The original documents are located in Box C45, folder "Presidential Handwriting, 7/27/1976" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.

THE PRESIDENT HAS SEEN.

THE WHITE HOUSE

WASHINGTON

July 27, 1976

MEMORANDUM FOR: DICK CHENEY

FROM: JIM CONNOR

The attached briefing paper, including two decision papers, came in from Bill Seidman late this afternoon. The first on maritime policy and the Jones Act has essentially been staffed by EPB. The memo itself, however, is nine pages long and verges on the incomprehensible. It is a perfect example of wasting the President's time. The second deals with wage settlements and the public response thereto and presents a number of suggestions, but has not in fact been staffed at all. It provides information for the President which may be useful, but I am afraid if it is used to discuss how we should make such announcements that an EPB meeting is the wrong forum for it. I think that the material should go to Gergen for his use.

I would suggest that we send the entire package back to Seidman for modification in two ways:

(1) To revise thoroughly the Jones Act memo so that it is comprehensible and read by the President before any meeting is scheduled, and

(2) That the decision paper concerning how to announce the policy on wage settlements by referred to Gergen for staffing and suggestions.

THE WHITE HOUSE

WASHINGTON

July 27, 1976

MEETING WITH ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

July 28, 1976
11:30 a.m.
Cabinet Room

From: L. William Seidman

I. PURPOSE

A. To review U.S. maritime policy and the Administration position on S. 2422.

B. To review Administration policy on wage settlements.

C. To review the current status of pending tax legislation.

II. BACKGROUND, PARTICIPANTS AND PRESS PLAN

A. Background: Maritime Policy. The EPB Executive Committee has reviewed the situation in the U.S. maritime industry in light of recent developments and pending legislation. A memorandum outlining developments in maritime policy and seeking your guidance on the Administration position regarding the most immediate pending legislation, S. 2422, a bill to require that oil shipments between the Virgin Islands and the U.S. mainland be carried in U.S. flag ships, is attached at Tab A.

The maritime industry has recently received assurances from Democratic Presidential candidate Jimmy Carter that he supports a strong U.S. maritime industry. A copy of a letter from Governor Carter on this subject is attached at Tab B. Maritime interests are once more pressing the Administration for a redefinition of our maritime policy.

Labor Settlements and Administration Comment. As you requested, the Council on Wage and Price Stability has

analyzed the collective bargaining settlements with the teamsters and electrical workers. When the Administration makes public its analyses of these settlements, questions will likely be raised regarding the Administration's view of their impact on inflation. The EPB Executive Committee has discussed the issue of whether a statement on inflationary effects should accompany release of the analyses. A memorandum discussing the analyses, reviewing the outlook for wage-push inflation, and outlining alternative public responses to the outlook, is attached at Tab C.

Tax Legislation Update. The Department of the Treasury reports that the tax bill, H.R. 10612, will likely be debated on the Senate floor for another week or two, perhaps longer. Treasury fully expects the Senate to pass the bill, possibly before the August 11 recess, and send it to Conference. A memorandum, prepared by the Department of the Treasury, describing the legislative outlook, estimating the ultimate contents of a tax bill, and outlining alternative Presidential actions with respect to the tax bill, is attached at Tab D.

B. Participants: William E. Simon, L. William Seidman, Elliot L. Richardson, W.J. Usery, Jr., Arthur F. Burns, James M. Cannon, Richard B. Cheney, John O. Marsh, Brent Scowcroft, Paul W. MacAvoy, Burton G. Malkiel, Paul O'Neill.

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

III. AGENDA

A. U.S. Maritime Policy

Secretary Richardson will review recent developments and policy alternatives for U.S. maritime policy.

B. Wage Settlements

Paul MacAvoy will review analyses of recent wage settlements, the outlook for wage-push inflation, and alternative public responses to these settlements.

C. Tax Legislation

Secretary Simon will review the current status of the pending tax legislation.

THE WHITE HOUSE

WASHINGTON

July 26, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN

SUBJECT: U. S. Maritime Policy

The EPB Executive Committee has reviewed the situation in the U.S. maritime industry in light of recent developments and pending legislation. This memorandum outlines developments in maritime policy, describes the situation in the U.S. maritime industry, and seeks your guidance on the Administration position regarding the most immediate pending legislation, S. 2422, a bill to require that oil shipments between the Virgin Islands and the U.S. mainland be carried in U.S. flag ships.

Developments in Maritime Policy

Since early 1975 an interagency committee of the Economic Policy Board has monitored the developing tanker situation and considered alternative approaches for providing relief to the industry.

The alternatives most actively considered include a number of forms of oil cargo preference for U.S. flag ships, and the manning of some military cargo vessels by non-government seamen. A meeting on March 7, 1975, with you was arranged for representatives of the industry, including maritime labor spokesmen. The industry representatives indicated that an oil cargo preference measure limited to existing and on-order ships would provide the relief they deemed necessary. An options memorandum on "U.S. Tanker Industry Problems" was sent to you on May 9, 1975. Your decision approving the trial substitution of non-government for government crews on four tankers under long-term charter to the Military Sealift Command is being implemented. However, the maritime industry continues to feel the Administration has not been fully responsive to their needs.

At the April 14, 1976 EPB Executive Committee meeting the Secretary of Commerce was asked to explore again alternative

actions that might help relieve the maritime industry situation. Five options were developed:

- o Limited Oil Cargo Preference
- o Extension of the Jones Act to the Virgin Islands Oil Trade
- o Increased Military Use of Commercial Tankers with Non-government Crews for Underway Replenishment
- o Amendment of "Buy American" Provisions of the Merchant Marine Act
- o A Shipping Agreement for the Movement of Soviet Oil

These options were considered at the May 26 EPB Executive Committee meeting. At that time it was concluded that extension of the Jones Act to the Virgin Islands represented the least objectionable measure that would provide significant relief to the U.S. maritime industry, if it were decided to provide any additional assistance. The Executive Committee directed that this option be further refined for your consideration.

A number of further issues affecting the maritime industry have arisen in the meantime. They are reviewed before turning to a discussion of legislation extending the Jones Act to the Virgin Islands, since they impact on the prospects for the U.S. maritime industry.

Third Flag Issue

On July 19, Federal Maritime Commission Chairman Karl Bakke announced that he had signed a "memorandum agreement" with the Soviet Union regarding Soviet participation in U.S. foreign trade. The "agreement" contains two principles:

1. Soviet-flag carriers will maintain freight rates at levels not lower than rates used for the same commodity by non-Soviet carriers in the particular trades involved.
2. Soviet-flag carriers will pursue membership in ocean shipping conferences covering the U.S. North Atlantic and Pacific routes.

Simultaneously, Chairman Bakke sent a letter to you indicating that "a legislated solution now appears to be unnecessary so long as the carriers involved move forward in good faith to implement the objectives of the agreement." A copy of his

letter is attached at Tab A. Chairman Bakke has similarly briefed key members of the appropriate Congressional committees.

U.S.-U.S.S.R. Maritime Agreement

On September 17, 1975 the U.S. and the U.S.S.R. agreed upon a rate formula for the carriage of grain to the Soviet Union by American-flag ships, effective through December 31, 1976, providing for a minimum charter rate of $16.00 a ton. This rate is sufficiently favorable under current market conditions to attract a substantial portion of the American tanker fleet to this trade. However, the Soviets have adopted tactics contrary to the principles of the U.S./U.S.S.R. Maritime Agreement assuring U.S.-flag vessels the opportunity to carry one-third of the grain cargoes. These tactics include: (1) offering future cargoes to U.S.-flag ships that are currently on Russian grain voyages and then cancelling the charters when the ships cannot meet the loading dates due to delays in Russian ports, (2) excluding tankers from discharging at Nakhodka, and (3) computing the U.S. share based on monthly Soviet projections, which tend to be lower than the amount of grain actually shipped. As a result, since September 1975 U.S.-flag vessels have carried only 25.6% of the grain shipments (19.2% have been carried by Soviet ships and 55.2% by third-flag vessels). The volume of cargo carried by U.S. ships is approximately 1 million tons less than a one-third share. These actions which in most cases are contrary to the specific provisions of the Maritime Agreement and, in all cases contrary to its spirit and intent, have been repeatedly and strongly objected to by the Maritime Administration. These tactics were the principal subject of discussions held between U.S. and Soviet maritime officials in a meeting in Moscow on June 17-24, 1976. To date the Soviets have refused to acknowledge their obligation under the Agreement to increase future grain cargo allocations to provide U.S. carriers their entitlement to a full one-third share of the shipments. This matter will also be the major topic of discussion at a meeting scheduled to be held in Washington in October 1976.

Even if U.S.-flag ships were provided a full one-third of the Soviet grain cargoes, this would not fully employ available U.S.-flag tankers seeking employment. Exclusive of those ships that are in actual lay-up status, each month approximately one million tons of U.S.-flag tankers are offered to the Soviet charterers as compared to the 300,000 to 400,000 tons of grain which constitute one-third of the monthly Soviet grain shipment program. Further, it appears that future program levels may be significantly decreased. Only one ship is scheduled for employment in this trade in August 1976 and the Soviets have advised that there will be no shipments in September.

Situation in the U.S. Maritime Industry

There are presently 22 U.S.-flag tankers of 1.2 million dwt in lay-up, representing about 10% of the U.S. tanker tonnage. About 16% of the worldwide tanker tonnage is in lay-up. The prospect for employment of many of these tankers is dim.

The world shipbuilding market is also deeply depressed, and the scramble for shipbuilding contracts has resulted in foreign price quotations so low as to impose strong upward pressures on U.S. construction subsidy rates for all types of ships. The Administration is currently supporting a bill which would assist U.S. shipyards by increasing the allowable Federal ship construction ceiling from the current 35% to 45% for negotiated contracts. The Congress is likely to further increase the ceiling to 50%.

The full impact of the worldwide tanker depression was first apparent in the United States early in 1975. It lead directly to cancellations of orders for nine tankers in U.S. yards. Substantial relief was afforded by Soviet grain purchases in 1975 and the U.S./U.S.S.R. transportation rate agreement for grain.

As a result of these factors, the number of U.S. tankers in layup declined from 33 in September 1975 to the range of approximately 20. There are currently 22 tankers in lay-up.

The opening of the Alaskan oil pipeline next year will provide substantial employment opportunities for U.S. tankers, although most of this employment will be provided to new, more efficient tankers currently being built in U.S. shipyards. Of course, employment prospects will also be dependent upon the levels of grain exports to the Soviet Union under the U.S./U.S.S.R. Maritime Agreement.

Extension of the Jones Act to the Virgin Islands

U.S. cabotage laws (the Jones Act) require that all U.S. domestic ocean shipping be reserved for vessels built and registered in the U.S. and owned, operated and manned by U.S. citizens. Traditionally, U.S.-flag ship operators have been high cost carriers. It is estimated that the exclusion of lower cost foreign-flag ship operators from the domestic ocean trades increases U.S. shipping costs by about $150-200 million annually.

The cabotage laws do not currently encompass the U.S. Virgin Islands/mainland trade, which has enjoyed an exemption since our purchase of the Virgin Islands from Denmark in 1917. This exemption has been based historically on insufficient U.S. flag

vessel capacity to serve the trade -- a situation which is no longer valid since sufficient capacity to transport oil is now available.

S. 2422, currently under consideration by the Senate Commerce Committee, would extend the cabotage laws to the Virgin Islands for the transportation of oil products only. The legislation has generated considerable interest since the Amerada Hess oil refinery, the world's largest refinery, is located in the Virgin Islands. This refinery produces residual fuel oil (used for industrial power and generation of commercial electric power) which represents a high proportion of consumption in the U.S. East coast. There is considerable support for S. 2422 within the U.S. maritime industry.

In the near term, the measure would involve a transportation cost increase of about 40¢/barrel. This is the present differential between U.S. tanker rates and currently depressed foreign rates. However, the additional demand for U.S.-flag tankers caused by enactment of S. 2422 would result in further rate increases, at least in the short-run. This would not only increase the differential in the Virgin Islands trade, but would also affect the rates for all other U.S.-flag tankers placed on new charters in domestic trade. Over the long term, however, as the worldwide surplus is gradually reduced, world tanker rates can be expected to rise and the differential would be reduced. The Commerce Department has hypothetically estimated a long term (post-1983) differential between U.S. and foreign tankers of 25¢/barrel.

Presently there are about 255 U.S. flag tankers. Of these about 125 are company owned, 50 are under long term charter and 50 are on single voyages or short term charters.

Extension of the Jones Act to the Virgin Islands would very likely cause increases in the rates charged for the 50 tankers under short term charter and, as longer term charters expire, also cause increases in rates for the tankers under long term charter. Thus, consumers on the East coast would experience price increases not only from Hess increased prices, but because oil products moving by tanker from the Gulf to the East coast would incur higher shipping costs.

In short, there is a substantial probability that enactment of this legislation would increase the cost of delivering residual fuel oil from both the Virgin Islands and the Gulf Coast to the East coast and lead to increases in all other markets where petroleum is moved by U.S. flag ship. The CEA

estimates that the total cost could be as much as $1.0 billion, 4 times the $240 million impact estimated for Hess.

It is argued that there may be offsets to the higher transportation costs. In particular, it is suggested that larger entitlement allocations, now in effect for Hess, would offset additional transportation costs. However, such entitlements are now reflected in present prices under price controls and any increases in transportation costs would eventually be reflected in higher prices as well. In short, extension of the Jones Act to the Virgin Islands will lead to increased petroleum costs on average.

The impact of higher charter rates may be reduced in the long run as more tankers are constructed. However, the cost of constructing these tankers in U.S. yards will be much greater than the cost of constructing them in foreign yards. Further, to the extent that there is an excess supply of tankers this is a misallocation of resources.

Congressional Status

The Merchant Marine Subcommittee of the Senate Commerce Committee held hearings on S. 2422 on February 18 and March 30. The Governor and the Congressional delegate from the Virgin Islands opposed the bill and the maritime and oil industries supported it. The Department of Commerce, in its maritime promotional role, favored the bill, while Interior, in its Virgin Islands stewardship role, opposed it.

Only two Senators, both from Louisiana, attended the March 30 hearings -- Senator Long, the Subcommittee Chairman, and Senator Johnston, who introduced S. 2422 but who is not a member of the Committee. Both Senators indicated strong support for the bill. Reportedly, the active interest of the two Senators is prompted by support of the bill by the Energy Corporation of Louisiana which is building a large refinery operation in the Gulf area that is intended to compete with Amerada Hess.

Chairman Long is presently devoting the bulk of his attention to the tax reform bill. Upon the conclusion of the Senate deliberations of the tax bill, it is anticipated that he will seek a favorable report on S. 2422 by the Senate Commerce Committee. However, because of potential opposition to the bill by East coast Senators, Senate floor action is uncertain.

In short, with or without Administration support, action in the Senate on this legislation is uncertain, and action by the full Congress is unlikely. No House action has yet been scheduled on a similar bill (H.R. 13251), and none is anticipated until Senate action is complete.

Options

Option 1: Announce Administration Support for Legislation Extending the Jones Act to the Virgin Islands for the Transportation of Oil Products. (S.2422)

Advantages:

- o Extension of the Jones Act to the Virgin Islands would provide employment to some 25 tankers (app. 30,000 dwt) or about 750,000 cargo deadweight tons.
- o Reserving this trade to U.S.-flag tankers would mean about 2,000 jobs for U.S. seamen. Employment of tankers currently in layup would account for 1,800 of this total.
- o Jones Act application to the Virgin Islands oil export trade would represent a logical extension of U.S. cabotage laws.
- o The balance of payments savings from using U.S.-flag tankers are about $15 million.
- o Considering the several marketing advantages enjoyed by Amerada Hess, the Virgin Islands refinery will continue to have a considerable advantage over other domestic refineries, who employ 3.5 to 4.0 million deadweight tons of U.S.-flag tankers, unless the requirement to use U.S.-flag vessels is extended to the Virgin Islands through the Jones Act.

Option 2: Announce Administration Opposition to Legislation Extending the Jones Act to the Virgin Islands for the Transportation of Oil Products. (S.2422)

Advantages:

- o Extension of the Jones Act to the Virgin Islands would entail increased prices to consumers due to higher tanker rates.

- o It is possible that higher tanker rates may make it more profitable to import oil products from foreign resources than to ship domestic products from the Gulf. This increases import vulnerability and is contrary to the goal of reducing import requirements.

- o This legislation is almost certain to be perceived as detrimental to the interests of East coast consumers. The price increases would come at a time when distillate price decontrols were put into place, thereby endangering that program to reduce controls in the oil industry.

- o Hess has threatened to shut down the refinery if this measure is enacted. This appears doubtful but is conceivable. The Virgin Islands would suffer increased unemployment if Hess' operation were terminated or curtailed, and tanker employment would also be affected.

- o Any reduction in economic activity in the Virgin Islands could lead to requests for increased Federal assistance. The Virgin Islands Refinery Corporation has already invested in real estate in preparation for construction of a small refinery. Enactment of S. 2422, with its attendant higher shipping costs, would discourage this construction.

- o This measure might lead to some U.S. tanker construction at a time when there are about 50 million deadweight tons of tanker capacity laid up worldwide, (1 million in U.S.).

Option 3: Do nothing at this time. Withhold a decision until after further Congressional action on S. 2422.

Advantages:

- o Withholding a decision at this time would preserve your options while awaiting the outcome of Senate action. The Senate Commerce Committee is expected to report the legislation, but it may be slowed by the Rules Committee and opposed on the Senate floor. It is understood that the House does not intend to move until the Senate acts. Congressional pressure for an Administration position is unlikely until House hearings are held.

- o Taking a position now would likely be viewed unfavorably either by Gulf Coast oil interests and maritime interests on one hand, or by the Virgin Islands, consumer groups (especially East coast), and Amerada Hess interests on the other.

Decision

Option 1 _____ Announce Administration support for legislation extending the Jones Act to the Virgin Islands for the transportation of oil products (S. 2422).

Supported by:

Option 2 _____ Announce Administration opposition to legislation extending the Jones Act to the Virgin Islands for the transportation of oil products (S. 2422).

Supported by: Treasury, CEA, State, Cannon

Option 3 _____ Do nothing at this time. Withhold a decision until further Congressional action on S. 2422.

Supported by: Commerce, OMB, Friedersdorf, Marsh, Buchen

Jimmy Carter
Presidential Campaign
For America's third century, why not our best?

May 25, 1976

Mr. Jesse M. Calhoon, President
National Marine Engineers' Beneficial
Association, AFL-CIO
400 First Street, N.W.
Washington, D. C. 20001

Dear Jesse:

I appreciate very much the opportunity of our recent meeting. As I told you then, there is no doubt in my mind that our nation's strength as a seapower must never be in doubt.

In that context, allow me to repeat my concern about the decline of our U. S. flag merchant marine as contrasted, for example, with the sharp rise of the U.S.S.R. merchant marine. Our merchant marine declined from first to eighth place since the end of World War II. During this same period, the Soviet merchant marine has risen from twenty third to sixth place. The Soviets have made clear their expectation to become the number one merchant marine by 1980. Please permit me to briefly outline some thoughts on a program required to reverse this dangerous trend.

In 1936 the U. S. Congress and President Franklin Delano Roosevelt created a merchant marine blueprint in the historic Merchant Marine Act of 1936. The preamble of this Act clearly mandated a privately owned and operated U. S. flag merchant marine capable of transporting all of our domestic waterborne commerce and a substantial portion of our foreign trade waterborne commerce. This preamble contained the wise requirement that our U. S. Flag Merchant ships should be of the number and type which would be immediately available to our national emergencies or outright war. This U. S. flag merchant marine was required to be built in American yards. It should be operated by effective management, and manned by civilian seamen trained in industry

schools and aboard ships. Besides the security implications of such an approach, our national economy is also a multiple beneficiary.

In 1970, the U. S. Congress enacted a ten-year program to construct for U. S. flag operation a total of 300 merchant ships. There were only 2 dissenting votes in this important legislation. I regret to note that now, just six years later, only 58 ships have been contracted for construction. For the first time in recent history the present administration has not requested any funds for merchant ship construction, and funds which have been approved by Congress and approved by the President remain unspent. Our nation's maritime program has become clouded with uncertainty and confusion.

My approach is to achieve a maritime program which will return us to the seapower status we deserve and need. I intend to work for the following objectives:

1. Assure continuing presidential attention to the objective of having our nation achieve and maintain the desired U. S. flag merchant marine.

2. Dedicate ourselves to a program which would result in a U. S. flag merchant marine with ships that are competitive with foreign flag ships in original cost, operating cost and productivity.

3. Enact and develop a national cargo policy which would assure our U. S. flag merchant marine a fair share of all types of cargo.

4. Continue to enforce our American cabotage laws, such as the Jones Act, which require that U. S. flag ships trade between our U. S. domestic ports.

We must attain the seapower status we need in order to meet our commitments to domestic and international security. As we both recognize, this program to achieve and maintain an adequate U. S. flag merchant marine would provide a great number of productive jobs, increase our economic base which would return many tax benefits to all levels of government, result in stimulating private capital investment and improve our nation's balance of payments.

In the months ahead, I hope to issue a comprehensive paper on our overall program for rebuilding our nation's strength as a maritime nation. In the development of this program, I shall ask the cooperation and concerted effort of labor, business, affected consumer groups and academia. Of course I shall keep in mind the constructive points you made during our discussion.

With best wishes, I am,

Sincerely,

Jimmy Carter

THE WHITE HOUSE

WASHINGTON

July 27, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN LWS

SUBJECT: Wage Settlements

As you requested, the Council on Wage and Price Stability has analyzed the collective bargaining settlements for the Teamsters and the electrical workers. When the Administration makes public its analysis of these settlements, questions will likely be raised regarding the Administration's view of their impact on inflation. The Economic Policy Board Executive Committee has discussed the issue of whether a statement on inflationary effects should accompany release of the analysis. Any Administration statement or comment could impact on the collective bargaining negotiations still in progress or scheduled for later in the year. This memorandum summarizes the analyses, discusses the outlook for wage-push inflation, and provides options on public responses to the outlook.

The Teamsters and Electrical Workers Settlements

The Teamster Collective Bargaining Agreement, signed April 3, 1976, provided for increases in total compensation of 9.9 percent in the first year, 11.3 percent in the second year, and 9.9 percent in the third year (assuming 6 percent inflation). Over the life of the contract, total compensation would rise by 34.3 percent, or an average annual rate of 10.5 percent, if inflation is 6 percent.

General Electric signed an agreement on June 27, 1976, with several unions raising wages by 14.9 percent in the first year, 7.8 percent in the second year, and 7.2 percent in the third year (assuming 6 percent inflation). Over the life of the contract wages would increase by 32.7 percent, or an average of 9.9 percent per year, assuming 6 percent inflation. The cost of living clause could raise the second and third year wage increases under the teamster and GE agreements if inflation exceeds 6 percent, but the increases would be smaller if the rate of inflation is less than 6 percent.

A number of major settlements remain during 1976, including rubber, where a strike has been in progress for about three months, and automobiles.

Wage Increases and the Outlook for Inflation

It is important to put the teamster and GE workers' settlements into perspective. For major collective bargaining settlements negotiated in 1976, first year increases in earnings were 8.8 percent and 8.2 percent in the first and second quarters, respectively. The average increases over the life of the contract (excluding cost of living adjustments in the second and third years) were 7.4 percent and 6.6 percent, respectively.

Compensation per man-hour for all private nonfarm workers increased at an annual rate of 7.5 to 8.0 percent in the first half of the year. The adjusted hourly earnings index increased at an annual rate of 6.4 percent in the first six months of the year. These increases are at least 1.0 to 2.0 percentage points below the CEA forecasts made in December 1975. It is a typical cyclical pattern for major union settlements to show larger wage increases than the economy as a whole at this point in the recovery.

The forecasts for the coming year do not contemplate significant wage-push inflation. The Troika forecasts increases in output per man-hour of about 3.5 percent in CY 1976 and 2.9 percent in 1977. However, recent data indicate a faster rate of growth in labor productivity than forecast--4.4 percent in the first half of this year. If the Troika forecast holds for the rest of the year, output per man-hour will grow by 3.7 percent in CY 1976. These increases in productivity should keep unit labor costs, and thus cost-based price increases, below 6 percent if compensation per man-hour increases by less than 9 percent per year. In fact, unit labor costs have increased by only 4.3 percent in the first two quarters of this year. The experience thus far suggests that compensation per man-hour can be expected to increase by less than 8.0 percent for 1976 and around 8.0 to 8.5 percent in 1977. Thus, when viewing the wage rate picture as a whole, wage increases are <u>not</u> likely to generate inflationary pressures in excess of 6 percent and are likely to be consistent with a 5 percent rate of inflation.

Wage Policy Alternatives

The prospect of wage inflation on the order of 5 percent or 6 percent each year has generated interest on the part of many economists for some type of "incomes policy." Both Governor Carter's economic policy statement and the Democratic Party platform include language sympathetic to the notion of some form of an incomes policy, although neither spells out what this would mean in practice.

Although "incomes policy" as practiced has meant many different sets of controls at different times, the basic thrust has been to keep wage, material costs, and profit shares roughly constant over time. Thus, an incomes policy applied to wage settlements would likely set limits on wage increases to prevent overall wage shares from rising and profits from falling. In practice, these policies have generally resulted in wage and price freezes.

At present, the Council on Wage and Price Stability (CWPS) does not pursue an incomes policy. CWPS does not set formal guidelines or legal limits on acceptable wage and benefit increases nor does it intervene in the collective bargaining process in an effort to shape the outcome of the negotiations. The Council establishes informal contact with the parties prior to the start of negotiations and monitors the progress of the talks. Once a settlement is reached, the Council requests information from both labor and management regarding the precise terms of the agreements. The Council staff then analyzes the cost of the settlement and attempts to assess its potential impact on labor costs and prices in the economy. Reports are circulated to Council members and other Administration officials for review prior to being released to the public.

Issue 1: What should be the Administration's policy regarding wage settlements?

The EPB Executive Committee has discussed a variety of alternative policies regarding the role the Administration should play with respect to wage settlements.

Option 1: Announce an "incomes policy."

Advantages:

- An incomes policy would visibly demonstrate Presidential concern.
- An incomes policy would assist employers in resisting large wage increases with an additional element of moral suasion.
- To the extent the policy is successful, it would result in a lower rate of wage increases.

Disadvantages:

- An incomes policy would ultimately require mandatory controls to implement.
- An incomes policy would need guidelines on prices, profits, and interest rates to appear even-handed, and these probably would have to be made mandatory as well.
- Almost any numerical guideline selected for either price or wage increases would look very high and could tend to set a floor rather than a ceiling.
- There is a high risk that labor and business would perceive an incomes policy as a first step back into controls, and would encourage high wage and price increases in anticipation of controls.
- A single numerical guideline would almost certainly emerge, if only informally, yet no single guideline is appropriate for efficient resource allocation throughout the economy.
- The Administration has often said that the controls of the early 1970's reduced investment and generated inefficiencies which helped to produce the current recession.

Option 2: Attempt to influence the outcome of upcoming settlements through jawboning.

Advantages:

- Active jawboning would visibly demonstrate Presidential concern.

- o Presidential jawboning requests could be tailored so that responsiveness by the parties was possible given the bargaining relationship.

Disadvantages:

- o Jawboning is unlikely to have a significant effect on wage settlements by itself and would lead to pressure for an incomes policy with mandatory controls.

- o Jawboning would require guidelines for increases in wages and in prices, with all of the disadvantages outlined in Option 1.

Option 3: Emphasize in public statements the inflationary effect of wage settlements which consistently exceed productivity increases.

Advantages:

- o Statements would visibly demonstrate Presidential concern.

- o Statements should promote public understanding of the relationship between wage increases and inflation.

Disadvantages;

- o A statement on wage increases would almost certainly require similar statements on price increases in excess of cost increases, at a time when increased profits are needed for stimulating investment.

- o Past erosion of real wages, such as in the rubber industry, makes some settlements in excess of productivity increases in 1976 virtually inevitable.

Option 4: Stress the need in public statements and speeches for overall economic policies which, by reducing inflation, reduce the incentives for large annual wage increases.

Advantages:

- o This approach represents sound economics and sound policy.

- o It is consistent with our past emphasis on the need for reducing inflation.

Disadvantages:

- o Such statements could appear unresponsive to the emerging desire for strong action with respect to specific short-term wage increases.

- o As in the previous options, any statement emphasizing or singling out wage restraint could be used by the labor leadership as evidence of Administration hostility to the rank and file worker.

Option 5: Maintain the present posture of post-settlement analysis by the Council on Wage and Price Stability. Continue to stress that collective bargaining is properly a private sector activity and that government should not attempt to effect the outcome.

Advantages:

- o It is consistent with the Administration position that government interference in the collective bargaining process should be kept to a minimum and with our more general posture of limited governmental intrusion in economic activity in the private sector.

- o Any action beyond our present posture runs the risk of stimulating pressure for greater specificity and intervention.

Disadvantages:

- o The Administration may be criticized as unresponsive to the growing concern over the size of recent labor settlements.

- o Our present posture does not directly address the problem of potential or built-in inflation from long-term wage settlements in excess of productivity.

Issue 2: How should the Administration make public its policy regarding wage settlements?

Option 1: Issue a statement or mildly cautionary cover letter on the teamsters and/or electrical workers settlements.

Advantages:

- o Upon release of the CWPS analysis the Administration will most certainly be pressured to comment on it. A statement or cautionary letter would permit greater precision and consistency in the Administration's response.

- o A statement would permit greater clarity in focusing concern on the indirect impact of upcoming negotiations.

Option 2: Do not issue a statement or mildly cautionary cover letter on the teamsters and/or electrical workers settlements.

Advantages:

- o The Administration has generally followed a "hands off policy" with regard to commenting on the results of collective bargaining. Were the Administration to comment on a particular settlement there would be considerable pressure for the Administration to comment on all future major collective bargaining settlements.

- o A practice of speaking out on wage and benefit increases would bring about pressure to evaluate specific price increases also, thus increasing even more the Administration's intervention into the market economy. The 1971-74 experience revealed that guidelines and other limited types of intervention yield great pressure for more detailed and mandatory controls. Even if we resist those pressures, the press will speculate about a return to controls, exacerbating business uneasiness and anticipatory wage and price increases.

- o The perception by labor and management that the Administration was adopting a more activist policy would affect our ability to assist collective bargaining in a mediation capacity. Management would likely request us to intervene at an early stage in the bargaining process in the expectation that we would try to reduce union wage demands to levels consistent with the perceived guideposts. At the same time, labor would understandably be more reluctant to request our assistance in settling disputes if they thought the Administration was seeking to bring about a settlement at or below a particular level.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

JUL 26 1976

MEMORANDUM FOR: Economic Policy Board
Executive Committee

FROM: Charles M. Walker CMW
Assistant Secretary for Tax Policy

SUBJECT: Appraisal of Pending Tax Legislation

Legislative Outlook

The tax bill, H.R. 10612, will likely remain under debate on the Senate floor for another week or two, perhaps longer. The Senate clearly will pass the bill, and send it to Conference. There is a possibility the Senate will pass the bill before it recesses August 11 for the Republican convention.

The earliest I think the bill could be considered by the Conference Committee would be August 23, after the recess for the Republican convention. With adjournment scheduled for October 2, in a climate which is showing (at least in the Senate) deteriorating enthusiasm for passing such a massive tax bill, I think it is entirely reasonable to expect the Conference Committee to recommend merely a continuation of the present tax cuts and let everything else drop out. This possibility is enhanced by the need to have some definitive Congressional action by August 31 which is the expiration date of the temporarily extended present withholding tax rates. Of course, that date could be further extended, as indeed the June 30 date has already been extended to August 31. Such a further extension, perhaps to October 31, would give the Conference Committee more time to work out a compromise.

However, even if the Conference Committee were to work into an extended period, the question is what it could agree upon. If the setting were one where there is a general concensus on the major thrust of a tax bill and a sense of urgency or enthusiasm to bring it forth, and if there were

no pressures of an upcoming November election campaign, a bill normally could be expected. But that is not the present setting. There is nothing like the affirmative setting during the closing days of 1969, when the Tax Reform Act of 1969 was passed--an act which is the most recent tax legislation having a magnitude comparable to the present bill.

Incidentally, Chairmen Long and Ullman each have received a forceful letter from Commissioner Alexander to the effect that if final passage of the tax legislation is deferred beyond September 1, the IRS will face a very difficult and costly logistical and administrative problem in printing and distributing forms, programing the computer, processing refunds etc.

Estimate of Ultimate Contents of Tax Bill
(based upon speculation about provisions to be in a bill that may be reported by the Conference Committee)

In terms of issues which are important to the Administration, it is necessary to itemize not only provisions which probably will be in the bill but also provisions which will not be in it. In the material that follows, note will be taken of the absence of desirable provisions, and of provisions which, as of July 23, it is reasonable to believe could be included in a bill to be reported by the Conference Committee. With respect to the expected contents of the bill, the Administration position has previously been stated on various provisions as "Support", "Support with modification", "No objection" or "Oppose". These degrees of position related to the substantive merits of the particular provision, and were not intended to reflect a view of relative importance to the Administration's program or to the tax system.

In evaluating the entire bill in terms of accepting it or rejecting it as a whole, the various ingredients have been classified as follows:

"Strong support": Given to a measure worth an affirmative fight.

"Support": Given to a measure worth having but not worth a fight.

"No objection": Given to an acceptable measure but one which is neutral or of lesser importance to the tax system as a whole than a "support" measure.

"Oppose": Given to an undesirable measure.

At the end of this paper is a tabulation which is number-keyed to the following paragraphs. It shows the classification of position and revenue estimates.

1. A key Administration provision which clearly will not be in the bill is the provision for deepened tax cuts, accomplished by introducing a higher personal exemption, a simplified standard deduction and rate reductions, while eliminating the refundable earned income credit and the nonrefundable per exemption or taxable income credit which are features of current law. The deepened tax cut proposal was, of course, tied to the spending restraint which will not be in the bill either.

2. Title IX of the bill contains a continuation of the present corporate tax rate reduction and enlarged surtax exemption. This is the same provision which the Administration proposed. Position: Strong support

3. The bill will doubtless contain some provisions designed to reduce the abusive use of tax shelters and to strenghten the present minimum tax. The differences between the House passed bill and the bill as it probably will pass the Senate are significant. However, there appears to be agreement between the House and Senate that legislation in this area is necessary. It is only a question of what to adopt. The House adopted a mixture of LAL (limitation on artificial accounting losses), an add-on minimum tax, and an "at risk" provision. The Senate rejected LAL and approved the add-on minimum tax and "at risk" provisions which varied somewhat from the House version.

The Administration recommended LAL as long ago as 1973 and has supported it ever since. This was to have been complimented by an alternative tax which would replace the present add-on minimum tax, a preferable approach in our view. The opposition to LAL, on the Senate side has been vociferous and effective. An alternative tax proposal along the lines suggested by the Administration failed by a very wide margin on the Senate floor.

Our best estimate at this point is that LAL will not survive the Conference. Instead, the bill will contain an admixture of provisions such as "at risk" limitations and modified capitalization requirements for certain expenses (e.g., real estate construction period interest and taxes to be amortized over a 10-year period or a shorter period to the extent of income derived from the property). With respect to the minimum tax, it is clear that it will continue as an add-on tax. The only question will be the compromise as to the offset for regular taxes paid--no offset under the House bill, full offset under the Senate bill. The likely compromise will be an offset for one-half the regular taxes paid.

The Administration position on Title II (tax shelters) and Title III (Minimum tax) is one of support. While there are some elements in these Titles that should be opposed they are not so severe as to cause the Administration to adopt the posture of opposing or giving only passive support to this first legislative effort to curb abusive use of tax shelters and to impose a more meaningful minimum tax. The likely compromise on the minimum tax is acceptable.

4. Title X and XI of the bill probably will contain the following provisions in the foreign tax area:

a. An incremental approach would be imposed upon DISC. The Administration has strongly supported DISC in its present form. Efforts were made in both the House and Senate to eliminate DISC entirely but each body instead adopted somewhat different versions of an incremental approach each of which has saved some two-thirds of the DISC benefits. Assuming an incremental approach is to be adopted, the Conference Committee will be in a position to take the best of the two versions into the final form.

If the tax bill fails of enactment, DISC will remain as it presently is, which is where the Administration wants it. Position: Oppose.

b. Repeal of the withholding tax on interest and dividends paid to foreign investors has been urged by the Administration but rejected by the House passed bill. The Senate agreed to repeal the tax on interest paid to portfolio investors (although not also on interest paid to direct investors) but did not agree to repeal the tax on dividends paid. Both bodies agreed to make permanent the exemption from withholding tax on interest paid by banks to foreign depositors, an exemption which otherwise will expire December 31, 1976. The bill is more likely to follow the House version than the Senate version, which means the Administration proposal will be rejected. In the absence of legislation, interest paid by U.S. banks after January 1, 1977 to foreign depositors will be subject to the withholding tax. Position: Support

c. Tax sanctions against taxpayers participating in an international boycott (originally proposed in connection with the Arab boycott of Israel) were included in the bill by the Senate Finance Committee. There is no similar provision in the House version. The Senate has not yet acted on this provision but probably will pass it. It is problematical whether the Conference Committee will be able to eliminate it. As a matter of tax policy it is highly undesirable. It would deny to taxpayers participating in the boycott the advantages of using foreign tax credits, deny them the advantages of deferring from U.S. tax the income of controlled foreign subsidiaries until the income is repatriated, deny them the advantage of the tax deferral provided by DISC, and deny their foreign based employees the exemption from tax on their earnings which would otherwise be available to them. Administrative problems abound in the proposal. Its impact is highly unpredictable, and can produce untold mischief. Whatever the merits of anti-boycott objectives, the matter should be handled through traditional procedures for regulating international activities. The proposed use of the tax system for this purpose is inappropriate, is bad tax policy, and should be opposed.

d. The tax sanctions just mentioned are also proposed with respect to taxpayers who have made illegal foreign payments. It too probably will be passed by the Senate. However, there is more likelihood of dropping this provision in Conference than is the case with the anti-boycott provision. It too is bad tax policy, and should be opposed. The tax law already denies deduction for such illegal payments.

e. There are numerous other provisions in Title X affecting the treatment of foreign income. On balance they deserve either a support or a no objection classification.

5. a. Title V (except section 505) contains a group of provisions denominated as simplification. They represent a move in the right direction, but only the smallest first step. The House and Senate versions are sufficiently similar to expect easy Conference agreement on them. Position: Support

b. Section 505 of Title V converts from a deduction to a refundable credit the tax benefit available to persons paying certain child care expenses. This is bad tax policy. Since the basic approach is to treat this expense as a cost of earning income, a deduction is preferable to a credit. The provision in the bill, which, incidentally, is expensive, should be opposed.

6. Title VI contains rules with respect to the deductibility of expenses attributable to business use of homes, rental of vacation homes, attendance at foreign conventions, the treatment of qualified stock options and legislators' travel expenses away from home. The House and Senate versions are sufficiently similar to expect easy Conference agreement on them. Position: Support

7. Title VII is a single section provision affecting the tax treatment of accumulation trusts. This is a desirable provision but not one of relatively high priority. The Conference Committee could easily agree to it. Position: Support

Paragraphs 8 through 16 below deal with capital formation, treated in Title VIII of the bill which is scheduled for Senate floor debate July 26. The following discussion thus is subject to change occasioned by floor action.

8. Neither the House nor Senate version has included the Administration's strongly supported proposal for integrating corporate and personal income taxes. This is a key element in the capital formation program. On the other hand, given our proposed effective date (January 1, 1978) there is no need for action now.

9. Neither the House nor Senate version has included the job creation incentive proposal designed to provide jobs in areas of high unemployment.

10. Neither the House nor Senate version has included the electric utility tax package presented as part of the Administration program.

11. The 10 percent investment credit is made permanent in the Senate version of the bill. The House would have extended the credit only until January 1, 1981. The Conference Committee action is not predictable on permanence of the credit. The Administration program recommended a permanent 10 percent credit. Position: Strong support

12. Provision for refundability of the investment credit was not included in the House passed bill. It is in the Senate version, but was removed from the bill by Finance Committee action July 23. Position on refundability: No objection

13. Investment credits and foreign tax credits carried forward from prior years and which otherwise would expire in 1976 can be carried forward an additional 2 years under a provision in the Senate version of the bill. There is no similar provision in the House passed bill, and it is doubtful that the Conference Committee would approve it. Retroactive changes such as this are generally bad tax policy. It would allocate benefits disproportionately to taxpayers according to the accidental distribution of expiring investment credits. Position: Oppose

14. a. Employee stock ownership plans (ESOPs) are an evangelical promotion of Senator Long. The Senate version of the bill, provides for an extra 2 percent

investment credit if an equivalent amount is contributed to an ESOP. In other words, the entire contribution is made by the government. There is no similar provision in the House passed bill. In prior tax bills, Senator Long has persuaded the House to go along with a 1 percent investment credit ESOP for a 2 year period. Perhaps he can persuade the House to go along now with a permanent 2 percent investment credit ESOP.

b. The Administration introduced a broadened stock ownership plan (BSOP) which provided a limited tax deduction for investments in corporate equity securities by low and middle income taxpayers. This can be contrasted to an ESOP in several ways: (1) the plan would be funded with the taxpayers' own money, not with the government's money as in an ESOP; (2) the investment would be in a diversified portfolio (perhaps through a mutual fund) of the taxpayers own choice, not solely in the stock of the employer as in an ESOP; (3) the plan would be available to anyone, whereas the ESOP is available only to employees of corporate employers who elect to adopt an ESOP. Employees of non-corporate employers are excluded, as are government employees and employees of corporate employers who do not elect to adopt an ESOP.

The Administration's BSOP proposal has not been made part of the tax bill, and there appears no likelihood that it will be, or that it will otherwise be adopted. Since the Administration has previously taken the position that it will not support the ESOP without a BSOP, it is appropriate to indicate a position of opposition to the ESOP.

15. Both the House and Senate versions of the bill contain similar provisions relating to the investment credit for movie and television films. This represents a statutory settlement of long pending litigation on the issue, and is agreeable to the IRS, Treasury, Joint Committee and the affected industry. Position: Support

16. The Senate version of the bill contains a provision, which would allow an investment credit for ships purchased with money withdrawn from the Capital Construction

Fund. There was no similar provision in the House passed bill. The Fund, authorized by the Merchant Marine Act of 1970, is comprised of shipping company profits which are not taxed if deposited in the Fund, and are not taxed when withdrawn from the Fund if used to purchase a ship. Ships paid for with money taken from the Fund have no cost basis to the shipowner, and therefore under the present investment credit law cannot qualify for an investment credit.

The proposal is bad tax policy, breaching significant long-standing tax rules of "basis". Position: Oppose

17. a. Title XII contains a number of administrative provisions. All but two of them can be supported.

b. One that should be opposed relates to the administrative so-called 3rd party summons procedure. The Department of Justice strongly opposes this in its present form and is endeavoring to obtain a sponsor to introduce a remedial amendment on the Senate floor.

c. Another that should be opposed relates to withholding tax provisions affecting employees of self-employed fishermen.

18. Title XIII contains 25 miscellaneous provisions. The bill section number, a descriptive phrase of the subject matter and the Administration position are as follows:

Bill Section	Description	Administration Position
1301	Tax treatment of certain housing associations..	Support
1302	Treatment of certain disaster payments.....	Support
1303	Tax treatment of certain 1972 disaster losses..	No objection
1304	Tax treatment of certain debts owed by political parties, etc., to accrual basis taxpayers.....	Support
1305	Regulations relating to tax treatment of certain prepublication expenditures of authors and publishers.....	Oppose
1306	Tax-exempt bonds for student loans.....	Oppose
1307	Interest of original issue discount on certain obligations.....	Oppose
1308	Personal holding company income amendments.....	Oppose
1309	Work incentive program expenses.....	Oppose
1310	Repeal of excise tax on light-duty truck parts.	Support
1311(a)	Eliminates a potential avenue of abuse under present law where a partnership transfers a franchise.....	Support
1311(b)	A very narrow grandfather clause.....	Oppose
1312	Employers' duties in connection with the recording and reporting of tips.....	Oppose
1313	Treatment of certain pollution control facilities.....	Support
1314	Clarification of status of certain fishmen's organizations.....	Postal Rate Matter
1315	Changes to subchapter S shareholder rules.....	Support
1316	Application of section 6013(e) to the Internal Revenue Code of 1954.....	Oppose
1317	Amendments to rules relating to limitation on percentage depletion in case of oil and gas wells.....	Support
1318	Implementation of Federal-State Tax Collection Act of 1972.....	No objection
1319	Cancellation of certain student loans.....	No objection
1320	Treatment of gain or loss on sales or exchanges in connection with simultaneous liquidation of a parent and subsidiary corporation.....	No objection
1321	Taxation of certain barges prohibited.....	Oppose
1322	Contributions in aid of construction for certain utilities.....	Oppose
1323	Prohibition of discriminatory State taxes on production and consumption of electricity.....	No objection
1324	Allowance of deduction for eliminating architectural barriers for the handicapped...	Oppose
1325	Reports.....	No objection

19. Title XIV contains capital gain provisions, including the following:

a. Extend to 8 years the present 5 year capital loss carryover provision in the case of regulated investment companies. This is in both the House and Senate version. Position: Support

b. The House passed bill increased from $1,000 to $4,000 the amount of ordinary income which could be offset by capital losses. The Senate version does not. The Conference Committee should be able to restore the House version. Position: Strong support

c. The Administration has recommended a sliding scale for reducing the amount of capital gain to be taxed in accordance with the length of time the asset is held. The House version did not contain such a provision. The Senate version does but it differs to some extent from the Administration's version. We nevertheless hope that the Conference Committee will agree with the Senate version. Position: Support

20. Title XV contains 10 provisions dealing primarily with individual retirement accounts and insurance taxation. The subject matters of the bill sections and the Administration position are as follows:

Bill Section	Description	Administration Position
1501	Retirement savings for certain married individuals	No objection
1502	Limitation on contributions to certain pension, etc. plans	No objection
1503	Participation by Government employees in individual retirement accounts, etc	No objection
1504	Participation by members of reserves or national guard in individual retirement accounts, etc	Support
1505	Certain investments by annuity plans	No objection
1506	Segregated asset accounts	No objection
1507	Study of salary reduction pension plans	No objection
1508	Consolidated returns for life and other insurance companies	No objection
1509	Restoration of certain amounts distributed by insurance companies	No objection
1510	Treatment of certain life insurance contracts guaranteed renewable	No objection

21. Title XVI contains 8 sections dealing with real estate investment trusts. The subject matters of the bill sections and the Administration position are as follows:

Bill Section	Description	Administration Position
1601	Deficiency dividend procedure.....	Support
1602	Trust not disqualified in certain cases where income tests were not met.....	Support
1603	Treatment of property held for sale to customers.	Support
1604	Other changes in limitations and requirements....	Support
1605	Excise tax.....	Support
1606	Allowance of net operating loss carryover.....	Support
1607	Alternative tax in case of capital gains.....	Support
1608	Effective date for title.....	Support

22. Title XVII contains 2 sections dealing with railroad tax accounting and the sequence in which to use investment credits. There are differences between the House and Senate version which should not be difficult to resolve.

a. One section contains provisions relating to depreciation of railroad grading and tunnel bores and replacement of wood ties with non-wood ties. Position: Support

b. Another section contains provisions for special sequential use of investment credits, and provisions which permit a 10 year amortization of certain track betterments. Position: Oppose

23. Title XIX is a very desirable group of provisions which appear in both the House and Senate versions of the bill. Although long, and seemingly unintelligible, these provisions strip from the Code many obsolete and rarely used provisions. This measure has been developed over the years in close collaboration between the Joint Committee and the Tax Section of the American Bar Association. It is known as the Deadwood Bill. Position: Strong support

24. Title XX contains 10 sections taken from prior proposed legislation on energy related matters. The House passed bill contained none of them. It is doubtful that the Conference Committee would adopt the Senate version.

a. A refundable credit is provided for certain expenditures to insulate a personal residence. The Administration proposed this measure in a different form (i.e., lower dollar limitation and nonrefundable). Position: Support

b. All other provisions in Title XX are opposed. The subject matters of the bill sections are as follows:

Bill Section	Description	Administration Position
2002	Residential solar and geothermal energy equipment	Oppose
2003	Investment tax credit changes relating to energy conservation and production	Oppose
[2004]	[Geothermal energy development]	Oppose
2005	Changes in investment credit relating to air-conditioning and space heaters	Oppose
2006	Credit for purchases of matter which can be recycled	Oppose
2007	Repeal of excise tax on buses and bus parts	Oppose
2008	Rerefined lubricating oil	Oppose
2009	Nonhighway use of special motor fuels	No objection
2010	Duty-free exchange of crude oil	Oppose

25. Title XXI contains 7 sections dealing with certain matters affecting tax exempt organizations. The House version of the bill contained no such provisions. The different versions should not be difficult to compromise in Conference.

a. Unrelated business income of a tax exempt organization is taxable notwithstanding the tax exemption of the organization. Problems exist in the definition of unrelated business income. Section 2106 would exclude the following from unrelated business income (i.e., permit receipt without tax burden):

(i) income from the conduct of public entertainment activities, including horse racing, at fairs and expositions.

(ii) income from trade shows, including fees charged to exhibitors.

Item (i) would be retroactive to 1963.

Item (ii) would be retroactive to 1970.

The Administration does not object to the substance of either (i) or (ii) (although the drafting of (ii) is defective) but does object to the retroactivity. Position: Oppose

b. The other provisions of Title XXI create no problems. The subject matters of the bill sections and the Administration position are as follows:

Bill Section	Description	Administration Position
2101	Disposition of private foundation property under transition rules of Tax Reform Act of 1969	No objection
2102	New private foundations set-asides	No objection
2103	Minimum distribution amount for private foundations	Support
2104	Extension of time to amend charitable remainder trust governing instrument	No objection
2105	Reduction of private foundation investment income excise tax	Support
2107	Declaratory judgments with respect to section 501(c)(3) status and classification	Support

26. Title XXII deals with estate and gift taxes. The House version contains nothing on that subject. The Ways and Means Committee, however, has been marking-up a separate bill on estate and gift taxes. Its proposals thus far include not only subjects included in Title XXII but additional subjects as well. Assuming the Conference Committee is unable jurisdictionally to bring forth any provisions on subjects not in the Senate version, the House conferees may insist that the entire title be dropped out of the bill.

Subjects which have been dealt with by both the Senate version of the bill and by the Ways and Means Committee in marking-up its estate and gift tax bill include the following which in some degree have been part of the Administration's program.

a. Remedy for the obsolete $60,000 exemption was provided by the Administration's proposal to increase the exemption to $150,000, phased in over 5 years, accompanied by appropriate changes in the rate structure.

Both the Senate version and the Ways and Means proposal have the same objective but use a credit mechanism instead of an exemption. The results are essentially the same. Position: Support

b. Liquidity problems for owners of farms and small businesses were remedied by the Administration proposal to extend the time during which the tax could be paid, and to charge a very low interest rate on the deferred payments. Some similar, but not adequate relief has been included in the Senate version. Still, it is a start in the right direction. Position: Support (and strive to improve)

c. The Administration proposed a free inter-spousal transfer rule, i.e., a provision permitting husbands and wives to transfer property to each other, by gift or inheritance, without incurring a gift or estate tax liability. The most that either the Senate version of the bill or the Ways and Means Committee provides is to include an enlargement of the marital deduction. This is not adequate relief, although it is certainly a step in the right direction. Position: Support (and strive to improve)

d. Both the Senate version and the Ways and Means Committee propose to impose a tax on generation skipping transfers. Thus, if a father's will leaves property in trust to provide income to his son for life and at the son's death to provide for distribution of the trust property to his grandson, there would be a skipped generation. That is, under present law there would be a tax at the father's death on the value of property transferred to the trust, but there would not be a second tax on the trust property at the son's death. The tax on a generation skipping transfer would impose a tax on the value of the trust at the son's death as though it were part of the son's estate.

Not only is the proposal extremely complicated (the statute is 20 pages long) but it seriously impacts on legitimate, non-tax motivated trust transfers to meet an infinite variety of personal family needs. The Administration has not yet formulated a position on the merits of this issue, although it suggested to the Finance Committee that the provision be deleted to permit the necessary study for development of a workable statute.

e. One subject included in the Ways and Means mark-up which is not in the Senate version of the tax bill, relates to a carryover basis at death. Under present law if a person dies owning property worth $100 which had cost him $10, his estate tax is computed on the $100 value and his heirs receive the property with a stepped-up basis of $100 for income tax purposes. A sale by the heir for $100 thus produces no taxable income.

Estate tax reformers have long complained about this, and have offered two alternative solutions:

(i) Impose a capital gains tax at death on the unrealized appreciation, or impose an additional estate tax upon the amount of unrealized appreciation.

(ii) Require a carryover basis so the heir, in the above example, will have a basis of $10 and a gain of $90 if he sells for $100.

By a narrow margin, the Ways and Means Committee rejected the capital gains at death concept, but by a wide margin approved of the carryover basis concept. If this subject is not in the Senate version (it is not included now but conceivably can be added on the floor), the Conference Committee may find it difficult to report out anything on estate and gift taxes. Position: Oppose (both capital gains at death and carryover basis)

f. Another subject handled by the Ways and Means Committee and the Senate version of the bill is special valuation to be given to farms, and presumably to small businesses. The suggestion is replete with practical problems of too great a magnitude to develop here. The proposed concept is extremely poor tax policy. Relief is better provided in the exemption and rate structure or in more generous tax deferred payment schedules. Position: Oppose

Title XXII would be added to the bill by committee amendments which include the estate and gift tax provisions mentioned above plus 32 other measures covering a wide range of unrelated subjects. None are of sufficient significance to mention here.

Options

1. Comment at this time upon the tax legislation. The purpose would be to induce one of the two following actions by Congress:

a. Conclude action on the bill by September 1.

Pro: Unless completed by Sept. 1, the immense effort already devoted to the bill can be jeopardized. Pre-election compaigning will divert attention. Post election action will require Congress to defer substantially its scheduled adjournment date. Thus, the bill might die.

Many provisions in the bill require administrative tooling-up by the IRS. A delay beyond Sept. 1 will cause expensive delays and aggravation to the taxpaying public.

Con: Congress knows full well both of the above factors, and does not need to be reminded of them.

There is waning enthusiasm in Congress for enacting a so-called tax reform bill. There is already some sentiment, and it may be growing, that Congress would prefer not to enact such a massive bill.

There is not enough in the bill warranting strong support to make an effort to get it passed. 8 significant items which have been urged by the Administration are omitted from the bill; only 7 items in the bill are worthy of strong support, 31 items are objectionable, and of the remaining items many are acceptable but not so meritorious as to be sorely missed if Congress allows the bill to die. There are a whole host of other measures that are of such relatively minor consequence as not to warrant evaluation except to note that they add complexity to the bill.

b. Split out the tax cuts and conclude them by September 1, leaving the rest of the bill for later action.

Pro: This will assure an uncomplicated handling of the tax cuts and permit the IRS to prepare necessary forms and computer programs in a timely manner.

Con: This will be a signal that the Administration is indifferent to, or opposes, the "tax reform" aspects of the bill.

It will be a tacit acceptance of the amount of the tax cuts and will hinder further support for the deeper cuts recommended by the Administration.

2. Await completion of Senate action, and then comment upon the bill.

Pro: This affords an opportunity to signal the Conference Committee on matters of primary concern to the Administration.

It lays the groundwork for a possible veto.

Con: Statement of Administration position, to extent it suggests a possible veto, may be interpreted as an anti-tax reform position and may limit our options respecting approval of inadequate tax cuts.

3. Await final legislation and approve it.

Pro: This will acknowledge the worth of the great effort expended on the legislation, starting with the tax shelter legislation in 1973.

It is a start toward preventing abusive use of tax shelters and toward having everyone pay a fair share of taxes.

It enacts many desirable measures, including administrative provisions.

Con: It is a monstrous piece of legislation, many features of which have not been adequately considered.

The tax reform elements are not worthy of the name. Instead of accomplishing a reasonable end to abusive use of tax shelters, many shelters are kept open, indeed some many be created.

Instead of being sure everyone pays a fair share of tax, the add-on minimum tax is a regressive measure that still allows less than a fair share of tax to be exacted from many people.

The bill adds a crushing weight of complexity to an already dangerously complex tax code. The voluntary compliance and self-assessment elements of our system will be severely damaged.

The tax cut provisions will impede continued support for the deeper cuts the Administration proposes for 1977.

4. Await final legislation and veto it (possible approach to a veto message is attached).

Pro: A veto will highlight the Administration's stand on deepened tax cuts and lower expenditures. If the bill were signed, a statement merely criticizing the lesser cuts will not be as effective. It is a monstrous piece of legislation, many features of which have not been adequately considered.

The tax reform elements are not worthy of the name. Instead of accomplishing a reasonable end to abusive use of tax shelters, many shelters are kept open, indeed some may be created.

Instead of being sure everyone pays a fair share of tax, the add-on minimum tax is a regressive measure that still allows less than a fiar share of tax to be enacted from many people.

The bill adds a crushing weight of complexity to an already dangerously complex tax code. The voluntary compliance and self-assessment elements of our system will be severely damaged.

Con: The worth of the great effort expended on the legislation, starting with the tax shelter legislation in 1973 should be acknowledged by approving the bill.

It is a start toward preventing abusive use of tax shelters and toward having everyone pay a fair share of taxes. Further steps can be taken in the future.

It enacts many desirable measures, including administrative provisions.

Draft Veto Message--Assuming H.R. 10612 passes in reasonably predictable form (House passed bill plus Senate action as of July 23, 1976)

I have vetoed H.R. 10612. The most significant shortcoming of the bill is its failure to provide for the tax cuts I recommended last October. Instead, there is only a continuation of the lesser cuts adopted over a year ago.

> [Insert here further reference to getting money back in the hands of the people--spending reduction--improved economy makes the point--claim credit for the progress.]

Quite aside from the bill's failure to give the American people an opportunity to make their own decisions, the bill itself is a monstrosity. It is such a gigantic compilation of complex provisions that the undesirable ones, of which there are many, cannot be separated from the desirable ones, of which there also are many.

There are provisions in the bill designed to prevent abusive use of tax shelters, and to assure that everyone pays his fair share of taxes. While I strongly support the general objectives of these provisions they fall far short of what the Administration has recommended and, to make matters worse, they add such complexity to the tax laws that I doubt the wisdom of adopting them.

I am also greatly disturbed by the large number of special interest provisions in the bill, the series of ill-advised energy conservation measures, and the provisions dealing with tax sanctions for participation with Israel boycott. It is not reasonable to include such an assortment of different provisions in a single bill where the only element in common among them is a place in the Internal Revenue Code.

This tax legislation must be reduced to manageable proportions. I therefore urge the Congress to present its tax proposals in separate bills, each of which handles a specific area. Examples would be separate bills for the tax cuts, for tax shelter and minimum tax provisions, for capital formation provisions, for foreign tax provisions, for estate and gift tax provisions, for administrative provisions, etc. I think it is important in this respect to present the special interest provisions as a separate bill, such as a Technical Amendments bill.

The magnitude of H.R. 10612, superimposed on the present inordinately complex Internal Revenue Code, vindicates the wisdom of having started within my Administration some months ago a project designed basically to restructure and simplify our tax laws. The scope of the work is so vast that the professionals engaged in the endeavor assure me it will be several months yet, perhaps not until the end of the year, before their report and recommendations can be completed and released. The need for such a revision is obvious. Tax legislation during recent years has often been called tax reform, but the enactments have not really deserved that name. They have, however, added much complexity to an already overly complex system. We owe it to our fellow citizens to restore rationality to our tax system. We must strive for a system which is comprehensible to the vast majority of our people and which makes it clear that everyone will be required to pay a fair share of taxes.