**The original documents are located in Box C28, folder "Presidential Handwriting, 10/6/1975" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.**

Dr A / MA



# REVIEW & OUTLOOK

## Extending the Tax Cuts

When Congress last March passed the 1975 Tax Reduction Act we described it as a "Mickey Mouse" bill, advised that it would provide little if any economic stimulus at a high price—$22.8 billion, and recommended that President Ford veto it and demand legislation that would maximize the economic stimulus for each dollar of revenue forgone. The President signed the bill.

Mr. Ford is now trying to decide if he wants to extend into 1976 the "temporary" adjustments in the tax code that he accepted for 1975. He has put off a decision as long as he can, hoping the economy would be throwing off clear signals one way or another to make up his mind for him. If the recovery by now were robust, he would be inclined to oppose the extension. If the recovery were flagging, petering out, he would presumably support an extension of the tax cuts. Alas, the economy is mixing its signals, forcing the President to make a hard decision.

We can understand the President's dilemma. The congressional tax cut probably didn't and won't do much to stimulate the economy, since its design concentrated less on stimulation than on redistribution of incomes. The loss of revenue it involves would add something like $12 billion in credit demands; and the high interest rates resulting primarily from swollen federal borrowing are already the number-one threat to the recovery.

Against this there is not only the obvious political appeal of being on the side of lower taxes, but real economic considerations as well. Tax rates should be lowered for 1976 to keep effective rates where they were at the beginning of 1975. Inflation has the unhappy side effect of increasing effective tax rates by pushing people into higher income-tax brackets even while their real incomes are falling, and by overtaxing business profits. These effects will also be destimulative unless President Ford proposes tax policies to neutralize them.

The only permanent solution to this dilemma is the reduction of government expenditures, the only way to achieve stimulative tax cuts without destimulative increases in government borrowing. But the President could go a long way to- ...ical dilemma ...ne as ...re behind the idea of indexing the tax schedules.

The President should propose to Congress that they both start afresh, forgetting about extending last year's cuts and working out a method to protect citizens and the economy from the silent tax increases caused by inflation. It would not be a terribly complicated matter, simply an adjustment in tax brackets. Dr. William Fellner of the American Enterprise Institute, formerly an economic adviser to President Ford, has already done the arithmetic.

The timing of this proposal could give the President some political and economic leeway. He could propose a new law, under which the first automatic adjustment would take place on January 1, 1977. This would avoid extra borrowing next year, when credit markets will be especially tight, and postpone it until a time when lower inflation may mean a smaller adjustment. The long-term benefits would still be reaped.

Even an immediate adjustment for past inflation is attractive compared with the extension Congress is otherwise likely to pass. At first glance the cost in forgone Treasury receipts would be slightly higher, but this is based on estimates assuming unchanged profits and personal incomes. Adjusting tax brackets to correct for the 1974-75 inflation would maintain incentives to produce, thereby raising profits, incomes and Treasury revenues. Extending the redistributive 1975 cuts would provide far less incentive.

At the same time, indexing the tax schedules is not merely a sop for the rich. The "tax trap" bears hardest on the lowest income classes, and correcting for inflation would help them more than the rest. Even liberals could, as some of them have, embrace the idea in good conscience. Nor is it a pie-in-the-sky proposal; Canada has already enacted it.

In fact, it continues to baffle us that neither President Ford nor his chief political and economic counselors have shown much interest in this approach to tax policy. As matters stand, Congress will pass another Mickey Mouse bill, and going into an election year may pass it over his veto. Only if he has his own program is the President likely to have real impact on tax policy. He has to take the lead.