The original documents are located in Box 63, folder "1976/12/06 - Economic Policy Board" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

8:30 AM - EPB

~~Monday~~, December 6, 1976

Tuesday

JMc December 3, 1976

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

Proposed Agenda

Monday, December 6, 1976

1.	Tax Policy Review	Treasury

Tuesday, December 7, 1976 PRINCIPALS ONLY

1.	Basic Tax Reform	Treasury
2.	Economic Outlook	Troika II

Wednesday, December 8, 1976

No Executive Committee Meeting

Thursday, December 9, 1976

No Executive Committee Meeting

Friday, December 10, 1976

No Executive Committee Meeting

JMC

MINUTES OF THE ECONOMIC POLICY BOARD EXECUTIVE COMMITTEE MEETING

December 2, 1976

Attendees: Messrs. Seidman, Lynn, Greenspan, Cannon, Dixon, Usery, Gorog, Porter, Kendrick

1. Steel Price Increase

The Executive Committee discussed the recent steel price increase effective December 1, 1976. The Council on Wage and Price Stability staff has prepared an interim report on the price increase which it is sending to Council members today and is releasing to the press early this afternoon. A copy of the interim report is attached at Tab A.

The discussion focused on the question of whether steel companies are discounting their prices and that the list price increases may well be an attempt by the steel companies to get a higher price on the books in anticipation of wage and price controls by the next Administration; the need to determine the real price that purchasers are paying for steel products; the relationship of a steel price increase and OPEC action; the prospects for success in securing a rollback; and alternative courses for Presidential action.

Decision

The Executive Committee requested Mr. Seidman's office to prepare a memorandum reflecting the Executive Committee discussion for submission to the President.

RBP

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

November 23, 1976

MEMORANDUM FOR THE EXECUTIVE COMMITTEE OF THE
ECONOMIC POLICY BOARD

Attached for your information is the Council of Economic Advisers' new estimates of "potential gross national product" and of the "full employment rate of unemployment".

Alan Greenspan

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

November 22, 1976

Potential GNP Estimates

	Potential GNP	Potential GNP Range	Unemployment Benchmark
1948	492.8	488-498	4.3
	514.4	509-520	4.2
1950	537.0	531-543	4.2
	560.5	555-567	4.1
	584.9	579-591	4.0
	608.2	602-615	4.0
	629.7	623-636	4.0
1955	651.4	644-658	4.0
	673.9	667-681	4.0
	697.2	690-705	4.0
	721.2	714-729	4.0
	746.2	738-754	4.1
1960	771.9	764-780	4.1
	798.6	790-807	4.1
	826.4	818-835	4.1
	857.1	848-866	4.2
	890.3	881-900	4.3
1965	925.0	915-935	4.4
	960.8	951-971	4.5
	996.3	986-1007	4.4
	1031.7	1021-1043	4.4
	1068.3	1057-1080	4.4
1970	1106.2	1094-1118	4.5
	1145.5	1133-1158	4.6
	1186.1	1173-1199	4.7
	1228.2	1215-1241	4.8
	1271.7	1253-1285	4.8
1975	1316.9	1273-1331	4.8
	1363.6	1305-1378	4.9
	1412.0	1351-1427	4.9
	1462.1	1400-1478	4.9
	1513.9	1451-1530	4.9
1980	1567.7	1503-1585	4.8

ZPB

Bill —
FYI!
Jim

THE WHITE HOUSE

WASHINGTON

December 2, 1976

MEMORANDUM FOR: JIM CANNON

FROM: PAUL LEACH Paul

SUBJECT: Steel Prices

As a policy matter, I think that the President's current "no jawboning" policy should be continued here. At best, all that could happen would be a delay in the results impelled by economic forces.

If anything is to be done about the oligopolistic pricing behavior of the steel industry, it should be the province of the antitrust laws. They would have to be changed to prohibit this type of pricing behavior and/or to prohibit industry concentration levels which lead to this type of behavior. However, we cannot do anything about the problem in the next six weeks and should not try.

INTERIM REPORT ON THE DECEMBER 1 STEEL PRICE INCREASE

Introduction

On Wednesday, November 24, National Steel Corporation announced increases in the prices of sheet steel mill products of between 6 and 7 percent to become effective on December 1, 1976. By November 29 all other major producers of these products had announced identical increases. Prices of these products had also been raised by 6 to 7 percent on June 14, 1976. In addition, in August a smaller increase in price for these products had been announced to become effective on October 1. However, before the October 1 effective date, the producers cancelled the increase because of market conditions.

The latest price increase for sheet products has occurred in the midst of a generally weak market for steel products. While raw steel production and steel mill product shipments were higher during the first nine months of 1976 than they were in 1975, the recovery has not achieved the levels forecast at the start of the year and has come to a halt in recent months. For example, at the start of 1976, industry spokesmen were generally predicting total shipments of about 96 million tons, far below the record shipments of 111 million tons shipped in 1973. Currently, shipments for 1976 are expected to reach only 90-92 million tons. Similarly, the rate of capability utilization in the production of raw steel rebounded from less than 75 percent in January 1976 to more than 90 percent in May, but then began to decline, falling to 80 percent in September and to less than 75 percent by mid-November.

Even sheet products for which demand had grown most rapidly earlier in the year, experienced a decline in shipments after the June 14 price increase. For example, by September sheet and strip product shipments had declined by more than 9 percent from their peak in June. Moreover, recent trends of shipments for autos and household appliances do not imply a rapid growth of production for these products which are major users of steel sheet products.

The Price Increase

On November 24, National Steel Corporation announced increases in the prices of sheet steel mill products to become effective on December 1, 1976. The increases are as follows:

Product	Price November 24	Price December 1	Percent Increase
Hot Rolled Bands	$231.00	$246.00	6.5
Hot Rolled Sheet and Strip	249.00	265.00	6.4
Cold Rolled Sheet	296.00	316.00	6.8
Galvanized Sheet	328.00	348.00	6.1

Extra charges were not increased.

After National Steel's announcement the other major steel producers all announced identical increases and in some cases also increased the prices of certain pipe and tube products.

Demand Conditions

Sheet and strip products comprise the largest single product group for the U. S. steel industry. Such products have traditionally accounted for from 40 to 45 percent of all steel mill product shipments. The largest user of these products is the automotive industry which received about 40 percent of total hot rolled sheet shipments, 47 percent of cold rolled sheet shipments and 18 percent of total galvanized sheet shipments in 1975. Another major user of sheet products is the appliance industry. In 1975 the appliance, utensil, and cutlery market received almost 9 percent of the shipments of cold rolled sheet.

During 1976 such traditional steel markets as construction, oil and gas drilling, and capital goods have remained considerably depressed with the result that shipments of steel mill products used by those industries have also remained depressed. In contrast, demand for automobiles and consumer appliances has been stronger with the result that shipments of steel sheet products (products which are used by those industries) have accounted for between 45 and 50 percent of total steel shipments during 1976 as compared to 38.5 percent in 1975. Tables 1 through 8 in the Appendix present recent data on production and shipments of steel mill products. As can be seen in Table I below, both total carbon steel shipments and shipments of sheet products peaked in May and June of this year. The surge in shipments during those months was, at least partially, an attempt by users to purchase in advance of their steel requirements in order to avoid the full impact of the price increases which were effective in mid-June. After the price increases, shipments declined sharply during the months of July, August, and September.

Recent events indicate that steel shipments, including sheet products, are currently rather weak. A number of producers have initiated production cutbacks and layoffs in recent months (see Table 9 in the Appendix). A price increase for sheet products, to have been made effective on October 1, was cancelled. Forecasts of total steel shipments for the fourth quarter of 1976 do not anticipate any substantial increase in shipments.

Moreover, auto and appliance sales are showing signs of weakness. In mid-October domestic new car sales were actually 5.3 percent below the corresponding 1975 period. This was due in large measure to the strike-caused shortage of Ford Motor cars, but other auto producers have announced temporary closings of various assembly plants. The most recent forecast of auto sales by Data Resources, Incorporated, for example, shows that automobile sales in 1977, assuming that there is a tax cut, will be 10.6 million units, or an increase over 1976 of only about 4 percent. Appliance sales, which were down 24 percent in 1975 compared to 1974, have increased by 5 percent during the first ten months of 1976. However, October 1976 shipments were actually 9 percent below the October 1975 level.

TABLE I

CARBON STEEL SHIPMENTS, 1976
(000 tons)

Month	Total Carbon Steel Shipments	Carbon Sheet and Strip Shipments	Percent of Total Shipments
January	6,528	3,092	47.4
February	6,131	2,990	48.8
March	7,417	3,739	50.4
April	7,026	3,503	49.9
May	7,419	3,777	50.9
June	7,682	3,834	49.9
July	6,779	3,387	50.0
August	6,755	3,529	52.2
September	6,831	3,483	51.0

Source: American Iron and Steel Institute

While shipments data indicate a relatively weak market for steel mill products, including sheet products, a number of producers state that new bookings and order backlogs have increased, implying that shipments will rise in the near future. Data on outstanding orders and order backlogs are publicly available only after a considerable delay. An attempt to obtain substantiating data from individual firms was made, but replies were not received in time for analysis and inclusion in this report. In any case, order backlog data for this industry are somewhat misleading because of the tendency of users occasionally to place orders in excess of needs and then later to cancel such orders.

Published information on new and unfilled orders, presented in Table II below and in Table 10 in the Appendix indicates that new orders peaked in May, before the June price increases and then declined by almost 30 percent by August. Similarly, unfilled orders peaked in June and then declined by 9 percent by September. Unfortunately, such data are not yet available for November; hence the statements concerning the current inflow of new orders cannot be assessed.

Information on inventories also supports the view that steel markets are weak since producing mills total inventories have increased from 16.4 million tons in January 1976 to 18.9 million tons in September. Consumer inventories (manufacturers only) declined earlier in the year, but began to increase slowly in June and July. Table III presents the recent trends of inventories and Table II in the Appendix presents similar data for a longer period.

A revival of imports from their low level in 1975 has also served to weaken the domestic demand for steel products from U. S. producers (see Table 12 in the Appendix). Although imports are not concentrated on sheet and strip products, their increased share of some products and for certain geographic markets has become important enough to lead U. S. producers to seek redress through the International Trade Commission.[a/] Net imports for the first eight months of 1976 were eleven percent higher than their total for the same period in 1975.

Implicit prices for imported cold rolled sheet, shown in Table 13 of the Appendix, increased 103 percent from January 1972 through September 1976, compared with an increase of 55 percent in list base prices for domestic cold rolled sheet. These implicit delivered prices represent approximately a two to three month lag from the date the steel was ordered by a customer, and include the charges for various extras. Import prices, which to a certain extent represent the value of incremental supplies of steel sold in the U. S. market, tend to reflect the level of demand for steel. During late 1974 and early 1975 import prices were in the range of \$300-\$322 per ton as steel ordered during the extremely tight 1974 market was delivered. The base price (excluding extras) for domestic cold rolled sheet was \$260 per ton during this period. Import prices dropped during the remainder of 1975 and reached a level of \$220/ton in March 1976, a drop of 31.7 percent, while domestic list base prices moved up to \$278/ton. As demand has recovered from the recession, low, import prices have increased although they are still below the 1974-1975 record levels. The most recent data available shows implicit import prices (including extras) at \$272/ton, compared to a base price of \$296/ton for the domestically produced product.

Recent Behavior of Prices

In June 1976, the price of hot rolled bands was raised by \$15 per ton or 6.9 percent; the price of hot rolled sheets was raised by \$15 per ton or 6.4 percent, the price of cold rolled sheets was increased by \$18 per ton or 6.5 percent, and the price of galvanized sheets was raised by \$20 per ton or 6.5 percent. At that time, certain extra charges for sheet products were also increased. Thus, the additional increases scheduled for December 1 as detailed above, when added to the June 14 increases, amount to 13.9 percent for hot rolled bands, 13.2 percent for hot rolled sheet, 13.7 percent for cold rolled sheet, and 13.9 percent for galvanized sheet. These calculations do not include the impact of increased extra charges made effective along with the June increase.

---

a/ See Table 12A in the Appendix.

TABLE II

STEEL MILL PRODUCTS: NEW AND UNFILLED ORDERS, 1976
(millions of dollars)

Month	Manufacturers' New Orders	Manufacturers' Unfilled Orders
January	3,770	9,463
February	3,434	9,362
March	3,830	9,455
April	3,634	9,418
May	4,985	10,476
June	4,305	10,687
July	3,944	10,647
August	3,511	10,327
September	3,644	10,029

Source: U. S. Bureau of the Census, Current Industrial Reports

TABLE III

INVENTORIES OF STEEL MILL SHAPES, 1976
(millions of tons)

Month	Producing Mills	Service Centers	Consumers (manufacturers only)
January	16.4	6.5	10.6
February	16.9	6.5	10.4
March	16.6	6.5	10.4
April	17.2	6.5	10.0
May	17.9	6.4	10.0
June	18.0	6.4	10.1
July	18.7	6.7	10.2
August	19.1	6.5	10.3
September	18.9	N.A.	10.2

N.A. = Not available.

Source: U. S. Bureau of the Census, Current Industrial Reports

A comparison of the rates of change of sheet steel prices with other steel mill product prices and with other broad indexes of commodity prices, as reported by the Bureau of Labor Statistics in the Wholesale Price Index, is presented in Tables IV and V below.[a] It can be seen in Table IV that from January 1972 to October 1976 (which does not include the December 1 price increase) the overall index for all commodities increased by 59.2 percent, the average of all industrial prices increased by 60.7 percent, and steel mill product prices rose by 66.3 percent. Thus, steel mill product prices rose by more during this period than did the average of all commodities or all industrial commodities. Furthermore, even before taking account of the December 1 increase, the prices of cold rolled sheets and of galvanized sheets rose by more than the average of all finished steel mill products. In contrast, the price of hot rolled sheets has risen by less than the average of all steel mill products.

Steel mill product prices and steel sheet prices rose by considerably less than the price index for all crude materials, excluding food. However, it must be remembered that the crude materials index was influenced strongly by the atypical movement of petroleum, coal, and other energy prices.

TABLE IV

CHANGE IN WHOLESALE PRICE INDEX ITEMS, JANUARY 1972 - OCTOBER 1976

Index	Jan 1972	October 1976	% change Oct 76 / Jan 72
All Commodities	116.3	185.2	59.2
Crude Materials, excluding food	125.6	261.5	108.2
Industrial Commodities	115.9	186.3	60.7
Finished Steel Prod	129.5	215.3	66.3
Rails Standard, Carbon	131.7	238.7	81.2
Structural Shapes	121.4	209.1	72.2
Bars Reinforcing	117.6	190.0	61.6
Sheets, HR Carbon	126.8	201.4	58.8
Sheets, CR Carbon	124.1	209.1	68.5
Sheets, Galvanized Carbon	122.1	207.1	69.6
Pipe, Black Carbon	132.5	223.2	68.5
Oil Well Casing	128.4	226.0	76.0
Mechanical Tubing	115.5	183.9	59.2

Source: Bureau of Labor Statistics

a/ Tables 14 through 20 in the Appendix exhibit the WPI items discussed in this section.

TABLE V

ANNUAL PERCENTAGE PRICE CHANGES $\left(\frac{\text{Dec}}{\text{Dec}} - 1\right)$X100

Wholesale Price Index	(WPI Code No.)	1972	1973	1974	1975	1976*
All Commodities		6.3	15.2	21.1	4.2	3.6
Crude Materials, excluding food		10.9	31.4	23.0	4.5	13.1
Industrial Commodities		3.4	10.7	25.6	6.0	5.8
Finished Steel Products	(101302)	1.7	4.0	41.8	5.0	6.8
Rails Standard, Carbon	(10130241)	0.0	4.3	41.8	14.1	7.4
Structural Shapes, Wide Flange	(10130239)	0.0	4.5	38.5	11.2	7.0
Bars, Reinforcing	(10130255)	-5.3	11.5	76.5	-16.0	0.5
Sheets, Hot rolled carbon, Coil	(10130259)	4.8	2.5	40.9	3.9	5.8
Sheets, Cold rolled carbon	(10130262)	5.5	2.2	38.2	3.7	6.1
Sheets, Galvanized carbon	(10130263)	4.5	2.3	48.2	6.6	5.0
Pipe, Black Carbon	(10130269)	0.0	4.0	43.0	6.6	6.3
Oil Well Casing, Carbon	(10130273)	0.0	4.0	44.9	12.4	4.0
Mechanical Tubing	(10130276)	5.0	5.9	36.8	0.9	3.7

*Change from December 1975 to October 1976.
SOURCE: Bureau of Labor Statistics

Table V shows the annual percentage price changes in the various aggregate groupings as well as for a number of steel mill products. The data reveal that although the prices of steel mill products rose over the entire period by an amount similar to the entire WPI, the yearly pattern was quite different. During 1972 and 1973 steel prices lagged behind the broad groupings. They then rose at almost double the rate of the WPI in 1974 with the ending of price controls. During 1975 and the first 10 months of 1976, steel prices continued to rise more rapidly than the overall WPI.

Within steel mill products, sheet prices rose faster than the average in 1972, more slowly in 1973, at about the same rate in 1974 (except galvanized sheet which rose faster than the average). Sheet prices continued to rise, but less rapidly than the average in 1975 (except galvanized sheet) and have risen less rapidly than the average mill product during the first ten months of 1976. It is interesting to note that the price of reinforcing bars, generally recognized as the most competitive of steel mill products because of imports and "mini-mills", exhibited much greater sensitivity to swings in demand, but rose by roughly the same magnitude as other mill product prices over the entire period.

Costs of Production

Product prices in a competitive market system are expected to respond to both demand and supply factors. The previous sections have delineated the current state of demand for flat rolled steel products. Supply forces in a competitive market are reflections of underlying costs of production. It is entirely possible that even under perfectly competitive market conditions a situation could arise in which a fall in demand could be accompanied by a rise in the costs of production sufficient to contract the industry supply to such an extent that the price would rise.

The likelihood of price increases in response to cost pressures, despite weak demand, would be considerably higher in an oligopolistic industry in which firms follow a cost-plus or target-pricing philosophy and avoid price discounting. This might explain the emphasis given to cost changes in public announcements of steel firms' pricing decisions.

In a highly capital intensive industry such as steel, cost per unit of output is influenced strongly by the level of capacity utilization and therefore meaningful time series data on changes in costs of production must exclude the effects of variation in utilization. Another complication arises because of the vertical integration into raw materials production which characterizes all the leading U. S. steel producers. Differences in internal accounting procedures in measuring the cost of self-produced raw materials (whether by actual cost incurred or by some transfer price) make the comparison or averaging of cost data obtained from the producers a somewhat arbitrary process.

With the above caveats in mind, Table VI below presents estimated data on the average costs of production of all mill products based on confidential information submitted to the Council by four large steel producers.

As can be seen in Table VI, costs of production for steel mill products are estimated to have increased by 74.1 percent from the first quarter of 1972 through the second quarter of 1976. However, it must be remembered that this estimate is not consistently adjusted for the effect of output variation, and is partially based upon calculation of raw materials costs valued at "market" prices rather than upon actual incurred costs of production. These problems probably result in an overstatement of actual rise in incurred costs of production. Despite this bias in the basic data, the cost index shows a rise which is only slightly above the 66.3 percent rise of finished steel prices as reported in the WPI from January 1972 through October 1976. Moreover, the WPI index does not completely reflect the increases of "extra charges" which have been instituted on various mill products. It is also clear from Table VI that the most rapid increases in costs occurred between the fourth quarter of 1973 and the first quarter of 1975. Over the last six quarters the index of steel costs has increased by less than 8 percent, considerably less than the increases in the prices of steel sheet products.

TABLE VI

COSTS OF PRODUCTION PER TON OF MILL PRODUCTS
(Weighted Average of four producers, 1972, first quarter = 100)

Quarter	Index of Cost
1972:1	100.0
2	101.6
3	103.1
4	103.9
1973:1	106.5
2	107.5
3	110.0
4	113.2
1974:1	123.0
2	136.7
3	146.7
4	153.4
1975:1	161.4
2	163.4
3	168.1
4	167.7
1976:1	171.4
2	174.1

SOURCE: Confidential Company Reports.

Steel production costs have continued to rise since the end of the second quarter of 1976. In accordance with the terms of a labor contract, steel workers' wages were increased on August 1. Based on partial reports of the impact of the higher labor cost, the cost index in Table VI may have reached 177.2 for the third quarter of 1976. Excluding the increases in extra charges, the base price of cold rolled sheets will be at an index level of 165.4 (January 1972 = 100) after the December increase, hot rolled sheets at 166.7, and galvanized sheets at 174.0.

Profitability

Due to the cyclical nature of the demand for steel and the relative magnitude of fixed costs, the profitability of steel production is subject to wide variation in response to the business cycle. As indicated in the previous section, steel production costs per ton rise sharply as volume decreases because there are fewer units of output to absorb the fixed cost elements. Similarly, profits fall even more sharply as volume and revenues decrease. Table VII below shows the changes in net income, the income to sales ratio, and the rate of return on stockholders' equity for all manufacturing and for the entire iron and steel industry during the period from 1972 through the second quarter of 1976. All the data in Table VII are index numbers based on the first quarter of 1972.

By second quarter of 1974, when the industry was operating at or close to full capacity, iron and steel industry net income was five times as large as it was in the first quarter of 1972, whereas net income had only doubled for all manufacturing. The ratio of net income to sales had tripled and the ratio of net income to stockholders' equity had increased by 4.7 times whereas these ratios had increased by 50 percent and 75 percent respectively for all manufacturing. By the second quarter of 1976, although profitability for the iron and steel industry was considerably below the peak levels of 1974, net income was 3.8 times higher, net income as a percent of sales was double and net income as a percent rate of return on stockholders' equity was 2.8 times higher than it was in the first quarter of 1972.

The actual <u>levels</u> of net income as a percentage of sales and as a percentage of stockholders' equity for both all manufacturing and for the iron and steel industry are detailed in Table VIII. In recent years, the U. S. iron and steel industry has generally exhibited rates of return below the average for all manufacturing. This was certainly true in 1972 and also occurs in the latter part of 1975 and the first half of 1976. However, during the last three quarters of 1974 and in the first quarter of 1975, the rate of return on stockholders' equity was higher for iron and steel than it was for all manufacturing. Indeed, during that period the ratio of net income to <u>sales</u> was also higher for iron and steel. The experience in 1974 and 1975 supports the view that the profit performance of the steel industry is crucially dependent upon the state of the economy and the level of capacity utilization which can be sustained by market demand. The relationship of prices to costs is obviously also crucial to the financial viability of steel producers; however, neither the price and cost data examined above, nor the net income to sales ratios in Table III indicate any underlying deterioration of the price-cost relationship.

TABLE VII

TOTAL IRON AND STEEL INDUSTRY VS. ALL MANUFACTURING: CHANGE IN NET INCOME NET INCOME/SALES, AND NET INCOME/STOCKHOLDERS' EQUITY
(annual rates) IQ/72 = 100

	Net Income		NI/Sales		NI/SE	
Yr./Qtr	All Manufacturing	Iron&Steel	All Manufacturing	Iron&Steel	All Manufacturing	Iron&Ste-
*72:1	100.0	100.0	100.0	100.0	100.0	100.0
2	121.5	188.2	112.5	160.9	118.9	187.5
3	111.4	123.1	105.0	108.7	106.3	122.5
4	127.8	193.5	110.0	160.9	121.1	190.0
73:1	132.9	198.8	112.5	152.2	122.1	195.0
2	164.6	271.0	127.5	191.3	147.4	260.0
3	146.8	243.2	115.0	173.9	129.5	232.5
4 a/	167.1	289.0	140.0	204.3	150.5	277.5
*74:1	170.9	289.3	140.0	204.3	150.5	280.0
2	206.3	500.0	150.0	295.7	175.8	470.0
3	196.2	591.7	142.5	330.4	162.1	530.0
4	169.6	482.2	120.0	269.6	138.9	417.5
*75:1	117.7	437.9	92.5	269.6	94.7	367.5
2	157.0	307.7	117.5	204.3	124.2	255.0
3	167.1	265.7	122.5	178.3	130.5	217.5
4	179.7	313.6	127.5	208.7	137.9	250.0
76:1	187.3	266.9	130.0	165.2	140.0	202.5
2	227.8	381.7	147.5	208.7	165.3	282.5

*During the first quarter of 1973, 1975, and 1976 a considerable number of the companies in the Iron and Steel group were reclassified; to provide comparability, the data for 1972, 1974, and 1975 have been restated to reflect these reclassifications.

SOURCE: FTC Financial Quarterly Reports, various issues.

a/ Between the third and fourth quarters of 1973, FTC changed its accounting methods.

TABLE VIII

TOTAL IRON AND STEEL VS. ALL MANUFACTURING:
NET INCOME/SALES AND NET INCOME/STOCKHOLDERS' EQUITY
(annual rates)

	Net Income/Sales		Net Income/Stockholders' Equity	
Yr./Qtr.	All Manufacturing	Iron&Steel	All Manufacturing	Iron&Steel
*72:1	4.0	2.3	9.5	4.0
2	4.5	3.7	11.3	7.5
3	4.2	2.5	10.1	4.9
4	4.4	3.7	11.5	7.6
73:1	4.5	3.5	11.6	7.8
2	5.1	4.4	14.0	10.4
3	4.6	4.0	12.3	9.3
4 a/	5.6	4.7	14.3	11.1
*74:1	5.6	4.7	14.3	11.2
2	6.0	6.8	16.7	18.8
3	5.7	7.6	15.4	21.2
4	4.8	6.2	13.2	16.7
*75:1	3.7	6.2	9.0	14.7
2	4.7	4.7	11.8	10.2
3	4.9	4.1	12.4	8.7
4	5.1	4.8	13.1	10.0
76:1	5.2	3.8	13.3	8.1
2	5.9	4.8	15.7	11.3

*During the first quarter of 1973, 1975, and 1976 a considerable number of the companies in the Iron and Steel group were reclassified; to provide comparability, the data for 1972, 1974, and 1975 have been restated to reflect these reclassifications.

SOURCE: Economic Report of the President, 1976; Federal Trade Commission, Quarterly Financial Reports, various issues.

a/ FTC changed its accounting methods in the fourth quarter, 1973.

Over the long-run prices, costs, and volume must be at levels sufficient to allow steel producers (or any other firms) to cover all costs of production including an adequate return to capital adjusted for risk. If steel producers were unable to attain such returns they would presumably be unwilling or unable to invest additional capital in steel production for replacement or expansion purposes. The data examined in this report suggest that, at the current price-cost relationship, steel profits could be sufficient to ensure a financially viable and growing steel industry <u>if demand recovered enough so that producers could operate at full capacity</u>.

Given the continued sluggishness of the recovery in steel demand and the attendant excess capacity, it is to be expected that profit performance will be unsatisfactory. Attempts to improve profitability by raising prices under the assumption that the total market demand for steel is price inelastic will not only worsen the economic inefficiency of idle capacity and unemployed labor, but may erode the competitive advantage of American steel producers <u>vis a vis</u> foreign producers. This recently attained advantage, stemming from modernization and improved efficiency of domestic producers along with realigned exchange rates and an advantageous raw materials position, had placed U. S. producers in an enviable position with respect to future growth of steel markets.

<u>Summary</u>

The slower than expected rate of recovery of the U. S. economy, especially in the capital goods and construction sectors, has had a depressing effect on the recovery of steel demand, production and shipments. Increased sales of autos and appliances earlier in 1976, aided by hedge buying in anticipation of a June price increase, served to expand the demand for steel sheet products at a faster pace than steel demand in general. In recent months the demand for sheet products has fallen from the levels attained in May and June. Raw steel production is currently at rates below 75 percent of capacity, and a number of production cutbacks and layoffs have occurred. Shipments of all steel products for 1976 are likely to be disappointingly low at only 90-92 million tons.

Despite the weakness of steel markets, costs of production have continued to increase, albeit at a slower rate than in recent years. These increases arise from higher labor costs and from the rise in per unit fixed costs due to the decline in volume. Other important inputs such as scrap and metallurgical coal have exhibited constant or declining prices.

This combination of circumstances has had its expected effect -- declining profitability for steel producers. Indeed some producers indicate that if self-produced raw materials are evaluated at "market price" rather than actual costs of production, steel making itself is unprofitable.

In our view there is some probability that this price increase will not be completely effective; this view is based on our assessment that market conditions have weakened even further from the conditions that led to the cancellation of the October 1 price increase. This assessment might be subject to revision as more current information becomes available.

APPENDIX

TABLE 1

U.S. MONTHLY RAW STEEL PRODUCTION
(Thousands of Net Tons) (All Grades; Carbon, Alloy, and Stainless)

	1972	1973	1974	1975	1976
January	10,001	12,373	12,726	11,584	9,835
February	9,980	11,626	11,598	10,862	9,907
March	11,588	13,088	12,758	11,980	11,294
April	11,588	12,788	12,442	10,667	11,439
May	11,936	13,174	12,752	9,864	12,136
June	10,980	12,488	12,185	8,744	11,605
July	10,341	12,290	12,155	8,371	11,400
August	10,842	12,182	11,837	8,648	11,128
September	10,913	12,229	11,849	9,295	10,463
October	11,657	12,876	12,617	9,214	
November	11,398	12,586	11,614	8,709	
December	11,878	12,722	10,960	8,846	
Total*	133,241	150,799	145,720	116,642	
Annual Average	11,103	12,567	12,143	9,732	

SOURCE: American Iron and Steel Institute, AIS-7

*Revised totals include adjustments not shown in monthly figures.

TABLE 2

STEEL
RATE OF CAPABILITY UTILIZATION*

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1976	74.4%	80.1%	85.4%	88.4%	90.8	89.7	84.8	82.8	80.4	75.7 1/	72.0 2/	

Source: American Iron and Steel Institute, AIS-7

Note: Rate begins January 1976.

*Based on tonnage capability to produce raw steel for a full order book based on the current availability of raw materials, fuels and supplies and of the industry's coke, iron, steelmaking, rolling and finishing facilities, recognizing current environmental and safety requirements.

1/ For the week ending October 30

2/ For the week ending November 20

TABLE 3

SHIPMENTS OF STEEL MILL PRODUCTS (CARBON STEEL)

TOTAL SHIPMENTS
Net Tons

	1972	1973	1974	1975	1976
January	6,018,092	8,308,098	8,843,022	7,404,565	6,528,079
February	6,023,030	7,862,728	7,842,420	6,162,038	6,130,965
March	7,122,702	8,924,810	9,259,597	6,337,431	7,417,341
April	6,863,539	8,307,714	8,683,840	6,121,497	7,025,750
May	7,361,821	9,101,307	9,021,445	5,619,444	7,419,235
June	7,224,839	8,748,647	8,305,412	5,449,940	7,682,087
July	6,242,510	7,903,601	7,896,418	5,111,938	6,779,132
August	7,096,387	8,500,553	8,125,153	5,609,312	6,755,485
September	7,195,365	8,025,928	7,642,626	6,830,682	6,830,551
October	7,496,041	8,923,531	8,346,986	5,660,014	
November	7,318,892	8,525,299	7,500,931	5,063,774	
December	7,314,161	7,793,039	6,533,868	5,377,567	
Annual Average*	6,931,102	8,410,365	8,162,315	5,896,989	
Annual Total*	83,173,220	100,924,387	97,947,777	70,763,865	

SOURCE: American Iron and Steel Institute

*NOTE: Includes revisions for previous months.

TABLE 4

PRODUCT PERCENTAGE OF TOTAL STEEL SHIPMENTS

$$\frac{\text{Annual Total Product (carbon)}}{\text{Annual Total All Shipments (carbon)}} \times 100$$

Product	1972	1973	1974	1975	1976 1/
Structural Shapes (heavy)	5.7	5.8	5.9	5.8	4.2
Rails - Standard (over 60 lbs.)	1.1	0.9	0.9	1.7	1.6
Bars - Reinforcing	5.4	5.1	5.2	5.2	4.7
Standard Pipe	2.9	2.9	3.0	2.9	2.2
Oil country goods	1.1	1.3	1.7	2.7	1.5
Line pipe	1.6	1.6	2.1	2.1	1.0
Mechanical Tubing	1.0	1.1	1.0	1.1	1.0
Pressure Tubing	0.2	0.2	0.3	0.4	.2
Total Pipe and Tubing*	(7.4)	(7.7)	(8.4)	(9.6)	(6.3)
Sheets - Hot rolled	16.4	16.1	15.4	15.2	18.1
Sheets - Cold rolled	19.0	19.8	18.1	17.8	22.0
Sheets & Strip - Galvanized (hot dipped)	6.2	6.5	5.9	5.0	6.2
Strip - Hot rolled	1.8	1.7	1.3	1.3	1.4
Strip - Cold rolled	1.1	1.2	1.2	0.9	1.0
Total Sheets and Strip*	(45.9)	(46.6)	(43.5)	(41.3)	(50.2)
Total Shipments	100.0	100.0	100.0	100.0	100.0
Other	36.5	35.8	38.0	37.9	

SOURCE: American Iron and Steel Institute

*NOTE: Subtotals are omitted to avoid double counting when computing total.

NOTE: Annual Totals include revisions for previous months.

1/ First nine months only.

TABLE 5

SHIPMENTS OF STEEL MILL PRODUCTS (CARBON STEEL)

SHEETS-COLD ROLLED
Net Tons

	1972	1973	1974	1975	1976
January	1,435,129	1,728,983	1,658,752	1,165,928	1,439,701
February	1,168,111	1,575,909	1,374,888	866,225	1,376,946
March	1,299,080	1,845,420	1,709,785	805,452	1,667,618
April	1,308,291	1,708,373	1,578,637	991,502	1,557,951
May	1,412,221	1,869,814	1,557,658	932,951	1,661,562
June	1,332,069	1,758,590	1,465,210	971,739	1,604,709
July	1,120,218	1,486,360	1,446,154	896,030	1,460,339
August	1,280,295	1,640,335	1,518,318	1,121,845	1,529,407
September	1,336,173	1,567,233	1,397,807	1,543,710	1,464,969
October	1,446,955	1,691,622	1,562,246	1,120,198	
November	1,395,451	1,642,346	1,377,111	1,056,138	
December	1,284,329	1,419,507	1,086,645	1,095,543	
Annual Average*	1,318,603	1,661,207	1,478,269	1,047,272	
Annual Total*	15,823,234	19,934,489	17,739,233	12,567,266	

SOURCE: American Iron and Steel Institute

*NOTE: Includes revisions for previous months.

TABLE 6

SHIPMENTS OF STEEL MILL PRODUCTS (CARBON STEEL)

SHEETS - HOT ROLLED
Net Tons

	1972	1973	1974	1975	1976
January	954,028	1,416,928	1,441,087	1,138,827	1,030,242
February	1,005,931	1,289,268	1,230,427	896,482	1,023,933
March	1,130,022	1,519,343	1,465,903	952,754	1,319,285
April	1,118,254	1,348,407	1,285,095	861,803	1,243,938
May	1,158,593	1,403,609	1,401,684	800,724	1,365,708
June	1,138,191	1,384,264	1,269,020	817,485	1,444,513
July	1,062,526	1,270,280	1,203,131	723,108	1,260,565
August	1,178,826	1,326,631	1,267,355	870,405	1,309,748
September	1,239,670	1,229,818	1,133,949	1,163,819	1,301,256
October	1,269,244	1,423,502	1,224,260	895,775	
November	1,275,575	1,380,125	1,122,507	787,658	
December	1,209,199	1,241,346	1,050,942	890,176	
Annual Average*	1,137,975	1,354,299	1,257,947	897,965	
Annual Total*	13,655,701	16,251,586	15,095,359	10,775,585	

SOURCE: American Iron and Steel Institute

*NOTE: Includes revisions for previous months.

TABLE 7

SHIPMENTS OF STEEL MILL PRODUCTS (CARBON STEEL)

SHEETS AND STRIP-GALVANIZED (hot dipped)
Net Tons

	1972	1973	1974	1975	1976
January	338,564	493,909	493,806	392,931	361,155
February	369,700	466,983	420,630	311,326	343,381
March	446,215	604,927	561,171	278,659	458,192
April	427,990	554,201	519,180	240,385	430,348
May	457,075	611,533	544,573	213,332	474,912
June	454,557	615,622	492,818	244,983	490,817
July	412,560	528,543	456,936	244,822	420,854
August	474,703	571,173	483,662	300,485	429,368
September	462,752	525,208	461,935	417,067	437,797
October	475,062	582,812	467,632	305,445	
November	457,009	513,465	461,894	278,731	
December	403,625	442,787	363,537	306,399	
Annual Average*	432,567	542,594	480,527	294,608	
Annual Total*	5,190,800	6,511,130	5,766,324	3,535,293	

SOURCE: American Iron and Steel Institute

*NOTE: Includes revisions for previous months.

TABLE 8

SHIPMENTS OF STEEL PRODUCTS BY MARKET CLASSIFICATIONS: ALL GRADES INCLUDING CARBON, ALLOY AND STAINLESS

In Thousands of Net Tons and Percent

	Steel Service Center and Distributors		Construction and Contractors		Automotive		Rail Transportation		Machinery, Industrial Equipment		Containers, Packaging and Shipping Materials	
	Net Total Steel Prod.	Percent of Total Shipment	Net Total Steel Prod.	Percent of Total Ship.	Net Total Steel Prod.	Percent of Total Ship.	Net Total Steel Prod.	Percent of Total Ship.	Net Total Steel Prod.	Percent of Total Ship.	Net Total Steel Prod.	Percent of Total Shipping
1972												
1	4,022	19.0	3,163	14.9	4,481	21.2	730	3.4	1,202	5.7	1,533	7.2
2	4,807	20.3	3,741	15.8	4,641	19.6	682	2.9	1,377	5.8	1,876	7.9
3	4,619	20.4	3,698	16.4	4,302	19.0	592	2.6	1,314	5.8	1,696	7.5
4	5,140	21.0	3,742	15.3	4,819	19.7	728	3.0	1,514	6.2	1,511	6.2
1973												
1	5,322	19.2	4,014	14.5	6.129	22.2	771	2.8	1,607	5.8	2,186	7.9
2	5,842	20.3	4,701	16.3	6.153	21.3	842	2.9	1,628	5.6	1,870	6.5
3	5,580	20.6	4,568	16.9	5,611	20.8	775	2.9	1,507	5.7	1,903	7.0
4	5,961	21.3	4,581	16.4	5,361	19.1	841	3.0	1,609	5.7	1,852	6.6
1974												
1	6.145	21.4	4,764	16.6	4,681	16.3	903	3.1	1,741	6.0	2,230	7.7
2	6,206	21.4	5,018	17.3	4,502	15.5	876	3.0	1,704	5.9	2,175	7.5
3	5,534	20.9	4,593	17.3	4,886	18.4	787	3.0	1,502	5.7	1,990	7.5
4	5,314	21.1	4,131	16.4	4,854	19.3	851	3.4	1,494	5.9	1,822	7.3
1975												
1	4,873	21.5	3,873	16.7	3,045	13.5	969	4.3	1,649	7.3	1,814	8.0
2	3,711	19.0	3,289	16.9	3,776	19.3	778	4.0	1,345	6.9	1,313	6.7
3	3,440	17.5	3,094	15.7	4,686	23.8	686	3.5	1,083	5.5	1,490	7.6
4	3,615	19.9	2,591	14.3	3,692	20.3	718	4.0	1,089	6.0	1,436	7.9
1976												
1	3,569	16.1	2,772	12.5	5,450	24.5	728	3.3	1,283	5.8	1,974	8.9
2	4,199	17.1	3,359	13.7	5,684	23.2	743	3.0	1,357	5.5	1,836	7.5
3	3,792	16.7	3,216	14.2	5,337	23.6	732	3.2	1,306	5.8	1,676	7.4
4												

Source: American Iron and Steel Institute

TABLE 9

LAYOFFS AND CLOSINGS IN THE STEEL INDUSTRY
August-November, 1976

FIRM	DATE	ACTION
U.S. STEEL	8/23/76	U.S. Steel lays off 400 to 500 employees in Ohio in order to cut inventories.1/
KAISER STEEL	9/14/76	Kaiser Steel idling 400 mill workers due to poor demand.1/
U.S. STEEL CORP., BETHLEHEM STEEL CORP., AND J&L	9/15/76	U.S. Steel trims work force at its Gary, Ind. works in order to reduce inventories. Bethlehem lays off 150 workers at Sparrows Point "due to slow business conditions." J&L plans to close sinter plant at its Cleveland works and lay off 50 workers. J&L decision to close plant based "solely on economic factors."1/
U.S. STEEL CORP. AND REPUBLIC STEEL CORP.	10/14/76	U.S. Steel Corp. closed down the bar and structural operations of its Gary (Ind.) works for a week beginning October 1, 1976 and is operating some departments of its South Works on a four-day week in a further effort to reduce inventory. Shut-down brings total out of work employees to about 1,700 workers at Gary. Republic Steel Corp laid off last month about 200 to 400 of its approximately 5,700 employees in Chicago.2/
REPUBLIC STEEL CORP.	10/14/76	Republic Steel Corp. said there were between 200 and 400 people laid off a couple of weeks ago, now there are only 150 layoffs in effect.2/
NORTHWESTERN STEEL & WIRE CO.	10/26/76	Northwestern Steel & Wire Co. will shut down its structural mill for two weeks in order to reduce inventory and offset the slack demand for heavy steel products.2/
YOUNGSTOWN SHEET & TUBE CO.	10/28/76	Youngstown shut down one of its blast furnaces and now has only two of the four furnaces in Indiana Harbor, Ind. working. One is down for relining.2/

TABLE 9 (Cont'd)

FIRM	DATE	ACTION
REPUBLIC STEEL CORP., U.S. STEEL CORP. AND COPPERWELD STEEL	11/4/76	Republic Steel Corp., U.S. Steel Corp., and Copperweld Steel Corp. were not operating all their furnaces in the Youngstown, Ohio area.
BETHLEHEM AND STEEL CORP. AND AARMCO STEEL CORP.	11/10/76	Bethlehem reported additional closings of certain steelmaking operations as well as employee layoffs at its Sparrows Point, Md., and Lackawanna, N.Y. plants. Layoffs and shutdowns stem from "a lack of orders and low volume levels." A total of 1,600 Armco workers have been on formal layoffs for more than a month. 2/
YOUNGSTOWN SHEET AND TUBE CO., U.S. STEEL CORP., AND REPUBLIC STEEL CORP.	11/11/76	Youngstown Sheet and Tube Co., Indiana Harbor, closed down its blooming mill "indefinitely" this week "because there's no demand for steel." U.S. Steel Corp. said the bar mill that was closed at the South Works last month is still down. Republic Steel Corp. said that they had put about half of the 400 workers laid off earlier back to work but this week the full 400 are again laid off. Republic Steel Corp. said "nothing's shut down."2/
PHOENIX STEEL CORP.	11/16/76	Phoenix Steel Corp. said it is closing its structural division in Phoenixville, Pa. in an effort to reduce its heavy losses and to help "achieve profitability by the end of 1977." Approximately 672 workers will be laid off as a result of the closing.2/
WISCONSIN STEEL	11/24/76	Wisconsin Steel is closing its no. 6 hot rolling mill from Thanksgiving to December 1, due to "lack of orders." About 100 employees will be laid off during the closing. Armco Steel Corp. has laid off workers.2/

TABLE 9 (Cont'd)

FIRM	DATE	ACTION
WISCONSIN STEEL, ARMCO STEEL, CORP., AND U.S. STEEL CORP.	11/24/76	U.S. Steel Corp. is currently operating two of its seven blast furnaces at the South Works.2/

1/ Wall Street Journal

2/ American Metal Market

TABLE 10

STEEL MILL PRODUCTS: NEW AND UNFILLED ORDERS, SEASONALLY ADJUSTED
(Million of Dollars)

	Manufacturers' New Orders					Manufacturers' Unfilled Orders				
	1972	1973	1974	1975	1976	1972	1973	1974	1975	197
January	2160	3369	2792	3275	3770	4494	7253	11,751	12,944	946
February	2302	3445	3447	2937	3434	4668	7788	11,921	12,041	936
March	2331	3902	3452	2156	3830	4792	8813	11,826	10,819	945
April	2275	3541	3021	2114	3634	4773	9515	11,285	9,525	941
May	2579	4010	5376	3132	4985	5088	10,593	12,842	9,568	1047
June	2694	3577	4813	2761	4305	5471	11,165	13,681	9,286	1068
July	2542	3331	4554	2885	3944	5717	11,448	13,950	9,179	1064
August	2677	3407	5278	3136	3511	5967	11,827	14,849	9,196	1032
September	2792	3251	4675	3168	3644 p	6204	11,971	15,158	8,647	1002
October	2776	3098	4096	3334		6300	11,823	14,666	8,795	
November	2895	3415	4121	3272		6527	11,986	14,346	8,935	
December	2990	3442	3375	3695		6668	12,224	13,751	9,827	
Annual Total	31,013	41,788	49,000	35,865		66,669	126,406	150,026	118,222	
Annual Average	2584	3482	4083	2989		5556	10,534	12,502	9852	

Source: Current Industrial Reports (Blast Furnaces, Steel Mills)
p: Preliminary

TABLE 11

INVENTORIES OF STEEL MILL SHAPES

PRODUCING MILLS INVENTORY, SERVICE CENTERS, AND CONSUMERS

Jan 1972 - March 1976

(In millions of tons)

1972

	Producing Mills Inventory			Service Centers (warehouses)	Consumers *2 (manufacturers only Inventories
	Total	Steel in Process	Finished Steel	Quantity *1	(end of month)
January	20.2	11.2	9.0	5.5	10.0
February	20.5	11.1	9.4	5.4	9.5
March	20.6	11.1	9.5	5.5	9.1
April	21.2	11.4	9.8	5.7	9.0
May	21.7	11.8	9.9	5.5	8.9
June	21.5	11.7	9.8	5.4	8.9
July	21.8	11.8	10.0	5.7	9.2
August	21.6	11.8	9.8	6.1	9.1
September	21.3	11.5	9.8	5.9	9.0
October	21.3	11.3	10.0	5.7	8.9
November	21.3	11.2	10.1	6.1	8.9
December	21.5	11.3	10.2	6.8	8.8
Annual Total	254.5	137.2	117.3	69.3	109.3
Annual Average	21.2	11.4	9.8	5.8	9.1

Source: Current Industrial Reports

*1. Derived from the dollar value of month end inventories

*2. Data include fabricating establishments of steel producing companies but exclude fabricating performed at producing mills.

TABLE 11 - (con'd)

INVENTORIES OF STEEL MILL SHAPES

PRODUCING MILLS INVENTORY, SERVICE CENTERS, AND CONSUMERS

Jan 1972 - March 1976

(In millions of tons)

1973

	Producing Mills Inventory			Service Centers (warehouses)	Consumers *2 (manufacturers only)
	Total	Steel in Process	Finished Steel	Quantity *1	Inventories (end of month)
January	21.0	11.0	10.0	6.1	8.9
February	20.5	10.8	9.7	5.7	9.0
March	19.7	10.5	9.2	6.0	8.9
April	19.2	10.2	9.0	6.5	9.0
May	19.0	10.0	9.0	6.3	9.5
June	18.0	10.0	8.0	6.1	9.7
July	17.9	10.0	7.9	6.3	9.9
August	17.6	10.0	7.6	6.5	10.0
September	17.4	9.9	7.5	6.2	10.7
October	16.8	9.5	7.3	5.8	10.7
November	16.3	9.3	7.0	6.1	11.0
December	17.1	9.7	7.4	6.6	11.2
Annual Total	220.5	120.9	99.6	74.2	118.5
Annual Average	18.4	10.1	8.3	6.2	9.9

Source: Current Industrial Reports

*1. Derived from the dollar value of month end inventories

*2. Data include fabricating establishments of steel producing companies but exclude fabricating performed at producing mills

TABLE 11 - (con'd)

INVENTORIES OF STEEL MILL SHAPES

PRODUCING MILLS INVENTORY, SERVICE CENTERS, AND CONSUMERS

Jan 1972 - March 1976

(In millions of tons)

1974

	Producing Mills Inventory			Service Centers (warehouses)	Consumers*2 (manufacturers only)
	Total	Steel in Process	Finished Steel	Quantity*1	Inventories (end of month)
January	16.6	9.4	7.2	6.2	11.7
February	16.2	9.2	7.0	5.9	11.9
March	14.8	8.6	6.2	5.9	11.9
April	14.2	8.3	5.9	6.1	11.8
May	13.6	8.2	5.4	5.9	11.6
June	13.3	8.2	5.1	5.9	11.8
July	13.4	8.5	4.9	5.9	12.2
August	13.0	8.2	4.8	5.8	12.4
September	13.0	8.2	4.8	4.8	12.6
October	12.9	8.2	4.7	6.4	12.5
November	12.8	7.7	5.1	7.0	12.9
December	13.3	7.7	5.6	7.4	13.7
Annual Total	167.1	100.4	66.7	74.5	147.0
Annual Average	13.9	8.4	5.6	6.2	12.3

Source: Current Industrial Reports

*1. Derived from the dollar value of month end inventories

*2. Data include fabricating establishments of steel producing companies but exclude fabricating performed at producing mills

TABLE 11 - (con'd)

INVENTORIES OF STEEL MILL SHAPES

PRODUCING MILLS INVENTORY, SERVICE CENTERS, AND CONSUMERS

Jan 1972 - March 1976

(In millions of tons)

1975

	Producing Mills Inventory			Service Centers (warehouses)	Consumers *2 (manufacturers only Inventories (end of Month)
	Total	Steel in Process	Finished Steel	Quantity *1	
January	13.0	7.7	5.3	7.6	13.8
February	13.7	8.1	5.6	7.9	13.9
March	15.4	9.4	6.0	8.3	13.8
April	16.2	9.9	6.3	8.4	13.3
May	16.6	10.2	6.4	8.0	12.7
June	16.9	10.6	6.3	7.7	12.4
July	17.2	10.8	6.4	7.8	12.0
August	16.9	10.8	6.1	7.6	11.7
September	15.7	9.9	5.8	7.1	12.0
October	15.8	9.7	6.1	6.7	11.3
November	16.4	10.1	6.3	6.6	10.8
December	16.7	10.0	6.7	6.7	10.5
Annual Total	190.5	117.2	73.3	90.4	148.2
Annual Average	15.9	9.8	6.1	7.5	12.4

Source: Current Industrial Reports

*1. Derived from the dollar value of month end inventories

*2. Data included fabricating establishments of steel producing companies but excluded fabricating performed at producing mills

TABLE 11 - (con'd)

INVENTORIES OF STEEL MILL SHAPES
PRODUCING MILLS INVENTORY, SERVICE CENTERS, AND CONSUMERS

(In millions of tons)

1976

	Producing Mills Inventory			Service Centers (warehouses)	Consumers*2 (manufacturers onl[illegible]
		Steel in Process	Finished Steel	Quantity*1	(end of Month)
January	16.4	10.0	6.4	6.5	10.6
February	16.9	10.2	6.7	6.5	10.4
March	16.6	10.1	6.5	6.5	10.4
April	17.2	10.4	6.8	6.5	10.0
May	17.9	11.0	6.9	6.4	10.0
June	18.0	11.2	6.8	6.4	10.1
July	18.6	11.5	7.1	6.7	10.2
August	19.1	11.9	7.2	6.5	10.3
September	18.9	11.7	7.2	N.A	10.2
October					
November					
December					
Annual Total					
Annual Average					

Source: Current Industrial Reports

*1. Derived from the dollar value of month end inventories

*2. Data include fabricating establishments of steel producing companies but exclude fabricating performed at producing mills

TABLE 12

STEEL MILL PRODUCTS

EXPORTS AND IMPORTS
(In Thousands of Short Tons)

	1972			1973			1974			1975			1976		
	Export	Import	Net Import	Export	Import	Net Import	Export	Import	Net Import	Export	Import	Net Import	Export	Import	Net Import
January	208	1093	885	288	1381	1093	455	827	372	289	1801	1512	150	1077	927
February	221	1129	908	221	1306	1085	448	830	382	257	1192	935	177	966	789
March	261	1095	834	323	1170	847	503	892	389	282	1153	871	212	1034	822
April	199	930	731	340	1051	711	533	971	438	270	959	689	229	948	719
May	245	1603	1358	372	1604	1232	627	1142	515	268	856	588	265	1071	806
June	211	1599	1388	323	1229	906	633	1292	659	256	927	671	232	1355	1123
July	220	1531	1311	343	1380	1037	647	1293	646	264	805	541	318	1190	872
August	301	1787	1486	324	1316	992	488	1607	1119	271	748	477	280	1201	921
September	304	1570	1266	281	1075	794	346	1260	114	202	697	495			
October	252	1910	1658	374	1235	861	387	2021	1634	228	818	590			
November	207	1824	1617	388	1313	925	296	1925	1629	185	903	718			
December	245	1609	1364	473	1092	619	470	1909	1439	182	1153	971			
Annual Total	2,874	17,680	14,806	4,050	15,152	11,102	5,833	15,969	10,136	2,954	12,012	9,058			
Annual Average	240	1,473	1,234	338	1,263	925	486	1,331	845	246	1,001	755			

SOURCE: Survey of Current Business, various issues.

TABLE 12A

RECENT ACTIONS WITH RESPECT TO INTERNATIONAL TRADE

Date	Type of Action	Agency Involved
October 1976 - present	Armco Steel Corporation filed a countervailing duty suit against Terni, the Italian state steel company, alleging that government subsidies allowed that firm to export steel to the U.S. at prices unfair to U.S. producers. Currently under review.	Treasury Department
October 1976 - present	Petition requesting quotas filed by Armco, Allegheny Ludlum, Colt Industries and other producers of stainless steel tube and pipe alleging unfair trade practices (predatory pricing) by foreign producers. Petition currently under preliminary investigation.	International Trade Commission
October 1976 - present	American Iron and Steel Institute filed a petition seeking elimination of discrimination, alleging that the recent European-Japanese agreement (limiting total Japanese exports of steel to Europe to a level approximately one-third lower than the previous year and thus possibly "deflecting" exports to the U.S.) is a violation of the GATT regulations concerning the imposition of quotas and equal treatment of most-favored-nation trading partners. Hearing to be held December 9, 1976.	Office of the Special Representative for Trade Negotiations
September 1975 - present	U.S. Steel Corporation filed a countervailing duty petition against the European Economic Community's practice of exempting value-added taxes on exported steel while applying this tax to imported non-EEC steel. Denied by Treasury Department; currently under appeal.	Treasury Department; U.S. District Customs Court, New York
June 1976	Quotas placed in effect on imports of stainless steel sheet and strip, plate, bar and rod. Individual countries are allowed to ship specified tonnages totaling 147,000 tons during the first year. Quota system will remain in effect for up to three years; the total tonnage allowed for the third year is 155,900 tons.	International Trade Commission
December 1975 - June 1976	Petition for quotas on stainless steel wire submitted by Stainless Steel Wire Industry Committee, December 1975, based on alleged injury to domestic industry. Denied, June 1976.	International Trade Commission

TABLE 12A (Cont.)

RECENT ACTIONS WITH RESPECT TO INTERNATIONAL TRADE

Date	Type of Action	Agency Involved
April 1975 - present	Under provisions of the Trade Act of 1974, American workers suffering loss of employment directly attributable to imports are entitled to monetary adjustment assistance and other aid. During the April 1975 - October 1976 period, 18,040 workers from 45 primary metal industry (SIC33) establishments were certified as eligible for benefits. (Many of these workers are in the speciality steel industry; no breakout between steel and other primary metals is available.) Exact dollar amount figures are not available, but are estimated at from five to seven million dollars. An additional 61 petitions covering an as-of-yet unspecified number of steelworkers were submitted in late November 1976.	Labor Department

SOURCES: International Trade Commission, AISI, Labor Department

TABLE 13

IMPLICIT IMPORT PRICES OF COLD ROLLED STEEL SHEETS
January 1972-September 1976 1/ 2/
(dollars per ton)

Month	1972	1973	1974	1975	1976
January	134	146	204	322	224
February	138	154	216	300	222
March	138	150	226	284	220
April	142	150	244	270	230
May	144	154	256	256	242
June	142	156	266	260	242
July	144	160	264	264	252
August	146	166	292	248	246
September	148	162	308	250	272
October	144	166	316	238	
November	148	172	322	240	
December	144	222	318	226	

1/ Non-alloyed, non-coated and unshaped; includes pickled and non-pickled; Schedule A #6744130.

2/ Total value/tonnage = price/lb. 1972-1973: declared Customs value, imports for consumption; 1974-1976: c.i.f. value (U.S. port), general imports. Excludes tariffs.

TABLE 14

WHOLESALE PRICE INDEX, ALL COMMODITIES
(1967=100)

	1972	1973	1974	1975	1976
January	116.3	124.5	146.6	171.8	179.3
February	117.3	126.9	149.5	171.3	179.3
March	117.4	129.8	151.4	170.4	179.6
April	117.5	130.5	152.7	172.1	181.3
May	118.2	133.2	155.0	173.2	181.8
June	118.8	136.0	155.7	173.7	183.1
July	119.7	134.3	161.7	175.7	184.3
August	119.9	142.1	167.4	176.7	183.7
September	120.2	139.7	167.2	177.7	184.7
October	120.0	138.7	170.2	178.9	185.2
November	120.7	139.2	171.9	178.2	
December	122.9	141.6	171.5	178.7	
Annual Average	119.1	134.7	160.1	174.9	

SOURCE: Bureau of Labor Statistics

TABLE 15

WHOLESALE PRICE INDEX, INDUSTRIAL COMMODITIES
(1967=100)

	1972	1973	1974	1975	1976
January	115.9	120.0	135.3	167.5	177.3
February	116.5	121.3	138.2	168.4	178.0
March	116.8	122.8	142.4	168.9	178.9
April	117.3	124.2	146.6	169.7	180.0
May	117.6	125.3	150.5	170.3	180.4
June	117.9	126.0	153.6	170.7	181.3
July	118.1	126.1	157.8	171.2	182.6
August	118.5	126.7	161.6	172.2	183.6
September	118.7	127.4	162.9	173.1	184.7
October	118.8	128.5	164.8	174.7	186.3
November	119.1	130.1	165.8	175.4	
December	119.4	132.2	166.1	176.1	
Annual Average	117.9	125.9	153.8	171.5	

SOURCE: Bureau of Labor Statistics

TABLE 16

WHOLESALE PRICE INDEX, CRUDE MATERIALS, EXCLUDING FOOD
(1967 = 100)

	1972	1973	1974	1975	1976
January	125.6	139.1	188.2	219.4	235.2
February	127.0	142.3	202.7	221.0	234.8
March	129.1	142.5	212.2	218.4	237.9
April	129.3	146.8	224.8	222.7	246.0
May	129.9	149.6	216.5	225.8	246.2
June	129.8	152.8	217.5	226.3	248.6
July	130.2	153.5	228.9	223.4	254.2
August	132.3	156.0	229.5	225.8	254.9
September	132.6	161.0	229.8	231.5	253.0
October	133.8	164.7	229.0	228.6	261.5
November	136.3	174.2	228.7	226.5	
December	136.8	179.8	221.2	231.2	
Annual Average	131.1	155.2	219.1	225.1	

NOTE: Not Seasonally Adjusted

SOURCE: Bureau of Labor Statistics

TABLE 17

WHOLESALE PRICE INDEX, FINISHED STEEL PRODUCTS
(1967 = 100)

	1972	1973	1974	1975	1976
January	129.5	132.6	138.1	196.1	201.5
February	131.0	132.6	139.0	195.8	202.3
March	130.9	133.2	146.6	195.8	201.8
April	130.9	133.7	150.5	195.3	201.9
May	130.7	134.1	162.1	194.5	202.7
June	130.3	134.3	169.8	194.4	209.4
July	130.3	134.2	181.6	194.0	210.1
August	130.2	134.3	188.2	194.0	212.8
September	130.2	134.3	190.3	194.3	213.6
October	130.2	135.3	190.9	201.6	215.3
November	130.2	135.4	191.2	201.5	
December	130.2	135.4	192.0	201.6	
Annual Average	130.4	134.1	170.0	196.6	

SOURCE: Bureau of Labor Statistics

TABLE 18

WHOLESALE PRICE INDEX, SHEETS, COLD ROLLED CARBON
(1967 = 100)

	1972	1973	1974	1975	1976
January	124.1	134.5	137.5	189.1	197.0
February	134.5	134.5	137.5	189.1	197.0
March	134.5	134.5	142.0	189.1	197.0
April	134.5	134.5	146.6	189.1	197.0
May	134.5	134.5	155.8	185.0	197.0
June	134.5	134.5	165.4	185.0	209.1
July	134.5	134.5	182.3	184.8	209.1
August	134.5	134.5	188.5	184.8	209.1
September	134.5	134.5	188.5	184.8	209.1
October	134.5	137.5	188.5	197.0	209.1
November	134.5	137.5	188.5	197.0	
December	134.5	137.5	190.0	197.0	
Annual Average	133.6	135.3	167.6	189.3	

SOURCE: Bureau of Labor Statistics

TABLE 19

WHOLESALE PRICE INDEX, SHEETS, HOT ROLLED CARBON, COIL
(1967 = 100)

Month	1972	1973	1974	1975	1976
January	126.8	126.8	132.4	183.2	190.4
February	126.8	126.8	132.4	183.2	190.4
March	126.8	126.8	137.8	183.2	190.4
April	126.8	126.8	138.9	183.2	190.4
May	126.8	126.8	148.6	182.0	190.4
June	126.8	126.8	156.2	181.3	201.4
July	126.8	126.8	179.1	180.4	201.4
August	126.8	126.8	182.9	180.4	201.4
September	126.8	126.8	184.0	180.4	201.4
October	126.8	130.0	184.0	190.4	201.4
November	126.8	130.0	184.0	190.4	
December	126.8	130.0	183.2	190.4	
Annual Average	126.8	127.6	162.0	184.0	

SOURCE: Bureau of Labor Statistics

TABLE 20

WHOLESALE PRICE INDEX, SHEETS, GALVANIZED CARBON
(1967 = 100)

	1972	1973	1974	1975	1976
January	122.1	122.1	127.5	185.1	196.6
February	122.1	122.1	129.8	185.1	196.6
March	122.1	122.1	134.1	185.1	196.6
April	122.1	122.1	139.0	184.9	196.6
May	122.1	122.1	149.4	183.9	196.6
June	122.1	122.1	157.3	183.9	206.0
July	122.1	122.1	172.3	184.0	206.0
August	122.1	122.1	183.6	184.0	206.0
September	122.1	122.1	183.6	184.0	207.1
October	122.1	124.9	185.1	197.3	207.1
November	122.1	124.9	185.1	197.3	
December	122.1	124.9	185.1	197.3	
Annual Average	122.1	122.8	161.0	187.7	

SOURCE: Bureau of Labor Statistics

EPB

THE WHITE HOUSE

WASHINGTON

976 DEC 3 AM 11 15 November 26, 1976

OK.

ADMINISTRATIVELY ~~CONFIDENTIAL~~

ECONOMIC POLICY DECISION MEMORANDUM 24

TO: Secretary of State
Secretary of the Treasury
Secretary of Agriculture
Secretary of Commerce
Secretary of Labor
Director, Office of Management and Budget
Chairman, Council of Economic Advisers
Assistant to the President for National Security Affairs
Assistant to the President for Domestic Affairs
Special Representative for Trade Negotiations

SUBJECT: Meat Import Policy for 1977

The President has approved undertaking negotiations to seek voluntary restraint agreements with major meat supplying countries at or near the 1977 meat import trigger level of 1,282 million pounds.

The Departments of State and Agriculture, in cooperation with the Department of the Treasury and the Office of the Special Representative for Trade Negotiations, are hereby requested to commence negotiations with the major meat supplying countries in accordance with the President's decision.

L. Wm Seidman

L. William Seidman

THE WHITE HOUSE

WASHINGTON

December 4, 1976

MEMORANDUM FOR ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEMBERS

FROM: L. WILLIAM SEIDMAN LWS

SUBJECT: Tax Policy Review

A paper, prepared by the Department of the Treasury, on "Tax Policy Options for the Fiscal 1978 Budget" is attached. This paper will be reviewed at the Monday, December 6 Executive Committee meeting.

Due to the sensitive nature of some of the material in the papers, I would appreciate you keeping its distribution strictly limited.

Attachment

December 3, 1976

Tax Policy Options for the Fiscal 1978 Budget

Introduction

This paper, which presents tax options for the Administration's FY 1978 budget, builds on material presented at the Tax Policy Review session held earlier this fall. To achieve consistency with the Tax Policy Review material, the same two sets of economic assumptions used then underlie the budget figures presented here. While these economic assumptions may change as a result of future Troika exercises, the effects of changes in assumptions on the budget numbers are not likely to be major. The two sets of assumptions--Cases I and Case II--are shown in Table 1-A.

For the purpose of reviewing major tax policy options, the Case I economic assumptions--which have lower real growth and inflation than in Case II--have been used. The Case I assumptions highlight the very difficult problems inherent in simultaneously renewing all of the Administration's previously announced tax initiatives and balancing the budget in FY 1979. Any alternative assumptions that move in the direction of higher nominal income levels, such as in Case II, would of course reduce the problem of meeting these two goals.

This paper is divided into two parts. Part One addresses three broad issues:

--the effect on current tax policy choices of attempting to balance the 1979 budget;

--Treasury recommendations on tax initiatives which should be given highest priority at this time; and

--possible approaches to raising additional revenues while still achieving the Administration's major tax policy goals.

Part Two provides a brief discussion of each of the tax proposals that have been advanced or supported by the Administration. Some of the proposals have a very small impact on receipts, but are important from a programmatic standpoint.

Part One. The Broad Issues

I. The Fiscal 1979 Budget Constraint

The principal constraint restricting tax options is the Administration's commitment to budgetary balance in 1979. The extent of this constraint is indicated in Table 1 which shows the current budget outlook based on Case I and Case II economic assumptions, the corresponding outlay estimates, and three alternative estimates of receipts:

(1) current law;

(2) current law plus permanent extension of temporary tax provisions; and

(3) current Administration policy, assuming effective dates as early as practicable.

The legislation included in (3) above is shown in Table 2 and consists of all outstanding Administration proposals that have not been made obsolete by the Tax Reform Act of 1976 or by other legislation. Tax proposals that have been dropped from the list of Administration initiatives because of legislation are: limitation on artificial accounting losses; minimum taxable income provisions; unemployment tax increases; and revisions in estate and gift taxes.

Table 1 highlights the difficulties ahead under Case I economic assumptions. Based on these assumptions, and assuming current Administration tax policy, the budget is in deficit by $26 billion in FY 1979, with receipts of $443 billion and outlays of $469 billion.

II. High Priority Tax Initiatives

To provide a framework for designing possible tax packages for the upcoming budget, it may be useful to review briefly the Administration's previously proposed tax initiatives listed in Table 2. These proposals fall into three categories:

1. Individual and business tax cuts initially proposed in October 1975 and incorporated into the 1977 budget recommendations. For individuals, these proposals consisted of an increase in the personal exemption from $750 to $1,000, a flat

standard deduction, and a general cut in tax rates. For businesses, the proposals were a two point reduction in the corporate surtax rate, changes in the surtax exemption and rates, permanent extension of the 10 percent investment tax credit, reproposal of the phased-in plan for corporate-personal tax integration, and a special package of relief for utilities.

2. To provide needed funds for the financing of social security benefits, the Administration proposed in the 1977 budget a 0.6 percentage point increase in the social security tax rate effective January 1, 1977.

3. The other items of Table 2 are related to the goal of capital formation or are independent tax proposals. Only some of these proposals were contained in the 1977 budget. Others represent prior Administration positions on the Tax Reform Bill and proposals developed after of the 1977 budget.

In view of previously defined positions, the Administration's initiatives which should be given the highest priority are the following:

1. Individual tax cuts. These proposals accomplish simplification and distributional objectives of the Administration. They should replace the tax cuts in the Tax Reform Act.

2. Integration of Corporate and Personal Taxes in Order to Eliminate the Double Tax on Dividends. This proposal could serve as the centerpiece of policy toward taxing income from capital.

3. Social Security Tax Rate Increases. Some form of increased funding is a necessary component of any program to improve the financial structure of the social security system.

The justifications for the three major initiatives suggested above are:

A. Individual Tax Cuts. The tax cuts of the Tax Reform Act represent an outgrowth of temporary measures which were first enacted as part of the

Tax Reduction Act of 1975, then extended through the first six months of the current year in the Revenue Adjustment Act of 1975, and now extended once again in the Tax Reform Act of 1976. These tax cuts, which were initially designed to temporarily stimulate the economy, do not represent desirable permanent features of tax law.

- The Administration has consistently opposed the refundable earned income credit as a most inefficient way of taking the first step in the direction of the negative income tax.

- The option of taking either a per exemption tax credit or a credit based on taxable income adds yet another complexity to an already overburdened system.

- The percentage standard deduction, with its quite limited range between the minimum and maximum, now has a relatively minor effect again at the cost of complexity. However, the increase in the standard deduction in the Tax Reform Act over 1975 law accomplishes some of the Administration's objectives in its combination of a flat standard deduction and increased exemptions.

The Administration's proposal represents significant movement toward a more easily understood set of tax calculations--$1,000 personal exemption, a flat standard deduction and a new structure of tax rates. In addition, the distributional consequences of this package are such that the main benefits are provided to taxpayers between $10,000 and $30,000 of adjusted gross income, those taxpayers who have received relatively smaller benefits from earlier rounds of tax reduction. The only modification recommended to the President's initial proposal is an increase in the flat standard deduction to $1,900 (from $1,800) for a single return and $2,700 (from $2,500) for a joint return to reflect the fact that the standard deduction limits have been increased since the proposal was first made.

B. <u>Integration of Corporation and Individual Taxes</u>. This proposal to eliminate the double tax on corporate dividends would reduce the tax burden on corporate source income and rationalize the way in which income from capital is taxed regardless of its source. Two previously-proposed tax initiatives could logically be subsumed by the integration approach. These are:

- The reduction of the overall corporate rate from 48 to 46 percent.

- The special tax package for electric utilities.

Thus, if dividend distributions were taxed only at the tax rates of the individual shareholder and not at the corporate tax rate as well, there would be no need to cut separately corporate rates as a means of reducing the total tax burden on corporate source income.

Similarly, integration would also greatly benefit electric utilities. Since utilities traditionally pay out a large fraction of their income as dividends, they and their shareholders would be among the major beneficiaries of a general integration plan.

Moreover, the six point electic utility package (see Part Two) has, in part, been overtaken by events. For example, the investment tax credit has been extended through 1980 although only at a 10 percent rate; five-year amortization for pollution control facilities has also been extended, and for the first time a five percent investment tax credit is allowed on such facilities; and with the passage of 15 months since the utilities package was first proposed, electric utilities are that much closer to a complete phase-in of progress payments eligible for the investment tax credit. Also, utility rates are catching up with the cost increases of 1974 so that special relief measures are no longer needed. Furthermore, one part of the package--allowing utility shareholders to defer taxes on reinvested dividends--is a form of integration and as such would be superseded by a more general integration proposal.

Corporate integration would help achieve the following objectives:

- Stimulating additional investment by reducing the high burden of taxation on capital income.

- Reducing the tax incentives of corporations to undertake excessive debt financing.

- Promoting efficiency in the allocation of capital between corporate and noncorporate investment.

Furthermore, integration can be phased-in over time as subsequent budgetary conditions allow.

C. <u>Social Security Tax Rate Increases</u>. The Administration believes that problems associated with the financing of the social security trust fund need to be addressed through reforms in the benefit structure (principally decoupling) and through an increase in taxes.

Social security taxes are scheduled to increase in January 1978 under existing law, with the rate rising from 11.7 percent to 12.1 percent and the tax base rising from $16,500 to an estimated $17,700. Together, these increases will raise FY 1979 receipts by about $6 billion. The Administration's proposed 0.6 percentage point increase in the social security tax rate--if it were to be effective in January 1978--would increase FY 1979 receipts by another $6 billion, thus doubling the increase scheduled under current law.

While some increase in revenues is undoubtedly required--indeed, the Social Security Administration now believes a rate increase in excess of 0.6 percentage points may be necessary--review should be undertaken of the desirability of this large an increase in social security taxes occuring at one time as well as of the needs of the social security trust fund as a whole.

<u>Other Tax Proposals</u>

The Treasury also recommends that several other proposals of Table 2 be included in the Administration's tax program. These are listed below.

1. <u>Extension of Corporate Surtax Exemption Provisions.</u> The Tax Reform Act of 1976 extends through 1977 the 20 percent rate on the first $25,000 of corporate taxable income and the 22 percent rate on the next $25,000. These provisions should be made permanent as proposed by the President in his FY 1977 budget.

2. <u>Withholding on Dividends and Interest Paid to Foreign Investors</u>. Since the Tax Reform Act of 1976 eliminated the U.S. withholding tax only on

bank interest payments to foreigners, it is recommended that the Administration repropose eliminating the tax on all interest and dividend payments to foreigners.

3. Sliding Scale for Capital Gains and Losses. To lower tax burdens on income from capital and roughly approximate an inflation adjustment for capital gains, it is recommended that the Administration's plan for a sliding scale on capital gains be reproposed.

4. Broadened Stock Ownership Plans (BSOP). BSOP should be reproposed as a device to encourage more widespread stock ownership, particularly among lower and middle income individuals.

5. Tax Credit for Mortgage Investment Under the Financial Institutions Act. In view of escalating cost estimates and the desire to coordinate this proposal with other measures to support the housing market, it is recommended that the starting date of this proposal be delayed until January 1, 1979.

6. Accelerated Depreciation in Areas of High Unemployment. The current high unemployment rate argues for including this proposal in the FY 1978 budget.

7. Exclude Charitable Contributions from the Minimum Tax and Reduce the Administrative Tax on Foundations from 4 Percent to 2 Percent. Both of these proposals have been advocated by the Administration to assist charities and foundations. The Senate, however, voted against excluding charitable contributions from the minimum tax but both of these proposals are minor items, and it is possible to include them in the budget at this time.

8. The Taxable Municipal Bond Option and Changes in the Tax-Exempt Status of Industrial Development Bonds. The Administration has advocated a 30 percent subsidy of interest costs for state and local securities which are issued on a taxable basis. Since the net budgetary costs are quite low, it may be desirable to reintroduce this

proposal, along with a companion proposal to remove from the tax-exempt market the essentially private demands for pollution control and other industrial development financing.

9. <u>Education Tax Credits</u>. The strong commitment of the Administration to this type of program indicates that some start should be made in allowing a tax credit for education expenses. However, any program should be kept at a low level and phased-in gradually to minimize budgetary impacts.

10. <u>Other Tax Recommendations</u>. These recommendations include three minor items--the write-off of discontinued silver certificates, allowing the Nuclear Regulatory Commission to collect annual fees to cover costs of licensing services, and collecting inland waterway user charges--as well as extending the Highway Trust Fund taxes when they expire in September 1979.

All of the above recommendations have been incorporated in a proposed Administration tax program for the FY 1978 budget. Table 3 presents the effects of these recommendations on budget receipts for Fiscal Years 1978 and 1979.

For FY 1979, this tax program yields budget receipts of \$446.4 billion. The starting point is a receipts figure of \$457.1 billion under extension of the Tax Reform Act. The revenue raising tax proposals then generate additional receipts of \$6.3 billion in FY 1979. These proposals are social security and railroad retirement tax rate increases, fees for regulatory and judicial services, waterway fees, the taxable municipal bond option, and the industrial development bond subsidy plan, although the last two involve expenditure increases as well. This produces a receipts figure of \$463.4 billion. Then, \$17.0 billion of tax reductions are provided through the other tax measures to yield the \$446.4 billion total.

Table 4 is a summary of budget receipts, outlays, and surpluses or deficits for Fiscal Years 1977 through 1979 under current Administration tax policy and the tax recommendations suggested in this paper. For FY 1979, the budget deficit of \$26.3 billion under current tax policy has been reduced to \$22.6 billion.

III. Other Tax Options

Table 5 indicates other tax options which may be used to raise additional receipts in FY 1979.

1. Individual Tax Cuts. The main policy decision for the Administration in this area is deciding which parts of its October 1975 proposal are most relevant. The recommendation in Table 3 would reduce taxes in the same manner proposed October 1975. This would involve replacing all the individual tax features of the Tax Reform Act with a $1,000 personal exemption, a flat standard deduction of $1,900 for single returns ($2,700 for joint returns) and a lower structure of tax rates. (The flat standard deduction has been increased over the 1975 proposal--$1,800 for a single return and $2,500 on a joint return--in the same amount that the 1976 law standard deduction has increased over 1975 law.) This proposal loses $11.1 billion in FY 1979.

It is possible to develop a tax cut which contains some elements of the President's 1975 proposal and yet "buys out" the exemption credit and the optional taxable income credit of the Tax Reform Act at considerably lower cost. For example, $3.4 billion smaller revenue loss in FY 1979 may be achieved by a plan which would replace the tax credits of the Tax Reform Act with a $1,000 exemption and would also reduce rates somewhat in the lower brackets, but would keep the Act's standard deduction provisions. Nonetheless, no taxpayers would have tax increases over 1976 law except for returns affected by the earned income credit.

2. Corporate Integration. The Administration's proposal on integration is composed of a deduction for dividends paid at the corporate level and a gross-up and credit at the individual level. The particular phase-in schedules for these two components can be structured to produce any desired revenue impact in the short run. The proposal presented in Table 3 is assumed to be effective January 1, 1978. The corporate dividend deduction is phased-in over a six-year period from calendar year 1978 to 1983; the individual gross-up and credit is phased-in over a five-year period from 1979 through 1983. This proposal could be phased-in at a slower rate to yield $1 billion of additional revenue in FY 1979.

3. <u>Other Revenue Raising Possibilities</u>.

- <u>BSOP</u>. This could be deleted to realize $0.5 billion in additional revenues in FY 1979.

- <u>ESOP</u>. Current law provides for an additional investment tax credit of up to 1.5 percent for contributions to employee stock ownership plans. Deletion of these provisions would yield $0.3 billion in FY 1979 receipts.

- <u>Accelerated depreciation in areas of high unemployment</u>. Deletion of this item raises $0.4 billion in FY 1979.

- <u>Repeal of foreign withholding on interest and dividends</u>. Deletion or postponement of this program could raise $0.3 billion in FY 1979.

- <u>Sliding scale on capital gains</u>. Deletion or postponement of this program would raise $0.9 billion in FY 1979.

- <u>Mortgage interest tax credit</u>. Deletion of this would raise $0.3 billion in FY 1979.

PART TWO

TABLE OF CONTENTS

PRESIDENT'S INDIVIDUAL TAX CUTS

Description of Issue

Should the President's program of individual income tax changes be reproposed?

	Fiscal Year Billions of dollars					
	1977	1978	1979	1980	1981	1982
President's proposal slightly modified (variation 1 below--effective date 1/1/77)	-8.1	-10.5	-11.1	-11.7	-12.4	-13.1
variation 2 (effective date 1/1/77)	-5.8	-7.2	-7.7	-8.2	-8.7	-9.3

Discussion

The President proposed last October to increase the personal exemption to $1,000 as a substitute for the temporary exemption credit, to introduce a flat standard deduction in place of the temporary standard deduction that was in effect at the time; and to provide further tax cuts through rate reductions. The earned income credit and other temporary measures were to be repealed. The President's proposal along with the major individual tax provisions of recent years is presented in Table 6.

The standard deduction changes of the Tax Reduction Act have since been enlarged and made permanent. The Administration should decide whether the part of its proposal dealing with the standard deduction is still relevant. It is also necessary to decide what level of rate reductions is now appropriate; a wide range of changes is possible to achieve the desired distributional goals and revenue targets.

Two variations which might be proposed are:

1. Reduce taxes in exactly the manner proposed in October 1975. Replace the earned income credit and other temporary credits with a $1,000 personal exemption, provide a flat standard deduction of $1,900 (or $2,700 on a joint return) and cut rates as proposed last October. (This flat standard deduction has been increased over the 1975 proposal by the same amount that the 1976-law standard deduction has increased over 1975-law.)

This proposal would cost-$11.1 billion in FY 1979. Its principal defect is that it results in tax increases over 1976 law for about 1.5 million returns, not counting those affected only by earned income credit outlays.

2. Exemption and Rate Cuts: "Buy Out" Plan. Replace the tax credits of the Tax Reform Act with a $1,000 exemption, and reduce tax rates, but keep the standard deduction provisions.

This proposal is designed to approximately "buy out" the exemption credit and the optional taxable income credit. (With the exception of returns affected by the earned income credit), it results in small tax increases over 1976 law for only head of household returns. The total revenue loss in FY 1979 is $7.7 billion.

Recommendation

Plan 1, the President's initial proposal adjusted for subsequent changes in the standard deduction, has been included in the recommendations of Table 3.

CORPORATE TAX RATE CUTS

Description of issue

Should the Administration repropose a cut in the maximum corporate income tax rate from 48 percent to 46 percent?

	Fiscal years					
	Billions of dollars					
Effect on receipts (Assumes a 1/1/77 effective date)	1977	1978	1979	1980	1981	1982
	-1.1	-2.6	-2.8	-3.0	-3.4	-3.6

Discussion

The corporate income tax is levied in two parts, the normal tax and the surtax. For firms with over $50,000 of taxable income the normal tax rate is 22 percent and the surtax rate is 26 percent--resulting in a combined rate of 48 percent. The proposal would decrease the surtax rate to 24 percent and the combined rate to 46 percent.

A reduction in the corporate rate would be expected to reduce somewhat the tax bias against investment and stimulate increased capital formation.

This proposal was first presented as part of the President's October 1975 tax cut and budgetary restraint package and was included in FY 1977 budget.

Recommendation

A change in the maximum corporate rate should be dropped as a separate proposal in favor of integration of corporate and personal income taxes as the major tax initiative to foster capital formation and to facilitate equity financing of corporate investment.

CORPORATE SURTAX EXEMPTION PROVISIONS

Description of Issue

Should the Administration propose that the corporate surtax exemption provisions of the Tax Reform Act of 1976 be made permanent?

		Fiscal year				
		Billions of dollars				
Effects on receipts (Assumes effective date of 1/1/78)	1977	1978	1979	1980	1981	1982
	--	-1.0	-2.4	-2.6	-2.8	-3.0

Discussion

Prior to the Tax Reduction Act of 1975, corporate taxable income was subject to a 22 percent normal tax and a 26 percent surtax, with a surtax exemption of $25,000. This Act modified the corporate surtax exemption provisions in two ways for calendar year 1975. First, the surtax exemption was increased from $25,000 to $50,000. Second, in place of a normal tax rate of 22 percent on corporate income, a 20 percent normal rate was established on the first $25,000 of income and a 22 percent normal rate on income above $25,000.

In October 1975, the Administration proposed making these changes in the surtax exemption provisions permanent, and included this proposal in the President's FY 1977 budget. The Revenue Adjustment Act of 1975 extended these provisions until June 30, 1976, and the Tax Reform Act of 1976 further extended these provisions until December 31, 1977.

Recommendation

The Administration should repropose a permanent extension of the corporate surtax exemption provisions of the Tax Reform Act.

PUBLIC UTILITY TAX PACKAGE

Description of issue

Should the Administration's six-point program of special tax relief for electric utilities be reproposed?

	Fiscal Year Billions of dollars					
	1977	1978	1979	1980	1981	1982
Effect on receipts ..... (assumes 1/1/77 effective date)	-.2	-.8	-1.1	-1.4	-1.6	-1.8

Discussion

The President's Labor-Management Committee's six-point program of tax measures to stimulate construction of new electric utility facilities, was presented to the Committee on Ways and Means on July 8, 1975.

The program would revise the tax laws applicable to electric utilities by (1) permanently increasing the investment tax credit to 12 percent; (2) permitting immediate investment credit on construction progress payments; (3) extending five-year amortization for pollution control facilities until 1981; (4) providing five-year amortization for costs incurred in converting from a petroleum-fueled generating facility; (5) permitting depreciation of construction progress expenditures during the construction period; and (6) allowing utility shareholders to defer taxes on reinvested dividends.

The Tax Reform Act of 1976 extends the 10 percent investment credit for all qualified property (including utility property) through the end of 1980, but no special provision for electric utilities is made. The Act also liberalizes and extends the election for five-year amortization of certain pollution control facilities and for the first time permits a 5 percent investment credit on such facilities.

Recommendation

The Administration should not include these proposals in its new tax program.

These proposals were developed in the spring of 1975 at a time when electric utility rates were not generating adequate profits to permit the financing of capital construction projects. The economic position of the industry, however, has improved considerably since then. Moreover, special tax relief will eventually result in lowering the cost of electricity, a result which is counter-productive to energy conservation. Finally, the Congress has given no indication that it is going to enact this package of proposals.

The Administration's integration proposal, which would eliminate the double tax on corporate dividends, would provide significant benefits to public utilities, since they distribute a large proportion of their earnings to shareholders.

SOCIAL SECURITY TAXES

Description of issue

In the January budget, the Administration proposed a 0.6 percentage point increase in social security taxes effective January 1, 1977. The Congress did not act on this proposal. The issues are when should the tax increase occur and how large should it be?

Discussion

The Administration's proposed 0.6 percentage point increase in the social security tax rate would increase the tax rate of both employers and employees by 0.3 percentage points. For the self-employed, the tax rate would be increased by 0.9 percentage points, which would return that rate to 75 percent of the combined employer-employee tax rate. If this proposal were to become effective in January 1978 it would increase receipts by roughly $4 billion in FY 1978 and by $6 billion in FY 1979. However, social security payroll tax increases are also scheduled to occur under existing law in January, 1978. First, the social security tax rate is scheduled to increase from 11.7 percent to 12.1 percent on January 1, 1978, which willincrease receipts by close to $3 billion in FY 1978 and by about $4 billion in FY 1979. Second, it is estimated that the social security tax base will increase from $16,500 to $17,700, raising receipts by about $2.5 billion in its first full year of effect. Thus, the first full year effect of social security tax increases already scheduled would raise receipts by about $6 billion. The Administration's proposed 0.6 percentage point rate increase, if it were effective January 1, 1978, would double the size of the tax increase occurring at that time.

	Fiscal Year Billions of dollars					
	1977	1978	1979	1980	1981	1982
Effect on receipts						
(effective date 1/1/77)..	3.5	5.4	6.0	6.6	7.2	7.7
(effective date 1/1/78)..		3.8	6.0	6.6	7.2	7.7
(effective date 1/1/79).			4.2	6.6	7.2	7.7

Recommendation

In view of the needs of the social security trust fund, some increases in social security taxes in addition to those already scheduled is needed. Therefore, a 0.6 percentage point rate increase is recommended, effective January 1, 1978.

In any event, careful review must be given to the needs of the social security trust fund over the long run including reforms of the benefit structure.

MORTGAGE INTEREST TAX CREDIT

Description of issue

Should the Administration repropose the mortgage interest tax credit (MITC) provision of the Financial Institutions Act (FIA) to replace the bad debt deduction allowed financial institutions under current law?

	Fiscal Year Billions of dollars					
	1977	1978	1979	1980	1981	1982
Net Effect on receipts .... (assumes effective date 1/1/77)	-.3	-.7	-.7	-.8	-.9	-1.0

Discussion

The MITC provision of the FIA, coupled with repeal of the special bad debt allowance, was originally designed and supported by the Administration as a revenue neutral means to encourage mortgage lending. The credit would equal a percentage of residential mortgage interest income ,rising from 1.5 to 3.8 ,as the percentage of mortgages in the portfolios of financial institutions increases from 10 to 80 percent. Since the proposal was first made in 1973, cost estimates have risen markedly. Under the most optimistic projections, benefits in terms of new home construction are small relative to the costs. If, for example, 50,000 new housing starts resulted from a reduction in mortgage interest rates of .25 percentage points, the implied cost would be $20,000 per unit. The sliding scale of the mortgage interest subsidy has effects contrary to the intent of promoting competition among financial institutions. Since the subsidy rate increases with mortgage holdings, the greatest benefits go to institutions with the greatest proportion of assets in mortgages, thereby making it more difficult for life insurance companies, commercial banks, and mutual savings banks to offer rates competitive with savings and loan associations.

Recommendation

In order to develop other alternatives and to procure time for consultation with HUD, the effective date of the MITC should be delayed until January 1, 1979.

BROADENED STOCK OWNERSHIP PLANS (BSOP)

Description of issue

Should the Administration's broadened stock ownership plan be reproposed?

	Fiscal Year Billions of dollars					
	1977	1978	1979	1980	1981	1982
Effect on receipts .... (assumes 1/1/77 effective date)		-.4	-.5	-.6	-.7	-.7

Discussion

Under BSOP, low and middle income individuals could deduct contributions of up to $1,500 for investment in common stocks. The BSOP program would be available to all workers and would enable them to hold a balanced portfolio of corporate stock for investment and retirement purposes. Withdrawals of funds from BSOPs would be taxed at capital gains rates.

Current law provides employee stock ownership plans (ESOPs) funded through a special investment tax credit. Under these ESOPs employees may acquire only the stock of their employers. Furthermore, these ESOPs are available only to those who work for corporations, and particularly benefit those working in capital intensive industries and for firms which have sufficient tax liabilities to avail themselves of the special investment tax credit. Since only the stock of the employing corporation may be held, ESOP investments are quite risky, particularly as a means of providing security for retirement.

The Administration's plan for eliminating the double tax on corporate dividends would also provide strong incentives for stock ownership. Thus, some of the objectives of both BSOP and ESOP would be achieved as a result of corporate integration.

Recommendation

BSOP should be reproposed to encourage more widespread stock ownership.

ACCELERATED DEPRECIATION IN HIGH UNEMPLOYMENT AREAS

Description of issue

Should the Administration propose again a program of accelerated depreciation for investment in plant and equipment in areas of high unemployment?

	Fiscal Year Billions of dollars					
	1977	1978	1979	1980	1981	1982
Effects on receipts..... (assumes 1/1/77 effective date)	-*	-.2	-.4	-.6	-.7	-.6

Discussion

The Administration's proposal put forth in January of this year provides a tax incentive to encourage investment in plant and equipment in areas experiencing unemployment in excess of 7 percent. Buildings are allowed straight line depreciation over a period equal to one-half their useful lives and equipment is allowed 5-year amortization with a full investment tax credit.

The President has strongly supported this proposal as an important component of any program to reduce unemployment.

Recommendation

This program for dealing with the problem of unemployment should be reproposed.

* Less than $50 million.

CORPORATE/INDIVIDUAL INCOME TAX INTEGRATION (CITI)

Description of Issue

Should the Administration's plan to integrate corporate and individual income taxes be reproposed?

	Fiscal Year					
	Billions of Dollars					
	1977	1978	1979	1980	1981	1982
Effect on Receipts (Assumes 1/1/78 effective date)		-1.1	-3.1	-5.4	-9.2	-14.2

Discussion

Under the current two-tier system, income earned in the corporate sector is taxed once at that level and any portion of that income paid out as a dividend is taxed again at the shareholder level. Integration, first proposed to Congress by the Administration in July 1975, is designed to encourage capital formation by correcting for some of the serious biases inherent in the two-tier system. The specific problems in the system that CITI addresses are: (1) the bias against saving and investment that arises from extra taxation of capital income; (2) the inhibition of the flow of savings to corporate equity investments; (3) the higher prices which consumers must pay for corporate products to provide a reasonable after-tax return to corporations; (4) the systematic bias against lower-bracket taxpayers' ownership of corporate stock; (5) the encouragement of high debt-to-equity ratios in corporate financing which make such businesses vulnerable to business cycle changes; and (6) the penalty against corporate decisions to distribute earnings which, by holding down dividends, keeps corporate earnings from the test of capital markets.

The integration proposal, by reducing the rate of tax on capital income and by providing more equal tax treatment of income from corporate capital compared to other income sources, will encourage additional savings and a more efficient use of all available capital.

Since July 1975, corporate integration has been strongly urged by the Administration in testimony before the Congressional tax writing committees. It has attracted broad and bipartisan support and a version of integration has recently been publicly supported by Chairman Ullman who is also heading the Capital Formation Task Force of the House Ways and Means Committee.

Recommendation

The Administration should urge corporate integration as the focal point of its tax policy to encourage capital formation and economic growth. This is the single most important tax initiative for the achievement of these important goals.

WRITE-OFF OF SILVER CERTIFICATES

Description of issue

Should the Administration continue to urge the Congress to enact legislation to write-off discontinued silver certificates which have been determined to have been lost or destroyed?

	Fiscal Year Billions of dollars					
	1977	1978	1979	1980	1981	1982
Effect on receipts (effective date 9/15/77)	.2					

Discussion

This proposal has been transmitted to every Congress since 1970. The Senate passed the bill in the 91st and 92nd Congresses, but neither house acted on it during the 93rd or 94th Congress. The proposal recognizes that these Federal Reserve bank notes and National bank notes will not be redeemed. The value of the certificates would be credited to a governmental receipts account, thus reducing the deficit in the year of receipt.

Recommendation

Introduce legislation to remove the current limitation of $200 million (already used up) on silver certificates which may be written off.

NUCLEAR REGULATORY COMMISSION FEES (MISCELLANEOUS RECEIPTS)

Description of issue

The 1977 budget included a proposal to allow the Nuclear Regulatory Commission to collect annual fees to cover the costs of its licensing services and its reactor safety research program in support of licensing.

	Fiscal Year Billions of dollars					
Effect on receipts	1977	1978	1979	1980	1981	1982
(January Budget estimate)	.1	.1	.1	.1	.1	.1

Discussion

Legislation submitted to the last session of the Congress never got out of the Joint Committee on Atomic Energy. The proposal is still thought to be a desirable one, and is consistent with OMB Circular A-25 on user charge policy.

Recommendation

That legislation be resubmitted in the next session of Congress.

WATERWAY USER CHARGES (MISCELLANEOUS RECEIPTS)

Description of issue

The 1977 budget included a proposal to collect inland waterway user charges to help offset the Federal subsidies presently dedicated to this mode of transportation. However, legislation was never submitted to the Congress, in part because of a disagreement between OMB and the Department of Transportation on the proper collection mechanism. It was finally decided that the issue should be resolved as part of a study being conducted by the Water Resources Council.

	Fiscal Year Billions of dollars					
Effects on receipts	1977	1978	1979	1980	1981	1982
(January Budget estimate)	.1	.1	.2	.2	.2	.2

Discussion

This issue is currently being reviewed independently by the Department of Transportation, the Water Resources Council, and by OMB. There is general agreement that these user charges should be implemented; the only question to be resolved is the form of these user charges.

Recommendation

This issue should be resolved in the decision-making process leading up to the 1978 budget.

WITHHOLDING ON FOREIGNERS

Description of issue

Should the Administration propose again the elimination of U.S. withholding on dividends and interest paid to foreign investors?

	Fiscal Year Billions of dollars					
	1977	1978	1979	1980	1981	1982
Effects on receipts (assumes effective date of 1/1/77).....	- .1	-.2	-.3	-.3	-.3	-.3

Discussion

During consideration of the 1976 Tax Reform Act, the Treasury strongly recommended eliminating U.S. withholding taxes on dividends and interest payments to foreign investors in the United States. In its final form the Act eliminated withholding for bank interest payments only.

Recommendation

The proposal for elimination of withholding on dividends paid to foreign investors should be reproposed.

CHARITABLE DEDUCTIONS UNDER THE MINIMUM TAX

Description of issue

Should the charitable deduction remain an item of tax preference subject to the minimum tax?

	Fiscal Year Millions of dollars					
	1977	1978	1979	1980	1981	1982
Effect on receipts ...... (assumes effective date 1/1/77)		-55	-60	-67	-73	-81

Discussion

Under the Tax Reform Act of 1976, the charitable deduction is one of the itemized deductions which, to the extent they exceed 60 percent of the taxpayer's adjusted gross income, constitute items of tax preference. Treasury has opposed making the charitable deduction an item of tax preference in any form.

Recommendation

The charitable deduction should be eliminated as one of the itemized deductions that can become a tax preference item.

AUDIT FEE TAX ON PRIVATE FOUNDATIONS

Description of issue

Should private foundations continue to bear the burden of a tax on their investment income to the extent it raises more revenue than is necessary to cover the cost of auditing all exempt organizations?

	Fiscal Year Millions of dollars					
	1977	1978	1979	1980	1981	1982
Effect on receipts .... (assumes 1/1/77 effective date)		-30	-30	-30	-30	-30

Discussion

Private foundations currently pay a 4 percent excise tax on their net investment income. Treasury has consistently supported a reduction in the rate of that tax from 4 percent to 2 percent, since a 2 percent tax will produce sufficient revenue to cover the cost of auditing all exempt organizations.

Recommendation

The excise tax on the net investment income of private foundations should be reduced from 4 percent to 2 percent.

SLIDING SCALE FOR CAPITAL GAINS AND LOSSES

Description of Issue

Should the Administration's sliding scale proposal for capital gains taxation be reproposed?

	Fiscal Year					
	Billions of Dollars					
	1977	1978	1979	1980	1981	1982
Effect on Receipts	0.1	-0.6	-0.9	-1.1	-1.2	-1.3

(Assumes 1/1/77 effective date)

Discussion

The sliding scale would reduce taxes on capital gains with longer holding periods. As at present, 50 percent of the gain would be taxed for assets held between 1 and 5 years. For each year between 5 and 25 years, the percentage of gain included in AGI would be reduced by 1 percentage point so that for assets held over 25 years, only 30 percent of the gain would be included in AGI. Capital losses as well as capital gains would be subject to the sliding scale in line with the symmetry in present law. The proposal includes repeal of the 25 percent alternative tax on capital gains. Repeal is necessary to preclude taxpayers from advantageously choosing which gains would be designated for the two different tax treatments.

The sliding scale provision was part of the 1974 Ways and Means Committee tax bill which was not acted on by the House. It was not included in the Ways and Means version of H.R. 10612. The Finance Committee first rejected and then included the sliding scale, but the provision was deleted on the Senate floor.

The sliding scale proposal would lower tax burdens on income from capital and, in particular, would stimulate demand for corporate stock as a financial investment. These same objectives are accomplished through corporate integration. The proposal would serve as an offset to the taxation of inflationary appreciation, but it is only a very rough approximation to a correct adjustment.

Recommendation

The Administration should repropose the sliding scale.

MUNICIPAL BOND OPTION

Description of issue

Should legislation be proposed denying the interest exemption for municipal bonds issued to finance industrial developement or issued with a Federal guarantee or other Federal support: Should state and local borrowers be provided with a subsidy to induce them to issue taxable rather than tax-exempt securities?

	Fiscal Year Millions of dollars					
Effect on outlays and receipts (assumes effective date 1/1/78)...........	1977	1978	1979	1980	1981	1982
TBO outlays		13	31	37	40	42
TBO receipts		2	16	30	31	32
IDB subsidy outlays		20	50	58	62	66
IDB subsidy receipts		5	40	71	75	78

Discussion

In past legislative and administrative actions, the Treasury and Congress have sought to improve the efficiency of the municipal market and prevent overloading that market with private credit, which drives up borrowing costs and increases the revenue loss to the Federal Government.

To further improve the efficiency of this market, Treasury this year proposed a taxable municipal bond option with a 30 percent subsidy. A 35 percent subsidy was narrowly approved by Ways and Means, but was never taken to the House floor.

Improved efficiency of the tax-exempt market, reductions in state and local borrowing costs, and a more rational Federal credit policy can be achieved through a combination of the taxable bond option and the requirement that IDB financing and Federally-guaranteed financing be limited to the taxable market.

A separate question is whether it is necessary to provide explicit interest rate subsidies to compensate IDBs for their removal from the tax-exempt market.

Recommendation

The Administration should propose the taxable bond option for state and local obligations with an interest subsidy of 30 percent of the first 12 percent of net interest expense.

This proposal should require that municipal bonds for industrial development purposes and those issued with a Federal guarantee or other Federal subsidy be excluded from the tax-exempt market. As an additional proposal, IDBs currently eligible for tax exemption would be required to be issued in the taxable market with a Federal interest subsidy not exceeding 20 percent of interest costs.

RESIDENTIAL INSULATION

Description of issue: Tax Incentives for Residential Insulation

	Fiscal Year Millions of dollars					
	1977	1978	1979	1980	1981	1982
Effect on receipts .... (assumes 1/1/77 effective date)		-193	-200	-212		

Discussion

Included in the 1976 Budget and reiterated in the President's 1976 Energy Message was a proposal for a 15 percent tax credit for the cost of "certain improvements in thermal efficiency in residences." This credit would apply to the first $1,000 of expenditures and could be claimed during the three years following enactment. The credit proposal passed the House as section 331 of H.R. 6860 and the Senate as section 2001 of H.R. 10612. However, the Conference deleted it from the Tax Reform Act of 1976 and H.R. 6860 was not enacted into law.

Recommendation

The Administration's new tax program should not include this proposal. It is questionable whether at today's high cost of utilities this tax credit would provide any real incentive to any incremental increase in the installment of home insulation. The energy savings alone should result in sufficiently lowered utility bills to act as an adequate incentive.

In addition, there are considerable administrative difficulties with such a provision. It will be very difficult to distinguish between qualified improvements for insulation and unqualified improvements which result in some increase in residential energy efficiency but which are primarily decorative. Also, determining what energy saving measures are to be approved by the Treasury for the credit, such as installing attic fans, will be very difficult.

Finally, it is impossible to anticipate or limit the amount of revenue loss that will result from this proposal. All kinds of other equipment (such as solar and geothermal equipment, heat pumps, clock thermostats, and even windmills) will probably be added to the credit in the course of enactment as indicated by the history of this proposal in the past Congress.

IRA ACCOUNTS FOR EMPLOYEES WITH LIMITED EMPLOYEE PLANS

Description

Should the Administration propose that employees with limited employer retirement accounts (LERA) be allowed to make tax deductible contributions to an individual retirement account (IRA) ?

	Fiscal Year Billions of dollars					
	1977	1978	1979	1980	1981	1982
Effect on receipts (assumes 1/1/77 effective date)	-.1	-.4	-.5	-.5	-.6	-.6

Discussion

Under current law, an active participant in a qualified retirement or similar plan maintained by his employer may not make a deductible contribution to an individual retirement account (IRA). This proposal would allow such an individual (including a public employee) to deduct the difference between the amount of the IRA deduction limitation for the year (the lesser of 15 percent of compensation or $1,500 ($1,750 in certain cases)) and the amount of employer contributions and forfeitures on his behalf under the employer's qualified plan and would also allow an employee to take as a tax deduction his contributions to such an employer plan. The Administration supported this proposal during Congressional deliberations on the Tax Reform Act. The House version contained this provision for private employees only. The Senate added public employees should the House provision survive conference. It did not.

In many cases an individual is denied the opportunity of making a deductible IRA contribution because his employer makes a very small contribution on his behalf to a qualified plan and the individual may not refuse to participate in the plan. Conversely, where employees are given the option of participating in an employer's plan, the plan may face disqualification because lower-paid employees who would receive relatively small contributions withdraw from the plan in favor of making their own IRA contributions. This proposal would alleviate both problems.

Recommendation

While the Administration should continue to support this proposal in principle, budget requirements may require it to be deferred.

EDUCATION TAX CREDITS

Description of issue: In his University of Michigan speech the President said, "We must also find ways through the tax system to ease the burden on families who choose to send their children to nonpublic schools and to help families cope with the expenses of a college education." If this initiative is to be included in the Budget a decision will have to be reached on the structure of the tax proposal.

Discussion: A simple tax credit for tuition paid to church-related elementary and secondary schools would probably be unconstitutional. Any new proposal should be based on a method that could reasonably be expected to survive a court challenge.

The tax credit for expenses of higher education was initially, attached to the Tax Reform Bill of 1975 on the Senate floor, (the Roth Amendment) but was dropped by the Conference Committee.

The basic issues raised by the Roth Amendment are (1) the extent to which a credit is to be given for "first dollar" costs--thus predominately aiding public institutions--or (2) for a percentage of total costs up to some limit--thus predominately aiding private institutions. There is also the question of whether or not the credit should phase out above some level of income. The following are illustrative of a wide range of alternatives.

Option 1: The Roth Amendment--a 100 percent tax credit for the first $100 of higher education expenditures phasing up to $250 over four years.

Option 2: Phase out the credit in the Roth Amendment for incomes above $25,000. For example, the $250 maximum credit could be reduced $2.50 for each $100 of adjusted gross income in excess of $25,000. If there was only one child in school the credit would disappear at $35,000 of income.

Option 3: To provide a tax credit equal to 10 percent of qualified educational expenditures. The total credit would again be limited to $100 per student the first year, rising to $250 in 1980 and future years.

Option 4: Provide a tax credit of 10 percent only for those educational expenditures in excess of 5 percent of adjusted gross income. The maximum tax credit would still be limited as in Options 1 and 2.

Recommendation

A compromise proposal which draws on various features of the above four options should be included in the 1978 budget. This compromise would provide:

--a maximum credit of $250, phased-in over a four year period in $50 increments, with an initial maximum of $100 in 1977.

--a variable credit rate which gives no credit for the first $100 of expenses, a 25 percent credit for the next $600 and a 10 percent credit for the next $1,000 of expenditures for higher education;

--an eligibility phase-out for adjusted gross income so that those with incomes between $20,000 and $40,000 receive reduced credits and those over $40,000 are ineligible;

--an effective date of 7/1/77.

	Fiscal Year Billions of dollars					
Effect on receipts	1977	1978	1979	1980	1981	1982
		-0.3	-0.4	-0.5	-0.6	-0.6

HIGHWAY TRUST FUND TAXES

Description of issue

Highway trust fund taxes are scheduled to expire in September 1979. The January budget and the Mid-Session Review both assumed that the highway taxes would be extended indefinitely.

	Fiscal Year illions of dollars					
Effect on receipts ...	1977	1978	1979	1980	1981	1982
(assumes 10/1/79 effective date)	----	----	----			

Discussion

The Administration is required to submit authorizing legislation to the Congress in CY 1977 relating to the extension of the Federal-aid Highway program in FY 1979 and subsequent years. The development of the Administration's legislative proposal will be dependent upon the completion of selected studies over the next six months. The legislative proposal will presumably include some type of modifications of the trust fund, but the exact form which this may take is unknown at this time.

Recommendation

That the 1978 budget continue to assume extension of these taxes, pending further review of this issue next spring.

TABLES

Table 1-A

Economic Assumptions
(dollar amounts in billions)

	Calendar Years						
	1976	1977	1978	1979	1980	1981	1982
Case I economic assumptions:							
GNP	1,694	1,876	2,066	2,279	2,512	2,733	2,914
GNP (1972 $)	1,266	1,334	1,396	1,464	1,545	1,625	1,689
(Percent change)	(6.2)	(5.4)	(4.7)	(4.9)	(5.5)	(5.2)	(3.9)
GNP deflator (1972=100)	133.8	140.7	147.9	155.6	162.6	168.2	172.5
(Percent change)	(5.1)	(5.1)	(5.2)	(5.2)	(4.5)	(3.4)	(2.6)
Unemployment rate	7.5	6.9	6.5	6.3	5.7	5.1	4.9
Incomes (current dollars):							
Personal income	1,382	1,534	1,682	1,855	2,043	2,221	2,365
Wages and salaries	894	996	1,097	1,211	1,333	1,449	1,543
Corporate profits	145	161	178	200	225	248	268
Case II economic assumptions:							
GNP	1,698	1,915	2,159	2,418	2,663	2,882	3,109
GNP (1972 $)	1,268	1,346	1,426	1,513	1,589	1,652	1,713
(Percent change)	(6.4)	(6.1)	(6.0)	(6.1)	(5.1)	(3.9)	(3.7)
GNP deflator (1972=100)	133.9	142.2	151.4	159.8	167.6	174.5	181.5
(Percent change)	(5.2)	(6.3)	(6.4)	(5.6)	(4.8)	(4.1)	(4.0)
Unemployment rate	7.5	6.6	5.9	5.3	4.8	4.6	4.5
Incomes (current dollars):							
Personal income	1,384	1,550	1,723	1,929	2,132	2,316	2,506
Wages and salaries	894	1,005	1,119	1,255	1,388	1,516	1,634
Corporate profits	148	179	220	250	270	286	302

October 15, 1976

Unified Budget Summary Based on the Office of Management and Budget's December 1, 1976 Outlay Estimates

($ billions)

Tax law and economic forecast 1/	Fiscal Years 1977	1978	1979
Current tax law:			
Case I: Receipts	357.7	411.1	470.8
Outlays	412.0	442.0	469.0
Surplus or deficit (-)	-54.3	-30.9	1.8
Case II: Receipts	363.7	429.6	504.0
Outlays	411.4	441.5	466.8
Surplus or deficit (-)	-47.7	-11.9	37.2
Current tax law plus extension of temporary tax provisions:			
Case I: Receipts	357.7	403.2	457.1
Outlays	412.0	442.0	469.8
Surplus or deficit (-)	-54.3	-38.8	-12.7
Case II: Receipts	363.7	421.7	490.3
Outlays	411.4	441.5	467.6
Surplus or deficit (-)	-47.7	-19.8	22.7
Current administration tax policy (including extensions):			
Case I: Receipts	349.1	390.3	442.7
Outlays	412.0	442.0	469.0
Surplus or deficit (-)	-62.9	-51.7	-26.3
Case II: Receipts	355.1	409.0	476.2
Outlays	411.4	441.5	466.8
Surplus or deficit (-)	-56.3	-32.5	9.4

December 2, 1976

Office of the Secretary of the Treasury
Office of Tax Analysis

Note: Surplus and deficit estimates based on rounded numbers.

1/ Case I: High unemployment, low inflation.
Case II: Low unemployment, high inflation.

Table 2

Estimated Unified Budget Receipts Under Current Law and Assuming Enactment as Soon as Practicable of Outstanding Administration Proposals Not Superseded by the Tax Reform Act of 1976 1/

($ billions)

Item	Effective date	Fiscal Years 1977	1978	1979
Current law receipts 2/		357.7	411.1	470.8
Permanent extension of temporary tax provisions:				
Extend Tax Reform Act of 1976 reductions:	1/1/78			
Individuals 3/			-6.8	-11.3
Corporations			-1.0	-2.4
Total			-7.8	-13.7
Receipts after permanent extension of temporary provisions		357.7	403.2	457.1
Proposed legislation:				
Repeal Tax Reform Act of 1976 (Extended) tax reductions and replace with President's proposed reductions:	1/1/77			
Individuals		-7.3	-9.6	-10.2
Corporations		-1.3	-3.0	-3.5
Total		-8.6	-12.6	-13.7
Social security tax rate increase	1/1/78		3.8	6.0
Railroad retirement tax rate increase	1/1/78		*	0.1
Financial institutions reform:	1/1/77			
Individuals		-*	-0.1	-0.1
Corporations		-0.3	-0.6	-0.7
Total		-0.3	-0.7	-0.7
Stock ownership incentives:	1/1/77			
Individuals			-0.4	-0.5

($ billions)

Item	Effective date	Fiscal Years 1977	1978	1979
Accelerated depreciation in high unemployment areas:	1/1/77			
Individuals		-*	-*	-0.1
Corporations		-*	-0.1	-0.3
Total		-*	-0.2	-0.4
Corporation tax integration:	1/1/78			
Individuals				-0.1
Corporations			-1.1	-3.0
Total			-1.1	-3.1
Write-off liability on silver certificates	9/15/77	0.2		
Fees for regulatory and judicial services	1/1/77	0.1	0.1	0.1
Miscellaneous (waterway) fees	1/1/77	0.1	0.1	0.2
Repeal withholding on portfolios of foreigners	1/1/77	-0.1	-0.2	-0.3
Exclude charitable contributions from minimum tax	1/1/77		-0.1	-0.1
Reduce administrative fees on foundations	1/1/77		-*	-*
Capital gains of individuals ..	1/1/77	0.1	-0.6	-0.9
Taxable municipal bond option 4/ .	1/1/78		*	*
Industrial development bonds 5/ ...	1/1/78		*	*
Home insulation credit	1/1/77		-0.2	-0.2
Limited employee retirement accounts 6/	1/1/77	-0.1	-0.4	-0.5
Education tax credit	7/1/77		-0.3	-0.4
Receipts after proposed legislation ..		349.1	390.3	442.7

($ billions)

	:Effective: date	Fiscal Years 1977	1978	1979
Changes in receipts from current law:				
Due to permanent extensions of temporary tax provisions			-7.8	-13.7
Due to proposed legislation		-8.6	-12.9	-14.4
Total		-8.6	-20.7	-28.1

Office of the Secretary of the Treasury, Office of Tax Analysis December 3, 1976

*Less than $50 million.
Note: Details may not add to totals because of rounding.

1/ Based on an economic forecast which assumes high unemployment and low inflation.
2/ Includes impact of the Tax Reform Act of 1976, recent administrative action to triple import duties on sugar and H.R. 10210 which increases unemployment taxes on employers.
3/ Assumes no change in withholding rates. Excludes outlay effects of permanently extending the earned income credit.
4/ Excludes outlays, estimated to be $13 million in 1978 and $31 million in 1979.
5/ Excludes outlays, estimated to be $20 million in 1978 and $50 million in 1979.
6/ Endorsement of House plus Senate provisions, tentative estimates.

Table 3

Treasury Recommended Tax Program
for the Fiscal Year 1978 Budget

($ billions)

Proposal	Effective Date	Fiscal Years 1977	1978	1979
Current law receipts................		357.7	411.1	470.8
Assumed permanent extension of temporary tax reductions:	1/1/78			
Individuals 1/..................			-6.8	-11.3
Corporations 2/.................			-1.0	-2.4
Total......................			-7.8	-13.7
Treasury proposed tax legislation:				
1. Excess of President's proposed tax reductions for individuals over current law reductions extended 3/........	1/1/77	-8.1	-10.5	-11.1
2. Social security tax rate increase of 0.6 percentage points......................	1/1/78		3.8	6.0
3. Railroad retirement tax rate increase.....................	1/1/78	*	0.1	0.1
4. Financial institutions reform:	1/1/79			
Individuals.................				*
Corporations................				-0.3
Total.....................				-0.3
5. Stock ownerhsip incentives (individuals)................	1/1/77		-0.4	-0.5
6. Accelerated depreciation in areas of high unemployment:				
Individuals.................	1/1/77	-*	-*	-0.1
Corporations................		-*	-0.1	-0.3
Total.....................		-*	-0.2	-0.4
7. Corporation tax integration:				
Individuals.................	1/1/78			-0.1
Corporations................			-1.1	-3.0
Total.....................			-1.1	-3.1

($ billions)

Proposal	Effective Date	Fiscal Years 1977	1978	1979
8. Write-off liability on silver certificates....................	9/15/77	0.2		
9. Fees for regulatory and judicial services...............	1/1/77	0.1	0.1	0.1
10. Miscellaneous (waterway) fees...	1/1/77	0.1	0.1	0.2
11. Repeal foreign withholding on portfolios...................	1/1/77	-0.1	-0.2	-0.3
12. Exclude charitable contributions from minimum tax................	1/1/77		-0.1	-0.1
13. Reduce administrative fees on foundations.....................	1/1/77		-*	-*
14. Capital gains of individuals....	1/1/77	0.1	-0.6	-0.9
15. Taxable municipal bond option...	1/1/78		*	*
16. Industrial development bonds....	1/1/78		*	*
17. Education tax credit............	7/1/77		-0.3	-0.4
Receipts after Treasury proposed legislation.........................		349.9	393.7	446.4

Office of the Secretary of the Treasury
Office of Tax Analysis

December 3, 1976

* Less than $50 million.

1/ Treasury's proposals include substituting the President's tax reductions.
2/ Part of the Administration's proposals.
3/ Consists of the individual tax reduction proposals specified by the President in October, 1975, modified to raise the standard deduction to $1,900 ($2,700 for joint returns). The revenue effect of these tax reductions on current law receipts is -$8.1 billion in 1977, -$17.3 billion in 1978, and -$22.4 billion in 1979. For corporations, the deepened tax cuts proposed by Treasury represent receipt changes from current law of -$1.0 billion in 1978 and -$2.4 billion in 1979.

Table 4

Summary of Receipts, Outlays, and Surplus or Deficit
Under the Tax Policy Recommendations 1/

($ billions)

	Fiscal Years		
	1977	1978	1979
Receipts under recommended tax policy.......	349.9	393.7	446.4
Outlays...................................	412.0	442.0	469.0
Surplus or deficit (-) under recommended tax policy............................	-62.1	-48.3	-22.6
Surplus or deficit (-) under current administration tax policy.................	-62.9	-51.7	-26.3
Increase in surplus or decrease in deficit due to tax policy accommodation...........	+0.8	+3.4	+3.7

Office of the Secretary of the Treasury
Office of Tax Analysis

December 3, 1976

1/ Estimates assume Case I economic forecast.

Table 5

Further Tax Policy Options Designed to Raise Fiscal Year 1979 Receipts
Above the $446 Billion Level Resulting from Treasury's Tax Policy Recommendations

($ billions)

Treasury Tax Policy Recommendation or Provision of Present Law: Proposal or Provision	Effect on fiscal year 1979 receipts	Possible option	Potential increase in fiscal year 1979 receipts
Deepened individual tax reductions	-11.1	Reduce further cuts ...	+3.4
Corporation tax integration	-3.1	More gradual phase-in .	+1.0
Stock ownership incentives (BSOP)	-0.5	Delete	+0.5
Present law ESOP	-0.3	Repeal	+0.3
Accelerated depreciation in areas of high unemployment	-0.4	Delete	+0.4
Repeal foreign withholding	-0.3	Delete or postpone	+0.3
Sliding scale on capital gains	-0.9	Delete or postpone	+0.9
Financial institutions reform	-0.3	Delete	+0.3
Total	-16.9	Total	+7.0

Office of the Secretary of the Treasury
Office of Tax Analysis

December 3, 1976

Note: Figures may not add to totals due to rounding.

Table 6

Comparison of Individual Income Tax Provisions

	1974 Law	1975 Law	1976 Law	President's proposal (October 1975)
1. Standard deduction:				
(a) Minimum standard:				
Single returns	$1,300	$1,600	$1,700	$1,800
Joint returns	$1,300	$1,900	$2,100	$2,500
(b) Percentage standard	15%	16%	16%	--
(c) Maximum standard:				
Single returns	$2,000	$2,300	$2,400	$1,800
Joint returns	$2,000	$2,600	$2,800	$2,500
2. Personal exemption deduction.	$750	$750	$750	$1,000
3. Tax credit:				
(a) Per capita	None	$30	$35	None
(b) Percent of taxable income.	None	None	2% up to $180	None
4. Earned income credit	None	10% up to $400	10% up to $400	None
				(President's proposal also has rate reductions)

Office of the Secretary of the Treasury
Office of Tax Analysis

October 15, 1976