The original documents are located in Box C28, folder "Presidential Handwriting, 10/3/1975" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.

THE PRESIDENT HAS SEEN....

THE WHITE HOUSE

WASHINGTON

October 3, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: RICHARD B. CHENEY
ALAN GREENSPAN

SUBJECT: Suggested Talking Points for Meeting on the Tax Cut

We believe it is time to discuss with the Executive Committee of the Economic Policy Board the fact that you are considering a major tax cut and significant expenditure reductions rather than a simple one year extension of last Spring's tax reductions.

In your meeting this afternoon, if you agree, you may want to do the following:

1. Tell them that you have decided to go beyond their recommendations for a simple extension of a simple tax cut.

2. You are giving instructions that you want work to begin immediately on a bigger tax cut.

3. You have already given instructions to Jim Lynn to come up with major expenditure reductions.

4. You want the group to get back to you tomorrow morning with a recommended course of action which emphasizes a new tax cut to take effect sometime in 1976 and an overall spending ceiling which can be recommended at the same time that you announce your new tax cut proposal.

5. You want a draft speech prepared immediately announcing your decisions, and the first draft should be ready by Saturday evening.

6. You want everyone to operate on a need-to-know basis concerning this policy, and there should be absolutely no leaks either to others in the Administration, to Members of Congress or to the press.

You would like to consider announcing your decision as early as Monday, October 6th.

THE PRESIDENT HAS SEEN....

THE WHITE HOUSE

WASHINGTON

October 3, 1975

MEMORANDUM FOR L. WILLIAM SEIDMAN LWS

FROM: ROGER PORTER RP

SUBJECT: Actions and Schedule of House Ways and Means Committee

In view of the discussion of taxes at today's Economic and Energy meeting I inquired of Treasury what precisely the Ways and Means Committee has done to date and what they are scheduled to take up prior to the recess.

I am informed that the Committee has tentatively decided the following:

Increased taxes on investments in shelters Real estate, farm operations, natural resources, etc.	$900 million
Increased minimum tax	$600 million
Increased taxation on foreign-source income	
DISCs	$600 million
Other foreign items	$150 million
Total Revenue Gains	$2.25 billion

The Ways and Means Committee has also tenatively approved individual changes affecting items other than income from capital entailing a revenue loss of about $150 million.

Attached is a table of the estimated revenue effects of the Committee's domestic tax reform decisions.

The present schedule of the Committee calls for consideration of individual income tax reductions on Tuesday, capital formation on Wednesday, and capital gains on Thursday.

Estimated Revenue Effects of Ways and Means Committee
Domestic Tax Reform Decisions

($ millions)

	Calendar Years					
	1976	1977	1978	1979	1980	[illegible]
Real estate limitation on artificial losses	251	372	485	540	531	[illegible]
Recapture of depreciation on real property	5	15	25	35	50	
Farm limitation on artificial losses	110	41	43	45	47	[illegible]
Accrual accounting for incorporated farms	30	30	30	30	30	[illegible]
Hobby farms	*	*	*	*	*	[illegible]
Repeal of farm excess deductions account	*	*	*	*	*	[illegible]
Credit for home garden tools	-29	-30	-32	-34	-35	[illegible]
Oil and gas limitation on artificial losses	241	104	32	15	32	[illegible]
At risk limit on deductions for intangibles	*	*	*	*	*	[illegible]
Recapture of gain from disposition of oil and gas interests	5	10	40	50	63	[illegible]
Motion picture limitation on artificial losses ...	28	32	35	36	37	[illegible]
At risk limit on deductions for motion picture losses						
Equipment leasing limitation on artificial losses.	10	16	21	22	18	[illegible]
Professional sports franchises allocation of purchase price to player contracts	2	5	8	8	9	[illegible]
Professional sports franchises recapture of depreciation on player contracts	4	5	5	5	6	[illegible]
Limitation of prepaid interest deductions	*	*	*	*	*	*
Partnership allocation of income, gain, loss, etc.	1/					
Partnership limitation of additional first-year depreciation to be passed through	*	*	*	*	*	*
Capitalization of syndication fees	*	*	*	*	*	[illegible]
Minimum tax for individuals, estates and trusts ..	629					
Deduction for business use of homes	162	185	210	240	275	[illegible]
Deduction of expenses for vacation homes	20	23	26	30	34	[illegible]
Deductions for foreign conventions	*	*	*	*	*	[illegible]
Retirement income credit	-340	-340	-340	-340	-340	[illegible]
Child care	-117	-129	-142	-156	-171	[illegible]
Sick pay and disability	303	327	353	382	412	[illegible]
Qualified stock options	7	22	36	32	4	[illegible]
Income tax return preparers	n.a.	n.a.	n.a.	n.a.	n.a.	[illegible]
Total domestic tax reform decisions (10/1/75)	1,321	688	835	940	1,0[illegible]	[illegible]
Provisions affecting income from capital	1,475	830	964	1,054	1,1[illegible]	[illegible]
Provisions affecting income from labor	-154	-142	-129	-114	-[illegible]	[illegible]

Office of the Secretary of the Treasury
Office of Tax Analysis

October 2, 197[illegible]

*Insignificant 1/ No estimate available. n.a.-Not applicable.

THE PRESIDENT HAS SEEN....

Date: October 3, 1975

MEMORANDUM FOR: THE SECRETARY

From: Charles M. Walker

Subject: Proposed $12 Billion Tax Cut for 1976

The package contains two parts. The first part is an extension of the 1975 standard deduction changes -- an increase in the minimum standard deduction to $1,900 for joint returns and $1,600 for single persons and an increase in the standard deduction to 16 percent with a maximum of $2,600 for joint returns and $2,300 for single persons. This extension costs $2.8 billion.

The second part of the package is a reduction in the marginal tax rates in all tax brackets up to 53 percent; that is, up to $64,000 of taxable income on a joint return. The rate cuts for joint returns are as follows:

Tax Bracket ($000)	Present Law Rates	Proposed Law Rates
0 - 1	14	12
1 - 2	15	13
2 - 3	16	14
3 - 4	17	16
4 - 8	19	18
8 -12	22	20
→12-16	25	24
16-20	28	27
20-24	32	30
24-28	36	33
28-32	39	36
32-36	42	39
36-40	45	41
40-44	48	43
44-52	50	46
52-64	53	50
$64,000 and over	55 and over	same as present law

	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Ex. Sec
Surname	Sunley	Bradford				
Initials / Date	EMS / 10/3/75	/	/	/	/	/

Form OS-3129
Department of Treasury

Compared to increasing the tax cut from $8 to $12 billion with the same income class distribution as the $8 billion cut, the proposed package has the following percentage distribtuion by income class.

AGI Class	50 Percent Magnification		Proposed Standard Deduction and Rate Cuts	
($000)	Amount ($ Billions)	% Distribution	Amount ($ Billions)	% Distribution
0 - 5	1.1	9	0.7	6
5 - 10	3.4	28	2.3	19
10 - 15	2.9	24	2.3	19
15 - 20	2.3	20	2.4	20
20 - 30	1.6	14	2.1	18
30 - 50	0.5	4	1.2	10
50 - 100	0.1	1	0.8	7
100 +	*	*	0.2	2
Total	12.0	100	12.1	100

Office of the Secretary of the Treasury
Office of Tax Analysis

October 3, 1975

The 50 percent magnification of the 1975 tax cut would require no change in withholding. The proposed tax cut, tilted towards middle-income families, would involve a tax increase for some low-income families because the rate cuts would not provide as much relief as the lapsing $30 credit. The proposed tax cut would involve a withholding increase for most families with less than $15,000 of income. Many of these families may perceive the withholding increase as an increase in tax liability.

THE PRESIDENT HAS SEEN...

THE WHITE HOUSE

WASHINGTON

October 2, 1975

ECONOMIC AND ENERGY MEETING
October 3, 1975
3:00 p.m.
Cabinet Room

From: L. William Seidman LWS

I. PURPOSE

A. To review tax reduction extension alternatives and the Federal Government expenditure outlook.

B. To review the current world grain situation and an analysis of the effects on food prices of additional grain sales to the Soviet Union and Eastern Europe.

C. To briefly review the current economic outlook.

II. BACKGROUND, PARTICIPANTS AND PRESS PLAN

A. Background: The Weekly Economic Fact Sheet is attached at Tab A. The Economic Policy Board Weekly Report is attached at Tab B.

At the September 26 Economic and Energy meeting you reviewed a memorandum on extension of the 1975 tax reductions, a copy of which is attached at Tab C. At that time you requested the preparation of a table that would show the effect of distributing a $12 billion individual income tax reduction to provide greater benefits for middle and upper income taxpayers than a simple extension of the 1975 Tax Reduction Act. The Office of Tax Analysis of the Treasury has prepared a table showing the amount of aggregate tax reduction by income class of: (1) Reducing the marginal rates to the 53 percent bracket; (2) Reducing the marginal rates to the 36 percent bracket; and (3) Widening all tax brackets by 30 percent. The table is attached at Tab D.

Representative Ullman informed the Treasury this morning that the House Ways and Means Committee intends to commence markup of extension of the Tax Reduction Act on Tuesday morning, October 7, and indicated that it would be helpful to have the Administration's views.

The House is scheduled to recess from Thursday evening, October 9 until Monday, October 20. Representative Ullman has indicated that he wants the entire tax reform bill including a decision on the tax cut extension concluded prior to the recess next week.

The Economic Policy Board has closely monitored the world grain situation and its impact on food prices. An analysis of the effects on food prices of additional grain sales to the Soviet Union and Eastern Europe is attached at Tab E.

B. Participants: William E. Simon, L. William Seidman, James T. Lynn, Alan Greenspan, John T. Dunlop, Frank G. Zarb, Donald Rumsfeld, Arthur F. Burns, Richard L. Dunham.

C. Press Plan: White House Press Corps Photo Opportunity.

III. AGENDA

A. Review of Tax Reduction Extension Alternatives

Secretary Simon will review the results of the Treasury runs on alternative distributions of a tax reduction. Jim Lynn will review the coordination of a potential tax reduction with restrictions on Federal expenditures.

B. Grain Situation and Food Prices

Alan Greenspan will review the current world grain situation and the effects on food prices of additional grain sales to the Soviet Union and Eastern Europe.

C. Review of the Current Economic Outlook

Alan Greenspan will briefly review the current economic outlook.

A

October 2, 1975
CEA

WEEKLY ECONOMIC FACT SHEET

During the past month, as new statistics have become available the economic recovery appears to be even stronger than earlier anticipated. Industrial production has grown rapidly since April, employment gains have been sharp, and the unemployment rate has fallen. Moreover, after rising at double digit rates during June and July, consumer prices rose only slightly during August as food and fuel, the underlying inflation rate appears to have settled in the six to eight percent range at the present time.

Production

- Last month the Federal Reserve revised the industrial production figures for May, June, and July upward and indicated a preliminary 1.3 percent increase in industrial production for August. Judging from the increase in hours of work estimated for last month, it is likely that August, too, will be revised upward.

- The Commerce Department is now projecting (on a tentative and not for publication basis) a 9.7 percent rise (annual rate) in real GNP from the second to the third quarter. This unusually high growth rate is due to a peculiarity, however, in the way in which the GNP price deflator is calculated. Adjusting for this peculiarity would result in something closer to seven percent real growth and a seven percent price change for the quarter. Part of this growth in real GNP is due to a sharp reduction in the rate of inventory liquidation. It appears that real final sales grew in the third quarter by only 3.9 percent. The index of leading indicators flattened in August but is 2.8 percent above the June figure.

- New orders for durable goods increased by 2.1 percent in August compared with a 4.9 percent increase in July. New orders have increased at an average monthly rate of 2.3 percent from April to July. The backlog of unfilled orders which had been declining sharply rose by 0.4 percent in July and 0.2 percent in August.

Housing

- Housing starts during the month of August were up 43 percent from the abysmal lows of December 1974. Recent increases in interest rates are not favorable, however. Roughly half of the last two issues of Treasury notes, yielding over eight percent, were awarded "noncompetitively." This indicates substantial public participation and may be a harbinger of desintermediation in the future. Clearly the level of rates could make a considerable difference to the outlook for this industry in 1976.

Employment and Unemployment

- The unemployment rate seasonally adjusted remained at 8.4 percent in August, significantly below the 8.9 percent average of the second quarter. Moreover, the average work-week in manufacturing increased sharply from the second quarter level by 0.7 hours and overtime increased by 0.3 hours. The unemployment rate for September will be announced on October 3.

Personal Income and Retail Sales

- Total personal income rose $18 billion (annual rate) in August after a small decline in July. Since May 1975 personal income has increased 3.5 percent which implies an annual rate of growth of 14.8 percent in nominal terms.

- Over the last three months retail sales have advanced at an annual rate of 12.4 percent although advanced estimates for the month of August suggest a small decline from the high July rate.

Prices

- After rising at roughly a 12 percent annual rate during July and August, due primarily to rapid increases in food and fuel prices, the CPI rose at a seasonally adjusted annual rate of 2.4 percent in August, as food and fuel prices stabilized.

- The WPI rose at an annual rate of 7.2 percent from August to September.

Monetary and Financial

- Interest rates have continued to move upward. Short term Treasury bill rates are approximately one percentage point higher than they were in May. The pattern of rising rates has spread into longer term markets as well.

- The rate of growth of the various monetary aggregates has flattened out since early July and this has brought the growth rates since April back under the 7.5 percent upper point of the target range set forth by the Federal Reserve earlier in the year.

B

October 2, 1975

ECONOMIC POLICY BOARD WEEKLY REPORT

Issues Considered by the EPB During the Week of September 25

1. Grain Situation
   Reviewed an analysis of the latest USDA supply and demand forecast.

2. New York City
   Discussed Secretary Simon's draft testimony for his appearance before the Joint Economic Committee.

3. Cocoa Agreement Negotiations
   Approved instructions to U.S. delegation at cocoa agreement negotiations in Geneva.

4. Taxation of International Investment
   Approved Task Force recommendations that the EPB reaffirm the CIEP statement on U.S. policy and objectives on international investment and the general principles outlined in the Task Force report. Requested the Task Force to submit a second report on: (1) the treatment of tax free transfers of technology to foreign operating subsidiaries; and (2) the allocation of expenses for research and development against foreign source royalty and dividend income.

5. Report on International Economic Conditions
   Reviewed CEA report on international economic conditions.

Task Force Status Reports

1. Subcommittee on Economic Statistics

   - Reviewing Consumer Price Index focusing on need for much more frequent monthly pricing.
   - Reviewing wholesale price index focusing on need to move from posted prices to transaction prices.
   - Upcoming projects include industrial capacity statistics, inventory figures, and the definition of full employment.

Major Upcoming Agenda Items

1. Reactivation of the suspended home ownership subsidy program.

2. Multilateral trade negotiations.

3. Report of Task Force on Antitrust Immunities.

4. Financial Conditions of major U.S. cities.
5. International Aviation Policy Statement.
6. Food Deputies Report.

C

THE WHITE HOUSE

WASHINGTON

September 25, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN LWS

SUBJECT: Extension of 1975 Tax Reductions

The economic forecasts are now sufficiently complete to allow consideration of tax cuts for the coming year. This memorandum summarizes the economic and budgetary outlook as they relate to the issue of continuing the 1975 tax cuts and outlines options regarding the size, duration, and composition of a tax reduction extension.

Background

Two types of reductions were provided in the Tax Reduction Act of 1975. First, one-shot "stimulus" reductions:

	1975 Liabilities ($ billions)
Rebate	-8.1
Five percent House Credit	-0.6

Secondly, reductions resulting in changes in the tax structure.

Low income allowance and standard deduction	-2.5
$30 credit per exemption	-5.3
Changes in corporate surtax and rates for small business and in WIN credit	-1.5
Earned income credit	-1.5
Investment credit (expires January 1977)	-3.3
	-22.8

All of these reductions expire at the end of 1975, except for the increase in the Investment Tax Credit which expires at the end of 1976. Thus, the reductions that will lapse total $19.5 billion.

There is little apparent sentiment or reason for another rebate in 1976 or for an extension of the five percent housing credit.

The issue is whether to extend the structural changes outlined above. The changes in the low income allowance, the standard deduction, and the $30 exemption credit are built into the wage withholding tables. They account for a 1975 reduction in taxes of approximately $8 billion and if they expire at the end of 1975 there will be an immediate and substantial increase in withholding.

To a lesser extent, a reduction in take home pay will occur even if the provisions are simply extended since the entire 1975 reduction was concentrated in the last eight months of withholding. In order to keep withholding constant, the tax reduction would have to be increased to $12 billion, or 50 percent more than the $8 billion reduction provided by the 1975 Act.

The 1975 legislation provides that both the reduction in liabilities and the reduction in withholding will expire at the end of this year. Thus, unless some action is taken, withholding will increase and disposable incomes will decrease as of January 1976.

The possibility of administratively altering the amount of withholding has also been explored. The Treasury indicates that changes in rates of withholding are a legislative matter with very limited administrative discretion. In 1974, the rates were changed through administrative action under existing legislation. The IRS view is that "there is no room left in the statute for further administrative changes."

Economic Outlook

The Troika forecasting group in its most recent exercise projects roughly a seven percent real rate of growth of gross national product through mid-1976, with the growth rate then declining gradually to somewhat lower sustainable levels by the end of 1977. This should enable the unemployment rate to fall gradually to the 7 1/2 percent range or possibly even as low as seven percent by the end of 1976. This forecast assumed gradual oil decontrol and indefinite extension of the 1975 Tax Reduction Act (except that the tax rebates, payments to social insurance beneficiaries, and the home purchase credit were not expected to be extended).

Moreover, reductions in individual income tax rates were assumed, effective January 1976, so as to keep withholding rates at their current levels. This implies a total package of tax relief for individuals of roughly $12 billion, plus continuation of corporate tax relief for small business and the Investment Tax Credit. The earned income credit of $1.5 billion was also included in the Troika forecast.

To assess the effect of extending the Tax Reduction Act of 1975, the Troika forecasting group ran an alternative simulation with identical assumptions except that the tax cut was allowed to expire. A comparison of the two forecasts reveals that differences in real GNP are relatively small in 1976. (Real GNP is only 4/10 of one percent lower and unemployment 1/10 of one percent higher in the third quarter of 1976. This is because the Troika forecast assumes greater investment in late 1976 as businessmen rush to take advantage of the investment tax credit which is scheduled to be reduced at the end of 1976. In 1977, however, greater investment no longer offsets reduced consumption expenditures and the restraining effect on real GNP is increased. (By the third quarter of 1977 real GNP is 1.1 percent lower and unemployment is 4/10 of one percent higher). The simulation shows that the effect of extending the tax cut has only a negligible unfavorable short run impact on the rate of inflation during 1976 and 1977, although the longer run effects may be greater.

Fiscal policy matters are subject to wide disagreement and, therefore, the Troika estimates of the impact of a reversal of the tax cut may be disputed. Some feel that the prospect of a smaller deficit would have a salutary effect on business and consumer psychology and would moderate inflationary expectations so that the negative impact on real GNP may be lessened and perhaps even reversed. On the other hand, the psychological effect on consumers of an apparent tax increase through failure to extend the reductions may result in a greater decline in consumer spending than is shown in the Troika forecast.

Budget Outlook

With an extension of the tax cut that keeps withholding rates constant and keeps a ten percent investment tax credit through the end of 1977, the current estimates of the budget deficits in fiscal years 1976 and 1977 are $79 and $68 billions, respectively. If the tax cut is allowed to expire, the deficits are lowered to $73 billion in 1976 and to $51 billion in 1977, if it is assumed that the expiration of the tax cut does not slow down the forecast economic recovery. If some slowdown does result from the expiration of the tax cuts, the 1976 deficit would not be affected perceptibly, but the 1977 deficit might be raised to the vicinity of $55 billion.

We are currently reexamining our revenue estimates for 1976 and 1977, and as a result of this exercise, the deficits might be lowered by $3 billion in 1976 and $5 billion in 1977. This would imply deficits in 1976 and 1977 of $76 billion and $63 billion if the tax cut is extended, and deficits of $70 billion and $50 billion if it is not extended and one assumes that the resulting tax increase slows down the recovery.

It should be emphasized that the deficit estimates are extremely sensitive to the underlying economic forecast. For example, an error of one percent in forecasting 1976-77 money GNP can result in a $4 to $5 billion error in our forecast of the 1977 deficit. Based on past experience, it is quite possible that errors in forecasting GNP will far exceed one percent.

Tax Reduction Extension Alternatives

Issue #1 - Should the Administration propose an extension of the 1975 tax reductions?

Option A: Propose no extension of the 1975 reductions.

Pros:

- Reduces the size of the FY 1976 and FY 1977 budget deficits.
- Reduces inflationary pressures.
- Eases Treasury financing difficulties.

Cons:

- Current congressional sentiment suggests that Congress will pass an extension and it may be difficult to sustain a veto.
- Failure to propose an extension of individual tax reductions may prompt criticism, in light of the Administration's capital formation tax proposals, that the Administration favors big business.

- Would be viewed as a tax increase and could have a negative psychological impact.

<u>Option B</u>: <u>Propose a one year extension of the 1975 tax reductions.</u>

By November 10, OMB must publish, in the Current Services Budget, a forecast of the economic and budget outlook for FY 1976 and FY 1977 which would reveal a marked difference in the deficits forecast if a one year only extension is passed.

Pros:

- Occasions reconsideration of the budget impact of further extension again next year.
- Permits more flexibility in dealing with the economy a year from now than would a permanent extension.
- Would enable the reduction in personal income tax, the expiration of the additional investment credit and the proposal for corporate integration to be considered next year as a single package enhancing the possibility of enacting the capital formation proposals.

Cons:

- Requires a consideration of tax legislation immediately prior to the 1976 election.
- Continues uncertainty of future tax rates which may inhibit personal and corporate spending.

<u>Option C</u>: <u>Propose that the 1975 reductions be made permanent.</u>

A permanent extension of the 1975 reductions is favored by the Labor-Management Committee in their statement attached at Tab A.

Pros:

- May help in applying pressure on Congress to restrain the growth of Federal expenditures.
- Would help sustain personal consumption essential to economic recovery.

- Represents a one-time reduction of tax rates to adjust for inflation.

- Consumers will be more likely to adjust their expenditure patterns, especially for durable goods, if the extension is made permanent.

Cons:

- Increases the size of the FY 1976 and FY 1977 budget deficits.

- Increases inflationary pressures.

- Increases Treasury financing difficulties.

Decision

Option A ____________ Propose no extension of the 1975 reductions.

Option B ____________ Propose a one year extension of the 1975 tax reductions.

Option C ____________ Propose that the 1975 reductions be made permanent.

Issue #2 - Tax Reductions for Individuals.

Option A: Extend only those items that affect the withholding schedules--the low income allowance, the standard deduction and the $30 exemption credit. This would reduce tax liabilities by about $8 billion.

Since a simple extension would spread the tax reductions over 12 months rather than over eight months as in 1975, withholding would increase accordingly in January.

Pros:

- Entails a relatively simple approach to restructuring the whole tax schedule and therefore is less likely to encourage other structural changes.
- Limits increase in budget deficit by $4 billion compared with a tax reduction which would maintain the present withholding rates.

Cons:

- Withholding rates will increase by $4 billion at the beginning of January.

  Note: This will involve a small amount for the average family. For example, a couple with two children earning $15,000, or less would have between $1 and $2 per week more withheld.

Option B: Increase those items that affect the withholding schedules to match the current withholding rates. This would reduce tax liabilities by about $12 billion.

This option is favored by the Labor-Management Committee.

Pros:

- Allows withholding to remain constant on average at the beginning of 1976.

Cons:

- Implies larger deficits in 1976 and 1977 than a simple extension.
- Congress may provide even larger cuts to show that they are more generous than the Administration.

Option C: Propose reductions in individual tax liabilities of $12 billion but redistribute the benefits over a wider range of income classes than is implicit in a simple extension of the 1975 reductions.

Pros:

- Provides somewhat more benefit to the middle income taxpayers who bear the bulk of the tax burden.

Cons:

- Only very small benefits are feasible for middle and upper income taxpayers if the tax cut extension is limited to $12 billion and if tax rate increases are avoided for lower income taxpayers.

Decision

Option A ____________ Extend only those items that affect the withholding schedules--the low income allowance, the standard deduction and the $30 exemption credit. This would reduce tax liabilities by about $8 billion.

Option B ____________ Increase those items that affect the withholding schedules to match the current withholding rates. This would reduce tax liabilities by about $12 billion.

Option C ____________ Propose reductions in individual tax liabilities of $12 billion but redistribute the benefits over a wider range of income classes than is implicit in a simple extension of the 1975 reductions.

Issue #3 - Tax Reductions for Corporations

The increase in the Investment Tax Credit does not expire until the end of 1976. The increase in the ITC provides for a reduction in tax liabilities for corporations of approximately $3.3 billion.

Option A: Propose extending the changes in corporate surtax and rates which will expire at the end of 1975. This would reduce tax liabilities by approximately $1.5 billion.

This option is supported by the Labor-Management Committee.

Pros:

- Is consistent with the Administration's goals of lowering the tax burden on capital.
- Particularly lowers the relative tax burden for small business.

Cons:

- Moderately increases the deficit.

Option B: Propose an indefinite extension of the increase in the Investment Tax Credit which is scheduled to lapse at the end of 1976.

This option is supported by the Labor-Management Committee.

Pros:

- Reduces uncertainty for businesses which must plan investment far in advance.
- Is a tax benefit proposal which does not increase the FY 1976 budget deficit.

Cons:

- We do not have to make a decision now and a delay would allow the issue to be considered with our corporate tax reform proposals.
- Postponing proposing a further extension allows time to determine whether economic conditions in 1977 are likely to warrant an extension.

Option C: Propose extending the changes in corporate surtax and rates which would cost about $1.5 billion. (Identical to option A). Propose a $2.5 billion one year reduction in corporate rates with the $2.5 billion earmarked for commencement of corporate integration in 1977 or broadening stock ownership.

Pros:

- May enhance the political chances of corporate tax reform.
- "Tilts" tax cut more in favor of capital formation.

Cons:

- Further increases the deficit.
- May encourage movement in Congress for larger reductions for individuals.

Option D: Do not propose any additional tax reductions for corporations.

Pros:

- Avoids additional increase in budget deficits.

Cons:

- Imposes a significant relative tax increase on small corporations.
- Is inconsistent with our efforts to stimulate capital formation.

Decision

Option A ____________ Propose extending the changes in corporate surtax and rates which will expire at the end of 1975. This would reduce tax liabilities by approximately $1.5 billion.

Option B ____________ Propose an indefinite extension of the increase in the Investment Tax Credit which is scheduled to lapse at the end of 1976.

Option C ____________ Propose extending the changes in corporate surtax and rates which would cost about $1.5 billion. (Identical to option A.) Propose a $2.5 billion one year reduction in corporate rates with the $2.5 billion earmarked for commencement of corporate integration in 1977 or broadening stock ownership.

Option D ____________ Do not propose any additional tax reductions for corporations.

September 17, 1975

The President's Labor Management Committee

Without further action by the Congress, withholding tax rates will increase on January 1, 1976. Action should now be taken to maintain the present withholding tax rates and investment tax credit without limit of time.

These recommendations reflect the views of the committee in its statement of December 30, 1974 to spur recovery.

The committee also reiterates its view that this tax action be enacted "independently of tax reform which should be studied and implemented at a later date."

In order to do this, in view of the tax action of the Congress earlier this year, the following should now be enacted with regard to personal taxes:

1. Continue the increased low income allowance

2. Continue the increased percentage standard deduction

3. Continue the current refundable tax credit

4. Increase the tax credit per exemption from the current $30 to a new level of $45

The committee is of the view there should be no tax rebates as in 1975.

The surtax exemption, which primarily benefits small business, should also be continued.

D

AMOUNT OF AGGREGATE TAX REDUCTION BY INCOME CLASS

Income (AGI) Class ($00)	1974 Law Tax Liabilities	Option A 1975 Act $8 Billion	Option B Magnified 1975 Act $12 Billion	Option C:1 Reduces marginal rates to 53% bracket	Option C:2 Reduces marginal rates to 36% bracket	Option C:3 Widens all tax brackets by 30%
To 0	283	--	--	--	--	--
0 - 5	1779	-800	-1086	-690	-691	-540
5 - 10	4092	-2252	-3389	-2415	-2540	-1582
10 - 15	9251	-1879	-2899	-2415	-2893	-1461
15 - 20	21239	-1606	-2334	-2527	-2886	-1868
20 - 30	20910	-1064	-1646	-2462	-2492	-2366
30 - 50	38417	-303	-466	-1301	-959	-1929
50 - 100	11875	-83	-127	-883	-291	-1452
100 +	10952	-16	-24	-237	-64	-581
TOTAL	116799	-8003	-11970	-12929	-12817	-11779

Office of the Secretary of the Treasury
Office of Tax Analysis

September 29, 1975

E

THE WHITE HOUSE

WASHINGTON

October 2, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN LWS

SUBJECT: The Effects on Food Prices of Additional Grain Sales to the Soviet Union and Eastern Europe

1. The Current Situation

Under current conditions of grain demand and inventories, any combination of (a) reduced domestic crops, and (b) additional Soviet sales, and (c) additional East European sales will have some domestic price impact. The size of the price impact will depend on two main factors. The first is the level of sales currently expected by grain traders and,hence, already incorporated in market prices. The second is the degree of price response to additional sales or to a crop shortfall.

The best available information indicates that current futures market prices anticipate about five million metric tons of additional sales to the Soviet Union. If the October 11 Crop Report shows no domestic crop reduction, announcement of more than five million tons of additional sales to the Soviet Union would increase grain prices, while an announcement of less than five million tons would depress prices.

2. Price Increases at the Farm from Additional Sales

The price consequences of additional grain sales beyond five million tons have been estimated from the statistical supply and demand models of USDA. The most pessimistic estimate is that a 40 cent per bushel increase in the price of wheat and a 12 cent per bushel price increase in the price of corn would result if increased demands or reduced supplies were eight million tons rather than five million tons. If these increases in feed grains prices occurred, it would result in a two percent increase in livestock and livestock product prices.

3. Retail Price Consequences of Additional Grain Sales

These farm price increases assuming eight million tons of additional sales would increase the June 1975 to June 1976 change in the food component of the CPI by an additional 0.4 to 0.9 percentage points. Thus, the estimated June to June increase of five to six percent from five million tons additional sales, would be increased at most by 0.9 percent with eight million tons additional sales.

All these forecasts assume that additional sales of five million tons to the Soviets and East Europeans, will be the total of their demands on our market. It is likely the Soviets and East Europeans will be able to divert some additional export demands to the United States indirectly, by purchases from third markets. As long as we maintain open export markets a certain amount of price impact due to indirect Soviet demands will reach U.S. grain markets in spite of limits on direct sales.

Even though the price effects do not seem large, extreme caution on additional sales is in order. The full eight million tons could consist of five million tons to the Soviets and three million tons to the Eastern Europeans, or in "leakage" through third markets, only if there are no further crop losses in the October 11 Crop Report. There is little basis for predicting price effects for totals beyond eight million tons, other than that they will be greater and may be proportionately much greater. Sales beyond this range would completely change market expectations and extreme price run ups could be in order.

A more detailed analysis of the effects on food prices of additional grain sales to the Soviet Union and Eastern Europe prepared by the Food Deputies Group is attached.

Attachment

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

ALAN GREENSPAN, CHAIRMAN
PAUL W. MACAVOY
BURTON G. MALKIEL

October 1, 1975

MEMORANDUM FOR: EXECUTIVE COMMITTEE-ECONOMIC POLICY BOARD

FROM: Paul W. MacAvoy and Bruce Gardner

SUBJECT: The Effects on Food Prices of Additional Grain Sales to the Soviets and Eastern Europe

1. The Outlook

In ten days the October Crop Report will provide new forecasts of the coarse grain crops in this harvest. Soon thereafter, decisions are likely to be made on additional sales to the Soviets and Eastern European countries. The demand and inventory conditions in this country and elsewhere now indicate that any combination of (a) reduced domestic crops and (b) additional Soviet sales and (c) additional Eastern European sales will have some domestic price impact. Any combination adding up to less than 5 million tons should keep grain prices close to present levels, and should keep increases in the food component of the CPI in the 5 to 6 percent range from the end of June 1975 to the end of June 1976. Larger crop losses or sales - adding up to a total of 8 million tons - should increase wheat prices by 5 to 9 percent and corn prices by 2 to 4 percent. These increases when worked through the cattle and hog markets should increase the food component of the CPI by an additional 0.4 to 0.9 percent from June 1975 to June 1976.

The basis for these very approximate forecasts is described in the following sections of this memorandum. First, grain prices at different levels of additional sales are forecast by applying different elasticity assumptions to the base supply and demand forecast of USDA. Second, price changes in the livestock industry are forecast. The basis for these forecasts is the feed prices as applied to USDA budgets for typical livestock feeding operations. Third, the higher grain and livestock prices are converted to wholesale prices in the WPI in the appropriate manner. Using the CEA WPI/CPI computer program, the CPI is forecast first based on present futures prices and then based on the grain and feed price changes.

2. Grain Prices at Alternative Sales Levels

The wholesale prices of wheat and corn are estimated at three different levels of "additional sales" of 3, 5, and 8 million metric tons. In each case the "additional sales" are assumed to be equally divided among corn and wheat, and to include both reductions in domestic crops and sales either to the Soviets or the Eastern Europeans.*

In order to make these comparisons meaningful, it is necessary to assume that if, for example, we limit sales to 3 million tons, then this will be the total additional amount. The Soviets will not be able to divert additional export demands to U.S. markets indirectly, by purchasing grain in third countries who would then buy from the United States. It is difficult, if not impossible, to prevent a certain amount of indirect Soviet demand from influencing our grain prices if we maintain open export markets towards non-Soviet buyers. Nonetheless, for purposes of this analysis it is assumed that a 2 million ton increase in sales to one country is a 2 million ton net increase in total U.S. grain exports.

The critical assumption for forecasting the domestic price impacts of more sales are the elasticities of supply and demand for grain. These parameters determine the price response for a given shift in supply from crop loss, or in

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* For example, the following "additional sales" provide possible combinations adding to 5 million tons.

	Case A	Case B	Case C
Reduction in grain production	0	3	-2
Sales to the Soviets	3	2	5
Sales to the East Europeans	2	0	2
Total	5	5	5

demand caused by additional sales. However, in the context of sales at this time, the supply response in production is negligible. The only source of additional supplies until new crops come in is drawdown of stocks, so that supply elasticity is that for stock drawdown. Thus, the central assumptions are the elasticity of demand and the elasticity of supply out of stocks.

The demand for wheat and corn in food and industrial uses is very inelastic. Typical estimates are in the range -.1 to -.2. However, feed use is generally estimated to be more responsive to price, and exports are also usually estimated to be price responsive. The elasticity of supply out of stocks is taken to be low but positive. The estimated price response to additional sales has to consider all these elements of the supply and demand. If responses are elastic enough, additional sales can be offset by reductions in domestic food and feed use, exports to other countries, and drawdown of stocks sufficient to prevent large price increases. If all these responses are inelastic, the price increases may be large.

The USDA has estimated supply and demand balances under 18 million metric tons of sales to the Soviets. This is taken to be equivalent to 8 million tons of additional sales to both the Soviets and Eastern Europeans. The supply and demand estimates are shown in Table 1. The USDA estimates the season average prices received by farmers for wheat and corn at $3.50 and $2.75 per bushel, respectively, at 8 million metric tons of additional sales.

The effects on components of the supply-demand balance of changes in sales may be sensitive to the timing and form of an announcement of additional sales. If smaller sales than are now generally expected are announced, say 3 million metric tons of additional sales, the resulting price decrease will be larger if the announcement is delayed very long. The reason is that within the next month cattlemen will be deciding whether to use cattle coming off the range for slaughter, fattening on grain, or breeding. If an announcement of low additional sales is made, but only after decisions to slaughter have been made, there will be less

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* With linear supply and demand functions, the price effects are the same as well for 3 million tons of additional sales and a 5 million ton crop loss in the October Crop Report.

TABLE 1

Supply, Use, and Prices Under 8 Million Metric Tons
of Additional Grain Sales*

(millions of metric tons)

	Wheat	Corn
Supply:		
Production and beginning stocks	66.8	151.8
Demand:		
Domestic use:	19.4	101.9
Exports:	34.0	35.5
Total Demand:	53.4	137.4
Ending Stocks:	13.5	14.4
Season-average price received by farmers:	$3.50	$2.75

*5.5 million tons of corn and 2.5 million tons of wheat, for the Crop year beginning July 1 for wheat and October 1 for corn.

opportunity for response to the lower feed prices of the nature of increased feeding. On the downside, feed demand will be less elastic than given a prompt announcement. Assuming that larger sales than forecast are announced, there is little or no effect from prolonging the announcement. Under these conditions more cattle can be slaughtered later. The asymmetry of results follows from the non-reversibility of too early slaughter in the first case.

Assuming that an announcement is made soon which will provide livestock producers with reasonable certainty, then the USDA estimates that each 1 million ton reduction in sales from the base level will reduce the price of corn 5 cents per bushel and the price of wheat 15 cents. The implied elasticities of demand are -.33 for corn and wheat.

Other sources have different estimates. Although there is reasonable agreement on elasticity of demand for food use, there is a wide range of estimates of elasticity of demand for all uses together (including exports and reservation demand for stocks). Some recent estimates for elasticity for all uses are:

	Source of Estimate		
	USDA	DRI	CEA (futures prices)
Wheat	-.33	-.25	-.55
Corn	-.33	-.50	-.25

All the estimates take into account current conditions of low stocks of corn and wheat.

The effects of 3, 5, and 8 million tons of additional sales at the high and low end of the elasticity range are shown in Table 2. It is assumed that the market expectation is for 5 million tons of additional sales.* Under the

* This is based on a wide variety of communications by CEA staff with market experts and traders in the last two weeks of September.

low elasticity estimates, which give the greatest price response, 8 million tons of sales increase the price of wheat 40 cents per bushel (9 percent) and the price of corn 12 cents (4 percent). These should be taken as maximum price responses to the 8 million ton sale, for two reasons. First, they use the lowest elasticity estimates. Second, the assumption of 5 million tons of additional sales currently incorporated in the market price may be too low. If 6 or 7 million tons are already in the market price, as some knowledgeable in the grain trade believe, then the 8 million ton sale would have a smaller price impact. Conversely, the 3 million ton sale would have a greater price-depressing effect than Table 2 shows.

2. Consequences for Livestock Prices

The grain price pertinent to the livestock sector is principally that for corn, which is three-fourths of total feed grains (corn, barley, sorghum grain, and oats). Because these crops are close substitutes for one another both in domestic feeding and in the export market, their prices tend to move closely together. Thus, the increases in corn prices generated by additional sales to the Soviets are a good indicator of price increases for all feed grains.

The livestock price consequences of feed grains price increases are dramatically different in the short run than over a longer period. In the short run there will be some tendency for farmers to liquidate livestock as food costs rise. The resulting increase in slaughter supply will tend to reduce meat prices. In the long run, given time to adjust fully to higher feed costs, farmers will not raise as much livestock. Slaughter is relatively less and meat prices are higher.

Attention is centered here on the long run four quarter period. The long run price impacts on livestock can be predicted even if very roughly because some data exist on feed requirements in producing weight gain on hogs, cattle, and poultry. At given weight gains, or supply, the required meat price change to pay for the higher feed prices can be estimated. Similar data for dairy and poultry allow an estimate of the impact of feed price increases on milk and egg prices as well.

TABLE 2

Grain price effects of 3, 5, and 8 million tons of additional sales, dollars per bushel, March wholesale price in Chicago*

	Additional sales (mil. metric tons)		
1. Assumed elasticity of demand = -.25 for wheat and -.25 for corn			
Wheat price	$4.22	$4.40	$4.80
Corn price	3.02	3.10	3.22
2. Assumed elasticity of demand = -.50 for wheat and -.50 for corn			
Wheat price	4.27	4.40	4.60
Corn price	3.06	3.10	3.16

*The March price is chosen to be roughly comparable to the USDA season-average price. The base price for 5 million tons of additional sales is the March futures price on September 29. To convert this figure to a farm level price 30 to 40 cents should be subtracted from the Chicago corn price and 35 to 40 cents from the Chicago wheat price.

The USDA budget data imply that corn price increases of the magnitude shown in Table 2 would have livestock and livestock product price impacts shown in Table 3. The price effects would be observed after a time period long enough for livestock breeders and feeders to adjust to the higher feed prices. Thus, the figures in Table 3 would pertain to livestock prices in mid-1976 as a result of additional sales this fall. Cattle, however, are an exception in that full adjustment would take somewhat longer. Futures-price behavior of fed cattle prices suggests that only about 60 percent of the price rise predicted by the USDA budgets would take effect by mid-1976. Nonetheless, in order to get a maximum price-change case, the USDA cattle budgets are used to predict the cattle-price effects of a grain price increase. In addition, it is assumed that soybean prices rise in the same proportion as corn prices.*

4. <u>The Effects on the Food Component of the CPI</u>

An estimate of the impact of additional sales on retail food prices depends on the lags with which grain prices are transmitted to livestock prices and then to retail prices. These lags are very difficult to estimate and quarter-by-quarter forecasts are therefore quite inaccurate. These forecasts of retail food prices are made only for mid-year or end of June 1976. This allows calculations of June 1975 to June 1976 food CPI changes under alternative sales levels. Marketing margins are assumed not to change as a result of changes in total sales to the Soviets or the Eastern Europeans.

*Soybean meal, though not nearly as important as corn, also makes a difference for feed costs and hence livestock prices. Because corn and soybeans are substitutes in feeding, and are also subsitutes in production by farmers, their prices tend to move together. Therefore, a grain sale which increases the price of corn will increase the price of soybeans even if no soybeans are sold directly. In the livestock price calculations of Table 3 it is assumed that the price of soybeans as well as other feed grains rise in proportion to the price of corn under the 8 million ton sale, and that they fall in proportion under the 3 million ton sale.

TABLE 3

Livestock and livestock product price changes
resulting from feed price increases

	3		5		8	
Elasticity of corn demand	-.25	-.5	-.25	-.5	-.25	-.5
Corn price increase ($/bushel)	-$.08	-$.04	0	0	+$0.12	+$.06
Associated livestock price increase by mid-1976:						
Hogs ($/cwt.)	-$.73	-$.36	0	0	+$1.09	+$.55
Cattle ($/cwt.)	-$.91	-$.46	0	0	+$1.37	+$.68
Broilers (¢/lb.)	-0.4¢	-0.2¢	0	0	+ .7¢	+0.3¢
Eggs (¢/doz.)	-0.7¢	-0.4¢	0	0	+ 1.0¢	+0.5¢
Milk ($/cwt.)*	-$.08	-$.04	0	0	+ .12	+$.06

*CEA estimate, not from USDA budgets.

For the forecasts shown in Table 4, the projected food CPI at 5 million tons of additional sales is based on current futures-market prices. Forecasts of the Food CPI are on the whole quite inaccurate, no matter which method is used. The USDA forecasts with econometric models and judgmental analysis. DRI and others use regression equations with changes in the CPI as the dependent variable and WPI components as independent variables. The futures markets prices are used here rather than these models because, as imperfect as they are, these prices show the impact of all the knowledge on future conditions on the estimate of futures price. Of the methods used, the futures price forecasts result in the lowest estimate of the increase in the CPI from June to June under the base case conditions. (Since we are concerned with the change in the CPI from additional sales, this use of the lowest forecast base is not a central consideration.) The food CPI for 3 and 8 million tons of sales is estimated by changing the futures prices by the amounts indicated in Tables 2 and 3 for crops and livestock.

The forecasts shown for elasticities of demand of -.25 may be viewed as estimates of the maximum price effect of additional sales, for several reasons. (1) The lower range of grain demand elasticities, and hence, highest feed price variability is used. (2) No change from current price prospects is assumed at 5 million tons additional sales; whereas, the market may already be incorporating more sales than this in futures prices. (3) The livestock-feed budgets assume no substitution for grain of other feeds, such as grass and roughage for cattle. (4) Barley, oats, sorghum grain, and soybeans are all assumed to increase in price by the same percentage as corn. (5) The length of time considered -- until June 1976 -- gives an appropriate maximum price effect while for shorter-term calculations, livestock prices probably would not rise as much.*

The effects of larger sales would not appear to be substantial, at least not within the 3 to 8 million ton range. The food component of the CPI would likely increase from .4 to .9 percent by going all the way to 8 million tons (as shown in Table 4).

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*To the contrary, it has been assumed that there is no leakage around any forecast level of additional sales. If leakage occurs, at assumed sales levels, prices will be higher than forecast. This can be compensated for in policy analysis by assuming additional sales of 6 million tons and 2 million tons leakage, for a total of 8 million tons, in the last column of Table 4 rather than assuming 8 million tons of sales and no leakage.

Table 4

Food at Home CPI
Under Alternative Sales Levels

		3	5	8
		Additional sales		
1. elasticity of demand for wheat and corn = -.25	Food CPI, June 1976	182.48	183.55	185.15
	Percent change from 5 m.t. sales	-0.6	0	0.9
2. elasticity of demand for wheat and corn = -.50	Food CPI, June 1976	183.02	183.55	184.35
	Percent change from 5 m.t. sales	-0.3	0	0.4

Extreme caution is in order. The full 8 million tons would consist of 5 million to the Soviets and 3 to the Eastern Europeans, only if there are no further crop losses in the October 11 Crop Report. If crops are reduced by 3 million tons, for example, either sales to the Soviets would have to be reduced to 2 million tons or additional sales to the Eastern Europeans cancelled in order to maintain the 8 million ton outer limit. There is scant basis for predicting price effects for totals beyond 8 million tons - other than that they will be greater and may be proportionately much greater.** Therefore, it is important to wait until the Crop Report to determine the appropriate level of additional sales to both the Soviets and the Eastern European countries.

** Extrapolation with constant elasticities is not appropriate this far outside the present or forecast range.