



For Release on Delivery  
Expected Around 1 P.M., EST  
Monday, November 5, 1979

REMARKS BY  
THE HONORABLE G. WILLIAM MILLER  
SECRETARY OF THE TREASURY  
NATIONAL JOURNAL TAX CONFERENCE  
WASHINGTON, D.C.  
NOVEMBER 5, 1979

It is a pleasure for me to participate in the National Journal Tax Conference. This forum offers an important opportunity to review our tax system, always a useful exercise. While it would seem premature for me to prescribe a specific blueprint for tax policy of the 1980's, it is timely to suggest a framework for discussion of the critical tax questions the nation will be facing in the years ahead.

#### GUIDELINES FOR TAX POLICY

Any thoughtful consideration of the tax system must be shaped by economic realities. As the 1980's begin, inflation will continue to be our most pressing domestic concern. Its impact is felt first hand by all Americans. Inflation erodes the value of a worker's wages and a business' profits. It endangers jobs and impairs investments. Clearly, inflation poses a serious threat to the quality of life in this country.

The Administration is firmly committed to waging a vigorous battle against inflation. But the battle will not be won quickly or easily. Building up over the past 15 years, inflation has become deeply embedded in the economy. A successful anti-inflation effort will therefore require a comprehensive, sustained attack on fundamental causes. Tax policy can and should play an important role in that effort.

Fiscal discipline is a major weapon in the war against inflation. An inflation-conscious tax policy must therefore be developed with a keen eye on the Federal budget. During the past 3 years, the Federal deficit has been reduced from 4 percent of GNP to 1 percent of GNP. The 1979 deficit of \$27.7 billion is the smallest since fiscal year 1974. Any proposed tax reduction should be analyzed in terms of its impact on the objective of moving toward a balanced budget.

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Economic progress with price stability is also critically dependent upon improvement in the rate of savings and investment in the private sector. Sluggish savings and investment performance over the past several years has contributed to a marked slowing of productivity growth -- a trend that has, in turn, contributed to spiraling wage and price adjustments. Tax policy cannot ignore these developments; it must be shaped to promote job-creating investment and to restrain business costs.

These tax policy guidelines are demanding. Discipline in fiscal policy limits the opportunity for a general tax cut in the immediate future. And, should it become appropriate to consider more narrowly focused tax reductions, an austere budget requires that tax proposals be fashioned with extreme care. The only acceptable tax policy is one that contributes to our overall economic goals efficiently, fairly and simply.

#### DISCUSSION OF SPECIFIC PROPOSALS

Specific illustrations may be helpful. Among the items listed on this conference's agenda are proposals to accelerate recovery of capital costs, to provide special tax benefits for individual savers, and to reduce social security taxes. Each of these proposals has been advanced as a potential response to the nation's economic needs; each should be evaluated with reference to the tax policy guidelines just outlined.

#### Liberalized Depreciation

Liberalized depreciation is the investment incentive proposal currently receiving most public attention. An example is the so-called "10-5-3" bill, which would restructure the system of tax allowances for capital recovery. Under this bill, nonresidential buildings could be written off over a 10-year period, most equipment over a 5-year period, and a limited amount of expenditures for cars and light trucks over a 3-year period. Accelerated depreciation methods would continue to be allowed, and the investment tax credit would be favorably modified.

There is widespread agreement with the major premises underlying 10-5-3. The depreciation system should be simplified so that all businesses, large and small, can readily comply with tax rules. The present system also provides too little incentive for capital investment during periods of high inflation and financial uncertainty; liberalized depreciation allowances should certainly be given prime consideration when a tax reduction is appropriate.

However, in evaluating the specifics of any depreciation proposal, one must not lose sight of the objective of providing incentives that are as efficient and fair as possible. Such an assessment reveals some shortcomings in the 10-5-3 proposal. However, these shortcomings could be rectified without sacrificing the basic objectives.

Revenue cost is one concern. The tax cut proposed by 10-5-3 is generous. When combined with a full 10 percent investment credit, the 5-year write off for machinery is more advantageous than immediate expensing. The budgetary implications of such a change are troublesome.

Another cause of concern is the effect of 10-5-3 on various sectors of the economy. The investment tax incentive would vary widely among industries. For example, based on Treasury Department projections, the tax reduction per dollar of investment would be 4.4 percent for the construction industry, 8 percent for motor vehicle manufacturers, 18.5 percent for the communications industry and 25.7 percent for gas utilities and pipelines.

There is no discernible relationship between the amount of tax incentive and the relative need for improved productivity performance. For example, the communications industry, which has experienced about 9 percent average annual productivity growth from 1973 through 1978, would be among the most favored industries under 10-5-3. The construction industry, which has experienced an actual decline in economic growth during that period, would be among the least favored.

The 10-5-3 formula would also provide a fertile ground for the formation of "tax shelters". High-bracket taxpayers could be expected to seek investments with the largest tax writeoffs. This would tend to increase inequities in the tax system, and at the same time divert investment funds from industries most in need of capital.

Analysis of capital recovery proposals should also involve consideration of expenditures mandated by Government, such as those for pollution control equipment. Recent data indicate that about 5 percent of all capital expenditures are devoted to abatement of pollution. While such expenditures are necessary for the welfare of the public, they do not add directly to production.

Some non-productive expenditures are now subsidized by the Government through special tax provisions. Others are borne by the consumers of the product, through higher product costs, and not by taxpayers generally. This allocation issue involves fundamental questions of economic and social policy -- questions that the Treasury Department is currently addressing in a study, requested by Congress, on the appropriate tax treatment of mandated expenditures.

### Savings Incentive for Individuals

Tax policy for the next decade must be concerned with the economic decisions of individuals as well as businesses. Individual Americans are consuming too much and saving too little. The nation's personal savings rate is now just over 4 percent of disposable income, the lowest rate in nearly 30 years. This disappointing rate has contributed to lagging productivity. For this reason, various tax incentives for savings have been suggested.

However, proposals for such tax incentives must be approached with caution. A delicate balance of competing considerations is required. On the one hand, the revenue loss of any proposal would have to be within reasonable bounds. On the other hand, an effective savings incentive would need to be applied broadly enough to provide a real inducement for increased savings and not merely a windfall for existing savers.

Consider current Congressional proposals to exempt a certain level of interest income -- ranging generally from \$100 to \$500. It is doubtful whether these proposals would have any appreciable impact on aggregate savings. A tax reduction would be available to individuals for savings activities they would already be inclined to perform; at most, such an incentive might result in an unproductive reshuffling of existing investments.

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Yet, in the final analysis, the best incentive for individual savings may not lie within the tax system. Small savers now receive low interest rates because of deposit

interest rate ceilings imposed under Federal law. The Financial Institutions Reform Act proposed by the Administration would phase out the interest ceilings set forth in regulation Q. The Senate version passed the Senate last week. Reliance upon the private market system to enhance the return on savings would seem to be desirable, providing incentive without specially tailored tax breaks.

### Payroll Tax Reduction

A third proposal -- a possible reduction in Federal payroll taxes -- would affect both individuals and businesses. In 1981, the combined social security tax rate for employers and employees is scheduled to rise from the current 12.26 percent to 13.30 percent, and the wage base is scheduled to increase from \$22,900 to \$29,700. The total tax increases are estimated at about \$18 billion. Some have recommended that these scheduled increases be trimmed back or eliminated.

A payroll tax cut does have attractive features. A reduction for employers would have the effect of reducing costs and thus prices. It would also be more progressive for individuals than almost any income tax reduction.

Yet, such a reduction would require alternate funding for future benefits. A schedule of payroll tax increases was adopted in 1977 for good reason: to protect the integrity of the social security trust funds. To allow for a payroll tax cut and still provide proper financing, one proposed alternative is a value added tax. Such a tax has far-reaching implications that will begin to be explored in Congressional hearings this week. The hearings should develop comparisons of the VAT, the income tax and the social security tax in terms of impact on the economy and on the equity and simplicity of the tax system.

### CONCLUSION

As the discussion of specific tax proposals suggests, there are many constraints on tax policy decisions. During the period ahead there must be a special concern for the efficient use of our limited economic resources. Budgetary discipline is essential.

One aspect of budget policy has received extensive public attention. There seems to be a consensus that closer budgetary control should be exercised over Government spending. There is a concern that Government resources are being wasted -- and Federal deficits expanded -- through inefficient spending programs.

The same sense of public concern should extend to the other side of the Federal ledger -- to the tax system. The tax system is now doing much more than just collecting revenues to pay for spending programs. The Internal Revenue Code is becoming, in itself, an unwieldy network of Government spending programs.

The Federal Government has two basic means by which it can carry out its social programs. It can do so directly, such as by making grants or loans, or it can do so by reducing liabilities otherwise owed to the Government. The two methods are economically equivalent; a potential recipient can be provided the same amount of aid using either method. When aid is provided through the reduction of tax liabilities, the special reduction is referred to as a "tax expenditure."

The Congressional Budget Act of 1974 requires a listing of tax expenditures in the budget. There are now over 90 different tax expenditure programs. For fiscal year 1980, the aggregate revenue cost attributable to tax expenditures will exceed \$150 billion.

Such a substantial portion of the budget must be subject to accountability. If the tax system is to be used to encourage savings and investment, the American public has the right to demand that the tax cuts be designed to accomplish the job efficiently. Likewise, housing, welfare, energy, agriculture, and a myriad of other programs effected through the tax code must be subjected to budget scrutiny. Where these tax programs are inefficient, unduly complicated or inequitable, they should be modified or repealed. Efforts to eliminate Government waste, reduce budget deficits and rationalize Federal programs must not end with an examination of direct Government spending.

The Federal tax system is, in many respects, the envy of other nations. Government revenues are collected primarily through a system of self-assessment with a minimum of Government involvement. The Internal Revenue Service has a reputation for integrity. The tax burden is generally imposed fairly in accordance with ability to pay. But the system can be improved. In the coming years, the challenge must be accepted -- in the name of good tax policy and of good budget policy.



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Any thoughtful consideration of the tax system must be shaped by economic realities. As the 1980's begin, inflation will continue to be our most pressing domestic concern. Its impact is felt first hand by all Americans. Inflation erodes the value of a worker's wages and a business' profits. It endangers jobs and impairs investments. Clearly, inflation poses a serious threat to the quality of life in this country.

The Administration is firmly committed to waging a vigorous battle against inflation. But the battle will not be won quickly or easily. Building up over the past 15 years, inflation has become deeply embedded in the economy. A successful anti-inflation effort will therefore require a comprehensive, sustained attack on fundamental causes. Tax policy can and should play an important role in that effort.

Fiscal discipline is a major weapon in the war against inflation. An inflation-conscious tax policy must therefore be developed with a keen eye on the Federal budget. During the past 3 years, the Federal deficit has been reduced from 4 percent of GNP to 1 percent of GNP. The 1979 deficit of \$27.7 billion is the smallest since fiscal year 1974. Any proposed tax reduction should be analyzed in terms of its impact on the objective of moving toward a balanced budget.

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Economic progress with price stability is also critically dependent upon improvement in the rate of savings and investment in the private sector. Sluggish savings and investment performance over the past several years has contributed to a marked slowing of productivity growth -- a trend that has, in turn, contributed to spiraling wage and price adjustments. Tax policy cannot ignore these developments; it must be shaped to promote job-creating investment and to restrain business costs.

These tax policy guidelines are demanding. Discipline in fiscal policy limits the opportunity for a general tax cut in the immediate future. And, should it become appropriate to consider more narrowly focused tax reductions, an austere budget requires that tax proposals be fashioned with extreme care. The only acceptable tax policy is one that contributes to our overall economic goals efficiently, fairly and simply.

#### DISCUSSION OF SPECIFIC PROPOSALS

Specific illustrations may be helpful. Among the items listed on this conference's agenda are proposals to accelerate recovery of capital costs, to provide special tax benefits for individual savers, and to reduce social security taxes. Each of these proposals has been advanced as a potential response to the nation's economic needs; each should be evaluated with reference to the tax policy guidelines just outlined.

##### Liberalized Depreciation

Liberalized depreciation is the investment incentive proposal currently receiving most public attention. An example is the so-called "10-5-3" bill, which would restructure the system of tax allowances for capital recovery. Under this bill, nonresidential buildings could be written off over a 10-year period, most equipment over a 5-year period, and a limited amount of expenditures for cars and light trucks over a 3-year period. Accelerated depreciation methods would continue to be allowed, and the investment tax credit would be favorably modified.

There is widespread agreement with the major premises underlying 10-5-3. The depreciation system should be simplified so that all businesses, large and small, can readily comply with tax rules. The present system also provides too little incentive for capital investment during periods of high inflation and financial uncertainty; liberalized depreciation allowances should certainly be given prime consideration when a tax reduction is appropriate.

However, in evaluating the specifics of any depreciation proposal, one must not lose sight of the objective of providing incentives that are as efficient and fair as possible. Such an assessment reveals some shortcomings in the 10-5-3 proposal. However, these shortcomings could be rectified without sacrificing the basic objectives.

Revenue cost is one concern. The tax cut proposed by 10-5-3 is generous. When combined with a full 10 percent investment credit, the 5-year write off for machinery is more advantageous than immediate expensing. The budgetary implications of such a change are troublesome.

Another cause of concern is the effect of 10-5-3 on various sectors of the economy. The investment tax incentive would vary widely among industries. For example, based on Treasury Department projections, the tax reduction per dollar of investment would be 4.4 percent for the construction industry, 8 percent for motor vehicle manufacturers, 18.5 percent for the communications industry and 25.7 percent for gas utilities and pipelines.

There is no discernible relationship between the amount of tax incentive and the relative need for improved productivity performance. For example, the communications industry, which has experienced about 9 percent average annual productivity growth from 1973 through 1978, would be among the most favored industries under 10-5-3. The construction industry, which has experienced an actual decline in economic growth during that period, would be among the least favored.

The 10-5-3 formula would also provide a fertile ground for the formation of "tax shelters". High-bracket taxpayers could be expected to seek investments with the largest tax writeoffs. This would tend to increase inequities in the tax system, and at the same time divert investment funds from industries most in need of capital.

Analysis of capital recovery proposals should also involve consideration of expenditures mandated by Government, such as those for pollution control equipment. Recent data indicate that about 5 percent of all capital expenditures are devoted to abatement of pollution. While such expenditures are necessary for the welfare of the public, they do not add directly to production.

Some non-productive expenditures are now subsidized by the Government through special tax provisions. Others are borne by the consumers of the product, through higher product costs, and not by taxpayers generally. This allocation issue involves fundamental questions of economic and social policy -- questions that the Treasury Department is currently addressing in a study, requested by Congress, on the appropriate tax treatment of mandated expenditures.

### Savings Incentive for Individuals

Tax policy for the next decade must be concerned with the economic decisions of individuals as well as businesses. Individual Americans are consuming too much and saving too little. The nation's personal savings rate is now just over 4 percent of disposable income, the lowest rate in nearly 30 years. This disappointing rate has contributed to lagging productivity. For this reason, various tax incentives for savings have been suggested.

However, proposals for such tax incentives must be approached with caution. A delicate balance of competing considerations is required. On the one hand, the revenue loss of any proposal would have to be within reasonable bounds. On the other hand, an effective savings incentive would need to be applied broadly enough to provide a real inducement for increased savings and not merely a windfall for existing savers.

Consider current Congressional proposals to exempt a certain level of interest income -- ranging generally from \$100 to \$500. It is doubtful whether these proposals would have any appreciable impact on aggregate savings. A tax reduction would be available to individuals for savings activities they would already be inclined to perform; at most, such an incentive might result in an unproductive reshuffling of existing investments.

Problems of tax equity also weigh heavily in the consideration of individual tax policy. A tax exemption creates disparate tax savings, depending upon the particular rate bracket of the taxpayer. Incentives for individual savings should be structured to minimize this inequity.

Yet, in the final analysis, the best incentive for individual savings may not lie within the tax system. Small savers now receive low interest rates because of deposit

interest rate ceilings imposed under Federal law. The Financial Institutions Reform Act proposed by the Administration would phase out the interest ceilings set forth in regulation Q. The Senate version passed the Senate last week. Reliance upon the private market system to enhance the return on savings would seem to be desirable, providing incentive without specially tailored tax breaks.

#### Payroll Tax Reduction

A third proposal -- a possible reduction in Federal payroll taxes -- would affect both individuals and businesses. In 1981, the combined social security tax rate for employers and employees is scheduled to rise from the current 12.26 percent to 13.30 percent, and the wage base is scheduled to increase from \$22,900 to \$29,700. The total tax increases are estimated at about \$18 billion. Some have recommended that these scheduled increases be trimmed back or eliminated.

A payroll tax cut does have attractive features. A reduction for employers would have the effect of reducing costs and thus prices. It would also be more progressive for individuals than almost any income tax reduction.

Yet, such a reduction would require alternate funding for future benefits. A schedule of payroll tax increases was adopted in 1977 for good reason: to protect the integrity of the social security trust funds. To allow for a payroll tax cut and still provide proper financing, one proposed alternative is a value added tax. Such a tax has far-reaching implications that will begin to be explored in Congressional hearings this week. The hearings should develop comparisons of the VAT, the income tax and the social security tax in terms of impact on the economy and on the equity and simplicity of the tax system.

#### CONCLUSION

As the discussion of specific tax proposals suggests, there are many constraints on tax policy decisions. During the period ahead there must be a special concern for the efficient use of our limited economic resources. Budgetary discipline is essential.

One aspect of budget policy has received extensive public attention. There seems to be a consensus that closer budgetary control should be exercised over Government spending. There is a concern that Government resources are being wasted -- and Federal deficits expanded -- through inefficient spending programs.

The same sense of public concern should extend to the other side of the Federal ledger -- to the tax system. The tax system is now doing much more than just collecting revenues to pay for spending programs. The Internal Revenue Code is becoming, in itself, an unwieldy network of Government spending programs.

The Federal Government has two basic means by which it can carry out its social programs. It can do so directly, such as by making grants or loans, or it can do so by reducing liabilities otherwise owed to the Government. The two methods are economically equivalent; a potential recipient can be provided the same amount of aid using either method. When aid is provided through the reduction of tax liabilities, the special reduction is referred to as a "tax expenditure."

The Congressional Budget Act of 1974 requires a listing of tax expenditures in the budget. There are now over 90 different tax expenditure programs. For fiscal year 1980, the aggregate revenue cost attributable to tax expenditures will exceed \$150 billion.

Such a substantial portion of the budget must be subject to accountability. If the tax system is to be used to encourage savings and investment, the American public has the right to demand that the tax cuts be designed to accomplish the job efficiently. Likewise, housing, welfare, energy, agriculture, and a myriad of other programs effected through the tax code must be subjected to budget scrutiny. Where these tax programs are inefficient, unduly complicated or inequitable, they should be modified or repealed. Efforts to eliminate Government waste, reduce budget deficits and rationalize Federal programs must not end with an examination of direct Government spending.

The Federal tax system is, in many respects, the envy of other nations. Government revenues are collected primarily through a system of self-assessment with a minimum of Government involvement. The Internal Revenue Service has a reputation for integrity. The tax burden is generally imposed fairly in accordance with ability to pay. But the system can be improved. In the coming years, the challenge must be accepted -- in the name of good tax policy and of good budget policy.