The original documents are located in Box C35, folder "Presidential Handwriting, 2/25/1976" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.

ECONOMIC AND ENERGY MEETING

Wednesday, February 25, 1976

2:00 P.M.

THE PRESIDENT HAS SEEN....

Pardon me, please--
I have to go
preach the Gospel
according to [the] Ford
to the Inland
publishers.

THE PRESIDENT HAS SEEN....

THE WHITE HOUSE

WASHINGTON

February 24, 1976

ECONOMIC AND ENERGY MEETING
February 25, 1976
2:00 p.m.
Cabinet Room

From: L. William Seidman LWS

I. PURPOSE

A. To review the current financial outlook for New York City and New York State.

B. To review the Administration's tax program and the Economic Policy Board's recommendations on specific tax policy issues.

C. To review the current status of the footwear import and specialty steel import cases.

D. To review agricultural policy organization.

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.

On February 17, Secretary Simon received the first formal financial report from New York City, submitted pursuant to the Credit Agreement entered into with New York City, New York State and the Emergency Financial Control Board. Treasury has analyzed that report and will review the immediate and longer term outlook for New York City and the current financial situation of New York State. A memorandum from Secretary Simon on the New York situation is attached at Tab C.

The Economic Policy Board has recently conducted an extensive review of tax policy in preparation for upcoming hearings in both the House and the Senate. The recommendations of the EPB Executive Committee on several tax reform issues and on estate and gift tax revisions are outlined and summarized in memorandums at Tab D. A brief review of the Administration's current tax initiatives is also found at Tab D.

Two recent International Trade Commission determinations on specialty steel imports and footwear imports are currently under consideration by the Trade Policy Committee. Brief summary papers outlining the background of the cases, the ITC determinations, the options available to you and the Congress (with relevant action dates), and the current status of the Trade Policy Committee review of these issues is attached at Tab E.

A memorandum outlining a proposed reorganization of agricultural policy making is attached at Tab F.

B. Participants: William E. Simon, L. William Seidman, Alan Greenspan, James T. Lynn, Elliot Richardson, W.J. Usery, Frank G. Zarb, Arthur F. Burns, James M. Cannon, Frederick B. Dent, Brent Scowcroft.

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

III. AGENDA

A. New York City

Secretary Simon will review the immediate and longer term financial outlook for New York City and New York State.

B. Tax Policy

Secretary Simon will review the Administration's tax program and the Economic Policy Board's recommendations on specific tax policy issues.

C. Footwear and Specialty Steel Import Cases

Ambassador Dent will review the current status of the footwear and specialty steel import cases.

D. <u>Agricultural Policy Organization</u>

William Seidman will review a proposed reorganization of agricultural policy making.

A

ECONOMIC FACT SHEET

The economic statistics of the past month or so have been quite favorable on balance. Employment and production have continued to rise, unemployment has declined, and price pressures have continued to recede. The recovery appears to be well established and solid.

Production

Revised data indicate a 4.9 percent annual rate of increase in real GNP during the fourth quarter with a rate of increase of 8.3 percent during the second half of last year.

Industrial production rose by 0.7 percent in January. The increase was most notable in the consumer goods area but the gain in production was fairly widespread. New orders for durable goods rose by 2.3 percent in January. Business inventories declined in November and December in the face of fairly strong sales, suggesting additional strength in production in the next few months.

Personal Income

Personal income increased $13.6 billion in January. Rising employment and a longer workweek lifted private wage and salary payrolls sharply ($9 billion). Since last April personal income has advanced at an 11.7 percent annual rate. Real per capita disposable income rose at a 5.1 percent annual rate during the last three quarters of 1975.

Retail Sales

The data available so far indicate that retail sales have held up quite well. Advance estimates indicate a 0.3 percent decline in retail sales during January, following the large 2.8 percent increase in December. Sales of domestic automobiles were strong in January and early February, with sales rates in the area of 8.5 to 8.7 million annual rates.

Housing Starts

Housing starts in January were down slightly to an annual rate of 1,221 thousand units. The rise starts has paused since November but building permits have continued to advance moderately. This, together with the continued improvement in the availability of mortgage financing suggests a continued moderate recovery in housing in the months ahead.

Prices

The consumer price index rose by a seasonally adjusted 0.4 percent in January, bringing the rate of increase during the past three months to an annual rate of 6.5 percent during the past three months. Retail food prices declined slightly in January. Wholesale prices have acually declined slightly over the past three months.

Employment and Unemployment

Employment as measured in the household survey rose by 800,000 in January but the magnitude of the increase may be overstated. Employment in the establishment survey, which is a more reliable month-to-month indicator, also rose sharply, by 360,000 in January. The improving labor market situation was also reflected in another increase in the length of the average workweek in manufacturing.

The unemployment rate declined by 0.5 percent - much more than had been expected. There is no doubt that unemployment is declining, but the sharpness of the January drop is unlikely to be repeated, and the rate could even edge back upwards slightly in February.

B

February 24, 1976

ECONOMIC POLICY BOARD REPORT

<u>Issues Considered by the EPB During Weeks of February 2, 9, and 16</u>

1. Loan Rates for Wheat, Corn and Soybeans
   Discussed USDA proposal to increase loan rates for corn and wheat and to reinstitute loan rate program for soybeans, Approved submission of options memorandum to the President.

2. Current Status of Banking Institutions
   Report by Chairman Burns and Governor Partee concluded that: (1) the flow of earnings for banks, even with large write-offs, is still strong and that the future outlook for increased earnings is very good; (2) there has been improvement in the liquidity quality of both bank assets and liabilities; (3) despite large write-offs, bank capital has continued to increase; and (4) the situation of the banks is significantly influenced by the state of the economy and this is in part responsible for the marked improvement in bank stock prices during the past few months.

3. Labor Negotiations Committee
   Approved establishment of an EPB Labor Negotiations Committee chaired by the Department of Labor and including Commerce, CEA, CWPS and FMCS.

4. Status of Tax Initiatives
   Reviewed the legislative status of the President's tax initiatives and held a special session on tax reform issues and estate and gift tax revisions.

5. Services and the Multilateral Trade Negotiations
   Approved creation of a Task Force on Services and the Multilateral Trade Negotiations under the auspices of CIEP. Commerce will chair the interagency task force which will: (1) review international issues of significance to U.S. service industries and describe and assess the effectiveness of existing international forums on these topics; (2) identify the problems faced by the U.S. service industries in international commerce not adequately covered at the present time; and (3) consider solutions for these problems and how the multilateral negotiations should relate to these solutions.

6. Coffee Agreement
   Approved recommending to the President that the United States sign the Third International Coffee Agreement and submit it for Senate ratification.

7. 1975 Defined Benefit Plan Terminations
   Reviewed DOL memorandum and requested Labor to continue its investigations of the effects of the Employment Retirement Income Security Act of 1974 (ERISA) on the rate of formation of new pension plans.

8. Financial Institutions Review of Pending Legislation and Legislative Activity
   Reviewed legislative status of the Administration's Financial Institution Act, congressional interest in bank regulatory agency consolidations, and congressional interest in greater oversight of bank regulation. Approved establishment of a Task Force on Financial Agency Regulatory Reform to develop recommendations regarding an Administration position on banking regulation and regarding congressional proposals for greater oversight by the Congress of the Federal Reserve.

9. Current Situation in Italy
   Reviewed Treasury memorandum on the current situation in Italy.

10. Taxation of Withdrawals from a Broadened Stock Ownership Plan
    Approved recommending that all withdrawals from a BSOP (other than realized appreciation in value of distributed securities) be taxed at capital gains.

11. Audit Reform
    Approved establishment of a task force to explore the need for reform of the Federal Government's audit system and to develop options on the issue for consideration by the Executive Committee.

12. Countercyclical Assistance
    Reviewed possible Administration responses to H.R. 5247.

<u>Task Force Status Reports</u>

1. Subcommittee on Economic Statistics

   - The Subcommittee is developing an Unemployment Cost Index (UPI) which would include fringe benefits as a proportion of total employment compensation. The comprehensive index will be available for some sectors of the economy in 1977 and economywide in 1978.

- The Subcommittee is exploring particular problems which potentially bias upward the CPI, including developing an alternative method to measure home ownership costs in the CPI. The Subcommittee will provide the Executive Committee with its recommendations on this issue in the Subcommittee's March monthly status report.

2. EPB/NSC Commodities Policy Coordinating Committee

   - Recommended that the U.S. sign the Third International Coffee Agreement and submit it for Senate ratification; likely economic effect of the Agreement is mildly positive; the Agreement relies on export quotas as its basic operating mechanism.

   - Recommended that the U.S. accept UNCTAD's invitation to an International Producer/Consumer Conference on Copper scheduled for March 23 through 26.

<u>Major Upcoming Agenda Items</u>

1. International Aviation Policy Statement
2. Product Liability Insurance
3. Study of U.S. Government Lending Guarantees for LDC Borrowing
4. New York City and State Financial Condition
5. Report of Task Force on Financial Agency Regulatory Reform
6. Report of Task Force on Services and the MTN

C

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

FEB 24 1976

MEMORANDUM FOR THE PRESIDENT

SUBJECT: Update on New York City

On Tuesday, February 17, I received the first formal financial report from New York City, submitted pursuant to the Credit Agreement we entered into with New York City, New York State and the Emergency Financial Control Board. Two key points stand out in the report:

1. New York City is close to target with respect to the current fiscal year (ending June 30) and should be able to repay our loans without disrupting services and without tapping other sources of funds (i.e., the pension funds) for substantial amounts.

2. The budget deficit which must be eliminated over the three fiscal years is substantially larger than was previously forecast: $1.021 billion versus $724 million.

This memorandum is in two parts. The first part addresses the outlook for New York City, both immediately and over the longer term. Part two deals with the current New York State situation, which is significant not only in its own right, but also because of its direct impact on New York City's finances.

Outlook for New York City

As noted above, New York City appears close to schedule for the current fiscal year. For the six months ending December 31, 1975, expenses were $3 million higher than planned. For the fiscal year as a whole, expenses are forecast at $218 million above the plan, due primarily to a $118 million increase in welfare and social services costs and a $90 million increase in debt service. This expenditure increase, however, will be largely offset by a $151 million increase in forecasted revenues.

While we cannot be certain that New York City will not incur at least a slight cash flow deficit this fiscal year, the Federal Government's immediate financial interest is protected by the fact that approximately $2.2 billion of the pension funds' $2.53 billion three year commitment remains available. Any shortages can be made up from this source.

The longer term outlook is considerably less clear. Given the enormity of the further budget cuts required -- over $400 million in FY 77 and an additional $400-500 million in FY 78 -- I doubt whether the job can be done with the piecemeal approach employed to date. In other words, unless New York City and New York State are willing to address head-on one or more of the following key problem areas, a permanent solution is unlikely:

-- employee compensation and fringe benefits;

-- welfare and social services;

-- courts and correction system;

-- City University.

Compensation. Employee compensation, particularly fringe benefits, is the root of the overall problem. Nationwide, fringe benefit costs average less than 20 percent of direct salary costs. In New York City, the average cost of fringe benefits exceeds 50 percent of direct salary. To quantify this burden: if New York City reduced its fringe benefit costs to the national average, the annual savings would be in the $1.5 - 2 billion range, creating an annual surplus well in excess of $500 million without any other expenditure cuts.

There is, at least theoretically, the opportunity in the months ahead to make significant progress in this area. Negotiations are beginning on the transit workers contract which expires March 31. The Teachers' contract, negotiated last fall but rejected by the Emergency Financial Control Board, has not been finalized. And most other major labor contracts will be up for negotiation this summer and fall.

The current transit negotiations will, in effect, serve as the bellweather on this front. If a cut in overall costs, either through a pay cut or a reduction in fringe benefits, is achieved, it will be a highly favorable sign. If, on the other hand, the new contract provides for higher compensation, it would be a cause for serious concern.

Firm action in this area could well precipitate one or more major strikes. More importantly, given Governor Carey's political ambitions, it is unlikely that he would be willing to take a strong position, which would be viewed as anti-labor. Accordingly, I do not believe we can be confident of meaningful progress in this area.

Other Areas. Progress in the other three areas -- welfare, courts and corrections, City University -- in effect requires a shifting of the financial burden to New York State. In light of New York State's own fiscal condition, it is unrealistic to expect a meaningful step in the welfare area, especially because any change in the relative state/local shares would have to be applied statewide. Such a statewide shift would substantially increase the billion dollar cost of taking over New York City's share.

The courts and the university are different matters. New York City is the only jurisdiction in the state that pays for its own portion of the state courts and corrections system. Integrating the system with the overall state system would result in a savings to New York City of $200 - 250 million. Given the efficiencies of integration, the additional cost to the state would be considerably less.

This is even more true in the case of the university. Transferring the university to New York State would save New York City more than $300 million, yet a rough estimate of the cost to the state is $100 - 150 million. The possibility of such a transfer is being given serious consideration by both Beame and Carey. We know of no concrete steps, however, towards implementing it.

In short, of the four key areas, the larger two -- compensation and welfare -- must be viewed as unlikely. However, the smaller two are quite feasible. I am confident that if New York City were relieved of the $500 - 600 million courts/university burden, that action, coupled with the existing cost reduction program, would result in achievement of a balanced budget by fiscal 1978.

Proposals for Delay. In the past week, both Governor Carey and Felix Rohatyn have expressed the view that New York City's problems may be too great to solve in 3 years and that an extension of the plan to 5 or even 10 years could be required. In addition, Rohatyn has taken the position that some new type of Federal aid will be necessary: either some permanent deficit financing for New York City or an RFC-type program for all cities.

Mayor Beame has publicly disassociated himself from this position. He was asked at a press conference about the Carey suggestion of a stretch-out and replied: "the law says three years and I intend to obey the law."

The problem can be resolved within the three years only if all interested parties -- New York City, New York State and the Emergency Control Board -- exert the maximum, good faith, effort. Given this necessity, it is especially disturbing that Governor Carey, as Chief Executive of two of the parties, shows signs of taking a different tack.

We suspect that the Carey/Rohatyn remarks could be the forerunner of a new bail-out type initiative in Congress. We will be watching closely for signs of this.

New York State

The outlook for New York State is considerably better, but there are bases for concern. New York State must find a way to meet its own seasonal financing needs of nearly $4 billion in April, May and June. Failure to raise these funds will render the State unable to make aid payments to New York City and every other local jurisdiction in the State. Since our loans were made in anticipation of these payments and since many other jurisdictions have borrowed in anticipation of such payments, a failure to make the aid payments would result in numerous defaults.

There are two threshold requirements to a successful spring financing by the State. First is prompt adoption of a balanced budget for the State's 1977 fiscal year (April 1). Second, there must be a solution to the financing problems of the State's agencies, particularly the New York State Housing Finance Agency.

Budget. At present, there appears to be bi-partisan recognition in the New York State Legislature of the importance of adopting a balanced budget quickly. While it is too early in the budget process to predict with any confidence whether this objective will be met, recent statements by leaders of both parties suggest a considerable change in attitude from that which prevailed last year. Accordingly, we are cautiously optimistic in this area.

Agencies. The agencies of New York State require approximately $2.5 billion in permanent financing. The bulk of this amount is to refund short-term notes which mature at a rate of $80 - 100 million per month over the next 18 months; the remainder is to finance completion of construction projects now in progress. It is clear that the market will not continue to supply any portion of the financing on a month by month basis. Accordingly, sources for the entire $2.5 billion must be committed at the outset.

The agency financing is itself contingent upon the adoption of a balanced budget. If a balanced state budget is adopted, a complex, but credible and workable, package has been developed to finance the entire amount.

New York State. The State picture is as follows. Approximately $1.6 billion of the $4 billion seasonal financing need can be handled through various state funds, leaving $2.4 billion to be done by the private sector. According to current plans, the private portion will be done in three ways:

-- bank credit;

-- public sale of securities;

-- pre-payment of taxes by major corporate taxpayers (in effect, tax anticipation financing).

In recent days, we have detected a new sense of determination and optimism among the leaders of the New York City financial community. Previously, key institutions were negative, hoping they could assume that more Federal help would be forthcoming. We made it clear that financial assistance would not be available.

The cooperative attitude of State Comptroller Levitt is also partially responsible. Much credit must be given to a newly created advisory board consisting of Bill Morton (former President of American Express and a municipal bond expert), Bill Martin (former Chairman of the Federal Reserve) and Gene Black (former Chairman of the World Bank). Given the fundamental soundness of the State and the adequacy of its cash flow, the current problems are largely psychological. Accordingly, the entry of new, but experienced, faces has given the entire effort an important lift.

The next 2 - 3 weeks will be critical in finalizing the financing arrangements for both the Agencies and the State. An essential element will be substantial participation by major banks located outside New York State. In that regard, Arthur Burns and I may well be called upon to help with the process of persuading such banks. I have quietly indicated that under appropriate circumstances -- a balanced budget and a sound overall financing package -- I would play such a role.

Congressional Activity

Senate Banking and House Appropriations have scheduled oversight hearings on April 1 and April 6 respectively. In addition, our liaison group with Senate and House Banking and Appropriations staffs will have its fourth meeting on February 26.

On February 20, a Senate/House conference reached agreement on new municipal bankruptcy legislation. We were successful in persuading the conferees to include language addressing the concern expressed by some state and government groups that the legislation would harm the bond market by making it too easy to go into bankruptcy.

William E. Simon

D

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

FEB 24 1976

MEMORANDUM FOR THE PRESIDENT

Subject: Tax Policy

This memorandum summarizes the principal recommendations of the Executive Committee of the Economic Policy Board on the subject of tax policy. A special meeting of the Executive Committee was held on February 21 to review both tax reform issues and estate and gift tax revisions. The attached memorandum sets forth the details.

A. REVENUE AND BUDGET CONSTRAINTS

We recommend that a proposed package of tax reform measures have a neutral effect on the Budget.

B. TAX REVISION PACKAGE

Six aspects of the House-passed Tax Reform Bill deserve special attention:

1. <u>Tax Shelters</u>

Our recommendations in the area of tax shelters are:

- We support the limitation on artificial losses ("LAL") as a sound concept to prevent taxpayers with high economic incomes from sheltering large amounts of that income by use of the tax system to a degree that has been perceived as abusive.

- LAL should not apply to exploratory or developmental oil and gas wells.

- LAL should not apply to sports franchises.

- We are opposed to a proposal to "recapture" intangible drilling cost deductions on the disposition of oil and gas properties.

- We are opposed to a $12,000 deduction limitation on personal and investment interest expenses.

2. Minimum Taxable Income

The House Bill does not adopt the 1973 Treasury proposal of a minimum taxable income ("MTI") concept as an alternative tax. MTI was designed to deal with taxpayers whose income tax liability is significantly reduced by the pyramiding of exclusions and personal deductions.

We continue to believe that the basic MTI proposal is sound and that it is preferable to both the current minimum tax and the minimum tax as amended by the House. We recommend modification of the proposal to raise the revenues necessary to maintain the fiscal neutrality of the tax revision measures. The proposal will not impact on charitable contributions but will impact on capital gains (raising the effective rate to 42 percent for certain taxpayers).

3. Simplification Measures

We are generally satisfied with the simplification provisions of the House Bill but do recommend reproposing the 1973 Administration initiated "simplification deduction" as a vital part of simplification.

4. Foreign Income Provisions

We recommend urging repeal of withholding taxes on dividends and interest remitted to foreigners with respect to their investments in the United States.

5. DISC

We recommend no change from present law with respect to the DISC provisions.

6. Capital Gains

We favor the House Bill amendments dealing with lengthening of the holding period requirement for long-term capital gains and losses. We also favor the increase in the amount of ordinary income which may be offset by capital losses. We will urge support of a 1974 Ways and Means Committee tentative decision for an increase of the 50 percent deduction for capital gains based on a sliding scale holding period.

C. OTHER CAPITAL FORMATION MEASURES

We support the integration proposal outlined last July and recommend continuing to advance the proposal. Given the existing budget constraints we recommend that no other new capital formation measures be suggested to the Senate Finance Committee.

D. ENERGY TAXES

We oppose any changes in the area of oil and gas taxation until price controls are fully removed. We do support the home insulation credit and the six-point utilities relief package.

E. ESTATE AND GIFT TAX REVISIONS

We recommend:

-- Increasing the estate tax exemption to $150,000.

-- Opposing any tax on unrealized capital gain on property transferred at death.

-- Allow free interspousal transfers without imposition of estate or gift taxes.

-- Reaffirming the Administration's proposal to relieve the liquidity problems of family farms and business by liberalizing the provisions for installment payment of estate tax.

-- Taking no position on the other principal issues of estate and gift taxes--unification of estate and gift taxes and additional taxes on generation-skipping trusts.

William E. Simon

THE SECRETARY OF THE TREASURY

WASHINGTON 20220

FEB 24 1976

MEMORANDUM FOR THE PRESIDENT

Subject: Tax Policy

This memorandum discusses the principal recommendations of the Executive Committee of the Economic Policy Board on the subject of tax policy. A special meeting of the Executive Committee was held on February 21, 1976 to review:

-- Tax reform issues which will be the subject of hearings before the Senate Finance Committee commencing on March 17, and

-- Estate and gift tax revisions which will be the subject of hearings before the House Ways and Means Committee commencing on March 15.

A. REVENUE AND BUDGET CONSTRAINTS

Critical elements in positioning the Administration with respect to any tax revision measures are the revenue and budget constraints. To the extent that tax revision measures we propose are taken into account in the 1977 Budget, no particular problems arise. However, to the extent that tax revision measures we propose are not specifically taken into account in the Budget, it is necessary to decide at the outset what our position ought to be.

We recommend that a proposed package of tax reform measures have a neutral effect on the Budget. This position accords with the assumptions upon which the Budget was prepared and permits us to be generally consistent with the Administration's previous position on various tax reform measures. Although the House-passed Tax Reform Bill would raise revenues by about $1.4 billion annually, history indicates this revenue gain will be eliminated by the Senate. We believe we should put forward <u>our</u> proposals for making the Bill fiscally neutral.

B. TAX REVISION PACKAGE

The House-passed Tax Reform Bill has 19 titles, more than 100 sections and is 661 pages long. The Bill is the product of more than two and one-half years of labor by the Ways and Means Committee. It is designed to achieve three objectives:

-- Improve the equity of the income tax at all income levels,

-- Simplify many tax provisions, and

-- Make important improvements in the administration of the tax laws.

Six aspects of the Bill deserve special attention:

1. Tax Shelters

In 1973 the Administration introduced proposals to deal with the problem of taxpayers with high economic incomes who pay little or no tax. The complementary proposals were a limitation on artificial losses ("LAL") and a minimum taxable income ("MTI") concept. LAL dealt with taxpayers who reduce their high gross incomes through the use of artificial losses created by accelerated deductions which under current law may be claimed before any income has been generated by the investment. MTI was designed to deal with taxpayers whose income tax liability is significantly reduced by the pyramiding of exclusions and personal deductions.

The House Bill adopts a modified version of the Treasury's 1973 LAL proposal. As adopted by the House, LAL would apply to real estate ventures, certain farm activities, developmental oil and gas wells, equipment leasing ventures, motion picture ventures, and sports franchises. The House Bill also provides for the recapture, on the disposition of oil and gas interests, of the excess of intangible drilling cost deductions over the deductions which would have been allowable had the expenses been capitalized. In addition, the House Bill provides for a $12,000 limitation on the deduction of personal and investment interest.

Our principal recommendations in this area are:

-- We generally support LAL as a sound concept,

-- LAL should not apply to developmental oil and gas wells because the provisions conflict with our general policy of energy independence,

-- For similar reasons, we are opposed to the proposal to recapture intangible drilling cost deductions,

-- LAL should not apply to sports franchises because the tax abuses in this area can be dealt with adequately at an administrative level by the Internal Revenue Service, and

-- We are opposed to the $12,000 limitation on personal and investment interest because it conflicts with our goal of encouraging capital formation.

2. Minimum Taxable Income

The present minimum tax is a 10 percent tax on nine items of tax preference, five of which are applicable to individuals. These include (1) the excluded half of capital gains, (2) accelerated depreciation on real property, (3) accelerated depreciation on personal property subject to a net lease, (4) the excess of percentage over cost depletion, and (5) the bargain element in a qualified stock option at the time of its exercise. The total amount of tax preferences is reduced by a $30,000 exemption and the taxpayer's regular income tax.

In 1973 the Administration proposed the minimum taxable income concept as an alternative to the regular tax. Under that proposal a taxpayer would pay a minimum income tax or the regular income tax, whichever is greater. The minimum income tax would be determined by applying the regular tax rates to the taxpayer's adjusted minimum taxable income base (described below).

The House Bill does not adopt the Treasury MTI proposal. Instead, the existing minimum tax provisions are amended to increase the rate of tax to 14 percent and to eliminate the deduction for regular income taxes paid. In addition, the $30,000 exemption is reduced to $20,000 and is phased out on a dollar-for-dollar basis as preference items exceed $20,000. The list of tax preferences is expanded to include (1) the excess of itemized deductions over 70 percent of adjusted gross income and (2) tax deferral items which are not deferred under the LAL proposal. The minimum tax amendments in the House Bill would increase Fiscal 1977 receipts by $1.08 billion.

In the past we have taken the position that the minimum tax is defective because in most cases it only slaps the wrist of taxpayers with large economic incomes, and it is primarily an additional flat rate tax on large capital gains.

We continue to believe that the basic MTI proposal is sound and that it is preferable to both the current minimum tax and the minimum tax as amended by the House. However, because of the revenue and budget constraints--i.e., the necessity of having a fiscally neutral package of tax revision measures--we recommend modification of our original proposal even though its application will increase the burden on capital gains (to 42 percent) of taxpayers subject to MTI. The MTI proposal we recommend will increase Fiscal 1977 receipts by $411 million, $672 million less than the House Bill.

The principal features of the MTI proposal we recommend are as follows: The starting point would be a taxpayer's taxable income. The items of tax preference would be the excluded portion of long-term capital gains and the excess of itemized deduction over 70 percent of adjusted gross income. The regular tax rates would apply to 60 percent of taxable income plus these items of tax preferences. The proposal will be fine-tuned to eliminate any impact on charitable contribution deductions. The advantages of the MTI proposal are:

-- The proposal is an alternative tax which is progressive rather than additional tax which is not progressive,

-- The computations are relatively simple to make, and

-- The proposal is generally consistent with the Administration's prior position.

3. Simplification Measures

The simplification provisions of the House Bill include modification of the sick pay exclusion, the child care deduction and revision of the retirement income credit provisions. These provisions are generally satisfactory.

The most important simplification provision, recommended as part of the 1973 Administration proposals, was the elimination of a series of hard-to-itemize deductions and the substitution of a "simplification deduction" which was easy to compute and on the average somewhat larger than the deduction given up.

The simplification deduction was not adopted by the House. We continue to believe that the simplification deduction is a vital part of simplification and <u>recommend</u> its adoption.

The proposal affects taxpayers who itemize their deductions. It provides for a $400 "miscellaneous deduction allowance" in lieu of a deduction for state gasoline taxes and the imposition or raising of certain floors on deductions for (a) certain employee business and miscellaneous expenses, and (b) medical expenses and casualty losses. Employee business and miscellaneous expenses--e.g., union dues, home office expenses, investment advisory services--will be deductible only to the extent they exceed $200. Medical expenses and casualty losses will be aggregated and deductible only to the extent they exceed 5 percent of a taxpayer's adjusted gross income. This proposal is expected to have a neutral effect on Fiscal 1977 receipts.

4. <u>Foreign Income Provisions</u>

While we generally favor the foreign income provisions of the House Bill, we <u>recommend</u> urging repeal of withholding taxes on dividends and interest remitted to foreigners with respect to their investments in the United States.

When capital controls were eliminated in early 1974, it became again possible for American capital to move freely abroad. That was a desirable development, consistent with the view that free capital markets and free capital flows are in the best interests of everyone. Consistent also with that view, the Administration proposed the repeal of the so-called withholding taxes imposed on dividends and interest remitted to foreigners with respect to their investments in the United States.

These withholding taxes are a serious impediment to free and competitive capital markets, they produce only minor revenues, they are largely circumvented, and they operate primarily to erect barriers of complexity which inhibit foreign investment and deprive our country of needed capital. The elimination of these taxes is in the best interest of competitive free capital markets and, therefore, in the best interests of everyone. The House Bill has made permanent an exemption for interest on foreign deposits with U.S. banks. This exemption should be extended to all forms of interest and to dividends on foreign portfolio investment. These taxes deter access to capital. Therefore, we recommend urging their repeal.

5. DISC

Under the House Bill, the earnings of a DISC would be available only to the extent that the gross receipts of the DISC exceed the adjusted base period gross receipts of the DISC. The adjusted base period gross receipts are an amount equal to 75 percent of the average of the export gross receipts of the DISC for taxable years during the base period. Complicated rules are provided for adjusting the base period amounts in cases where trades or businesses are disposed of or acquired.

We continue to believe that the DISC provisions provide a significant cash flow for domestic investment and that their curtailment must be viewed as an increase in taxes on those companies which are trying to manufacture and export at a time when investment capital and jobs are needed. Therefore, we recommend no change from present law.

6. Capital Gains and Losses

The House Bill extends the holding period to qualify for long-term capital gain or loss treatment from "more than 6 months" to "more than 12 months," phased-in over three years. The House Bill also increases the amount of ordinary income against which capital losses may be deducted from $1,000 to $4,000 (phased-in over 1976-1978). Although the House provisions are piecemeal tinkering with capital gains, they are generally acceptable.

We recommend the adoption of a sliding scale approach for capital gains along the lines of the 1974 Ways and Means tentative decisions. The principal feature of this proposal is a new deduction (in addition to the present 50 percent deduction) varying from 1 to 20 percent of the gain for each year the asset is held in excess of five years. The Administration endorsed these proposals in 1974 and in 1975. The impact on Fiscal 1977 receipts is estimated to be minimal because of the anticipated "unlocking" effect. In the long-run, annual revenue decreases are estimated to be $800 million.

C. OTHER CAPITAL FORMATION MEASURES

The Administration is on record on the integration proposal (as outlined in my testimony before the Ways and Means Committee last July). We recommend continuing to advance the proposal, keeping in mind the January 1, 1978 effective date to minimize the impact on Fiscal 1977 receipts.

We are also on record on the proposed reduction in corporate rates, the proposed increase in the investment credit and the broadened stock ownership proposal. All of these measures bear on capital formation and are accounted for in the 1977 Budget.

Given the existing budget constraints, we recommend no new measures be suggested to the Senate Finance Committee but that the occasion be taken to articulate our long-run goal of advancing capital formation and to lay out our views on the basic issue of how the tax system should provide for the taxation of income from capital.

D. ENERGY TAXES

Our overall attitude in the area of taxes that may have an impact on energy activities is that no additional impediments on these activities are justifiable until price controls are fully removed. Thus, as noted above, we oppose the application of LAL to any oil and gas ventures.

In testimony before the Senate Finance Committee last July, we opposed most of the tax aspects of H.R. 6860--a bill which includes provisions for restrictions on oil imports, tax incentives for consumer conservation, tax incentives for business conservation and conversion to alternative energy sources, and creation of an energy trust fund. The only provision of the bill we continue to support is a nonrefundable income tax credit (up to a maximum of $150) equal to 30 percent of qualified insulation expenditures up to $500 with respect to used homes. The anticipated revenue loss is approximately $260 million in Fiscal 1977.

In addition, we continue to support the six-point utilities relief package which is an energy-related item and is accounted for in the 1977 Budget.

E. ESTATE AND GIFT TAX REVISIONS

Over the past decade there has been much discussion of estate and gift tax reform but little action. There are a number of reasons.

-- Estate and gift taxes affect relatively few taxpayers and generate relatively little revenue.

-- The reform proposals are mainly proposals to increase taxes, for example by taxing capital gains on property transferred at death.

-- The issues are relatively technical and complex.

During this period pressures have been building up for tax relief rather than reform. From a tax on the rich, the estate tax has become a broad-based tax with 11 percent of decedents' estates required to file returns (7.6 percent pay estate tax). Adjusting the $60,000 estate tax exemption for inflation since 1942 would require a $210,000 exemption. Small business and farm interests have been particularly vocal in complaining about the impact of estate taxes, and the pressures for relief have been brought to a head by the Administration's proposal to liberalize the installment payment provisions.

We <u>recommend</u>:

-- Increasing the estate tax exemption to $150,000. To minimize the revenue impact, the lower rate brackets (3 percent to 28 percent) on the first $90,000 of taxable estate would be eliminated and the new rate schedule would start with a 30 percent rate.

  o The revenue cost would be $1.16 billion annually but would be phased in over five years, with a first year cost of $155 million.

-- Opposing any tax on capital on property transferred at death. Any such tax would in reality simply increase death taxes and would attract strong opposition from small business and farming interests.

-- Allow free interspousal transfers without imposition of estate or gift taxes.

o Present law allows a deduction for transfers to a spouse under the gift tax equal to one-half of the amount transferred to a spouse and under the estate tax equal to the amount transferred to the spouse but with a maximum limit on the estate tax deduction of one-half of the adjusted gross estate.

o Free interspousal transfer rule supported by most prior studies and by women's organizations; it comports with the tendency of many couples to common management of their assets without regard to nature of ownership as joint property, separate property, etc.

o The revenue cost, in addition to a $150,000 estate tax exemption, would be about $500 million, which could be phased in over a period of years.

-- Reaffirming the Administration's proposal to relieve the liquidity problems of family farms and business by liberalizing the provisions for installment payment of estate tax.

-- Taking no position on the other principal issues of estate and gift taxes--unification of estate and gift taxes and additional taxes on generation-skipping trusts.

o These are more technical issues, the solution of which can impinge on estate plans unless carefully handled with adequate transition rules.

o Our testimony would discuss the issues and the pitfalls.

o There would be a limited technical recommendation dealing with a particular abuse through gifts in contemplation of death to utilize the existence of a separate gift tax structure to minimize total estate and gift taxes.

William E. Simon

William E. Simon

THE SECRETARY OF THE TREASURY

WASHINGTON 20220

FEB 24 1976

MEMORANDUM FOR THE PRESIDENT

Subject: Current Status of Administration-Initiated Tax Proposals

This memorandum outlines the current status of Administration-initiated tax proposals.

1. Deepened Tax Cuts

A bill has been drafted but has not yet been introduced. We have not yet decided whether this bill should be introduced in the House at this time. Undoubtedly, the proposal will be considered by the Senate Finance Committee when it takes up the House-passed Tax Reform Bill which contains tax cut proposals for the full year 1976.

2. Broadened Stock Ownership Plan

Pursuant to a meeting with Senator Long which Mr. Seidman attended, we have not submitted a bill on BSOPs. Instead, we are working with Senator Long's staff to attempt to develop a mutually satisfactory proposal covering the concepts of broadened stock ownership and employee stock ownership. We have promised the Ways and Means Republican Members that we will prepare a draft which they may introduce.

3. Job Creation Incentive

We have drafted a bill which has been introduced by Republican members of the Ways and Means Committee.

4. Estate Tax Relief for Family Farms and Businesses

We have drafted a separate bill on this topic. It will be considered by the Ways and Means Committee along with the general consideration of estate and gift taxes which is scheduled for hearings commencing on March 15.

5. Municipal Bond Option

The Joint Committee Staff, with Treasury input, is drafting a bill for introduction by Mr. Ullman.

William E. Simon

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February 24, 1976

FOOTWEAR CASE BACKGROUND

Nonrubber footwear imports amounted to nearly $1 billion in 1974. This represented a three-fold increase over 1968 imports. Imports now have a 43% share of the market, compared with a 21.5% share of the market in 1968. Half of the footwear plants existing in 1970 are now closed. Domestic production of nonrubber footwear has dropped by one third since 1968. Unemployment in the industry is currently at about 16%.

The footwear industry has been seeking relief for a number of years, including a nearly successful attempt at obtaining quota legislation in 1970, and a Tariff Commission tie vote in an escape clause case. This report was not directly acted upon by the President. President Nixon did, however, send Ambassador Kennedy to Spain and Italy to discuss voluntary restraint by those two countries of their footwear exports to the United States. Neither country imposed restraints, although Italy monitored its exports.

The Trade Act contains a requirement that the President negotiate an international arrangement (similar in some respects to the Multi-Fiber Textile Arrangement) as soon as practicable. The Administration has fulfilled its commitments to the Congress to consult with key exporting countries with respect to the footwear import problem. Consultations were held by STR during the fall with Brazil, Taiwan, South Korea, Italy, and Spain.

The footwear import problem has been a significant one in trade policy for the last eight years. There will be strong feeling on the part of a substantial number of Congressmen and Senators that import relief should be provided. If the President does provide relief, this can be presented as a legitimate response to domestic grievances provided through the operation of our domestic trade laws. Depending on the type of action the President took, there could be concerns domestically over the impact on inflation and concerns abroad over the impact on a number of countries for whom footwear exports to the United States are extremely important.

The leading producers of nonrubber footwear are Pennsylvania, New York, Massachusetts, Missouri, Tennessee, Maine, and New Hampshire. In each of these states, except Tennessee, there has been a substantial drop in production as well as unemployment since 1968. The greatest effect has been felt in Massachusetts, New Hampshire and Maine, which have lost nearly half their production during this period. In each of the seven states listed above, there would be a substantial interest in the provision of import relief.

February 24, 1976

FOOTWEAR IMPORT CASE

On February 20, 1976 the U.S. International Trade Commission (USITC) determined that increased imports are injuring the domestic footwear industry. Three Commissioners recommended the imposition of high tariffs (varying from 35% in the case of the lowest priced footwear to 25% for higher priced footwear), phasing down slowly over five years. Two Commissioners recommended the imposition of tariff-quotas, allocated to countries on the basis of their 1974 share of trade. The over-quota rate would be 40% in the first year, phased down by 5% a year over the next five years. One Commissioner recommended that only adjustment assistance be provided.

The President can provide import relief in the form of increased tariffs, tariff-quotas, quotas, or the negotiation of orderly marketing agreements. He can decide to provide no relief if he determines that it is not in the national economic interest to provide relief.

In the normal case, the Congress has 90 working days after the President's decision to override his decision and put into effect the USITC's recommendation of relief. However, because a majority of the Commissioners could not agree on a form of relief, there is arguably no Commission recommendation, and therefore a Congressional override could not be effective.

The President's decision of whether or not he will provide import relief must be published by April 21. If import relief is to be provided through the negotiation of orderly marketing agreements, the President may announce by April 21 that he has chosen this course of action, in which case import relief must be made effective by July 20.

The Special Trade Representative, as Chairman of the Cabinet-level interagency Trade Policy Committee, is to transmit to the President the Committee's recommendations as to what action the President should take. An interagency task force is currently working on initial recommendations in this case.

The problems posed by the tariff recommendation of the three USITC Commissioners are that its implementation would require a large payment of tariff compensation to exporting countries (if the form of decreased duties on a similar amount of trade, over $1 billion in potential trade coverage) and it would adversely affect consumers. At the same time it does not take into account the industry's petition for quotas, or the Trade Act's directive that an international footwear agreement be negotiated.

February 24, 1976

SPECIALTY STEEL CASE BACKGROUND

Specialty steel imports amounted to nearly $200 million in 1975. This represented a nearly two-fold increase compared with 1970 imports of about $110 million.

In tonnage terms, imports of stainless and alloy tool steel in 1975 were the second highest level since 1968. Import penetration rates were about 20% in 1970, 1971, and 1975, substantially higher than for the intervening years.

Domestic production and shipments more than doubled from 1970-1974; however, in 1975 a decline of roughly 45% occurred. Employment trends over the last several years have also been generally upward; hwoever, in 1975 approximately 8500 workers were in lay-off status representing approximately 25% of the industry's work force.

The specialty steel industry is suffering to a large extent from the domestic recession and is expected to recover substantially as the domestic economy recovers. Long-run prospects for the U.S. market appear favorable with a higher growth rate likely than for carbon steel products. Further, the domestic industry appears to be cost competitive with Japan and the EC, the principal sources of imports aside from Sweden. A major question mark on the horizon is Korea which has purchased a large specialty steel facility from the U.S. and plans to begin production in late 1976 which could lead to exports to the U.S. market amounting to roughly 1/5 total U.S. imports.

The specialty steel industry has urged the U.S. Government for many years to grant protection against import competition. Such pressure in 1971 led to negotiation of stainless steel subceilings under the steel voluntary restraint agreements (VRAs) with Japan and the European Community. Experience under those restraints indicates that Japan did not fill the levels allocated--probably due to high demand in other world markets--and that the EC probably exceeded the levels provided for under the VRA.

The domestic industry feels that it has followed the processes required by the Trade Act of 1974 and that foreign interests have had an opportunity to make their case and have lost. The industry feels, therefore, that it is entitled to relief. The principal objective of the industry appears to be a permanent international arrangement safeguarding against disruptive imports. Given the depressed level of activity and high levels of unemployment in the industry, it is expected that a decision to grant no relief would be likely to be overridden by Congress thus implementing the ITC's proposed quantitative restrictions. Those restrictions are deficient in several respects and would have adverse effects on prices to consumers and on international relations (with Japan particularly).

The specialty steel industry is geographically concentrated in the eastern half of the United States with the largest number of plants located in Pennsylvania. Substantial production also is found in New York, Ohio, Maryland, Michigan and Indiana. Pennsylvania in particular has been hard hit by cut-backs in domestic shipments.

Specialty steel imports account for only 5% of U.S. steel imports by value and 1% in tonnage terms.

February 24, 1976

SPECIALTY STEEL IMPORT CASE

On January 16, 1976 the International Trade Commission (ITC) found, as a result of an import relief investigation under the 1974 Trade Act, that the U.S. specialty steel industry had been injured by increased imports. It recommended imposition of quantitative restrictions on imports for a five-year period.

The President is required by the Act to determine whether import relief is in the national economic interest and, if so, what form of relief he will provide from among those authorized by the Act (i.e. tariff increases, tariff-rate quotas, quantitative restrictions, orderly marketing agreements, or combinations thereof). He also may announce other actions to assist the industry such as ordering the Secretary of Labor to expedite processing of adjustment assistance petitions or seeking consultations or sector negotiations on steel in the MTN.

If the President does not accept the USITC's recommended action, the Congress may override his decision by a majority vote of the members of both houses, present and voting, within 90 legislative days following the date of his decision, or the date of his proclamation of relief, if any, (probably until sometime in September 1976). If the override is successful, the President would be required to implement the USITC recommendation (5-year quotas).

The President must announce his decision by March 16, 1976. If he accepts the USITC recommendations or decides to provide an alternative quota system, tariff increases, or tariff-rate quotas, such relief must be proclaimed and take effect no later than March 31, 1976.

Should he decide to negotiate orderly marketing agreements he has until June 14, 1976 to negotiate such agreements or, if unable to do so, to proclaim and put into effect by that date an alternative type of relief.

Interagency review of the specialty steel case has proceeded through the Trade Policy Staff Committee and is scheduled to go to the Trade Policy Committee (Cabinet level) on Friday (Feb. 27). Recommendations will be forwarded to the President no later than March 2.

February 24, 1976

ANALYSIS OF THE SPECIALTY STEEL CASE

Consultations with interested members of Congress indicate that a decision not to provide relief would be overridden by the Congress putting into effect the USTIC recommended remedy, quotas for five years.

In discussions in the Trade Policy Staff Committee last week, agency representatives took the following positions: State and Agriculture would provide no relief. Treasury and Labor recommended relief in the form of an increase in steel tariffs. Commerce and STR recommended that the President announce on March 16 his decision to seek to negotiate one or more orderly marketing agreements (relief would be effective by June 14). The duration of these agreements would be tied to the recovery of the industry.

The USITC case involves only the stainless steel and alloy tool steel industries (the specialty steel industry), and not the much larger carbon steel industry. However, the entire steel industry suffers from similar problems, cyclical swings in demand resulting in excess capacity in periods of recession, aggravated by governmental actions abroad. While the impact on domestic specialty steel production has been much sharper than with respect to carbon steel the effect on the whole steel industry has been substantial.

The imposition of unilateral import restraints (tariff increases, tariff quotas, or quotas) is not well-suited to the steel problem. Proclaiming five years of relief might well prove disruptive during economic recovery. Granting one or two years of relief might prove inadequate to protect the industry from injurious import competition if U.S. economic recovery slows, and could easily result in a Congressional override. This latter risk is particularly great if a decision to grant very limited relief is announced in March, in the midst of the election primaries.

The longer-run solution is clearly an international negotiation directed at identifying the problems faced by international steel trade and providing solutions for these problems in the context of further trade liberalization. The immediate decision in the specialty steel case could be made in a manner which provides appropriate near-term relief to this part of the steel industry, while leading to longer-term solutions for international steel trade.

If the President announced on March 16 that he was going to seek one or more orderly marketing agreements, he would then have 90 days in which to negotiate standstill agreements with major supplying countries. These could provide that imports be held to their most recent levels. To avoid the imposition of unnecessary relief, the agreements could terminate automatically if U.S. employment and capacity utilization increased to stipulated percentages. In addition, the agreements could terminate upon the entry into force of an international sectoral steel agreement which afforded a more flexible means of resolving the cyclical problems of the steel industry while liberalizing overall steel trade.

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THE WHITE HOUSE

WASHINGTON

February 6, 1976

MEMORANDUM FOR THE ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

FROM: L. WILLIAM SEIDMAN LWS

SUBJECT: Organizing Agriculture Policy Making

Four principal entities have been created by the Ford Administration to coordinate and review agricultural policy:

1. The Economic Policy Board was created on September 30, 1974, to advise the President on the formulation, coordination, and implementation of all economic policy.

2. The Food Deputies Group was created to monitor agricultural developments and prepare materials on selected issues for consideration by the Economic Policy Board. It reports biweekly to the EPB Executive Committee.

3. The International Food Review Group was established on November 12, 1974, to coordinate the follow-up to the World Food Conference.

4. The EPB/NSC Food Committee was created by the President on September 9, 1975, for the purpose of developing negotiating strategy for and monitoring the negotiations on grain sales to the Soviet Union.

In view of the fact that the United States has developed and proposed an International Food Reserves System and that the negotiations for a long-term grain agreement with the Soviet Union were successfully concluded on October 20, 1975, the following arrangement is recommended for agriculture policy making.

As at present, the Economic Policy Board will be responsible for the overall coordination of agricultural policy issues. The EPB/NSC Food Committee will be modified as follows:

1. The Department of Agriculture will chair the Committee.

2. The Committee will be renamed the EPB/NSC Agricultural Policy Committee.

3. The Committee will report to the Economic Policy Board Executive Committee periodically on policy issues with options and recommendations. The scope of the Committee will include both domestic and international issues and will include the international policy issues that previously were the responsibility of the International Food Review Group.

4. Membership on the Committee will be at the Assistant Secretary level or above.

The Secretary of Agriculture and the Assistant to the President for National Security Affairs are invited to attend EPB Executive Committee meetings when agricultural policy issues are considered.

The Food Deputies Group will, as at present, be responsible for staffing and monitoring food related issues and reporting to the EPB Executive Committee on a biweekly basis.

Final recommendations to the President on international agricultural issues will be submitted in a joint memorandum to the President from the EPB and NSC.