prompt reduction in corporate tax rates would not only increase the after-tax cash flows to corporations; it would also, if large enough, significantly raise the after-tax rate of return on investment. Hence, corporate tax rate reductions serve both to increase the ability and willingness of corporations to invest and the incentives for individuals to invest in corporations.

Nevertheless, the administration has concentrated almost complete attention on consumer purchasing power and has largely ignored the need for encouragement to job-creating business investment. The administration's program—when and if it goes into effect—will, it is true, change the role of Government for the first time since 1951 from that of a majority stockholder in corporations to that of a minority stockholder. But every corporation in the country with over $25,000 of income will still have to pay to the Government stockholder 47 percent of its net earnings even if the President's program is fully enacted. While we strongly believe in the need for tax reduction for individuals, we are also aware that the change from 52 to 47 percent will not go very far in removing the impediments dampening the incentives of corporations to add to plant and equipment or of savers to invest in the stocks and bonds of corporate enterprises.

Imagine, however, the change in incentive and psychology that would occur if corporations were told that they could retain, for example, 60 percent of their earnings, rather than the present 48 percent. It seems clear that a reduction of this magnitude would encourage a vast amount of additional investment which would implement the production and distribution of new goods and services for which our people would have a preference if they were available.

Similar results would occur if tax rates were substantially reduced for individuals in noncorporate businesses. In these instances, even more than in the case of corporations, investment decisions depend upon the amount of after-tax savings that can be obtained from internal sources. It is no exaggeration to say that a primary contribution to the effectiveness of our entire competitive system could be obtained if the tax "brakes"—to use the administration's term—were released for small- and medium-sized businesses. These businesses constitute a balance wheel in our entire competitive system, and it is here that tax burdens are now most oppressive. The administration has proposed only a first and timid step in the alleviation of the tax burdens on these businesses.

3. Federal spending and prolonged budget deficits

In his testimony before the committee, Dr. Burns said that "the major problem facing the country at the present time is one of limiting the increase in the public debt." [27] Using reasonably conservative assumptions, he predicted that if the President's tax program is

[27] Hearings, p. 503.

approved and if Federal expenditures continue to increase as they have in recent years, the budget would not balance until 1972 and the increase in our debt would be about $75 billion over the period.[28]

Secretary of the Treasury Dillon, on the other hand, has estimated that under the tax program the budget would not balance before 1967 and probably later without the tax cut. These new deficits would be on top of 4 years of steadily mounting deficits. In the fiscal years 1961 through the estimates for 1964, these will total over $30 billion, or more than the total net deficit of the previous 10 fiscal years. The deficits from fiscal 1961 through the estimates for 1964 will add about $1 billion to the interest burden of the public debt.

The administration says that its tax program is the only way to bring the budget into balance, even in periods of prosperity. It is counting on the stimulative effect of tax reductions to result in a higher level of Federal revenues than would be experienced without the reductions. Elsewhere, we have expressed some of our doubts about whether this would be the effect of the program as it now stands.

With or without a tax cut, we are in for a long spell of continuing deficits unless firm and determined action is taken to control rapidly rising Federal expenditures.

The administration asserts, however, that any reduction in expenditures would offset the stimulative effects of tax reduction. But this is only begging the question upon which we and the administration disagree.[29] Is the primary problem of our economy inadequate demand? If, as we believe and as we have tried to show in these views, the problem is not one of inadequate demand, then the administration's argument against expenditure reform is without merit.

Even if an inadequacy of demand were a major problem, tax cuts accompanied by expenditure reform still would remove impediments to savings and investment, which would serve to release job-creating enterprise.

The reduction and earlier elimination of budget deficits by itself would have salutory psychological and economic effects. It would eliminate the dangerous side effects of financing high Federal deficits, which we discuss on pages 81–84 of these views.

We have heard only words, but have not seen any concrete evidence, that the administration and the Democratic-controlled Congress intend to make any serious effort at expenditure reform.

The administration's 1964 request for new spending authority is $107.9 billion. This is $4.7 billion over the 1963 level, of which $1.4 billion is earmarked for the Department of Agriculture and $1.8 billion for the Department of Health, Education, and Welfare. The 1964 level of new obligational authority is $21.2 billion—or nearly 25 percent—over the level enacted in fiscal 1961.

[28] Maurice Stans, former Director, Bureau of the Budget, has recently said that he did not believe the budget could be balanced within 10 years under the President's fiscal program and that, in the meantime, deficits would total $100 to $150 billion.

[29] See Senator Javits' additional views.

TABLE I.—*Comparison of original 1962 budget (as submitted by President Eisenhower) with 1964 budget—New obligational authority—Selected agencies and total*

[Dollar figures in millions]

Department or agency	1962	1964	Increase	Percentage change
Department of Agriculture	$5,509	$8,144	$2,635	+47.8
Department of Commerce	612	981	369	+60.3
Department of Defense	42,812	53,327	10,515	+24.6
Department of Health, Education, and Welfare	4,026	7,158	3,132	+77.8
Department of the Interior	888	1,279	391	+44.0
Department of Justice	297	355	58	+19.5
Department of Labor	264	527	263	+99.6
Department of State	351	374	23	+6.6
Department of Treasury	9,719	11,297	1,578	+16.2
Atomic Energy Commission	2,598	2,893	295	+11.4
Federal Aviation Agency	686	810	124	+18.1
General Services Administration	556	659	103	+18.5
Housing and Home Finance	948	829	−119	−14.4
National Aeronautics and Space Administration	1,110	5,712	4,602	+414.6
Veterans' Administration	5,101	5,580	479	+9.4
All agencies	80,867	107,927	27,060	+33.5

In addition to the increase in spending authority which the administration is requesting, it is also planning to increase civilian employment from 1963 to 1964 by 36,400. From June 30, 1961, through the estimates for June 30, 1964, total civilian employment in the executive branch will increase by 163,471. Only 25,000 of this increase represents new employees in defense and space activities.

Both the increases in new obligational authority and in civilian employment clearly show that the trend of Federal spending will be sharply upward for years to come.

At the same time that it is requesting more spending authority, the administration is planning to increase actual budget expenditures in 1964. These will rise $4.5 billion over the 1963 level. At $98.8 billion, they will exceed spending at the peak of World War II. The administration's claim that civilian expenditures are being held below the 1963 level is illusory and is largely achieved by selling off assets of the Government to conceal increases in spending.

If we examine the sharp increases in actual budget expenditures from fiscal 1961 through the estimates for the current fiscal year, the case for expenditure control becomes convincing.

The administration's excuse for its rising expenditure level is that most of the increased spending has been devoted to defense, space, interest, and veterans.[30] However, increases in these expenditures account for less than half of the total $13 billion spending increase from 1961 to 1963, while the rise in defense spending alone accounts for only 29 percent of the total.

As table II shows, while the percentage increase in total Federal spending was 15.7 percent over the 2-year period, 1961–63, the increases for many civilian agencies, such as Agriculture; Health, Education, and Welfare; Housing and Home Finance; Commerce; and Interior, were considerably larger than the average. At the same time, the percentage increase in defense spending was only 8.2 percent, or far below the average.

[30] Since many military space activities are included in the defense budget, we can see no reason for the administration's practice of linking space with defense, except possibly to confuse the public into regarding space spending as "untouchable" as defense apparently has become.

The fact is that from fiscal 1961 through the estimates for fiscal 1964, the administration will have increased Federal spending at an average rate of 7 percent a year, contrasted to an average annual increase of 2.2 percent from 1954 through 1960. The huge increases in spending on certain programs in recent years makes this a particularly appropriate time to stop and take stock of where we are and where we may be heading.

TABLE II.—*Budget expenditures by selected agencies*

[Dollar figures in millions]

Department or agency	1961 actual	1963 estimate	Percentage increase, 1961–63
Agriculture Department	$5,920	$7,493	26.4
Defense Department	45,640	49,406	8.3
Health, Education, and Welfare	3,685	5,048	37.0
Interior Department	801	1,054	31.6
Commerce Department	498	745	49.6
Housing and Home Finance Agency	502	1,088	116.7
National Aeronautical and Space Administration	744	2,400	222.6
Veterans' Administration	5,401	5,532	2.4
Treasury Department (interest only)	9,100	9,800	7.7
Total, all Federal agencies	81,515	94,311	15.7

Source: The Budget of the United States for 1963 and 1964.

Such a review of expenditure policy should concentrate primarily on civilian expenditures where recent increases in outlays have been particularly sharp. But we should not permit any area of spending, even defense, to become a "sacred cow." As former President Eisenhower said recently: [31]

> * * * no reasonable person wants to endanger national security by cutting defense spending below safe limits. The Red threat will be with us for a long time, and we must maintain a powerful military establishment—although, even here, money alone cannot solve the problem, and to spend more than necessary can damage our overall position as surely as spending too little.

Defense expenditures should be subjected to the closest examination in order to insure that we get the most from our dollars. Unless this is done, programs may expand too fast and result in waste, which in the final analysis may impair our national security.

The same is true in other areas. As an example, Basil O'Connor, president of the March of Dimes and former president of the American Red Cross, recently warned that in the area of medical research alone much Federal money is often spent wastefully and on unsound projects and "constitutes a positive threat to excellence.[32]

The administration must recognize that rapidly rising expenditures, just as surely as lagging revenues, can lead to budget deficits and an intensification of our debt management problems. These are difficult and important problems, which the administration has failed to discuss.

Two questions must be considered: (A) How will the budget deficits be financed? and (B) What effects will the financing of these

[31] Saturday Evening Post, Aug. 11–18, 1962.
[32] Washington Post, Jan. 17, 1963.

deficits have on interest rates, on the level of private investments, and on prices?

With respect to the first question, if the deficit is largely financed out of savings, with the new Government securities sold to individuals and nonbanking institutions, such as insurance companies, the effect would be an increase in interest rates above what they would have been without the Federal deficit. The reason for this is that the non-Government demand for loanable funds is likely to remain relatively constant or increase. However, a new demand for loanable funds is created when the Government enters the financial markets and borrows to finance the new deficits. As a result, the prices of Government securities—and ultimately all securities—must be driven down and the interest rates must correspondingly rise.

To the extent that interest rates rise as a result of deficit financing, an element of business costs—as well as Government costs—have been increased. The same conclusion holds true with respect to financing of consumer purchases. To the extent that interest rates on consumer borrowing are raised, the real income of consumers is lowered.

More important, however, is the effect of higher interest rates in discouraging private investment. Since a rapid rate of economic growth requires a high level of private investment, growth is slowed when high interest rates deter investment and when savings are drawn off to finance Federal deficits rather than investment. Discussing the financing of deficits from savings, T. O. Yntema, Chairman of the Research and Policy Committee of the Committee for Economic Development, said in a statement to the Joint Economic Committee:[33]

> We would not be growing as rapidly as we might because we would not be investing the available savings. This is the basic reason for not being satisfied to run deficits at high employment. It is, in fact, the basic reason for not being satisfied merely to balance the budget at high employment but to seek a surplus, which will retire public debt and in so doing add to the funds available for private investment.

In his statement presented to the Joint Economic Committee, George Terborgh further explained the effect which Government competition for available investment funds would have in depressing private investment. He said:[34]

> There is no hoard or pool of idle funds that the Treasury can absorb without detriment to other borrowers. Under these conditions, it is by no means certain that an added Federal deficit financed from savings would be significantly stimulative. In all probability, it would be substantially, if not largely, offset by the displacement of non-Federal investment.
>
> Obviously, such displacement is precisely what the economy does *not* need.

Alternatively, what are the effects from that portion of additional Government debt financed from banking institutions? Here the answer depends on the actions of the monetary authorities. If the monetary authorities place an absolute limit on the amount of total banking reserves, then commercial banks are in exactly the same

[33] Hearings, p. 696.
[34] Ibid., p. 779.

position as nonbank lenders, i.e., the amount of their total lending has not been changed even though a new demand for loanable funds has been created. The result in this instance must be exactly the same as in the case of Government borrowing from nonbank institutions.

However, if the monetary authorities permit an increase in reserves, the banking system can simply create the additional funds necessary to finance the new Federal deficits. The administration apparently has assumed this situation, but it has neglected to mention that newly created "money," whatever the amount or purpose, is just so much added to the inflationary potential. The administration argues further that "no inflationary problems should arise so long as there is unemployment and capacity available to produce additional goods and services." This is not necessarily true because the increased demands of individuals and businesses may be for goods and services where excess capacity and trained manpower do not exist, which an analysis of our present situation reveals is the case. Further, if the additional demand raises prices and costs in these areas, there may be a "spillover" effect toward increasing costs and some prices throughout the economy. Hence, some price rises may be expected even with unused resources in the economy.

However, there is a further inflationary element. If the money supply increases through deficit financing more rapidly than the rate of change in real as distinguished from inflated gross national product, then general inflationary forces will be felt even though there is a substantial amount of unused resources in the economy.

Not one administration spokesman before the committee has given any evidence that the financing of deficits will not result in increases in money supply more rapid than the increases in real gross national product. It seems clear that the administration's policy of planned deficits will intensify our inflationary problems long before we reach a 4-percent unemployment level.[35]

Even with a high level of unemployment, the economy is experiencing moderate inflationary pressures. The consumer price index, for example, continued its steady upward movement in 1962, rising 1.2 percent over the year.

The dangers and injustices caused even by modest doses of inflation were highlighted by the majority of the Joint Economic Committee in its 1960 report on "Employment, Growth, and Price Levels." In that report, the majority said (pp. 9–10):

> The acceptance of continuing increases, *even though quite modest*, in the general level of prices may result in acceleration of the inflationary pressures and lead to economic instability.
>
> Inflation is unjust. This is true *whether it creeps or gallops*. It redistributes income and wealth according to the ability of people to protect themselves against its effects. Because of this it benefits the strong at the expense of the weak. The avoidance of inflation, therefore, is an important goal of economic policy. [Italic ours.]

We are tempted to underscore for the benefit of the present administration this good advice from the Democratic majority of this committee 2 years ago.

[35] See Senator Javits' additional views.

For the reasons stated above, and because of the balance-of-payments and gold outflow considerations to be discussed in the next section, we believe that tax cuts without expenditure control would create real and possibly permanent economic damage. We do not suggest an across-the-board nor a dollar-for-dollar cut in Federal expenditures. In view of the Nation's present domestic needs and international and security commitments—and the administration's political commitments—such an approach would be unrealistic.

What we do seek, however, is a reform of Federal expenditure policy to effect important savings, without impairing the national security, and which would stimulate rather than retard economic growth. Indeed, thoughtful and selective control of, and judgment in determining, Federal expenditures—with prudent establishment of national priorities—can increase our national security and remove impediments to our economic growth.

We believe that Federal expenditure policy requires thorough, objective, and nonpartisan examination. Support for the principle of tighter control and more effective use of Federal expenditures is virtually unanimous; support for specific suggestions for achieving it is more difficult to attain. The difficulty of the task, however, should not deter us from making the attempt.

Three steps should be taken:

a. As the first step to controlling Federal expenditures, we recommend that a ceiling of $95 billion [36] be placed on Federal spending while the Advisory Commission on Federal Expenditures, suggested in point 3 below, is making its studies. This ceiling should be strictly observed, except for such increases as may be required to cope with national emergencies. Holding budget expenditures to $95 billion—or slightly above the fiscal 1963 level—would enable budget balance to be attained in fiscal 1965 providing the tax program stimulates a moderately higher level of economic activity, or in fiscal 1966 without such stimulus, but barring recession.

b. Congress should establish a Joint Committee on the Budget which could improve the appropriations process and congressional control over expenditure of Federal funds. Creation of such a committee is provided for in S. 537, introduced by Senator John L. McClellan and sponsored by 76 other Members of the Senate. The committee would serve in the area of appropriations roughly the same function which the Joint Committee on International Revenue Taxation has in the field of taxation. It should have a high level professional staff which includes minority representation.

c. As the final essential step to a reform of Federal expenditure policy, we suggest appointment of a Presidential Advisory Commission on Federal Expenditures, composed of private citizens from business, labor, education, the professions, and Members of Congress equally from both parties. The work of this Commission, assisted by a staff, should parallel the 3-year period over which the tax program is scheduled to take effect. During this period, the Commission should conduct studies and

[36] See Senator Javits' additional views.

periodically make public its recommendations in the following areas:

(1) Establishment of spending priorities among Federal programs, separating the merely desirable from the essential, in order to serve as a guide to the administration in drawing up the budget, particularly in years of expected deficits.

(2) Appraisal of Federal activities in order to identify those programs which tend to retard economic growth or which have outlined their usefulness and for which expenditures should be reduced or eliminated.

(3) Improvement of the Federal budgeting process in order to increase effective control of expenditures.

(4) Examination of responsibilities and functions which are now assumed by the Federal Government, but which could be performed with superior effectiveness by the private economy.

(5) Review of Federal responsibility and functions in order to determine which could be better performed at the State and local levels.

(6) Improvement of Government organization and procedures in order to increase efficiency and promote savings, including a review of the recommendations of the first and second Hoover Commissions, in order to determine how those already implemented have worked out in practice and whether those not yet implemented should be given further consideration.

(7) Determination of policies with regard to the level of user charges and fees to be made for special services furnished to members of the public by the Government.

The recommendations of an objective and nonpartisan citizens' commission of the kind described should command widespread support among the public and within the Congress. Its proposals would offer a sound basis upon which to begin the reform of Federal expenditure policy.

D. BALANCE OF PAYMENTS AND GOLD OUTFLOW PROBLEMS AND MONETARY POLICY

1. Balance of payments

The administration's hope of reducing the balance-of-payments deficit in 1962 to $1 billion or $1.5 billion was not realized. Instead, the deficit reached $2.2 billion and, according to estimates made by the National Foreign Trade Council, the deficit will remain at about the same level in 1963.

At the same time, the problem of the gold outflow continues. The Treasury gold loss in 1962 amounted to $911 million, compared to $878 million in 1961. Under Secretary of the Treasury Robert V. Roosa has warned that we face a renewed heavy gold drain this year.

We should keep in mind that the balance-of-payments deficit in both 1961 and 1962 would have been considerably greater except for foreign debt prepayments. Without these advance payments, the deficit would have been nearly $700 million higher in both years. While we can still expect some further help from early remittances, there is obviously a limit to that means of softening the impact of adverse balances. Prepayments on the scale of recent years would use up in

3 or 4 years the entire amount (with the exception of World War I debts) owed to the United States by the countries now in the financial position to make prepayments.

Federal Reserve Chairman William McC. Martin told the committee that the "time bombs" that concerned him the most were inflation and the balance-of-payments problem. A continuation of the balance-of-payments problem and the related gold problem not only imperils the free world's trade and payments system, but it also serves to dampen our domestic propsperity. Persistent balance-of-payments deficits and fear for the strength of the dollar undoubtedly have restrained business investment and growth in this country. As Chairman Martin told the committee, "one of the important deterrents to growth has been the shadow that overhangs us from the balance-of-payments problem." [37]

It is well to remember that the problems of balance-of-payments deficits and domestic economic growth are two sides of the same coin. Even after we solve the balance-of-payments problem, and are in a position to pursue domestic economic policies with greater freedom, balance-of-payments considerations will continue to exert some restraint upon us.

A program of tax reduction and reform will have conflicting effects on our balance of payments. Insofar as it encourages investment in modern plant and equipment, and thus reduces costs, it will have a strongly beneficial effect in improving our competitive position in world trade.

What would happen, however, if we cut taxes and did not restrain spending? In that case, prolonged budget deficits leading to continued inflation or even the fear of inflation are likely to reduce exports and increase imports, deepen our balance-of-payments deficits, and cause a continuation of the heavy outflow of gold as foreign dollar holders see the purchasing power of the dollar drop.

It is significant that in 1962 our imports rose at a much more rapid rate than our exports, narrowing our trade surplus and worsening our balance-of-payments deficit. If our competitive position in world trade should worsen, for whatever reason, chances of eliminating our balance-of-payments deficit, while still carrying our defense and foreign aid burdens overseas, would be remote.

Even without continued inflation, the gold outflow will be a serious problem. Foreigners now hold more than $20 billion in short-term dollar balances. Since our gold stock is less than $16 billion, of which about $12 billion is required by law to back our currency, a continuation of the gold outflow could eventully lead to devaluation of the dollar and a breakdown of the free world's trade and payments system.

The possibility of an "inward looking" Common Market, suggested by the rejection of British membership, adds another element of pessimism to our balance-of-payments and gold outflow problems. We do not know what results recent events will have. Prudence, however, would dictate that we follow a cautious and responsible fiscal policy so as not to compound the possibly adverse effects of developments in the Common Market.

As these remarks suggest, we are convinced of the urgency of correcting the balance-of-payments problem and believe that stronger

[37] Hearings, p. 362.

measures than have been adopted by the administration are called for. While we share the view that we should improve our trade balance, we feel that the administration and the Democratic Congress must recognize their responsibility to put "our own house in order." Accordingly, we would give a greater weight than the majority apparently does to removing clearly and beyond all doubt, uncertainties and fears about the financial responsibility of the United States and the soundness of the dollar in international trade. Worthy as the hope may be, we fear that it is an insufficient and weak reed to continue to place chief reliance on negotiation and on the hope that other nations will change their conduct.

Further, considering the key role of the United States in the Western community, we would immediately put to rest all suggestions that the United States give serious consideration to restrictive moves, such as prohibiting access by any foreign issues to the U.S. market or limiting the direct U.S. private investments abroad. Before inhibitions are put upon private placements or private investments, we suggest that some of the Government programs involving expenditures abroad are not beyond questioning.[38]

2. Monetary policy

We note the disappointment expressed in the majority report over the failure of monetary policy to provide the stimulus necessary to substantially reduce unemployment.

We are quite aware, however, of the constraints upon monetary policy imposed for balance-of-payments reasons. Perhaps, as the majority suggests, too much confidence has been placed in monetary policy in recent years. Chairman Martin's view is that monetary policy in 1962 did "just about what could and should be expected of it"[39] and that "the domestic liquidity of our banks is now so high that still further monetary stimulus would do little if any good—and might do harm * * *."[40] Notwithstanding these points, the administration recently reappointed Chairman Martin to another term.

Certainly one of the broad general controls available to the Government in fostering growth and stability is having to be deemphasized while the Congress is being entreated to consider larger and larger Government deficits as the chief effective instrument.

E. AGRICULTURE

Producing 70 percent of the raw materials used in the United States, this basic industry must be healthy if our national economy is to prosper. Bringing production and consumption into reasonable balance and assuring farmers a fair share of the national *net* income by reducing the cost-price squeeze are fundamental objectives. However, we oppose programs labeled with these objectives which point in the direction of nationalizing this industry. We are encouraged to note that, after 2 years of unsuccessful efforts to force compulsory-type programs through Congress, this administration has now recommended the "voluntary" principle for future programs.

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[38] See Senator Javits' additional views.
[39] Hearings, p. 338.
[40] Remarks at the joint luncheon of the American Economic Association and the American Finance Association, Pittsburgh, Pa., Dec. 28, 1962.

We sound a warning, however, that difficult years lie ahead unless the administration, with its broad discretionary powers and the strong Democratic control over both Houses of Congress, takes coordinated action along these lines:

1. Reductions in price supports should be gradual: Moving broad areas of agriculture (*along with other types of industry*) toward a position of independence of the Federal Government will take years if harsh social consequences of such an adjustment are to be avoided. Under the administration-backed farm bill of 1962, price supports of feed grains can drop to 50 percent of parity commencing in 1964. This is not a "gradual" reduction. On the other hand, *increases* in price supports should be avoided, since these encourage excess production, depress markets, and lead to Government controls requiring more Government employees to enforce.

For example, dairy price supports have been manipulated during the past 2 years with a resulting aggravation of the surplus problem. Cost to Commodity Credit Corporation of the dairy program increased from $277.8 million for fiscal 1961 to $532 million for fiscal 1962. Over the objections of the soybean industry, the Secretary of Agriculture, on March 22, 1961, announced an increase in the support price for soybeans for 1961 and 1962 crops. Despite large exports of soybean oil, carryover Commodity Credit Corporation stocks of soybeans has grown from 4.49 million bushels at the end of 1960 to 36.7 million bushels at the end of 1962. This has had an adverse effect on the market, with the price per bushel falling from $2.68 before the announcement to $2.35 on December 15, 1962.[41]

2. Far greater efforts should be made to develop new and increased industrial uses for agricultural products—especially those in excess production. Emphasis in research activities should be shifted to this objective away from one of increased production.

3. Soundly determined inventory objectives should be established for all price-supported commodities. There has been too much loose talk about "surpluses" and practically no effort to compute reserve stock levels required in the national interest. Only after such requirements are reached is it meaningful to refer to "surpluses."

4. The expenditure of millions of dollars on reclamation and irrigation projects, while at the same time permitting the growing of crops (or substitutes) determined by the U.S. Department of Agriculture to be in surplus, is inconsistent, wasteful, and should be stopped.

5. Consideration must be given to programing specific countervailing action to offset the loss of U.S. export markets resulting from the recent discriminatory action against imports of poultry [42] from the United States by the Common Market. Such a policy could head off similar actions against some of our other agricultural products which would be invited by continued inaction of the administration.[43]

6. Programs such as the Emergency Public Works Act of 1962 and the Area Redevelopment Act of 1961 should be amended to provide for projects in agricultural areas which have suffered a sharp drop in

[41] In only 2 months since the announcement has the price not been under $2.68 per bushel.

[42] Examples of the ad valorem equivalent of variable import duties on poultry in effect today (with duties prior to Jan. 1, 1962, shown in parentheses) would include: West Germany—turkeys, 29 percent (15 percent), broilers, 43 percent (15 percent); *France—turkeys, 67 percent* (20 percent), broilers, 45 percent (20 percent); Italy—turkeys, 10 percent (none), broilers, 21 percent (none). Over $50 million in poultry exports is in danger of being lost.

[43] Sec. 252(b)(3) of the Trade Expansion Act of 1962 specifically empowers the President to take such action. The Common Market's policy of self-sufficiency in agriculture (unrealistic though it is when land used to grow feed grains costs as much as $1,000 per acre) was a major factor in the adoption of this provision which, incidentally, was not included in the original administration bill.

farm population. To limit projects to areas of so-called "chronic" unemployment causes people moving off the farm to move into industrialized areas, adding to the unemployment problem.

7. In the decade 1950–60, the number of persons employed in agriculture declined by 41 percent. This structural dislocation requires consideration of measures to finance the voluntary transition of such people to more productive employment in accordance with traditional American practices.

8. In the absence of disaster-type situations, Government subsidy of crops in one area in preference to another area should be stopped. It is discriminatory and moves away from the market forces which characterize our capitalistic economic system.

F. OTHER RECOMMENDATIONS

The administration's almost exclusive emphasis on its tax program raises the danger that exists in all panaceas. Even Gerhard Colm, of the National Planning Association, told the committee, if we cut the taxes without taking other important actions, the effect on economic growth could be negative. Therefore, in addition to our recommendations for tax and spending policies set forth above, we wish to list briefly actions which should be pursued in other areas.

I. Facilitating adjustment to technological change

A. Education and training.—Young people without job experience, persons without skills or with obsolescent skills, and members of minority groups suffer the highest rates and the longest duration of unemployment. The direct relationship between the bulk of our unemployment problem and lack of education and skills requires that we focus our attack in the area of education and training.

The solution to the problem of technological displacement demands a broad national effort to upgrade the labor force by small stages all along the line—providing the unskilled with minor skills, preparing the semiskilled for skilled work, and turning the skilled into advanced technicians. Workers on all levels of the skill ladder must be encouraged and helped to move up into higher and more demanding jobs, leaving the positions which they once held to be filled by the less skilled, but striving applicant. Every level of government and every sector of the private economy must contribute in this national effort to upgrade skills to the demands of our increasingly service-oriented and technologically advancing society.

While these recommendations primarily concern activities by Government, we must not lose sight of the primary role that business with the cooperation of labor must play in smoothing the way to technological progress. Business has long recognized that rapidly advancing technology requires continual retraining of employees. For example, Ford Motor Co. in 1960 retrained nearly 3,000 workers to handle advanced hydraulic and electrical equipment. General Motors, in addition to its broad apprenticeship program, retrains about 7,200 employees a year. International Business Machines trains about 100,000 workers each year in the operation of the computers and other equipment which it sells and leases. Even relatively small companies have farsighted internal retraining programs. Xerox Corp. of Rochester, N.Y., for example, trains certain employees to take jobs that do not yet exist while it is preparing to introduce new processes and equipment that will eliminate their old jobs. Government should encourage in every way possible such activities in the private sector.

To promote the education and training required for these new skill requirements, we suggest the following:

(1) One of the most important barriers to employment of the chronically unemployed is lack of basic reading, writing and mathematical skills. Before many of the so-called unemployables can benefit from training, they must remedy their deficiencies in basic education. The Manpower Development and Training Act should be broadened to include such adult education in basic subjects as is required before an unemployed person who is accepted for training actually begins his occupational training or retraining program.

(2) Vocational education has been treated as the stepchild of our educational system for too long. It is of critical importance that the Nation afford skilled craftsmanship the same dignity and worth as it does to other forms of labor. Vocational education in our high schools, in junior colleges, and in special technical institutes must receive greater emphasis in order that our society do justice to the millions of young people whose tastes or aptitudes enable them to make their greatest contribution and receive their highest satisfaction in this type of work.

Broader opportunities for vocational education keyed to the Nation's need for skills would reduce the problem of the high school "dropout." It would also provide a source of trained personnel at the technical and semiprofessional level, where severe shortages today often retard economic growth. This is primarily the job for local and State governments, but the Federal Government can do much to encourage greater activity on these levels. We accordingly recommend a substantial broadening of the Federal vocational and technical education programs. Additional Federal expenditures in this area, which would be growth inducing, should be offset by reduction in, or elimination of, programs which exert a drag on growth.

The skill demands of our developing economy also require, of course, that in addition to greater emphasis on vocational training, the Nation must continue its progress in providing better general educational opportunities for our young people at both the public school and college levels.[44]

(3) We urge that the vocational programs of the Department of Health, Education, and Welfare and the apprenticeship program of the Department of Labor be coordinated to the fullest extent possible with one another and with the vocational training programs of the military services.

In addition, we urge the administration to review the statutes bearing on military service obligations in order to determine how and to what extent they interfere unnecessarily with the smooth transition of our young men from school to civilian employment. Such a review should yield recommendations for changes in the law, as well as in procedures under the law, to minimize such impediments and to promote more effectively the preparation of our young men for civilian careers.

(4) The Manpower Development and Training Act should be amended to authorize the training of large numbers of young men

[44] See Senator Javits' additional views.

and women, particularly high school "dropouts" with no skills or previous work experience, in order to prepare them for lives of useful and productive employment. This would achieve—and more effectively—the *objectives contemplated by the youth employment* opportunities bill.

(5) The redundancy and inconsistency which exist among the adjustment provisions of the Trade Expansion Act of 1962, the retraining features of the Area Redevelopment Act, the Manpower Development and Training Act, and the unemployment insurance program are impairing the effectiveness of our training and retraining efforts. We believe it is urgent for the administration to examine the relationship of these programs to one another and to provide for their more effective coordination in order to better promote the objectives of the programs.

(6) Our tax laws should be amended to eliminate obstacles in the path of new skill development. For example, we should permit a taxpayer to deduct, as a business expense, the amount spent for education or training to obtain a new or better job. Today such expenditures are deductible only if required to maintain existing skills or to keep a present job. Further, we should encourage individuals to train, either in academic or vocational subjects, at the post-high-school level by providing a tax credit of 30 percent of the amount spent for such education or training up to a limit of $450 in any one year. The credit could be taken either by the student himself, or by a parent or benefactor who is supporting such a student in furthering his academic or vocational education.

(7) Companies planning technological changes should be given an incentive to train for new jobs in the company the workers who would be displaced, thereby keeping them off the unemployment roles. To this end, States should be encouraged to broaden merit ratings under the unemployment insurance laws to include the concept of such on-the-job training so as not to penalize the employer who extends this opportunity to his workers.

(8) Twenty States now permit an individual to receive unemployment compensation up to the normal amounts and limits while undergoing training or retraining. Efforts must be made to encourage all of our States to take this vital step to encourage individuals to upgrade their skills. Furthermore, an offer of suitable work should not disqualify an individual from receiving unemployment benefits, if the offer is refused during the period of training or if the job would prevent him from completing the course.

(9) Just as workers who refuse employment without good cause are disqualified from further unemployment insurance benefits, we should consider disqualifying workers receiving such benefits who are referred to training, but who refuse it without good cause.[45]

B. Mobility.—Mobility in the labor market is essential to smooth adjustment in our changing economy. The following steps would promote mobility:

(1) The tax laws should be amended to change the tax definition of "home" from the place of a worker's principal employment to the place where a worker owns a home and maintains his family.

(2) We support the provision in the administration's tax reform bill which would permit new employees to exclude from taxable in-

[45] See Senator Javits' additional views.

come reimbursement received from their employers for moving expenses or permit a deduction for moving to a new job.

(3) In order to ease the impact of automation and other causes of economic dislocation in a dynamic economy, both governmental and nongovernmental means should be considered to encourage the transferability of pensions and other job rights for individual workers who must change jobs.

(4) We should consider paying subsistence or transportation allowances to unemployment insurance claimants who look for work in areas beyond a predetermined distance from their home.

C. Job information and research activities.—(1) The U.S. Employment Service should be strengthened and encouraged to put more emphasis on preventing unemployment, rather than on alleviating its effects alone, as by increased emphasis on counseling. At the same time, it should provide encouragement—not competition—to private employment services, which perform a key role in facilitating labor market adjustments.

(2) The Department of Labor should pursue with great urgency its efforts to establish a nationwide job displacement "early warning system" to facilitate advance planning for technological change by business, labor, and government at the community level.

(3) In order to assure that training is in needed skills, we recommend the establishment of a national clearinghouse for the identification and classification of emerging skill requirements, of existing skill needs, and of obsolescent skills. The clearinghouse should also maintain a list of job vacancies throughout the country for the use of the U.S. Employment Service, employers, private employment services, and others, in matching the jobless man and the manless job.

D. Unemployment insurance.—To alleviate the hardships resulting from long-term unemployment, we believe that the States—not the Federal Government—should adopt a permanent system of temporary extension of unemployment insurance which would go into effect when certain National or State indexes or recession-level unemployment are reached.[46]

II. Productivity

In order to provide the maximum standard of living for our growing population consistent with our international obligations and the requirements of national defense, it is essential that we increase our productivity. Increased productivity, which is one of the keys to a higher rate of economic growth, depends largely upon invention and innovation. In order to stimulate invention and innovation and other activities to increase productivity we support:

A. The bipartisan objective of encouraging research and development efforts in industries serving civilian markets and to make the fruits of military and space research more easily available for use by civilian industry.

B. The creation of a National Productivity Council to promote the organization of voluntary labor-management-public councils at the industry, regional, and community levels. These councils would provide a framework within which all interested parties could cooperate in smoothing the adjustment to technological change by promoting worker training, eliminating make-work practices, stimulating

[46] See Senator Javits' additional views.

invention and innovation, and taking such other actions as would promote increased productivity.

C. The proposal, which we have long supported and which is now endorsed by the administration, to permit a tax deduction as a business expense of outlays for machinery and equipment to be used in research and development activities.

D. Constant review of depreciation schedules. In spite of the long-needed revision of depreciation schedules last year, it is not yet clear that the new schedules will be sufficiently responsive to the needs of the economy. Depreciation schedules must be kept up to date to reflect the economic reality of useful life. In addition, allowances for obsolescence arising from advancing technology must be promptly provided for. In this way, we can encourage investment in modern and efficient plant and equipment and not only provide more and better jobs for our people, but also strengthen America's competitive position in world trade.

E. Consideration of means to encourage profit sharing by employees, including restricted stock options, stock-purchasing plans, and other methods of stockholding, as part of or in lieu of increases in wages and salaries. Contrary to the administration's tax philosophy, we believe tax policy should encourage—not discourage—such activity.

F. Additional incentives and aids to encourage business participation in the export expansion program initiated during the Eisenhower administration—including constant review of the Export-Import Bank and Foreign Credit Insurance Association export credit guarantee program; consideration of tax incentives for exports, consistent with our obligations under the General Agreement on Tariffs and Trade; and coordination of all Federal programs for export promotion in order to make them available to the maximum to the individual businesses throughout the country.

III. Antitrust

We recommend the establishment of a commission on antitrust laws to determine the impact of antitrust laws upon U.S. productivity, long-range economic growth, trade, and on foreign investment and foreign economic policy generally. This commission, which should be comprised of experts, selected on a bipartisan basis, from the executive department, Congress, and private life, should make such recommendations for changes in the substance and procedures of the antitrust laws as seem necessary to promote our economic objectives.

IV. National emergency strikes

Loss of time through work stoppages constitutes a heavy drag on economic growth. In fact, there is considerable opinion that the protracted steel strike in 1959 has had this precise effect on our economy.

Because the adjustments required by rapid technological advance may contribute to a rise in serious and protracted labor disputes, we strongly urge that the administration submit legislation to deal with emergency strikes which cause nationwide economic paralysis or which endanger the public health or safety.

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V. Discrimination in employment and training

The Council of Economic Advisers on September 24, 1962, estimated the economic loss to the United States resulting from racial discrimination in employment at about $13 billion a year. The full utilization of the present capabilities of the nonwhite population, the Council said, would increase gross national product by about 2.5 percent and assist significantly in promoting a higher rate of growth in the coming years. The drag which racial discrimination in employment and training exerts upon our growth makes it imperative that management and labor undertake a major effort to eliminate such discrimination.

While we hear more about racial discrimination, we should also be aware of the heavy costs involved in discrimination in employment of the young and older workers of all races. The relatively heavy concentration of unemployment among our young and older workers makes it important for both labor unions and businesses to eliminate bias against any person because of his age when no distinction is warranted by the reasonable demands of the job. In the case of labor unions, progress should be made particularly in opening up the opportunities for union membership, and especially for apprenticeship training, to young people. Further, we should consider the desirability of legislation to prevent businesses engaged in interstate commerce or those holding Federal contracts or subcontracts from practicing age discrimination.

CONCLUSION

The main point of these minority views is that our economic problems are deeper and more complex than the administration would have us believe. A simple increase in consumer spending, which the administration proposes as the primary means to full employment and faster growth, would fall far short or miss the mark entirely. What we need is greater emphasis on measures to facilitate adjustments to structural change, particularly rapid technological advancement, and on tax rate reform to provide incentives to save and invest in job-creating enterprises.

We agree with an editorial comment of the New York Times of December 8, 1962, that—

> * * * it is doubtful that resort to general economic policies, whether through deficit spending or easy money or tax reduction can solve the unemployment problem. A faster rate of economic growth can ameliorate the situation, but specific policies are needed to deal with the specific problems of the jobless.

Besides failing to strike at the roots of our high unemployment, the administration's tax program could aggravate many of our other existing economic problems. This danger would be especially great if while reducing revenues through tax cuts, the administration failed to control Federal spending and bring the budget into balance in the near future. In view of the Nation's serious balance-of-payments and gold outflow problems and continuing inflation, we oppose the deliberate piling up of large so-called temporary deficits year after year as far as one can see into the future.

Therefore, while we agree with the administration's goal of removing some of the tax system's built-in impediments to economic growth, we believe the program should be revised along the lines we have suggested to give greater assurance of attaining this objective.

At the same time, the administration and the Democratic Congress must take determined action to hold the line on Federal spending until the budget is balanced.

Measures to encourage growth, particularly those designed to facilitate adjustment to the technological revolution which is altering dramatically the way our people live and work, must be pursued.

In conclusion, legislative proposals such as the administration's tax recommendations, which could have such a critical and long-term impact on our economy, must be considered in a calm and thoughtful atmosphere rather than one of haste or panic. We should not forget that these recommendations are designed to affect our long-term economic position and would have relatively little influence on current economic conditions. Whatever economic developments occur in the near future will result principally from existing policies. Nevertheless, the sooner the administration and the Congress act along the lines we have recommended, the better off *all* of our people will be.

ADDITIONAL VIEWS OF SENATOR JAVITS

I have joined in the minority report (having noted my differences with it) because it does answer forthrightly the one overriding question raised by the tax reduction and reform program of the President (his most important 1963 legislation) which is supported by the majority: Will it be adequate to meet the issues of endemic unemployment, underused production facilities, and a lesser rate of growth in productivity than we can afford to accept? The minority says, and I agree, that this economic program is likely to fail if it continues to rely solely on a tax cut and tax reform to achieve its objectives and does not undertake additional measures.

The minority suggests certain additional measures required for the needed economic advance, and my additional views hereinafter contain further specific recommendations. Also, there are certain points of emphasis which I should like to make. Most of these points are appropriately noted in the minority report by reference to my additional views.

I believe that the tax reductions proposed by the President can serve to stimulate consumer demand for staples and for necessities at the lowest income levels. In this way the role of excess capacity—insofar as this excess capacity actually results from individual inability to satisfy needs consistent with life in a relatively rich and growing society—should be substantially reduced as a cause for lagging economic growth. The excess capacity is, however, present for another reason, too; excess capacity caused by obsolescence is also a major factor. To stimulate the use of obsolescent facilities now unused is uneconomic. Such excess capacity must be removed through additional incentives for business modernization—tax incentives which are not adequately emphasized in the President's program.

Although a reform of tax-law provisions should be undertaken (provisions which now channel economic activity into areas not of optimum benefit to the national interest in accelerated economic growth), the greatest care must be exercised to prevent such reforms from undermining the basic incentive purpose of the tax cut.

It appears to me that a temporary and limited budget deficit cannot be avoided in carrying out a tax cut and in order to support its objectives. Therefore, I consider the suggested $95 billion ceiling on Federal expenditures not as doctrine but as representing a general order of magnitude and a national goal. In proposing such a ceiling, we must consider the effect of a cutback and a slowdown of Federal programs both on basic national resources and on immediate economic activity. Such Federal programs include the support of education at all levels—education which increases our capacity to take advantage of any stimulus a tax cut may provide. Further, we must consider the manner in which reduced Federal expenditures in certain sectors may affect individual businesses and persons which are supposed to derive benefits from the tax cut.

Similarly, in considering foreign aid and defense expenditures abroad, I believe that budgetary and balance-of-payments problems must not deter us from making such sacrifices as are necessary for the maintenance of the U.S. role as prime guarantor of free world peace. Much can be done through a careful examination of individual items and spending procedures within these programs to reduce their budgetary impact. Also, an equitable sharing of foreign aid and defense expenditures by our allies would both directly and indirectly assist the United States in meeting its own balance-of-payments problems—but the role required of us by world peace, security, and freedom must be fulfilled.

In the matter of unemployment insurance, I urge basic safeguards to prevent injustice in the means by which workers could be disqualified from receiving benefits for refusing to take certain retraining courses. As has been demonstrated by the present system of depriving workers of benefits for refusing to take available work, this requirement can be evaded. On the other hand, problems of individual freedom in choosing appropriate retraining programs may arise. Therefore, although I support this suggestion in principle, I believe the mechanism for its application must protect against abuse of authority or its arbitrary exercise. Further, I continue to support enactment of permanent improved Federal standards of unemployment compensation to help those workers who, through lack of training and other factors, find themselves at a disadvantage at the current stage of our economic development without the penalties which inadequate approaches exact in certain States.

I am pleased that the minority accepted my suggested additions to the list of measures required to assure adequate economic growth—those on an antitrust law review; the transferability of pension rights to aid worker mobility; stockownership and profit sharing; and added incentives to engage in the export trade. In addition to the program outlined in the minority report, I suggest two areas of activity needed to supplement an effective incentive tax cut.

(1) Establishment of a Federal Limited Profit Housing Corporation to finance middle-income housing through the sale of bonds in the capital market; and

(2) Establishment of a Federal Council of the Metropolitan Areas, representing both existing and to be created regional councils which can handle problems—such as transportation, sewage disposal, water supply, air pollution, etc.—extending across traditional lines of State and city.

At this point I also wish to express my agreement with the international economic recommendations of the majority insofar as they do not limit the free flow of capital. Of special importance are the recommendations (1) to expand the international reserve base; (2) to amend the Trade Expansion Act of 1962 to provide the President with tariff negotiation authority broad enough to make U.S. bargaining power effective whether or not the European Economic Community (EEC) is expanded or cooperates fully in our efforts for free world economic integration (I have offered a bill for this purpose as has Senator Douglas of Illinois); and (3) to initiate a study to determine whether or not EEC agricultural policies which have already caused damage to our poultry exports and threaten our other agricultural exports are in violation of the General Agreement on Tariffs and Trade.

Clearly, a tax cut cannot be relied upon as the sole needed remedy for the slow economic growth experienced by our Nation. I have supported an incentive tax cut and repeatedly urged the administration last year to offer it or at least to present its program for public discussion and congressional consideration substantially in advance of the time for action. Unfortunately, we are now faced with the need to act on a program which requires many changes and many additions, if it is to succeed. We have not had the time for a mutually beneficial exchange of views, and we must do the best we can with a program which was not thoroughly exposed to preconsideration and may be, therefore, both incomplete and not adequately conceived in terms of the national interest. The situation is further complicated by the President's proposals for tax reform—some of which are sound and others of which I oppose—like the 5-percent gross income deduction prior to itemized deductions. Many of these will probably have to be separated from the incentive tax cut, and considered and dealt with parallel to it if we are to have any final action at all in 1963.

It is my hope that the minority report and the additional considerations presented by me will serve to place the President's tax program in perspective. Short as may be our time for positive action, such a perspective should give us the opportunity to deal realistically with the human and economic problems of our Nation, and of our Nation's position in the world.

ADDITIONAL VIEWS OF SENATOR MILLER

[These views relate to: (1) Incentive taxation of growth income; (2) the Multiplier Theory; and (3) growth rate required to make up for budget deficits and revenue loss from tax cut.]

Although I share the views of my Republican colleagues that an annual tax reduction of from $7 to $8 billion, *necessarily* accompanied by "important savings" through expenditure control and policy reform, "might" be a desirable target, I am anything but optimistic that those now in control of Congress, following the dictates of the administration, will reduce expenditures enough to make room for such a tax reduction in order to avoid aggravating our serious budget deficit and promoting continued inflation.

The problem is that there is deep disagreement between those in control of the "majority" on the one hand, and those in control of the "minority" on the other hand, over just what expenditures can be reduced "without impairing the national security or retarding economic growth." The President has submitted what he terms a "frugal" budget, stating that it includes "only those expenditures which meet strict criteria of fulfilling important national needs." However, Senator A. Willis Robertson, Democrat of Virginia, states that almost $2 billion can be saved by eliminating new programs in the budget, another $1.8 billion by reducing foreign aid, and $1.2 billion by reducing Department of Defense requests. House Republican leaders believe the budget can be trimmed by at least $10 billion in spending and authorization requests.

I, for one, am not content to see us remain on dead center while meaningful tax reduction awaits the outcome of debate over what Federal expenditures are "needed." Accordingly, I have proposed a tax reduction plan which will not interfere with the administration's spending program *and* will not, at the same time, aggravate the budget deficit. I call it "Incentive Taxation of Growth Income."

(1) Incentive Taxation of Growth Income

The word "incentive" is usually associated with tax reduction, either through outright tax rate reduction or so-called "tax reform," or both. This assumes that tax reduction will automatically be followed by economic growth, but there is no guarantee that this will happen. Most of us probably would anticipate an overall growth in our economy if we had tax reduction *accompanied by stable purchasing power of our money*. However, there would probably be taxpayers who would happily enjoy their tax reduction without seeking to contribute to economic growth. They would, so to speak, receive the reward without having earned it. It seems to me that a true "incentive" tax change should not give the reward of tax reduction unless the objective of growth is fulfilled.

In a nutshell, my plan proposes to tax any increase in income of individuals, corporations, trusts, and estates over that of the preceding year at *one-half* the rates that would otherwise apply. One might liken such treatment to an excess profits tax in reverse. This increase in income represents "growth income," and tax reduction would take effect only with respect to it. The reward of tax reduction would have to be merited.

Examples of Miller plan for incentive taxation of growth income (effective Jan. 1, 1963)

Year	Adjusted gross income	Tax at old rate	Increase in tax over prior year at regular rate	Tax reduction (1/2 increase)	New tax
	Individual, married, 4 children, using optional standard deduction, with adjusted gross income from a salary, wages, profession, or business				
1962	$10,000	$1,108	(1)	(1)	(1)
1963	15,000	2,304	$1,196	$598	$1,706
1964	20,000	3,740	1,436	718	3,022
	Individual, married, 2 children, using optional standard deduction, with adjusted gross income from a salary, wages, profession, or business				
1962	$5,000	$420	(1)	(1)	(1)
1963	5,500	510	$90	$45	$465
1964	6,000	600	90	45	555
	Corporation, taxable income as shown in 2d column (note 1st $25,000 taxes at 30 percent; all over $25,000 taxed at 52 percent)				
1962	$100,000	$46,500	(1)	(1)	(1)
1963	120,000	56,900	$10,400	$5,200	$51,700
1964	140,000	67,300	10,400	5,200	62,100

[1] Change not in effect.

From the Government's standpoint, the Treasury would be assured of the same amount of revenue from the same amount of income as the previous year, so that the tax reduction under this plan could be confidently predicted to not cause any loss of revenue. However, I suggest that the prospect of paying tax at only one-half the regular rate on growth income would be a tremendous incentive for taxpayers to improve their income positions. Wasteful or marginal costs, which too often are tolerated because they are "tax deductible," would be avoided. Thus the plan contains its own built-in tax reform.

GROWTH INCOME DEFINED

The definition of "growth income" must be precise and realistic. It should certainly include business and farming income. With respect to other items of income, either of two approaches may be used. One approach, which is simpler, would be to specify the items. The other approach would be to include all income except certain items which do not have any particular relevance to growth during the current year due to the taxpayer's labor or capital; for example, pensions and annuities, income in respect of a decedent, income from death benefits, compensation from injuries, income from an estate or trust, alimony and separate maintenance benefits, income from the discharge of indebtedness, and the like. Even with these exclusions, however we would still be faced with situations under which an incentive would be extended to increase income that would be of marginal or questionable significance insofar as labor or capital are concerned, not to mention illegal income, which is nonetheless taxable.

Accordingly, I would propose that in addition to business and farming income, wages and salaries, rents, ordinary dividends, royalties, and interest be specified as the only other type income which can be used in computing growth in adjusted gross income (in the case of individuals) or taxable income (in the case of estates, trusts, and corporations). These items constitute the major sources of income of the vast majority of taxpayers and are relatively easy to ascertain; and from the standpoint of administration, it is desirable to keep them at a minimum. Moreover, all of them have a clear connection with the utilization of labor or capital in the production of income. Capital gains, including capital dividends, may happen to be realized during the current taxable year, but they usually include growth which has occurred prior to the current taxable year; moreover, they already receive special incentive tax treatment. I would therefore exclude them from the definition of growth income.

ADJUSTMENTS TO BUSINESS INCOME

To have a realistic measurement of growth in business income, certain adjustments should be made. For example, a lump-sum payment received in the taxable year which reflects services rendered over a period of several years cannot reasonably be attributed, in its entirety, to growth during the taxable year. A ratable allocation to the current year under the option available to the taxpayer should be the limit. Income from a change in method of valuing inventory, from a change in method of accounting, or from a change in method of computing depreciation hardly reflects economic growth. Additional income of a corporation resulting from another corporation being merged with it, to the extent of the other corporation's income, certainly does not represent growth of the first corporation's business. Additional income of an individual resulting from the transfer to him (through dissolution) of the business of his corporation would not represent his growth. These items of taxable income should be eliminated in computing growth income.

To be fair, there are other adjustments that should be made to eliminate deductions which are properly allowable for tax purposes but have no essential relationship to growth. Thus net operating loss carryover deductions or capital loss carryover deductions should not be taken into account in determining growth income. It would seem that a loss deduction attributable to fire, flood, windstorm, theft, or other casualty, not covered by insurance or otherwise, should not be permitted to destroy the growth a taxpayer may otherwise have achieved and should also be eliminated.

Another adjustment appears to be desirable in the case of corporations. Contributions to charitable, educational, religious, scientific, and similar activities are becoming increasingly important and are to be encouraged. If a corporation's growth income could be enhanced merely by cutting back its contributions, a longstanding policy of Congress to encourage corporate giving would be frustrated. Accordingly, it appears desirable to provide that growth income of a corporation may not be so achieved.

Business income from illegal activities should be excluded altogether, for I presume this kind of growth is not to be encouraged.

PRIOR YEAR ADJUSTMENTS

Adjustments with respect to the current year are not the only ones required to properly measure growth. Income of the immediately preceding taxable year, which ordinarily would serve as the base for measuring growth, also requires some adjustments. First of all, we must decide whether a base year income of less than zero should be permitted. Although I would admit that coming from a loss of $10,000 in one year to a profit of $10,000 in the following year represents $20,000 in growth, I do not believe it wise to permit growth income to be measured from a loss position, particularly since a taxpayer already has the benefit of a net operating loss carryover or carryback deduction.

Next, we should not measure growth income in the current year from a fictitiously low economic income base. Thus, if income during the preceding year has been lowered for tax purposes by taking into account a net operating loss deduction, a capital loss carryover deduction, a loss deduction arising from fire, flood, windstorm, theft, or other casualty, not covered by insurance or otherwise, or a deduction for the extra first-year depreciation allowed by section 179, these adjustments should be added back.

I am dubious over permitting a lowering of the base year's income by eliminating income arising from a change in method of valuing inventory, change in method of accounting, or change in method of depreciation. Such changes are usually voluntary on the taxpayer's part and often are made with a view to improving his tax position. Accordingly, I would propose that a lowering of the base year's income by eliminating such income be permitted only where the change in method has been forced on the taxpayer by the Government.

Where a joint return is filed for the current taxable year, it would be unrealistic to measure the income reported therein against the income of only one of the spouses for the preceding year if separate returns were filed by them (either as married or single persons) unless the income on the joint return represents the actual income of only one of them. I use the word "actual" to make it clear that community property law will not enter into this calculation.

PREVENTION OF WINDFALLS, WHIPSAWING, AND OTHER UNDESIRABLE RESULTS

In order to prevent windfalls, whipsawing (fluctuating income from one year to another to take undue advantage of the reduced rates on growth income), and other undesirable results, certain provisions are necessary.

The question arises whether a taxpayer who becomes a wage earner, salaried person, or business operator for the first time should be permitted to treat any or all of his first year's income as "growth income." The answer would seem to be "no." Birth of income is not the same as growth in income. A similar answer should apply in the case of the first year of operation of an estate, trust, or corporation. Accordingly, I would define growth income in such a way as to require it to be measured against the first immediately preceding full taxable year, so that at least 1 full year's experience will be used as a basis for calculating growth. But that first year's experience may represent only part-time or nominal activity. To prevent a windfall by using the income from such a year as a base, I would provide that the tax reduction from the special rates on growth income not be in excess of the amount of tax for the preceding year.

> *Example:* B, a college senior, graduates in midyear and commences full employment, earning $5,000, with regular tax thereon of $813. During the preceding year he worked part time, earning $1,200 and paying tax of $98. His tax reduction for the current year would be $98—not $357.50 (one-half the difference between $813 and $98).

An individual in control of a corporation (or a corporation in control of another corporation) might seek to obtain growth income by arbitrarily having the controlled corporation declare extraordinary dividends. To prevent this type of abuse, it would seem desirable to limit the amount of dividends that could be counted for this purpose—say to 125 percent of those received from the controlled corporation during the preceding taxable year and, in any event, limit such dividends to the amount of current earnings of the corporation. In ascertaining whether or not a taxpayer is in control of a corporation, constructive ownership of stock under the attribution rules of section 318 should be taken into account.

With the "payback" provision, which I shall presently discuss, the graduated tax rates applicable to individuals, trusts, and estates do not offer much opportunity for whipsawing. There is, however, some opportunity for whipsawing in the case of corporations. To discourage this, I would propose using as a base year the immediately preceding full taxable year (as in the case of individuals, estates, and trusts), with the limitation that the taxable income for such base year be not less than the taxable income for fiscal or calendar year 1962. If the corporation was not in existence or active during fiscal or calendar year 1962, its first full taxable year would be used for this purpose. However, one can conceive of situations where a corporation's taxable income for fiscal or calendar year 1962 might be abnormally high, leaving little or no incentive to the corporation to seek growth because of the arbitrary selection by Congress of the taxable income of such year as a limitation on the base year. To cover these situations, I would propose that in lieu of fiscal or calendar year 1962, a corporation could elect to use (as a limitation against the taxable income of the base year) the average taxable income of fiscal or calendar 1962 and the 2 preceding taxable years (or the preceding taxable year, if the corporation was not in existence or active during the 2 years preceding fiscal or calendar 1962).

> *Example:* Corporation X had taxable income as follows: (1960) $75,000; (1961) $100,000; (1962) $200,000; (1963) $100,000; (1964) $150,000. No adjustments were required to taxable income for 1963 and 1964. Obviously there was no growth income for 1963 and no tax reduction. Growth income for 1964 cannot be measured against taxable income of $100,000 for 1963, because 1963 taxable income cannot be less than the $200,000 taxable income for 1962. However, the corporation elects to take the average taxable income for 1960, 1961, and 1962, which is $125,000, as the limitation below which base income for 1962 cannot go. Growth income for 1964 would be $25,000.

Deliberate whipsawing by taxpayers may possibly be attempted notwithstanding the precautionary provisions built into this plan. With a view to discouraging such efforts, it would seem proper to provide that where income or deductions have arbitrarily been shifted from one year to another by a taxpayer for no business purpose other than reduction of taxes arising from the reduced rates on growth income, the Commissioner may make such adjustments as are necessary to protect the revenue. The doctrine of "business purpose" is reasonably well settled by the tax law, regulations, and court decisions, and such a provision should be unwelcome only to those who would seek to frustrate the purpose of this new plan.

ELIMINATION OF SMALL REDUCTIONS

Elimination of tax reductions of under $5 in the case of individuals and under $15 in the case of corporations would greatly reduce the administration requirements of the plan. Cost-of-living wage increases under escalation clauses do not really represent economic growth, and the $5 limitation would eliminate most of these cases.

TAX REDUCTION PAYBACK

Not only do we wish to encourage growth: we wish to discourage going backward after growth. Such a policy, coupled with a policy against whipsawing, prompts me to recommend what I call a "tax reduction payback" provision. It would require the voiding of a tax reduction based on growth income if, in the following year, the taxpayer's income decreases. The tax reduction would be voided according to the proportion that the decrease bears to the amount of growth income on the basis of which the tax reduction was computed.

Example: Corporation A has taxable income (adjusted) of $100,000 for 1962, $100,000 for 1963, and $100,000 for 1964. It pays $46,500 tax for each year. It has no tax reduction for 1963 and 1964 because there is no growth income. On $200,000 combined income for 1963 and 1964 its combined tax is $93,000.

Corporation B has taxable income (adjusted) of $100,000 for 1962, $150,000 for 1963, and $50,000 for 1964. Its combined income for 1963 and 1964 is $200,000, and its combined tax is $93,000—the same as corporation A, computed as follows:

	1963	1964	Total
Taxable income	$150,000	$50,000	$200,000
Tax	72,500	20,500	93,000
Tax reduction	−13,000		
Tax reduction payback		+13,000	

If, instead of a decrease from taxable income (adjusted) of $150,000 for 1963 to $50,000 for 1964, corporation B dropped only to $125,000, the tax reduction payback would be only $6,500 (one-half of $13,000 tax reduction for 1963 based on the proportion of the decrease of $25,000 in 1964 to the growth income of $50,000 for 1963).

The amount of the tax reduction payback is to become a part of the tax due and payable for the year of the decrease in income. I do not believe it is necessary to require payment of interest inasmuch as the taxpayer will already have lost the use of tax money paid on the higher tax that would have been due for the growth year—even after allowance of the tax reduction.

Conclusion

Like any other major plan of tax reform, this one has its minuses. I recognize that a good many taxpayers would not benefit from it. Some are in a declining income position which is beyond their control. Others (including Members of Congress) are on a stable income basis with little likelihood for improvement—although this plan will provide encouragement to make the most of opportunities for improvement. However, similar criticism could be made of other tax reduction provisions in the Internal Revenue Code. For example, faster depreciation methods and rates are meaningless to a taxpayer caught in the same tax bracket with or without them. Percentage depletion does not benefit a taxpayer to the extent that it exceeds 50 percent of net income. The deduction for medical and hospital expenses does not help over half the taxpayers under 65, who either use the optional standard deduction or find such expenses exceeded by 3 percent of their adjusted gross income. Most of the benefit arising from the recently enacted investment tax credit will go to only a relatively few taxpayers. Nevertheless, all of these have been enacted because Congress considered that they were in the national interest.

In those situations where weather conditions can have an important bearing on income—such as in the agricultural and construction industries—growth (or decrease in income) will be affected regardless of the capital or labor contributed. However, the plan does provide relief for casualty losses; and where weather has had a severe impact on business or wage conditions, there will be the incentive to work harder to make up for it.

Incentive taxation of growth income is entirely workable and administratively feasible. It would be simple for most taxpayers to compute their reduction because they would have few if any adjustments to make. Corporations and individuals operating a business would, in some cases, find it a bit complicated. However, when we recall how terribly complicated the excess profits tax law was, perhaps we should not be too impatient with a far less complicated proposal which will, unlike the excess profits tax law, reduce taxes.

(2) The "Multiplier" Theory

So much reliance has been placed by the majority on the "multiplier" theory that I believe a little more refutation is in order.

The supplementary materials (p. 45) appended to the majority report sets forth the theory of the "multiplier" and so-called "accelerator." In a completely regimented country, where the government controls wages, prices, profits, raw materials, etc., the theory might work. In a capitalistic economic country like the United States, deeply involved as it is in world trade, the theory will not work—at least to any measurable degree.

In the first place, the theory depends on the psychology of the people. No one can predict this with any accuracy. Consumers may decide to save additional dollars resulting from a tax cut instead of spending them. Businessmen may decide to not expand productive capacity and to not hire more people, especially if they believe that the administration has an "antibusiness" attitude. Investors may decide to not invest in new businesses or to not expand present businesses, feeling that caution is warranted by both domestic and foreign uncertainties.

In the second place, the theory must be premised on a stable dollar. For example, the multiplier effect of extending to consumers $2.7 billion more purchasing power through the administration's proposed tax cut for fiscal 1964 would be frustrated if inflation during the same period, generated by the administration's proposed $12 billion deficit, reduces purchasing power by $2.7 billion or more.

Those who adhere to the multiplier theory admit that it has its limitations. When the suggestion is made that perhaps we should have a tax cut of $20 billion in order to increase gross national product by $40 billion or more, they express concern that this would "overheat" our economy. Oddly enough, all administration spokesmen are in complete agreement that a $2.7 billion tax cut for fiscal 1964 will provide just the right temperature; whereas the majority of this committee is of opinion that a $6 billion tax cut for fiscal 1964 is needed to properly warm up the economy.

(3) Growth Rate Required To Make Up for Budget Deficits and Revenue Loss From Tax Cut Proposal

To make up the $10 billion net revenue loss involved in the President's tax reduction and reform proposal *plus* the current fiscal 1963 budget deficit of nearly $9 billion *plus* anticipated increases in Government expenditures (likely to run at least $5 billion a year under administration policies) would require an increase in gross national product on the order of $135 billion over the 3-year period to supply the tax revenue. Such an increase would mean an annual rate of growth in excess of 7 percent. In the last year our rate was slightly over 3 percent, so we can hardly expect a 7-percent rate to be achieved under this administration. It should be pointed out that even if the President's tax reduction stimulated an increase in rate to 5 percent, the annual deficit could well exceed $10 billion or more if the spending side of the budget is not brought under control. It is hard, cold figures like these, coupled with the Federal spending policies of the administration and the Democratically controlled Congress, which prompt the critical projections of Dr. Arthur Burns and Maurice Stans in the minority report.

COMMITTEE AND SUBCOMMITTEE ACTIVITIES IN THE PAST YEAR

The Joint Economic Committee is directed by the law creating it (Public Law 304, 79th Cong.) to report to the Congress on the main recommendations of the President's Economic Report and to make a "continuing study" of the economy.

The work of the full committee and the subcommittees for the period March 1962 to February 1963 is summarized below:

FULL COMMITTEE

January 1962 Economic Report of the President

During the latter part of January and the first part of February the committee held 9 days of hearings on the 1962 Economic Report of the President and the economic situation and outlook, at which Government officials, academic experts, and representatives of business and labor presented their views. A report was prepared and submitted to the Congress on March 7.

State of the economy and policies for full employment

In August the committee held 12 days of hearings on the "State of the Economy and Policies for Full Employment." The purpose of these hearings was to investigate current trends in the national economy and to determine what changes in fiscal or monetary policies, both, were needed to stimulate employment and economic growth.

Dimensions of Soviet economic power

During the fall of 1962 the committee issued a compilation of 24 study papers on "Dimensions of Soviet Economic Power," written by experts on the subject of the Soviet economy. On December 10 and 11 the committee held public hearings on the same subject.

Federal Reserve System Open Market Committee

During the year the committee continued its investigation of the adequacy of the Federal Reserve's reporting system, and in December made public an extensive memorandum showing why more information should be provided to the public by the Board of Governors, and setting forth reasons for publishing the condensed version of the 1960 minutes of the Open Market Committee.

SUBCOMMITTEE ON ECONOMIC STATISTICS

Measures of productive capacity

Hearings on "Measures of Productive Capacity" were held May 14, 22, 23, and 24 at which experts were asked to give their considered judgments as to the uses that are made or could be made of measures of productive capacity, the extent to which measures are now available, the coverage and reliability of existing capacity measures, and what should be done through public and/or private sources, if anything, to improve data on productive capacity. The subcommittee issued a unanimous report on this subject on July 24.

A Federal statistics program for the 1960's

In October the subcommittee published a report prepared by the Office of Statistical Standards, Bureau of the Budget, entitled "A Federal Statistics Program for the 1960's." This report describes briefly the improvements recently made or currently underway in each subject matter area of the Federal statistics program. It then indicates the direction and nature of further development and improvements which are viewed as objectives in years ahead.

Productivity, prices, and incomes

The subcommittee began work on bringing up to date the Joint Economic Committee's 1957 study of "Productivity, Prices, and Incomes." It is planned that this updating may include preparation of unit cost indexes, unit value added indexes, contributions to price change, and related materials.

Other subcommittee studies

The staff, under the direction of the subcommittee, investigated suggestions for revisions in Economic Indicators and incorporated in the November 1962 issue such additions and revisions as seemed desirable. At the same time the staff, with the assistance of the Bureau of the Budget, revised and brought up to date the "Supplement to Economic Indicators Historical and Descriptive Background."

Members of the Subcommittee on Economic Statistics were Senator William Proxmire, chairman; Senators Paul H. Douglas and J. W. Fulbright; and Representatives Richard Bolling, Thomas B. Curtis, and William B. Widnall.

SUBCOMMITTEE ON ECONOMIC STABILIZATION, AUTOMATION, AND ENERGY RESOURCES

Continuing its study of "Inventory Fluctuations and Economic Stabilization" begun in 1961, the subcommittee obtained papers from experts in government, the universities, and research organizations which were printed in four separate parts. It also published two task force reports on "The Role of Inventory Changes During Expansion and Contraction" and "Inventory Fluctuations, Price Level Changes, and Economic Growth." Hearings were held July 9 to 13 at which witnesses testified on the role inventory changes may play in magnifying economic recessions and booms, and perhaps in influencing the turning points in business cycles.

Members of the Subcommittee on Economic Stabilization, Automation, and Energy Resources were Representative Wright Patman, chairman; Representatives Henry S. Reuss, Martha W. Griffiths, Clarence E. Kilburn, and William B. Widnall; and Senators William Proxmire, Claiborne Pell, and John Marshall Butler.

SUBCOMMITTEE ON INTER-AMERICAN ECONOMIC RELATIONSHIPS

The subcommittee held hearings May 10 and 11 on "Economic Developments in South America" at which 10 witnesses submitted papers and responded to questioning by the subcommittee. These hearings were conducted in two roundtable discussions: One, with specialists on Latin American agriculture, taxation, and labor; the second with representatives of firms with long South American investment and business experience. On July 20 the subcommittee made a report containing summary comments on these hearings.

Representative Martha W. Griffiths, as a member of the subcommittee, in December 1962 held numerous conferences with embassy and local officials in five cities in four countries of Central America, including the Canal Zone and Mexico, and submitted a report based on her observations, titled "Economic Policies and Programs in Middle America."

Members of the Subcommittee on Inter-American Economic Relationships were: Senator John Sparkman, chairman; Senator John Marshall Butler; and Representatives Richard Bolling, Hale Boggs, Martha W. Griffiths, and Thomas B. Curtis.

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

The subcommittee published a compilation of papers prepared by experts from Government, universities, and research organizations as part of its broadly based study of the need and means for reducing the deficit in the U.S. balance of payments, as well as appraising the opportunities for international trade and payments cooperation and the usefulness of a policy of relatively high domestic interest rates in stemming the recent dollar outflow. This publication is titled "Factors Affecting the U.S. Balance of Payments." Hearings were held on December 12, 13, and 14 and later published as "Outlook for U.S. Balance of Payments." Later in December the subcommittee issued a report based on the study papers and hearings entitled "U.S. Payments Policies Consistent With Domestic Objectives of Maximum Employment and Growth."

Members of the Subcommittee on International Exchange and Payments were: Representative Henry S. Reuss, chairman; and Representative Hale Boggs; and Senators Paul H. Douglas, William Proxmire, Claiborne Pell, Prescott Bush, John Marshall Butler, and Jacob K. Javits.

CHANGES IN COMMITTEE MEMBERSHIP

At the beginning of the 88th Congress, Senator Jack Miller, of Iowa, and Senator Len B. Jordan, of Idaho, were appointed to fill the two vacancies in the Senate Republican membership of the Joint Economic Committee created by the retirement from the Senate of Senator Prescott Bush, of Connecticut, and Senator John Marshall Butler, of Maryland.

CHANGES IN COMMITTEE STAFF

James W. Knowles was appointed executive director of the staff of the Joint Economic Committee, effective February 1, 1963, to succeed Wm. Summers Johnson, who resigned to become staff director and clerk of the Committee on Banking and Currency of the House of Representatives. John W. Lehman, deputy executive director, resigned on September 17, 1962, to become director of the Cleveland, Ohio, regional office of the Bureau of Labor Statistics of the U.S. Department of Labor. Mr. Lehman came to the committee on May 1, 1947, as the first clerk of the committee.

PUBLICATIONS OF THE JOINT ECONOMIC COMMITTEE

March 1962 to March 1963

Full Committee:

†Hearings, *January, 1962 Economic Report of the President,* January 25, 26, 30, 31 February 1, 2, 5, 6, 7, and 8, 1962 (sale price $2.25): March 1962.

Joint Economic Report, Report of the Joint Economic Committee on the 1962 Economic Report of the President, House Report 1410 (sale price 50 cents): March 1962.

Inventory Fluctuations and Economic Stabilization, Part IV, Supplementary Study Papers (papers prepared for the Joint Economic Committee by experts from the Government, universities, and research organizations), committee print (sale price 35 cents): May 1962.

The Role of Inventory Changes During Expansion and Contraction (Report submitted to the Subcommittee on Economic Stabilization, Automation, and Energy Resources of the Joint Economic Committee), committee print (not on sale): July 1962.

Inventory Fluctuations, Price Level Changes, and Economic Growth (Report submitted to the Subcommittee on Economic Stabilization, Automation, and Energy Resources of the Joint Economic Committee), committee print (not on sale): July 1962.

Hearings, *State of the Economy and Policies for Full Employment,* August 7–10, 13–17, 20–22, 1962 (sale price $2.75): September 1962.

1962 Descriptive Supplement to Economic Indicators (Historical and Descriptive Background) (Prepared for the Joint Economic Committee by the Committee Staff and the Office of Statistical Standards, Bureau of the Budget), committee print (sale price 65 cents): January 1963.

Dimensions of Soviet Economic Power (Compilation of studies prepared for the Joint Economic Committee, combined with Hearings, December 10 and 11, 1962) (sale price $2.75): January 1963.

Hearings, *January 1963 Economic Report of the President: Part 1,* January 28, 29, 30, 31, February 1, 4, 5, and 6, 1963 (sale price $1.75): March 1963; *Part 2,* Statements of Economic Interest Groups (sale price 55 cents): March 1963.

1963 Joint Economic Report, Report of the Joint Economic Committee on the 1963 Economic Report of the President, Senate Report No. 78 (sale price 35 cents): March 1963.

†*Economic Indicators* (a monthly publication of the Congress under Public Law 120, 81st Cong., 1st sess.) (sale price 25 cents a copy, $2.50 a year): Issued monthly.

Subcommittee on Economic Statistics:

Hearings, *Measures of Productive Capacity*, Subcommittee on Economic Statistics, May 14, 22, 23, and 24, 1962 (sale price 45 cents): July 1962.

Measures of Productive Capacity (Report of the Subcommittee on Economic Statistics), committee print (sale price 15 cents): July 1962.

A Federal Statistics Program for the 1960's (A Study prepared for the Subcommittee on Economic Statistics), committee print (sale price 25 cents): October 1962.

Subcommittee on International Exchange and Payments:

†*Factors Affecting the United States Balance of Payments* (Compilation of studies prepared for the Subcommittee on International Exchange and Payments), committee print (sale price $1.75): December 1962.

U.S. Payments Policies Consistent with Domestic Objectives of Maximum Employment and Growth (Report of the Subcommittee on International Exchange and Payments), committee print (sale price 10 cents): December 1962.

†Hearings, *Outlook for United States Balance of Payments*, December 12, 13 and 14, 1962, Subcommittee on International Exchange and Payments (sale price 65 cents): January 1963.

Subcommittee on Inter-American Economic Relationships:

**Economic Policies and Programs in South America* (Report of the Subcommittee on Inter-American Economic Relationships), committee print (sale price 35 cents): January 1962.

†Hearings, *Economic Developments in South America*, Subcommittee on Inter-American Economic Relationships, May 10 and 11, 1962 (sale price 40 cents): June 1962.

†*Economic Developments in South America* (Report of the Subcommittee on Inter-American Economic Relationships), committee print (sale price 10 cents): July 1962.

Economic Policies and Programs in Middle America (Report of the Subcommittee on Inter-American Economic Relationships), committee print (sale price 15 cents): January 1963.

Subcommittee on Economic Stabilization, Automation, and Energy Resources:

Hearings, *Inventory Fluctuation and Economic Stabilization*, Subcommittee on Economic Stabilization, Automation, and Energy Resources, July 9–13, 1962 (sale price 65 cents): August 1962.

Out-of-print publications are denoted by an asterisk. Publications available only from Superintendent of Documents are denoted by a dagger (†)

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