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THE WHITE HOUSE
WASHINGTON

Don R

note Charlie Walker's

memo.

Sent to DR 9/20

**CHARLS E. WALKER'S
WASHINGTON ECONOMIC REPORT**

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Dear Subscriber:

In this issue, we warn about the direction "tax reform" might take in this Congress and evaluate President Gerald R. Ford's first year as at least a beginning effort to reduce the scope and power of the Federal Government.

TAX REFORM: HOLD ON TO YOUR HATS!

A funny thing happened on the way to Congressional passage of the "Tax Reform Act of 1975": In its first crucial (but tentative) step, the House Ways and Means Committee whapped the bejeepers out of the potent real estate lobby. Last Thursday, the Committee voted 24-10 to raise taxes on "sheltered" income by an ultimate \$1 billion, by limiting "artificial" accounting losses on construction of both commercial and residential property (smaller operators excluded on the latter). Yesterday, the Committee moved as speedily but not so severely on farm "tax shelters." Several conclusions--tentative, to be sure, but none comforting to the business community--can be drawn from these votes.

First, the Doubting Thomases who were highly skeptical of the fast track approach to "marking up" the bill laid down by Chairman Al Ullman (D-Ore.) are having second thoughts. Promising to complete the mark-up in only 20 legislative days (which, on a schedule of three days per week, comes to about two months on the calendar), Ullman appeared to be laying out an almost impossible schedule. But the speedy disposition of the sticky real estate and farm "shelter" problems implies that, if not interrupted by the need to report out some type of windfall profits tax to accompany decontrol of "old oil," Ullman just might meet his ambitious timetable. If so, little time will be available to debate some proposals that could be downright devastating to business in general and capital formation in particular.

Second, although still on the slim side, the chances that a hard-to-veto tax reform bill will be on the President's desk before New Year's day have increased. Up until Thursday's action, we believed that the Committee might well bog down in the special interest "tax shelter" areas and have to settle for quick extension of the 1975 individual income tax cut (a politically inevitable event, in our judgment), plus a few other provisions. Among the reasons for this new prospect might be the strong desire of a "liberal Congress," up to now largely frustrated in terms of fundamentals by a strong veto-minded President, to find an outlet for its visceral desire to help the "little man" versus the Fat Cat and Big Business. This drive is reinforced by the bite of the pincers of inflation and tax burden on the typical American. These economic factors, coupled with the media misrepresentation of our Federal income tax system as being fundamentally unfair to the "little fellow," makes the typical taxpayer boil when he hears about high-income individuals who pay little or nothing (the fact is that those people are few and far between).

Why would any such bill be hard for Ford to veto? Partly because the Administration is supporting some tax reform measures (the limitation on "artificial" accounting losses was originally proposed by the Nixon Treasury in 1973); partly

because the final legislation might include just enough to promote capital formation (e.g., some extension of the investment credit beyond 1976; some liberalization of depreciation) to gain some support from the business community, even though provisions relating to foreign source income might be tightened significantly (these primarily affect the big multinational businesses).

Which brings us to a final conclusion, namely, the corporate community has its work cut out. Not that many corporate leaders are unwilling to see some tightening up of the highly publicized tax shelters, but the revenues available there are small compared with the advertised cost of the incentives to promote capital formation, jobs and growth. According to some "experts," the tax "give-aways" to business add up to billions and billions of dollars. For the zealous "reformer," that's where the real red meat is.

Therefore, the corporate community had best ponder the Committee's actions with care, do its homework, and speak out with clarity and force. With only one day to be devoted to debate on the vital issue of capital formation, businessmen must get across to individual members of Congress just what is at stake--and that argument has to be a fully documented and persuasive brief dedicated to the fact that higher business taxes will destroy jobs, impede growth, foster inflation, and reduce our competitiveness in world markets.

Last Thursday, Ways and Means, in effect, steam-rolled the powerful real estate lobby with the ease of "Mean Joe" Greene flattening Caspar Milquetoast. In politics as well as sports, "momentum" is often the name of the game.

FORD'S FIRST YEAR: END OF A 40-YEAR CYCLE?

Economists are familiar with the "long waves" theory of a Russian named Krongratieff, who argued that the 4-to-7 year regular business cycles identified by the great American economist, Wesley Mitchell, were superimposed on longer swings of three to four decades in duration. Some economists hold similar views with respect to interest rates. Experience provides support for these theories.

The "long cycles" of economics may have their counterparts in our system of Government: In fact, the first year of the Ford Administration, ended just over a month ago, may well have marked the cresting of a "wave" that began with FDR in the 1930's, rose at a diminished rate during the Eisenhower years, accelerated under JFK and greatly under LBJ, and was beginning to slow once again in Richard Nixon's last two years.

Reference is to the trend toward a massive, centralized national government dedicated to national defense (quite proper); stabilizing economic activity (also quite proper); helping raise all citizens to decent living levels (also quite proper, but much more difficult to achieve than originally believed); and utilizing Federal regulation to serve social and economic goals (in many instances, a task best left to the market or State and local governments).

The result of this four decades of New Deal, Square Deal, New Frontier and Great Society (plus high defense spending) can be calculated in numerical terms: a Congressionally-approved spending "target" of \$367 billion; a national debt of roughly \$550 billion; deficits in 14 out of the past 15 years; close to 2,000,000 on the Federal payrolls (not counting over 2,000,000 in the military service or 558,000 working for the postal service) and almost countless "independent," or so-called "alphabet agencies," not to mention those (such as the FDA) which are not independent of the Administration of the day.

The Nixon Years. Up until the debacle of Watergate, Richard Nixon usually had his finger on the pulse of the people "out yonder." The typical low- to middle-income worker was becoming increasingly disenchanted with a know-it-all, do-it-all Federal Government--as well as with Big Business and Big Labor (remem-

ber that less than a fourth of the labor force is unionized; the typical worker therefore identifies not with the minions of Meany, Abel, Woodcock, or Fitzsimmons).

The landslide of November 1972 was, therefore, much more than an anti-McGovern outcry; it reflected in addition an electorate that wanted the traditional "pause that refreshes"--a go-slow approach to new Federal programs, an evaluation of the worth of old programs, and perhaps different courses in the future.

(The wide support for general revenue sharing was a manifestation of this yearning. And because of this support, Congress approved the measure even though it was anathema to most members, breaking a prime law of politics: If you raise money by taxes, then you darnsure better get credit for spending it. Revenue sharing funds are raised by Congress but spent by state and local officials--ofttimes chief coveters of the seats that the Congressmen occupy.)

Understanding that mandate, Nixon proceeded to do what Congress had refused to do. Knowing that most citizens believed that "Uncle Sam ought to be able to struggle along on a quarter of a trillion dollars a year" RMN turned his back on Congressional refusal to vote an ironclad \$250 billion spending ceiling in FY 1973 and, through "impoundments" later declared illegal, held spending below that level by might and main.

The public approved--and it seemed that the four-decade trend to bigger and bigger Federal Government might be arrested. But Watergate exploded and the promise of November 1972 appeared to be lost.

But along came Gerald R. Ford.

A Caretaker President? The first unelected President in the nation's history; a man depicted as none to bright by both a deceased President and the Washington press corps; a person said to be lacking in "charisma"; a chief executive whose full pardon of Richard Nixon, reflecting his sense of right (the decision was politically astute, also), infuriated the press and displeased the public--this was the man slated to occupy the Oval Office, God willing, until January 1977.

Could he be elected in his own right? No way, said the "smart money." And if that be true, then the chance of permanent cresting of the wave toward Big, Do-It-All Federal Government would be reduced. For, needless to say, before the election, Ford cannot make more than a start in this direction, and this, through Congressionally sustained vetoes, he has done. To repeat the crucial question: Can Ford be elected in his own right on November 2, 1976?

Cannon on the Right; Machine Guns on the Left. Although the "smart money" is having second thoughts about its earlier put-down of Ford's electoral chances, you can, as usual, expect the "smart money" to flip-flop all over the place with each up- or down-tick in GRF's popularity in the polls. Our advice is to take these surveys with a grain of salt and stick to fundamentals.

First, Ford can't get elected unless nominated. Second, if nominated, he is likely to win only if the basic issues of Peace and the Pocketbook are working for him. Although the possible charisma and popularity of his opponent should not be taken lightly, with Senator Edward Kennedy vowing not to run we don't see much glamor among the potential candidates. Also, many voters appear to be deeply disenchanted by promises of a Utopia that has not arrived (quite the contrary). These voters are issue oriented, prefer substance to style, and are much more interested in what's in the package than the ribbon and wrapping.

As to prospects for the nomination, Ford is being peppered with criticism from Republicans on both left and right. Liberals warn that he might get the nomination but cannot win unless he tones down his conservatism. The next day a Republican conservative warns just the opposite.

Obviously, Ford is hewing to the middle of the Republican road. This is good strategy to be elected President, but it may not assure the nomination. If the Republican conservatives who dominated the last two conventions do so again and

etc.

place winning second to an oath of allegiance to Adam Smith and William McKinley, then they may well lose in 1976.

But if these people have learned the hard lesson of Presidential politics, then Ford is on a track that, barring the unpredictable, is likely to lead to the nomination and a good base on which to launch his election campaign. The problem for Ford: We are not convinced that these people have learned that lesson.

The Election. If nominated, can Ford win? Again ignoring the unpredictable, assuming no significant missteps on Ford's part as Chief Executive (and thus far, he has made some little mistakes but avoided the big ones), and minimizing the need for more than a few of those unpopular actions a President must take in the public interest, he can run a very good race indeed--provided Peace and the Pocketbook are moving in the right direction.

As to Peace, who can tell? At the moment, with the recently completed Egyptian-Israeli agreement, things are going well. From a long-run standpoint, with the Soviet's apparent determination to relegate the U. S. to permanent second-class military status at the earliest possible date, things aren't going well at all. But the ultimate negative impact of this long-run factor probably extends well beyond the 1976 election. And, in fact, Ford can pick up votes in Middle America (a political, not geographic concept) by promising to fight off the second-class status which the Vietnam War and its legacy have been pulling us toward.

As to the Pocketbook, there is always the danger that the economy will fall out of bed--a term that until recently would have been interpreted as high unemployment, but today would include elevation, to an intolerable level, of an inflation rate that is already too high. In this respect, Ford would do well to stick with a steady-as-you-go policy; recovery may take longer, but it surely will be more solid and sustainable. In any event, neither Ford nor the Federal Reserve should heed the words of the expansionists, whose policies helped get the economy so fouled up in the first place. That route is the route to early, devastating, and vote-destroying inflation.

Conclusion. The permanent cresting of a political wave that has extended over four decades? Perhaps. But anything approaching a final answer will have to be delayed until November 3, 1976--the day following the next Presidential election.

HIGH INTEREST NOTES (PEERING INTO THE CRYSTAL BALL)

Look for the abortive assassination attempt to raise GRF's popularity in the polls. The net negative impact of press interpretation of the First Lady's recent candid remarks--especially in the "Bible Belt"--may be largely offset. This negative impact would have waned anyway, but the sympathy engendered by what many are convinced was a "near miss" on the fourth major assassination here in less than 13 years will give a short-term (but only short-term) boost to GRF's popularity.

Given the multiplying financial problems of the nation's cities, more and more mayoral, city council, and school board nominees can be expected to run on hard-line, anti-union platforms. The typical voter recognizes that as recently as the late 1960's municipal employees were discriminated against but, in the larger cities at least, no more. Therefore, the typical voter will do just what you expect--rebel and elect politicians who promise to crack down on the exorbitant demands of municipal workers' unions.

Sincerely yours,

Charles E. Walker