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CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

March 28, 1975

Dear Mr. President:

I have given careful thought over recent days to what should be done about the tax bill being presented to you by the Congress. Our economy can benefit from prompt, temporary tax relief. But the wrong kind of tax reduction program can do much harm, particularly over the longer run.

I have concluded, regretfully, that if the tax bill becomes law, our national finances will be distorted for many years, inflation will not be checked, and -- most important of all -- the bill virtually overlooks the middle-income class on which this country's economic future so vitally depends. The defects of the bill are serious.

First, many of the provisions of the bill will become permanent. It is true that most provisions are written so that they will technically expire by the end of this year. But it will be virtually impossible to terminate such "reforms" as the increase in the standard deduction, the addition of the earned

income credit, and the increase in the corporate surtax exemption. Our government, which has been operating, year in and year out, on borrowed money simply cannot afford further erosion of the tax base.

Second, numerous individual provisions of the bill, considered on their merits, are undesirable. Their effect will be to remove millions of individuals from the tax rolls, and to distort the equity or thrust of overall tax policy.

-- The earned income credit constitutes an opening wedge for a negative income tax. Moreover, since the credit is not proportional to the shortfall of income -- indeed, it has a perverse effect up to \$4,000 -- it will inevitably invite later liberalization, so as to make it accord with need.

-- The special payment to social security recipients blurs the distinction between the insurance fund and the tax resources of general government. This will provide a precedent for financing social security from general tax revenues -- an objective sought for many years by those who believe that self-financing of social security is too constraining.

- The house purchase credit is a giveaway. It substitutes tax money as a sales incentive in the building industry for similar programs financed by the automobile companies and other manufacturers with their own funds.
- The increase in the corporate surtax exemption will have only a very selective benefit for small businesses. The millions of firms operated by individuals or in partnership form will not be affected, nor will the many corporations that cannot expect to report earnings of more than \$25,000.
- The 1 per cent tax credit for corporations that choose to distribute stock of equivalent value to their employees is a discriminatory gift, financed in its entirety from the Treasury.
- The ending of the oil depletion allowance, except for the smallest operators, is premature. Tax actions that will sharply reduce oil company income, with adverse effects on exploration and development, should be considered only in the context of an overall package of energy measures.

Third, while I do not regard the aggregate amount of the tax cut as a fundamental difficulty, I do think that a line must be drawn and that anything in excess of \$20 billion should be resisted.

The financing job that will have to be done to fund the deficit is already gigantic. It threatens to overburden our financial markets, and to crowd out the private sector demands for credit that will accompany economic recovery. Market participants are already much aware of this threat; even the homebuilders are becoming concerned, when they look ahead at the prospects later this year and on into 1976.

The objectives that I have cited may or may not be acceptable to the public in its present mood. If they are not, you alone have some chance of mobilizing the good sense that still abounds in our land. If you should feel that the prospects of success are dubious, as they may well be, you must still answer the question: If you do not take a firm position on fiscal responsibility now, will you soon have another equally good chance to do so?

In closing, let me say only that my heart goes out to you as you move towards a decision. I know only too well that I have covered only a few of the considerations that you need to weigh. May God bless your efforts!

Respectfully yours,



Arthur F. Burns

The Honorable Gerald R. Ford
The President of the United States
The White House
Washington, D. C.