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(Elliott)

June 24, 1981
First Draft

Tax
Speech

CA. TAXPAYERS ASSN. (ALTERNATIVE SPEECH)

I've noticed that the "politics" of tax reduction has gotten a lot of attention lately, but today I would like to discuss something just as important: the "idea" behind tax reduction.

This is an idea that we Californians have always viewed with great sympathy. You will remember that during my other Administration when I was your Governor, we were able to return to the people of California \$5.7 billion in tax relief over 8 years. We were also able to implement the first comprehensive property tax relief program of its kind in California. Thanks to your support, we accomplished these and many other important tax relief measures.

When I left in pursuit of this new position, I am happy to say you didn't take your eye off the ball. The result, as we know, was the prairie fire of Proposition 13, followed by Proposition 4, that swept the country, burning a path all the way to the Halls of Congress.

In truth, of course, there's nothing new about Americans resisting excessive Government and punitive taxation. It was just these frustrations that became the driving force behind the American Revolution. The Declaration of Independence strongly condemned the new "offices" and "officers" with which King George III was burdening the colonies.

From their careful study of history and their own experiences with the British Crown, the Founding Fathers knew that "the power to tax"--as John Marshall would later put it--"involves the power to destroy."

And this was why Jefferson, one of the most brilliant men of all time, could say, in his Inaugural address, that the sum of good government involved one simple rule: more rewards for people, less control by Government.

The whole idea, as Henry Grady Weaver pointed out in his book "The Mainspring of Human Progress," was to protect the freedom of the individual citizen, not just from outsiders, but from insiders as well -- and especially those in public office. Government must be strong enough to protect the people, but not to dominate them. Government must be servant, and never again the master.

This is America's revolutionary gift to the world. And this conviction that individual freedom is an inalienable right granted by God to all as a birthright is at the core of everything we've accomplished so far. It's still the most unique, the newest and the most exciting and successful idea the world has ever known.

Does anyone doubt why America does not import one bushel of grain from the principal communist countries, but why they must import millions and millions of tons from us to keep their people alive?

There is nothing new or progressive, or even revolutionary, about communism. It rests on that same, discredited old-world belief the Founding Fathers opposed: namely, that Government has the right and the ability to direct the lives of the people better than the people themselves.

Well, it's easy enough to criticize when you're using extreme examples. But the truth is, as you know, we're not entirely guilt-free ourselves. In fact, if there is one reason why we've suffered in recent years from an inflated currency, prohibitive taxes, and burdensome regulations, it's because we forgot some of those basic lessons from our own history -- the ones that never failed us when we lived up to them.

We forgot that we were the keepers of the power, forgot to challenge the notion that the state is the principle vehicle of social change, forgot that millions of social interactions among free individuals and institutions can do more to foster economic and human progress than all the careful schemes of government planners.

Well, at last we are remembering; remembering that only when we make Government live within its means, and restrict its role in our personal lives, can we unleash the spirit of individual enterprise so essential to prosperity and the preservation of freedom itself.

Our Administration has set one, overriding domestic goal for the early 1980's: revive the spirit of the American revolution by turning this economy back to you -- the people.

And the way we're trying to do this is by changing just one, little two-letter word: control "by" government to control "of" government.

The desire to restore the proper relationship between citizen and Government is what unifies our entire program -- whether it be cutting wasteful Government spending, establishing block grants, or reducing tax rates for every working American. In essence, we're trying to return the money and the decisions now under the control of a few to millions of Americans like all of you. If we can, it will be like, as someone said, removing the constriction from the base of a giant, dying tree, knowing the sap will then flow a thousand shoots and branches.

Well, we're on our way, and I'm happy to report that the Congress has made a strong bipartisan effort, but we're not home-free yet.

While much progress has been made, there are too many automatic spending programs that still have not been reduced sufficiently. Without those added reductions, we will have given up just as we are on the brink of a great national victory. Without those reductions, we will have nearly \$22 billion of red ink, an unbalanced budget, and more inflationary pressure in the next few years. But more important, without those reductions, we cannot guarantee the success of our economic recovery program, and that would be the biggest tragedy of all.

We must help the Congress shoulder the burden of taking tough, but necessary action to finish the job that's almost complete. If they do not finish the job, America will have merely delayed the day of reckoning -- the day which will cause us to slip once again into the terrible quicksand of built-in inflation, high interest rates and Government out of control.

The same holds true for our proposals to consolidate over 80 confusing and duplicative Federal programs into block grants. It's not fair to ask taxpayers to send their earnings to Washington, and then charge them billions more to have this same money turned around and sent right back with strings attached. We can do better than that -- and we can do it by cutting out the middleman and putting funds in the hands of State and local governments where the citizens of American can have greater control.

Cutting the increase in the rate of spending is only part of our economic recovery program. Government is taking too great a percentage of the GNP as its share of the people's earnings. This percentage must be reduced if we are going to have the incentive we need to increase productivity. And we're not going to have economic recovery until we increase productivity, which requires capital investment in American business and industry.

What we have proposed is not just a tax rate cut to relieve the over-burdened citizenry. In fact, in some ways

we aren't proposing a tax cut at all. We are proposing to reduce or eliminate a tax increase already built into our system; the biggest single tax increase in our Nation's history. And it comes on top of the fact that our Federal taxes have already doubled just since 1976.

If I could paraphrase Will Rogers' line about never having met a man he didn't like, it seems that some in Government never met a tax they didn't hike. We are living with a Social Security payroll tax that was increased a short time ago and which is scheduled to automatically increase several more times the next 5 years. And these increases have a kind of double whammy. The rate increases, but at the same time the percentage of earnings the rate is applied to also goes up. Thus, like the graduated income tax, we have a bracket creep penalizing workers whose wage goes up to keep pace with the cost of living.

Ironically, some of those who helped pass the tax increases of which I've spoken are now the first and loudest in charging that our proposed tax package is designed to benefit the wealthy. That's not true. Those who will get the biggest percentage reduction in their total tax burden will be lower -- and median-income families. Our program provides new incentives so that more people can share in a growing prosperity.

Their other charge is that it is too risky to cut the tax rates when we are running giant budget deficits. I hope

I'll be forgiven for pointing out they are also the same people who helped create those deficits.

To all these doubters, I address one question and I've asked it over and over and never received an answer: "Why is it inflationary for you to spend your money the way you want to spend it and it isn't inflationary if Government takes it and spends it the way Government wants to spend it?"

But I'm happy to say there are others in the Congress on both sides of the aisle who have come together in a coalition supporting a bipartisan tax bill co-authored by Republican Barber Conable and Democrat Kent Hance.

The principle of across-the-board cuts in the marginal tax rates over a 3-year period has been maintained. It is true we moved from a 30 percent cut to 25 percent for personal income but this made possible other tax cuts which I believe will be great stimulants to saving, investment and increased productivity.

I don't feel I can accept any further changes even though those who are unenthusiastic about tax cuts generally are pressing for a 15 percent cut over 2 years. In the first place, that built-in tax increase I described will amount to 22 percent over 3 years. Our proposal will eliminate that and give at least a small reduction. In addition, I believe the third year is important particularly for small business which creates 80 percent of our new jobs and which pays the individual tax rather than the corporate tax.

Individual entrepreneurs can look ahead and make plans better with the assurance of 3 years stability in the tax picture.

Let me say a word about marginal tax rates, the rates we propose to reduce across-the-board. These, as you know, are the brackets above the base income tax. They dictate how much of every extra dollar you get -- whether from a pay raise, interest on savings, or income from your profession, shop or whatever -- must go to Government.

In this land, born of the desire to be free, middle-income Americans are being pushed into punitive tax brackets once reserved for the wealthy. Not too many years ago, only 3 percent of those who work and earn were in a 30 percent bracket -- today a full one-fourth of the work force is paying that marginal tax rate. And when your social security and State income taxes are included in the total tax burden, average families this year are facing 40-44 percent marginal tax rates.

No wonder middle-class families find they can't put money aside or have the means to send their children to college. The worker finds it not worthwhile to put in overtime or try to upgrade him or herself and so we become less competitive in the world market.

We must have a change from the practice of "tax and tax, spend and spend, elect and elect," and we must have it now;

not at some distant hoped-for time when somehow prosperity we are to assume will return all by itself and budgets will be magically balanced.

It is economic nonsense to say a lowering of tax rates will add to our deficits. We've had tax increases and the deficits increase anyway because Government doesn't tax to get the money it needs. Government will always find more needs for the money it gets. By contrast, we find that every time Government has had a broad reduction in tax rates the boost in prosperity is so immediate that, while taxpayers pay less individually, Government revenues go up because of that increased prosperity. The reason is clear: People don't work just so they can pay taxes. They work to earn more after-tax income.

So the Conable-Hance tax bill will give almost three-fourths of the income tax relief to those earning between \$10,000 and \$60,000 a year -- the people who presently pay 72 percent of the total income tax.

In addition, the unjust penalty imposed on married couples where husband and wife are both working will be relieved. Individuals will be allowed to deduct \$1,000 a year for personal retirement programs.

Of special interest to farmers and family businesses, the estate tax exemption will be raised to \$600,000. And of even greater help there will be no estate tax for a surviving spouse.

The Conable-Hance bill also calls for lowering the 70 percent ceiling on so-called unearned income to 50 percent. The capital gains tax will be lowered. And business will get the biggest tax reduction in our Nation's history -- some \$60 billion in depreciation allowances, etc.

Some have accused me of fighting too hard for these reforms and for not wanting to compromise on key principles. Well, to some of these accusations I plead: guilty.

For too long, Government has stood in the way, taking more of what our people earn, no matter how hard they try. Who can blame them for fearing they are trapped inside an economy with no bright tomorrows -- an economy that has lost its soul?

This is why we must revive the spirit of the American Revolution and of Proposition 13. Why, we must remind Washington that it's your money -- not theirs. That you earned it -- they didn't. And that it's time they let you keep a bigger share.

You're not demanding the impossible. You're just demanding some of the same opportunities the Founding Fathers risked their lives, property and sacred honor for more than 200 years ago: A commitment that if you work or save more tomorrow than you did today, your reward will be higher than it was. More of every dollar of earnings will be yours to keep, more of your added wages, your added interest. This is what we mean by incentives. This is what will unlock the spirit

and energy of our people, and drive Americans to dream
and dare, and take great risks for a greater good. Unlock the
spirit of Fulton and Ford, the Wright Brothers and Lindbergh,
and of all our astronauts.

We did it before -- we survived the Great Depression;
we came back from Pearl Harbor to win the biggest military
victory in world history; and we put men on the moon and brought them
safely home, even as many scoffed and said it couldn't be
done.

Well, we can do it again. We can solve the energy crisis . . .
and pioneer technological break-throughs . . . and rebuild our
cities . . . and, in the process, strengthen our families
and create new jobs and real hope for young Americans everywhere.
Yes, we can do all that and save the American ~~d~~ream, but only
on one condition: That we always remember we owe our progress
to a unique form of government that allows the freedom to choose
our own destiny -- a government that answers to "we the people."
And with your help, we will thank you very much and God bless
you.

Read

TAX POLICIES

FOR THE

1980s

DISCUSSION PRESENTED BY

NORMAN B. TURE

TO THE

TAX CLUB OF CLEVELAND

MONDAY, APRIL 20, 1981

CLEVELAND ATHLETIC CLUB

CLEVELAND, OHIO

TAX POLICY FOR THE 1980s: NEW DIRECTIONS

- IT IS A PLEASURE TO BE WITH YOU THIS EVENING AND TO HAVE THE OPPORTUNITY TO TALK WITH YOU ABOUT THE NEW DIRECTIONS IN FEDERAL TAX POLICY. LAST NOVEMBER, WITH THE ELECTION OF RONALD REAGAN, THE NATION COMMITTED ITSELF TO A NEW COURSE. THIS NEW PATH CALLS FOR REDUCING DEPENDENCE ON THE FEDERAL GOVERNMENT FOR SOLUTIONS OF REAL AND FANCIED PROBLEMS AND FOR RELYING ON THE PRIVATE SECTOR TO PROVIDE THE DRIVING FORCE FOR OUR ECONOMIC AND SOCIAL PROGRESS. THE PROPOSALS FOR TAX CHANGES WHICH PRESIDENT REAGAN PRESENTED TO THE NATION ON FEBRUARY 18 ARE A KEY ELEMENT IN HIS FOUR-PART PROGRAM FOR RENEWAL OF THE NATION'S ECONOMIC PROGRESS. MY FOCUS ON TAXES THIS EVENING SHOULD NOT BE CONSTRUED AS DEROGATING THE IMPORTANCE OF THE OTHER ELEMENTS OF THIS PROGRAM --- REDUCING FEDERAL SPENDING, REFORMING REGULATORY POLICY, AND ACHIEVING A SLOW, STEADY GROWTH IN THE STOCK OF MONEY. THESE ARE ALSO ESSENTIAL PARTS OF THE OVERALL ECONOMIC POLICY INITIATIVE TO WHICH THE ADMINISTRATION IS COMMITTED. EACH OF THEM PLAYS AN IMPORTANT AND NECESSARY ROLE IN PURSUIT OF THE

BASIC OBJECTIVE --- TO TURN THE U.S. ECONOMY BACK TO THE PEOPLE.

PERMIT ME TO ELABORATE ON THIS POINT BEFORE TURNING TO THE TAX PROGRAM ITSELF. IT IS, IN FACT, THIS CENTRAL THRUST OF THE ECONOMIC PROGRAM WHICH PROVIDES THE BASIC EXPLANATION OF WHY THE TAX PROPOSALS HAVE TAKEN THE FORM THEY HAVE.

ALL OF US ARE AWARE OF THE UNHAPPY FACTS WHICH COMPRISE THE RECORD OF THE ECONOMY'S PERFORMANCE IN THE LAST SEVERAL YEARS. THE YEARS SINCE 1976 ARE MARKED BY DECLINES IN THE RATE OF GROWTH OF REAL GNP, HIGH RATES OF UNEMPLOYMENT, AND A SOARING PRICE LEVEL. THE SAME PERIOD HAS BEEN CHARACTERIZED BY A DISTRESSING DETERIORATION OF PRODUCTIVITY. IN THE PAST FOUR YEARS, WE HAVE SEEN THE MOST UNSETTLED CONDITIONS IN OUR FINANCIAL MARKETS IN THE ENTIRE POST-WAR ERA. WE FIND OUR ONCE VITAL

AND VIGOROUSLY GROWING BASIC INDUSTRIES AND OUR MAJOR MANUFACTURING SECTORS IN SERIOUS STRAITS. AND, PERHAPS MORE DISTRESSING THAN THESE DISTURBING MEASURES OF TOTAL ECONOMIC PERFORMANCE IS THE GROWING AND WIDENING EVIDENCE OF ECONOMIC DISLOCATIONS AND OF DIFFICULTIES IN ADJUSTING TO CHANGING CIRCUMSTANCES.

EXAMINATION OF THIS RECORD DOES NOT TURN UP EVIDENCE OF ANY FUNDAMENTAL FLAWS OR FRAILTIES IN THE PRIVATE MARKET SYSTEM. INSTEAD, IT AFFORDS ONE INDICATION AFTER ANOTHER OF THE UNHAPPY CONSEQUENCES OF GROWING GOVERNMENT INTRUSION IN THE NATION'S ECONOMIC LIFE. THE FINE-TUNING FOCUS OF FEDERAL ECONOMIC POLICY HAS NOT PRODUCED THE SHORT-RUN ECONOMIC STABILITY IT SEEKS; IT HAS RESULTED IN GREATER INSTABILITY WHILE CURTAILING GROWTH IN

PRODUCTION POTENTIAL OVER THE LONG-TERM. PURSUIT OF THE INCOME AND WEALTH REDISTRIBUTION OBJECTIVES WHICH HAVE BEEN THE HALLMARK OF FISCAL POLICY HAVE NOT CHANGED THE SHAPE OF THOSE DISTRIBUTIONS NOR ELIMINATED POVERTY, BUT THEY HAVE PENALIZED SAVING, CAPITAL FORMATION, AND PRODUCTIVITY - ADVANCING PERSONAL EFFORTS. WHAT SUCCESSES MAY BE CHALKED UP FOR REGULATORY POLICIES HAVE BEEN PURCHASED AT AN ENORMOUS COST, ESTIMATED IN THE HUNDREDS OF BILLIONS BEFORE TAKING ACCOUNT OF THE COSTS IN LOSS OF PRODUCTION EFFICIENCY FROM MISALLOCATION OF OUR PRODUCTION CAPABILITY. MONETARY POLICIES FOCUSED ON CONTROLLING INTEREST RATES AND RELYING ON THAT CONTROL TO DETERMINE MONETARY AGGREGATES HAVE FAILED OF THAT PURPOSE; THEY HAVE GIVEN US INSTEAD, OUR WORST AND MOST PERSISTENT PEACE-TIME INFLATION.

THE LITANY COULD BE EXTENDED ENORMOUSLY, BUT SURELY THERE IS NO NEED FURTHER TO BELABOR THE POINT THAT OUR OBSERVED ECONOMIC WOES ARE NOT THE CONSEQUENCES OF FAILURE OF OUR MARKET

SYSTEM BUT OF INEPT, HOWEVER WELL-INTENTIONED, GOVERNMENT POLICIES. THE LESSON TO BE LEARNED FROM THIS IS THAT IT IS FAR PAST TIME TO REVERSE THE TREND OF EVER-INCREASING GOVERNMENT CONTROL OF OUR ECONOMIC LIFE. IT IS TIME TO RELY MORE AND MORE ON THE INITIATIVE, THE VITALITY, THE INNOVATIVENESS, THE PRODUCTIVE ENERGY OF A ROBUST PRIVATE SECTOR. IT IS TIME TO GIVE THE ECONOMY BACK TO THE PEOPLE --- THE ULTIMATE AND MOST VALUABLE RESOURCES OF OUR NATION.

THE PRESIDENT'S TAX PROGRAM IS WHOLLY IN THAT SPIRIT. IT IS A FIRST MAJOR STEP IN WHAT, I HOPE, WILL BE A CONTINUING EFFORT TO MOVE OUR TAX SYSTEM TOWARD GREATER NEUTRALITY - TOWARD LESS TAX-INDUCED DISTORTIONS OF THE SIGNALS WHICH THE MARKET PLACE CASTS UP TO ALL OF US CONCERNING THE BEST WAYS TO USE THE RESOURCES AT OUR DISPOSAL.

IT IS IN THIS OBSERVATION THAT WE FIND THE PRINCIPAL GUIDEPOST FOR THE NEW DIRECTIONS IN TAX POLICY. TO PUT THE MATTER

IN ANOTHER WAY, WE ARE DETERMINED TO REVISE THE TAX SYSTEM IN SUCH A WAY THAT IT WILL STRENGTHEN RATHER THAN FRUSTRATE THE EFFICIENT OPERATION OF THE MARKET SYSTEM. THE TAX PROGRAM WHICH THE PRESIDENT HAS PROPOSED IS WHOLLY IN THAT SPIRIT.

THERE IS NO NEED, I AM SURE, TO DETAIL THESE TAX PROPOSALS TO THIS GROUP. INSTEAD, I'D LIKE TO DISCUSS THE REASONING UPON WHICH THE PROPOSALS ARE BASED.

IN DEVELOPING OUR BUSINESS TAX REDUCTION PROPOSALS, WE HAVE BEEN MINDFUL OF THE WIDE RANGE OF BARRIERS TO BUSINESS GROWTH AND PROGRESS IMPOSED BY THE PRESENT TAX LAWS. WE RECOGNIZE, FOR EXAMPLE, THAT THE LEVEL OF CORPORATE INCOME TAX RATES, ITSELF, INVADES CORPORATE SAVING AND CAPITAL FORMATION, AND THAT THE PRESENT TAX TREATMENT OF DIVIDENDS NOT ONLY ARTIFICIALLY INFLUENCES FINANCING ARRANGEMENTS, BUT DEPRESSES THE AGGREGATE FLOW OF SAVING INTO CORPORATE BUSINESSES. WE KNOW THAT SUCH FEATURES OF THE LAW AS THE MINIMUM TAX, WHILE

GENERATING LITTLE TAX REVENUES, CONSTRAIN BUSINESS DECISION-
MAKING AND OPERATIONS, AS OFTEN AS NOT TO LITTLE USEFUL PURPOSE.
WE KNOW THAT THE APPLICATION OF THE INCOME TAX TO INCORPORATED
AND UNINCORPORATED BUSINESSES ACCENTUATES THEIR PROBLEMS IN
FINANCING NOT ONLY THEIR GROWTH BUT THEIR ON-GOING OPERATIONS.
WE KNOW THAT THE DETERIORATION OF BUSINESS CONDITIONS IS
ASSOCIATED WITH A MARKED DECELERATION IN RESEARCH AND
DEVELOPMENT ACTIVITY, AND WE ARE CONCERNED FOR THE POSSIBLE
ADVERSE INFLUENCES OF THE TAX STRUCTURE THEREUPON. THESE AND
OTHER MATTERS WILL BE THE SUBJECT OF A CONTINUING PROGRAM OF
CONSTRUCTIVE TAX CHANGES.

PUBLIC POLICY, HOWEVER, MUST ALWAYS BE CONCERNED WITH
PRIORITIES. IMPORTANT AS ARE THE PROBLEMS NOTED, WE CONCLUDED
THAT IN OUR CURRENT CIRCUMSTANCES THE TAX PROBLEM MOST URGENTLY
CALLING FOR CORRECTION CONCERNED CAPITAL RECOVERY.

LET ME FLESH OUT THE FACTUAL BACKGROUND FOR THAT CONCERN.
TO BEGIN WITH, CONSIDER THE PATTERN OF EMPLOYMENT GAINS WHICH

HAS EMERGED OVER THE PAST DECADE. SINCE 1969, THE NUMBER OF FULL- AND PART-TIME WAGE AND SALARY WORKERS IN NONAGRICULTURAL ESTABLISHMENTS INCREASED BY MORE THAN 20 MILLION. DIFFICULT AS IT MAY BE TO BELIEVE, ONLY 200,000 OF THESE JOBS WERE IN MANUFACTURING. IN CONTRAST, DURING THE 11 YEARS PRECEDING 1969, THE GAIN IN MANUFACTURING EMPLOYMENT WAS ALMOST 4-1/4 MILLION.

TO BE SURE, MANY FACTORS ACCOUNT FOR THE CHANGES IN EMPLOYMENT PATTERNS IN THE U.S. ECONOMY DURING THE PAST DECADE. ONE OF THE MOST IMPRESSIVE LABOR FORCE DEVELOPMENTS OF THE PERIOD IS THE INCREASE IN PARTICIPATION IN THE WORK FORCE BY AND IN EMPLOYMENT OF WOMEN. FROM 1969 THROUGH 1981, THE INCREASE IN EMPLOYMENT OF WOMEN EXCEEDED 12 MILLION, REPRESENTING ABOUT 60 PERCENT OF THE GAIN IN TOTAL EMPLOYMENT IN THAT PERIOD. SINCE MUCH OF THIS GAIN IN EMPLOYMENT OF WOMEN WAS IN PART-TIME

JOB, IT IS TO BE EXPECTED THAT IT WOULD OCCUR PRIMARILY IN NON-MANUFACTURING INDUSTRIES --- IN TRADE, SERVICES, FINANCE, SECTORS WHICH CAN FAR MORE READILY THAN MANUFACTURING ACCOMMODATE PART-TIME EMPLOYMENT. BUT THE TYPE OF JOB ONE LOOKS FOR IS MUCH MORE THAN MERELY A MATTER OF HOURS PER WEEK; IT ALSO DEPENDS ON THE AFTER-TAX REAL WAGE OR SALARY RATE AVAILABLE IN ALTERNATIVES. CLEARLY, THE GREATER THE ATTRACTIVENESS OF HOURS, WORKING ENVIRONMENT, AND JOB CHARACTERISTICS IN TRADE, SERVICES, AND FINANCE COMPARED WITH MANUFACTURING, THE GREATER MUST BE THE AFTER-TAX REAL WAGE RATE ADVANTAGE OF MANUFACTURING OVER OTHER JOBS IN ORDER TO ATTRACT ADDITIONAL EMPLOYEES. FUNDAMENTALLY DETERMINING REAL WAGE RATES IS PRODUCTIVITY, AND THE BASIC DETERMINANT OF PRODUCTIVITY IS HOW MUCH CAPITAL IS

USED WITH LABOR SERVICES IN THE PRODUCTION PROCESS. IF
MANUFACTURING EMPLOYMENT WERE TO HAVE GAINED IN PROPORTION TO
TOTAL EMPLOYMENT, MUCH MORE RAPID GAINS IN PRODUCTIVITY THAN
ACTUALLY OCCURRED WOULD HAVE BEEN NECESSARY. AND THIS, IN
TURN, WOULD HAVE REQUIRED MUCH MORE RAPID GAINS IN THE AMOUNT
OF CAPITAL OF THE SORT USED IN MANUFACTURING --- IN LARGE PART,
LONG-LASTING FIXED CAPITAL --- THAN ACTUALLY WERE REALIZED.

THIS BRINGS US TO THE CRUX OF THE MATTER. WHATEVER
OTHER FACTORS MAY HAVE CONTRIBUTED TO THE INADEQUACY OF CAPITAL
FORMATION IN MANUFACTURING, SURELY THE INTERACTION OF INFLATION
WITH THE EXISTING TAX PROVISIONS, PARTICULARLY THOSE PERTAINING
TO DEPRECIATION, MUST HAVE BEEN OF MAJOR IMPORTANCE.

INFLATION IS A TAX ON SAVING. AS THE PRICE LEVEL RISES, THE NET OF TAX REAL RETURN ON THE DOLLARS SET ASIDE FROM CONSUMPTION TO BUY MORE INCOME IN THE FUTURE IS LIKELY TO FALL BEHIND. THIS OCCURS BECAUSE CURRENT DOLLAR RETURNS, EVEN IF THEY GROW WITH INFLATION, ARE LIKELY TO BE TAXED AT HIGHER AND HIGHER RATES, DUE TO BRACKET CREEP. INFLATION, THEREFORE, TENDS TO DISCOURAGE SAVING AND INVESTING IN ANY FORM. THIS BIAS IS ACCENTUATED WHEN THE SAVING IS INVESTED IN DURABLE CAPITAL, SINCE MORE AND MORE OF THE RETURNS ON THE INVESTMENT WILL BE ERODED BY HIGHER TAXES IN RESPONSE TO BRACKET CREEP. EVEN MORE IMPORTANT IN THIS CASE IS THAT THE DEPRECIATION DEDUCTIONS FOR RECOVERY OF THE INVESTMENT IN THE CAPITAL ARE BASED ON THE ORIGINAL COST OF THE FACILITIES;

THESE DEDUCTIONS, THEREFORE, DO NOT INCREASE AS INFLATION PROCEEDS, AND MORE AND MORE OF THE GROSS RETURNS ON THE CAPITAL WHICH SHOULD BE TREATED AS CAPITAL RECOVERY IS INSTEAD TREATED AS TAXABLE PROFIT. AS A CONSEQUENCE, THE REAL RATE OF TAX ON PROFITS TENDS TO BE FAR HIGHER THAN THE APPARENT RATE OF TAX. FOR EXAMPLE, ADJUSTING DEPRECIATION DEDUCTIONS FOR CURRENT RATHER THAN HISTORICAL COSTS, THE EFFECTIVE TAX RATE ON CORPORATE PROFITS, AS MEASURED IN THE NATIONAL INCOME ACCOUNTS, WAS MORE THAN 100 PERCENT IN 1974.

IN VIEW OF THE INFLATION SURGE OF RECENT YEARS, IT IS OBVIOUS THAT THE INTERACTION OF INFLATION AND THE TAX SYSTEM HAS DISTORTED THE PATTERN OF SAVING AND CAPITAL ACCUMULATION TO THE GROSS DISADVANTAGE OF MANUFACTURING WITH ITS SUBSTANTIAL RELIANCE ON LONG-LASTING FIXED CAPITAL. UNDOING THIS

DISTORTION IN THE INTERESTS OF ACHIEVING FAR MORE VIGOROUS GROWTH IN INDUSTRIAL OUTPUT AND EMPLOYMENT, THEREFORE, MUST BE A PRIME CONCERN OF A TAX POLICY AIMED AT ALLOWING THE MARKET SYSTEM TO OPERATE MORE EFFICIENTLY. AND TO UNDO THIS DISTORTION, IT IS NECESSARY TO FOCUS ON CONSTRUCTIVE CHANGES IN CAPITAL RECOVERY PROVISIONS.

I HAVE BEEN AT PAINS TO EXPLAIN THE RATIONALE FOR THE PRIORITY GIVEN TO THE PROPOSED ACCELERATED COST RECOVERY SYSTEM (ACRS) AS THE PRINCIPAL INSTRUMENT FOR BUSINESS TAX REVISION IN THE FIRST TAX BILL WHICH THE PRESIDENT HAS PROPOSED. THE MAJOR IMPROVEMENTS IN CAPITAL RECOVERY FOR TAX PURPOSES WHICH ACRS WILL AFFORD WILL GO FAR TOWARD AMELIORATING OTHER BUSINESS TAX DIFFICULTIES. NEVERTHELESS, WE WILL CONTINUE

OUR EFFORTS TO IDENTIFY AND TO IMPLEMENT OTHER CONSTRUCTIVE CHANGES IN THE INCOME TAXATION OF BUSINESS.

THE NEED FOR ACRS OR A SIMILAR CAPITAL RECOVERY SYSTEM TO REPLACE EXISTING DEPRECIATION PRACTICES IS WELL UNDERSTOOD AND VERY BROADLY SUPPORTED. REGRETTABLY, THE TAX REDUCTIONS FOR INDIVIDUAL TAXPAYERS WHICH PRESIDENT REAGAN HAS PROPOSED ARE NOT AS WELL UNDERSTOOD. IMPROVING THAT UNDERSTANDING IS REQUIRED IF THE KIND OF TAX REDUCTIONS WHICH THE PRESIDENT HAS PROPOSED AND WHICH ARE THE KEY TO LOOSING THE TAX CHAINS ON PERSONAL INCENTIVES ARE TO BE PROOF AGAINST FAR LESS DESIRABLE SUBSTITUTES.

THE OUTSTANDING AND ESSENTIAL ATTRIBUTE OF THE PROPOSED INDIVIDUAL TAX CHANGES IS THAT THEY ARE REDUCTIONS IN

MARGINAL TAX RATES. THERE IS A CARDINAL PRINCIPLE IN THE ECONOMICS OF TAXATION, A PRINCIPLE TO WHICH ALL ECONOMISTS AND OTHER PUBLIC FINANCE EXPERTS SUBSCRIBE, IRRESPECTIVE OF THEIR PHILOSOPHICAL PREFERENCES, THAT TAXES ENTER INTO A PERSON'S DECISION-MAKING AT THE MARGIN. IT IS THE AMOUNT OF TAX ONE MUST PAY ON THE NEXT DOLLAR OF INCOME OR ON THE USE OF ANOTHER DOLLAR OF INCOME IN ONE WAY AS OPPOSED TO ANOTHER WHICH INFLUENCES OUR CHOICES AND AFFECTS OUR BEHAVIOR. IT IS THE "MARGINAL" TAX RATE WHICH ENTERS INTO OUR DECISIONS ABOUT SAVING OR CONSUMING, ABOUT INVESTING IN THIS VERSUS THAT OUTLET FOR OUR SAVING, ABOUT WORKING OR USING OUR TIME AND RESOURCES IN ACTIVITIES THE RESULTS OF WHICH LIE OUTSIDE THE TAX SYSTEM, ABOUT THE SELECTION OF JOBS AND CAREERS, ETC.

IN SHORT, IT IS IN THE MARGINAL TAX RATE THAT THE EFFECTS
-
OF TAXATION ON INCENTIVES ARE CONVEYED.

THE EXISTING STRUCTURE OF TAX RATES WHICH INDIVIDUAL
TAXPAYERS CONFRONT SERIOUSLY IMPAIRS INCENTIVES TO WORK,
TO SAVE AND INVEST, TO UNDERTAKE ENTERPRISES, PARTICULARLY
RISKY ONES, ^{AND} TO ADVANCE ONE'S PRODUCTIVITY AND EARNING POWER.
REDUCING THESE TAX-IMPOSED DISINCENTIVES IS A BASIC
REQUIREMENT IF THE ECONOMY IS TO GET ONTO A HIGH-GROWTH
PATH AND IF THE MARKET SYSTEM IS TO OPERATE MORE
EFFICIENTLY.

ALL OF US HAVE, IN ONE WAY OR ANOTHER, WITNESSED
THESE DISINCENTIVE EFFORTS IN ACTION. THE DISINCENTIVE

MAY APPEAR AS REFUSAL TO ACCEPT OVERTIME WORK OR PRESSURE FOR SHORTER WORK HOURS, LONGER VACATIONS, SHELTERED FRINGE BENEFITS, RATHER THAN STRAIGHT PAY INCREASES. IT IS TO BE FOUND IN THE DISTORTION OF SAVING PATTERNS -- IN THE OBSERVATION THAT MORE AND MORE INDIVIDUALS IN BRACKETS BELOW 50 PERCENT ARE INVESTING IN TAX-EXEMPTS AND ONE OR ANOTHER KIND OF SHELTERED OUTLET. ONE OF THE MOST STRIKING AND DISTRESSING INDICATIONS OF THE DISINCENTIVE EFFECT OF HIGH BRACKET RATES IS TO BE FOUND IN THE PLUNGE IN THE PERSONAL SAVING RATE IN RECENT YEARS. SINCE 1976, THE FRACTION OF AFTER-TAX PERSONAL INCOME WHICH INDIVIDUALS HAVE SAVED HAS FALLEN TO THE LOWEST LEVELS SINCE THE POSTWAR CONSUMPTION SPREE OF THE LATE 1940s. THIS IS A CLEAR REFLECTION OF THE IMPACT OF INFLATION IN PUSHING TAXPAYERS INTO HIGHER TAX BRACKETS.

THERE SHOULD BE NO QUESTION ABOUT THE URGENCY OF
REDUCING THE PRESENT INDIVIDUAL TAX BIAS AGAINST WORKING
AND SAVING AND INVESTING. REGRETTABLY, YEARS OF PUBLIC
POLICY EFFORTS TO CONTROL AGGREGATE DEMAND BY CONTROLLING
CONSUMPTION THROUGH FISCAL MEASURES HAVE DEEPLY IMPLANTED
THE NOTION THAT INDIVIDUALS ARE MERELY CONSUMPTION MACHINES
AND THAT INDIVIDUAL TAX REDUCTIONS MERELY PROMOTE CONSUMPTION
SPENDING. THIS VIEW OF THE EFFECTS OF INDIVIDUAL MARGINAL
RATE CUTS IS AS WRONG AS IT CAN BE, NOT MERELY IN THEORY
BUT ALSO AS EVIDENCED BY ACTUAL EXPERIENCE. REDUCING
MARGINAL TAX RATES MAKES IT RELATIVELY LESS COSTLY TO WORK
AND REDUCES THE COST OF SAVING AND INVESTING RELATIVE TO
CONSUMING. UNLESS ALL OF US ARE PERCEIVED AS IRRATIONAL
AND STUPID, IT MUST BE ASSUMED THAT WHEN IT'S LESS COSTLY

TO WORK --- WHEN THE AFTER-TAX REWARDS FOR GIVING UP
LEISURE ARE INCREASED --- WE'LL BE INCLINED TO WORK
MORE. AND WHEN IT'S LESS COSTLY TO SAVE AND INVEST ---
WHEN WE CAN HAVE MORE AFTER-TAX FUTURE INCOME FOR EVERY
DOLLAR OF CURRENT CONSUMPTION WE FOREGO, IT MUST BE
ASSUMED WE'LL SAVE AND INVEST MORE.

THESE ASSUMPTIONS ARE BORNE OUT BY THE HISTORICAL
RECORD. THE LAST OCCASION ON WHICH MARGINAL TAX RATE
REDUCTIONS OF A MAGNITUDE COMPARABLE TO THOSE PROPOSED BY
PRESIDENT REAGAN WERE MADE WAS THE KENNEDY-JOHNSON RATE
CUTS OF 1964-65. THE RESPONSE WAS DRAMATIC. THE
LABOR FORCE PARTICIPATION RATE, WHICH HAD BEEN DRIFTING

DOWNWARD SINCE THE MID-1950'S, IN 1965 BEGAN A STEADY AND PROLONGED RISE. THE UNEMPLOYMENT RATE WHICH HAD BEEN ABOVE 5 PERCENT SINCE 1957, FELL SHARPLY BELOW 5 PERCENT IN 1965 AND DECLINED TO 3.5 PERCENT IN 1969. THE PERSONAL SAVING RATE ROSE MARKEDLY FOLLOWING THE 1964-65 CUTS; FROM A RANGE OF 5.4 TO 6.3 PERCENT IN THE PRECEEDING 5 YEARS, THE RATE WENT UP TO 6.7 PERCENT IN 1964; IT WAS 7 PERCENT OR HIGHER IN NINE OF THE NEXT 11 YEARS AND 8 PERCENT OR HIGHER IN 6 OF THOSE YEARS.

THIS EXPERIENCE, AS WELL AS SOUND ECONOMIC ANALYSIS, ARGUES FORCEFULLY THAT THE PERSONAL SAVING RESPONSE TO THE MARGINAL RATE REDUCTIONS PRESIDENT REAGAN HAS PROPOSED WILL BE AT LEAST AS PRONOUNCED AS THOSE FOLLOWING THE 1964-65 CUTS.

MOREOVER, IF THE PRESIDENT'S PROGRAM SUCCEEDS IN REDUCING
-INFLATION AS WE ARE CONFIDENT IT WILL, THE POSITIVE INCENTIVE
EFFECTS WE EXPECT FROM THE EXPLICIT TAX REDUCTIONS WILL BE
AUGMENTED BY THE TAX CUTS ON SAVING IMPLICIT IN MODERATION OF
INFLATION.

ON THE OTHER HAND, IF WE DO NOT ACHIEVE THE INDIVIDUAL
RATE CUTS WE SEEK AND IF INFLATION IS NOT CURTAILED, THE RESULTS
WILL MORE THAN DUPLICATE THE BRACKET CREEP OF RECENT YEARS.
BRACKET "CREEP" IS ~~AN EUPHUISM~~ ^{EUPHEMISM}; "SURGE" IS MORE REALISTIC.
CONSIDER THAT IN 1965, ONLY ONE IN 17 TAXPAYERS FACED A
MARGINAL TAX RATE AS HIGH AS 25 PERCENT. TODAY, AT LEAST
ONE OF EVERY THREE TAXPAYERS IS IN THE 25 PERCENT BRACKET, *or HIGHER.*
SINCE 1965, THE MARGINAL TAX RATE FOR A MEDIAN INCOME FAMILY
HAS JUMPED FROM 17 PERCENT TO 24 PERCENT. UNDER CURRENT LAW
AND INFLATION RATES, IT WOULD LEAP AHEAD TO 32 PERCENT IN
1984. IN FACT, WITHOUT THESE CUTS, IT IS ESTIMATED THAT
VIRTUALLY EVERYONE NOW PAYING FEDERAL INCOME TAX WILL BE PAYING
THE TOP BRACKET RATE OF 50 PERCENT BY THE LATE 1990s --- NOT

TWO DECADES AWAY. CONSIDER THE DISINCENTIVES OF THAT DEVELOPMENT!

THESE ARE THE CONSIDERATIONS WHICH REQUIRE THE INDIVIDUAL TAX CUTS TO TAKE THE FORM OF MARGINAL RATE REDUCTIONS. INCREASES IN PERSONAL EXEMPTIONS WON'T DO THE TRICK OF CANCELLING TAX DISINCENTIVES. INCREASING THE ZERO-RATE BRACKET WILL DO VERY LITTLE AT PROPORTIONALLY FAR GREATER A LOSS IN REVENUES. THESE ARE THE VERY TYPES OF TAX CUTS WE'VE RELIED ON OVER THE PAST DECADE. THEY'VE HAD, CLEARLY LITTLE EFFECT IN SLOWING BRACKET SURGE. MANY OF THE SO-CALLED TARGETED SAVING PROPOSALS, SIMILARLY WOULD HAVE LITTLE EFFECT IN REDUCING THE MARGINAL RATE OF TAX ON RETURNS FOR SAVING, HENCE WOULD AFFORD LIMITED INCENTIVES FOR SAVING. MOREOVER, MOST OF THE TARGETED SAVING TAX CUTS INVOLVE GOVERNMENT'S DIRECTING THE USE OF SAVING, NOT MERELY INCREASING ITS AGGREGATE AMOUNT. MARGINAL RATE CUTS IN CONTRAST, DO NOT DISTORT DECISIONS ABOUT

HOW TO SAVE. THIS APPROACH IS CONSISTENT WITH THE
PRESIDENT'S BASIC EFFORT TO ALLOW FREE MARKETS TO WORK.-

ONE OF THE CONCERNS EXPRESSED ABOUT THE PROPOSED
INDIVIDUAL TAX CUTS IS THAT IT WILL GENERATE A RESURGENCE
OF INFLATION. THE IDEA APPEARS TO BE THAT THESE REDUCTIONS
WILL RESULT IN A HUGH SPURT OF CONSUMPTION, FAR IN EXCESS OF
ANY INCREASE IN OUTPUT, AND THAT THIS, IN ITSELF, WILL
IGNITE AN INFLATION SURGE. THE FEAR IS UNFOUNDED. THE
TAX CUT, IN AND OF ITSELF, DOESN'T --- IT CAN'T ---
INCREASE TOTAL DEMAND. IN ITSELF, THE TAX CUT REDUCES
THE COST OF SAVING COMPARED WITH CONSUMPTION, OF WORKING
COMPARED WITH NOT WORKING. THE LOGICAL RESULT IS THAT
PEOPLE WILL WANT TO SAVE, NOT CONSUME, A LARGER SHARE

OF THEIR PRESENT INCOMES, AND TO USE A LARGER SHARE OF THEIR TIME AND RESOURCES IN WORKING RATHER THAN IN NOT WORKING. THE RESULT WILL BE AN INCREASE IN TOTAL OUTPUT AND INCOME, OUT OF WHICH THERE WILL BE BOTH MORE SAVING AND CONSUMPTION. BUT CLEARLY THE RESULTING INCREASE IN CONSUMPTION CANNOT EXCEED THE INCREASE IN OUTPUT.

A VARIATION OF THIS ARGUMENT IS THAT THE TAX CUT WILL GENERATE A SIGNIFICANT INCREASE IN THE DEFICIT WHICH ITSELF WILL FUEL AN INFLATION RESURGENCE. BUT THESE TAX REDUCTIONS WILL RESULT IN SUBSTANTIAL INCREASES IN SAVING IN THE PRIVATE SECTOR, SUFFICIENT TO FINANCE THE ADDITIONAL DEFICIT AS

WELL AS LARGE GAINS IN CAPITAL FORMATION. NO INFLATION WILL RESULT UNLESS THE MONETARY AUTHORITIES MISTAKENLY CHOOSE TO MONETIZE THE DEFICIT. SINCE THE ADDITIONAL SAVING WILL BE MORE THAN ADEQUATE TO FINANCE THE DEFICIT, ANY SUCH MONETARY ACTION WOULD BE COMPLETELY UNCALLED FOR.

FINALLY, THE TAX CUTS PROPOSED FOR INDIVIDUALS MUST BE SEEN AS NO LESS ESSENTIAL TO THE SUCCESS OF THE PRESIDENT'S ECONOMIC PROGRAM AS THE ACRS PROPOSAL FOR BUSINESS. ONLY THESE MARGINAL RATE CUTS WILL REDUCE THE EXISTING TAX BARRIERS TO WORK AND OTHER PRODUCTIVE EFFORT IN THE MARKET SYSTEM. AND THESE REDUCTIONS ARE ESSENTIAL TO REMOVE THE TAX CONSTRAINTS ON PERSONAL SAVING. WE SHOULD ALL BEAR IN MIND, IN THIS CONNECTION, THAT ULTIMATELY ALL OF THE SAVING AND INVESTING

IN OUR ECONOMY IS DONE BY INDIVIDUALS, WHO ARE THE ULTIMATE OWNERS OF EVERY SINGLE DIME'S WORTH OF THE NATION'S STOCK OF CAPITAL.

THE FAVORABLE EFFECT OF THE INDIVIDUAL MARGINAL RATE CUTS ON SAVING AND INVESTING WILL BE ENHANCED BY THE ACCOMPANYING, BUILT-IN REDUCTIONS IN THE TAX ON CAPITAL GAINS. WHEN FULLY EFFECTIVE, THE TOP TAX RATE ON NET LONG-TERM CAPITAL GAINS WILL BE CUT FROM THE PRESENT 28 PERCENT TO 20 PERCENT.

THESE INDIVIDUAL RATE CUTS, NO LESS THAN ACRS, WILL IMPROVE THE BUSINESS CLIMATE. THEY WILL SLOW THE INCREASE IN PRE-TAX CURRENT DOLLAR WAGE RATES WHILE PROVIDING GREATER GAINS IN AFTER-TAX REAL WAGES AND SALARIES. THEY WILL, THEREBY, EXPAND BOTH THE LABOR SUPPLY AND EMPLOYMENT. AND, FOR THE VAST MAJORITY OF U. S. BUSINESSES, WHICH ARE BOTH SMALL AND UNINCORPORATED AND WHICH ACCOUNT FOR ALL BUT A SMALL FRACTION OF THE TOTAL EMPLOYMENT GAINS OF RECENT YEARS, THESE INDIVIDUAL RATE CUTS ARE THE ONLY PRACTICAL WAY TO CUT BUSINESS INCOME TAX LIABILITIES. ACHIEVING THE HIGH-GROWTH, FREE ECONOMY

TO WHICH THE PRESIDENT'S PROGRAM IS ADDRESSED, EARMARKS THE PROPOSED INDIVIDUAL MARGINAL TAX RATE CUTS AS A CRITICALLY IMPORTANT POLICY DEVELOPMENT.

PRESIDENT REAGAN'S TAX PROGRAM IS A MAJOR FIRST STEP TOWARD ACHIEVING THE KIND OF TAX SYSTEM WHICH WILL ALLOW THE U.S. TO REALIZE ITS ENORMOUS POTENTIAL FOR ECONOMIC PROGRESS. DESPITE ITS IMPORTANCE, THE PROGRAM WILL NOT JUST HAPPEN. IT WILL BE ACHIEVED ONLY IF THE AMERICAN COMMUNITY AS A WHOLE AFFORDS ITS RIGOROUS SUPPORT. THAT SUPPORT WILL BE THE MORE SOLID THE BETTER IT IS INFORMED. IT IS MY HOPE THAT THIS DISCUSSION WILL CONTRIBUTE TO THAT BETTER INFORMATION AND TO THE ULTIMATE REALIZATION OF A TAX ENVIRONMENT FAR MORE CONGENIAL TO A FREE ECONOMY THAN WE HAVE KNOWN FOR YEARS PAST.