NAM

National association of manufacturers.
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For the Good of the Nation

A FEDERAL FISCAL PROGRAM

The Federal fiscal program of the National Association of Manufacturers is designed to preserve and improve the economic health of the whole economy. It consists of three closely related parts, as follows:

I. CAPITAL FORMATION, to provide for greater production, better jobs, more pay, and higher living standards for all of the people.

II. TAX REDUCTION, of a character and proportions that will provide tax relief where it is most needed, release income for capital investment, and restore the economic incentives to work, to save and to invest.

III. BUDGET REDUCTION, of dimensions sufficient to make possible the necessary tax reduction within the framework of a balanced budget.

I. CAPITAL FORMATION

The key to a sound and permanent remedy of the present economic ills that beset the nation — shortages, high and rising prices, fear of further inflation and the restoration of controls — is more production.

With the available labor force now almost fully employed, the other way to increase production substantially is by providing the workers with more and better tools. A look at the ramshackle taxicabs, the dilapidated railroad rolling stock, and the price of a Ford automobile should be sufficient proof of the nation's need for more production through more and better capital equipment.

The record of national growth demonstrates that this growth has been the result of regular and continuous additions to our capital. Data covering the period 1869 to 1928 reveal that, on the average, some 20 percent of the gross national product has gone into capital formation. Since 1930 we have fallen well below that average rate of "plow back", and we are now suffering the consequences.

In particular, there is a serious deficiency in the type of capital known as "risk" or "venture" capital. This refers to the kind of investment which involves a considerable risk. The formation and development of new businesses, and the expansion of established businesses into new fields or new territories illustrate the areas of greatest risk, and also of greatest need for more capital.

Yet it is these kinds of development which are most urgently required to assure the continued growth and expansion of the national economy.

The present deficiency of venture capital is an important factor in the advance of inflationary tendencies since the end of the war. It is well understood that the primary cause of inflation is an expansion of bank credit. The inflationary effect of credit expansion is the same, whether the bank loans be made to government or to private business. Although there has been no material net increase of government bank loans since the war ended, there has been a substantial increase of bank loans to business.

In part, perhaps in large part, this rise in private bank loans has been caused by the inability of business concerns to obtain equity capital. The present scarcity of equity capital, and its fundamental importance for a sound economy, are forcefully emphasized in the following passage from a recent tax report issued by the New York Stock Exchange:1/

"Equity capital is the essence of a dynamic economy. Only government capital does not require an 'equity' behind its debts. Venture capital is lost sight of and languishes, whereas private debt mounts — bank loans to business (short and long term), consumers' debts, and mortgage debt — creating a heavy superstructure of obligations, whereas what is required is a broadening of the base on which our economic society rests — venture capital."

Additional expert testimony on the fact, and the consequences, of the shortage of venture capital is provided by the following excerpt from the National City Bank Letter for November, 1947:2/

"In the present juncture, the supply of new savings out of current incomes of individuals is seriously deficient in relationship to the demands for capital. For example, the individual investor has come close to disappearing as the source of new capital for private business. Estimates of the Securities and Exchange Commission indicate that individuals in all of 1946 added nothing, net, to their holdings of corporate stocks and bonds. The same is true for the first half of 1947. A major cause is income tax levels so high as to force continuous dissaving in the higher income brackets and shut down new supplies of savings farther down the line.

1/ Economic Progress: Tax Revision and the Capital Markets, A Tax Study submitted by the New York Stock Exchange, November 1947, p. 39.

2/ Monthly Letter on Economic Conditions, Government Finance, by The National City Bank of New York, November, 1947, p. 130.

"The individual savings that take place today in largest volumes are either institutionalized savings, reflected in accumulations of insurance and pension funds, or savings in anticipation of consumption. These funds are not available for equity investments in common stocks. The absence of substantial individual savings for taking risks of ownership is a serious missing link in the structure of sound financing of postwar prosperity. Without them, the pressure is on the corporation to sell bonds and to go further into debt to the banks and to the institutional investor. This has been the cheapest and easiest way of raising new funds. Often it has been the only practicable way."

A constructive, long-range policy for the maintenance of national economic growth must be one which recognizes our historic trend and experience. We have always sought to make a bigger pie, not merely to parcel out a small pie. The only alternative now proposed by the Administration is rationing and other controls, a policy which will never produce a bigger pie. Rather, this policy is more likely to restrict than to expand production.

II. TAX REDUCTION

The only way to provide a larger flow of funds into capital investment is to reduce the share which existing taxes now take out of available incomes. Reduction of the corporation income tax would release additional funds for capital formation, but NAM does not recommend this as the first step.

a) Because it would benefit only existing companies, whereas the great need is for the promotion of new business, corporate and unincorporate;

b) Because corporations would not in all cases be permitted to retain larger earnings without being penalized under section 102;

c) Because the existing heavy rates of the individual income tax would prevent individual investors from saving any substantial portion of the additional dividend income paid out to them.

For these reasons, the first step in logical sequence is the revision of the individual income tax. It is recognized that this tax is too heavy for all taxpayers. The problem is to effect a reduction of the burden for all while holding to the necessary objective of stimulating saving and investment. NAM's solution for this problem is as follows:

a) Retain for the present the existing personal exemptions and credits for dependents;

b) Recast the tax rate scale throughout. In the brief filed with the Ways and Means Committee in July, 1947, it was suggested that a new rate scale (normal tax and surtax combined) be imposed, to begin with a total rate of 12 percent on the first bracket of taxable income ($0 - $2,000), and to rise to a maximum rate of 50 percent on taxable income in excess of $100,000. In view of the present high levels of national income, it may be possible to set the first bracket rate at 11 percent, or even at 10 percent. The 12-50 percent rate scale would represent approximately an across-the-board reduction of 37 percent.

c) Allow two additional deductions, as follows:

1) A deduction not to exceed $500 on account of life insurance premiums paid by the taxpayer on the insurance of his own life;

2) Permit deduction for medical expense incurred by the taxpayer for himself or his dependents, during the taxable year, up to $1,250 for a single person and $2,500 for a married person, without regard to the present restriction of such deductions to the amount incurred in excess of 5 percent of net income.

These additional deductions would afford chief benefit to persons with small incomes because of the limitations suggested. When reasonable amounts for such purposes are taken into account, the tax to be paid by persons in the lowest taxable income groups would be reduced from the 1945 level by as much as 60 percent.

The complete NAM long-range program embraces other features, but the points outlined here are all that are asked for now. Eventually there must be a reduction of the corporation tax, a correction of excise tax inequalities, and less severe taxation of estates and gifts. For the near future, NAM would concentrate upon the most urgent problem, which is that of the individual income tax.

It is submitted that a tax revision along the lines indicated here would be more constructive and more fruitful for the whole economy than any program of narrower scope or more limited application. At a national income level of $166 billion, which is the only basis that has been used thus far by the Treasury and by private experts for estimating the revenue effects of tax revision, the total tax reduction below the 1945 tax burden would be as follows:

Net Income Classes	Tax Liability At 1945 Rates	Tax Liability At 12-50% Rates	Tax Saving At 12-50% Rates
	(Billions of Dollars)		
0-$ 5,000	9.44	5.97	3.47
5,000- 10,000	1.32	.86	.46
Over 10,000	6.25	3.91	2.34
Totals	17.01	10.74	6.27

The additional tax reduction from the proposed insurance and medical deductions are estimated, on the same national income basis, at $645 million, most of which would accrue to persons in the net income classes up to $5,000.

Out of the tax savings here indicated, it is estimated that some $3 billion would be available for new investment. For the near future this would be of immense importance in the expansion of capital facilities required to overcome the existing shortages and thus to combat the inflationary pressures. Over a long period our studies of the problem of capital formation indicate that the need for new venture capital will be materially greater than $3 billion annually, a result which emphasizes the need for attention, within a short period, to other aspects of tax reduction in order to meet this greater need.

A word as to the reasonableness of the program here outlined. It is a balanced program, in that it provides substantially uniform treatment, relative to present tax burdens, for all taxpayers. It does not emphasize mere tax relief alone, which would call for concentration of the reduction at the bottom of the income scale. It does not emphasize capital requirements exclusively, which would call for much greater relative reductions for the higher incomes out of which something can be saved. It balances relief for the small incomes with reduction in the income areas where saving and investment must mainly occur. It is the only tax program that has been offered to the Congress which recognizes the fact that those with small incomes need not only tax relief for themselves, but tax reduction clear up the line, if their jobs and their income are to have a chance of security.

Moreover, it is the only program that is definitely pointed toward future maintenance of income and job security through greater capital formation. It rests on the bold and challenging proposition that we cannot now afford to gamble with the future by making only a cheese-paring cut, one that would overemphasize tax relief here and there while neglecting the established facts of capital need.

III. BUDGET REDUCTION

There can be no hope of resuming investment and capital formation on the scale required by a prosperous economy, because there can be no hope of adequate tax reduction for that purpose, unless there can be a sufficient reduction of the Federal spending to make these things possible.

The budget is, therefore, the keystone of the economic and fiscal arch. NAM offers, for the fiscal year 1949, an outline budget of $31 billion. This total is only $500 million less than the amount set by both the Joint Committee on the Legislative Budget and by the House as the Congressional budget ceiling for the fiscal year 1948.[1/]

The recommended maximum budget of $31 billion for the fiscal year 1949 has been developed, except for one class of expenditure, from the reports of the subcommittees on the appropriation bills for 1948. The House subcommittee reports contained, in general, lower figures for the year 1948 than the corresponding Senate subcommittee reports, and in addition, they supplied more complete explanations in support of the committee actions. The House reports therefore had significant influence in shaping the proposed budget. The exception referred to is the function which, in the NAM outline, is entitled "Contingencies including international affairs and finance." The budget estimates for 1948, revised as of August, 1947, provided the principal basis for this section of the recommended budget.

In general, the following facts about the NAM budget study should be noted:

a) It is based largely upon the reports of appropriations subcommittee recommendations for 1948, with special references to the criticisms of departmental business standards, excessive personnel, and duplicating services which are set out in those reports;

b) It contemplates no impairment of defense and no encroachment upon veterans' services and benefits. Subcommittee comments regarding excessive costs arising from low managerial standards and other causes are given due weight.

c) It assumes, for the next fiscal year, no shrinkage in the scope of Federal services. Action along this line is suggested, however, as the next step toward a much lower budget in future.

1/ In an address before NAM's Congress of American Industry on December 4, 1947, Senator Harry F. Byrd stated that, in his opinion, the Federal budget for 1949 could be reduced to $32 billions including the Marshall Plan.

d) It makes what is believed to be reasonable provision for foreign aid requirements. The official announcements regarding these requirements thus far made have presented only a general outline of the long-range program. Eventually a detailed plan must be submitted to Congress for scrutiny and criticism. In all probability the amount finally voted will be less than the preliminary discussion suggests.

We hold no brief for an over-niggardly policy here. Large stakes are involved, and efficient use of American aid may yield incalculably large returns. We would stress the efficient use of our funds, for the war experience demonstrated conclusively that the availability of unlimited funds does not contribute to efficiency. In the case of foreign aid, likewise, it is more than likely that prudent appropriations, wisely applied, will accomplish all that can be done by lavish appropriations which are unwisely used.

Whether the amount set out in our recommended budget for this purpose, namely $4 billion, is as much as can be wisely and prudently used is a matter for the Congress to determine. Obviously, the reduction to a minimum of the burden of any foreign aid program upon our own taxpayers and our own citizens as consumers must involve, first, the most careful and cautious appraisal of foreign need, second, the promotion of private contributions to this need in the greatest degree possible, and third, the utilization of foreign resources to whatever degree this can be done without impairing the budgetary and monetary stability of the countries that are receiving our help.

To minimize further the burden of this aid, whatever the necessary amount may prove to be, there should be the most determined effort to effect counterbalancing economies in the domestic costs of government. Examination of the documentary evidence pertaining to the Federal expenditures convinces us that a foreign aid program moderately in excess of $4 billion for 1949 can be absorbed through offsetting economies beyond those we have suggested without impairment of any essential Federal service. If the Congress should appropriate a sum greatly in excess of $4 billion, we recognize that there would be considerable difficulty in holding the 1949 budget total to $31 billion for the reason that it will not now be possible to make sufficient progress in the elimination of duplicating and unnecessary agencies and services before the opening of the fiscal year 1949. The point to be emphasized is that a $31 billion budget is entirely feasible, even under the existing Federal organization, if the foreign aid should be $4 billion or only moderately in excess of that figure.

The people must do a lot of individual belt-tightening if the available food and other products are to be shared with those in need elsewhere. It is proposed that there be governmental belt-tightening also, through deferment of construction and similar projects, through reduction of excess personnel, thereby adding to the labor force available for increasing the output of goods and services, and through stretching the dollars allotted by raising the standards of managerial efficiency.

The overall prospects for the fiscal year 1949 under the foregoing budget and tax program may be briefly summarized. When the program was first set up, last summer, the revenue loss was estimated to be $7 billion in round total. As already noted, these calculations were based upon an assumed national income of $166 billion. It was then pointed out that if Federal net receipts in 1949 were to be no more than $41 billion, there would be a margin of $3 billion for debt retirement after giving effect to the tax reduction program. This amount exceeds NAM's recommendation which is that there should be a minimum of $2½ billion devoted annually to debt reduction.

Currently, national income is much above $166 billion. Federal net receipts for 1949 may be expected to exceed $41 billion, possibly rising to as much as $45 billion according to some forecasts. At this higher income level, the individual income tax yield would be up, and the NAM rate schedules would involve a greater amount of reduction. If we assume that the NAM program would reduce revenues by $8 billion, there would remain a margin of $6 billion over and above a budget of $31 billion, assuming that receipts should be as much as $45 billion. This would afford ample leeway for debt reduction and for an expansion of the tax revision program through further reduction of the first bracket rate and in other ways.

To sum up: NAM offers a constructive and comprehensive fiscal program. It is a new and sound approach which rests upon the known historical facts of capital formation as one of the main sources of national growth. It offers as opportunity to make a clean break with the temporizing and inadequate tax program of 1947, already twice vetoed, and to set the policy for inflation control, foreign aid, and domestic prosperity on a high plane. It offers more, and can deliver more, for all of the people than any other fiscal program that has been put before the Congress.

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