PROBLEMS OF FEDERAL TAX POLICY

30 October 1963

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COLONEL TILLMAN: Admiral Rose, Gentlemen: This morning we consider the problems of Federal tax policy. This is a subject of interest to all of us, particularly in our common role as taxpayers.

Our speaker is especially well qualified to address us on this subject, since he has recently been the Director of the Treasury's Office of Tax Analysis.

It is indeed a pleasure to welcome Dr. Harvey E. Brazer and to present him to the Class of 1964.

Dr. Brazer.

DR. BRAZER: Talking about tax policy and particularly the economics of tax policy is something that I had done for a long time before 1961 and my acceptance of a position with the Treasury Department. The assumption of the responsibilities that went with that position gave me an opportunity to put into practice, I thought, as I accepted the position, a great deal of my study, thinking, and teaching over the period of the previous 13 or 14 years. Here was an opportunity to begin with a pledge from the President of the United States to initiate action in tax reform designed to achieve the major objectives that all of us had sought for a long time.

Nevertheless, I knew that, however rational, logical, and completely warranted my ideas might be, the legislative body responsible for action might find itself in disagreement for a number of reasons. I was under no illusions as to what might be achieved through the legislative process in Washington, but I was convinced that the time was most opportune for what I had hoped would be at least a major educational effort on the part of the Administration.

One must recognize, to be realistic, that there are at least two aspects of tax policy, or fiscal policy, that have to be taken into account, and these are sometimes in conflict. They are the economics of tax or fiscal policy and the politics of tax or fiscal policy. From the economist's point of view you can be as right as it is possible to be, and from the politician's point of view, or from the view of politics, you can be absolutely dead wrong, particularly, say, under circumstances in which the three States that produce the great bulk of our oil and gas--Louisiana, Texas, and Oklahoma--are not safe political States, under circumstances wherein the State of Oklahoma, for the first time in its history, elects a Republican Governor and the State of Texas sends a Republican to the Senate.

But in the formulation of tax policy the economist's job is to spell out the objectives and the policies designed to meet those objectives without consideration of the question of what happens in the November 1964 elections. This, of course, is the way in which we proceeded.

If you assume, as I prefer to do, that the level of public expenditures is given by the community's expression of relative preference for public goods and services versus private goods and services, the major burden, then, of achieving your objectives in economic policy necessarily falls on tax policy. This is especially the case if your faith in the ability of the monetary authorities to influence economic activity through monetary policy is limited.

In any event, I would look to tax policy as the principal means for achievement of our goals in terms of employment, income, economic growth, and price stability, given the level of public expenditures at the Federal level.

Now, what was it that we wanted to achieve through tax policy back as far as late 1961, when we began to think seriously about the tax program for 1963? In the first place we recognized that by late 1961 the economy had been operating for close to 5 years with unemployment not having dropped below 5 percent for any one month. The last time that unemployment was at a level below 5 percent of the labor force was sometime in 1957.

The second fact to be recognized was that, whereas the economies of nations such as Japan, West Germany, Italy, France, and several other major industrialized nations of the West had been growing at rates ranging from 4 to 7 or 8 percent, and the estimated rate of growth of the Soviet economy was in excess of 6 percent, our rate of growth was at a not very impressive level of about 3 percent, or slightly below 3 percent, depending upon the time period you used for measuring this rate of growth.

Thus a second objective, in addition to the attainment of full employment, or at least a better record of employment than is indicated by the unemployment experience we have had in the last few years, was acceleration of the rate of economic growth in this country. It is not always realized, I think, how much even a comparatively small increase in the rate of growth, from 3 percent to, say, 3.5 percent, would mean. A .5 percent increase in the rate of growth means, at the end of 5 years, operation at a level some $15 to $20 billion higher in terms of gross national product than would have been achieved without that increase.

When you consider that our total expenditures in this country for education, for example, run to $20 billion a year, you find that if our rate of growth is greater by only one-half of 1 percent per year after 5 years we are producing a sufficiently larger gross national product to provide the resources with which to carry out our educational program at the elementary, secondary, and higher education levels--or provide for some 40 percent of our defense effort, or a much lighter burden of financing public expenditures generally, in terms of private goods and services foregone.

Another reason for emphasis on our rate of growth, of course, is what may be called the demonstration objective. A good many countries, particularly the newly formed countries around the world, look to the United States and the Soviet Union and other Communist nations for guidance for the directions to be taken by developments in their own countries. It must certainly impress some of these people adversely, from our point of view, when it is observed that rates of growth in the Soviet bloc have run as much as twice as high as the rate of growth in recent years in the United States. The fact that we start from a much higher level of output and therefore that it is that much more difficult to achieve a higher increase in the rate of growth, the fact that we start from a much higher level of technological development than these other countries do, and a lot of other facts may help to explain the differences in the rate of growth, but these facts unfortunately are too often overlooked.

The third major objective of tax policy involves the question of equity in the distribution of tax burdens. Here we are concerned with what may be termed horizontal equity; that is, equity or fairness in the distribution of tax burdens among people who are equally or similarly circumstanced. Horizontal equity demands that, if you have two families each made up of five people, and if the income of each of the families is $10,000, with other circumstances the same, both families ought to pay the same amount in taxes, irrespective of the source of income or the dispositon of that income in consumption or savings.

A fourth objective, one which fortunately we have not had to worry about excessively over the last 6 years, is the objective of price stability. As the Administration has taken pride in pointing out on more than one occasion--I should say more than one occasion each week--the level of wholesale prices in this country has remained virtually unchanged since 1957. Consumer prices do edge upward, but this is a function in large part, it seems to me, of improvements in quality that are not taken into account fully in the measurement of prices. It is a function also of the increasing importance of services, wherein labor productivity tends to lag in its advance behind labor productivity in other areas of the economy.

In any case, we attempted to develop a major program of tax reform that would achieve all of these objectives simultaneously. One thing that was clear was that tax reduction was called for, tax reduction being called for as a means of increasing purchasing power in the economy, as a means of boosting demand both for consumer goods and capital or investment goods. Tax reduction was called for also as a means of increasing the rewards to effort, increasing the net rewards to risk-taking and investment, inspiring a greater flow of investment, a greater willingness to assume risk on the part of investors and entrepreneurs, and inspiring a greater effort on the part of the labor force, particularly some important segments of the labor force that are so crucial to our level of economic activity and rate of growth.

But the question of how much tax reduction we could have was necessarily closely related to the objective of maintaining price stability. A good many economists argued in 1961-1962 that it would take a $20 billion tax cut to achieve full employment (I use the term "full employment" as shorthand for an interim target of 4 percent unemployment; nobody claims that it is more than an interim objective).

On the other hand, a quick, massive tax cut of that kind may well have adverse repercussions on our price-stability objective, because, clearly, this would mean a very rapid and massive increase in demand that could exert such pressure on prices as to lead to a resumption of major inflationary process. We therefore had to concede that a $20 billion tax cut was probably too large.

Another constraint, of course, was the size of the deficit that would be forthcoming, at least in the early years following such a tax cut. As an economist I am compelled to argue that the size of the deficit should be regarded merely as the incidental outcome of tax policies designed to achieve our economic goals, given levels of expenditure determined in the manner I suggested a few minutes ago. The size of the deficit in these terms is relatively unimportant. But, there is what some of us might regard as a bit of a cultural lag in this respect, because clearly Senator Byrd does not regard the size of the deficit as being merely an incidental outcome of tax policies appropriate to the achievement of economic objectives.

I mention this name only because he happens to be Chairman of the Senate Finance Committee, and it is important that he not be offended. But he is not alone in this. I was amazed during the course of my tenure in the Treasury to discover how many people there are--and I suppose this is not a random sampling of Americans, because if you took a random sampling of Americans you would find that very few of them write letters to the President or to the Secretary of the Treasury--who do write letters, and to find out how many of these people wrote to tell us that, given the fact that the President had projected a deficit for fiscal 1964 of $9.2 billion, they felt that the Treasury and the Federal Government needed the money more than they did and they would prefer not to have a tax cut if it was going to increase the deficit.

There is, of course, the view that a tax cut must be accompanied by an expenditure cut, because you cannot allow a tax cut to increase the deficit. Of course, if you cut expenditures by as much as you cut taxes, then there is something wrong with one of my first premises, namely, that expenditure levels should be determined by the preferences of the public with respect to the choice between private and public goods, between automobiles and caviar and cabbage on the one hand and defense and welfare services, and so on, on the other.

Also, of course, it must be recognized that a cut in expenditures by definition is a cut in demand for goods and services, so that, if you were to cut taxes by $10 billion and cut expenditures for goods and services by the Federal Government by $10 billion, clearly you would be making no headway whatsoever. In fact, you might move backward in your attempt to achieve the goal of full employment and a more rapid rate of growth.

Another factor to be taken into account was that the largest previous peacetime deficit realized in this country was $12.4 billion under the previous Administration in fiscal 1959. Politically, it is generally good to set records, but the political mood is such that one of the records you do not want to set is the record for the largest peacetime deficit ever achieved in history.

The economist is not bothered by this but clearly the public is, and the Congress is. I think this is unfortunate, but it is nevertheless a fact of life.

So our tax cut was tailored to take into account these considerations. It was limited to $10 billion to take effect over a 3-year period, the first year's tax cut to constitute one-quarter of the total, the second year's tax cut one-half of the total, and the third year, 1965, would complete it with the other quarter. This was tailored in such fashion that it would achieve in our estimates a deficit of just under $12 billion--11.9.

Now, given the $10 billion tax cut, there was the question of how to distribute it. We provided for a reduction in tax rates from the existing 20 to 91 to 14 to 65 percent under the President's program, with rate cuts of about 20 percent across the board between the 20 percent level and the 91 percent level. Here again, there is no magic in the 14 to 65 percent. There is a good deal of sentiment around the country for getting top rates down to at least 65 percent. You can do that easily, except for political considerations, because there is so little income taxed at those high levels that it does not cost much to reduce rates from 91 to 65 percent. You can do it for a few hundred million dollars. But, if you cut the top bracket from 91 to 65, you are cutting it by 29 percent. If you are going to achieve what is in the view of many equity, if you cut the top by about 30 percent, you have to cut the bottom by 30 percent. This is how one arrives at 14 percent. It happens to be 30 percent less than 20 percent. Then in between you just cut the suit to fit the cloth and you get a reduction across the board that averages in excess of 20 percent.

How important this should be to incentives, particularly at the top, may be seen in the fact that under present law, if you are unfortunate enough not to have a variety of loopholes available to you, for every additional dollar earned you keep only 9 cents. At a 65 percent rate we quadruple the proportion of additional dollars earned through effort or investment that is kept. That is, we raise it from 9 cents to 35 cents.

Now, if pecuniary motives have any significance at all, the quadrupling of the net rate of return must have some substantial impact. Below the top rates of course it is doubtful how effective a tax-rate reduction can be in achieving greater work effort and greater incentives to invest. Economists have been long aware that reaction to taxation or to changes in after-tax income is a function of two forces, one of which we call the income effect and the other the substitution effect.

The substitution effect may be seen in the work-leisure choice, for example. If you increase the after-tax rate of return per hour of effort, you are at the same time increasing the price of leisure. That is, if I work for $1 an hour and the tax rate is 50 percent, the cost of taking an hour off is only 50 cents. If you cut the tax rate to 25 percent, the cost of taking an hour of leisure becomes 75 cents. Thus the substitution effect should work toward greater work effort, as well as greater risk taking and greater investment.

The income effect works in the opposite direction. Again, to follow up my illustration, if I am working for $1 an hour and the tax rate is 50 percent, I have to work a given number of hours in order to achieve my net income or consumption objective. If I need $20 a week, I have to work 40 hours in order to get it. If you reduce the tax rate from 50 to 25 percent, I can achieve that same $20 with less effort.

Such studies as have been made do not make it clear that the substitution effect prevails over the income effect.

Then we come to the horizontal or the equity objective. Here the main problem lies in the fact that some kind of income, or income from some sources, is taxed at one rate, and income from other sources is taxed at another rate, and income from still other sources is not taxed at all.

This is hardly horizontal equity. If you have income in the form of interest on municipal government bonds, for example, it is exempt from taxation. Conspicuous illustrations abound of people whose incomes come from sources such as operations in oil and gas and whose tax liabilities are zero or very minimal.

We find that you have differentials that do not seem to make much sense in other ways as well. For example, take the physicist who writes a book expounding bold, new theories in physics. He copyrights the book. He sells 500 copies. He makes about $750 on the sale, and it is ordinary income. Some guy comes along who paid the $10 for the book, he applies the theory and develops a. patentable invention. He licenses the use of the invention. He receives royalties. They both receive royalties. But his are more than $750. The amount does not matter. His royalties are not taxed as ordinary income. They are treated as capital gains and taxed at rates not ranging from 20 to 91 percent but at rates ranging under present law from 10 to 25 percent. This is not horizontal equity.

In achieving horizontal equity one should also achieve greater efficiency in the allocation of resources and thus contribute to a higher rate of full employment growth because, under circumstances in which one kind of economic activity is favored through the tax laws over another, you will get a diversion of resources or you will get an allocation of resources that will overallocate resources to the favored area relative to the other areas. This, almost by definition, must mean a lesser output per unit of input before taxes than would otherwise obtain.

We are therefore concerned with horizontal equity not just from the point of view of fairness and justice but also from the point of view of neutrality and efficiency and rates of economic growth.

Well, how far did our program go? Clearly, not as far as the fiscal economist, given a free hand, would have taken it. We advocated some reduction in personal deductions, arguing that, if allowable medical expenses, interest, taxes--State and local taxes--paid, and contributions exceeded 5 percent of the individual's income, he ought to be allowed to deduct that excess and only the excess, because it was only more than 5 percent that represented any degree of hardship or that represented a successful effort to stimulate giving to charitable religious, educational, and other such institutions, and so on.

We argued in our reform package that capital gains of the so-called statutory kind--the patent royalties on inventions, for example, capital gains on the holding of breeding cattle, capital gains on coal royalties--be called ordinary income.

We argued that various other inequalities in the tax law be removed. We did not advocate substantial reductions in depletion allowances. We did not advocate taxing municipal bond interest. We did not advocate some other things which people have found advocated in my earlier writings or in the writings of Assistant Secretary Surrey, but, after all, these things were written before we came to work for the Treasury. While we were professors, in the one case of law and in the other case of economics, we could advocate without having to carry responsiblitiy. There is a big difference between setting up the blueprint and setting up a program that can command the majority of the votes cast in both Houses of Congress.

In later discussion I will be glad to go into details of the program to the extent that you are interested. What is clear now is that the tax bill that emerged from the House Ways and Means Committee and that was passed by the House and is now under consideration by the Senate Finance Committee is not a tax bill that contains everything the President asked for. In some respects it contains only very little that the President asked for. The main feature, a tax cut of $10 or $11 billion, is still there. We didn't get the timing we wanted. We had proposed that the tax rate cuts take effect 1 January 1963. We will be most fortunate if we get the tax cuts by 1 July 1964. We did not get many of the reform measures. When it came to reducing deductions you can imagine what the reaction of charitable, church, educational, and other such institutions was. You can imagine what the reaction of real estate boards was. You can imagine what the reaction of various other lobby groups was to any suggestion that personal deductions be limited.

We were the evildoers who were upsetting--not only upsetting but discouraging and perhaps destroying--religion, ruining the real estate or construction industry, discouraging home ownership. We probably beat our mothers and sinned in various other ways.

When it came to, say, statutory capital gains, these were not loopholes. The late Senator Kerr pointed out in an article in "Look Magazine" in 1962 that there are no loopholes, because every one of the paragraphs in the Internal Revenue Code was put there by Congress after due and proper consideration, and that anything that was called a loophole, or anything that resulted in horizontal inequity or unneutrality was there because it served important, overriding national or social objectives.

Not only did the Congress not decide to treat coal royalties, which, after all, are quite the same in most respects as any other kind of royalty, like royalties on copper, zinc, lead, or tin, or anything else, but what they did was keep coal royalties as capital gains, and in order to even things up they made royalties on iron ore capital gains, too.

This is how tax reform went. What you have now is a tax bill that comes close to meeting the President's demands in terms of tax rate reductions. In terms of reform it does, I am afraid, relatively little.

COLONEL TILLMAN: Gentlemen, Dr. Brazer is ready for your questions.

QUESTION: Dr. Brazer, what is your opinion on stimulating the economy through the increase of public spending rather than through a tax cut?

DR. BRAZER: Well, I think this has both a political and an economic answer. One is that the Congress is not in a spending mood. The House is a very conservative body as it is presently constituted. The House, it seems to me, in particular, is less likely to move in the direction of increasing expenditures than it is to cutting taxes. The second, and more important from my point of view, reason is economic, and I would argue that to increase expenditures for the sake of stimulating a higher level of economic activity is wrong, in the sense that the level of public expenditures represents a choice between the use of resources for production, consumption, and investment in private goods and services--those things that we buy through the market--and consumption of public goods and services, whether it be a trip to the moon or raising teachers' salaries.

Now, I think that the question of the level of public expenditures should be determined by the choice that we make between allocating our resources to producing highways versus allocating our resources to producing food, clothing, vacation trips, and other things that we spend our incomes on privately.

I think that once that choice is given then it is wasteful and uneconomic to spend more of our resources through the public sector rather than through the private sector. The only way in which I would modify this is in terms of a situation of less than full employment, when, if our resources are not fully employed to start with, then the cost of public services in real terms, in terms of private goods and services foregone, may be zero, because in an economy that is less than fully employed, you can have both more private goods and services and more public services.

But, if it is the objective of your fiscal policy, expenditure, or tax policy, to reach full employment within a short period of 2 or 3 years, then you face the fact that once an expenditure program has been initiated, has been designed to achieve that full employment, and once full employment is realized, that expenditure level may be out of line with people's desires or preferences. An expenditure level may be out of line with people's desires or preferences. An expenditure program once initiated is extremely difficult to curtail, because, clearly, a large body of vested interests builds up behind any expenditure program.

So it seems to me that the preferable route to full employment and the achievement of our other objectives is tax policy. We could achieve full employment through increasing expenditures, but this would not give us the advantage that cutting taxes does, namely, the favorable incentive effects on private investment and work effort that lower tax rates bring.

So that, if the two are equal in other respects, I would prefer the tax route because of the extra bonus that it brings in terms of incentive effects. Of course, strictly speaking, if you want to achieve a given level of aggregate demand, and one of your objectives is minimizing the deficit needed in the interim to produce it, you can achieve the objective through increasing expenditures rather than reducing taxes with a lower deficit than through reducing taxes. This is because if you increase expenditures each dollar of increase in expenditure results in an increased dollar of demand. If you cut taxes a portion of the tax reduction will be saved rather than spent. But, hopefully, the incentive effect makes up for this, so that the two may not necessarily involve different amounts of deficit.

I would argue, as I did earlier, not that deficits are unimportant but that they should be regarded as secondary, more or less incidental outcomes of policy choices made in order to achieve major economic objectives.

QUESTION: What is the possibility of the benefits of the Federal tax cut being offset by a corresponding increase in the State and local taxes? If this is a problem, what has been done or can be done to counter it?

DR. BRAZER: Well, it is my view, the view that we expressed in the Treasury, that a Federal tax cut, far from being offset by an increase in State and local taxes, will make it possible for the States and their local subdivisions to finance their public service needs with lower tax rates that would otherwise be required. This follows from the assumption that a cut in Federal taxes will raise the level of income and spending in the economy as a whole. So that States, for example, using income and sales taxes, would find that if the tax cut of $10 billion leads to an increase of gross national product of, say, $30 billion, their sales tax receipts will go up because people will have more income and more money to spend, and will spend more, their income tax receipts will go up because people's incomes will be higher, more people will be employed, and so on.

So I firmly believe that the Federal tax cut, far from being offset by increases in State and local tax rates, will result in State and local tax rates being increased less than they otherwise would have been.

What you need to recognize is that State and local expenditures have been rising since the end of the war, at an average rate of close to 10 percent a year. They are likely to continue to rise at an average rate of about 10 percent a year. This has meant and will continue to mean increasing tax rates at the State and local level.

But I think that it makes sense, clear sense, to argue that State and local tax rates will rise less rapidly under a Federal tax cut than they would in the absence of the tax cut, and in the circumstances in which we remained well below full employment and in which our rate of economic growth was slower than I believe it will be if this tax bill is enacted.

I think that this is an argument that I have seen time and time again in editorials all over the country. I have seen it expressed by taxpayers in various positions, and so on. What I do know is that a good many Governors, in drawing up their budget statements for January 1964, are taking into account explicitly the anticipated expansion in the economy that will be forthcoming as a consequence of the tax cut.

We develop some estimates in the Treasury of the effect on State and local tax receipts given fixed tax rates of a $10 billion tax cut. The Joint Economic Committee staff estimated that this $10 billion would raise gross national product by $40 billion. Our calculations, translating this $40 billion increase in GNP into increase in State and local tax receipts at existing rates, suggested that the $10 billion tax cut by the Federal Government would bring an increase in State and local tax receipts of about $4 billion, without an increase in tax rates.

So I am convinced that this argument holds pretty strong.

QUESTION: Professor, I noticed that you did not list as one of the objectives of the tax reduction the balance-of-payments. Is that because you do not feel that this is an important objective? If the answer is yes, will you indicate why?

DR. BRAZER: Well, as in any organization, there is not always agreement. The Secretary of the Treasury says that a tax cut with tax reform is going to improve the balance-of-payments position, and if I were still in the Treasury I would say that the Secretary of the Treasury says it will and therefore it will.

The trouble with this view is that there are two sides to this picture. We find that, as our incomes increase as a consequence of a tax cut, our imports are going to increase. There is nothing about an increase in our income that should lead to a commensurate increase in exports. As a matter of fact, you may find that exports would fall because of the greater attractiveness of selling in the domestic market under conditions of higher employment and income.

So that on trade account the tax cut could have an adverse effect on the balance-of-payments. Offsetting this, however, is the fact that a tax cut in the United States will increase the after-tax net rate of return on investment in the United States relative to investment abroad, and this may lead to an improvement in our balance-of-payments on capital account, with some investment that would otherwise have been made abroad being made here, and with some investment of foreigners in the United States that would not otherwise have taken place taking place.

Also, if our tax reduction, including the depreciation and investment credit of 1962, results in an acceleration of the rate of investment in plant and equipment, this should give us a more efficient productive capacity, which will reduce our costs, improve the quality of our products, and possibly enable us to compete more effectively in foreign markets, and thus offset some of the adverse effects I suggested on trade account.

Now, I frankly am at least an agnostic on this issue. I am not by any means sure that the tax cut will improve our balance-of-payments position. I would say only that it is possible that the tax cut with tax reform will improve our balance-of-payments position. It does not necessarily follow.

You know, whenever you advocate a given line of policy, it is always well to be able to line it up on the side of the angels. We have a tax cut that is going to do five things, according to the official statements: It is going to help to achieve full employment; it is going to accelerate our rate of growth; it is going to achieve greater equity in our tax system; it is going to improve our balance-of-payments; and it is going to balance the budget. It will balance the budget, of course, by so much accelerating the rate of growth and the level of economic activity that tax receipts will be greater after the tax cut than they would have been in the absence of the tax cut.

Well, one might add that it will also make for more pleasant motherhood and that out of higher income levels we may expect higher levels of giving to the church, and thus we will combat sin, and so on.

QUESTION: I wonder if you would evaluate the efficacy of a national sales tax and what impact this might have on the effect of the reduction of income tax. I understand that most European nations have this tax.

DR. BRAZER: Most of the European nations have sales taxes of one kind or another. Germany has its turnover tax; France has its value added tax; Britain relies heavily on selected excise or purchase taxes; and so on. Canada has its manufacturers' sales tax. We have only the selective excises on a fairly narrowly defined group of products, although the list is quite long.

It seems to me that the objective of the sales tax has to be primarily redistribution of the tax load toward lesser progression. If this is the objective you want to achieve it can be achieved through the adjustment of the income tax without the introduction of a new tax at the Federal level. I see nothing that can be achieved through the sales tax that cannot be achieved through adjustment of the income tax.

If you want to achieve this kind of adjustment in the income tax, that is, in the distribution of tax burdens, or in the degree of progression or regression, it may be more politically feasible to do it through the introduction of a sales tax while reducing income tax rates, rather than through adjustment of the income tax itself.

But this, I think, is something of a subterfuge that I would rather not be a party to.

Another objection that is often raised to the sales tax is, of course, the fact that the States rely very heavily on the sales tax, and there would be very strong and perhaps somewhat justified objection to Federal incursion into the one major area of taxation that is still the sole province of the States.

But there are advantages to the sales tax. For example, if you cannot reach the income of people whose incomes are in the form entirely of, say, municipal bond interest, one way to impose some tax on these people is through a sales tax. There are other, I think, attractive aspects of a sales tax.

I do not think we need the sales tax. I do not think that it would improve our tax structure in a way that cannot be achieved in some other manner. I think that if you look at European experience, particularly in countries like France and Italy, you are likely to find that the imposition of sales taxes is a function not so much of a desire to achieve the kind of objective that would be realized in this country through the introduction of a sales tax, but heavy reliance on indirect taxes is, I think, attributable in large part in other portions of the world to the fact that people in other parts of the world do not take their obligations to pay an income tax as seriously as we do in this country. That is, tax morality is far lower in these other countries than it is in this country.

In Italy, Spain, and Latin America, it is not considered particularly unpatriotic to not declare your income. Frequently what happens in these countries is that income tax is assessed by the tax collector on the basis almost solely of external indicia of affluence. If you have two maids and one chauffeur you pay so much. If you have four maids and two chauffeurs, you pay so much more, and so on.

QUESTION: Doctor, would you comment on reducing corporation taxes as a means of stimulating growth, and will you relate your answer to the report that industries today have large amounts of excess cash on hand?

DR. BRAZER: Reducing the corporate income tax should provide a stimulus to growth through stimulating investment primarily in two ways. One is the way in which the statement of your question suggests, through increasing the flow of cash available for investment. Now, it is true that, if you look at corporations in the aggregate, you will find that the rate of increase in cash flow, or funds available for investment, has exceeded in this period of recovery since 1961 the rate of growth in new investment. But I think that the aggregate data hide a great deal of the truth.

If you looked at the "Wall Street Journal" early this week or late last week, for example, you would find that the steel industry plans to spend greatly increased sums in renovation and introduction or expansion of plant. Here is an industry which, according to my discussions with industry executives, tends to spend whatever is available, under reasonably good circumstances, internally, from internal sources, for new plant and equipment and for renovating old plant.

Other industries are in different circumstances. It seems to me that the availability of internally generated cash is, at least in a large part of the economy, an important constraint on the level of investment in plant and equipment, and that a cut in the corporate tax rate will on balance, of course, add to this cash flow and will in substantial measure produce a higher level of investment.

The other side of the coin is the rate-of-return aspect of investment. A cut in the corporate tax rate means that the net rate of return after taxes, associated with any given project, is necessarily increased. If on the one side as a constraint you have the availability of funds, on the other side you have the carrot of rate of return as an incentive to investment on the part of corporations. This must necessarily be improved as a consequence of a corporate tax rate reduction.

I think that in the short run the cut in personal taxation will be a far more important factor. What we must look to in this tax program is not aimed purely at the short run. We must look not merely to recovery to full employment, at which time, of course, existing plant capacity will be much more fully utilized and the incentives to invest will be much greater, but we must look to and shape our tax structure to the situation that will confront us under conditions of full or fuller employment when the level of investment will in larger part at least govern our rate of growth.

COLONEL TILLMAN: Gentlemen, I want to announce that later on this morning Dr. Brazer will visit sections B, D, E, and J. It is suggested that if any others of you have questions you come into the faculty lounge in the intervening period between now and 10:30 and talk to Dr. Brazer.

Dr. Brazer, on behalf of both the faculty and the students, thank you very much for a very informative presentation.

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