The original documents are located in Box 30, folder "Treasury Department/Simon (1)" of the Ron Nessen Papers at the Gerald R. Ford Presidential Library.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE W04-2041

January 21, 1975

MEMORANDUM TO THE TREASURY STAFF

For your information and guidance, we have produced the transcript of the remarks made by Secretary William E. Simon at a Treasury Department Press Conference held on January 16, 1975.

Office of Public Affairs

Attachment

9:30 a.m., January 16, 1975

SECRETARY SIMON:

I am going to be here only briefly. This week I have had very important negotiations going on at the International Monetary Fund, which will carry me through tomorrow, and attempting to change constantly from a domestic hat to an international hat has been a bit of a problem.

I thought it important that we call this briefing this morning so you could talk to Ed Fiedler and Fred Hickman, our Assistant Secretary for Economic Policy and Assistant Secretary for Tax Policy, respectively, about the President's State of the Union proposals.

These form a truly integrated and comprehensive program that has to be taken as a unit. And as with all such units it is not a fruit basket from which people can pick and choose the parts they like and forget the rest. For instance, we all know that everybody loves a tax cut; nobody likes a tax increase. So we are going to work terribly hard with the Congress to have it enacted as a package.

At the outset, I think I ought to talk for a second about the direction or thrust of the President's program. Philosophy is a word I don't particularly like because I prefer to live and deal in the real world.

It will take more time than this Administration has to move away from the massive government control of many years, and to better utilize the marketplace. But we must make a start.

You can go two routes: either to more government controls -- or you can take the route of the marketplace, with decision-making being given back to the American people and with less encroachment by the Federal government.

The government today has 33 percent of our Gross National Product. It is growing at what the President and I consider alarming proportions. Before the turn of the century, it will certainly be over 50 percent, which would effectively end the system of free enterprise that we have had in this country -- and which has provided the highest standards of living and the greatest prosperity on earth.

I recognize that there are people who think it's a good idea to have more government, that government is more capable of making decisions for America.

Well, I am sorry; this not a philosophy that this Administration, or our President, or I can abide in.

When I talk about freedom, that is not just an idle term. It means you are free to do what you wish to do, and this great freedom is inextricably linked with economic freedom. If the government takes away your economic freedom, your social and political freedoms will not be far behind.

That is a brief overview of the way we approach the problem and the two routes we could travel. People say rationing is equitable -- but I wish you could have had the benefit of sitting with me when we designed the various rationing programs a year ago this time.

Anyone who thinks a program of rationing in this very complex economy is equitable ought to think it through very carefully. Especially should he think about government decision-making and the government employees who will make the decisions down here not only about how you drive to work each day and what you are allowed to do, but whether you are allowed to open a business, how much fuel will be allocated and the political pressures that spring up as to the decisions by government.

I don't think that is the way our economy should be run.

Anyway, I can go on with this subject at great length, and I realize today in many quarters what I say is pretty unpopular stuff; but it is something I very deeply believe in and I guess we will be debating with Congress over coming days the more controversial aspects of our program.

As I said, I have been deeply involved with the IMF Ministers night and day all week, and I will be again today and tomorrow. However, I intend to make myself available to the press in the days and weeks ahead on quite a few occasions because, as we work through the legislative process, there are going to be lots of questions that are going to be asked, and we want to be as responsive to these questions as we can.

This program that the President announced on Monday and yesterday involved some painful decisions for the President because he, like other members of his economic team, is a firm believer in fiscal discipline.

Yet as the leader of all our people, our President knew that millions of Americans were suffering under the present economic circumstances -- and, therefore, that some measures were required that involved a shift of emphasis.

It is a measure of his capacity as a leader in this country that he had the courage to chart a new course and a new emphasis in the direction of his policy. It also ought to be reassuring for this country to know that when we pull out of the recession, which surely we are going to, that we have a man of his philosophy at the helm, for he personally understands what is necessary in the long run to rebuild the foundations of our economy.

I just want to make one thing clear this morning, and that is that this Administration is fully behind our President; we are united in his proposals, and we believe the American people will unite behind him as well.

Three weeks ago we heard a lot of critics who said we were still fighting inflation at the cost of unemployment and recession, and now we are hearing that we are fighting unemployment at the expense of inflation.

I must admit that I feel both views are rather off the mark.

The President continues to fight inflation and recession because they are both part of the same disease, as we have said over and over again.

Obviously, pressures have been put on the price structure throughout our economy. Prices are declining and competition is reasserting itself. The inflation rate is beginning to decline.

There has been a change, obviously, in our policy. This change, as I stress, is a change in emphasis. We are significantly stepping up the battle against recession because our economy is sliding downhill more rapidly than we expected two months ago.

Consumer confidence, which is a fragile thing, can never be predicted by anyone -- not that anyone can predict many other events, either. But this is especially difficult to do, and consumer confidence has been shattered in this country by a combination of factors -- most recently, I believe, by the frightening double-digit inflation we have experienced during this year.

The important thing to understand is that we are not abandoning our long-run battle against inflation.

As you were told in the briefings yesterday, we do expect some slight increase in inflation as a result of the President's programs on the energy side -- approximately two percentage points in the Consumer Price Index.

While the cost of these actions is higher than we would like, we believe the cost of inaction in terms of unemployment and hardship would be much higher.

I think these programs are bold, but I don't believe they are reckless. They are the right medicine at the right time for the right reasons.

Let's emphasize one thing: economic policy does not get put into place like concrete. I think there is some confusion in the country today that when the President puts out a proposal, that this is what it will be for all time, and that is going to solve the problem and then we can all get back to work again.

Economic policy is an ever-evolving mechanism -- one that requires change to match changing circumstances. As changes and events occur that no one can predict at this time, so shifts in our policy reflect our responses to these changes.

In lifting our country out of the doldrums, we have attempted to be extremely careful to avoid actions which would set off another inflationary spiral. That is why we have placed heavy emphasis on limiting the tax cut to just one year and, most importantly, on putting a mandatory ceiling on new spending programs.

We <u>must</u> stop the explosive growth of federal spending in this country. Both of these actions -- the one-year moratorium on new spending programs and the absolute spending limit with the exception of any energy proposals that would cost money -- are imperative in order to keep a lid on prices.

I said a week ago that the President's program would be tough and comprehensive and effective. We believe that is exactly what it is, and will prove out to be, if we give it a chance.

As I say, this program is not a fruit basket. It is a cocktail, and it should be taken in its entirety. At the same time I recognize that we do go through a democratic process of debate which I will start in the House Ways and Means Committee next week on the Hill -- where we will be going to discuss not only our tax proposals but also a debt ceiling increase request.

I think as we approach the financial aspects of this problem with the Congress, they will understand the magnitude of the problem and see the wisdom, as I believe the American people will see the wisdom, that we have to get this crazy government spending under control once and for all -- and the time to start is right now.

I have about three minutes and I will assure you that I will be back next week to talk to you again. And if you have any special requests, you can get in touch with Jim Sites and I will be as available as I have always tried to be within the limits other duties place on me.

QUESTION:

As you know, there have been a good many published stories in recent days that you are on the way out.

Can you tell us what your status is, and are you still the Administration's chief economic spokesman?

SECRETARY SIMON:

I am the chief economic spokesman and Chairman of the Economic Policy Board. If I am on my way out, I have not been told that, nor have I submitted my resignation.

I have said that I am serving at the pleasure of the President and I intend to continue to do that.

QUESTION:

Do you have any intention of resigning?

SECRETARY SIMON:

No, sir.

QUESTION:

Do you know the origin of these stories?

SECRETARY SIMON:

No, I don't. I think I have learned a great deal since I have been in government and I will go home a wiser man in many respects, but the one thing I am absolutely positive that I will not know when I go home is who "the White House source" is that everyone cites.

QUESTION:

Mr. Simon, does the size of the projected deficit in the President's budget concern you?

SECRETARY SIMON:

I would say the size of the deficit horrifies me. I think that is a problem. What you have to do is take a look at the origin of the deficit. It is induced through the recession, which causes the Treasury revenues to drop, and through certain programs such as public service employment that are necessary during the recessionary period to take care of those that bear the disproportionate burden of our battle against inflation and recession; it also reflects most importantly the growth in federal spending that is automatic year after year, as illustrated by the $4.7 billion plan of deferrals and recisions the President sent to Congress before they went home in December.

That is $4.7 billion this fiscal year, but it becomes $7 billion next fiscal year -- and judging by any past standards on what Congressional action would be, it could later become 10, 12, 15, 20 billion; it just gets locked into a spiral which is alarming.

That is why 75 percent of our expenditures in our budget today are so-called "uncontrollables." Yet, as I have often said, I don't buy this uncontrollable business because nothing is uncontrollable. Admittedly, it takes legislation to change this.

We have to form this partnership with the Congress, and that is what we would be attempting to do to begin to change and re-order some of the priorities.

We cannot continue to promise the American people absolute instant prosperity in every single sector in the magnitude that we have been doing, especially for the past decade, without paying enormous bills for it. And the bills, as the President said yesterday, are coming due right now.

We had pretty high bills in 1966. We refused to pay them. We refused to pay them again in 1969 and 1970. Today they are even higher.

I suggest if we don't win the battle this time, the next time the bills will be presented, they will be unacceptably high and I think that is very dangerous for the American way of life.

QUESTION:

Taking account of the circumstances as they exist, do you think the President's program is too stimulative and do you think the deficit is too large?

SECRETARY SIMON:

I do not believe that the President's program is too stimulative. Actually, the tax cut is for one year. We must get the economy rolling again to take care of one side of the equation that I spoke of a minute ago, and that will produce an increase of Treasury revenues which will narrow this deficit.

It is not going to narrow it in time for us not to have strains in our capital markets, however, because we are going to have an impact on the capital markets where we encroach on the centerpiece of the free enterprise economy that supplies the needed capital for productive capacity and new jobs and cheaper goods and services. Each year the government is taking a larger and larger share of it, and the arithmetic is pretty simple: Government at all levels is going to be taking about 80 percent of the traditional debt markets -- the traditional markets that industry at all levels borrows from -- and that is horrible.

Thank you, ladies and gentlemen -- I will look forward to seeing you again soon.

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Department of the TREASURY NEWS
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STATEMENT OF THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
WASHINGTON, D.C., WEDNESDAY, JANUARY 22, 1975

It is a privilege to appear before this Committee as you begin the work of the 94th Congress. During the next two years, you will be considering many of the most significant issues facing the United States. There will be times when we will differ on those issues, but as in the last Congress, I want to work with you as closely as possible to ensure that those who are served best are those whom we all serve, the people of this country. Toward that end, I pledge to this Committee the full cooperation of my office and of all who work at the Treasury Department.

President Ford, after considerable study and consultation, has proposed to the Congress an integrated and comprehensive program in both the economic and energy fields. In my view, the President's program represents the best means of dealing with those problems. In working with you, my first objective will be to obtain swift passage of legislation that is necessary to carry out our program.

The occasion for my appearance this week is to discuss two items: First, the President's tax proposals and their impact on the economy; and secondly, the need to raise the federal debt limit. With the consent of the Committee, I propose to discuss the first of these items today and to address the second tomorrow.

The President's program is designed to deal with three basic and urgent problems:

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--inflation;

--recession; and,

--energy independence.

These problems are difficult and complex, and their solutions will also be difficult and complex. To some extent, the remedies work at cross purposes with each other. The answers are neither black nor white, but matters of balance and judgment.

Some say we can't solve all these problems, at least not all at the same time. I believe we can. The President believes we can, and has charted the course to do it. Indeed, we have no other choice, for the penalty for inaction could be frightening. We will ultimately be held responsible for the results, no matter what the pollsters say today about our approach.

The proposal for a temporary tax reduction to stimulate the economy has the very highest priority and we urge that you enact it immediately, even if that means separating it from the other elements of the President's proposals. However, all of the elements in the proposal are interrelated and, therefore, I need to deal with them all here today.

Inflation.

Inflation, like interest, tends to compound. It reached an annual rate of more than 12% in 1974, the highest level in peacetime history. The damage has been extensive. The lifetime savings of many have shriveled in real terms. Interest rates have risen to all time highs, with adverse effects on the livelihoods of millions, on the opportunity for families to own their own homes, and on the ability of others to start or stay in business. The uncertainties created by inflation undermined the confidence of both consumers and investors, with consequent damage to jobs and to the new investment and increased productivity which are required to stem inflation. I do not believe that our economic system, as we know it, could long survive such a trend. In 1919, J. M. Keynes wrote:

"There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose."

I'm told that statement was a follow-up by Keynes on a similar remark of Lenin, to the effect that inflation could destroy capitalism.

Inflation is popularly said to be caused by "too much money chasing too few goods." That is an oversimplification, but it captures the essential truth.

There have been many causes for this inflation, but, in my opinion, the biggest single factor has been a prolonged period of large government deficits, including the off-budget lending and loan-guarantee programs.

The momentous growth in federal expenditures and federal deficits has been truly startling. It took 186 years for the federal budget to reach $100 billion, a line it crossed in 1962, but then only nine more years to reach $200 billion, and only four more years to break the $300 billion barrier. Revenues, of course, have not kept up with expenditures, so that when we close the books on fiscal year 1975, we will have had budget deficits in 14 of the last 15 years--and the accumulated debt for that period alone will exceed $130 billion.

There can be no doubt about the inflationary impact of such huge deficits. They added enormously to aggregate demand for goods and services and were thus directly responsible for upward pressures on the price level. Heavy borrowing by the federal government has also been an important contributing factor to the persistent rise in interest rates and to the strains that have developed in money and capital markets--a subject I will address in more detail tomorrow. Worse still, continuation of budget deficits has tended to undermine the confidence of the public in the capacity of our government to deal with inflation. In short, when the federal budget runs a deficit year after year, especially during periods of high economic activity such as the ones we have enjoyed over the past decade, it becomes a major source of economic and financial instability.

When the government runs a deficit--when it spends more than it receives--it must borrow to make up the difference. Under our modern monetary system, that kind of borrowing almost always results, sooner or later, in the creation of too much money. It seldom results in the commensurate creation of additional goods and services.

Government borrowing does not necessarily require the immediate creation of too much money, for the government can borrow existing money in the private capital markets. To that extent, it competes with private demands for capital, preempts funds that would otherwise be used for private investment and, in a period of strong private demand, causes interest rates to rise.

If government borrowing in the private capital market grows so large that it threatens to dry up credit for private borrowers or causes abrupt changes in interest rates, the Federal Reserve customarily steps into the market and purchases government bonds for its own account. The Federal Reserve pays for that purchase not with money already in the system, but by setting up a new credit balance on its books. That almost immediately causes the total money supply to increase by several times the amount of the credit. In this way, the financing of large deficits causes the money supply to increase substantially, which creates more inflation. This has been a major part of the inflation explosion over the past decade.

In times of recession, private borrowing typically slackens as businessmen have fewer needs for credit. If additional government deficits simply take up that slack, it does not jeopardize the needs of the private sector and does not drive up interest rates. In the current recession, however, there may be less slackening in private demands than usual because of the high debt-equity ratios that have become typical, the general illiquidity of business, the inability of corporations to raise capital in the equity markets, and the necessity to finance inventories and capital goods at inflated prices.

If we cannot finance the deficit within the recession induced slack in the capital markets, then we shall have a credit "shortage" that will drive up interest rates significantly. The Federal Reserve could prevent that only by significantly increasing the supply of money. As we assess that situation, we must remember, too, that what appears to be slack at the moment may disappear as business bounces back

and its demand for credit returns to normal. When the recession is over, and goods and services have returned to their original pre-recession levels, if the money supply has been significantly increased, we shall have created additional inflation.

There is no way to escape the basic dilemma presented by large government deficits. On the one hand, if the deficits cause a significant increase in the money supply, we shall have further inflation. On the other hand, if deficits are not permitted to increase the money supply, we must be prepared to endure tight credit and high interest rates.

This is a very difficult circle to break. The only solution is to take a long-term view and resist the temptation to deal with each painful aspect of the cure as a crisis to be solved by short-term remedies, i.e., by more deficits.

A most important tool in beating inflation is increased productivity. We need to encourage and facilitate conduct that will increase the supply of goods and services, so that the increased money supply, that will surely flow from these deficits will be chasing an amount of goods and services that has also increased. Just getting back to pre-recession levels of goods and services is obviously not enough.

<u>Recession.</u>

We are presently in a full-fledged recession. It is in substantial part attributable to our inflationary excesses. It is the hangover that follows the revelry.

One of the major factors in the current recession is the decline in the housing industry, which is a key component in our economy. The housing industry is especially vulnerable to high interest rates, and was thus hard hit when inflation caused interest rates to rise to all time highs. Thus, so far as housing goes, it is inflation itself which caused the recession. We cannot expect the housing industry to regain its full health until we get inflation under better control.

It is tempting to believe that housing can be helped by driving down interest rates through a more rapid increase in the supply of money. That does not work in an inflationary climate, however, because the increase in the money supply further increases inflationary expectations, sometimes with a lag and sometimes almost immediately, and thereby sends interest rates not lower, but higher. Thus, housing is hurt, rather than helped, by such policies.

In the same way, inflation was a major factor--perhaps the major factor--in demolishing consumer confidence. Polls taken by the Survey Research Center at the University of Michigan show that the precipitous decline in consumer confidence began when prices started hitting new peaks--well before the effects of the recession were clearly felt. While the recession has driven confidence even lower, it was inflation that pushed it over the brink. This loss of consumer confidence has caused the biggest drop in consumer purchases since the Second World War and is a significant part of the current recession.

Some part of the recession is also attributable to the program to bring inflation under control. When we embarked on that program, we knew that it would dampen economic activity, for that is an inevitable side effect of the process of slowing inflation. The principal tool in winding down inflation has been a policy of monetary restraint, which was in effect most of last year. If the money supply had been permitted to increase fast enough to accommodate all of the price increases we were experiencing, the additional money would have caused the prices to spiral even faster. Thus, it was necessary to slow down the rate of growth in the money supply. Whenever that is done, some are caught in the crunch.

Those are the hard trade-offs. Inflation causes dislocations. And stopping inflation causes additional dislocations. Dislocations cause the economy to fall off.

To cure our economic problems, we will have to administer the medicine continuously over a period of years. We are a long way from full recovery. And we have to watch the patient carefully all the while, because the side effects of the medicine are strong and we may need to adjust the prescription from time to time.

Our goal must be to keep a balance. We want to do as much as we can to stop inflation without unduly hampering economic activity. At the same time, we all recognize today that recession has become a much more serious problem, causing widespread hardships and unemployment. Moreover, it has developed more rapidly and has been steeper than anyone expected. It is apparent that under these circumstances we must shift the balance of our policies more heavily in the direction of fighting the recession. The President's recommendations for a temporary tax cut are designed to ensure that the recovery we expect in the middle months of the year is sharper and stronger than would otherwise be the case.

We can and must have recovery from the current recession, but we must do that in a way that does not lead to an overheating of the economy again. We will lose the opportunity to achieve stable economic growth if we switch to excessively stimulative policies. That has been the repetitive pattern over the past decade. Every time the economy showed signs of hesitation, there was a pronounced shift to stimulative monetary and fiscal policies.

One of the best examples occurred only a short time ago. After a rapid acceleration in the rate of inflation during the late 1960's, a program of fiscal and monetary restraint was started in 1969. As a result, inflation peaked out at 6% and then declined slowly to about 3-1/2% by 1972. The upward momentum of inflation had been stopped. But then, instead of maintaining the policies of moderation, we became more expansive again and we very swiftly propelled ourselves into the inflation that we are experiencing today.

The result of such stop-and-go policies is that we have pushed the inflation rate up onto higher and higher plateaus. In 1966, the peak inflation rate was about 4%; in 1970, it was about 6%; and now prices are rising at about a 12% rate. The same process ratchetted interest rates higher and higher. In 1966, rates on long corporate bonds peaked at a little over 6%; in 1970, they reached almost 10%; and this past year, the high was 12%.

Energy Independence.

Energy independence is both a political and an economic problem for the United States.

Oil is an extremely important and pervasive commodity in our economy. In recent years, our consumption has risen rapidly but our production has declined. We are now dependent on foreign sources for nearly 40% of our needs. Major foreign suppliers have organized a cartel and, at least at present, have the power to bring about political and economic spasms of the kind which we have recently experienced. In the last year and half, the Arab embargo created major disruptions throughout our economy, and the quadrupling of foreign oil prices has contributed significantly to both the inflation and the recession we are now experiencing.

Our economic system is strong and resilient and can undoubtedly survive almost any unfortunate development that is likely to occur in the near future with respect to oil. But many other nations are less fortunate, and our own economy is so interconnected with that of other nations that their problems are in substantial degree our problems. Trouble in one or more national economies abroad could have very serious effects on our own.

If we are to retain control over our own economic destinies, we must achieve independence. We can do it. And when it is clear that we intend to do it, we will regain a great deal of control over the situation. We will control very little from our knees.

The President's energy program is therefore designed primarily to reduce our dependence on imported oil. In order to do that, we will need to develop alternatives for oil and we will also need to reduce our total demands for energy of all kinds.

We are dealing with a long-term program. We believe we can achieve virtual independence in 10 years, but only if we start promptly, work hard and continuously, and make significant reductions in our demands for energy.

Rationing is one way of curbing demand and a number of national leaders have proposed it. Public polls also show a surprising amount of support for rationing. I cannot imagine, however, that the American public will really want it once they think it through or would live with it if they got it. Remember that we are talking about a permanent program. If we should opt to travel the rationing route, we will not get rid of it. If we were to let it go we would--overnight--be again non-self-sufficient.

We could perhaps live with rationing in a period of temporary emergency. But as a way of life, I suggest it is fundamentally inconsistent with our system and with the spirit of the American public.

Even in times of emergency, rationing has never worked fairly or efficiently. To cut a million barrels a day from our consumption by rationing only gasoline for private households, we would have to hold drivers to an average of less than 9 gallons per week--a reduction of about 25% from today. To reach the 1977 goal of a 2 million barrels a day reduction would require a second 25% reduction. Some persons would obviously need more, which means that the basic ration for ordinary persons would have to be even less. But gasoline accounts for only part of each barrel of oil, and we would clearly need to ration the remaining products, too--fuel oil, jet fuel, diesel fuel, refinery products going into petrochemicals, etc. Who would decide which persons needed more and which needed less of each of these things? Every family, every car and motorbike, every store, school, church, every manufacturer--everything and everybody--would have to obtain a permit for a certain quantity of gasoline, electricity, natural gas, etc. Those allocations would have to be changed every time someone was born or died or moved or got married or divorced, and every time a business was started, merged, sold out or bought another, or the church or school added on a new room. And some government official would have to approve it.

What would the rationing bureaucracy do about such cases as:

- The low-income worker who owns an old car that gets only nine miles per gallon but can't afford to trade it in? His affluent neighbor who buys a new car that gets 22 miles per gallon?

. The low-income family that heats with oil a small but poorly insulated house, while their wealthy neighbor heats a large, well-insulated house with gas?

. The Montana rancher who drives nearly 600 miles per month and the Manhattan apartment dweller who drives less than 100 miles?

. The family that has to move from New York to California and use up several months' coupons in making the trip? One out of every five families moves every year.

. The family with sick members? The family that does turn off the heat in empty rooms and the family that does not? The family with few children and many rooms to heat and the family with many children but few rooms?

. The migrant worker who drives large distances every year but can't afford a more economical car?

. The shortages that would inevitably develop in areas where the coupons happen not to match the gasoline supplies?

. The gas stations, with limited quantities to sell, that maintain only limited services and are always closed on evenings and weekends?

. The collusion, counterfeiting and illegal activities that would inevitably develop?

Last year, when we considered the feasibility of rationing gasoline, we concluded that while it could be implemented, it would take four to six months to set up, employ about 15 to 20,000 full-time people, incur $2 billion in federal costs, use 40,000 post offices for distribution, and require 3,000 state and local boards to handle exceptions. When we consider the problems of just getting the mail delivered, are we really ready to trust an army of civil servants--however able and well-intentioned--to decide who deserves just what of this basic commodity?

People should ask themselves which they prefer: the suggested increase in prices, or a system in which someone else could tell them now and for the indefinite future where and when they might drive or how warm they might keep which rooms.

Does anyone honestly believe that the American public is willing to trade these basic freedoms--in perpetuity--for 10¢ a gallon?

The President has proposed instead that we reduce consumption of oil by the most neutral and least bureaucratic system available--through the price system. The energy proposals would raise the price of oil. At the same time, income tax cuts would increase the disposable incomes of every household. Taxpayers could, if they wish, continue to purchase more expensive oil and oil products. And they would have extra money to do it with. The question they would face is whether they wish to spend that extra money for more expensive oil or whether they wish to use it for some other purpose. A great many will choose to use it for other purposes. That is particularly true of businesses, which alertly switch to alternative products when a price advantage appears. The economic data available, updated by the experience of the last year, indicate that a tax of 10¢ a gallon spread across all the products manufactured from a barrel of crude oil will reduce consumption enough to meet our goals.

There has been a great deal of talk about the public being willing to make sacrifices. I believe they are. But for the average consumer this program should involve little sacrifice. For most, it would not even involve inconvenience or extra expense. The average consumer would be faced with higher oil prices, but he would also have additional money that would fully compensate him. He would retain total freedom of choice.

I realize that it is not immediately apparent to the average citizen how this program as a whole would reduce consumption and yet cost him little or nothing. Education is essential and I am counting heavily on the objectivity and expertise of this Committee and its able staff to achieve it.

The Need for Business Tax Relief.

The proposed program provides tax relief for both individuals and business. Individual income taxes account for about three times as much revenue as corporate income taxes, and relief would be allotted in that same three-to-one ratio.

Businesses, like people, have been badly buffeted by our economic difficulties. Many are in precarious financial situations. One need only look at the unemployment rolls in Detroit to see how important it is to all of us to maintain a healthy climate for business. Surely, the misfortunes of the auto industry have created many more hardships for auto workers than for auto stockholders. We will all be losers if our businesses are unable to earn reasonable profits and thus to make the investments that will mean more jobs and greater productivity in the future.

The suggestion in recent years that businesses have prospered while individuals have suffered is simply untrue. Corporate profits in the aggregate, realistically stated, are at an all time low as a percentage of our total national income.

Reported profits may be higher than in the past, but they do not tell the full story. There are two major elements which substantially overstate reported earnings in periods of inflation. They are inventories and depreciation.

The inventory situation may be illustrated by assuming a company that normally maintains an inventory of 100,000 widgets. If inflation causes the price of widgets to increase by \$1, from \$2 to \$3, under traditional FIFO accounting the \$100,000 increase in the value of the inventories is reported as profits, even though the company is no better off in real terms than it was before the inflation. Economists have long recognized that this increase is not a true "profit" and the Department of Commerce national income accounts have, from the inception of those accounts in the 1940's, separated it from profit figures.

For 30 years, business taxpayers have been permitted to exclude these amounts from taxable income, but only if they reported on the same basis to their shareholders and the public. Many businesses have preferred to pay higher taxes rather than report lesser earnings to their shareholders. With the rapid inflation which has occurred in the last year, however, the penalty in increased taxes on unreal income has become so great that there has been a major shift to LIFO accounting. This is long overdue and I regret that it has taken the business world and the accounting profession so long to get there.

A similar situation exists with respect to depreciation. In a period of rapid inflation, depreciation deductions based on historical cost result in reporting as income amounts which do not represent an increase in wealth but which are required merely to stay even. In a period of constant and substantial inflation, this subject urgently needs re-examination. Under current tax and accounting rules, business management is powerless to deal effectively with this problem. Businessmen often complain that depreciation charges are too low for tax purposes because of this factor but their credibility is severely impaired by the fact that, more often than not, they report to their shareholders and the public less depreciation (and therefore more income) than that which they are permitted to deduct for tax purposes.

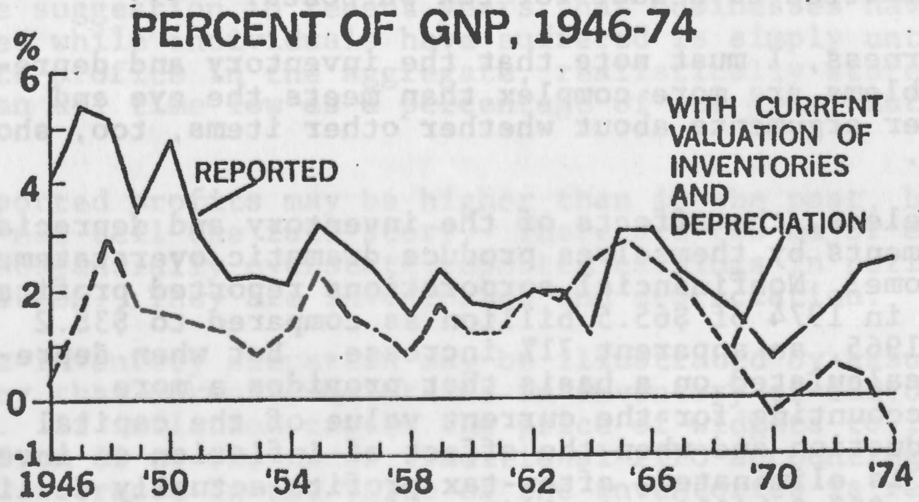
In fairness, I must note that the inventory and depreciation problems are more complex than meets the eye and raise further arguments about whether other items, too, should be adjusted.

Nonetheless, the effects of the inventory and depreciation adjustments by themselves produce dramatic overstatement of real income: Nonfinancial corporations reported profits after taxes in 1974 of \$65.5 billion as compared to \$38.2 billion in 1965, an apparent 71% increase. But when depreciation is calculated on a basis that provides a more realistic accounting for the current value of the capital used in production and when the effect of inflation on inventory values is eliminated, after-tax profits actually declined by 50%, from \$37.0 billion in 1965 to \$20.6 billion in 1974. A major factor contributing to this decline is that income taxes were payable on these fictitious elements of profits. That resulted in a rise in the effective tax rate on true profits from about 43% in 1965 to 69% in 1974. Thus, a realistic calculation shows that the sharp rise in reported profits was an optical illusion caused by inflation.

Since, in our economy, corporate profits are the major source of funds for new investment in productive capacity, all of this has grave implications for investment and growth. That is perhaps seen best in the figures for undistributed profits of nonfinancial corporations, restated on the same basis to account realistically for inventories and depreciation. It is the undistributed profits that corporations have left to fund additional new capacity (as distinguished from the replacement of existing capacity). In 1965, there were $20 billion of undistributed profits. By 1973--after eight years in which real GNP (the rest of the economy) grew 36%--the undistributed profits of nonfinancial corporations had dropped to $6 billion. And for 1974, our preliminary estimate is that the figure for undistributed profits is a minus of nearly $10 billion. That means that there was not nearly enough even to replace existing capacity, and nothing to finance investment in additional new capacity.

The following chart shows with dramatic--and frightening--clarity the true state of affairs.

UNDISTRIBUTED PROFITS OF NONFINANCIAL CORPORATIONS AS A PERCENT OF GNP, 1946-74



The business community is properly distressed that the public does not realize the seriousness of this situation. I have to say, however, that at least a portion of the blame can be laid at the door of business itself. Businesses like to report high earnings to their shareholders and to the public. Reported earnings are the "report card" for management. The willingness of business to continue using methods which overstate real economic incomes in an inflationary period leads the public to believe that business is a major beneficiary of rising prices. That causes the man in the street to believe that the total income pie is larger and that he has a legitimate claim on it, which in turn, heightens the wage spiral and intensifies the squeeze on corporate profits and the difficulty of capital formation.

The fact that these overstated profits are also subject to tax presents a serious problem that we hope you will look into when you turn to tax reform later this year. The problem is too complex to deal with quickly, but it may affect the ultimate use of the revenues allotted to business relief.

While the deterioration of business profits may not be apparent to the man in the street, or even in the stockholders' reports, the professionals have not been fooled. The devastating effect of inflation on business profits has been reflected in sharp price drops in the equity markets. This decline in the stock market has rendered it practically impossible for most companies to raise money on favorable terms in the equity markets. As a result, corporations have been forced to rely more heavily on borrowed money, thus raising their debt-equity ratios to unusually high levels and driving up interest rates. Such interest rates become a major depressant on corporate earnings. Equally important, the lessening of the equity "cushion" leaves businesses inflexible and very vulnerable to bankruptcies in a business downturn.

The oil and environmental problems have been a further and major exacerbation. The past year's increase in the cost of petroleum products has rendered many business operations substantially less profitable, if not unprofitable. The airline, auto, travel, and electric utility industries--which are all closely related to oil usage--were hard hit. Increased oil prices have caused lower profits, lesser incomes, and fewer jobs in many businesses--which, stated another way, means that businesses were not able to pass on fully increased energy costs, and were required to absorb a significant portion in the form of lesser profits.

All of these developments argue strongly that tax relief for business is both deserved and required. We should also keep in mind that our system of business taxation bears more heavily on corporations than do the tax systems of almost every other major industrial nation. Our provisions for capital recovery are more restrictive than those in most other countries. More importantly, almost all our major trading partners have in the last few years largely eliminated the classical two-tier system of corporate taxation in which income is taxed once at the corporate level and again at the shareholder level. Through a variety of mechanisms they have adopted systems of "integrating" the personal and individual income taxes so that the double taxation element is eliminated or radically lessened. This has occurred in Canada, the

United Kingdom, France, Germany, Japan, and Belgium. The European Economic Community is asking that all of its members adopt such a system. While the complexities of this subject are best left for another occasion, the point I am making does bear on the general question of whether the tax burden on our corporations is excessive and should be relieved in some degree.

The Need for Anti-Recession Stimulus.

The need for some form of stimulation must be apparent to every member of this Committee. The recession is already serious and it will get worse before it gets better. Our latest estimates indicate that the rate of unemployment should rise to approximately 8%. We continue to believe, in fact, that even in the absence of further stimulation the economy should bottom out in the middle months of the year and that we should begin a recovery phase thereafter. The temporary tax cut would be of significant help in making the recovery more solid and more certain. It would also help to reduce the unemployment rate from what it might otherwise be. Moreover, since we are likely to have a margin of slack in the economy for some time, taxes can be cut temporarily without seriously compromising our efforts against inflation. Under these circumstances, we should do what we can to strengthen the economy through a temporary reduction in taxes.

$16 Billion Temporary Anti-Recession Tax Cut.

In order to provide the needed economic stimulus, the President proposes a one-time, temporary tax reduction of $16 billion, to be placed in effect within the next 90 days. Making it temporary avoids building into the system the larger deficits that would later refuel inflation.

The temporary tax reduction will be an across-the-board refund or tax reduction for all taxpayers. The total of $16 billion is allotted $12 billion to individual taxpayers and $4 billion to business taxpayers, which is the same 3 to 1 ratio that individual income taxes bear to corporate income taxes.

Refund of 1974 Taxes to Individuals.

Individual taxpayers will receive a refund of 12% of their income taxes for 1974, with a maximum refund of $1,000 per tax return. The great majority of taxpayers would thus benefit in proportion to the income taxes they pay for 1974, but high-income individuals would not receive excessively large refunds.

Taxpayers are now filing their income tax returns for 1974 and nearly all will be filed by April 15. All taxpayers will continue to file their returns and pay income tax in accordance with present law. After their returns are filed, the Internal Revenue Service will calculate the amount of their refund, which will then be paid to them by checks in two equal installments.

I cannot emphasize too strongly the point that individuals should continue to file their tax returns in accordance with existing law. The sooner they do that, the sooner the system will be able to process their returns and mail their refunds. They should, under no circumstances, try to compute and deduct their own refunds. If they do, they will face possible fines and penalties and, at a minimum, an Internal Revenue Service examination of their return will probably be necessary to straighten out their final liability.

If, as requested by the President, the 12% refund is enacted by April 1, 1975:

--refund checks for the first installment--in total about $6 billion--would begin to be mailed in May and would continue through June as the later filed returns are processed; and

--refund checks for the second installment of the remaining $6 billion would be mailed in September.

The effect of the tax refund can be illustrated for a family of four as follows:

Adjusted Gross Income	Present Tax	Proposed Refund	Percent Saving
$ 5,000	$ 98	$ 12	-12.0%
7,000	402	48	-12.0
10,000	867	104	-12.0
12,500	1,261	151	-12.0
15,000	1,699	204	-12.0
20,000	2,660	319	-12.0
40,000	7,958	955	-12.0
50,000	11,465	1,000	- 8.7
60,000	15,460	1,000	- 6.5
100,000	33,340	1,000	- 3.0
200,000	85,620	1,000	- 1.2

Taxpayers with incomes of less than $15,000 now pay 31% of the income tax, and they will receive 36% of the refund. Eighty percent of the refund will go to taxpayers with less than $30,000 of income who pay 68% of the income tax. At the upper extreme, 24% of the income tax is paid by taxpayers with incomes in excess of $40,000. These taxpayers will receive only 11% of the refund.

Adjusted Gross Income Less Than:	Percent of 1974 Tax Liability Before Refund	Percent of Refund
$ 10,000	13.0%	15.1%
15,000	30.8	36.0
20,000	48.4	56.6
30,000	68.5	80.0
40,000	76.3	89.1
50,000	80.8	93.4
100,000	90.8	98.7

This proposed method of tax relief has the following advantages:

- Larger amounts can be returned faster by mailing refund checks based on 1974 taxes, than by reducing tax liabilities for the year 1975.

- A reduction in 1975 tax liabilities would be achieved through reductions in withholding. It would not occur for at least a month after enactment of the tax reduction and then only in relatively small weekly or biweekly amounts stretching all the way through December of this year.

- With a refund based on 1974 taxes, taxpayers will know more precisely the total reduction they will receive and can plan accordingly, thus accelerating the stimulative impact.

- Receipt of two relatively large refund checks should have a greater psychological effect on family budget decisions and consumption attitudes than receiving the same total a few dollars at a time, thus increasing the impact of the $12 billion temporary tax reduction. This should also help the sales of cars, furnishings and other big ticket items that have been depressed by the recession.

- With a refund based on 1974 taxes, taxpayers will be assured of getting the refund whether or not their incomes may be reduced or uncertain in 1975. Thus, taxpayers who had jobs in 1974 but are now unemployed would be assured of refunds; they would not receive such refunds if they were applied only to 1975 income.

- Paying the refund in two checks rather than one will ease the strains on the capital markets that would be caused by the Treasury's financing of the entire amount all at once.

Emergency 12% Investment Credit.

The remaining $4 billion of the total $16 billion temporary tax refund and reduction will go to corporations, farmers and other business firms in the form of a one-year increase in the investment tax credit. That should stimulate the demand for capital goods and help increase productivity and employment.

The investment tax credit would be increased temporarily to 12% for qualified machinery and equipment placed in service in 1975 or ordered by the end of 1975 and placed in service by the end of 1976. As under existing law, special rules apply to property constructed by the taxpayer or to his special order.

We propose that this increase in the investment credit be effective beginning January 1, 1975. That is extremely important, as we want businesses to move ahead promptly with new investment, and it would be most undesirable if they were to suspend purchases and orders until Congress has finally acted. For this reason, Congress has in the past adopted a retroactive effective date like that proposed, and based on our conversations with members of the tax writing committees we are confident that it will do so here, too, if the proposal for an increase is ultimately enacted.

Because of the need for speedy enactment and because this emergency increase in the rate of the investment tax credit is for only one year, no other changes or restructuring of the present investment tax credit are proposed at this time, except for utilities. Because of the particular plight of the Nation's regulated public utilities, we recommend that the following additional changes be made:

- The discrimination against public utilities, which under current law are allowed only a 4% investment credit, would be eliminated permanently. Under the temporary emergency investment tax credit, and thereafter, public utilities would receive the same general investment credit rate as other businesses.
- The provision of present law which limits the maximum credit to 50% of liability for tax in excess of $25,000 would be modified in the case of regulated public utilities. The limitation would be increased to 75% in 1975, and be reduced by 5 percentage points each year through 1979, returning to 50% in 1980.

The proposed 12% rate would be extended for two additional years, through 1977, for property, not fired by oil or gas, that provides power to electric generating facilities, including property converted from oil or gas use. This two-year extension will provide significant incentives for the development and use of nuclear, geothermal, coal, hydro, solar and other petroleum-saving power sources.

Increasing the rate of the investment tax credit has proved very helpful in reversing adverse economic trends. When the investment tax credit was repealed and other provisions increasing the tax burden on business were enacted in 1969, there followed a period of rising unemployment and business stagnation. Subsequent to the reenactment of the credit in 1971, new investment increased by 9% in 1972 and 13% in 1973. Further, in the period 1972-1973 industrial production increased 19% and there was a significant decline in unemployment.

Energy Taxes in General

The goal of the energy tax package is to reduce total consumption of oil and natural gas, which will reduce imports in like amount.

The package has three parts:

(1) An import fee increase ultimately settling at $2 per barrel on crude oil and products and a corresponding excise tax on domestic crude oil.

(2) Decontrol of crude oil prices and a Windfall Profits Tax.

(3) Price decontrol of new natural gas and the equivalent of the $2/bbl. oil excise tax (namely, 37 cents/thousand cubic feet) on all natural gas, to curtail its use and discourage switching from fuel oil to natural gas.

This combination of fees, taxes and decontrol will raise the prices of oil, and gas and related products relative to other prices. That will discourage their unnecessary use, encourage the substitution of other energy sources, and induce the replacement of existing energy-using devices.

Gasoline Tax as Alternative.

Many persons have suggested that a gasoline tax would be preferable to taxes on crude oil.

There are several reasons for preferring a tax on crude oil to a gasoline tax:

. A price increase in crude oil is far more effective in reducing consumption than a gasoline price increase. The increased prices under the proposals amount to about 10¢ per gallon, distributed across all of the products that come from a barrel of crude. It would take a gasoline tax of 45¢ to 50¢ per gallon to achieve the same reduction in consumption. There are two explanations for that. First, since the price of gasoline is higher than for other refinery products, a larger cents per gallon change is required to get the same percentage change. Second, gasoline accounts for only about 40% of the barrel of crude and a tax on only 40% must obviously be higher than a tax on 100%.

With a 45¢ to 50¢ gasoline tax, gasoline prices would rise an aggregate of $45 billion. That compares with oil price increases of only $21 billion under the proposed program.

Crude oil--not gasoline--is the problem. We want to reduce consumption of each of the elements in a barrel of crude.

. There is just as much opportunity to conserve other petroleum products and other forms of energy and energy intensive products as there is to conserve gasoline. For example, many thermostats could be turned down with no real discomfort. Our trash cans are heaped with direct petroleum products such as plastics, and other products that require large amounts of petroleum related energy to create, such as aluminum. We can conserve a little on a wide range of items and save a lot in total.

. It is fairer to let all petroleum users make a moderate adjustment than to impose a drastic increase on just gasoline users. And it is easier for the economy as a whole to accommodate a moderate, broadly distributed increase than a very large, more narrowly based increase. The proposals avoid devastating the automobile industry, the travel industry, and others which depend on gasoline for survival.

$2 License Fee and Excise.

The U.S. now imports about 4.1 million barrels per day of crude oil and about 2.6 million barrels per day of fuel oil and other refinery products. An additional import fee of $2 per barrel on crude and product is to be imposed in stages of $1 each on February and March 1 by Presidential Proclamation under the authority of the Trade Expansion Act of 1962. In addition, if Congress has not enacted the excise tax on domestic oil by that time, the import fee will be raised another $1 on April 1, for a total increase of $3. Adjustments in the fees on imported products will be made to reflect obligations under the old entitlements program.

The $2 per barrel increase in the fee will raise the average price of imported crude oil and its products by $2 per barrel. In the case of crude oil, that means an increase from around $11 per barrel to $13 per barrel. Domestic crude would also sell at about $13 per barrel, and the excise tax of $2 would leave the effective price to domestic producers also at $11 per barrel.

The import fees will bring in revenues of $3.2 billion in 1975 and $4.1 billion in 1976 and the excise tax will raise $4.8 billion in 1975 and $7.2 billion in 1976.

Decontrol and Windfall Profits Tax.

Last year the United States produced 9.2 million barrels of crude oil per day. We now produce only about 8.8 million barrels of crude oil per day, approximately 60% of which, or 5.3 million barrels, sell at an average price of $5.25 per barrel because of price controls. If present controls continue, this year's production will decline further to perhaps 8.6 million barrels per day. Our system of price controls is seriously counterproductive to our need for greater domestic supplies.

An illustration of the way that price controls discourage production occurs in connection with the "stripper well" exemption, which permits oil produced from leases which average fewer than 10 barrels per day per well to sell at the world price. The exemption encourages producers to let their wells decline from 15 or 16 barrels a day to 9.9 barrels per day. They actually make money by suffering a production decline.

Another illustration arises in connection with secondary and tertiary recovery processes, which are used to stimulate additional production after original production has declined. Those processes are costly and part of our production decline is attributable to the fact that they are uneconomic at controlled prices. Money will not be invested to produce more controlled oil at $5.25 per barrel if it can be invested in producing uncontrolled oil at $11 per barrel, or in some completely unrelated business at a higher rate of return. Regulation of prices drives people out of the regulated business and into other lines of business not so subject to uncalculable, nonmarket risks. Price controls were imposed as a means of preventing windfall profits, but clearly we must find a more sensible approach.

The combination of price decontrol and the Windfall Profits Tax is a workable solution to the problem. In 1975, we estimate that a producer of controlled oil would receive $11 per barrel after decontrol (net of the $2 excise), or an increase in price of $5.75 per barrel ($11.00 - $5.25 = $5.75). The Windfall Profits Tax proposed would average $4.53 per barrel, reducing the producer's net price increase to $1.22 per barrel. That $1.22 translates into about 76¢ per barrel after tax.

After decontrol, the price for all oil will be the same, thus eliminating all the inefficiencies of the two-tier pricing system. Producers of uncontrolled oil will begin to pay a windfall tax on the increased prices they have enjoyed for more than a year. As a result, they will pay $2.81 per barrel more tax on those increased profits than they paid last year. Producers of controlled oil will begin to receive the same increased prices but will be permitted to keep only 76¢ of that increase. Both controlled and uncontrolled oil will receive the same prices and pay the same taxes.

	Uncontrolled Oil	Controlled Oil
Price per barrel	$11.00	$11.00
Former price	(11.00)	(5.25)
Net price increase	-0-	5.75
Windfall Profits Tax	(4.53)	(4.53)
Gain (loss)	(4.53)	1.22
Income tax at 38%*	1.72	(.46)
Net effect after tax	($ 2.81)	$ .76

*Corporate rate of 48% adjusted for percentage depletion and minimum tax.

Most significant producers have both controlled and uncontrolled oil and, compared with last year, they will net less on the uncontrolled oil and net more on the controlled oil. For the industry as a whole, net after-tax income will be reduced by $2 billion, which means that the benefits from decontrol will be more than offset--by $2 billion--by additional taxes paid to the Treasury. Those Treasury revenues are among those to be returned to taxpayers in the form of tax reductions.

The concept of the proposed Windfall Profits Tax is the same in general as the Windfall Profits Tax proposed last year, although the new proposal has been structured to raise substantially higher revenues. In summary, the tax is designed to capture a windfall profit--that is, one which results from a sudden change in price caused by a circumstance which is accidental and transitory. It is difficult to separate ordinary market prices from prices which permit windfall profits (or "excess" profits if one wishes to think of it that way). We have made an estimate--a judgment--as to the "long-term supply price," i.e., the minimum price to producers that will be sufficient to induce an increase in our supplies of oil sufficient to make us energy independent by 1985. Our judgment is that the price required for this is around $7 to $8 at today's price levels, assuming the continuation of percentage depletion. The tax is designed to permit producers to retain an amount equal to the long-term supply price by the time additional oil supplies will be coming on line three to five years from now.*

*If percentage depletion should be eliminated, the net to producers from a $7 to $8 price would be reduced, a higher price would be required to produce the same net return and the same oil production, and the proposed Windfall Profits Tax base and brackets would need to be revised upwards accordingly.

The proposal does not include a credit for so-called "plowback" investments, nor does it include exemptions for certain classes of producers. Plowback is not justified because the amounts oil producers will retain, after the tax as it is structured, will provide a price incentive sufficient to attain our energy independence goals. To put it another way, there is no convincing evidence that permitting a plowback credit will produce significantly more energy than not doing so. Further, a plowback credit means that persons already engaged in oil production can make investments with tax dollars supplied by the government, while new investors must use their own money. We do not believe that kind of discrimination and anti-competitive effect can be justified.

In the case of different classes of producers, we simply believe that a windfall produced by cartel prices is a windfall to large and small producers, high- and low-cost producers and producers located everywhere. Producers all receive a cartel price and not a free-market price.

The issue of plowbacks and special exemptions ultimately boils down to whether windfall profits should go to oil producers or to the public in the form of tax reductions. The permanent tax reductions proposed depend upon the government receiving these revenues. If the revenues are curtailed, the tax reductions will need to be curtailed, too. We have tried to design a tax that will not inhibit those investments in oil production which are economic and which are needed to reach our goals. If we believed that the tax would inhibit needed investment, we would not propose it. Plowback credits and special exemptions would undoubtedly make existing oil producers wealthier than they would otherwise be, but would not significantly increase oil production. It is taxpayers generally who pay the prices that produce the windfall, and the revenues should go for the benefit of taxpayers generally.

Decontrol of New Natural Gas and Excise Tax.

Natural gas shortages last year forced major curtailments of supplies to many industrial firms and denial of service to many new residential customers. Curtailments and denials are much greater this year and are causing not only extra costs and hardships, but, in many cases, business close-downs and loss of jobs.

New natural gas goes primarily into intrastate, uncontrolled markets where prices range around $1 per thousand cubic feet ("m.c.f."). Gas in the interstate market averages less than 40¢/m.c.f. The result is that interstate supplies are insufficient, and the energy gap in nonproducing states is made up with imported oil, which on a BTU equivalent basis costs about $2.00, and with imported liquefied natural gas at $1.80/m.c.f. Deregulation will permit new domestic gas to flow into the interstate markets with an aggregate savings to existing customers in those markets, an end to curtailments, and a net saving in national resources.

Whether or not new natural gas is deregulated, the President proposes an excise tax of 37¢/m.c.f. on natural gas. That is equivalent, on a BTU basis, to the proposed $2.00 excise tax on oil and will prevent fuel oil users from switching to gas. It will also bring the average interstate price close to the market clearing price (the price at which supply and demand will coincide), and end the careless use of this fuel by those for whom it is cheap at present prices.

An equivalent tax, based on BTU content, will also be placed on natural gas liquids. Gas wells produce about 86 percent "wet" gases and 14 percent "dry" gases. The wet gases are treated to remove the natural gas liquids, such as propane and butane, and the dry gas goes on into the natural gas pipeline. The dry gas and liquids will thus be treated consistently. For example, the tax on natural gas liquids sold in mixed stream would be $1.43 per barrel.

The liabilities for this tax would be $6.3 billion in calendar 1975 and $8.5 billion in calendar 1976.

Effectiveness of Energy Package.

The energy package will reduce consumption significantly, with modest adjustments by most of our citizens.

It is natural for businessmen and consumers to react to a sudden increase in price of particular goods with the thought: "This will merely increase my costs. It won't cause me to reduce my purchases." That reaction reflects the fact that we are creatures of habit. But we are also rational beings who adapt our habits to changing circumstances.

When meat prices rose sharply in the early months of 1973, the instantaneous response was a loud complaint as each of us found his grocery bill inflated. In time, we adjusted to the higher price by buying less meat. There is no doubt that the portions of meat being served by many families today are smaller than they were only three years ago. We didn't like it, but it had to be done. There was no other way to adjust to the new situation--no way that was better.

So it will be with energy. None of us relishes the prospect of higher oil and gas prices. We have all developed habits of energy use conditioned by two decades of declining relative prices of energy. As in the recent experience with meat, after the initial shock of resentment at the higher prices of petroleum products and gas, our rational selves will take over and we individually and collectively will find ways to reduce our useage of energy.

Immediately, we will slice smaller portions of the energy pie for ourselves:

- We will turn off the lights when we leave the room to save electricity bills.
- Thermostats will be adjusted downward in winter, upward in summer, and heat will be turned off in rooms not in use.
- Marginal trips in cars will not be taken; some second and third cars will be scrapped.
- Married couples will look closer-in for their first home, and possibly settle for an apartment instead of a detached home; and owners of homes and buildings who formerly considered the fuel savings from insulation, weather-stripping, and otherwise improving the thermal efficiency of structures too costly to obtain will now reconsider.

Equally important, over the longer run:

- Industrial firms, ever on the lookout to cut costs, will speed-up the replacement of energy-using machinery and processes that were perfectly adequate in the days when oil cost $3 a barrel and gas only a few cents per thousand cubic feet, with substitute equipment and processes that may have higher initial costs but which consume less energy and thus have lower over-all costs of operation.
- Families will replace their present autos featuring comfort and speed at the expense of low mileage with lighter and more utilitarian cars that use less of the now expensive energy; and they may eliminate some of their most frivolous appliances while replacing others with initially more costly but more energy-efficient substitutes.
- Materials which require large amounts of energy to produce will be displaced by substitute materials which have become relatively cheaper because their production consumes less energy.
- More recycling will occur.
- The higher relative cost of oil and gas as energy resources will stimulate the development of other energy sources. Oil and gas will fill a smaller share of energy requirements. Just as coal displaced wood as our basic energy source, and oil and gas displaced coal, oil and gas will be displaced.

All of these examples are illustrations of what in the technical jargon of economics is known as "price elasticity of demand": quantities of things consumed decrease when their prices rise relatively to other prices. Every food merchant knows he will sell more bananas and oranges when a crop failure causes the prices of apples and pears to be high, and vice-versa. He may not have heard the term "price elasticity," but he knows how it operates.

Yet many remain skeptical that there is price elasticity in the demand for oil, or that if there is any, whether it is sufficiently large to make any difference in the volume of our oil imports. Experience since 1973 should put doubt to rest even if the findings of such major research efforts as those of the Ford Foundation Energy Project and the Federal Energy Administration do not.

For example, during the decade prior to 1974 when utility rates were steady, consumption of electric energy increased at a rate of 7.4%. Normally, one would expect any given period in 1974 to be 7.4% higher than the comparable period of 1973. But for the six-month period April through September, 1974 consumption was not 7.4% above 1973, it was one percent less, a swing of 8.4 percentage points below expectation. Some of this reduction in consumption could be attributed to the then just perceptible slowing-down of the economy, but a major portion of the reduction can be attributed to the energy price effects on electric utility rates. Experience with oil demand and prices is similar. During the decade prior to 1974, total U.S. petroleum demand increased at an annual rate of just over 5%. But the April-September 1974 petroleum demand was under the comparable 1973 period by 2.7%, a swing of 7.7 percentage points below expectation.

We need another reduction in petroleum useage of about 5% in order to reduce consumption by a million barrels a day. All of the econometric data indicates that the proposed price changes are on target.

Econometric models of the economy, such as those underlying the Ford Foundation Energy Project report, A Time To Choose, and the Project Independence Report, suggest that the short-term responses to energy price increases that we have already seen are half, or less, of the long-term response we can expect after households and business firms have had an opportunity to adapt fully to the higher costs of energy.

Thus, we have confidence that the President's energy program will easily achieve the one million barrel reduction in consumption by the end of this year and an additional one million barrel reduction by 1977.

Permanent Tax Reduction and Restructuring.

The Treasury will collect an additional $30 billion in taxes from the windfall profits tax and the excise taxes and fees on oil and natural gas. The private sector will bear an estimated $25 billion of that in the form of higher costs of energy related items they buy, and Federal, state and local governments will bear the remainder.

The $25 billion paid by individuals and businesses will be returned to the economy by the permanent reductions in individual and corporate income taxes. Like the temporary anti-recession tax cut, the $25 billion total is divided in approximately the ratio of individual and corporate income tax payments generally, so that about $19 billion is allocated to individuals and $6 billion to corporations.

These are major income tax reductions. They accomplish multiple purposes, rest on multiple foundations, and should be considered in that way.

First, the changes proposed in the individual and corporate income tax structures are desirable on their own merits. They have heretofore been too expensive to accomplish within existing revenue constraints.

Second, these tax reductions return to the economy the energy conservation taxes. Thus, the energy conservation measures reduce energy consumption without reducing the aggregate purchasing capacity of the private economy.

Third, these income tax reductions will provide energy consumers with additional after-tax spendable income to help meet higher energy costs if they still wish to consume the same amount of energy as before. Alternatively, they can buy more of other products and cut back on their energy consumption--and many will do that. The income tax reductions are such that most individuals in the lower and middle income range, up to about $15,000, will receive tax reductions greater than their increased energy costs even if they should choose to continue consuming the same amount of higher-cost energy. Taxpayers in higher income brackets will receive significant income tax reductions also, but generally less in proportion to their greater expenditures for energy.

Fourth, these permanent income tax reductions are approximately similar to what is required to offset the so-called "bracket and deduction compression" caused by inflation over the last three years. Because deductions and rate brackets are stated in dollar terms, when inflation causes money incomes to rise, deductions offset a lesser portion of the same real incomes and the remainder is taxable in higher brackets.

Benefit for Individuals.

For individuals, the President proposes an income tax reduction of $16-1/2 billion beginning in 1975. This will be accomplished--

- By increasing the Low Income Allowance from its present level of $1,300, to $2,600 for a couple and $2,000 for single taxpayers, which will provide benefits of------------------------ $5 billion
- And by cutting in half, from 14 to 7%, the tax rate for the first taxable income bracket and making substantial, but smaller, reductions in tax rates in the next four brackets,1/ which will provide additional benefits of------- $11-1/2 billion

Low Income Allowance.

The Low Income Allowance is the minimum standard deduction allowed to everyone regardless of his income level or the amount of deductions he actually has. In combination with the $750 personal exemption, the Low Income Allowance determines the minimum or base income on which no income tax is levied. In 1969, Congress defined the threshold taxability level by reference to so-called "poverty level" data, the assumption being that families with "poverty level" incomes did not have the requisite ability to pay and should be excused from liability. The Low Income Allowance was the mechanism adopted to achieve that result

The Low Income Allowance is now $1,300. That means that a family of four with four $750 personal exemptions for a total of $3,000, plus a $1,300 Low Income Allowance, currently does not pay income tax if its income is $4,300 or less.

1/ Illustrates rate changes for married persons filing jointly. Comparable changes are made in other rate schedules.

Because of inflation, the poverty level for a family of four is now estimated to be about $5,600. Nevertheless, under present law, this family would in 1975 be required to pay income tax of $185.

The proposed increase of the Low-Income Allowance to $2,600 on a joint return will bring the nontaxable level for the family of four up to the new poverty level of $5,600, which is $3,000 of personal exemptions plus the new Low-Income Allowance of $2,600. The proposed increase in the Low-Income Allowance will also make comparable changes for single persons and families of other sizes, as shown by the following table.

No. in the Family	Estimated 1975 Poverty Level	Tax-Free Income Level Present	Proposed
1	$2,850	$2,050	$2,750
2	3,686	2,800	4,100
3	4,382	3,550	4,850
4	5,608	4,300	5,600
5	6,618	5,050	6,350
6	7,446	5,800	7,100

Increasing the Low-Income Allowance to the levels proposed will provide benefits of about $5 billion to low-income taxpayers and relieve from income tax altogether over 5 million presently taxable returns.

Reduction of Tax Rates.

In addition to the change in the Low-Income Allowance, which benefits the lower income taxpayers, the proposals will reduce income tax rates for the 62 million remaining taxpayers in a generally progressive manner.

The present income tax rates for married persons filing jointly would be reduced as follows: The 14% rate reduced to 7%; the 15% rate reduced to 10%; the 16% rate reduced to 13%; the 17% rate reduced to 15%; and the 19% rate reduced to 17% for part of the present bracket and the balance of that bracket to remain at 19%. Rates for other income brackets would remain the same, except that the present 28% and 32% rates would be increased 1 percentage point each. Taxpayers with incomes falling in those brackets would still have a substantial net reduction in liability because a part of their income will also be taxed in the brackets in which rates have been reduced. Comparable reductions will be made in the tax rates for single returns and other types of returns also. The revised rate schedules are set forth in the appendix.

Progressive Income Tax Reduction.

The effect of the two elements of the proposed income tax reduction for individuals, both singly and in combination, is progressive. The proposed tax reductions are proportionately greater in both dollar amounts and percentages toward the lower end of the income spectrum. Nevertheless, taxpayers at all income levels share significantly in the proposed reductions.

The benefits from doubling the Low-Income Allowance are heavily concentrated in the adjusted gross income classes below $5,000, $10,000 and $15,000. The benefit of the reduction in tax rates goes 96% to persons with adjusted gross incomes below $20,000 and 89% to those below $15,000. When the two tax reductions are combined, 41% goes to persons with adjusted gross incomes below $10,000, 70% to persons with adjusted gross incomes below $15,000 and 86% to those below $20,000.

The following table shows the percentage reduction in the income tax by income class:

1975 Levels

Adjusted Gross Income Class ($000)	Income Tax Paid Under Present Law ($ billions)	Amount of Income Tax Reduction	Percentage Reduction in Income Tax
0 - 3	$ 0.3	$- 0.25	-83.3%
3 - 5	1.8	1.20	-66.7
5 - 7	4.0	1.96	-49.0
7 - 10	8.9	3.38	-38.0
10 - 15	21.9	4.72	-21.6
15 - 20	22.8	2.70	-11.8
20 - 50	44.4	2.15	-4.8
50 - 100	13.5	0.11	-0.8
100 and over	13.3	0.03	-0.2
Total	130.9	-16.50*	-12.6

*Does not include payments to nontaxpayers.

Some have suggested that there is no reason to cut taxes at all for upper bracket taxpayers. We believe, however, that fairness requires some--though lesser--relief in the upper brackets. It is important to remember that:

- Only about 12% of all taxpayers have gross incomes above $20,000, and they now pay about 52% of total individual income taxes. They will pay an even higher percentage of individual income taxes if our proposals are enacted.

- Upper income individuals have been adversely affected by inflation, just as lower income individuals. The prices of the things they buy have increased too, and since they buy more, the increase is greater. Also, "bracket and deduction compression" has adversely affected high-income taxpayers just as it has affected lower income taxpayers. Everybody has had, in effect, an income tax increase because of inflation.

- Upper income taxpayers play a disproportionately large role in providing the investments which help everyone's income to increase.

The following table illustrates the tax reductions that will be received by a typical family of four at various income levels.

Adjusted Gross Income	Present Tax 1/	New Tax	Tax Saving	Percent Saving
$ 5,600	$ 185	$ 0	$185	100.0%
7,000	402	110	292	72.6
10,000	867	518	349	40.3
12,500	1,261	961	300	23.8
15,000	1,699	1,478	221	13.0
20,000	2,660	2,450	210	7.9
30,000	4,988	4,837	151	3.0
40,000	7,958	7,828	130	1.6

1/ Calculated assuming Low-Income Allowance or itemized deductions equal to 17% of income, whichever is greater.

Increased Energy Costs Compared with Tax Reductions.

The proposed changes in the structure of the individual income tax stand on their own merits and were not designed primarily to offset increased energy costs.

Solving the oil problem will require the public, and particularly large energy users, to make adjustments that will be unpopular and which in some cases will cost money. Nonetheless, the proposed tax reductions are very substantial for low and middle income taxpayers below the $15,000 income level and we believe are, on average, sufficient to more than offset the average increases in their energy costs. The Council of Economic Advisers has calculated that the increase in the Consumer Price Index attributable to this program will be 2% or less. Others have suggested different percentages.

The following table provides some guidance by indicating how much the tax reductions add to after-tax disposable income. It is after tax income which individuals have at their disposal to buy goods and services, including energy. If the cost of living goes up 1%, a 1% increase in after-tax income should leave the average taxpayer even. The table indicates that with a rise in prices of 2% or less, average taxpayers through the $15,000 AGI class will be ahead.

Adjusted Gross Income Class ($000)	After-tax Income	Proposed Tax Reduction	Reduction as a Per-cent of Present After-tax Income
	(.........Billions.....)		(.....Percent.....)
0 - 3	21.7	0.3	1.2 1/
3 - 5	33.2	1.2	3.6 1/
5 - 7	46.0	2.0	4.2
7 - 10	86.1	3.4	3.9
10 - 15	183.1	4.7	2.6
15 - 20	162.2	2.7	1.7
20 - 50	235.6	2.2	0.9
50 - 100	36.5	0.1	0.3
100 and over	21.7	*	0.1
Total	826.1	16.5	2.0

*Less than 50 million
1/ Many taxpayers in the two lowest income classes will benefit from the $80 special distribution.

$2 Billion for Payments to Nontaxpayers.

Individuals whose incomes are so low that they do not pay any income tax will not benefit from the income tax reductions. Because of their low incomes, these persons are likely to have the least flexibility in shifting their consumption patterns as energy becomes relatively more costly.

In order to avoid hardships from higher energy costs, an additional $2 billion of the energy tax revenues has been allocated to provide cash payments of $80 to each adult in this low income, nontaxpayer category. These persons will thus not be forced to reduce their energy consumption, although they, like others, will have the choice. In addition, very low income persons who now pay some income tax and who will receive some benefit from the proposed tax reductions will also be eligible to receive distributions in amounts approximately sufficient, when added to the income tax reduction, to give them a total benefit of about $80 per adult. In total, this payment system is estimated to involve about 26 million adults, 21 million of whom are nontaxpayers under present law, and to provide a total benefit to them of about $2 billion.

Payments will be made as early in 1975 as possible, and if the energy taxes are enacted by April 1st, as the President requests, we believe that payments can be made in the summer. The payments will be made by the Internal Revenue Service and will be based on a return--comparable to a very simple income tax return--filed by those persons eligible. In designing this system for payments, emphasis has been placed on making it simple and speedy. While we should be generous in order to be certain that we have avoided genuine hardships, we should not create an additional welfare system or bureaucracy.

The essential details of this system for cash payments are as follows:

Adults 18 years or older and not eligible to be claimed as a dependent on an income tax return would file with the Internal Revenue Service a simple income tax return showing their name, social security number and their adjusted gross income for 1974.

- Adults are eligible to file and receive a payment if they are married persons filing a joint return and their adjusted gross income is less than $5,500 and if they are single persons and their adjusted gross income is less than $2 750.

To take account of the fact that some persons eligible for payments will also receive income tax reduction, payments will be made under the following schedule:

For Married Persons Filing Joint Returns

If their income is $4,500 or less, the payment is-------------------- $160

If their income is more than $4,500, the payment is reduced by $4 for every $25 of income over $4,500

For Single Returns

If their income is $2,250 or less the payment is-------------------- $ 80

If their income is more than $2,250, the payment is reduced by $4 for every $25 of income over $2,250

This schedule of payments will result in phasing-out the payments as income rises to the level where the amount of income tax reductions that have been received equal $80, or $160 on joint return. For example, a married couple with two children and income of $5,600 would have received $185 of income tax reduction and would therefore receive no additional cash payment.

Because the payment system is simple and distinguishes only between single returns and joint returns, there cannot be complete precision and some persons will receive payments which, when combined with income tax reductions, will vary somewhat from the $80 per adult minimum. Imprecision is the price of simplicity. Precision can be obtained only with returns that report the number of personal exemptions and itemized deductions--i.e., a full tax return. Exemptions and deductions are major problems, even with higher income persons, and, as a practical matter, would be unpoliceable on these returns. The $80 per adult minimum is an average and somewhat arbitrary (though generous) figure in the first

instance, and it would be quixotic to construct a second and complicated tax system to see that no family, regardless of size or need, varied slightly from the figure.

The amount of $80 per adult appears adequate to compensate individuals in these low-income classes generally, with a margin for extraordinary situations. The total increase in energy cost for the households represented by the about 26 million adults who will participate in the $80 payment system is estimated to be $1.3 billion, an average of $50 per adult. This group includes 17 million single adults and 9 million married persons who would file jointly. Thus, the average increase in energy cost per filing unit, or roughly speaking, "household," in this category is about $60. Looked at another way, the increase in energy cost may induce an increase in the Consumer Price Index of as much as 2%. A 2% increase for a person with $2,000 income would be only $40, and for a family with an income of $5,000 would be only $100.

In contrast, total benefits of $2.1 billion are proposed for this group by the combination of cash payments and income tax reductions. The basic benefit will be $80 for a single adult and $160 for a married couple.

In addition there are another 7 million adults whose adjusted gross incomes are below $5,000, but who will receive $80 or more entirely through income tax reductions.

Residential Conservation Tax Credit.

To complete the total of $19 billion of tax and cash payment benefits for individuals, a residential conservation tax credit will be allowed for expenditures for thermal efficiency improvements for existing homes. Such improvements include storm windows and doors, and insulation and weather-stripping. The credit will be effective for years 1975, 1976 and 1977 and the maximum credit allowed over that three-year period will be $150 per family. It is estimated that at least 18 million homes will be eligible for the credit and that the total credits will be $500 million annually for the three years.

Corporate Tax Rate Adjustment.

The President proposes that the corporate tax rate, which is now 48%, be reduced to 42%. This will provide benefits of approximately $6 billion. This reduction will be accomplished by reducing the corporate surtax rate on taxable income in excess of $25,000 from the present 26% to 20%. The basic or normal rate applicable to all corporate taxable income will remain at the present 22%. Thus, the first $25,000 of a corporation's taxable income will continue to be taxed at a rate of 22%. The balance will be taxed at a total normal and surtax rate of 42%. We propose that the reduction be made in the high surtax rate because that is where the excessively heavy double tax burden on corporate earnings falls. Corporations that pay only the normal tax rate of 22% are paying tax at about the average top marginal tax rate of individuals.

The reasons for recommending reduction in corporate taxes by means of a rate reduction instead of by some other means are as follows:

Rate reduction is the most neutral way of reducing corporate taxes. Neutrality means that all corporations now paying at a 48% rate will share in the tax reduction, will have maximum flexibility in making business and investment decisions, and can therefore operate most efficiently without regard to tax consequences.

Reduction of the presently high corporate tax rate will be the most meaningful and symbolic signal to business, to investors and to the market of a serious intent to assist business. This type of tax reduction will provide corporations the maximum assurance of continued more favorable climate for the long-term investment decisions that are necessary to ensure prosperity and control inflation.

Rate reduction has a character of permanence. We have proposed to make the permanent tax reduction for individuals in large part by rate reduction. We should do the same for corporations.

The amount of the proposed corporate tax reduction of about $6 billion is approximately the 25 percent corporate share--when divided in the 75%-25% ratio of corporate and individual tax payments--of the total of $25 billion of permanent tax reductions and payments we propose to make. This proposed corporate tax reduction of $6 billion reflects

the fact that corporations, too, will have an additional burden from higher energy costs. Corporations will bear these additional costs in a variety of ways--higher energy costs reflected in costs of equipment they buy, not all of which they will be able to pass on to consumers; reduced sales and lower prices for some products as demand for energy is reduced; and the additional capital equipment and other costs that will be involved for many corporations in shifting over to lesser energy using processes and products.

As their energy costs increase, business will be under pressure to pass these costs through to consumers and they will be successful in varying degrees. To the extent that this increase in cost is offset by a decrease in income tax cost, a part of that pressure to pass through energy costs to consumers will be relieved.

Corporate tax reduction is seldom politically popular, because it is levied against an inanimate entity. But corporate taxes are borne by people--in part by people generally in the cost of what they buy from corporations, and in part by shareholders in the form of a reduced return on the capital they have invested in the businesses.

In recent years other nations, including our principal trading partners, have recognized this and adopted various "integration" plans which move towards eliminating the double tax on income earned in corporate form. But the United States still imposes a double tax on income earned from a business conducted in corporate form, thus taxing that income more heavily than other income.

As you consider the President's proposal to reduce the corporate rate from 48% to 42%, you should have firmly in mind that income earned in a corporation would still be taxed at 42%, and then taxed again at rates going up to 70% when paid out as a dividend--producing a maximum tax of 82.6%.

I have already discussed the compelling reasons for a reduction in corporate taxes wholly apart from any increase in energy costs. These reasons are real and serious. While corporate tax reduction may be unpopular, the consequences of increasing unemployment and declining productivity will be even more unpopular. They already are.

Conclusion.

It is clear that our country faces serious economic problems. I am confident that we can solve them. They are complicated problems and their solutions will require painstaking attention and balanced judgments. The President's program, which I have outlined to you, provides an integrated blueprint for action. I am confident that as we consider the problems in the objective and professional manner for which this Committee is distinguished, we will be able to reach joint decisions that will set us back on the path to continued prosperity. I look forward to working with you.

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THE WHITE HOUSE

WASHINGTON

FEB 15 1975

Dear Sid:

I have your letter of January 31 and, for the purpose of keeping the records straight, I will, of course, accept your resignation as Deputy Assistant to the President, effective on this date.

In doing so, I welcome this opportunity to thank you for your more than five years of service to our Nation in several responsible positions of economic policymaking. These are particularly challenging times for economists, and I know the exceptional demands that have been placed on you. You have always carried out your responsibilities, however, with skill and energy and have made significant contributions to this Administration and to the well-being of our fellow citizens. I know of the high regard Secretary Simon holds for your work, and I want you to know as well of my own genuine admiration.

It is with these qualities in mind that I look forward to your continued service to my Administration. I am confident you are bringing to your duties as Counselor to the Secretary of the Treasury the same excellent talents and dedication to responsible government that you have demonstrated throughtout your public career.

You have my best wishes for every continued happiness and success.

Sincerely,

Jerry Ford

Mr. Sidney L. Jones
8505 Parliament Drive
Potomac, Maryland 20854

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

January 31, 1975

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

Dear Mr. President:

The creation of the Economic Policy Board has resulted in a new assignment for me to serve as Counselor to the Secretary of the Treasury, William E. Simon. This change in responsibilities makes it necessary for me to resign from my position as Deputy Assistant to the President and Deputy to the Counsellor for Economic Policy. In this new role I will continue to serve in your Administration and I look forward to this opportunity.

I have observed the processes of economic policymaking during the past five years from various positions within the Executive Office. I believe that a significant advantage in the current organization has been your personal involvement in meetings with your economic advisers. Your leadership will be the key variable in sustaining responsible monetary and fiscal policies which are the proper basis for solving our current economic difficulties.

I have appreciated my past opportunities and welcome the opportunity to continue to serve in your Administration.

Sincerely,

Sidney L. Jones

Sidney L. Jones
Counselor to the Secretary
of the Treasury

CBS NEWS
2020 M Street, N. W.
Washington, D. C. 20036

FACE THE NATION

as broadcast over the

CBS Television Network

and the

CBS Radio Network

Sunday, May 4, 1975 -- 11:30 AM - 12:00 Noon, EDT

Origination: Washington, D. C.

GUEST: WILLIAM E. SIMON
Secretary of the Treasury

REPORTERS:

George Herman, CBS News

Eileen Shanahan, The New York Times

Robert Pierpoint, CBS News

Producer: Mary O. Yates

Associate Producer: Joan Spiegel Barone

HERMAN: Secretary Simon, after a lot of gloomy news and a lot of gloomy predictions, we're now beginning to get some cheerful predictions--administration economists saying things look good, we're bottoming out, and we're starting--we're about to start, or will soon start an upturn. After the record of administration and other economists in prediction for the last few years, how can we trust this cheerful prediction?

SEC. SIMON: Well, we recognize the imprecision of analysts in their economic forecasts, but it must be remembered that every recession sows the seeds of its own recovery, and this recession is certainly no exception. We've seen a dramatic decline in inventory liquidation, and the important part of that is that sales are progressing at a more rapid rate than production. Retail sales have increased for three months in a row. Our inflation rate is down further and faster than anyone had expected or forecasted. Short-term interest rates are dramatically lower from last summer's peak. And this has set the necessary preconditions for an upturn in housing. But we're not letting this economic recovery go to chance. There's massive fiscal stimulus as well, in the very large budget deficit, in the largest tax reduction in our history. What we have to make sure of is that we don't overheat the economy, and for once just warm it up so we can look forward to longterm, stable economic growth with low inflation.

ANNOUNCER: From CBS News, Washington, a spontaneous and unrehearsed news interview on FACE THE NATION, with Secretary of the Treasury William Simon. Secretary Simon will be questioned by CBS News White House Correspondent Robert Pierpoint; Eileen Shanahan, Economics Reporter for the New York Times; and CBS News Correspondent George Herman.

HERMAN: Mr. Simon, we may have, as you say, the preconditions for recovery. Then I guess if that is true, the next question is, what kind of a recovery? Economists talk about V-shaped, where we go down, bounce right back up again; or an L-shaped recovery, where we go down and just sort of lie along the bottom of the graph for a period of months before we start back up again. What are you expecting?

SEC. SIMON: Oh, I don't think anyone expects that we will, as you say, lie along the bottom of the graph before it begins to pick up. The difference of opinion ranges in how sharp the recovery will be toward the end of this year and going into fiscal '76. That is the only difference of opinion among the forecasters that--the many forecasters that I've spoken to.

SHANAHAN: Mr. Secretary, let's assume the optimists are right--the extreme optimists--and that we may come roaring out of this recession at an eight per cent growth rate, a rate that'll get unemployment down below seven and a half per cent by the end of next year. You have said we can't have a recovery that strong without running all sorts of financial risks, the risk of inflation. Suppose we do get a strong recovery, and unemployment really is going down very sharply--would you adopt policies or advocate policies to actually slow that recovery down?

SEC. SIMON: Well, the point is that--as I said at the outset--we have to be concerned with an over-stimulation of our economy to avoid the runaway growth that we have experienced in the past, with the attendant inflationary pressures that that brings. And I think the real problem is going to be in the money supply, the monetary policy area. As we pull out of this recession and economic recovery commences, at that point we observe the rate of growth and the demand in our economy, and monetary policy should be moderated at that point.

PIERPOINT: Mr. Secretary, could I go back to this question of unemployment? I don't think you said specifically that you thought that unemployment was dropping off, and that that particular factor in the economy was improving. What is your feeling about unemployment? Is it going to increase again?

SEC. SIMON: Well, our forecast for recent months has been that unemployment would continue to increase and only begin to stabilize after the economic recovery had already occurred. We have forecast that unemployment would peak in the area of nine per cent. I'm heartened by the recent statistics released last Friday, where unemployment, while again it increased according to our expectations to 8.9 per cent, the total labor force grew at the same time. That's a heartening statistic for us.

PIERPOINT: So you think that we're approximately at the highest level of unemployment that we will reach.

SEC. SIMON: Approximately, that's correct.

HERMAN: The big push comes in June, doesn't it, when the colleges let out and your labor force swells? And even with seasonal adjustment, do you think you'll be able to hold it down under nine per cent, or--

SEC. SIMON: Well, I wouldn't be optimistic or make a prediction that we could hold it down under nine per cent. As I say, our forecasts were approximately nine per cent unemployment. Nobody can guage with any precision to a tenth or a twentieth of one per cent.

PIERPOINT: Well, what about the problem of over-stimulation that you mentioned? If unemployment stays above seven per cent, let's say, but the economy otherwise seems to be coming out of the recession, moving upward, what would you do then?

SEC. SIMON: Well, again, I'd go back to my response on the monetary policy side; and this has been our concern, only because we have history to judge as a guide in what we've done in the past in over-stimulating an economy, pulling out of a recession, because as far as the federal spending goes, the impact of federal spending occurs just at the time the economy is improving and private demands begin to resurge, and that is where the danger lies.

SHANAHAN: Mr. Secretary, you have consistently, for a long time, talked about the dangers of coming out of the recession too fast, in particular with relation to the problems you foresee in the financial markets if that happens. Now, of course, a few economists do support your point of view, but Congress has heard testimony from dozens of others--and not just liberal economists--bank economists, people like that--who say, Simon is wrong, there isn't this danger. And the preponderance of informed opinion certainly seems to be against yours. Why are you so seemingly certain that you are right?

SEC. SIMON: Well, I don't--I don't necessarily agree that the preponderance of opinion is in disagreement with me, because I speak to a great many financial experts in the marketplace all over the country every day. That is my--one of my jobs as chief financial officer of the United States. I perceive a very real danger. I don't forecast that I am absolutely correct. I'm foreseeing a danger. And let's remember what I have said, and that is, that a budget deficit in excess of what the President proposed would pose these very real dangers, that the spending would occur just at the time that the economic recovery commences, that interest rates would not be allowed to decline as much as they normally would during a recession, and that we'd start this renewed demand from a higher level. And these dangers are indeed very real.

PIERPOINT: Mr. Secretary, is your problem that you feel that high budget deficits is more of a danger to the economy than high unemployment because you're Secretary of the Treasury and you see that as your job, or is it because your political philosophy is that you're not as concerned about high unemployment as you are about high budget deficits?

SEC. SIMON: Let's understand one thing. I don't have a per se political policy. I am financial man. I've been a banker all of my adult life, and when I look at the cause--

HERMAN: I think Bob's phrase was philosophy, not policy.

SEC. SIMON: Oh--or philosophy. What I'm attempting--

PIERPOINT: Well, you are in a political administration.

SEC. SIMON: Yes, and what I--you always are in this city, and what the role is of the Secretary of the Treasury--much like George Humphrey in 1958, when he was warning of the same things right now, which again is what I believe to be my responsibility in a measured way, pointing out all of the parameters of this problem. It is inflation, caused by excessive fiscal and monetary policies for a decade, that caused the recession and caused the high unemployment. And if we embark on the same over-stimulative policies in the future, bringing back the resurgence of inflation, we're only going to have a worse recession and higher unemployment, and that is what I'm attempting to prevent -- and that's what Arthur Burns is attempting to prevent--and begin to adopt a longer term view, because the best thing that we can do for the underprivileged and the unemployed in this country is to have good, stable, long-term, non-inflationary growth.

HERMAN: I don't mean to pick on the phrase that you tossed out there, but are you really trying to tell us that you have no political philosophy of your own--this is what I understood you to say?

SEC. SIMON: Well, I am a financial man, as I say, not a politician. I believe very deeply in what we're attempting to accomplish as far as the long term and the capital formation and the need for savings and investment in this country, because the only way we can increase productivity is to--and increase the standard of living--is to devote more of our capital per GNP to savings and investment.

HERMAN: But you have no political philosophy yourself? You could work equally well for a Democrat or some other President or administration?

SEC. SIMON: Ah, that's a--that may be deemed a leading question. There are certain Democrats or certain--

HERMAN: No, I'm just bemused at finding somebody in this city with no political philosophy.

SEC. SIMON: There are certain Democrats and certain Republicans, even, that I cannot embrace their economic and financial policies. I think that that crosses against--across party lines, myself.

PIERPOINT: Mr. Secretary, you've just come back from a trip overseas. You've been visiting in countries where they have somewhat similar problems to ours. I'm not sure whether you were in West Germany or not, but at least you're very familiar with what's been going on in West Germany. They are a modern industrialized country. They have budget deficits. They also have a lower unemployment rate than we do by far. Why can they and the Scandanavian countries seem to solve some of these problems and we cannot?

SEC. SIMON: Well, let's talk about Germany for a moment. Of course, they're in the fortuitous position, as far as their visible unemployment rate, of being able to export the first per cent or two of their unemployment, because they are an importing of labor country. But basically, Germany recognizes and fears inflation, and has a keen memory as to their experience in the 1920's with runaway inflation and what happens to countries who allow this to continue. And they put demand restraint programs in in their country a year and a half ago, primarily on the monetary policy side, and that is the reason that they have the lowest rate of inflation in the world.

PIERPOINT: What kind of demand restraints would you advocate for this country?

SEC. SIMON: Well, what we've been pursuing is moderate--moderation as we pull out of this recession. Remember, our primary focus is to get this recession over, to begin to reverse the trend in unemployment, and begin to start working it downward in a non-inflationary way, at the same time moderating monetary expansion. And this is a job that cannot be done overnight or even indeed in a matter of months. It requires patience, and that is the most difficult thing in this city--patience.

PIERPOINT: How about higher taxes? The Germans pay much higher taxes in terms of their gross national product than we do. When we begin to come out of this, would you advocate that we increase our taxes again?

SEC. SIMON: I must admit that I'm an advocate of lower taxes, personal and corporate-wise, to stimulate and make this economy more dynamic. We have a great capacity shortage in this country, and this is being debated, and I'm preparing testimony now for the coming months as to the true capacity in this country. We have many of our industries today--several of our very basic industries, such as steel--that is functioning today at 90 per cent capacity, or close to it. And as we pull out of this recovery--if, as you said a few minutes ago, Eileen, it is sharp, well, it's not going to take terribly long until we're bumping right at the ceiling with all the attendant price pressures, and we have to have expanded capacity, and this is going to require investment in these industries, and profitability, that has not occurred in the last decade; because this is what means more jobs in the United States, and a higher standard of living.

(MORE)

SHANAHAN: Mr. Secretary, we know you are working at the Treasury on a major tax reform proposal with some of these very ideas in mind. I've heard somebody say that you're for the repeal of all taxes on capital gains. Is that true?

SEC. SIMON: Oh, I don't--I think when we adopt policies of what we would like, we also have to take a look at what is possible at the same time, so, I have favored--

SHANAHAN: In other words, you've favored--

SEC. SIMON: --I have favored, for some time, a declining capital gains rate for the length of the asset held, yes, and I think that this is important.

SHANAHAN: And do I gather from what you said by way of introduction there that if it were politically possible, you'd actually like to see an end to all taxes on capital gains.

SEC. SIMON: Well, many countries have recognized the importance of long term capital gains and long term investment, and as a result, have adopted these policies, but again, I'd prefer to move in the area of integration of corporate and personal taxes and not penalize the dividend.

SHANAHAN: How would that come about? What does all that mean?

SEC. SIMON: Well, that means that the corporation could deduct the interest or the--deduct the dividend that it pays to the individual in a similar fashion to the way it deducts its long term bond indebtedness, or the individual could, or a combination of both.

SHANAHAN: Well, you mean in effect, no corporate income tax, don't you?

SEC. SIMON: Oh, no, I don't mean that at all. They should bear a burden, but let's not get to the common misunderstanding--there seems to be a notion in many quarters that individuals don't pay taxes, corporations do, and that really is most incorrect, because corporations are people, and the taxes that are paid are passed on to the American people in the form of higher prices, and of course less retained earnings, which is quite apparent to everyone today who is a student of this, less retained earnings in order to plow back into the business for replacement--lessens their ability to attract capital for investment in their company because they're not profitable, and this is what's occurred in the last decade.

HERMAN: Mr. Secretary, when you left on this trip--in fact, early on in the trip, you made a number of statements about oil prices going to come down, in fact, and the question is not, if they're going to come down, the question is when they're going to come down. Are you still so certain that oil prices will come down to any significant degree?

SEC. SIMON: Well, this again, George, has been misinterpreted since last summer when I started to be questioned about this. I wasn't suggesting it was going to happen next week or next month, but again the necessary conditions are there. There's a very large surplus in the world today. The OPEC nations today control 67 per cent of the world's proven reserves. They have tremendous internal needs for funds. Today, shut-in production amounts to about a third of their total production, and by summer it could rise to 40-45 per cent of production, at the same--

HERMAN: What do you see as a scenario? What do you think will happen? Not an immediate price drop, but what--how do you see it coming about?

SEC. SIMON: I see as the additional production in non-OPEC sources and project independence moves forward in the United States that they no longer will have the 67 per cent of the proven reserves; their proportion of the world's reserves will decline, coupled with their internal demands for funds to industrialize and diversify, and all of the needs in their various economies, that it's going to put pressure on the prices, and I think we'll see a lower price of oil, and I have no idea what level, because no one can forecast that either before the end of this decade.

HERMAN: Before the end of this decade? You're talking in that long a term?

SEC. SIMON: Well, it could happen before, but again, no one can forecast.

PIERPOINT: Mr. Secretary, what about the money that the oil countries are accumulating? Do you encourage them to invest this money in this country, and do you think it will help our capital market?

SEC. SIMON: Bob, I look at the flow of funds that has gone to the OPEC nations as a pool of savings, and this pool of savings should be used for productive levels both in the developing and the developed countries, and this is by means of saying yes, we want to encourage investment in this country and have as few restrictions as possible, and that's what we've been working to, to remove the impediments to investment, both real and imagined, but of course, we have to do this consistent with our national security, and we have many regulations--

HERMAN: One of the proposals to help us in our national scurity on oil money flows was--so that we could get Project Independence under way--was the suggestion of a floor under oil prices. Do you support that, that we hold our oil prices up?

SEC. SIMON: We support a mechanism that would protect domestic investment against a precipitous decline in world oil prices, because, you know, you are not going to get the needed investment in this country--three-quarters of a trillion to a trillion dollars, it's estimated, over the next decade if indeed the fear is there that oil prices will decline and destroy the investment that's been made, so some provision has to be made to give a little safety to this for a period of time, and that--that's what this whole notion's about.

PIERPOINT: How long a period of time are you personally thinking of?

SEC. SIMON: Oh, I think that depends--that depends on the investment. Every--every component of energy has its own dynamics in the market place, whether it's oil or coal, or the more alternate sources of oil shale, liquefaction and gassifications. Each have a different time frame, and some are unknown economically as far as to the cost of the crude.

SHANAHAN: Mr. Secretary, there's a report in the New York Times this morning that the administration is thinking of compromising with Congressional Democrats on the issue of decontrolling the price of oil and willing to take a longer period--a four-year period of gradual decontrol, to lessen the impact on consumer pocketbooks, stretch it out? Are you for that?

SEC. SIMON: I'm in favor of doing just what we are doing, and that's working with the Congress to get an energy bill that is going to give us the ability to move forward with Project Independence and attain the ability for self-sufficiency in this country. I'm heartened by the fact that they're moving toward market forces, and utilizing the President's approach, which is a higher price to curb consumption, a higher price to give the incentive to bring on the additional production, and that can only be done if we remove the controls from this area. We've erected too many impediments to the development of energy resources in this country. Now, whether it's a matter of two years--we'd prefer it as soon as possible, but this is the Democratic process of negotiation and we want to cooperate with the Congress and work together in this area.

SHANAHAN: Did you say yes?

SEC. SIMON: Well, I'm not going to--

SHANAHAN: --To my question?

SEC. SIMON: --I'm not going to foreclose the President's ability to negotiate, so I wouldn't speculate as to what will happen in the final analysis. We still favor the fastest possible removal of the control mechanism.

HERMAN: I don't know if it's fair to ask the Secretary of the Treasury this, but why did mortgage rates go up recently? Why is there a little upward jag in mortgage rates?

SEC. SIMON: Well, even though short term rates have declined in response to the monetary stimulation recently, and money has flowed back into the thrift institutions, mortgage rates are influenced by the free market, the free market of corporate, government and state and local borrowing, and there's been a stickiness in the decline of state and local borrowing, and that's reflected in an inordinately high mortgage rate at this point. That is--that is another example of why I'm saying that the federal deficits that must be financed have to--we have to make sure that they're temporary in nature. That's the most important thing.

HERMAN: So you think this is a first faint sign of crowding out of--in the borrowing in the money markets?

SEC. SIMON: Well, you know, there again, a bell doesn't go off when somebody is crowded out of the capital markets, and that's a--

HERMAN: But the rate goes up.

SEC. SIMON: When a rate goes up, many decisions are made as to the ability to make a profit when they're paying these costs. There is no doubt that public utilities and housing, and emerging businesses, if you will--the small and medium-sized businesses--cannot afford to pay those extraordinary rates.

HERMAN: Do I gather from this that you think that this is not a temporary phenomenon but something that's likely to stay with us? There's little upward pressure now on interest rates?

SEC. SIMON: No. There, again, I will go back to what I said before. That depends on the actions of the federal government, both in the fiscal and the monetary area.

PIERPOINT: What you're really saying is, to a large extent, the actions of Congress, in not voting too many expenditures above the President's budget, isn't that correct?

SEC. SIMON: Yes, that's exactly correct.

PIERPOINT: Where do you think we ought to draw the line, specifically, and what areas of public spending do you think we ought to cut back?

SEC. SIMON: Well, let's talk about stopping the growth of federal spending and not try to roll back the clock, because I rather suggest that would be difficult if not impossible. It's the growth of federal spending that we have to curb right now, and the President has drawn the line at 60 billion dollars in the budget deficit this year, and we're going to try to maintain that.

SHANAHAN: Mr. Secretary, on that subject, the leader of the Republican Party on the budget resolution, Senator Bellmon of Oklahoma, said last week in almost these words that the 60 billion dollar figure is a phoney, that if the administration were using honest estimates, it--under its own programs, not what Congress might change--under its own programs--that the deficit would actually be very close to what Congress voted. How do you respond to that kind of criticism from a very loyal member of the President's party?

SEC. SIMON: Well, when--

PIERPOINT: In thirty seconds.

SEC. SIMON: I don't know whether he said honest estimates or not, but my friend Henry Bellmon and I are striving for the same thing in this country, and that's fiscal responsibility. We made our estimates of where we'd like to hold the budget and where we must indeed hold the budget, and we made some assumptions to do that. Now if other people deem these assumptions unrealistic, well, that's their judgment. But we intend to fight to make sure that we attempt to the best of our ability to maintain that lid at 60 billion.

HERMAN: Thank you very much, Secretary Simon, for being with us today on FACE THE NATION.

ANNOUNCER: Today on FACE THE NATION, William Simon, Secretary of the Treasury, was interviewed by CBS News White House Correspondent

Robert Pierpoint; Eileen Shanahan, Economics Reporter for the New York Times; and CBS News Correspondent George Herman. Next week, another prominent figure in the news will FACE THE NATION.