The original documents are located in Box C9, folder "Presidential Handwriting, 1/3/1975 (1)" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.

 1/3/75

THE PRESIDENT HAS SEEN...

THE WHITE HOUSE

WASHINGTON

December 24, 1974

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN

SUBJECT: ECONOMIC POLICY REVIEW

Attached are two background documents for your Economic Review with the EPB Executive Committee on Saturday, December 28, 1974. The first, Economic Policy Review and Initiatives, is a summary of the economic review held by the Executive Committee immediately prior to our meeting with you last Saturday afternoon. The second, Tax Proposals and Options, is a revised and more detailed version of the options paper discussed at last Saturday's meeting.

Troika-2 and Troika-3 are currently evaluating the economic impacts of the tax proposals under consideration. Their analysis should be completed prior to the Saturday, December 28 meeting.

Milt Friedman has been supplied copies of these documents.

Attachments

December 24, 1974

ECONOMIC POLICY REVIEW AND INITIATIVES

I. Goals and Principles

This paper summarizes the Economic Policy Board's review of the economic outlook and policy conducted December 19-21. Difficult decisions are now required to achieve short term goals: (1) reduction of unacceptable double-digit inflation to around seven percent by mid-1975 and four to five percent as an intermediate-term goal; (2) resumption of real output growth to improve standards of living and to create job opportunities adequate first to stabilize unemployment and then gradually to reduce it. In addition, economic policy must be consistent with our long term goals discussed below.

II. Economic Outlook

The economy has deteriorated more rapidly than expected. Unemployment has jumped from 5.4 percent in August to 6.5 percent in November and indicators point to further sharp increases to perhaps the eight percent level in 1975. The layoff rate is expected to peak in the next month or two but unemployment will continue to rise for many months. While the automobile and housing sectors have led the decline, the drop in economic activity is now pervasive. Real output fell sharply in the quarter just closing and will decline again in the first quarter (for the fifth consecutive quarter). The outlook is for continued sluggishness well into 1975; the consensus forecast is that an economic recovery will not get underway until at least the third quarter. Furthermore, even if the recovery turns out to be vigorous and durable, a large amount of economic slack will exist for several years.

The current situation has created even more concern than recessions usually do--considerably more. For one thing, this recession is likely to be the most severe since at least 1958, and probably the worst since the 1930's. At the same time, there are qualitative differences in the current situation that make it especially worrisome. One such difference is the continued rapid inflation. A second is the shock of huge food and fuel price increases. A third is anxiety about the quality of credit throughout our economy, created by the precarious financial condition of the electric utilities and a number of large industrial and financial firms. A fourth qualitative difference, to which the others have contributed, is the decline in consumer and business confidence in the economic system. For all these reasons, there are widespread expectations among the American people that we are having not just a recession but a depression.

Thus economic policy must deal with all our problems simultaneously: energy, inflation, recession and the decline in confidence. The economic review held by the Economic Policy Board indicates that temporary stimulus is now required. Our challenge is to do this in a way that will not trigger renewed inflationary pressures in the years ahead and that will help rather than hinder the restoration of consumer confidence.

III. Current Policy Framework

A. Budget Outlook -- Budget outlays in FY 1975 are now expected to be well above the recent public estimate of $302.2 billion and could be as high as $311.0 billion. The combination of rising expenditures and reduced revenues caused by sluggish economic activity and changes in corporate accounting practices will result in a FY 1975 deficit of more than $20 billion.

The outlook for FY 1976 includes the expectation of rising budget outlays and an even larger deficit, $40 billion or even higher, as government programs respond to the recession and tax revenues fall below original estimates. This pattern of outlays and deficits raises several crucial policy issues:

1. The upward momentum of the Federal budget is seriously restricting future fiscal flexibility and current economic planning. The Federal budget first exceeded $100 billion in FY 1963; it went over $200 billion in FY 1971; outlays will be well over $300 billion this year and FY 1976 commitments will approach $350 billion; the FY 1977 total could be $400 billion.

2. The unified budget deficits are only part of the Federal Government's impact on the general economy and capital markets. From FY 1965 through FY 1974 unified budget deficits totaled $103 billion. New borrowings for "off-budget" programs totaled $142 billion. The combined Federal claims of one quarter of a trillion dollars in a single decade have created serious distortions in the capital markets, especially in housing. The anticipated deficit for FY 1976 and the "off-budget" net borrowing needs raise serious questions about the availability and cost of capital needed for housing and business investment to support economic recovery.

3. The outlook for the $4.6 billion package of specific budget recisions and deferrals is not bright. Nevertheless, serious consideration must be given to blunting the momentum of expenditure growth, because of the overwhelming size of the anticipated deficits. The adverse impact of such deficits on capital markets and on the general level of confidence should not be ignored. The recommended tax reductions would significantly increase prospective budget deficits, suggesting that renewed efforts to determine whether realistic ways of substantially reducing expenditures can be found.

4. Finally, current budget decisions will determine the long-term pattern of government spending and ultimately the very nature of our economic system. When Federal spending (other than the automatic stabilizers such as unemployment insurance) is used for short term economic stabilization, such spending programs tend to become permanent, distorting budget priorities. The importance of controlling the upward thrust of Federal budget outlays cannot be overemphasized.

B. Unemployment Programs -- In his October 8 speech to the Congress the President emphasized the Administration's support for expanded unemployment compensation coverage and creation of a public service employment program. Legislation is now in place. The total outlays expected in calendar 1975 are uncertain because the level of unemployment cannot be accurately predicted, but the two programs will provide sizable stimulus:

75| 313 - 287 - $25: (30 to 35)

76| 346 - 309 - $37. (50+)

	Calendar 1975 Outlays in Billions			
	Level of Unemployment			
	6.5%	7.0%	7.5%	8.0%
Total outlays	$18.83	$20.13	$21.53	$22.83

C. Confidence -- Various measures of consumer confidence report sharp drops to historically low levels. Business confidence is more difficult to measure, but erosion seems to be indicated in reports of purchasing agents, cutbacks in new orders, and capital expenditure surveys that show a decline in real outlays next year.

77| 380 - ($95)

IV. Review of Policy Options

The Economic Policy Board considered modifications to existing policies as well as new initiatives to correct current conditions. In addition to addressing general economic policies, attention has been given to economic sectors that are either keys to economic recovery or have been especially hard hit by the current situation.

Taxes

The Economic Policy Board has concluded that it is now necessary to provide the economy with additional stimulus. The Board recommends that this stimulus be provided by tax cuts rather than by expanding Government spending programs. The Board recommends a three step tax program:

(1) A temporary tax cut for economic stimulus.

(2) A crude oil tax and tariff and a windfall profits tax to be rebated through tax reductions.

(3) Tax reform.

Details of the above recommendations are contained in the attached issue paper. Steps (1) and (2) are proposed together for immediate action while Step (3) is intended for more deliberate action.

Housing

Housing starts fell to an annual rate of 990,000 units in November, less than half the total for last year. Significantly, multi-family starts were down 72 percent.

Recently, however, deposit flows into savings insitutions have resumed and mortgage rates have started to decline. These are the financial preconditions for a recovery in housing starts, which we (like most forecasters) expect to see shortly. This could be thwarted, however, if the large Federal borrowing requirements over the next 18 months overstrain the capital markets and thereby reduce the availability of mortgage credit.

There is a further major qualification attached to this recovery in homebuilding. Housing industry officials complain that the demand for new housing has disappeared because of the severe decline in buyer confidence. Should confidence remain depressed the housing recovery in 1975 could be materially retarded. We might then get less than the widely predicted 1.4 to 1.5 million starts next year, which would bring calls for new assistance to the industry, because housing production would not be getting back to the area of 1.9 million starts that is estimated to be the basic annual demand for housing.

Issue: Should the Federal Government provide further stimulus for the housing industry and, if so, what policies are available to do so?

Options

1. Extend the Tandem Plan for conventional mortgages into the new year using the $600 million to $750 million expected end year residual. If this is done, it should be announced before January 1.

   Pro -- Fulfills commitment to make $3 billion available. The interest rate of about eight percent would be one-fourth percent lower than the December program rate and may offset some of the confidence problem. Is in place; no new legislation required. Consistent with long term housing policies.

   Con -- Impact is small, will work with lag of six months to a year and, depending on later market rates, could increase budget outlays.

2. Having fully committed the original $3 billion tandem, authorize an additional Tandem Plan program (out of the remaining $4.75 authorization).

   Pro -- Better than 235 etc, and could help hold off congressional mandating of that program in response to more bad news on starts in January. If interest rate set low; e.g. 7 1/2 percent or 7 3/4 percent; could offset confidence factor to some extent.

Con -- Same as option one but substantially increased risk on outlay costs.

3. A partial 235 plan (Interest Subsidy for Buyers) starting at five percent and phasing up or at fixed six percent rate.

   Pro -- Popular with Congress and building industry. Would be compromise to full 235 program.

   Con -- Represents a significant policy change. Commits the Government to subsidize mortgages far into the future. Phasing up would raise serious questions regarding legality and eligibility standards. Would take substantial time to become operational.

4. Traditional 235, 236 (Rent Subsidies) and public housing.

   Pro -- Housing industry and union leaders support; HUD has experience with programs.

   Con -- Totally against current public policy (and most cons of two above).

5. No action.

   Pro -- Holds down budget outlays. Avoids further disruptions of capital markets and uncertainties regarding interest rates in planning housing programs.

   Con -- Almost certain to face congressional action. Negative reaction from builders and buyers that nothing is being done. Could result in mandating of tradtional 235.

Recommendation: Adopt option one before January 1. Decide on other options when we have a better picture of December savings and loan inflows.

Automobile Industry

U.S. automobile manufacturers have experienced a steady decline in demand for new cars, with 1975 model-year-to-date sales down 23 percent from 1974. The hardest hit companies have been Chrysler and American Motors where November sales are off by 36 percent and 50 percent respectively. The largest factor in the sales downturn appears to be the lack of consumer confidence in the economy. Layoffs in the industry have been increasing rapidly and by the end of January, 260,000 workers will probably be out of work. Auto industry layoffs are causing significant increases in national unemployment levels, as related industries feel the effects of automobile production cutbacks.

Issue: Should the Federal Government take special steps to aid the automobile industry, e.g., through a tax credit for car purchases?

Recommendation -- Since a recovery in the automobile industry is so closely tied to consumer confidence and general economic recovery, most of us feel that the best policies for recovery in the auto industry are those policies that will bring about general economic recovery. We also believe that nominal price cuts or purchase subsidies will provide only a marginal stimulus to production, and would be much too costly in lost tax revenues. We therefore recommend that no action be taken at this time, although we do support the changes in safety standards now under consideration by DOT.

Public Utilities

Regulated public utilities, principally the electric utilities, are experiencing severe financial difficulties at a time when new capital requirements are very large. Unless the utilities get adequate financial relief soon, we could face a power-short economy in the 1980's.

Earnings and internally generated funds of public utilities have been deteriorating steadily due to regulatory lag, energy conservation, environmental standards, high interest rates and other cost increases. At the same time, new capital requirements for public utilities are large. Such requirements, about $17 billion in 1974 alone, must increasingly be financed externally, and increasingly by sales of equity.

Option -- The only long-term solution to this problem that is consistent with our basic principles and does not entail further Federal encroachment in the industry is that rates, which are set by the States, must be increased promptly to cover rapidly escalating costs and provide a margin of profitability that will permit new capital investments to be financed. Marginal relief can be provided by proposals we have made previously.

Recommendations -- We should again support:

1. Parity for utilities on the investment tax credit.
2. Relaxation of the Clean Air Act and the Federal Water Pollution Control Act.

Otherwise, we suggest no new initiatives at this time.

Agriculture

Because of disappointing crops in 1974, the USDA forecasts a 15 percent annual rate of increase in retail food prices until the 1975 crops are harvested (beef prices are expected to increase less rapidly). Fertilizer and energy shortages do not pose major problems at this time. Also, it appears that our export limiting mechanisms are working reasonably well and that we will come close to meeting our export targets. Except for rice, peanuts, and long staple cotton, there are no Government limitations on planting.

Recommendation: No major new action is recommended at this time.

Wage and Price Restraint

While the Economic Policy Board strongly opposes use of mandatory controls, it recognizes pressure is building in the Congress for stronger wage-price measures. Several initiatives to strengthen the powers of the Council on Wage and Price Stability were considered. Exercising such powers would require expansion of the staff.

Issue A: Should prenotification filings be required prior to major wage and price decisions?

Pro – Prenotification would provide advance warning and pertinent information to CWPS to prepare government reaction and would enable CWPS to negotiate a position with the parties before public announcements solidify positions.

Con — The disadvantages include: (1) the paperwork burden created; (2) possible disclosure problems involving the Freedom of Information Act; and (3) increased government activity without gaining major advantages.

Recommendation: Not needed for present program in general, but CWPS could ask for such responses in special situations.

Issue B: Should CWPS have the power to subpoena company records?

Pro -- Advantages include: (1) gives impression of greater government activity; and (2) may be necessary in certain cases.

Con -- Disadvantages include: (1) CWPS feels it is capable of obtaining necessary information without subpoena; (2) loses cooperation of firms that usually exists; and (3) initiation of litigation often results in protracted proceedings rendering information useless.

Recommendation: Not necessary to present functions.

Issue C: Should CWPS have the power to suspend wage and price decisions for 45 days?

Pro: Advantages include: (1) allows time for thorough government investigation; (2) possible public relations benefits; and (3) provides time for CWPS to work with private sector to explore possible adjustments.

Con: Disadvantages include: (1) CWPS would be in a disadvantageous position in seeking the rollback of announced decisions; (2) implies that CWPS can establish a set of guidelines to determine what is reasonable; and (3) significantly increases arbitrary power of CWPS; (4) the power is of no use after the 45 day waiting period; and (5) unions and firms may consider such actions to be unfair harassment.

Recommendation: Not desirable.

Issue D: Should legislation be sought to require formal reports by CWPS on significant abuses of economic power?

Pro: Advantages include: (1) would provide an institutional format for attacking such abuses; and (2) would provide information to support corrective action.

Con: Disadvantages include: (1) CWPS can already initiate such actions under existing authority; (2) it would require an expansion of staff and financial resources.

Recommendation: Do not add this function to the present work program developed at CWPS.

Issue E: Should "jawboning" be intensified?

The use of "jawboning" to moderate wage and price decisions should be reviewed. It can be considered in terms of the number of initiatives, the pressures brought to bear in each case, and the Administration's position on the approach.

Banking and Finance

A major current concern is the stability of the existing financial system and its ability to meet the financing needs of business firms and individuals. There may be numerous cases where companies cannot remain financially liquid even though their long term prospects are favorable. Thus, the particular strains caused by the current economic sluggishness may justify special governmental financial assistance to guard against major company bankrupticies which could cause serious unemployment problems and unwanted repercussions throughout the financial system. There is a precedent for such financial aid in the role of the Reconstruction Finance Corporation during the 1930's and 1940's (liquidated in 1953), the loan guarantee program provided for Lockheed Aircraft Corporation, the assistance for the Penn Central Corporation and the approximately 100 Government programs which provide direct loans and loan guarantees. The Economic Policy Board discussion emphasized the importance of passing the Financial Institutions Act and implementation of financial regulations being prepared by the FRB and other agencies. But there was also recognition that a "lender of last resort outside of the commerncial banking system" might be required during the difficult transition period.

Recommendation: That a careful study of possible financial assistance programs be prepared by the Department of the Treasury and the Federal Reserve System. Preparatory work at both agencies has been underway for several weeks and a joint effort was initiated on December 21. However, this is a major step with implications that should be carefully considered before implementation.

V. <u>Long Term Economic Goals</u>

Although current economic concerns are concentrated on the immediate problems of inflation and recession, policy actions must recognize long term goals to avoid expedient measures that may generate immediate relief but only at the cost of even more serious difficulties in the future. The current demands that strong economic stimulus is required must be tempered by consideration of the inflationary pressures that will quickly escalate if policy adjustments are exaggerated.

Recognition must also be given to basic secular trends that complicate current economic policy issues:
(1) the sharp decline that has occurred in "adjusted" corporate profits (rate of return) which restricts capital investment and technology improvement;
(2) the stagnation of productivity gains in recent years; (3) the profound shift of incomes to nonworkers and to those who do less saving and investing; and
(4) the tendency for each round of inflation to begin from a higher plateau as the price level moves upward without ever returning to previous low rates. These secular shifts in our economic structure seriously threaten the future of the U.S. economy. Our goals and policies can be stated in terms of the inflation, unemployment and output objectives referred to in the opening paragraph, but there are also other important economic goals that must not be ignored.

1. <u>Emphasize private sector economic decisions that respond to interests of the people as individuals.</u> The public must be alerted to the trend toward increasing Government intervention in their personal economic affairs. Both freedom and efficiency are served by primary emphasis on decentralized economic decision making.

2. <u>Maintain flexible policies and institutions capable of adjusting to changing demand and supply conditions</u>. Historically, the U.S. economy has been very

successful in anticipating and reacting to the changing interests of consumers. Political pressures to maintain the status quo should not be allowed to thwart the productive evolution of the system.

3. Maintain efficiency in the allocation of resources. The profit incentive has historically been the basis for capital investment and new technology. The resulting high and sustained growth in productivity has enabled the U.S. economy to create an unprecedented standard of living. Unfortunately, there are specific examples of the abuse of economic power and Government policies that unnecessarily restrict the effectiveness of the system. When these specific abuses are identified, strong corrective action should be taken to restore competition and maximize productivity.

4. Strive for more stable economic conditions to avoid disruptive boom and bust swings in the economy. Economic cycles are a basic part of any economic system but the amplitude of cyclical changes should be minimized through the use of automatic stabilizers and moderate policy adjustments. Policy shifts that were both too large and too frequent have exaggerated the business cycle through the postwar period.

5. Maintain long term perspectives. One of our most important goals should be to stimulate capital investment to create the future job opportunities and economic growth desired. In some situations the Government may occasionally have to develop research and demonstration projects to stimulate private sector interest in situations where the size or uncertainty of commitments may preclude private action. The Government also plays a key role in balancing the economic and environmental concerns in developing national policies. The current emphasis on conserving valuable resources is a good example.

6. <u>Fulfill international obligations including creation of a more open world economy</u>. As the premier economy in the world the U.S. has many important responsibilities, which include:

   a. Support for international monetary reform based on stated rules which would include provisions for adjusting exchange rates and policy adjustments to correct chronic payments disequilibrium.

   b. Support for further development of trade including the multilateral reduction of tariff and non-tariff barriers; however, such policies must be based on reciprocal actions by trading partners and recognition of domestic economic conditions (example: 1974 grain exports).

   c. Support for the free flow of capital for loans and for portfolio and direct investments; better statistical information about such investments is not inconsistent with this freedom (probably a future prerequisite).

   d. Encourage freedom of access to raw materials.

   e. Encourage international cooperation in developing new resources, conservation and coordinating domestic economic policies.

   f. Encourage sharing of development aid efforts.

   g. Encourage strengthening of international private financial institutions.

   h. Encourage strengthening of international economic institutions.

December 24, 1974

TAX PROPOSALS AND OPTIONS

The Executive Committee of the Economic Policy Board discussed possible tax changes in the context of three distinct but interrelated problems and objectives. The first deals with the need for a tax cut for temporary stimulus to the economy. The second deals with approaches to tax reduction to offset the effects on the budget and on incomes of individuals and businesses of a tax and tariff on crude oil designed to achieve energy conservation objectives. The third deals with tax reform measures to rationalize the incidence of taxes and promote capital formation.

The first two steps were considered as a package that could be introduced quickly for prompt congressional action so that their influence on the pace of economic activity and on energy conservation would be felt promptly. Consequently, the alternative proposals discussed in Step I and Step II are relatively simple while those in Step III are more complex and controversial.

STEP I: Tax cut for temporary economic stimulus.

The current weakness in the economy, the state of consumer and business confidence, and the outlook for the near future lead to the recommendation that a tax cut to provide short-term fiscal stimulus to the economy should be considered. This recommendation is made despite the recognition that large budget deficits are in prospect for FY 1975 and FY 1976, that financing these deficits will further strain financial markets and threaten the achievement of lower interest rates, and that continuing inflation remains a serious problem.

Issue 1 -- Tax reduction conditional on expenditure restraint

Projected deficits for fiscal years 1975 and 1976 are rising as entitlement commitments increase and projected revenues decline. In view of financial market strains and inflationary expectations that may result from large deficits, further restraint on Federal outlays should be considered in connection with the tax cut.

Option A: A proposed moratorium on new spending programs.

Option B: A partially offsetting reduction in spending from levels currently projected after the present budget is submitted.

Recommendation: Option A. The tax cut should be accompanied by a request for a moratorium on all new spending programs.

Issue 2 -- Duration of temporary tax reduction.

The fiscal impact of a temporary tax reduction should be prompt and take effect early in calendar year 1975. A shorter duration emphasizes its temporary nature.

Option A: One year.

Option B: Two years.

Recommendation: Option A. (Opinions mixed)

Issue 3 -- Size of temporary tax cut.

A tax cut of less than $10 billion was generally viewed as too small for a significant effect on spending and confidence. A major concern of a larger tax cut is its impact on an already large budget deficit. The Joint Economic Committee and some policy analysts have recommended cuts in the $10-15 billion range.

Option A: $10 billion. 11,5

Option B: $20 billion.

Recommendation: Option B (Opinions mixed)

Issue 4 -- Division of tax cut between individuals and corporations.

Allocation of the tax reduction is in part a matter of strategy. We should consider (a) the views of labor leaders; and (b) probable changes by the Congress. At present personal and corporate income tax receipts are divided approximately three-quarters individuals and one-quarter corporations.

Option A: Two-thirds individuals, one-third corporations.

Option B: Three-fourths individuals, one-fourth corporations.

Recommendation: Option A.

Issue 5 -- Form of a temporary tax cut for individuals.

Simplicity and a rapid fiscal impact are the main features desired for a temporary tax cut to stimulate the economy. Complex approaches providing more relief for low income taxpayers or rationalizing taxation of corporate and personal income were discussed but reserved for longer-term tax reform initiatives.

Option A: Lump sum negative surtax (i.e. a rebate) for tax liabilities applicable for calendar year 1974.

Rebate

This proposal, which entails administrative problems, was made by former FRB Governor Andrew Brimmer. Its estimated cost would be $13 billion.

Option B: An income tax credit equal to 2% of wage and salary income up to $12,000.

This proposal was made by Arthur Okun and would entail an estimated cost of $12 billion.

Option C: Negative surtax on income accruing in 1975.

This is similar to Option A except that the tax reduction would take the form of lower withholding rates during the year rather than a lump sum rebate.

Option D: Increase in personal exemption level.

Recommendation: Option C. (Opinions mixed)

Issue 6 -- Form of a temporary tax cut for corporations.

A temporary negative surtax or cut in the corporate tax rate would be simple and parallel to the form recommended for individuals. A temporary investment tax credit, it is believed, would create greater incentives for investment than a reduction in the corporate tax rate.

Option A: Temporary increase in the investment tax credit.

Option B: Temporary negative surtax or cut in the corporate tax rate.

Recommendation: Option A. (Opinions mixed)

STEP II: Crude Oil Tax and Tariff Coupled with a Permanent Income Tax Cut

The Energy Resources Council has recommended a tax and tariff on crude oil to promote energy conservation. To offset the fiscal impact of such a tax and tariff a tax reduction of comparable size is proposed. To ameliorate the impact on costs of the petroleum taxes, it might be desireable to phase in the program. One issue that was not addressed in the EPB discussions is the proposed tax on natural gas.

Issue 1 -- Size of the crude oil tax and tariff

The Energy Resources Council has recommended a tax and tariff of $2 per barrel. The EPB considered a tax of $3 per barrel and Frank Zarb supported this level as consistent with energy conservation purposes. A tax of $3 per barrel, coupled with decontrol (see next issue), is estimated to increase the general price level by 1.3% which would increase payments such as social security, federal pensions, and wage escalators linked to the Consumer Price Index.

Option A: $2 per barrel

~~Option B: $3 per barrel~~

Recommendation: Option B

Issue 2 -- Decontrol of all crude oil prices

Decontrol of all crude oil prices would remove the artificially low price of oil and would relieve the necessity of government allocation of oil. However, this action is estimated to increase the general price level by about 0.5%.

Option A: Decontrol of all crude oil prices.

Option B: No change in oil price controls.

Recommendation: Option A.

Issue 3 -- Windfall Profits Tax

The ERC opposes a plow-back as unnecessary to stimulate energy exploration. If crude oil prices are decontrolled, profits will skyrocket in the absence of a windfall profits tax. This is certain to be a controversial issue and could tie up the legislation in Congress.

Option A: Windfall profits tax with a plow-back.

Option B: Windfall profits tax with no plow-back.

Option C: No windfall profits tax.

Recommendation: Option B.

Issue 4 -- Termination of the oil depletion allowance

The depletion allowance issue is relevant both to incentives for oil exploration and to oil company profit levels. Higher oil prices have created significantly greater incentives for exploration.

Option A: Continue oil depletion allowance.

Option B: Terminate oil depletion allowance.

Recommendation: Option A. Termination of the depletion allowance is controversial and should be considered in connection with comprehensive tax reform. (Step III)

Issue 5 -- Allocation of offsetting tax reduction between individuals and corporations.

The considerations on this issue are similar to those for the temporary tax reduction since the crude oil tax will directly raise corporate costs as well as those for individuals.

Option A: Two-thirds individuals, one-third corporations.

Option B: Three-fourths individuals, one-fourth corporations.

Recommendation: Option A.

Issue 6 -- Use of crude oil tax revenues to create energy conservation incentives.

Some portion of the crude oil tax receipts could be used to create special incentives for energy savings instead of rebating the entire amount through general tax reduction. The main issue is the efficiency of such special tax credits in promoting energy conservation.

Recommendation: Propose use of some portion of the tax revenues for special energy saving programs if, and only if, efficient programs can be identified.

Issue 7 -- Form of the tax cut for individuals.

Option A: Equal proportional cuts applied to all rate brackets.

Option B: Reduction in tax payments by income bracket proportionate to petroleum usage to compensate for the price effects of the increase in petroleum cost.

?

Option C: A combination of (1) increasing the minimum standard deduction, (2) special compensation for low and middle income taxpayers, and (3) a reduction in tax payments by income bracket proportionate to petroleum usage.

Recommendation: Option C.

Issue 8 -- Form of the tax cut for corporations

A temporary increase in the investment tax credit was recommended to provide short-term stimulus. Limits on the ability of the economy to absorb increased investment spending must be considered in judging an overall tax package.

Option A: Negative surtax or cut in the corporate tax rate.

Option B: Increase in the investment tax credit.

Recommendation: Option A.

Issue 9 -- Compensatory measures for the poor who cannot benefit from tax reduction.

The mechanism for compensating those unable to benefit from tax reduction is complex. Programs for income transfers assisting the poor, such as social security payments, food stamps, housing subsidies, etc. are linked to the CPI which reflects with a lag the impact of petroleum price increases. These increased budget expenditures partially offset the influence of the increased petroleum tax on the poor. Such expenditures should be taken into account in estimating the net impact on the federal budget of the petroleum tax increase and in estimating the proceeds of the tax increase available for distribution. A comprehensive income maintenance program could provide the most complete offset to higher petroleum prices, but existing programs provide a partial measure of relief.

<u>STEP III</u>: <u>Comprehensive Tax Reform to be discussed with the Congress</u>.

THE WHITE HOUSE

WASHINGTON

January 3, 1975

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: L. WILLIAM SEIDMAN

FROM: JERRY H. JONES

SUBJECT: Economic Policy Review

Your memorandum to the President of December 24 on the above subject has been reviewed and the following notations were made with regard to Tax Proposals and Options:

Step I; Issue 2 -- Option A: One year.
Step I; Issue 3 -- $15 billion.
Step I; Issue 4 -- Option A.
Step I; Issue 5 -- the following notation was made:
-- Rebate.
Step I; Issue 6 -- Option A.

Step II; Issue 1 -- Option A.
Step II; Issue 5 -- Option A.
Step II; Issue 7 -- Option C was circled with a question mark.
Step II; Issue 8 -- Option A.