

PROBLEMS OF FEDERAL TAX POLICY

12 November 1964

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NOTICE

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COLONEL TILLMAN: General Schomburg, Gentlemen: This morning we consider the "Problems of Federal Tax Policy." It is a subject of great interest to us not only as students in this unit on Economic Policies for National Strength, but also as individual taxpayers.

We are fortunate to have as our speaker this morning a man who was Director of the Treasury's Office of Tax Analysis until he returned to teaching just a little over a year ago.

It is a pleasure to welcome Dr. Harvey Brazer back to the College and to present him to the Class of 1965. Dr. Brazer.

DR. BRAZER: I am pleased to be here for a second time, partly because I assume that the people who are responsible for the program in the College make every effort to avoid making the same mistake twice. So, I am both pleased and flattered because I have been asked to return to talk to you again this year.

Talking to you this year involves the discussion of tax policy under somewhat different circumstances than those that obtained a year ago. Among other things, a year ago I was somewhat pessimistic about the prospects of the Revenue Act of 1964. I was pessimistic not only with regard to the prospects for passage of the bill, but also pessimistic because of the fact that while we were not sure that the bill would pass in acceptable form, the White House had made very strong commitments for curtailing expenditures. And if we had had a curtailment in Federal expenditure such as was actually proposed in the January 1964 budget, and if there had been coupled with that the kind of delay in enactment of the bill which many of us believed would occur, then the net impact of this kind of fiscal policy on the economy could have been seriously deleterious or seriously depressing.

The Congress acted much sooner than many of us had expected and passed a bill which at 1965 levels of income will have reduced federal tax receipts by an estimated \$13.5 billion, a level of tax cut which most economists applauded very enthusiastically. In any case too, there had been in the economy, particularly in the latter half of 1962 and in parts of 1963, suggestions of hesitation, at least, in the advance of the recovery and progress toward full employment, if not suggestions of imminent recession.

In the fall of 1964 the tax bill is history and the record of the economy as we review it over the period of the last 44 months is a very encouraging one, although there is still, I think, a good deal that needs to be done. Let me review just briefly where we have come in this period of 40-odd months. Looking first at total employment as a measure of economic advance or progress, we find that in 1961 average total employment was 67 million. In October of 1964 the figure is 71 million. And the figure for 1964 as a whole will average close to that. So, we have been adding approximately a million jobs a year; quite a remarkable performance, I think, but perhaps a performance upon which we are going to have to improve in light of the fact that in the remainder of the decade of the 1960's, the labor force--those seeking jobs--will expand at a substantially more rapid rate than has been true in the course of the last decade.

In any event, adding a million jobs a year meant that with only about 3/4 of a million people entering the labor force each year we have in this past 4 years managed to cut unemployment down from a peak of over 7 percent and an average for 1961 of 6.7 percent to just over 5 percent. We actually hit a level just under 5 percent--barely under 4.9 percent in late summer, something we have not been able to do for some 5 years. So that, in terms of employment again, and in terms of reduction in unemployment, we have made substantial progress. If you look at industrial production, again the record is a very bright one and a very encouraging one. We have moved from an index of industrial production in which the base period is 1957 to 1959, from a level of under 110--109.7 to a current level of about 134, an increase in industrial production proceeding at an average rate of some 5 percent per year, which is among the most impressive records ever achieved in the economy.

If you look at another measure of economic progress you find that in examining gross national product we hit a recession low in early 1961, of GNP at an annual rate for the first quarter of 1961, of

just over \$500 billion; a level for 1961 as a whole of \$518 billion, as compared to third quarter 1964 annual rate of \$627 billion, an increase of well over \$100 billion in less than 4 years. And the likelihood is that the figure for 1964 as a whole will approximate \$625 billion. If I were to offer a guess as to the level for 1965 it would be in the \$650 to \$670 billion range.

Finally, we are also concerned, for purposes of economic policy, with the maintenance of price stability. Here we find that almost all our gains in dollar value of output have been real gains, not merely illusory gains that are represented in dollar terms which do not mean very much because of inflation. Rather, we find that, for example, the Consumer Price Index, at just over 104 on the 1957-1959 base in 1961, is now at about 108.5. This is a very remarkable record of price stability. I would say that the increase in the Consumer Price Index of about four points in 4 years represents essentially no price increase at all. The reason I say this is because the Consumer Price Index does not adequately reflect over a period such as this improvements in the quality of things we buy.

There is some presumption, for example, that the \$3,000 automobile purchased in 1964 is a somewhat better product than the \$3,000 automobile purchased in 1961. You may dispute this, but I am saying there is some presumption that this is the case. The same would be true for television sets and a variety of other things.

If you look at a more basic index, the Wholesale Price Index, which does not reflect, of course, the influence of the price of various services, you find that this has not moved at all. It was 100.3 as an average for 1961, and in October 1964 it is still 100.3. So that the record certainly, over the last 4 years, looks good. Gross national product has been growing at a rate of about 4.5 percent a year. Industrial production has been growing at a rate of about 5 percent a year. We have been adding a million jobs a year. Unemployment is down substantially from levels of 1961. Prices have been highly stable.

One might then conclude that all is for the best in the best of all possible worlds. But I can hardly do that and fulfill my function here this morning, nor can I do that and present to you honestly my views as to the nature of the need for rational tax policy in the period immediately before us. First of all, we need to recognize that while a growth rate of 4.5 percent is very impressive we are

measuring that growth from a recession low and the important question we have to ask ourselves is, once we have attained the level of economic activity and comparatively low level of unemployment that has now been achieved, can we continue to sustain the growth rate as high as 4 to 4.5 percent?

Secondly, while we have made substantial advances over the last 4 years, the fact is that we still have more than 3.5 million people in our labor force who want to work, are able to work, but are unable to find jobs. As a statistic measured against a labor force of about 74 million people it is a small number; it is 5.2 percent. But in terms of human beings it is an intolerably high number. And while a gross national product of \$627 billion annual rate in the third quarter of 1964 is impressive, in order to reduce unemployment to the Administration's interim target of 4 percent, we would have had to be producing a gross national product not of \$627 billion, but of approximately \$650 billion.

In other words, the 4 percent employment gap, or to use an unfortunate shorthand term, the full employment gap is now, according to best estimates, somewhere in the neighborhood of \$20 billion. In the course of the last year it has been reduced by some \$10 billion; from a level of over \$30 billion to about \$20 billion. This is progress, but what I am suggesting is that there is still a substantial distance to go, even to reach that interim target of 4 percent unemployment, a target which I think no reasonable individual would regard as a satisfactory target. There is no reason to believe that we must operate this economy with a level of unemployment as high as 4 million in good years.

If we are to reach more satisfactory levels of 2.5 or 3 percent we have even further to go yet. And our experience certainly suggests it is possible to reduce unemployment to as low as 2.5 or 3 percent without substantial inflation. But, clearly, this would take an even larger increase in GNP above the level that we have in fact attained, and are likely to attain in the absence of overt policy designed to reduce this output gap.

The other thing that concerns me immediately in viewing the demands on tax policy is the fact that over the next decade we are going to have to find jobs for more than the 3/4 of a million or so new entrants in the labor force that we have had over the last few years. One statistic that makes a very important impression on me

is the simple fact that in the fall of 1964 there are 1 million more 17-year olds than 18-year olds. This comes to me partly in my concern for what must happen in higher education, but it also obviously has important implications for the size of the labor force and the number of young people who will be seeking jobs in the next 1, 2, 3, 4, and 5 years.

So, we have to look forward to a situation where, if we are going to maintain unemployment at tolerable levels we must find jobs for between 1.1 and 1.4 new entrants to the labor force each year, and in addition we must also find jobs for some 1.5 to 2 million people who each year lose their jobs as a consequence of changing technology and rapidly increasing productivity in various sectors of the economy. Some people use the term "automation" for the two or three phrases I have just uttered. I do not like the term because it implies something different rather than a continuation of what has been going on at least since the beginning of what we call the "Industrial Revolution," and, I suspect, before that.

I suspect that it may have made just as much difference when people changed from plowing with a stick to plowing with a sharp stick, as some of the technological changes that are going on at the present time.

Well, tax policy, I think, has played a large role in producing the encouraging record of the last 2 or 3 years. Tax policy, has, I think, a large role to play in sustaining our momentum, and, in fact, advancing our progress beyond levels achieved to date.

Let me just review briefly what tax policy has contributed in the course of the last 2 to 3 years. The first efforts of the Administration to bring tax policy to bear on the problem of expanding the rate of growth in the economy came under the 1962 Revenue Act, which included the very important, for our purposes, investment tax credit. The investment tax credit provision of the 1962 Revenue Act is designed to increase the level of investment on the part of business, in machinery and equipment, above that level which would be attained in its absence. What it does is provide for a credit against income tax otherwise payable in the amount of 7 percent of the sum invested in machinery and equipment.

This has the effect of increasing substantially the profitability of new investment. It also has the effect of reducing the need for

funds with which to finance new investment, and on both scores should be expected to accelerate the level of business investment in plant and equipment. Actually, we find that there had been, prior to 1963, a substantial lag in investment on the part of business, in plant and equipment. We did not reattain the level of business investment in plant and equipment achieved in 1957 until 1963. Now we find that business investment in plant and equipment is, while not approaching boom proportions, advancing rapidly, and in the eyes of most people, very satisfactorily; from a level of about \$39 billion in 1963 to almost \$45 billion in 1964, and projected to increase some 8 to 12 percent above that in 1965.

In the effort to encourage or stimulate investment--which most observers view as being important to growth in the economy--in addition to the tax credit, we had, in 1962 through administrative action of the Treasury, depreciation reform--a reform which provides business with much more latitude in the rate at which it writes off business machinery and equipment, thus providing for a shorter payout period, providing for higher profitability, and also providing some of the funds needed for the financing of investment.

These two measures taken together, the investment tax credit and the depreciation reform, amount to more than \$2.5 billion a year in tax savings to business. Together, with respect to those kinds of business machinery and equipment, which means almost everything, eligible for the new more liberal depreciation and the investment credit, this means an increase in average expected profitability of some 30 percent, as well as providing the \$2.5 billion in additional funds available to business.

The 1964 Revenue Act originated in President Kennedy's tax message of January 1963 as a tax reduction-tax reform measure. As the bill came out of Congress in late winter of 1964 it was primarily a tax reduction bill and the reform is confined, in the most important respect, to reform in tax rates. The achievement here, I think, is a remarkable one in that the total reduction when the bill's measures are in full effect at 1965 levels of income, amount to \$13.5 billion, something in the neighborhood of \$3 billion of which accrues to corporations, the remainder to individuals--a remarkable achievement also, in that tax rates which had for many years been in the range of 20 to 91 percent, for 1965 will be in the range of 14 to 70 percent.

While 70 percent still sounds like a very high figure for the top brackets, it should be kept in mind that with respect to marginal dollars of income in those top brackets a 90 percent rate is now being switched to a 70 percent rate, which means that 30 cents instead of 10 cents is kept by the individual. So, in these terms it is an extremely large reduction in the sense that it triples the after-tax income available. It is not easy to triple the after-tax income available at the lower levels because taxes relative to income, of course, are far lower. But even here in the first bracket the reduction is 30 percent which clearly is substantial and is likely to have, and is having, appreciable effects on demand for goods and services in the economy.

If we now look at budget prospects, what we find is that despite the very substantial tax reductions that have taken place in the course of the last 2.5 years the budget of the United States is approaching closer to balance than it has in a long time. We had no appreciable tax cuts between 1954 and 1959, but as a consequence of repeated recessions we had in 1959 a budget deficit of some \$12.4 billion. The prospect for fiscal 1965, according to current estimates, is that expenditures will amount to the astronomical level of \$97.2 billion, approximately equal in current dollar terms to our gross national product in the 1929 prosperity year. And revenues will amount to \$91.5 billion, so that the budget deficit will come to something just under \$6 billion for fiscal 1965.

If the budget for fiscal 1966 is kept in line with the announced policies of President Johnson I should expect that expenditures projections for 1966 will run between \$97 and \$98 billion. Tax receipts for 1966, assuming a continuing upward movement in the economy, will run to approximately \$96 billion, and what we will have by 1966 is something within a couple of billion of a balanced administrative budget. But in terms of the cash budget, taking into account trust fund accounts, et cetera--old age and survivors' insurance trust funds, highway trust funds, et cetera--if my projections for the administrative budget are correct, we will, in fact, be realizing a cash budget surplus. In other words, by fiscal 1966 I expect that the budget of the Federal Government will be providing not a stimulus to the economy, but will be imposing some drag on the economy.

If Federal expenditures after this rise at a rate of, say, \$1 billion to \$3 billion a year, as a consequence, perhaps, of a continuing decline in defense expenditures accompanied by a modest increase

in expenditures for domestic purposes, then what we find is that we face the problem of the reemergence of a serious fiscal drag on the economy which will not have been corrected by the tax actions taken so far. If you suppose that we reach approximate balance by 1966, and this allows for an excise tax cut next year of something in the neighborhood of \$1.5 to \$2 billion, then what you face is a situation in which our economy, if it continues to expand at a rate of approximately 4 to 5 percent per year, with our existing tax structure will produce some \$6 billion in additional revenue each year. This means, then, a rising budget surplus which will be added to at the rate of \$3 to \$5 billion a year.

It would take an economy that was operating at full blast in the private sector to overcome this fiscal drag of the budget and still maintain adequate levels of growth, output, and employment. So that it seems to me that there is still a great deal that needs to be done in tax policy if we are to sustain a high rate of growth, if we are to achieve and maintain full employment with price stability, and avoid serious recessions.

The prospects are that the action taken in the 1965 session of the Congress will be restricted to excise tax reduction. If you looked at this morning's "Washington Post" you got another bit of information on this. President Johnson has been committed to excise tax reduction for some months. The Treasury has promised an excise tax reduction for some years. And I am sure Secretary Dillon does not relish going before the Ways and Means Committee sometime this spring and urging that the temporary Korean excise taxes be extended for, I think, now, the twelfth year in a row. Clearly, some action here is required. Action here is required, I think, not only because the budget may be approaching balance too soon in terms of the economy's ability to sustain its momentum, but also because the excise tax structure is badly in need of reform as a consequence of the fact that most of it constitutes a set of relics from past emergencies, misguided insofar as the emergencies arose during the depression; perhaps not insofar as they arose in World Wars I and II.

I should go further back than that. If you trace the legislative history of our excise tax structure you find that the bulk of it is a product of measures taken to meet emergency war demands which go back at least to the Civil War, if not the War of 1812. For example, the retail excise taxes were discussed in this morning's

newspaper. They yield \$500 million a year currently. They were introduced in the middle of World War II. Why? In order to divert resources from the consumption of such nonessential items in a period of war as jewelry, furs, cosmetics, luggage, handbags, etc., to divert resources from the production of these nonessentials to the production of more important things like guns, ships, tanks, et cetera.

Why do we have them now, when we are desperate to encourage expansion of output in all areas? Why do we have now, when we have no reason to discourage consumption of these items relative to others, the continuation of these excise taxes? It is true that during the war the rate was 20 percent; now it is 10 percent. But what justification is there for selecting these particular items for especially heavy taxation? The justification certainly cannot be found in terms of the original purpose for which these taxes were imposed. Some would justify them on the grounds that these are luxuries, but the only good definition I have ever heard of a luxury is that a luxury is something which poor people should do without but won't. Certainly a tube of lip rouge or bathpowder is not regarded by most women as a luxury. A handbag is not regarded by most women as a luxury.

If you look further at the excise tax structure you find that in an economy heavily dependent upon production and employment in the auto industry we impose a tax of 10 percent on the manufacturer's price of automobiles. We imposed that tax first in 1932 as a desperation emergency depression measure. We increased the tax in World War II in order to discourage production of automobiles and divert resources to tanks, planes, et cetera. We raised the tax from 7 to 10 percent in the Korean war for the same reason.

What sense does this tax make in those terms in 1964? It is difficult to rationalize. We have taxes on electric light bulbs. Well, why tax electric light bulbs particularly? If what you are after is taxing consumption items and items that go into business production costs generally, then the sales tax at a uniform rate might well make some sense. But these selective excises make little or no sense. What have we got? I would argue that if they make sense they make sense only in terms of a sumptuary motive. And here the \$6 billion levied through taxes on liquor and tobacco are probably sacrosanct. You are not going to get a Congress to reduce the tax on cigarettes in the face of the recent reports by the Surgeon General, the medical profession, et cetera.

Congress, when faced with alternatives is not going to lose much revenue reducing the \$10.50 per proof gallon tax on alcoholic beverages. It is not good for you to drink; it is not good for you to smoke; and so Congress helps you along by imposing high taxes on these items of consumption, the view being that high taxes discourage consumption. Of course, if they discouraged consumption effectively they would not yield \$6 billion. The fact that they do yield \$6 billion suggests the sumptuary motive is just so much nonsense. What, in fact happens, is that the guy who wants to drink, drinks. The kids may not have so much milk and their shoes may not be replaced as often as they should, but he drinks. And certainly, speaking not so much as a drinker but as a smoker, I might well find my kids doing with less milk before I cut my cigarette consumption down, despite my best efforts and intentions.

I do not believe that the sumptuary motives here are important. But they do make a lot of sense politically. The highway excise taxes too are sacrosanct. They are earmarked and the whole highway Federal aid program depends on them. So, what we are left with is about \$4.5 billion in excise taxes which make very little sense. We tax television sets. Now, I could argue, I think, even more effectively with respect to the sumptuary motive regarding television than I could with cigarettes or the modest intake of scotch. But, most people would not take that very seriously either.

What sumptuary motive is there involved in taxing telephone service at 10 percent? Again, some people might argue that there is something to be done, but your teenaged daughters are not going to be discouraged by this tax from using the telephone. At any rate, at the local level the tax does not vary much with usage.

We have a large number--some 75--of excise taxes imposed in a highly discriminatory fashion in a manner that makes little or no sense. The difficulties involved in any program that will be forthcoming early in 1965 involve the question of how much revenue can be lost. And if the Administration feels that a \$4 billion tax cut which would wipe out these excises other than sumptuary and highway excises would be too large, then you really face a tough problem in knowing how to select among them. Because, any time you make selections you are going to make a lot of people angry. And that is a tough thing to do. Besides, it is difficult to make selections on any rational basis, politics aside. And so, the program will be a tough one to justify; that is, to rationalize, if it amounts to less than \$4 billion.

My guess is that in the interests of being able to present something that comes as close as possible to a balanced budget, the President will recommend reduction in excises in the neighborhood of about \$1.5 billion. My further guess is that Congress, subject to pressures, in its wisdom will enact an excise tax bill which will cost closer to \$4 billion. The excises that will not be cut will persist if the Congress somehow can find some fall guys with poor lobbyists operating in their behalf. But then the Administration will be able to lay the blame for a larger deficit than it prefers on the Congress, not on itself. And this may give the Administration the excise tax cut it really wants without the Administration having to bear the onus for a larger deficit than it feels is politically proper.

But even once this excise tax cut is done--I think there is a very good prospect that it will be done in this coming session of the Congress--then we still face two problems. There is still that fiscal drag I talked of, and this, I think, will require periodic reductions in income tax rates. I can readily foresee a situation in which, if things go well, particularly in the budget--and this means, I suppose, if things go well on the international scene--I can readily envisage within the course of the next 10 years a personal income tax rate structure with rates ranging, say, from 10 to 40 percent.

In any case, I think this will be needed and I think a close look at this kind of prospect is being taken. I cannot help, then, coming back to the need for tax reform. Some of us never quit despite the beatings that we have taken. I came to Washington in 1961 solely because I was convinced that there was an opportunity to put at least a substantial part of the tax reform I had been preaching for years into action. Well, we put it into action in part, insofar as the President's tax message was concerned, but the Congress threw it out.

Under conditions of substantially less than full employment, tax reform can be placed in a very secondary position. Because, when you talk about reform in the area of taxation of mineral resources--oil, for example--you argue that the problem here is that inefficiencies are created as a consequence of the special depletion allowances permitted the oil industry. This tends to result in overinvestment, misallocation of resources in oil relative to other industries. But then, when you present this program and the Congressman from Texas says, "What do you mean overinvestment in oil? Hell, we have hundreds of well-trained drilling technicians

who are unemployed because we are not drilling enough wells, and there is no place for these fellows to go where their skills can be used." That is a hard argument to beat in times of substantially less than full employment.

If we are to maximize our rate of growth, then what we must be able to do is avoid the distortion of investment decisions; avoid situations that arise now in which the investment choice often is directed to a project, the pretax rate of return on which is much lower than the pretax rate of return that could be obtained somewhere else but because of special tax treatment the posttax rate of return, which the investor is interested in, is higher in the first instance than in the second.

From the point of view of the economy as a whole, clearly this is wasteful. And as we approach full employment such waste becomes increasingly intolerable.

Similarly, with respect to individuals, we must look to tax reform that will avoid distortion of choices that tend to bring about a lower level of welfare or satisfaction than otherwise obtains. One must re-ask the question, "Are certain deductions under the income tax justifiable?" When I look at one kind of disposition of my income and I see that when I spend a dollar there the Federal Government takes 10, 15, 30, or 40 percent of that cost by allowing me to deduct that dollar, but if I spend a dollar somewhere else I cannot deduct it, clearly this involves a distortion of choice, a distortion of choice that is sometimes justified on the ground that distortion is good in the sense that it helps to achieve certain community goals. But this, I hold, is highly questionable.

I have regard to the deductibility of State and local taxes, deductibility of charitable contributions, and deductibility of several other such items.

In other words, what I look to is reform of the income tax base, reform that will provide for uniform treatment of income irrespective of the manner in which individuals dispose of that income; uniform treatment of income irrespective of the form in which it is received; irrespective of the source be it oil, be it iron ore, be it wages, be it deferred income versus current income, et cetera. All of this, of course, is a very tall order; it will take a very great effort; and it won't be achieved overnight.

All of it, I think, becomes increasingly important as we come closer to the achievement of the goal of full employment and a high growth rate. I am not optimistic. I am more optimistic about the prospect of tax cuts than I am about tax reform. But keep in mind that what is crucial for economic growth, for effort, for incentive, are marginal tax rates. And broadening the tax base by cutting out exclusions, by cutting out deductions, or at least limiting them, by broadening the tax net to take into account income in a more inclusive and uniform fashion, brings the advantage that it permits lower marginal tax rates.

If we had a truly broad tax base of the kind I should like to define it would be possible to raise the same \$48 billion or so of revenue under the personal income tax with rates ranging not from 14 to 70 percent, but with rates ranging from somewhere like 12 percent or so to 40 percent.

One final word, and that is that I would also wish to provide for substantial reform in the area of business taxation. A corporate income tax which in effect says, "The more efficient you are, the more able you are to earn profits, the higher the tax penalty we impose upon you," makes little sense to me. A value added tax or some other such more neutral form of tax, insofar as you think it is necessary, and I think it is, to have business share in some degree in the financing of Government costs, would be far preferable. But the difficulty involved in all of this is that these various areas of reform mesh into each other. There is no point cutting depletion allowances if you do not do something about capital gains. There is no point worrying about exemption of municipal bond interest if you do not do something about capital gains, and vice versa, because tax avoidance is much like a balloon. When you press it in one area it bulges out in another.

Thank you very much.

QUESTION: Professor, a very arid area for need for tax relief is the area of college education. In other words, I would like to be able to deduct college expenses from my gross income. I notice it has been considered, but what are the arguments against it?

DR. BRAZER: The arguments against it, I think, are several. For one thing, we increasingly recognize higher education as a necessity rather than a luxury to be available only to the sons and

daughters of the well-to-do, or only to the dedicated few who will work their way through college, we are increasingly recognizing that whether they learn anything or not, young people should spend 4 years in college and therefore that this is a necessity. But there are a good many other necessities of life; the food I put on my table every day is also a basic necessity. The clothing I wear is necessary. A lot of other things in life are necessities with at least as strong a claim for special treatment as college expenses. This is one aspect of it.

I talked earlier about the tax system distorting people's choices with respect to disposition of income. Deductibility of college expenses would constitute precisely that kind of distortion.

A further objection is that Federal aid to education--and this is what it would be--through the income tax, if it were to come in the form of a deduction from income like your State and local taxes or your charitable contributions, would be worth more the less you needed it. In other words, for a family with eight kids and an income of \$6,000 a year, deductibility of college expenses would not be worth a nickel because there is no income tax liability. For the family with three kids, and an income of \$6,000 or \$7,000, deducting \$1,000 would provide toward financing that education the magnificent sum of \$140. For the same family with \$150,000 income, deducting the \$1,000 would be worth, at 1965 tax rates, \$700.

So that, there is an inverse relationship between need and assistance through deductibility. Answering this objection some Congressmen have suggested that there ought to be a credit against tax liability computed, say, at the first bracket rate. You would deduct from your tax liability, say, \$140 for every \$1,000 spent. Here, again, it would do no good for the low income family. It would provide only a token amount of assistance, and the amount of aid would vary directly with the actual expenditures incurred which would be very little for the kid who goes to a "streetcar college" as we used to call it, an urban college, who lives at home, relative to the kid who goes to Yale.

Beyond that, even if you can get around that objection, I would agree that if it were to cost, say, \$1 billion--and anything less than that is probably not worth bothering with--if it were to cost \$1 billion, well, I say it is not worth bothering about because we have an enrollment in higher education now of over 4.5 million kids, and

this will be 8 million before we are much older. And so, anything less than a billion, again, is not really very much. I would think that if we are to use such sums for purposes of facilitating the achievement of higher education, there probably is a more efficient and more effective way to achieve that objective than through tax credit or tax deduction. We do subsidize higher education very substantially. Our people in Michigan, in-State residents, pay \$300 per year for tuition for a college education that costs us close to \$2,000 a year per student. And what I see this \$1,700 subsidy subsidizing in very large part is not an education, but an automobile. And I do not want to see the Federal Government playing that game. And it would be playing that game in substantial degree were we to provide for aid to higher education through the income tax.

One final point relates to the first point I made. You allow deduction or credit to higher education and there is no end of things that Congressmen can think about for which there ought to be a special deduction or a credit. One of the favorite means of increasing employment that has been proposed by a group of Congressmen is a deduction under the income tax for wages paid to domestic help; gardeners, chauffers, maids, et cetera. Why? Because this will encourage the employment of people who are relatively unskilled. But it has a good many other kinds of repercussions, most of which would be regarded as undesirable.

If you think of doing anything through the income tax by way of subsidization, think of it in these terms. It costs, say, a billion dollars. It produces a distribution of assistance that looks like so. Could you, in full conscience, offer a bill that would provide for an appropriation that would distribute the money in that way? Because, in fact what you are doing is appropriating Federal funds otherwise available. If your income tax scheme is justifiable in terms of what you think would make sense through an appropriation of funds, then, and then only, I think, would I regard it as a good scheme. But I find it difficult to believe that an income tax deduction or credit scheme would fit that category.

It is an appealing notion, and my fear is that it is so appealing that it may pass. And the other fear I have is that if it does ever pass, it will represent a very serious blow against prospects for Federal aid to higher education. Because, it will then provide the excuse for not doing it.

What I have given you is the essence of the dozens of memoranda I wrote or reviewed in 2 years.

QUESTION: I wonder if you could explain the rationale of applying the 1965 withholding rate to your 1964 income which creates a problem for the people at the time that they have to pay their taxes when they find their withholding is \$300 or more short of what they expected?

DR. BRAZER: There are very few people for whom withholding will be short as much as \$300; that is, \$300 more than it would have been in the absence of the tax cut. There are some. Let us keep some facts in mind.

First of all, in a normal year, of 60 million people who file tax returns, 35 million people get tax refunds which amount in the aggregate to \$5 billion. And that is just the way the Internal Revenue Service likes it. The reason the Internal Revenue Service likes it this way is that it is a heck of a lot easier to overwithhold in little bits at a time and then make people happy by sending them a refund check which is very easy to process with high-speed machinery, than to go out trying to dun a lot of little people for \$8, \$20, \$50, et cetera. So that, we had, under the 18 percent rate a great deal of overwithholding.

Most people are not bothered by this. The tax rate reduction for 1964 was $2/3$ of the total reduction. So, if the act had become effective January 1, 1964, which is when the rate reductions take effect, we should have reduced the withholding from the 18 percent rate down to $2/3$ of the difference between 18 and 14 percent. We should have reduced the rate to about $15-2/3$ to keep the bottom rate in line with the withholding rate that has prevailed.

The fact is that the law was not passed until February and the new withholding rates did not go into effect until March. If the new withholding rates had not gone into effect until sometime around the end of April, then the 14 percent rate prevailing from May through December where the 18 percent rate had prevailed from January through April, would just about have done the job. Well, why did we go from 18 to 14 percent instead of 18 to 15 percent and then 14 percent? For two reasons. One, going to 14 provided the biggest, quickest, possible impact on take-home pay and presumably spending, and we needed it.

The other reason was that both the Internal Revenue Service, and particularly employers, find it costly and inconvenient to be making changes in the withholding rate. And so, it was felt that it just was not worthwhile taking the jump in two steps, for that reason. Because, this would have meant a change in March and then a change in January 1965.

I think that there has been some exaggeration of the extent to which there will, in fact, have been underwithholding. My own preference is always for underwithholding, because anytime anybody wants to give me an interest-free loan I will take it. But if you object, then the way is always open to you to reduce the number of exemptions that you claim, in which case you are either denying yourself that interest-free loan, or you are giving an interest-free loan to the Government. I do not like overwithholding for the latter reason. I am perfectly willing to pay the Government \$8, \$12, \$50, or \$300, in April.

Unfortunately, I have been in so good a position that I have had to pay a lot more.

QUESTION: (INAUDIBLE)

DR. BRAZER: There are not many knowledgeable tax people in the Bureau of the Budget. I presume you mean the Treasury Department. There are some very knowledgeable and very able people in the Bureau of the Budget, but the Treasury is jealous of its prerogatives in the field of tax policy. You know, this depends upon whether you mean how much they share this view privately, or how much they share it publicly. I think that it is safe to state that at all levels, at least in terms of what they believe to be rational tax policy, privately, the view I expressed is shared more or less unanimously from the very top on down.

Among academic economists in the budget, finance, or tax field, again, I would say that it is shared by the vast majority. If not; if the view is not unanimous, at least there is what one might call a very large qualified majority; say 80 or 90 percent or something like that. In tax policy the difficulty is not so much in getting agreement among "experts," as to what should be done except in a few areas, the difficulty is getting agreement on how it should be done, when it should be done, and getting agreement on priorities.

Let me add just one more word. There is complete unanimity, I would say, in the view that the present tax structure leaves a lot to be desired.

QUESTION: Dr. Brazer, a former Commissioner of Internal Revenue has recommended abolition of the income tax. Can you explain the rationale for this?

DR. BRAZER: My personal view is that he was a poor choice for Commissioner. I cannot really elaborate on that answer other than to say that this is a common view held by people who ordinarily are closely associated with the far right. I think it involves in large part the question of the role that ought to be played by the Federal tax structure in the distribution of income. And there is, as you know, a movement of which the gentleman of whom you speak is a member that favors either the abolition of the personal income tax or a constitutional amendment limiting the top rate to 25 percent.

Fortunately, these people are in a very small minority. Commissioners of Internal Revenue are not necessarily experts in tax policy. They may be experts in administration. They may be experts in the law of taxation, as in the case of Commissioner Caplan; they are not necessarily experts in the economics or philosophy of taxation. They are not necessarily keen and astute observers of the social scene, shall we say, and in some cases they are even none of the first three things I mentioned, but happen to be convenient political choices.

(20 May 1965--6, 500)H/ ca: en:ekh