The original documents are located in Box 18, folder "Tax Reduction and Spending Restraint Program" of the Robert T. Hartmann Files at the Gerald R. Ford Presidential Library.

THE WHITE HOUSE

WASHINGTON

October 16, 1975

MEMORANDUM FOR: Donald Rumsfeld
Ronald Nessen
Robert Hartmann
John Marsh
Philip Buchen
William Baroody

FROM: L. William Seidman LWS

Two questions and answers regarding the President's Tax Reduction and Spending Restraint Program prepared by the Council of Economic Advisers and approved by the Economic Policy Board Executive Committee are attached for your information.

Attachments

Q. Since you recommend a tax cut as of January 1, and expenditures restraint starting October 1, isn't the President's program in fact one of significant stimulus in the period prior to the election in 1976?

A. It is true that the President's proposal would increase the deficit for fiscal year 1976 and the transitional quarter (July - September 1976).

Since the temporary tax cut expires on December 31, 1975 the effective date of permanent tax legislation recommended by the President has to be January 1, 1976. Otherwise we would confront the American taxpayer with increased uncertainty with respect to what his taxes are going to be. Uncertain and rapidly changing tax policies are undesirable. If the Congress accepts the President's recommendation on expenditure cuts for the remainder of this fiscal year the problem posed by the slightly larger deficit for the period immediately ahead would be easily resolved.

In the event that the Congress does not act to hold spending in the current fiscal year to the recommended totals a larger deficit in the first three quarters of 1976 could affect the economy. Standard econometric analysis, based largely upon average relationships for the post WW II period, suggest a relatively minor expansionary effect on the pattern of economic recovery over the two year period beginning next January. This analysis would suggest a slightly larger increase in production and employment in calendar 1976 than would otherwise occur but these effects would be small in any event.

At the current and prospective levels of budget deficit it is questionable whether the so-called standard econometric approach is producing the correct answers. It is not clear whether larger deficits will stimulate or depress the economy in the short-run, i.e. it is not clear whether an increased deficit for the first nine months of 1976 is expansionary or contractionary. It is clear, however, that continued deficits in excess of $60 billion annually would certainly act to depress the economy as it recovers. They would reignite inflationary pressures, generate higher interest rates and depress levels of production and employment. The President's program has the effect of reducing the longer term danger from this problem, and without raising other risks for the short-term.

In any event, merely abstracting the short run impacts of the President's program is deceptive. The 1976 deficit is more than offset by a decrease in deficit spending for fiscal 1977 and beyond. Hence the financial markets are likely to discount the improved fiscal outlook well in advance and at least partially offset some of the negative short-term effects on financial markets stemming from the increased Treasury financing requirements during January - September 1976.

As the President pointed out in his October 9th Press Conference the tax cut - spending limitation proposal is not proposed as a stimulant for the early part of 1976. "...(It) is not aimed at affecting the economy in any significant way whatsoever" during that period. The major economic thrust of the President's program is its longer-run impact on our economy and hence our society. It is an attempt to defuse the underlying inflationary momentum which we face, which, if not accomplished, is likely to prevent an early attainment of full economic recovery. Unless the growth in federal expenditures is markedly slowed, the choice in future years will be between higher taxes and highly inflationary budget deficits followed by significant inflation distortions which are inconsistent with a stable prosperity. The President's proposal is focused on reducing the rapid growth in expenditures and reducing the tax burden imposed upon the American people -- and in a manner which would reduce the inflation risks. We have become accustomed to looking at the near term and to assessing the short-term benefits of what governments do. As a consequence, we often lose sight of where we are heading and the costs we have imposed upon the American people, and upon productivity of our economic system. It is time to stand back and take stock of where we are going.

As the President pointed out in his State of the Union message last January "Part of our trouble is that we have been self-indulgent. For decades, we have been voting ever-increasing levels of Government benefits -- and now the bill has come due. We have been adding so many new programs that the size and growth of the Federal budget has taken on a life of its own.

One characteristic of these programs is that their cost increases automatically every year because the number of people eligible for most of these benefits increases every year. When these programs are anacted, there is no dollar amount set. No one knows what they will cost. All we know is that whatever they cost last year, they will cost more next year.

It is a question of simple arithmetic. Unless we check the excessive growth of Federal expenditures or impose on ourselves matching increases in taxes, we will continue to run huge inflationary deficits in the Federal budget."

Q. Isn't it unrealistic to request of the Congress a ceiling on 1977 expenditures as low as $395 billion?

A. The implication is that Congress does not want to come to grips with the problem of accelerating federal spending and that somehow that must be taken as unattenable given when we formulate tax and spending policies. The more important question to ask is what happens if we do not blunt the rise in federal outlays and we are on the "spending as usual" path throughout fiscal 1977 and beyond. The implications of that scenario are that we have accepted the inevitable path that has led other great nations and great cities to the brink of fiscal collapse.

It will be exceptionally difficult to bring expenditures to a $395 billion level in the next fiscal year as the details of the President's budget will clearly indicate, but if we value the future of this country's economy and society we do not have the luxury of "spending as usual."

As the President said in his speech (October 6th)

"For several years, America has been approaching a crossroads in our history. Today we are there..... I deeply believe that our nation must not continue down the road we have been travelling. Down that road lies the wreckage of many great nations of the past. Let us choose instead the other road -- the road that we know to be tested, the road that will work."