Institute for Research on the Economics of Taxation.

U.S. TAX POLICY AND INTERNATIONAL COMPETITIVENESS

Statement by

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Mr. Chairman, Members of the Committee, I am pleased to have the opportunity to appear today to discuss with you some of the issues concerning enhancing the competitiveness of American businesses in the world economy.

The Committee on Ways and Means is to be highly commended for undertaking this ongoing inquiry into factors affecting the competitive status of American business in the world economy. As the Committee's press release announcing these hearings makes clear, a very wide range of influences are at work in this connection. For this reason, the Committee must recognize that changes in the competitive position of American business does not depend on any one or a few public policy innovations. A great many things need to be done to enhance competitiveness. Among these things are significant revisions in the federal income tax to reduce the excessive cost of saving and capital formation, of new business enterprise, of implementing technological progress and innovations in products and production processes, and of undertaking business activity abroad.

My testimony focuses primarily on the influence of tax policy on competitiveness and on a limited number of tax policy changes that would reduce, if not eliminate, tax barriers to more effective participation by American businesses in the world market place.

Overview

The Institute for Research on the Economics of Taxation (IRET) has a long-standing interest in the issues, especially the tax policy issues, concerning competitiveness. This interest stems from our recognition of the changes that have been occurring in the economic world and the need for our policy makers to identify and respond to the opportunities and challenges those changes present. The world economy is growing rapidly and becoming increasingly diversified and complex with every passing day. Economic progress in the United States depends critically on the capacity of U.S. businesses to compete effectively in a world-wide market, not merely here at home in the domestic market. In a very real sense, national borders have simply vanished so far as the production and marketing of an ever-increasing number and variety of products and service. The extraordinary advances in communication and transportation technology that have occurred in just a few decades have enormously expanded the scale of markets with respect to production as well as distribution. Production of a great many of the products Americans take very much for granted has been globalized in the literal sense; before these products get to our shelves, they have undergone processing in several, not just one or two, national jurisdictions. The concept of localized production of an entire product, or even of large portions of it, has become meaningless. American content, per se, is no longer a relevant variable in assessing American competitiveness.

For this very reason, the volume of our exports, imports, and trade balance do not serve as useful indicators of our economic performance. It is no longer meaningful, if it ever was, to rely on the trade balance as a measure of the effectiveness of our international economic policy. Our economic well being does not depend in significant degree on the excess, if any, of our merchandise exports over our merchandise imports. Our domestic economic activity depends to a significant extent on how successful are the foreign operations of American multinational businesses; by the same token, the success of those foreign operations depends in significant part on how productively and efficiently our businesses operate here at home.

The interconnections between economic progress at home and the competitiveness of American businesses everywhere in the world has been extensively explicated and documented. IRET's Spring 1989 conference on this very subject brought out the positive influence of the foreign operations of U.S. businesses on domestic employment, output, and economic growth. The conference established, on the basis of the actual experience, that constraining American business investment and operations abroad doesn't expand their U.S. domestic investment and operations; it merely allows other nations' businesses to expand their share of the foreign markets. Materials presented at the conference showed that, on the contrary, the foreign operations of American businesses served to expand domestic production and employment.

An IRET conference, cosponsored by Arthur Andersen, entitled "U.S. Foreign Tax Policy: America's Berlin Wall," held last Fall, focused on how the present federal tax provisions bearing on foreign source income affect the competitive position of a broad cross section of American multinational businesses vis a vis that of foreign multinational companies. The case studies presented by the tax executives of a number of major companies along with the analyses by other tax experts of the impact of a wide range of our foreign tax provisions on U.S. businesses' foreign operations afforded a chilling exposition of the difficulties our tax laws cast up. (The published proceedings of this conference will be available around Labor Day and will be made available to members of this Committee). Taken together, the two conferences show how importantly our economic progress depends on the competitiveness of American businesses throughout the entire world market and how severely that competitiveness is impaired by existing U.S. federal tax laws.

My thesis is that some rudimentary improvements in our tax laws that will bring them in closer conformity with basic canons of taxation would also enhance the competitive position of U.S. business to the benefit of the nation as a whole and that of all of our partners in the world economy. This is not to say that tax considerations are the only determinant of competitiveness nor that the market position of American business in the near and long term will depend solely on tax policy. Far more basic factors will be at work, and many other public policy developments will also have an important bearing on how well or how poorly U.S. business fares in the world market place. Notwithstanding, tax policy has an extremely important role to play. This Committee has the opportunity to make a signal contribution to the Nation's economic progress by moderating, if not entirely eliminating, the existing tax barriers to efficiency, growth, and competitiveness.

The Concept of Competitiveness

The Committee will have noted that I have spoken of the competitiveness of American businesses in the world marketplace. Effectively dealing with the competitiveness issue requires focusing on the business unit. An economy is neither competitive nor noncompetitive. A nation doesn't compete in the international marketplace. Economic units -- businesses -- compete. Competitiveness, therefore, refers to how profitably a business unit operates, how fast and for how long it grows, what share of the relevant market its production and sales represent and whether that share is growing or shrinking. The principal determinant of a business's competitive position is its costs relative to those of other businesses operating in the same market.

Many things influence those costs; some of these influences are basic economic phenomena and others are the products of public policies. Much as they sometimes might wish to, public policy makers can't directly alter the basic economics; they can, however, augment business costs by instituting policies that warp and distort the functioning of the private market system. Where this occurs, of course, it is not because policy makers wish to impair efficiency and competitiveness, but because they tend to ignore the effects of their actions on private economic performance.

Public policies that raise business costs impair the competitiveness of the affected businesses by eroding the profitability of the existing scale of their operations. The response of these businesses is to curtail operations to the point at which some minimally acceptable rate of profit can be realized. When their adjustments to their higher costs have been made, these businesses will have relinquished sales to businesses of other countries. The businesses experiencing the cost increase will have lost market share. The consequences of shrinking market share include less efficient production, hence lower levels of output, employment, real wages, and employment.

The key to enhanced competitiveness is reduction in costs relative to those of other market participants. The central focus of public policy efforts to increase American businesses' competitiveness must, therefore, be on the impact of public policies on business costs.

To a distressing extent, the escalation of American business costs is attributable to public expenditure policies. With few exceptions, government spending programs raise the costs of production inputs to the private sector, because government either preempts these resources, bidding up their costs in private uses, or through transfer programs, raises their reservation prices for productive employment. The expansion of government spending, moreover, is a prime mover for raising taxes, which year after year are a higher and higher part of total business costs and also exert upward pressure on the supply prices of production inputs. However worthy the objectives of these government spending programs, policy makers should not overlook the costs these programs impose and the consequences of these higher costs. As indicated, these consequences are not confined to the owners of the affected businesses, but are borne throughout the nation.

As the Committee is aware, many public policy developments in recent years have acted to increase the costs of production for much of the business community. In most cases, these policy initiatives were addressed to what were perceived to be urgent social or environmental problems. Unfortunately, many, if not most, of these initiatives were adopted without a careful assessment of their costs. Realistically, one must assume that more such initiatives will be undertaken in the future. The greater is their number and scope, the more urgent it is to ameliorate their adverse impact on business efficiency and competitiveness by reducing the cost-increasing impact of the federal tax system.

Tax Neutrality: The Underlying Criterion for A Pro-Competitive Tax Policy

Enhancing competitiveness gives a particular focus to tax policy but one that is consonant with the more fundamental objective of minimizing tax impediments to efficiency and economic progress. Successful pursuit of this objective does not call for extending tax subsidies to businesses with respect to any of their activities. Instead, it calls for conforming the tax system more closely than at present with the requirements for tax neutrality.

Tax neutrality is defined in terms of the impact of a tax or tax provision on relative costs and prices. A perfectly neutral tax system would not alter any of the cost or price relationships that would prevail in an efficiently functioning private market, free of influence from government actions or policies.

No tax ever devised has been perfectly neutral. An inherent property of every tax is that it raises the cost or price of the thing that is taxed relative to the costs or prices of other things. Every tax, in other words, has an excise effect. As an operational matter, neutrality in taxation means that taxes distort relative prices and costs to the least possible extent.

As applied to the income tax, neutrality calls for designing the tax so as to alter in the same proportion the costs and prices of all alternatives confronting taxpayers. Thus, the tax should raise the cost of saving in the same proportion as the cost of consumption and of each form of saving and of consumption to the same degree. It should raise the cost of any particular employment in the same proportion as it increases the cost of doing any other kind of work. It should increase the cost of capital services in the same proportion as it raises the cost of using labor services in production processes. It should have the same proportionate effect on the cost of any one kind of capital use as it has on that of any other.

The existing income tax severely violates these tax neutrality conditions. An income tax, per se, is inherently at odds with neutrality because the tax increases the cost of activities that generate income subject to the tax compared to the cost of all other activities. Apart from this basic problem, however, the tax as now imposed in the United States is severely biased against saving and in favor of current consumption uses of current income. It is biased against the use of one's time and resources in activities that give rise to income that falls within the purview of the tax and in favor of uses that produce nontaxable rewards, i.e., "leisure." Because of rate graduation, it increases the cost of activities that enhance one's productivity, hence earnings. It discriminates against long-lived capital and in favor of shorter-lived facilities. It favors financing corporations' capital requirements with debt as opposed to equity. It raises the cost of using capital services proportionately more than it raises the cost of using labor services. And so on. In varying degrees, these same deficiencies are to be found in the income taxes of other nations.

These shortfalls from the standard of tax neutrality induce misallocation of production inputs, i.e., lead to less than the most efficient uses of these inputs. This efficiency loss, in turn, raises costs of production and thereby impairs competitiveness. Enhancing competitiveness, accordingly, calls for efforts to make the tax system, particularly the income tax, more nearly neutral.

It is regrettable that tax legislation during the past decade has, with few exceptions, moved the tax system away from rather than toward neutrality. The Economic Recovery Tax Act of 1981 made material contributions toward reducing the tax-induced extra cost of saving, capital formation, and market-directed personal effort. Since then, we have experienced a long string of revenue-driven tax enactments that have raised the cost of work, saving and capital formation, and innovation, and enormously complicated the income tax and made compliance and enforcement vastly more costly. Virtually the only exceptions were the individual and corporate income tax rate reductions enacted in the Tax Reform Act of 1986, and as the Committee well knows, the individual rate reductions have not been maintained. The result, it should come as no surprise, is that American businesses confront greater competitive challenges in the world market place than otherwise would be the case.

If enhancing competitiveness is truly an urgent goal of public economic policy, policy makers should give high priority to moving the federal tax system into closer conformity with the requirements of tax neutrality. Doing so will allow American businesses to operate more efficiently, hence to compete more effectively in both the domestic and foreign markets. Policy makers should keep clearly in mind that the nation's economic progress depends as much on how effectively our businesses compete in foreign markets as on their performance in the domestic market. And in both domestic and foreign markets, efficiency and growth depends significantly on minimizing tax distortions of the signals cast up by the market's operations, hence on minimizing tax impediments to the most productive allocation of production inputs.

The tax revisions called for to ameliorate the distorting impact of the tax system are wide ranging and vast in scope and number. The types of tax changes suggested in the following discussion are only a few of the large inventory of revisions that would create a tax climate far more conducive than at present to the efficient functioning of a free market economy.

A Pro-Competitive Tax Agenda

Initiate Efforts to Integrate the Individual and Corporate Income Taxes

One of the major violations of the neutrality criterion in the existing income tax is the imposition of the tax on income generated by corporate businesses, in addition to taxing corporate distributions to individual shareholders and the capital gains these shareholders may realize upon disposition of their equity interests. The corporate tax represents an additional layer of tax on earnings that in economic reality are those of the individual shareholders. As such, it is a highly punitive excise on corporate shareholders and on conducting business in the corporate form. It not only raises the cost of capital for corporate business relative to unincorporated forms of business organization, it also increases the cost of capital throughout the economy. As a result, the labor force is employed with smaller amounts of capital, hence is less productive than it otherwise would be, hence confronts a lower demand for its services and at lower real wage rates than would prevail in the absence of the tax. The burden of the tax, therefore, is far from confined to wealthy shareholders; its major burden is imposed on labor. Indeed, the economic distortions the tax generates impose costs on the entire economy.

An often overlooked cost of the corporate income tax is the cost of compliance and of administration and enforcement that it imposes. In a recent IRET **Policy Bulletin**, "Competitiveness and the Taxation of Corporate Income," Bill Modahl, Director of Tax Affairs for Digital Equipment Corporation, cites an Arthur D. Little study undertaken for the Internal Revenue Service, estimating a compliance cost of over 60 cents per dollar of revenue. Modahl also refers to academic research producing estimates of deadweight losses of around $150 billion annually for the economy as a whole resulting from a tax that raises perhaps $105 billion.

The long-standing rationale for the corporate income tax is that in the absence of the tax, individuals would use the corporation as a means of sheltering their earnings from the individual income tax. With the present individual and corporate tax rates, this is no longer valid, if ever it was. In any event, the answer is to allocate corporate-generated earnings to individual shareholders as those earnings are realized. That such allocations can be made without significant increases in complexity or compliance and administration-enforcement burdens was demonstrated by David F. Bradford and the U.S. Treasury Office of Tax Policy staff in **Blueprints for Basic Tax Reform**, first published early in 1977 and reissued in 1984 by Tax Analysts of Arlington, Virginia, 1984.

Tax integration is not a matter of equalizing the tax treatment of differing forms of corporate financing. It's true objective is the elimination of the corporate income tax as a separate levy.

Complete elimination of the corporation income tax may well not be a realistic prospect for the near term. Progress toward this end, however, can be initiated as part of an agenda to make the U. S. tax system more nearly neutral, hence less of an impediment to competitiveness. One step in this direction is the proposed change in the tax treatment of capital gains, discussed below. A companion measure would be to provide for the deduction by the corporation of dividends paid with respect to net new issues of its common stock.

Repeal or Modify TRA86's Foreign Tax Provisions

Elimination of the corporate income tax would, of course, make moot many of the thorny issues that arise in attempting to apply the tax neutrality standard to the foreign-source income of U.S. multinational companies. Until corporate-individual income tax integration is a reality, close attention should be given to the barriers to effective competition that are erected by the present U.S. foreign-source income tax provisions.

TRA86 made extensive and drastic changes in the tax treatment of the income derived from foreign operations of U.S. multinational companies. These changes not only made this tax treatment extraordinarily complex, thereby greatly increasing compliance costs, but also significantly increased the cost of capital employed in the foreign operations. Moreover, the reasons given for the changes conform with no acceptable criteria relevant to the taxation of foreign-source income. In an era of expanding economic opportunities in a broadening world market place, it is difficult to rationalize the imposition of new and substantial tax barriers to effective competition by U.S. businesses with foreign competitors, both at home and abroad.

The tax neutrality standard calls for excluding entirely from the purview of the federal income tax the income or losses sustained by American businesses on their foreign operations. This territorial principle should have guided the changes made in 1986 in the foreign tax provisions, given the then rapidly growing perception of the competitive disadvantages of U.S. businesses. TRA86, however, moved in the opposite direction. It intensified the highly protectionist cast of the U.S. foreign tax provisions that has increasingly, over the years, characterized these provisions. In a paper produced for the IRET conference, **U.S. Foreign Tax Policy: America's Berlin Wall**, Dr. George Carlson of Arthur Andersen and I pointed out the fallacies of the analysis adduced to rationalize the long-standing federal tax policy approach to the tax treatment of income produced by U.S. multinationals in their foreign operations. Our paper also pointed out that this tax protectionism is virtually the same as trade protectionism, with the same sort of adverse effects on the efficiency and productivity of the U.S. economy.

A further change in direction is called for in the interests of tax neutrality and to reduce the tax-imposed limitations on the ability of American businesses to compete with foreign businesses.

Realistically, the territoriality approach is not likely to be adopted in the near term. It should serve, however, as a guide to changes that should be made in the foreign tax provisions. Interim reform measures should include repeal of the TRA86 multiple basket treatment of differing types of foreign earnings, expense allocation rules, the passive foreign investment company provisions, and the expanded reach of Subpart F. Let me quote some of Modahl's observations on this score.

> "Many types of active business income ...now...fall within the passive definitions, and therefore suffer accelerated taxation. This is becoming a worse problem with the technological revolution, because an increasing proportion of value added in world trade is accounted for by intangibles, income from which may fall within passive definitions even though it represents active business income....
> To the extent Subpart F applies to wholly foreign transactions, precluding avoidance of foreign taxes, we may be shifting tax revenues from the U.S. fisc into foreign coffers. Current U.S. taxation of Subpart F earnings may induce shifting the site of foreign operations to higher-tax jurisdictions so that foreign income eventually comes back to the U.S. carrying substantial foreign tax credits....
> The rationale for the United States attempting to preclude its multinationals from minimizing foreign tax is elusive. Perhaps it can be viewed as some sort of foreign aid out of the pockets of U.S. business, transferring revenues to foreign treasuries where they would not otherwise have collected them..."

Remaining tax barriers to U.S. companies selecting low-tax jurisdictions in which to undertake their foreign operations should be critically examined, looking to their early repeal or modification.

As the Committee is aware, one of the most difficult and contentious issues in the tax treatment of foreign earning of U.S. multinationals arises at the state level in those states relying on the so-called unified business theory to tax corporations doing business in their jurisdictions. In effect, the application of this theory allows these states to extend the reach of their taxes to income outside of their jurisdictions. Apart from the constitutional issues involved, this tax treatment raises the aggregate tax load on foreign operations of U.S. companies. Adding insult to this injury is the IRS regulation 1.861-8(e)(6)(i) that requires U.S. multinational corporations paying taxes to such states to allocate a pro rata amount of the state taxes to their foreign source income. My colleague, Dr. Michael Schuyler, points out in IRET **Byline** No. 98, "The IRS's Unlegislated Tax on Foreign-Source Income," that "The regulation is an unlegislated, backdoor increase in the federal income tax on the foreign earnings of these companies." Legislation to prevent this result should be part of the agenda to enhance American businesses competitiveness. Congressman William M. Thomas has introduced H.R. 1429 that would explicitly allow U.S. business taxpayers to deduct from their U.S.-source income their payments for state and local income and franchise payments. The bill is a useful step.

Expanding the presence of American businesses in foreign markets, an integral part of enhancing these businesses' competitiveness, very often is best served by assigning U.S. employees to the foreign operations. In many cases, the employee's compensation costs multiples of the amount for his or her employment in the United States. U.S. and foreign taxes paid on behalf of the employee by the employer make up a substantial fraction of the additional cost the employer incurs.

The territoriality principle should apply to the employee's foreign source income no less than to the employer's. Under present law, this principle is recognized only to a limited degree by the provision of a foreign earned income exclusion of $70,000. Given the costs of employment in many foreign jurisdictions, this exclusion is too low to allow many of the technical and managerial personnel to maintain a living standard comparable to that they would have in employment in the United States. The exclusion, therefore, should be materially increased. Doing so would reduce the cost to American companies of relying on American personnel in the companies' foreign operations and would thereby certainly enhance these companies' competitive position.

Reduce Payroll Tax Rates

One of the major impediments to growth, market efficiency, and international competitiveness is the artificial escalation of unit labor costs resulting from government policies. Payroll taxes are major offenders in this regard. They increase the employer's total compensation costs, hence curtail the amount of labor services demanded by employers. At the same time, payroll taxes raise the price that employees demand for their services, thereby curtailing labor supply. It is impossible to reconcile payroll taxes that impose these excise effects with the widely-professed desire by public policy makers to improve the competitive position of American business in the world market. Reducing both payroll tax rates and the compensation base to which they apply should receive high priority in a pro-competitive tax program.

Payroll tax reduction necessarily implies significant changes in the existing Social Security and Medicare programs. The track records of both urge that these programs should be phased down, with responsibility for provision of retirement income and of medical care insurance for older persons shifted back to the private sector. As the Committee knows, several members of Congress have developed proposals for privatizing both of these functions, without jeopardizing the situations of current beneficiaries or of persons who would become beneficiaries in the succeeding one or two decades. One of the important byproducts of implementing these proposals would be significant increase in personal saving and enhancement of the individual's responsibility for his or her own economic well being.

Moderate the Income Tax Bias Against Individual Saving

The tax bias against saving in the existing income tax can and should be eased by various tax changes, such as expansion of IRAs and reducing constraints on their use and substantial liberalization of employer-provided pension plans, including 401(k) and similar provisions.

Neutrality in the income tax treatment of saving and consumption calls for either excluding from income subject to tax income that is saved while fully taxing all of the gross returns on the saving, or including income that is saved in the tax base while fully exempting from tax all of the returns on the saving. The Bentsen-Roth IRA proposal combines both, giving the individual taxpayer the choice as to which approach better serves his or her needs. The exclusion from employees' taxable income of employers' contributions to retirement income plans conforms with the former approach to neutral tax treatment of saving. Limits on the amount of employees' income that may be saved in this way and excluded from taxable income are arbitrary and should be eased, if not eliminated.

Reduce the Marginal Tax Rate on Capital Gains

Neutral tax treatment of saving, as explained above, calls for the complete exclusion of capital gains from taxable income, given the fact that the saving invested in capital assets comes from after-tax income. Not only does taxing capital gains violate the neutrality criterion, it also distorts the signals cast up by the financial markets and impairs the efficiency with which these markets operate by immobilizing capital assets. As a first step toward neutrality in this respect, the rate at which capital gains are taxed should be significantly reduced. To prevent the effective rate from escalating thereafter, the basis of capital assets should be indexed by the inflation rate.

An alternative approach to moderating the tax bias against saving in this regard would be to provide rollover treatment for all capital gains, deferring the tax on realized gains to the extent they were reinvested in other eligible assets, reducing the basis of the new assets by the amount of the deferred (indexed) gain.

Improve Capital Recovery Provisions

Tax neutrality requires expensing of outlays for depreciable business property or, equivalently, multiple year deductions in such amounts that the present value of the deductions equals the amount of the costs incurred to acquire the property and put it into use. The ACRS provisions and the increase in the investment tax credit enacted in 1981 roughly approximated expensing for a wide variety of depreciable property. TEFRA in 1982 rolled back much of the benefits of the 1981 legislation, and TRA86 repealed the investment credit and further curtailed ACRS. Since 1981, the tax law has moved in the wrong direction with respect to production facilities.

The Committee has heard testimony from other witnesses concerning the impact of the 1986 revisions of the capital recovery provisions on the cost of capital, particularly for machinery and equipment. The occasion for reconsideration of capital recovery allowances, however, is far more substantial than the percentage increase in capital cost for any particular kind of depreciable property wrought by the TRA86 or the comparison of U.S. provisions with those of other countries. The issue isn't whether the cost of capital is higher in the United States than in other countries. The real concern should be that the cost of capital here is higher than it would be if the capital recovery provisions in the federal income tax conformed more closely with the neutrality standard. These provisions should be revised to conform more closely with the neutrality requirements presented above, no matter by how much doing so would reduce the cost of capital here or in comparison with that of businesses in other countries.

A useful first step would be provide a significant first-year deduction for capital outlays. The deduction might be 100 percent of the first, say, $200,000 of capital outlays in the taxable year, plus, say, 10 percent of any additional outlays in the year. An alternative approach might be to maintain the present write-off schedules for depreciable property and to provide a significant additional deduction when the property is retired and replaced. Neither the additional first-year or terminal year deductions should be treated as a preference item for alternative minimum tax purposes.

Provide expensing of research, experimentation, and development outlays

R, E, and D outlays differ from other capital outlays primarily with respect to the greater risk their undertaking involves. In the usual case, a substantial amount of such outlays result in no direct income-generating results. For this reason, requiring the write off of these outlays over some specified period of years is entirely arbitrary. For R, E, and D, as for investment in depreciable property, tax neutrality calls for expensing. While it may be feasible in the case of depreciable property to approximate expensing with extended period write offs, as suggested above, it is more difficult to do so in the case of R, E, and D. As a first step, therefore, some significant fraction of R, E, and D expenditures, say 50 percent, should be expensed. Short of this, the present R and E credit should be made permanent and should apply to all R and E outlays, not merely to incremental expenditures, and not merely to outlays for so-called basic scientific research. The objective of the credit is to facilitate innovation in products and production processes and the implementation of these innovations. Distinctions between pure and applied research, experimentation, and development do not belong in the Internal Revenue Code and are not appropriately made by the Internal Revenue Service.

Reduce the Alternative Minimum Tax

The alternative minimum tax on corporations, enacted as part of TRA86, is in effect a special additional excise on corporate business growth. In most cases, AMT is triggered by additions to the company's stock of depreciable assets, because the capital recovery allowances for ordinary tax purposes exceed those allowed for AMT purposes during the first several years after the property is acquired. The ordinary tax capital recovery allowances, as pointed out above, are a retreat from neutral tax treatment of investment in depreciable property; the AMT allowances are wholly arbitrary. This anti-growth excise effect should at the least be moderated, by drastically reducing the AMT rate or by substantial modifications in the designation of preferences, particularly in the case of capital recovery allowances. It would be desirable, for example, to replace the AMT system of allowances by those used for ordinary tax purposes, so that significant capital outlays would no longer trigger the AMT's imposition.

Conclusion

Beyond doubt, the agenda of tax revisions delineated above would result in a substantial reduction in federal tax revenues, whether measured by the conventional static revenue estimating techniques or by more realistic dynamic revenues estimating methods. Rather than viewing this revenue effect as a draw back or as limiting serious consideration of the proposals, the focus should be on the effects of the proposed tax changes on the performance of the U.S. economy. It is difficult, if not impossible, to make a case that the results would be anything but highly salutary.

One of the highly desirable results of the decrease in federal tax revenues that would result from implementation of this agenda would be the strong pressures that would be exerted for curtailing federal outlays. As I've stated above, federal spending programs themselves impair the economy's efficiency and erect barriers to effective competition by American businesses in the world marketplace. If nothing else were needed by federal policy makers to signal the need for the most rigorous reevaluation of federal spending, the mere fact that outlays will be 25 percent or more of GNP this year should ring alarm bells. Over the last several years, the fiscal policy has been to have revenues chase after spending. This is topsy-turvy fiscal policy. What is needed is the creation of a tax system that will least impair the efficiency and growth of our economy, and a budget policy that constrains spending to no more than that tax system generates in revenues. I respectfully urge the agenda presented above as a modest beginning effort to the attainment of that tax system.