Ph.D. Dissertation, 2014

A Prelude to Fiscal Gridlock of the United States

Social Policy, Taxation and Policymaking of the Administration of John F. Kennedy

Seiichiro Mozumi
The Graduate School of Economics, Keio University, Tokyo

Contents

Introduction: The United States as a Gridlocked State

The United States has huge flows of red ink in the Federal budget. Federal government spending grew substantially during the George W. Bush administration. Measured in current dollars, total federal outlays increased 49 percent between fiscal year 2001 and 2007, from $1.86 trillion to $2.78 trillion. That was almost twice as fast as the rate of growth in federal spending under President Bill Clinton.[1] After the global financial crisis in 2007-2008, the federal government attempted to blow a hole in its finances as it plugged the gaps caused by lost revenues from the crash with deficit spending and debt issuance. By 2013, the amount of debt accumulation has reached to $2013 trillion.[2]

The fiscal conditions sent the country huge shock waves. On May 16, 2011, the amount of accumulated federal debts reached to its statutory ceiling ($14.294 trillion). Then the secretary of the Treasury Department, Timothy F. Geithner stated that the federal government could avert the default by the measure such as the suspension of the contribution to Federal Employee Retirement System. On Friday, August 5, 2011, however, the United States lost its AAA credit rating when it was downgraded to AA+ by the rating agency Standard & Poor's (S&P's). On the following Monday, August 8, 2011, the Dow Jones Industrial Average (DJIA) lost 635 points, its sixth worst loss ever.[3] To avoid the default, on August 11, 2011, President Barack Obama signed Budget Control Act of 2011 that would provide coercive

---

[1] Office of Management and Budget, *Historical Tables, Budget of the United States Government, Fiscal Year 2008*, 25-26.
[2] Mark Blyth, *Austerity: The History of a Dangerous Idea* (New York: Oxford University Press, 2013), 6.
[3] Ibid., 1.

across-the-board spending cuts (about $1,200 billion for next 9 years) effective on January 2, 2013 unless the Congress would reach to the agreement on the spending-cut bill by January 1, 2013, the day before that tax increase and government spending cuts would be carried out – so-called "the fiscal cliff." The Congressional Budget Office (CBO) estimated that it would bring about the drop of GDP by 0.5% with the rise of unemployment to 9.1% in 2013.[4] Though the federal government has attempted to avoid the crisis by the American Taxpayer Relief Act of 2012, or the Continuing Appropriation Act 2014 on October 17, 2013, the debate concerning over federal debt spending and debt ceiling has been continuing.

There are two obstacles that have prevented Republicans and Democrats from reaching to the agreement; tax increases on the one hand, and spending cuts on the other. When these issues were taken upon the table and the news headline, "austerity," the policy of cutting the state's budget, debts, and deficits to inspire "business confidence" and promote growth, has been advocated as supposed cure since the government, its advocates believe, would neither be crowding-out the market for investment by sucking up all the available capital through the issuance debt, nor adding to the nation's already "too big" debt. If government spending is cut, however, its effects will be unfairly and unsustainably distributed across the income distribution. Those at the bottom of the income distribution will lose more than those at the top just because those at the top rely far less on government-produced services and can afford to lose more because they have more wealth to start with. The middle or the bottom half of the income and wealth distribution usually rely on the government services that are the

[4] Congressional Budget Office, *Economic Effects of Policies Contributing to Fiscal Tightening in 2013* (November 2012), 1.

transfers across the income distribution. In short, as Mark Blyth criticized, "Austerity policies mean the deprivation of public services of them inequitably."[5]

While the debate concerning over federal debt spending and debt ceiling has been continuing, the crisis of State and local government finance has emerged as another issue. Since American economy turned into the recession since 2007, of 289 cities that more than 100 thousands people populate, four cities applied for the Chapter 9 of the "Bankruptcy Code": Vallejo (2007), Stockton (2012), San Bernardino (2012), California, and Detroit (2013), Michigan. All these localities experienced rapid growth of economy and population involved with industrial development. Detroit in the first 20 years of the early 20th century, on the one hand, experienced the development of motor vehicle industry, and the inflow of the workers from European countries, Canada, Mexico and the other regions of the United States. During the WWII, African American flocked into Detroit against backdrops of the shortage of labor force, the decrease in immigrants from Europe, and the segregation inside the military and in the other areas, mainly in the South. After the WWII, on the other hand, the development and expansion of government military facilities happened in Vallejo, Stockton, and San Bernardino, which boosted the populations and economies of the cities as a part of Sunbelt. In the late 20th century, however, all of these cities experienced the decline because of the change of industrial structure, the social affairs such as segregation, the widened gap between the wealthy and the poor and the outflow of population, and poverty,[6] which resulted in leading up to the reduction of their tax base and the increase in property taxes, the resistance against social services and tax increase, and today's crisis of State

[5] Mark Blyth, *Austerity*, 14.

[6] Chapter I will demonstrate the detail of the transformation of economic situation and social affairs after the WWII.

and local government finance.[7]

American Welfare State could have been in charge of dealing with the changes of social affairs through operating social policies. The studies concerning over American welfare state, however, argued that it has restrained the size of direct social expenditures smaller than that of European welfare states.[8] As Christopher Howard demonstrated, today it is generally argued that American Welfare State has increasingly utilized conventional tax preferences as "tax expenditures," expanding the so-called "Hidden Welfare State."[9] In response to the argument, however, Eugene Steuerle pointed out that expanding use of tax expenditures has narrowed tax base after WWII.[10] The CBO demonstrated that it has favored higher-income classes unfairly relative to lower-income classes.[11] Suzanne Mettler renamed the "Hidden Welfare State" the "Submerged State." She pointed out that it has consumed considerable amount of the tax revenues available for programs for low- and middle-income classes and has

---

[7] W. Elliot Brownlee, "Bankruptcy in Detroit: A Crisis that Illuminates the Social Order" (in Japanese) in SEKAI (The World), no. 849 (November 2013), 161-168: Isaac W. Martin, "The Urban Crisis that Tax Resistance Produced" (in Japanese) in SEKAI (The World), no 849 (November 2013), 169-174.

[8] Theda Skocpol, *Social Policy in the United States: Future Possibilities in Historical Perspective* (Princeton: Princeton University Press, 1995); Margaret Weir, "The Federal Government and Unemployment: The Frustration of Policy Innovation from the New Deal to the Great Society" in Margaret Weir, Ann S. Orloff, and Theda Skocpol ed., *The Politics of Social Policy in the United* States (Princeton: Princeton University Press, 1988). Norman Furniss and Timothy Tilton, *The Case for the Welfare State: From Social Security to Social Equality* (Bloomington: Indiana University Press, 1977); June Axinn and Herman Levin, *Social Welfare: A History of the American Response to Need* (New York: Dodd, Mead & Company, 1975).

[9] Sven Steinmo, *The Evolution of Modern States: Sweden, Japan, and the United States* (New York: Cambridge University Press, 2010); Michael B. Katz, *The Price of Citizenship: Redefining the American Welfare State, Updated Edition* (Philadelphia: University of Pennsylvania Press, 2008); Jacob S. Hacker, *The Divided Welfare State: The Battle over Public and Private Social Benefits in the United States* (New York: Cambridge University Press, 2002); Christopher Howard, *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States* (Princeton: Princeton University Press, 1997).

[10] C. Eugene Steuerle, *Contemporary U.S. Tax Policy, 2nd ed.* (Washington, D.C.: The Urban Institute Press, 2008), 38-42.

[11] Congressional Budget Office, *The Distribution of Major Tax Expenditures in the Individual Income Tax System,* (http://www.cbo.gov/sites/default/files/cbofiles/attachments/43768_DistributionTaxExpenditures.pdf, 2013).

submerged from people's sight how it provides benefits.[12]

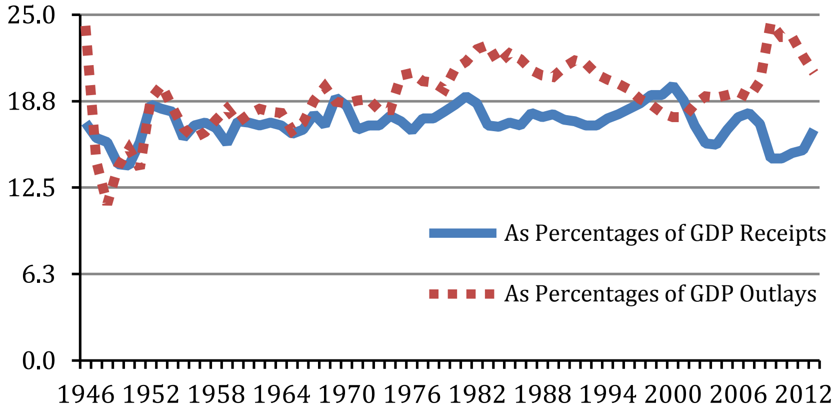
Now, the United States does not have the ability to raise tax revenues to finance its public policies, and to help the lower- and middle-income classes out of persistent unemployment and poverty. How a fiscally gridlocked state has the United States become?

I. The Beginning of Small Taxation in 1960s

Why has the federal deficit accumulated? Figure 1 shows the trends of federal government outlays and receipts as percentages of GDP. Since the end of WWII, especially since the late 1960s, federal government receipts as a percentage of GDP have not increased relative to the high rate of growth of outlays. In 1990s, the budgetary condition had moved from a deficit to surpluses because of the economic growth, the restraint of direct federal expenditure increase, and the increase in federal income tax rates under the administration of Bill Clinton. George W. Bush, however, broke it by five-time tax cuts and the expansion of defense outlays at the cost of direct social spending. Throughout 21st century, federal receipts as a percentage of GDP have never kept up with the growth of federal outlays as a percentage of GDP has increased.

[12] Suzanne Mettler, *The Submerged State: How Invisible Government Policies Undermine American Democracy* (Chicago: The University of Chicago Press, 2011).

Figure.1 Trends of Federal Government Outlays and Receipts as percentages of GDP



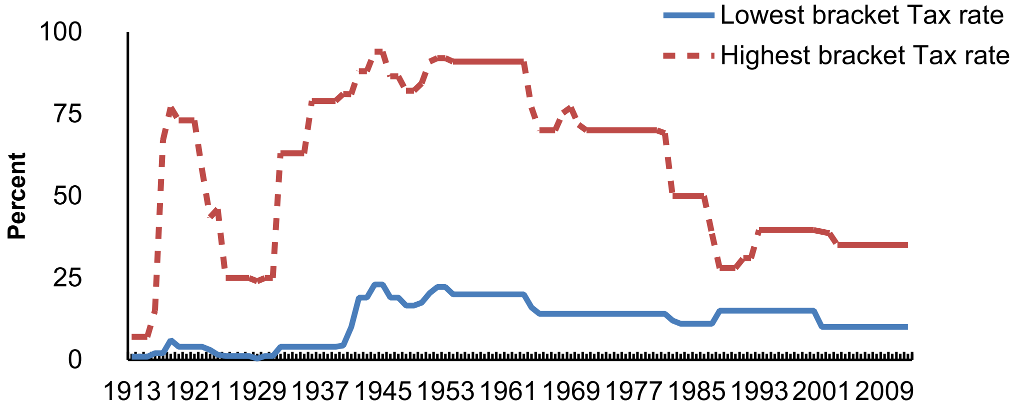
Source: Office of Management and Budget Historical Tables [http://www.whitehouse.gov/omb/budget/Historicals]

It might be to raise tax revenue that is a mean to avoid the continuing deficits, and austere direction. Tax policies accomplished in 20th and 21st century in the United States, however, have produced not only huge flows of red ink in the Federal budget but also an inequitable income tax system through frequent use of tax-cut measures, which has provided “small taxation” and the obstacle to tax increase. Hundreds of thousands of homeowners across the United States rebelled against the repeal of the privileges for local property tax in the 1970s. After this wave of tax revolt, Political entrepreneurs – mostly in the Republican Party – seized on tax cuts as a populist issue that they could use to define themselves and their party in the political market place. They led the charge for what would become the largest income tax cut in American history, the Economic Recovery Tax Act of 1981.[13] The memory of the campaign and the tax cut, according to Jacob Hacker and Paul Pierson, lighted George W. Bush to

[13] Isaac W. Martin, *The Permanent Tax Revolt: How the Property Tax Transformed American Politics* (Stanford: Stanford University Press, 2007), 1-2.

accomplish tax cuts five times.[14] The Bush tax cuts mainly benefited corporates and the wealthy, curtailed the capability of Federal government to finance its direct expenditures, and weakened the equity and progressivity of the Federal income tax system.[15]

Figure 2. Highest and Lowest Bracket Individual Income Tax Rate, 1913-2012



Source: Tax Policy Center
[http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=543]

When did the "tax cut" history begin? Figure 2 shows Federal individual income tax rates have generally declined since early 1960s. The lowest rate increased in 1988, so did highest rate in 1991 and 1993, and both of them did in 1968. But the increase in 1968 was temporary, and both rates declined to the previous level in 1970-71. The tendency of frequent use of tax-cutting measures through rate reduction and tax preferences appeared in the early 1960s, the period of the administration of John F. Kennedy.

---

[14] Jacob S. Hacker and Paul Pierson, *Off Center: The Republican Revolution and The Erosion of American Democracy* (New Haven: Yale University Press, 2005), 30.

[15] Joel Slemrod and Jon Bakija, *Taxing Ourselves: A Citizen's Guide to the Debate over Taxes, 4th ed.* (Cambridge and London: The MIT Press, 2008); Eugene C. Steuerle, *Contemporary U.S. Tax Policy, 2nd ed*. (Washington, D.C.: The Urban Institute Press, 2008); W. Elliot Brownlee, *Federal Taxation in America: A Short History, 2nd ed.* (Cambridge: Cambridge University Press, 2004). The five-time tax cuts of George W. Bush mainly accomplished the reduction of individual income tax rates, temporary estate tax cuts, accelerated depreciation, the exclusion of dividend income, the cuts in capital gain taxes, and the provisions for corporate tax breaks. Bush tax cuts also included other measures such as the expansion of child tax credit and the deduction of higher education.

II. The Policies of Kennedy Administration and Its Evaluation

In the 1960s, Kennedy administration adopted the combination of the restraint of social expenditure increase and tax cuts. On the one hand, they accomplished the expansion of public assistance programs such as Aid to Dependent Children (ADC) to Aid to Families with Dependent Children (AFDC) and unemployment compensation, and attempted the expansion of education and training programs such as Area Redevelopment Act (ARA) and Manpower Development and Training Act (MDTA). But previous studies evaluated these programs as follows: The fact that educational and training programs were futile for the needy and that the administration focused on the expansion of public assistance programs on the one hand;[16] and on the other hand, budget expenditures increase for public services such as education and training programs were restrained in the early 1960s because the policymakers such as the Council of Economic Advisers (CEA) desired the accomplishment of high rate growth and the alleviation of poverty and economic inequality through tax cuts and minimum government expenditures.[17]

On the other hand, Kennedy administration initiated two tax cuts, one in 1962; and the other enacted in 1964, "Kennedy-Johnson tax cut," which has been

---

[16] Sven Steinmo, *The Evolution of Modern States: Sweden, Japan, and the United States* (New York: Cambridge University Press, 2010); James T. Patterson, *America's Struggle against Poverty in the Twentieth Century* (Cambridge: Harvard University Press, 2000); Michael B. Katz, *In the Shadow of The Poorhouse: A Social History of Welfare in America* (Basic Books, a division of Harper Collins Publishers, 1986).

[17] Theda Skocpol, *Social Policy in the United States: Future Possibilities in Historical Perspective* (Princeton: Princeton University Press, 1995); Margaret Weir, "The Federal Government and Unemployment: The Frustration of Policy Innovation from the New Deal to the Great Society" in Margaret Weir, Ann S. Orloff, and Theda Skocpol ed., *The Politics of Social Policy in the United* States (Princeton: Princeton University Press, 1988); Herbert Stein, *Fiscal Revolution in America* (Chicago: The University Press of Chicago, 1969).

often cited as the largest postwar tax reduction until 1981. One of them in 1962, originally proposed on April 20, 1961, was enacted as the tax cut involving with investment credit, depreciation reform to promote private investment for plant and equipment, and several tax structural reform measures to offset revenue losses. The other in 1964 provided huge rate cuts of individual and corporate income tax, and a few structural reforms. Though their explanation have differed somewhat, all scholars who discussed the tax cut have concluded that they marked a major departure in using tax policy as an economic stimulant incorporating Keynesian ideas.[18] And Walter W. Heller, who served on the chairman of the CEA from 1961 to 1965, called the two tax cuts as a part of "the completion of Keynesian revolution."[19]

Many existing studies have been argued that the "Keynesian revolution" elevated the importance of the national budget because effective fiscal policy was viewed as the key to economic prosperity in the 1950s and 1960s. According to them, by the late 1950s, leading economists increasingly saw the balanced budget dogma as the main obstacle to rational economic policymaking. And president's

---

[18] Steuerle, *Contemporary U.S. Tax Policy*; Brownlee, *Federal Taxation in America*; Julian E. Zelizer, *Taxing America: Wilbur D. Mills, Congress, and the State, 1945-1975* (Cambridge University Press, 1998); Iwan W. Morgan, *Deficit Government: Taxing and Spending in Modern America* (Chicago: Ivan R. Dee, Inc., 1995); Ronald F. King, *Money, Time, & Politics: Investment Tax Subsidies & American Democracy* (New Haven & London: Yale University Press, 1993); Cathie Jo Martin, *Shifting the Burden: The Struggle over Growth and Corporate Taxation* (Chicago and London: The University of Chicago Press, 1991); John F. Witte, *The Politics and Development of the Federal Income Tax* (The University of Wisconsin Press, 1985); W. Elliot Brownlee, *Dynamics of Ascent: A History of the American Economy, 2nd ed*. (Alfred A. Knopf, Inc., 1979); Herbert Stein, *The Fiscal Revolution in America* (Chicago and London: The University of Chicago Press, 1969); Edward S. Flash, Jr., *Economic Advice and Presidential Leadership: The Council of Economic Advisers* (New York: Columbia University Press, 1965). It should be noted, however, that Stein changed his assessment on the 1964 tax cut: "The idea that domesticated Keynesianism had become the accepted national policy by 1964, when the Kennedy-Johnson tax cut was passed, was wrong and naïve. From here that action does not look like the end of an evolution toward 'rationality' but merely looks like one episode in a history that was, and still is, far from completed." See Herbert Stein, "The Fiscal Revolution in America, Part II," in in Brownlee ed., *Funding the Modern American State, 1941-1995*, p. 197.

[19] Walter W. Heller, *New Dimensions of Political Economy* (New York: W.W. Norton & Company, Inc., 1966), 2.

economic advisers believed that deliberate pursuing the precise level of aggregate taxing and spending would give the state of the economy the most appropriate. In this context, while restraining the increase in federal social expenditures, Kennedy administration carried out two large tax cuts. After "Kennedy-Johnson tax cut" was accomplished by the administration of Kennedy's successor, Lyndon B. Johnson, the United States turned into the most prosperous time in the postwar period. Then, "Keynesianism's greatest triumph came with the large tax cut enacted by Congress in 1964."[20]

In the late 1960s, deliberate creation of budget deficits through fiscal policy was no longer evil for policymakers. On the basis of the idea that had been formulated by Kennedy administration, Johnson administration succeeded in the expansion of social programs and expenditures in the name of the policy for "Great Society."[21] Keynesian presidential advisers then developed a hybrid concept, the "full-employment" budget. The idea was that the government would adopt fiscal policies that would cause the budget to be in balance at full employment. The Kennedy-Johnson tax cut and social program expansion by Johnson administration were explicitly sold to the public on these grounds. Walter W. Heller, who was the chairman of the CEA during Kennedy administration, later called it "the completion of Keynesian revolution."[22] Then, it is said the expansionary fiscal regime through taxing and spending appeared on the center of the economic policy for prosperity – including this

---

[20] Eric M. Patashnik, "Budgeting More, Deciding Less," in Martin A. Levin, Marc K. Landy, and Martin Shapiro eds., *Seeking the Center: Politics and Policymaking at the New Century* (Washington D.C.: Georgetown University Press, 2001), 42.

[21] Michael B. Katz, *In the Shadow of the Poorhouse: A Social History of Welfare in America* (Basic Books, A Division of Harper Collins Publishers, 1986), 254.

[22] Walter W. Heller, *New Dimensions of Political Economy* (New York: W.W. Norton & Company, Inc., 1966), 2.

period, Eugene Steuerle termed the period from 1950s to 1970s "the era of easy finance."[23]

In the context of the effect of inflation to push taxpayers slowly into higher tax brackets, "bracket creep," tax policy had taken the enviable form of returning some of the revenues to voters in the form of "tax cuts," while retaining some of them for government programs. When the economy experienced "stagflation" in the mid-1970s, however, Keynesians were bewildered and lost confidence, and the expansionary fiscal regime began to collapse. The crucial background condition was the sharp fall in economic growth in the mid-1970s as the long postwar boom came to an abrupt end. Then poor economic performance dampened tax revenue growth, pushed up public expenditures, especially in social programs, and led to stagnant real incomes for most of the population. Then the dominant economic goal shifted from stimulating consumer demand to controlling inflation and boosting productivity. These changes were reinforced by three policy shifts that were adverse to the expansionist regime and helped fuel the shift to a climate of austere trends: the maturation of existing governmental commitments that crowd out potential new spending initiatives, and the expanding role of tax expenditures in the federal budget.[24] The indexation of tax brackets introduced in 1981 was the juncture that tax revenues had raised by "bracket

[23] Particularly, Steuerle argued tax-cutting measures fitted in nicely in postwar era till late 1970s. See Eugene C. Steuerle, "Financing the American State at the Tum of the Century," in W. Elliot Brownlee ed., *Funding the Modern American State, 1941-1995: The Rise and Fall of the Era of Easy Finance* (Cambridge, Eng. and Washington, D. C.: Cambridge University Press and Woodrow Wilson Center Press, 1996), 409-444. But I don't regard this period as "the era of easy finance," at least from the late 1950s to the early 1960s. As chapter 2 and 3 demonstrate, the policy-makers, especially staffs of Office of Tax Analysis of the Treasury Department, thought that government expenditure increase devised in the period needed more tax revenues than being actually raised. And as Chapter 4 demonstrates, the increase in government expenditure for nondefense programs was continuously restrained throughout the early 1960s.

[24] Paul Pierson, "From Expansion to Austerity: The New Politics of Taxing and Spending" in Martin A. Levin, Marc K. Landy, and Martin Shapiro eds., *Seeking the Center: Politics and Policymaking at the New Century* (Washington D.C.: Georgetown University Press, 2001), 61.

creep" turned restrained. Because of the "tax-cutting culture" till 1970s, after 1981, by contrast, government's seeking higher revenue would face the politically precarious task of voting openly for new revenues. The restraint on the revenue side made the policy-making on the spending side so much harder. By the mid-1980s, very few politicians or mainstream economists believed anymore in using the budget to manage the economy. The expansionary fiscal regime operated in the name of "Keynesian" finally gave way to a regime of "austerity" that politicians scrambled to keep existing programs in check, and significant spending initiatives were effectively precluded.[25]

III. The Ideas about Fiscal Policy of Keynes and His Contemporaries

While the fiscal regime of the United States had gradually been shifting from expansionary to austerity, the criticism against the idea of John Maynard Keynes and "Keynesian" in the circle of fiscal community in the 1970s. The representative critics against Keynes and "Keynesian" were James M. Buchanan and Richard E. Wagner, who attacked "Harvey Road Presumption" *Democracy in Deficit*.[26] But did they really grasp the real thought of Keynes?

The letter Keynes sent Franklin D. Roosevelt in late 1933 and *The General Theory of Employment, Interest and Money*, it's generally said, spread Keynes' fiscal thought.[27] In both writings, however, he advocated a completely different tax policy from the 1964 tax cut, which has been generally regarded as representing

[25] Eric M. Patashnik, "Budgeting More, Deciding Less," 43-44; Paul Pierson, "From Expansion to Austerity: The New Politics of Taxing and Spending," 56-61; C. Eugene Steuerle, "Financing the American State at the Turn of the Century," 419-425.
[26] James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, Inc., 1977).
[27] This letter appeared on *The New York Times* on December 31, 1933.

"Keynesian policy." To stimulate national purchasing power as a short-range measure for recovery from the slump, in the letter for Roosevelt, Keynes emphasized the importance of the transfer through taxation and existing income to finance governmental expenditure, while describing the passage of recovery measures, social reforms that were long overdue, and the price stability through monetary policy as long-range purpose.[28] As Seymour E. Harris, who is called as one of most famous "Keynesian" economists, described, "Keynes scarcely ever mentioned tax reduction as the appropriate approach."[29]

In *General Theory*, Keynes elaborated his tax thought more clearly. He argued that a low propensity to consume under highly developed capitalism would widen the gap between aggregate income and aggregate consumption, and this would in turn reduce the incentive for investment while increasing savings. Then Keynes wrote that "Income taxes, especially when they discriminate against 'unearned' income, taxes on capital-profits, death-duties and the like are as relevant as the rate of interest…If fiscal policy is used as a deliberate instrument for the more equal distribution of incomes, its effect in increasing the propensity to consume is, of course,

---

28 Donald Moggridge, *The Collected Writings of John Maynard Keynes, Volume 21: Activities 1931-1939: World Crises and Policies in Britain and America* (Macmillan: Cambridge University Press, 1982), pp. 290-293.

29 Seymour E. Harris to Arthur Burns, October 18, 1962, Historical Special Collection (HSC), Harvard Law School Library (HLSL), Stanly Surrey Papers Collections (SSPC), Box 59, File No. 208-4C, File: Consultants Prof. Seymour Harris (B), 1962-1968. He went on: "I believe in reading certainly everything that Keynes wrote I only found one or two instances when he discussed the possibilities of tax reduction as an approach to treating the economy in depression." Certainly, as he said, Keynes, Hansen and Lerner mentioned tax cuts as the measure for stimulating recovery. However, I would put greater emphasis on following two points. At first, when Keynes referred to the possibility of tax cut in *The Means to Prosperity* in 1933, the world was in the midst of Great Depression. Keynes recommended tax cuts as temporary measures to promote recovery. Hansen and Lerner also argue that controlling individual income tax rates could have useful short-term purposes such as recovery and restraining inflation. Second, all of them, especially Keynes, stressed that tax cuts are applicable to all additional expenditure made, not in substitution for other expenditure, but out of savings or out of borrowed money. Their arguments were absolutely different from those of "Keynesian" See John M. Keynes, *The Means to Prosperity* (Oxford: Benediction Classics, 2011); Abba P. Lerner, *The Economics of Control: Principles of Welfare Economics* (New York: Macmillan, 1947); Alvin H. Hansen, *Economic Policy and Full Employment* (New York: McGraw Hill, 1947), pp. 137-144.

all the greater." "Assuming that the State applies the proceeds of these duties to its ordinary outgoings so that taxes on incomes and consumption are correspondingly reduced or avoided," he went on, "it is, of course, true that a fiscal policy of heavy death duties has the effect of increasing the community's propensity to consume."[30] In short, he suggested income tax reform aimed at redistributing income equally through (a) the combination of capital levies such as capital gain taxation and estate and gift taxation to raise funds for government program, and (b) the reduction of taxes on income and consumption.

In *How to Pay for the War*, Keynes desired to take advantage of "the opportunity of war finance to effect a considerable redistribution of incomes in the direction of greater equality" through accomplishing a number of other interrelated goals. He sought to prevent inflation and the exhaustion of resources, to raise the fund for government expenditures to prevent deflation and unemployment in the first recession after the war, and to prevent the aggravation of the inequity of income and consumption level among working class, the capitalist and the rich. To accomplish these goals Keynes advocated: (a) Boosting progressivity sharply by the exempt minimum and a tax increase mainly on middle- and high-income classes, and (b) "Deferred pay."[31] In addition, to deal with the difficulty the government would face in accomplishing the recovery program and the retirement of debts accumulated during wartime, he argued for a general capital levy after the war to adopt a tax structure that would enable the government to finance the expansion of fiscal demands without increasing debts.[32] It can be concluded that Keynes

[30] John M. Keynes, *The Collected Writings of John Maynard Keynes, Volume 7: The General Theory of Employment, Interest and Money* (Macmillan: Cambridge University Press, 1973), pp. 94-95, 372-373.

[31] Keynes suggested it as a deposit of a certain part of tax revenue into a public institution that would be paid back to the public after the war when the economy declined.

[32] John M. Keynes, *How to Pay for the War* (London: Macmillan, 1940), pp. 34-51.

emphasized the boost of vertical and horizontal equity, progressivity, contra-cyclical tax flexibility and the ability of government to finance through income tax system.[33]

The two representative fiscal policy scholars in the United States, Alvin H. Hansen and Abba P. Lerner, followed Keynes tax thought.[34] Hansen made the following points: (a) Because the tax structure of the United States was based heavily on customs, excises and property taxes during the 1930s, it was likely to be heavily regressive and burdensome upon low-income classes; (b) Under such a tax structure, the increase in debt issues had expanded the income stream paid in the form of interest to the wealthy holders of bonds, making the economic inequity among each income classes worse; (c) The responsibility of the federal government to alleviate the fiscal difficulty of state and local governments through federal emergency expenditures had become significant; (d) It was necessary to carry out deficit financing not through bank credit expansion but voluntary savings to constrain inflationary pressure; and (e) The tax structure should be used to control the fluctuation of consumption in order to offset and correct the fluctuation of private investment and minimize general economic instability. Based on these points Hansen recommended a tax structure based on progressive taxation of individual incomes in order (a) to redistribute assets and income fairly, (b) to create private savings to pay for government expenditures, and (c) to balance the budget when

---

[33] It seems that Keynes drew his tax ideas from the development of British income tax system. Since 1799, the British income tax system had increased its progressivity until 1920, the year in which the full development of the progressive principle became a permanent part of English income tax. See F. Shehab, *Progressive Taxation: A Study in the Development of the Progressive Principle in the British Income Tax* (Oxford at the Clarendon Press, 1953). Focusing on the aspect of political economy, Martin Daunton examined the detailed process of its development. See Martin J. Daunton, *Just Taxes: The Politics of Taxation in Britain, 1914-1979* (Cambridge: Cambridge University Press, 2002); *Trusting Leviathan: The Politics of Taxation in Britain, 1799-1914* (Cambridge: Cambridge University Press, 2001).

[34] Heller reputed Hansen had achieved "Americanization of Keynes." See Heller, *New Dimensions of Political Economy*, 4. Lerner is generally reputed as one of old fiscal policy scholars influenced by Hansen.

national income approaches to full employment.[35] Lerner also argued "Total demand can be increased by a redistribution of income from the rich to the poor." Lerner went on as follows: "Increased taxes on the rich, offset by decreased taxes on the poor or by greater bonuses to the poor, will increase total demand without unbalancing the budget."[36]

Their ideas spread among economic scholars in the United States and were so influential for them to establish the theory of "Keynesian economics."[37] Compared the ideas of Keynes and his American contemporaries with the result of policymaking of Kennedy administration in the early 1960 – the combination of social expenditure restraint and tax cuts, however, it is quite obvious that Kennedy administration accomplished the "Keynesian policy" which was further away different from the one that Keynes, Hansen and Lerner really suggested. Then how and why did Kennedy administration took the combination – social expenditure restraint and tax cuts? Why has it been the result evaluated as the representative "Keynesian policy?" Finally, how has the result and the evaluation formed the modern American Welfare State that is gridlocked? This paper attempts to examine the three questions.

[35] Alvin H. Hansen, *Fiscal Policy and Business Cycles* (New York: W.W. Norton & Company, Inc., 1941), 125-185, 289-312.

[36] Lerner, *The Economics of Control,* pp. 319-320.

[37] In June, 1939, Hansen presented a preliminary report on *Fiscal Policy and Business Cycles* to a conference of specialist in the fields indicated, called together under the auspices of the Social Science Research Council at Rye, New York. Several famous scholars participated in the conference. They included Roy Blough, J.M. Clark, Gerhard Colm, Lauchlin Currie, Gottfried Haberler, C. O. Hardy, Simeon E. Leland, Abba P. Lerner, Arthur W. Margaret, Lawrence H. Seltzer, Carl Shoup, and John H. Williams. And he described he learned much from conversation with, and from the writings of Joseph A. Schumpeter, Haberler, and Seymour E. Harris, and from prolonged discussions on many points with graduate fellows and younger faculty members, especially J. Keith Butters, Emile Despres, John T. Dunlop, John K. Galbraith, R.V. Gilbert, Benjamin H. Higgins, G.G. Johnson, Martin Krost, Richard A. Musgrave, Kenyon E. Poole, Walter Salant, Paul A. Samuelson and Paul M. Sweezy. See Alvin H. Hansen, *Fiscal Policy and Business Cycles*, vii-viii.

IV. Organization of the Paper

This paper explores the emergence of the modern fiscal regime of the United States that is gridlocked, focusing on the era of Kennedy administration, especially on the period from the late 1950s to the early 1960s as the vital years. To comprehend the significance of the policymaking and its result of Kennedy administration, this paper must first appreciate their devisal of social programs and federal budget projection. Chapter 1 begins with the portrait of the economic, social, and State and local fiscal landscapes of the postwar period. It shows how the transformation of post war economy and social movements provided the United States with two faces – affluent society and the "Other America." Despite their traditional role as main operator of social programs, State and local governments had been losing their ability to deal with the appearance of transformation because of the defects of their tax system and federal grants system. Then State governors and Advisory Commission on Intergovernmental relations (ACIR) recommended the federal government launch the measures to resolve the problems concerning with both the change of social affairs and financial hardship of State and local governments. In response to them, Kennedy administration threw the significant attempts from viewpoints of the arguments of American Welfare State studies and intergovernmental relations studies – the expansion of social programs and expenditures through general or block grants. In addition, they crafted their program with the intention to grasp the public demand and economic and social condition. Therefore, their attempts could have been the watershed of the history of intergovernmental relations and social policy of the United States.

The conclusion of Chapter1 provides us with the next subject to consider – the ability of the United States as the state to accomplish a policy to deal with the change of social affairs – the ability to finance through the federal tax system. This is the point that has been ignored by the existing studies concerning over American welfare state and social policy, though Theda Skocpol emphasized its importance.[38] As we shall see in Chapter 2 and Chapter 3, however, the federal income tax system, a mean not only to finance federal public policy but also to help State and local finances out of their financial hardship, ended up in being transformed into a measure to pursue economic prosperity, due to a misuse of the idea and name of Keynes and his contemporaries by "Keynesians." Chapter 2 traces the process that tax reform in 1962 prevented the study of federal tax reform in the late 1950s from accomplishing its original goal –"one package" comprehensive tax reform. In the late 1950s, several tax experts, Tax Analysis Staffs (TAS) of the Treasury Department, and the Committee on Ways and Means (CWM) led by Wilbur D. Mills cooperated in examining the defects of federal tax system – narrow tax base, excessive high tax rate, the inequity among both income classes and types of income, and weak progressivity – and crafting the ideal tax reform proposal to be a description for them. In 1959, they finally reached to the agreement that every recommended tax change would have to be coordinated with other simultaneous changes in tax structure "as one package" constructive tax reform after Kennedy's inauguration. But the plan confronted with the recession of 1960-61 after the tax reform discussion, and with the argument of economic advisers of Kennedy for presidential campaign for stimulating investments through investment credits. By tax reform bill in 1961 composed of investment credit and several reform measures discussed in the late 1950s, one-package constructive tax reform plan torn apart. To

[38] Theda Skocpol, "Bringing the State Back In: Current Research" in Peter B Evans, Dietrich Rueschemeyer and Theda Skocpol eds., *Bringing the State Back In* (New York: Cambridge University Press, 1985), 3-37.

make matters worse for them, tax reform bill 1961, originally proposed as small tax increase, finally was enacted in 1962 as a relative larger tax cut in the last decade.

After tax reform bill 1961 was proposed, the staffs of the Treasury led by tax experts such as Stanley S. Surrey and Harvey E. Brazer, and Mills didn't abandon their ideal tax reform proposal and still continued their effort for its accomplishment in 1962 or 1963. As Chapter 3 will demonstrate, however, "Keynesian" economists appeared at the center of policymaking stage as members of the Council of Economic Advisers (CEA) for Kennedy after his inauguration, and crashed the effort of comprehensive tax reform proponents since 1950s by neglecting real Keynes' tax thought. Chapter 3 first examines the ideas about taxation of Surrey and the Treasury staffs, Mills and the CEA. Surrey and the other staffs of the Treasury followed a strong tradition of support within the Treasury, since the 1930s, for base-broadening reforms. Mills agreed to their ideas. In terms of domestic economic condition since 1950s, however, the CEA viewed the federal tax system had a strong revenue-raising capacity that had produced so much "full-employment budget surplus" as a "fiscal drag." And they argued that it should be eliminated by tax cuts as a "fiscal dividend." Inside Kennedy administration, the devisal of comprehensive tax reform bill proceeded along their tax thoughts, and reached the agreement among policymakers by November to be proposed as "one package" comprehensive tax reform in 1962. As the condition of political economy had been changing, the CEA turned their attitude into putting forth "two-step approach" that divided the "one package" tax reform plan into two parts – rate cuts first, and reform measures later. The Treasury and Mills compromised on the CEA plan to accomplish several base-broadening measures. As a result, most of base-broadening reform measures vanished, and the tax reform bill, which would have been proposed as “one package” comprehensive tax reform, was finally enacted as the largest tax cut until 1981.

Instead of the tax cuts, the CEA could have exerted social program expansion involving government expenditure increase, which they actually planned as we shall see in Chapter 1, as the other “fiscal dividend.” As Chapter 4 shows, however, they could not choose it because of very great resistance against added expenditure programs in the early 1960s. Kennedy administration devised the combination of the income security programs such as public assistances and public works and vocational training, and the expansion of the programs such as education and medical services. Most of them would be financed from general fund of the federal budget. But businesses and farmers opposed the expansion of deficit-finance for fear that it would increase inflationary pressure and the production cost they burdened. Inside the administration, the Cabinet, Kennedy, and the CEA didn’t reach the agreement over unemployment, economic recovery situation, and the expansion of social programs. And they also feared the opposition from fiscal conservatives of the Congress to their programs. Tax revenue didn’t increase more than the BOB estimated because of the continuation of slack. Then the debt limit was raised several times, but the margin of raised fund was mostly used for the increase in defense outlays. Moreover, tax reform bill was proposed as net tax cut in 1963, nondefense expenditures on general fund was restrained in order to secure the same amount of source as curtailed by tax cut, and to pass tax cut bill through the CWM and Senate Finance Committee (SFC). Finally, social expenditure for the programs the administration emphasized was restrained more than the administration expected.

The paper concludes “the completion of Keynesian revolution” accomplished by "Keynesian" in 1960s opened the door to the road to the modern "fiscal gridlock" of the United States. But it stands on a definitely different viewpoint of Buchanan and Wagner. As we saw in Section **III**, what Keynes really emphasized was the role of taxation as a mean to raise revenues to pay for government expenditures aimed at protecting the state and the public from the threat of the war and economic fluctuation. As the paper demonstrates, however, "Keynesian" in the period regarded taxation as a measure for economic prosperity in the face of the fiscal and political difficulty to increase government expenditures to stimulate economy as much as they desired. When Johnson administration began their attempt to accomplish tax increase to deal with the expansion of federal budget deficits and inflationary pressure, it was too late for them to retrieve the role of taxation that used to be, and what Keynes and his contemporaries thought of taxation. When "Keynesian" did away with them in the early 1960s, they let the United States into the road to be a gridlocked state that has made the public soaked in the idea of "austerity."

1

The Beginning of Austerity?: The Attempt of JFK Administration to Support State and Local Government Finance through Distributing Federal Fiscal Grants

Introduction

Kennedy administration accomplished the expansion of public assistance programs such as Aid to Dependent Children (ADC) to Aid to Families with Dependent Children (AFDC) and unemployment compensation, and attempted the expansion of education and training programs such as Area Redevelopment Act (ARA) and Manpower Development and Training Act (MDTA). But previous studies evaluated these programs as follows: The fact that educational and training programs were futile for the needy and that the administration focused on the expansion of public assistance programs on the one hand,[1] and budget expenditures for education and training programs were restrained in the early 1960s because the policy-makers such as the Council of Economic Advisers (CEA) desired the accomplishment of high rate growth and the alleviation of poverty and economic inequality through tax cuts and minimum government expenditures.[2]

---

1 Sven Steinmo, *The Evolution of Modern States: Sweden, Japan, and the United States* (New York: Cambridge University Press, 2010); James T. Patterson, *America's Struggle against Poverty in the Twentieth Century* (Cambridge: Harvard University Press, 2000); Michael B. Katz, *In the Shadow of The Poorhouse: A Social History of Welfare in America* (Basic Books, a division of Harper Collins Publishers, 1986).

2 Theda Skocpol, *Social Policy in the United States: Future Possibilities in Historical Perspective* (Princeton: Princeton University Press, 1995); Margaret Weir, "The Federal Government and Unemployment: The Frustration of Policy Innovation from the New Deal to the Great Society" in Margaret Weir, Ann S. Orloff, and Theda Skocpol ed., *The Politics of Social Policy in the United* States (Princeton: Princeton University Press, 1988); Herbert Stein, *Fiscal Revolution in America* (Chicago: The University Press of Chicago, 1969).

But this chapter examines the process that Kennedy administration devised their social programs and budget projection in terms of social and economic affairs and State and local government finance condition. Few previous studies have illuminated how the changes of social affairs before Kennedy administration's inauguration influenced the administration's budget projection and devisal of government programs. And despite the fact that State and local governments have traditionally carried out social programs in the United States, few studies have focused on the situation of State and local government finance in the period. This chapter demonstrates that Kennedy administration expected their devisal of social programs involving expenditure increase would resolve both the hardship of State and local government finance, and the emergence of two aspects of the United States: The "economically" affluent society on the one hand, and the depressed society on the other.

When one discusses over State and local government finances, intergovernmental relation through the distribution of federal fiscal grants appears as an important subject to be focus on. Many existing studies argued that "Cooperative Federalism" built during New Deal era has transformed into the following three forms: (a) "Creative Federalism" that federal government stepped into State and local finances through using categorical grants since the period of the administration of Lyndon B. Johnson, (b) "New Federalism" during the period of Richard M. Nixon that used "General Revenue Sharing (GRS)" and block grants to delegate authorities and discretions to State and local governments and increased the utilization of categorical grants and government regulations at the same time, and (c) "New Federalism," after the period of the administration of Ronald Reagan, combined "Competitive Federalism" that State and local governments incline to compete each other for economic development and obtaining revenue resources with "Coercive Federalism" involving the creation of new categorical grants and block grants and the increase in unfunded mandate.[3] And they have regarded (a) "Creative Federalism" of Johnson administration through using categorical grants as a germination of "Coercive Federalism," and (b) the consolidation of categorical grants into block grants accomplished by Reagan administration as a catalyst of progress of "Competitive Federalism." At least to my knowledge, however, no scholars have focused on the intergovernmental relations the period from post-WWII to the administration of John F. Kennedy. Thus to illuminate undiscovered historical facts, this chapter demonstrates that federal fiscal grants program crafted by Kennedy administration had the possibility that could have provide intergovernmental relations history with a different course from "Creating Federalism" and today's "New Federalism."

I. The Prosperity of American Economy and the Changes of Labor Market

After WWII ended in 1945, the United States became the most prosperous country in the world. GNP grew from $213 billion in 1945 to $500 billion in 1960. And National Income at constant price rose 25% during 1946-1959. But inflation progressed only at a rate of 2-3% during 1950s. The high rate of growth was led by substantial growth of military industry and manufacture. Several did so much of their business with federal government that they became dependent on Defense

[3] John Kincaid, "Three Faces of Contemporary American Federalism," in Iwan W. Morgan and Philip J. Davies eds., *The Federal Nation: Perspectives on American Federalism* (New York: Palgrave Macmillan, 2008), 63-81; David B. Walker, *The Rebirth of Federalism: Slouching toward Washington, 2nd ed.* (Chatham House Publishers of Seven Bridge Press, 2000).

Department orders.[4] In the South and West, where much of the new military activity was concentrated, dependence on federal defense spending was even greater. Especially, the development and expansion of military facilities and defense contracting during the Cold War helped boost the populations and economies of Los Angels and other Sun Belt cities. Moreover, federal expenditure underwrote several portions of the cost of research on aviation and space, electricity and electronics, scientific instruments, and automobiles. With the government footing part of the bill, corporations transformed new ideas into useful products with unprecedented speed.[5]

The economic conditions changed the structure of labor market. Research and development of corporations increased new investment of plant and equipment in the boom, which progressed the automation and mechanization. Then the demand for the worker who didn't have skills or knowledges declined, while the demand for skilled worker who was able to control the plant and equipment increased. These changes occurred in the sectors that had been automated rapidly such as agriculture, iron and steel, mining, and automobile assembly.[6] In contrast, the number of the white-collar, one of sectors that grew the most rapidly, increased. From 1947 to 1957, whereas the number of factory worker decreased by 4%, the number of salaried office workers increased by 61%. Moreover, the growth of corporations and the increase in the people who were educated in colleges and universities brought about the increase in the number of workers in the dominant sectors in the late 20th century such as big business, government agencies, finance, and defense industries.[7]

---

[4] For instance, by the mid-1960s, Boeing and General Dynamics received 65% of their income from military contracts, Raytheon 60%, Lockheed 81%, and Republic Aviation 100%.

[5] Harld G. Vatter and John F. Walker ed., *History of the U.S. Economy since World War II* (New York: M.E. Sharpe, 1996), 65-70; W. Elliot Brownlee, *Dynamics of Ascent: A History of the American Economy, 2nd ed*. (New York: Alfred A. Knopf, 1979), 445-460; Harold G. Vatter, *The U.S. Economy in the 1950s: An Economic History* (New York: Norton, 1963), 1-27.

[6] Eleanor G. Gilpatrick, Structural Unemployment and Aggregate Demand: A Study of Employment and Unemployment in the United States, 1948-1964 (Baltimore: The Johns Hopkins Press, 1966), 40-49, 53.

[7] Ibid., 142-154.

II. The Growth of Suburbs, and the Decline of Cities

In the same period, American people gravitated toward urban areas called "Standard Metropolitan Statistical Areas (SMSA)."[8] The shift of population into SMSA explained 81% of the growth of total population in the United States during 1940-50, and 97% during 1950-55. The shift changed SMSA into the center of economic activities. According to a survey of Advisory Committee on Intergovernmental Relations (ACIR), 62 relatively larger metropolitan areas created two-thirds of added-value produced by manufacture industries in the United States in 1957, and held 78% of all bank savings in 1958. ACIR estimated that the tendency would continue and that total population of SMSA would increase about 80 million during 1950-80.[9]

There were strong cultural an class variations among suburbs. The outstanding increase in residents in the area occurred in the suburbs rather than in the cities. Most of suburban areas were agricultural areas when WWII ended. But quite a few residences were built during the Great Depression and the wartime so that veterans and their family faced with an acute shortage of residences after WWII. Then, in the suburbs, there was a dramatic surge in construction in the late 1940s and 1950s, and many people flocked to the areas from cities. In the suburbs, the older and wealthy, mainly white, occupied the most pleasant locations, such as the hills north and west of Los Angels, Chicago's North Shore. Less affluent firefighters, plasterers,

---

8 Bureau of Budget (BOB) defined SMSA as the county or group of counties that included at least one city populated by more than 50 thousand residents. The county that was essentially regarded as a metropolitan and was integrated with central city socially and economically were classified into metropolitan areas. Metropolitan areas usually consisted of a central city that had more than 50 thousand people and 10-50 miles surrounding areas.

9 Advisory Committee on Intergovernmental Relations (ACIR), "Briefing Paper: Metropolitan Areas," April 25, 1960, National Archives College Park (NACP), RG 56, Office of Tax Policy Subject Files (OTPSF), Box 31, File Folder #23: Advisory Commission on Intergovernmental Relations: Briefing Papers, 1960-61.

machine-tool makers, and sales clerks were far more likely to move to less pleasant location than the wealthy moved.[10] ACIR estimated that the increase in population during 1950-80 would be about 16 million (about 30%) in the cities, while about 64 million (about 180%) in the suburbs.

The flock to the suburbs raised the demand for automobile and highway system. The residents in the suburbs needed automobiles to get to work and to take their children to school. About 90% of suburban families owned cars, and 20% and more than one. In 1945 Americans owned 25 million cars, but by 1965 the number had tripled to 75 million. More cars required more highways, which were funded largely by federal government. In 1947, the Congress authorized the construction of 37,000 miles of highways; the National Interstate and Defense Highway Act of 1956 increased this commitment by another 42,500 miles. Highway construction expanded the area that automobile users moved. Moreover, the increase in the population in metropolitan areas involved the increase in the workers in the areas. Then ACIR estimated that improvement of mass transportation would be important issue to be resolved.[11]

III. The Baby Boom and the Education

Total population in the United State also increased due to the uprising in birth rate after WWII. The birth rate shot up between 1948 and 1953 mainly because of the drop in the marriage age that had begun during the war. The average age at marriage fell to twenty-two for men and twenty for women in the period. The drop in the marriage age resulted in so-called the "Baby Boom." Women

[10] Kenneth Fox, *Metropolitan America: Urban Life and Urban Policy in the United States, 1940-1980* (London: Macmillan Publishers Ltd, 1985), 57-70.
[11] ACIR, "Briefing Paper: Metropolitan Areas," April 25, 1960, NACP, RG 56, OTPSF, Box 31, File Folder #23: Advisory Commission on Intergovernmental Relations: Briefing Papers, 1960-61.

who came of age in the 1930s had an average of 2.4 children; their counterparts in the 1950s averaged 3.2 children. This explosion in fertility peaked in 1957 and remained at a high level until the early 1960s. As a result, the American population rose dramatically from 140 million in 1945 to 179 million in 1960.

The baby boom, and also the change in the labor market, prompted a major expansion of the nation's educational system and their needs. In their effort to direct large organizations through the uncertainties of the postwar economy, the managers of corporations placed more emphasis on planning. Increasingly, companies recruited top executives who had business-school training, the ability to manage information, and skills in corporate planning, marketing, and investment.[12] The parents in the period obtained the recognition that educational system was necessary to socialize their children and to obtain position, so that they

IV. The Other America

Whereas the post-war economic growth had been progressing, there were the people who couldn't enjoy its benefits. At first, the rural areas became depressed. The shift of energy resources from the coal to the oil in those days closed coal mines mainly around Appalachian mountains. In the agricultural sector, in the 1930s and 1940s, there was a sharp decline in the supply of farm labor as New Deal agricultural programs accelerated the mechanization of farming and as defense mobilization for WWII lured rural dwellers to the cities. The continuing shortage of agricultural labor in the postwar era spurred manufacturers to introduce new tractors, harvesters, and other farm machinery onto the market. Though new technology contributed to an astonishing increase in agricultural productivity after 1945, it also

[12] James A. Henretta, W. Elliot Brownlee, David Brody, Susan Ware, and Marilynn S. Johnson ed., *America's History Volume 2: Since 1865,* 3rd ed. (New York: Worth Publishers, 1997), 899.

required major capital investments. Between 1940 and 1955, the cost of fuel, fertilizer, and repairs for farm machines quadrupled, and total operating costs tripled. Then many family farms often lacked the introduction of new technology and investments, and many of them left the land for cities, which accelerated the inflow of population from rural areas into cities. An outstanding example is the case of cotton industry in the South: the progress of mechanization and the development of synthetic fiber such as Dacron and rayon made the number of cotton farms decreased from 43 million acre in 1929 to 15 million acre in 1959. As a result, the number of agricultural workers in the South declined from about 16.2 million in 1930 to 5.9 million in 1960. Total agricultural worker in the United States in 1945 was about 24 million (percent of total population was 17.5%). But in 1960, the number declined to about 15 million (percent of total population was 8.7%).[13]

The decline of rural areas engendered serious poverty and the poor, especially the poor of Latino and African American. Since the New Deal era, to deal with the shortage of labor force especially during WWII, the U.S. government had actively sought Mexican workers called "bracero" to come into the United States. Before WWII, most of braceros settled and engaged in agricultural work at agriculture in rural areas. Nearly 275,000 Mexicans came in the 1950s, and almost 444,000 in the 1960s. Under the bracero program, at its peak in 1959, 450,000 braceros entered the United States, accounting for one-quarter of the nation's seasonal workers. When the bracero program was discontinued in 1964, an estimated 350,000 postwar braceros settled permanently in the United States. Because of the decline of agriculture described above, however, they moved primarily to western and southwestern cities such as Los Angeles, Long Beach, El Paso, and Phoenix, where they found jobs as

[13] Frances Fox Piven and Richard A. Cloward, Regulating the Poor: The Functions of Public Welfare (New York: Pantheon Books, 1971), 200-205; Gilbert Fite, *American Farmers: The New Minority* (Bloomington: Indiana University Press, 1981), 101-136.

migrant workers or in the expanding service workers. They also settled in Chicago, Detroit, Kansas City and Denver. Another Spanish-speaking migrants were Puerto Ricans. Migration increased dramatically after WWII when the mechanization of the sugarcane industry pushed man rural Puerto Ricans off the land. Cuban refugees, third large group of Spanish-speaking migrants, left their land for the United States due to Fidel Castro's seizure of power in 1959. Internally, African American's flow into the cities also brought large numbers of people to the cities. Though the trend had already begun during WWI, about 3 million African American headed to Chicago, New York, Washington, Detroit, Los Angels, and other large cities between 1940 and 1960. From 1950 to 1960, the nation's twelve largest cities lost 3.6 million whites while gaining 4.5 million nonwhites.[14]

What the immigrants met in the cities, however, was terribly blighted environment of urban America such as unemployment, poverty and disadvantaged education that would be recognized as "inner city problem" later. After WWII, under urban renewal programs, city planners and real-estate developers razed blighted city neighborhoods to make way for modern construction projects. The projects demolished about 400,000 buildings and displaced 1.4 million people between 1949 and 1967, while produced high-rise housing projects and created anonymous open areas that were vulnerable to crime. Many downtown revitalization projects replaced established racial-ethnic neighborhoods with expensive rental housing or office buildings where suburban commuters worked.[15] Then those who lost their residences were forced into less desirable parts of the city. The 575,000 units

[14] James A. Henretta, W. Elliot Brownlee, David Brody, Susan Ware, and Marilynn S. Johnson ed., *America's History Volume 2,* 908-909.

[15] For instance, Boston's West End, a poor but flourishing Italian community, was razed by a private developer between 1958 and 1960 to build Charles River Park, and apartment complex whose rents were far too steep for the old residents. In San Francisco some 4,000 residents of the Western Addition, a predominantly black neighbor hood, were displaced under an urban renewal program that built luxury housing, a shopping center, and an express boulevard.

of public housing built nationwide by 1964 came nowhere close to satisfying the need for affordable urban housing. Due to the outflow of middle- and high-income classes to the suburbs, migrants found that many of those opportunities of work had relocated to the suburban fringe. Steady employment was out of reach for the poor, those who needed it, the most in the cities.[16]

V. State and Local Government Deficits and the Metropolitan's Structure

State and local government had historically taken the role to deal with the spreading issues in the United States. But State and local government revenues in the 1950s had not meet the expenditures, and then lost their ability to accomplish their role. Total expenditures of State and local governments between 1953 and 1957 was almost $200 billion. Total State and local governments revenues, however, about $149 billion. Then the left of gap between them, almost $49 billion, was bridged by financial aid from the federal government (about $16 billion) and borrowings (about $33 billion).[17] In 1958, total State and local government outlays rose to $44.851 billion, but the total revenues were only $41.219 billion.[18]

The accumulation of State and local government deficits stemmed from their tax structure that was composed of property taxes, estate and gift taxes, indirect taxes, and individual and corporate income taxes. But major revenue resources, indirect taxes and property taxes, were not elastic to the change of economic climate. Individual and corporate income taxes were introduced at the State

[16] James A. Henretta, W. Elliot Brownlee, David Brody, Susan Ware, and Marilynn S. Johnson ed., *America's History Volume 2,* 909-910.
[17] L. Laszlo Ecker-Racz and I. M. Labovitz, "Practical Solutions to Finance Problems Created by the Multi-Level Political Structure," Undated, NACP, RG 56, OTPSF, Box 30, File Folder #2: Practical Solutions to Finance Problems Created by the Multi-Level Political Structure, 1959.
[18] ACIR, "Briefing Paper: Metropolitan Areas," April 25, 1960, NACP, RG 56, OTPSF, Box 31, File Folder #23: Advisory Commission on Intergovernmental Relations: Briefing Papers, 1960-61.

and local level aimed at supplementing State and local revenues, but the percentage of them to total State and local tax revenues were so small. Though some States carried out the measures such as raising individual income tax rates or introducing withholding system, the percentage of them to total State and local tax revenues rose to about 6% in 1957 from 5% in 1953. State corporate income taxes, imposed in 34 states and Washington D.C., raised almost $1 billion per year, but it was only 6.6% of total state tax revenues, and less than 4% of total State and local tax revenues. Certainly, estate and gift taxes revenues had continued to increase with the rise of property values.[19] But the tax structure that mainly consisted of indirect taxes, estate and gift taxes and property taxes did not have the ability to meet the fiscal demand of State and local governments.

State and local government of course attempted to raise more tax revenues through tax increase measures. But it was almost impossible for State and local governments to accomplish self-finance to meet their fiscal demands through tax systems of their own. At first, there were the various ways among State and local governments that each of them had various individual and corporate income tax system, and whether they were adopted individual and corporate income tax systems or not.[20] 36.3% of total population in the United States was not taxed under State

[19] Total estate and gift tax revenues reached $168 million in 1950, $244 million in 1955, $340 million in 1957, and $344 million in 1958. L. Laszlo Ecker-Racz and I. M. Labovitz, "Practical Solutions to Finance Problems Created by the Multi-Level Political Structure," Undated, NACP, RG 56, OTPSF, Box 30, File Folder #2: Practical Solutions to Finance Problems Created by the Multi-Level Political Structure, 1959.

[20] As to individual tax system, by 1959, New Hampshire and Tennessee taxed only on interests and dividends, but 31 states and the District of Columbia introduced individual income tax at the state level, and 5 states did at the local level. Ohio and Pennsylvania didn't adopt State individual income tax system, but local tax system raised revenues to finance government activities. Of the other three states that adopted both state and local individual income tax system, local individual income tax imposed a certain income once in Missouri, and five times in Kentucky. Local individual income tax generally adopted low flat rate only on salary, wage, and the net profits of non-corporate businesses and professionals. Meanwhile, as for corporate income taxes, 28 states and the District of Columbia adopted flat rate, and 6 states graduate rate structure. Of the former, on the one hand, almost states employed 5% rate, but 1.75% in New Jersey, 2% in Iowa, Missouri and New Mexico, and 8% in Idaho. Of the latter, on the other,

individual income taxes - they concentrated on the states that industries had developed such as Connecticut, Illinois, Michigan, New Jersey, Ohio, and Pennsylvania. The share of state individual income tax to total federal tax revenues was unevenly distributed in the United States - in 1958, seven states raised less than 5%, 12 states less than 10%, 12 states more than 10%. Generally, most of corporations settled their main offices in the industrialized areas. But about 28% of the corporations that earned net profits ran their offices in one of 14 states that didn't impose corporate income tax on them. And the share of State corporate income tax to total tax revenues was also unevenly distributed. For instance, in 1958, the percentage of state corporate tax revenues to total tax revenues in New York was 17.2%, while that in Iowa was 1.3%. In addition, the intricate provisions of deduction and excessive high individual and corporate income tax rate structure of federal tax law tended to restrain revenues from property taxes and estate and gift taxes.[21]

The issues concerning over the coordination of tax system and distribution of tax resources among the federal, State and local government were to be solved in terms of intergovernmental relations. Under the conditions, however, the federal Treasury Department viewed it impossible to accomplish in the short-range. In the report L. Lazslo Ecker-Racz, the Secretary of the Treasury Department in the period of the administration of Dwight D. Eisenhower, and I. M. Labovitz, a staff of Library of Congress prepared, "As was demonstrated above," they described, "the existing wide interstate variation in the weight of income taxation is a n effective obstacle to many Federal-State Coordination devices." And as to property tax and estate and gift tax systems, "Despite the extensive documentation that has

Kentucky placed two-stage bracket system that was divided at $250 hundred, four-stage in North Dakota, five-stage bracket in Arkansas and Mississippi, and seven-stage in Arizona and Wisconsin.

21 L. Laszlo Ecker-Racz and I. M. Labovitz, "Practical Solutions to Finance Problems Created by the Multi-Level Political Structure," Undated, NACP, RG 56, OTPSF, Box 30, File Folder #2: Practical Solutions to Finance Problems Created by the Multi-Level Political Structure, 1959.

accumulated," they argued, "there is no visible prospect for an accommodation or innovation that would still the continuing controversy in this area of inter-level fiscal relations."[22]

While State and local tax system didn't work enough to meet their fiscal demands, the structure of metropolitan areas was an obstacle to authorities' reaction to the problems occurred in the cities. In addition to the national government and the governments of the 50 States, there were over 100,000 governmental units in the United States.[23] They built up intricate metropolitan areas structure. Of 30 metropolitan areas that were composed of several counties and subsumed in one State, 19 metropolitans consisted of 2 counties. 6 metropolitan areas where were formed in the industrialized areas consisted of 3 counties.[24] Moreover, there were the areas that were built up with 4, 5, or 6 counties.[25] Most of them were industrialized areas. The territory of an additional 24 metropolitan areas was interstate. More than one-fourth of the Nation's population resided in either currently or potentially interstate metropolitan areas. In interstate metropolitan areas the variation between units were pronounced because comparable units situated on opposite sides of a State boundary operate under different State Constitutions, different State laws and different degrees of functional and financial authority. Thus

---

[22] L. Laszlo Ecker-Racz and I. M. Labovitz, "Practical Solutions to Finance Problems Created by the Multi-Level Political Structure," Undated, NACP, RG 56, OTPSF, Box 30, File Folder #2: Practical Solutions to Finance Problems Created by the Multi-Level Political Structure, 1959.

[23] In 1957, in the United States, tremendous local governmental units existed as follows: (a) 3047 localities such as city, county and town, (b) 17,183 municipalities, (c) 17,198 townships, lower-level administrative division of county, (d) 50,446 school districts, and (e) 14,405 special districts. ACIR, "Briefing Paper: Taxation and Revenues," April 25, 1960, NACP, RG 56, OTPSF, Box 31, File Folder #23: Advisory Commission on Intergovernmental Relations: Briefing Papers, 1960-61.

[24] Albany, Schenectady, and Troy (New York), Atlanta (Georgia), Brockton (Massachusetts), Detroit (Michigan), Knoxville (Tennessee), and New Orleans (Louisiana).

[25] The metropolitan areas consisted of 4 counties were Denver (Colorado), Minneapolis and Saint Paul (Minnesota), and Pittsburgh (Pennsylvania). Boston area consisted of 5 counties, and the area of San Francisco and Oakland included 6 counties.

the fractionated jurisdictions of action did not coincide with the boundaries of the task or with the technological requirements of efficient operation.[26]

The federal fiscal grants system, the institution that all-level governments could use to deal with the issues they faced, didn't bolster up the programs especially urgent in the late 1950s in terms of two aspects - total amount and differences among regions of distribution of the federal aids. In terms of net federal budgetary expenditures, federal aids to State and local governments in cash and in kind in the early 1950's equaled only about 9% of total State-local general revenues. Taking all the federal grants together, the national per-capita average in fiscal 1957 was $23.11. But in the 16 States with the lowest per-capita personal incomes, the federal grants averaged $30.54 per capita - 32% above the national average. The median State in this group was 29% below the national average for personal incomes. In the 16 States (including the District of Columbia) with highest per-capita personal incomes, the federal grants per-capita averaged $18.76 - 19% below the national average. The median State in this group was 18% above the national average for personal incomes. In the 17 middle-income States, average federal grants at $26.43 per-capita were 14% above the national average. The median State was 11% below the national average for personal incomes. Relative to personal incomes, State-local revenue from the federal government was lowest in the New England,[27] Mideast,[28] and Great Lakes States.[29] With the exception of Vermont and Maine, the 16 States in these three regions all rank from 34th to 48th in the ratio of

---

[26] ACIR, "Briefing Paper: Metropolitan Areas," April 25, 1960, NACP, RG 56, OTPSF, Box 31, File Folder #23: Advisory Commission on Intergovernmental Relations: Briefing Papers, 1960-61.
[27] Maine, Massachusetts, New Hampshire, Vermont, Rhode Island, and Connecticut.
[28] Delaware, the District of Columbia, Maryland, New Jersey, New York, and Pennsylvania. This material excluded the District of Columbia from this category.
[29] Illinois, Indiana, Michigan, Ohio, and Wisconsin.

federal revenue to personal income. In contrast, it was the highest in the Far West,[30] Rocky Mountain,[31] and South west States,[32] where 9 of 13 States were in the top one-third.[33] In short, more federal grants were distributed to the States with lower per-capita income, and the regions where more population flocked into cities such as the West and the South.

The amount of federal grants distribution to the programs that seemed to be needed in the late 1950s, however, was relatively small. Of $16 billion of federal grants distributed in the 5 years from 1953 to 1957, the federal government distributed more than $13 billion of federal grants for the programs of public welfare, highway and education. The federal government funded 46% of total expenditures of State and local government for public welfare through distributing federal grants, and 49.8% of that major segment of public welfare was "public assistance." Federal payments for highways, though substantial in amount - $3.3 billion for the five years - covered only 10.4% of the $32 billion that State and local governments spent for highway purposes. Federal assistance for education had been dominated by the geographically spotty distribution to school districts especially affected by federal government activities. The aggregate federal payments of $2.6 billion covered but it was only 4.4% of the near-$60 billion total of State-local direct expenditures over the 5-year period. Health and hospital expenditures in the aggregate amounted to $13 billion in the 5 years, barely more than a fifth of the amount for education. Federal payments of $481 million financed 3.7% of State-local expenditures for health and hospitals. All other functional categories of State and local service, such as airport

[30] Alaska, California, Hawaii, Nevada, Oregon, and Washington. This material excluded Alaska and Hawaii from this category.
[31] Colorado, Idaho, Montana, Utah, and Wyoming.
[32] Arizona, New Mexico, Oklahoma, and Texas.
[33] L. Laszlo Ecker-Racz and I. M. Labovitz, "Practical Solutions to Finance Problems Created by the Multi-Level Political Structure," Undated, NACP, RG 56, OTPSF, Box 30, File Folder #2: Practical Solutions to Finance Problems Created by the Multi-Level Political Structure, 1959.

construction, slum clearance, urban renewal, low-rent housing, disaster relief, soldiers' homes, federal grants were relatively small in aggregate amount.[34]

Taking the grants by separate function or program categories, the 1957 arithmetic analyses revealed the difference among regions of the Federal grants distribution to the programs that were devised to deal with the change of society. For public assistance, while the average per-capita federal grant in the 16 lowest-income States was 45% above the national average, it was 21% below the national average in the 16 highest-income States. For health services, the grant average in the lowest-income States was 70% above the national average, and in the highest income States, 35% below. For other welfare services, the per-capita grant average in the lowest-income group was 34% above the national average, and in the highest-income group, 12% below. The expense of the employment-security, the full administrative expenses of the State unemployment compensation system and employment services, ran highest, relatively to total population, in the more industrialized States where were with the highest per-capita incomes. Thus, the Federal grants for employment security in the 16 lowest-income States averaged 25% below the national per-capita average, and the average for the 16 highest-income States was 17% above the national average. In grants for education, the largest amount of Federal aid in those days had been for school districts especially affected by Federal government activities, such as military installations. Education grants in the aggregate in the 16 lowest-income States averaged 11% above the national per-capita average but they were still higher in the

[34] L. Laszlo Ecker-Racz and I. M. Labovitz, "Practical Solutions to Finance Problems Created by the Multi-Level Political Structure," Undated, NACP, RG 56, OTPSF, Box 30, File Folder #2: Practical Solutions to Finance Problems Created by the Multi-Level Political Structure, 1959.

middle-income group - 24% above the national average. For the 16 highest-income States, grants for education fell below the national average by 14%.[35]

VI. The Arguments of State Governors and ACIR

State governor, ACIR, and the federal Treasury department argued that the federal government had the responsibility to deal with the conditions described above through federal grants system.

The first example is the report made by Joseph M. Robertson, the commissioner of Minnesota Department of Taxation. He clarified that combined State-local tax collections increased 238% from fiscal 1942 through 1957, and a 38% increased from fiscal 1953 through 1957. But, at the same time, "In spite of the importance of economic growth tan date boost it will give our state-local tax systems," he pointed out, public services needs in the areas such as "more and better educational facilities; expanded water sources and pollution control; more modern and effective programs in the mental health and rehabilitation areas based on new developments from research in these fields; urban redevelopment; improved transportation facilities; and a host of other public services" would be greater in the next few years because their population was increasing, particularly "in the older and younger age groups which require added public expenditures for new and expanded programs." Meanwhile, he described that while prices of the national output generally went up 30% from 1947 to 1957, prices of federal purchases of goods and services were rising 35%, prices of construction material and labor were increasing by 43%, the prices of goods that State and local governments bought were up by 54%. But he

[35] L. Laszlo Ecker-Racz and I. M. Labovitz, "Practical Solutions to Finance Problems Created by the Multi-Level Political Structure," Undated, NACP, RG 56, OTPSF, Box 30, File Folder #2: Practical Solutions to Finance Problems Created by the Multi-Level Political Structure, 1959.

indicated that the federal government's proportionate contribution to the support of domestic public service programs (excluding national security) had been declining steadily since 1948. At that time the federal government financed about 47% of domestic programs, but by 1957, the percentage had decreased to about 35%. Certainly, he referred to the necessity of State and local tax reforms. To deal with the problems, however, Robertson argued, "Ways must be found to coordinate public service programs so that their costs can be borne as equitably and as conveniently as possible within the framework of our federal system of government."[36]

ACIR and the Treasury also argued that devising federal social programs financed with the federal grants would improve national social affairs, and State and local finance situation. In the report titled "Briefing Paper: Equalization Features of Federal Grant Programs," ACIR argued for the necessity to distribute Federal grants relative to each region's fiscal demand as follows: "In the absence of some form of equalizing aid, differences in the resources of the States would normally result in wide variations in amount s spent for public services. Where there is a strong national interest in a public service." And they went on, "Inadequate levels of services or payments to families would defeat the purposes of the grant. Variation in the size or share of the Federal grant can permit a reasonable standard of public service to be achieved even in the poorer States." And ACIR estimated that pressures would accumulate for across-the-board enlargement of the federal share of costs, direct and wholly federal program operations such as public assistance, highway programs, slum demolition, urban redevelopment and education, and for unmatched

[36] Joseph M. Robertson, "Some State Revenue Problems," Undated, NACP, RG 56, OTPSF, Box 30, File: Some State Revenue Problems (Paper by Joseph M. Robertson, Comm. Minnesota Dept. of Taxation), 1959

grants.[37] Finally, the Treasury argued that meeting these demands by the federal government "may arrest the deterioration of central city areas, ultimately salvaging a significant part of the local tax base and strengthening city finances."[38]

VII. Kennedy Administration and Their Social Programs

In 1950s, poverty and the other social problems were not taken up on discussion. But the civil right movement of African American in the South changed the situation.[39] Through the cases such as *the Brown v. Board of Education of Topeka, Kansas* in 1954, *the Montgomery Bus Boycott* of Alabama in 1955, and *Little Lock Crisis* of Arkansas in 1957, the movement against segregation had spread gradually in the United States.

John F. Kennedy, a candidate from the Democratic Party, raised the social affair as one of political issues for the presidential election in 1960. Then the platform of the Democratic Party included the expansion of education, medical programs, welfare programs, and the support for the civil rights movements. Kennedy addressed the meeting of African American, and expressed his support for the "sit-in" happened all around the South. The most crucial event for the victory of Kennedy was a series of actions of Kennedy's camp for the arrest of Martin Luther King, Jr. On October 19, 1960, King was arrested for "sit-in" inside the department store in Atlanta, and sentenced to 4-month servitude. When Kennedy heard it, he gave Mrs. King a call to cheer her. Robert Kennedy, young brother of JFK, called the Governor

---

[37] ACIR, "Briefing Paper: Equalization Features of Federal Grant Programs," January 13, 1961, NACP, RG 56, OTPSF, Box 31, File Folder #23: Advisory Commission on Intergovernmental Relations: Briefing Papers, 1960-61.
[38] L. Laszlo Ecker-Racz and I. M. Labovitz, "Practical Solutions to Finance Problems Created by the Multi-Level Political Structure," Undated, NACP, RG 56, OTPSF, Box 30, File Folder #2: Practical Solutions to Finance Problems Created by the Multi-Level Political Structure, 1959.
[39] Bruce S. Jansson, *The Reluctant Welfare State: American Social Welfare Policies – Past, Present, and Future, 4th ed*. (Belmont: Brooks Cole, 2001), 239-243.

of Georgia for extracting the promise that King would be discharged if Robert called the judge sentenced King to forced labor. On October 27, King was released. This result increased African American's support for the Democrats.[40] Finally, Kennedy won the presidential campaign of 1960, which meant that Kennedy administration then had to accomplish the programs in their platform that would benefit their advocates.

The administration proposed the social programs carried in their platform as economic policies. American Economy had been in the recession since the second quarter of 1960, which contained the problems such as unemployment rate higher than 6%, and excessive productivity. The organization that had the responsibility to devise the programs to deal with the problems was Pre-Presidential Economy Task Force, led by the Chairman, Paul A. Samuelson. Samuelson thought that "This recession is superimposed upon a half-decayed of slow growth and slackness in the economy - with unemployment now above 6% and showing a rising threat, with considerable excess capacity, and with an eroding base of profits," and that "with an activist recovery program the deficit could, in the short run, be several billion dollars larger; but larger deficits early in this four year term should mean somewhat larger surpluses later." Then he proposed the expenditures (a) for defense programs, depressed area programs, public road programs, and unemployment compensations operated on federal trust fund as the programs that could be helpful in dealing with the short-run problems, and (b) for urban renewal, aid to education, health for the aged and similar long-run program as the builders of a better and faster growing economy that would be paid out money "after a considerable delay." And he

[40] Carl Brauer, *John F. Kennedy and the Second Reconstruction* (New York: Columbia University Press, 1977), 16-17, 204.

emphasized that "Pledged new expenditure programs [as their platform] should be pushed hard."[41]

In "Special Message to the Congress: Program for Economic Recovery and Growth" of February 2, 1961 ("Special Message"), Kennedy administration made the first reference to their plan of social programs to deal with both the change of social affairs in the late 1950s and the slack. They proposed at first income security programs aimed at stimulating short-term economic recovery such as the extension of the duration of benefits of unemployment compensation from 13 weeks to 39 weeks, an interim amendment to the ADC to include the children of the needy unemployed such as a person who had exhausted unemployment benefits and was not receiving adequate local assistance, liberalizing the requirements and broadening benefits of the Old-Age, Survivors, and Disability Insurance (OASDI). Secondary, they proposed the acceleration of public works such as procurement and construction which would have an early effect on unemployment, needed natural resource conservation and development, maintenance and repair works, and to make available to the States immediately the entire balance of Federal-aid highway trust funds.

Secondary, the administration proposed distressed area redevelopment program and the expansion of employment service. The former program was aimed at improving the employment situation through providing the means for loans for private projects, technical assistance, loans for private projects, loans and grants for public facilities, and programs for training and retraining workers. The latter was proposed to provide better service for unemployment

---

[41] Paul A. Samuelson, "Preliminary Report of Task Force on the Economic Outlook and Anti-Recession Policy," December 19, 1960, John F. Kennedy Library (JFKL), Papers of John F. Kennedy, Pre-Presidential Papers, Transition Files (JFKTRAN), Box 1071, File: Economy-Task Force (Preliminary) Report.

insurance claimants and other job applicants registered with the United States Employment Service. The programs, the message described, would require expanded counseling and placement services for workers or job-seekers (a) in depressed areas; (b) in rural areas of chronic underemployment; (c) displaced by automation and technological change in factories and on farms; (d) in upper age brackets; and (e) "recent graduates" from college and high school. The administration also proposed the public-assistance-in-kind programs for needy family such as the expansion of (a) the distribution of surplus food, (b) the pilot Food-Stamp programs, and (c) the improvement and strengthening school lunch and nutrition program regardless of the economic condition of his family or local school district. In addition, based on the argument that "Modern machines and advanced technology are not enough, unless they are used by labor force that is educated, skilled and in good health," they proposed the programs to strengthen education, health, research, and training activities.[42]

VIII. The Discussion over Expenditure Expansion inside the Administration

The administration progressed the embodiment of the programs referred in the "Special Message." On the one hand, on April 17, 1961, "the drafting committee," organized from Kermit Gordon of the CEA, Robert Turner of the Bureau of Budget (BOB), and Lee C. White of the White House Office, drafted and distributed the members of the Cabinet the report titled "Proposals for a Second-State Economic Program." In the report, they proposed that the following programs be added to the programs of the "Special Message": (a) To provide the President with the

[42] *Public Papers of the Presidents of the United States, John F. Kennedy, 1961*, pp. 43-51.

authority to finance the preservation programs, public works and the other programs aimed at creating employment by federal, State and local governments, and (b) to provide the programs to dissolve persistent unemployment, to expand the work opportunity of the young, and to coordinate labor's skill and the working opportunity. At first, the following public works that the federal government would operate were proposed: (a) the preservation programs such as forest regeneration, forest fire prevention and soil preservation ($100-125 million added), (b) maintenance, repair, and modernization of constructions ($105 million added), (c) the public works contingent on the beginning before December 31, 1961 and its accomplishment within 18 months ($600 million added to maintenance, repair, and modernization programs described above, $800 million as grants-in-aid to State and local government, and $ 1.3 billion as federal public works). Secondary, the drafting committee proposed the following programs that would be operated by State and local governments: (a) Public works, mainly water supply and sewage facilities (additional $500-700 million) and the construction and repair of the road (additional $500-1000 million); (b) closing neglected quarry and died-out mine by the federal and State government; (c) the aid by the federal aid to the public assistance for the needy ($750 million added); and (d) the establishment of educational television station ($250-500 million added).[43]

On the other hand, the Cabinet and the Labor Department put the emphasis on the measures to deal with the structural problems of labor. "The drafting committee" of the Cabinet proposed in the report: (a) "The young protection program" aimed at easing the inflow of the young from school to labor market; (b) the programs for the unemployment; (c) the combination of the expansion and improvement of vocational training and reeductional program and the provision of life

[43] "Proposals for a Second-Stage Economic Program," April 17, 1961, NACP, RG 174, Record of Secretary of Labor Arthur J. Goldberg (RSLAJG), Box 22, File: General Files.

and travel assistances for the trainee; (d) the provision of broader work opportunity for the young people through preservation activity and the other programs; and (e) the introduction of the program aimed at matching the work opportunity with labor's skill and character.[44] The labor Department proposed in their report: (a) the expansion of the range of recipient and the term of short-term unemployment compensation; (b) federal grants distribution to State governments that recorded higher unemployment rate than the national average; (c) the deprivation from the unemployed who would refuse training or reeducation of the qualification for the unemployment compensation, (d) the prohibition that the trainee would refuse to receive the unemployment compensation, (e) the minimum income security for the trainee on the job training and his family, and (f) the travel provision for the worker necessary to retrain.[45]

Based on these proposition and ideas, three acts were legislated: ARA and Accelerated Public Works Act (APWA) of 1961, and MDTA of 1962. ARA's program included (a) the allocation of area redevelopment expenditure of "Health, labor and welfare" function on general fund to the depressed areas, (b) the invitation of corporations to the depressed areas to stimulate their industries, (c) the creation of work opportunity in the localities, (d) the provision of relocation assistance for a corporation that would move to the depressed areas, and (e) the provision of OJT for the unemployed. APWA located Public Works Administration to localities in localities, and attempted to fix up the employment contract with the unemployed when the corporation invited by ARA would be on a construction

---

[44] "Proposals for a Second-Stage Economic Program," April 17, 1961, NACP, RG 174, RSLAJG, Box 22, File: General Files.

[45] "Discussion Paper Prepared by the Department of Labor: An Act to Implement the Employment Act of 1946," April 13, 1961, NACP, RG 174, RSLAJG, Box 23, File: White House Files, President, April.

program.[46] MDTA aimed at supplementing vocational training included in ARA through two programs; the one operated by the federal government on the one hand, and State governments on the other. The federal program included (a) the provision of vocational training and of the assistance for the one who would be educated instead in private school, (b) the addition of the basic educational course regarding reading, writing and calculation for the one who would be judged not having basic skill to learn training and education, (c) the extension of the term of vocational training given by ARA from 12 weeks to 104 weeks, and (d) the provision of $5-20 of the tuition, travel expenses, and the cost of living per week for the applicants of the program. Meanwhile, State government would provide OJT and pay all of its cost.[47]

In addition to the vocational training and reeduational programs, the administration emphasized the expansion of health and education programs and expenditures referred in "Special Message" on February 2. In the memorandum for Kennedy on July 14, 1961, Walter W. Heller, the chairman of the CEA, argued that the expansion of medical care services means more active work hours every day, and people's obtaining medical care has the same importance as the expansion of labor force, thus contribute to the foundation of economic growth. As to the importance of education, "From the lower grades of elementary school to Ph.D.," Heller wrote, "education is another hidden, but strong source…your programs that aids all-level education" would bring about the huge growth of output.[48]

[46] Sar A. Levitan, *Federal Aid to Depressed Areas: An Evaluation of the Area Redevelopment Administration* (Baltimore: The Johns Hopkins Press, 1964).
[47] Jonathan Grossman, *The Department of Labor* (New York: Praeger Publishers, 1973), 119-121; Garth L. Mangum, *The Emergence of Manpower Policy* (New York: Holt, Rinehart and Winston, Inc., 1969), 106-112.
[48] Walter Heller to John F. Kennedy, "Present and Prospective Measures to Accelerate Economic Growth," July 14, 1961, JFKL, Walter W. Heller Personal Papers (WWHPP), Box 5, File: Memo to JFK 7/61.

IX. Administration's Consideration over the Public Opinion

The administration reviewed how the people in the United States regarded the government programs. On August 1, 1961, Heller sent Kennedy the survey results of voter attitudes toward government spending conducted by "The Survey Research Center at the University of Michigan." Table 1 shows the attitudes toward the following question: "The government spends money on many things. On this card is a list of some of the things on which the government spends money. How about…do you think the government should be spending more money, less money, or about the same amount?" It demonstrates: (a) Most of voters agreed to the increase in the government expenditures for help to older and needy people, education, hospital and medical care, and slum clearance and city improvement; (b) as to the level at that time of expenditures for public works, highway construction and unemployment benefits, the percentage of the voter that agreed to its maintenance was higher than that to its increase. Table 2 shows the voter's attitudes toward the following question: "Some people say that there will be some disarmament and therefore our government will spend less on arms and defense. Suppose this is the case, what would you say should be done with the money saved?" It shows that 39% of voters chose "public welfare program" as first choice. Finally, Table 3 demonstrates that more than a half voters reacted "agree strongly" or "agree, but not strongly" to federal grants distribution to school construction programs by State and local governments, economic assistance for foreign countries, and the increase in federal expenditures for medical care services.

I, the author, never mean that all the nation of the United States had opinions as the tables show. But Heller certainly sent the survey results to Kennedy with the memorandum that said "On the politics of government spending, these survey results may be of interest to you. The Survey Research Center at Michigan, which conducted the survey, is widely recognized as a competent and objective group."[49] It suggests, I surmise, the policy-makers inside the administration such as the CEA and Kennedy devise programs with considering how the public viewed the government's actions.

Table 1. Attitudes Towards Government Programs

(%)

Program	All Families				
	Government should spend…				
	More	Less	Same	No Opinion	Total
Help to older people	74	3	20	3	100
Help to needy people	64	7	25	4	100
Education	60	7	25	8	100
Hospital and Medical Care	56	9	26	9	100
Slum clearance, city improvement	55	9	24	12	100
Public Works	48	11	31	10	100
Highway construction	37	10	45	8	100
Support for small business	37	11	31	21	100
Unemployment benefits	33	13	44	10	100
Parks, recreational facilities	31	14	44	11	100
Support for agriculture	22	26	33	19	100

Source: Walter W. Heller to John F. Kennedy, "Voter Attitudes toward Government Spending," August 14, 1961, JFKL, WWHPP, Box 5, File: Memo to JFK 8/61.

[49] Walter Heller to John F. Kennedy, "Voter Attitudes toward Government Spending," August 14, 1961, JFKL, WWHPP, Box 5, File: Memo to JFK 8/61.

Table 2. Alternative Uses of Government Funds

(%)

	Public Welfare Programs	Build Schools Highways and the Like	Reduce Government Debt	Reduce Income Taxes	Increase Financial Help to Other Countries
Ranked as first choice	30	23	24	16	3
Ranked as second choice	22	31	15	21	5
Ranked as third choice	19	24	16	24	9
Ranked as fourth choice	17	13	29	22	11
Ranked as fifth choice	5	2	8	11	60
Not ascertained	7	7	8	6	12
Total	100	100	100	100	100
Number of cases	2700	2700	2700	2700	2700

Source: Walter W. Heller to John F. Kennedy, "Voter Attitudes toward Government Spending," August 14, 1961, JFKL, WWHPP, Box 5, File: Memo to JFK 8/61.

Table 3. Respondent's Reactions to Various Proposals

(%)

Reaction	"If cities and towns around the county need help to build more schools, the government in Washington ought to give them the money they need."	"The United States should give economic help to the poorer countries of the world even if those countries can't pay for it."	"The government ought to help people get doctors and hospital care at low cost."
Agree Strongly	38	30	49
Agree, but not strongly	16	22	11
Not sure; depends	10	15	11
Disagree, but not strongly	8	6	5
Disagree strongly	17	14	14
Don't know, no opinion	10	12	9
Not ascertained	1	1	1
Total	100	100	100
Number of cases	1200	1200	1200

Source: Walter W. Heller to John F. Kennedy, "Voter Attitudes toward Government Spending," August 14, 1961, JFKL, WWHPP, Box 5, File: Memo to JFK 8/61.

X. The Administration's Plan of the Distribution of Federal Grants

Budget projecting of Kennedy administration for fiscal 1961 and 1962 was the revision of the plan made by Eisenhower's administration. Kennedy administration crafted their original budget projections for fiscal 1963 and 1964. In 1963 federal financial assistance to State and local governments under existing proposed programs would total an estimated $9.9 billion, including net expenditures of $6.3 billion from general fund and $3.6 billion from the Highway and Unemployment trust funds. The total includes $208 million under proposed legislation for education, public assistance, transportation, and school lunch programs. For 1963, the total of budget and trust fund expenditures under existing and proposed programs for financial assistance to other levels of government was expected to be $1,216 million more than in 1962 and $2,613 million larger than the actual total for 1961. The major increases over the 1962 estimate were expected to be in total federal-aid highway construction, which was estimated increase by $227 million to $3,258 million; in public assistances, which was estimated to increase by $206 million to $2,775 million; in the educational assistance programs, which were estimated to rise by $152 million to a total of $694 million; in the civil defense programs, which would increase by $114 million to a total of $135 million; in contributions of surplus agricultural commodities to State programs, which were estimated to rise by $103 million to $533 million; and in the housing and community development programs which would rise by $224 million to a total of $753 million. The remaining increase was distributed among other programs including area redevelopment, $30 million ($15 million increase from previous years), hospital construction, $191 million ($18.4 million increase from previous year), community and environmental health activities $54.9 million ($16.6 million increase), school lunch and special milk programs, and watershed protection and flood preservation. Federal aid to State and local governments would be affected by several of the recommendations for legislative change or for new programs which were provided for in the 1963 budget. Among those for which specific amounts were included were: (a) Grants to State and local governments for construction of civil defense shelters in selected community buildings, such as schools and hospitals, $105 million; (b) grants to State for public elementary and secondary school construction and teachers' salaries, $90 million; (c) grants to States for projects to improve the quality of elementary and secondary education, $19 million; (d) loans for the construction and modernization of college classrooms, $8 million; (e) grants to States for the improvement of public welfare programs, $93 million; (f) amendment of the National School Lunch Act, $20 million; and (g) selective Federal assistance to help improve public transportation in urban areas, $15 million.[50] In short, though, as previously, the major federal-aid programs were highway and public assistances, the administration attempted to increase the federal-aid to the programs such as education, area redevelopment, and hospital construction.

Federal financial assistance program for fiscal 1964 followed the same direction as the one for fiscal 1963. In 1964 federal financial assistance to State and local governments under existing or proposed programs would total an estimated $10.4 billion, including net expenditures of $6.6 billion from general fund and $3.8 billion from the Highway and Unemployment trust funds. The total included $278 million under new proposed legislation, of which $215 million was for education. The remainder was for comprehensive maternal and child health services, increased contributions to the District of Columbia, urban transportation assistance, land and water conservation, and hospital construction. Major federal-aid programs for 1964 were highway construction, $3.4 billion (increased by $379 million); public works acceleration for area redevelopment assistance, $317 million (increased by $168

[50] *The Budget of the United States Government for the Fiscal Year ending June 30, 1963*, 340-347.

million); educational assistance programs, $560 million (increased by $113 million); public assistance, $3 billion ($112 million increase); the civil defense program, $74 million (increased by $49 million); and housing and community development programs $693 million (increased by $81 million). The remaining increase was distributed among other programs including community and environmental health activities, maternal child health, vocational rehabilitation, waste treatment construction and school lunch and special milk programs.[51] Kennedy administration attempted to use the form of "the federal grants for inner-cities," which has been generally emerged in the period of Johnson administration. At the same time, the administration attempted to deal with the problems of the depressed areas such as rural areas through its distribution. In short, they attempted to deal with domestic social affairs broadly through distributing federal grants.

As to the federal grant program, the fact that should be put emphasis on was that the Bureau of Budget (BOB) was unwilling to use the form of formula categorical grants, nor project categorical grants. In the report that Labor and Welfare Division of the BOB sent the BOB's director, David E. Bell on January 25, 1961, the division expressed their objection to the proposal of categorical grants for educational programs by the Health, Education, and Welfare Department (HEW), and emphasized the necessity to: (a) minimize the possibility that federal aids might be substitution for State and local funds, (b) require the effort of State and local governments to maintenance and increase financial resources of their own, and (c) meet the demand through providing more federal grants with the areas that had the most needs but received the smallest federal fiscal assistances. "In developing general

[51] *The Budget of the United States Government for the Fiscal Year ending June 30, 1964*, 408-416.

aid proposals," the division argued in the report, reconsideration should be given to the existing categorical project grants programs such as vocational education programs and elementary and secondary school support programs "in view of a general assistance program."[52] In the report the same division made on February 2, 1961, with regard to the federal grants distribution for community medical services and facilities expansion programs, in opposition to the HEW that proposed these programs as a new categorical formula grant program ($7-15 million), the division thought "It is undesirable to establish small categorical grant programs." "In order to emphasize changing needs," then they argued that it was desirable to use the block grants or general grants and to increase the amount of their distribution so as to provide more support and flexibility for State and local government to deal with the situation they faced then.[53] In short, as to social programs expansion, BOB argued for its accomplishment not through providing grants with strings for State and local governments that has been utilized since Johnson administration's period, but through distributing general or block grants that could give more discretion to State and local governments.

The BOB had the same intention as to the federal grant programs aimed at dealing with the problems of urban areas that generally said would increase since the period of Johnson administration. In the report sent to Bell on January 24,

[52] Labor and Welfare Division to the Director, "Proposed Programs on Aid for Education," January 25, 1961, NACP, RG 51, Records of the Office of Management of Budget: Records Relating to Budgetary Administration, Federal Security Agency – Department of Health, Education and Welfare, Fiscal Years 1953-1961 (OMBDHEW), Box 1, File: DHEW Transition Papers – Kennedy Admin., 1960-61.
[53] "New Formula Grant Program to Enlarge Community Health Service and Facilities," February 2, 1961, NACP, RG 51, OMBDHEW, Box 1, File: DHEW Transition Papers – Kennedy Admin., 1960-61.

1961, in response to the HEW's proposal of categorical grants for education for urban areas, Labor and Welfare Division pointed out: (a) Available statistical data indicated that the large urban areas typically spent more per capita for education in providing educational services that were of a better quality and of a more diversified nature than did the rural areas; (b) the problem of financial aid to metropolitan areas was on affecting other important programs and services such as housing, urban renewal, welfare and public transportation, as well as educational services; and (c) the problems ad characteristics of metropolitan areas varied widely and "This make it difficult to devise a formula grant which will work satisfactorily."[54] In another report the division made on the same day, as to the proposal of expansion of public assistance programs, they pointed out: (a) The federal government then made public assistance grants to the States to aid needy individuals in four selected categories; Old Age Assistance (OAA), Assistance to the Blind (AB), Assistance to the Permanently and Totally Disabled (APTD), and ADC, (b) individual outside these categories were assisted by General Assistance (GA) that only State and local governments operated and provided generally lower payments, sporadic coverage, and in many States it was not available if the individual or his parent was employable. Then the division claimed that the expansion of ADC should be temporary, and indicated the alternative that could make existing federal categorical grants available to assist any needy individual consolidated and could take the form of a new public assistance category as GA. "From the point of view of more equitably assisting the Nation's needy," then the

[54] Labor and Welfare Division to the Director, "HEW Proposal for Special Grants for Aid to Education in Large Cities," January 24, 1961, NACP, RG 51, OMBDHEW, Box 1, File: DHEW Transition Papers – Kennedy Admin., 1960-61.

division argued, "We believe that the GA approach is preferable."[55] BOB devised the use of general or block grants to increase discretion of State and local governments to use the federal grants that has been referred as prominent examples as the ones distributed to mainly inner cities, such as the grants for education, urban renewal, and public assistance programs.

The use of general and block grants was not aimed at intervening to, or restricting the action of State and local governments. *The Budget of the United States Government* for fiscal 1963 described "Increasing population and rapid urbanization have led to greater responsibility, particularly at the State and local level, for providing essential public services in education, health, housing, urban renewal, highways and public transportation, and the safeguarding of economic security." "While the major burden of such public services rests with the 90,000 State and local governmental jurisdictions," it went on, "the Federal Government has a vital role, both through direct operation of programs and by providing financial assistance to State and local governments." Moreover, "The task of providing public services," *The Budget* for fiscal 1963 argued, "can be facilitated through improved intergovernmental cooperation and coordination concerning revenue sources and expenditure programs."[56] *The Budget of the United States Government* for fiscal 1964 contained

---

[55] Labor and Welfare Division to the Director, "HEW Proposals for Expansion of Public Assistance," January 24, 1961, NACP, RG 51, OMBDHEW, Box 1, File: DHEW Transition Papers – Kennedy Admin., 1960-61.
[56] *The Budget of the United States Government for the Fiscal Year ending June 30, 1963*, 341.

sentences that had similarly meaning.[57] In short, these sentences suggested that federal government attempted to provide more public services, "cooperate and coordinate" intergovernmental relations through fiscal aids to State and local governments.

[57] *The Budget of the United States Government for the Fiscal Year ending June 30, 1964*, 408.

2

A Prelude to the Flood of Red Ink: From the Study of Comprehensive Tax Reform in 1950s to Federal Tax Reform 1962

Introduction

Kennedy administration faced with the necessity to finance their attempt of social program expansion. It would have been a mean to pay for it without accumulating federal debts to construct federal tax system that could raise revenues enough to the demand. As many scholars have referred, however, the administration accomplished two tax policies that deliberately reduced the ability of federal tax system to raise revenues. One of them in 1962, originally proposed on April 20, 1961, was enacted as the tax cut involving with investment credit, depreciation reform to promote private investment for plant and equipment, and several tax structural reform measures to offset revenue losses. And the scholars traced the enactment process that structural reform parts were defeated by fervent opposition in the Congress and the interest groups, while investment credit and depreciation reform barely passed through it.[1]

This paper, however, demonstrates the investment credit and revenue-raising structural reforms appeared from different context, and the latter had significant role no scholar have illuminated. Since 1950s, several tax experts, Tax Analysis Staffs (TAS) of the Treasury Department, and the Committee on Ways and Means (CWM) led by Wilbur D. Mills cooperated in examining the defects of federal tax system - narrow tax base, excessive high tax rate, the inequity among both income classes and types of income, and weak progressivity. In 1959, they finally reached to the agreement to propose "one

[1] Martin, *Shifting the Burden*; Stein, *The Fiscal Revolution in America*; Flash, Jr., *Economic Advice and Presidential Leadership.*

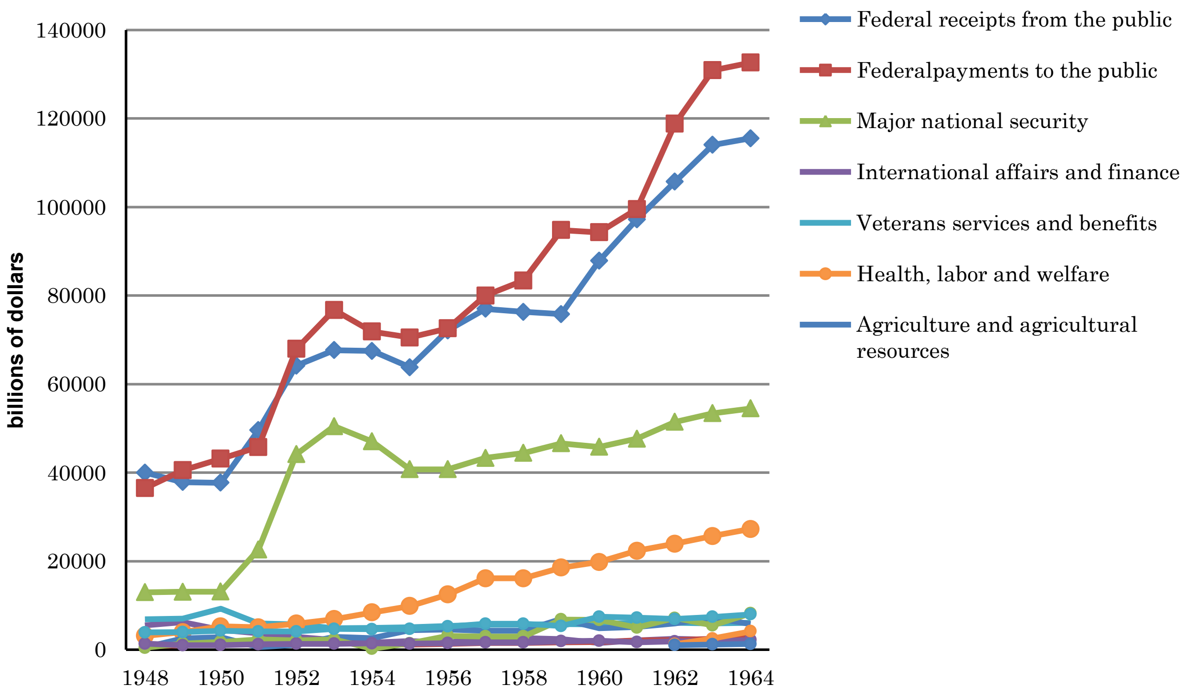
package" constructive tax reform that would improve tax structure – closing loopholes and lowering excessive high tax rates without any revenue loss after Kennedy's inauguration. Structural reform measures composed of tax reform bill 1961 were the parts departed away from the agreed tax reform plan.

Investment credit was one of measures proposed as a stimulant to the slack economy by Kennedy's economic advisers for presidential election. From the standpoint of "Keynesian macroeconomic theory," nothing seems to conflict with tax cut proposal in the recessionary time.[2] But the Bureau of Budget and the Treasury estimated federal budget deficit would increase due to economic decline in 1960 and 1st quarter of 1961, and to projected social program expansion. They desired it should be avoided to create deficit more than necessary. Then tax reform bill 1961 was proposed as small revenue-increasing tax reform involving investment credit and the reform measures which came from 1959 agreement. As this chapter elaborates, however, through the policymaking process of the tax reform bill, investment credit, depreciation allowance, and opposition in the Congress and the interest groups doomed the desire of the Treasury and its proponents to accomplish comprehensive tax reform.

I. Fiscal Condition and Income Tax Structure in 1950s

[2] See, e.g., Gregory Mankiw, *Principles of Macroeconomics, 2nd ed*. (Harcourt College Pub, 2000).

Figure 1. Federal Receipts from the Public and Payments to the Public



Source: The Budget of the Government for the Fiscal Year Ending June 30, 1962, p. 979, The Budget of the Government for the Fiscal Year Ending June 30, 1963, p. 280, The Budget of the Government for the Fiscal Year Ending June 30, 1964, p. 38,The Budget of the Government for the Fiscal Year Ending June 30, 1965, p. 41, The Budget of the Government for the Fiscal Year Ending June 30, 1966, p. 36.

Federal government expenditures had persistently grown in the postwar period (Figure 1). Major national security expenses, though in decline 1954-1956, had expanded since the outbreak of Korean War, and these expenses constituted most of federal expenditures during the 1950s. Meanwhile, the amount of health, labor and welfare function had consistently expanded since 1948. Nevertheless, the amount of Federal tax revenue had been unstable since early 1950s. As table 1 shows, the fluctuation of individual income tax revenues had clearly conditioned total tax revenues. Though estate and gift taxes had not been swayed by economic condition, the revenue acquired from these taxes had been very small. In the light of the expansionary tendency of federal expenditures, it was necessary to construct a tax system capable to raise individual income tax revenues sufficient to finance federal deficit during the boom, and estate and gift tax to bolster up both income tax revenues to meet fiscal demand.

Table1. Sources of Budget Receipts from Taxation, 1953-1966.

(In millions of dollar)

	Individual income taxes	Corporation income taxes	Excise taxes	Employment taxes	Estate and gift taxes	Customs	Miscellaneous receipts	Subtotal	Deduct interfund transactions	Total budget receipts
1953	30,108	21,238	9,868	4,980	881	596	1,859	69,530	154	69,376
1954	29,542	21,101	9,945	5,423	934	542	2,309	69,796	235	69,561
1955	28,747	17,861	9,131	6,217	924	585	2,562	66,027	181	65,846
1956	32,188	20,880	9,929	7,294	1,161	682	3,004	75,138	315	74,823
1957	35,620	21,167	9,055	7,578	1,365	735	2,760	78,280	467	77,813
1958	34,724	20,074	8,612	8,641	1,393	782	3,200	77,426	567	76,859
1959	36,719	17,309	8,504	8,850	1,333	925	3,160	76,800	355	76,445
1960	40,715	21,494	9,137	11,156	1,606	1,105	4,062	89,275	694	88,581
1961	41,338	20,954	9,063	12,502	1,896	982	4,080	90,815	654	90,161
1962	45,571	20,523	9,585	12,561	2,016	1,142	3,204	94,602	633	93,969
1963	47,588	21,579	9,915	14,862	2,167	1,205	4,435	101,751	513	101,238
1964	48,697	23,493	10,211	16,832	2,394	1,252	4,076	106,955	664	106,291
1965	48,792	25,461	10,911	16,905	2,716	1,442	3,749	109,976	870	109,106
1966	55,446	30,073	9,145	20,022	3,066	1,767	5,231	124,750	635	124,115

Source: The Budget of the Government for the Fiscal Year Ending June 30, 1962, pp. 979, 1021, The Budget of the Government for the Fiscal Year Ending June 30, 1963, pp. 49-53, The Budget of the Government for the Fiscal Year Ending June 30, 1964, pp. 54-58, The Budget of the Government for the Fiscal Year Ending June 30, 1965, pp. 62-67, The Budget of the Government for the Fiscal Year Ending June 30, 1966, pp. 56-61, The Budget of the United States Government for the fiscal year ending June 30, 1967, pp. 60-67, The Budget of the United States Government for the fiscal year ending June 30, 1968, pp. 64-69.

The administration of Dwight D. Eisenhower accomplished tax reform in 1954 aimed to constrain inflationary pressure, to finance expenditure increase, to alleviate taxpayer's burden, and to stimulate private investment. This reform included not only the reduction of individual income tax rate scale from 22.2-92% to 20-91%, but also reform measures designed to narrow the tax base. The reform measures included the application of income-splitting return rule to widows having dependents, child care deduction up to $600 per year for widows and lower income working women, the expansion of itemized deductions, retirement income tax credit, the exclusion of employer health insurance contribution, the exclusion of first $50 of dividend against shareholder's taxable income, and 4% credit of dividend in excess of the $50.[3] The 1954 tax reform didn't meet the expansionary tendency of federal expenditure.

The tax reform 1954 weakened the ability of federal individual income tax system to raise revenues, and to provide the equity among taxpayers. As table 2 (below) demonstrates, while the number of returns reporting salaries and wages increased and

[3] *Annual Report of the Secretary of the Treasury on the State of the Finances for the Fiscal Year Ended June 30, 1954*, 43-53, 246-286.

accounted for the largest proportion of total income returns – generally 88% - from 1955 to 1964, the number of income returns reporting unearned income such as sales of capital assets, dividend and interest increased even more rapidly. But the preferential treatments to the unearned income included: (1) the exclusion of a wide range of personal receipts such as government transfer payments, employee benefits, or income in kind; (2) The deductions for certain expenses, non-expenses, and capital gains and losses from their adjusted gross income;[4] (3) the choice between itemized deductions for expenses and non-expenses, and standard deduction equal to 10% of the adjusted gross income under $1,000;[5] and (4) tax credits for several types of unearned income.[6] The percentage of itemized and standard deductions to adjusted gross income (a much closer approximation of economic income than taxable income) increased from 9.0% in 1940 to 15.0% in 1960.[7] In 1960, the proportion of income deductions to the total amount of adjusted gross income in the tax bracket lower than $2,000 was 12.2%, but the proportion for the bracket higher than $500,000 was 21.5%.[8] The amount of the personal exemption for the single taxpayer was $3,000 when federal income taxation was introduced in 1913. But it was reduced to $600 in 1948 and the standard had been kept till 1960. As a result, the total amount of adjusted gross income of all of taxpayers in 1959 was $335.1 billion, but the various loopholes reduced taxable income to $167.9 billion, tax liability

[4] Individuals were allowed to deduct: (1) Expenses paid and incurred in carrying on any trade or business such as salaries and wages, compensation for personal services, (2) Expenses for production of income, losses realized on the sale or exchange of property, 50% of the excess of net long-term capital gains over net short-term capital losses, (3) Non-expenses such as medical expenses exceed 3% of taxpayer's adjusted gross income, contributions to certain types of nonprofit organizations, tax paid import duties, excises and stamp taxes, death and gift taxes, interest on indebtedness, and certain extent to alimony and separate maintenance payments and to losses from fire and casualty.

[5] The maximum for a married person filing a separate return was $500.

[6] A tax credit was granted to interests income against Federal long-term security, 4% of dividend against adjusted gross income, received from domestic corporations in excess of $50 exclusion, and 20% of retired income of older than 65 up to $1,200, and of younger than 65 up to $900.

[7] Richard Goode, *Individual Income Tax, 1st ed.* (Washington, D.C.: Brookings Institution, 1964), p. 236. The utilization of itemized deductions especially accounted the largest share of returned deductions, which were taken on 24.1 million or 39.5% of all the returns filed in 1960. See Warren Smith to Walter W. Heller, "The 5 Percent Floor under Itemized Deductions and Repeal of the Sick Pay Exclusion," January 27, 1963, John F. Kennedy Library (JFKL), Walter W. Heller Personal Papers (WWHPP), Box 22, File: Tax 1/16/63-1/31/63.

[8] *Statistics of Income, Individual Income Tax Returns, 1960*, 66.

to $39.9 billion, and the overall effective rate to 23.3%.[9] Individual income tax system contained narrowed tax base and favored unearned income recipients and relatively higher-income classes.

Total individual income actually subject to tax was considerably less than half of total personal income, and about two-thirds of the income actually subject to tax at ordinary income tax rates fell within the first tax bracket. Though rate structure ranged 20% from 91%, of the $39.3 billion of individual income tax liabilities in 1959, before credits (excluding fiduciaries), the amount taxed on the rate of the lowest bracket (20%) accounted for $33.4 billion.[10] The availability for tax preferences usually limits the application of the rate structure to particular type of income. In this case, if only base-broadening measure is accomplished, whole tax liabilities would be so much heavier excessively. But if only high bracket rates are reduced alone, it would unfairly privilege higher-income classes. In the light of improving equity among income class and alleviating the influence to economy, it was necessary to reduce overall tax rates along with base-broadening measures in order to retain progressivity.

9 *The Federal Revenue System: Facts and Problems, 1961*, 1-6, 10.
10 *The Federal Revenue System: Facts and Problems, 1961*, 7-8.

Table 2. Number of Individual Income Tax Returns, 1955-1964

(Thousands)

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964
Salaries and wages	51,256	51,913	52,597	51,588	52,851	53,604	54,105	55,096	56,303	57,524
Business or profession										
Net Profit	6,736	7,381	6,775	6,881	6,895	6,831	6,980	6,918	4,835	4,889
Net loss	1,509	1,591	1,475	1,500	1,715	1,768	1,728	1,710	876	903
Farm										
Net Profit	*	*	*	*	*	*	*	*	2,108	2,000
Net loss	*	*	*	*	*	*	*	*	1,086	1,110
Partnership										
Net Profit	1,688	1,551	1,607	1,611	1,646	1,589	1,537	1,588	1,573	1,499
Net loss	267	245	266	266	302	330	346	368	412	433
Sales of capital assets										
Net Profit	2,900	3,148	2,937	3,469	4,007	3,842	4,698	4,323	4,947	5,321
Net loss	654	784	1,038	921	900	1,154	1,097	1,599	1,595	1,502
Ordinary gain from sales of depreciable property	-	-	-	-	-	-	-	-	152	188
Sales of property other than capital assets										
Net gain	110	99	127	104	98	100	150	86	100	82
Net loss	158	206	150	131	150	136	177	184	182	186
Dividends in adjusted gross income	3,716	3,925	4,168	4,235	4,683	4,933	5,038	5,831	6,638	5,667
Interest received	6,331	6,715	7,286	7,408	9,274	10,288	10,032	14,737	21,387	22,229
Pension and annuities	768	823	920	1,009	1,071	1,136	1,278	1,534	1,617	1,788
Rents										
Net income	3,987	4,091	4,098	4,089	4,114	3,876	3,863	4,077	4,079	3,916
Net loss	1,253	1,319	1,405	1,513	1,605	1,695	1,795	1,885	2,040	2,078
Royalties										
Net income	*	*	*	*	*	409	409	403	443	482
Net loss	*	*	*	*	*	23	28	26	32	33
Estates and trusts										
Net income	360	375	362	371	381	392	413	426	459	Not tabulated
Net loss	21	28	20	22	19	26	30	30	28	
Total Individual Income Tax Returns	58,250	59,197	59,825	59,085	60,271	61,028	61,499	62,712	63,943	65,376

Source: U.S. Treasury Department, Statistics of Income, 1964, p. 114.

II. Discussion on Tax Reform Bill before Kennedy's Inauguration

To deal with the fiscal issues, Tax Analysis Staff (TAS),[11] a bureau for taxation in the Treasury Department, sought to research "Possible areas in which intensive consideration by the Staff [of TAS] might well yield practical suggestions for improvement and simplification of the tax structure." The report they drafted on July 22, 1958, enumerated the tax reform concerning with (a) Capital gains, (b) Tax-exempt interest, (c) Percentage

[11] In 1961, TAS changed its name into Office of Tax Analysis (OTA).

depletion, (d) Income averaging, (e) Travel and entertainment expenses, (f) Exclusions, (g) Medical deductions, (h) Fringe benefits, and (i) Treatment of the aged.[12] The research of TAS in 1958 led to the report, “Suggested Outline for Tax Study” on March 9, 1959, which mentioned three principle areas concerning their tax study. As to first area, “Economic effects of taxes,” though described “This is not primarily a matter for new research,” it pointed out personal income tax, corporate income tax, gift and estate taxes be analyzed with considering over (a) Incentives, saving, mobility, and demand, (b) Both horizontal and vertical equity, (c) Capacity to produce revenues, (d) Cyclical flexibility, (e) Effectiveness in allocation of resources, and (f) Distribution of tax burden. Second point was “Tax base” to “Weigh the merits of the various exclusions, deductions and exemptions that make the tax base so much narrower than personal income from which it derives” along the criteria of the first issue. Thirdly, “Tax rates,” it was argued, be considered from the viewpoints (a) What total amount of rate reductions would be possible as a result of such base broadening as can be accomplished, and (b) How the tax burden should be distributed among the various taxes and income groups.[13]

While the Treasury progressed with its study, Committee on Ways and Means (CWM), led by Wilbur D. Mills assumed the chairman on January 7 1958, started to study and discuss tax issues. The hearings “Will be utilized as a source of information,” the former chairman Jere Cooper declared on January 8, 1958, “in order to obtain a revenue system which is fair, equitable, neutral in impact between similar dollars of income, responsive to changes in economic conditions, and capable of compliance and administration with a minimum of taxpayer and governmental effort, and which will at the same time

[12] “Areas of Possible Tax Reform and Simplification,” July 22, 1958, National Archives College Park (NACP), RG 56, Office of Tax Policy: Subject Files (OTPSF), Box 68, File Folder #56: Suggestions for TAX REFORM Submitted to Treasury for Comment, 1959.
[13] “Suggested Outline for Tax Study,” March 9, 1959, NACP, RG 56, OTPSF, Box 68, File Folder #55: Tax Legislative Program for 1959-1960, Mills Subcommittee, 1959-1962.

produce the needed revenues for the Government."[14] CWM successively started to work on this subject. On February 15, 1959, Mills argued tax reduction in the near future should not be carried out until budget surpluses could be accurately foreseen, while stating that existing tax system had contributed to the industrial operation at less than full capacity, and affected employment, economic stability and growth because the situation the United States had then was "Part peacetime and part wartime" due to the Cold War. Regarding the tax revision to add specific tax preferences as "Tax erosion," he argued that eliminating unjustifiable tax differentials and preferences and lowering tax rates for everyone was the hallmark of a "Constructive tax revision program."[15] Besides, on May 18, 1959, the constructive tax revision, Mills stated, had to be without sacrificing revenues required for responsible financing of government.[16] As the representative of CWM, Mills argued for the comprehensive tax reform that would be able to provide a more responsive, a more equitable and fairer tax system both for economic stability and growth, and adequate tax revenues to finance government programs.

To discuss what specific measures the constructive tax reform aimed at meeting the criteria set forth above should include, CWM, cooperating with the Treasury, held the hearings on the subjects over tax reform from November 16 to December 18 in 1959. CWM invited tax experts from colleges and universities, research organizations, business, labor, and agriculture.[17] Before this series of hearings concluded, CWM made the report,

[14] "Chairman Jere Cooper of the Committee on Ways and Means Releases a Further Announcement Relative to the General Tax Revision Hearings Scheduled to Begin January 7, 1958," September 11, 1957, Historical Special Collection (HSC), Harvard Law School Library (HLSL), Stanley S. Surrey Papers (SSSP), Box 39, File No. 28-1: Ways and Means Committee, 1957-1960.

[15] "Address of Chairman Wilbur D. Mills, Committee on Ways and Means, U.S. House of Representatives, before the Ninth Annual Mid-Year Conference of the Tax Executive, Shoreham Hotel, Sunday Evening, February 15, 1959," February 15, 1959, NACP, RG 56, OTPSF, Box 68, File Folder #55: Tax Legislative Program for 1959-1960, Mills Subcommittee, 1959-1962.

[16] "Chairman Wilbur D. Mills, Committee on Ways and Means, House of Representatives, Announces Committee's Plans for Study Aimed at Revision of Federal Tax System," May 18, 1959, NACP, RG 56, OTPSF, Box 68, File Folder #55: Tax Legislative Program for 1959-1960, Mills Subcommittee, 1959-1962.

[17] "Program of Panel Discussion in General Revenue Revision, 1959," September 8, 1959, NACP, RG 56, OTPSF, Box 68, File Folder #55: Tax Legislative Program for 1959-1960, Mills Subcommittee, 1959-1962. As to this series of hearings, see U.S. House of Representatives, Committee on Ways and Means, *Tax Revision*

"Tax Policies for Economic Growth" on December 17, 1959 to set out the outline of expected tax reform proposal. As to individual income tax rate structure, it recommended (1) Reducing marginal rates on personal income, (2) To revise the income tax brackets and rates especially in the lower-income scale so as to smooth progressivity, and (3) Splitting the lowest bracket and taxing the lower part at lower rates as to improve both equity and built-in flexibility. It proposed rate reform should involve with base-broadening measures such as (1) Eliminating exclusions, exemptions, tax credits, and special dispensations discriminated among sources of income and industries and resulted in waste from misallocation such as tax-exempt interest on state and local securities, special treatment of mutual and cooperatives, special capital gains treatment for banks, livestock, or timber, (2) Increasing deductibility of capital losses, and (3) Redefining capital gains to prevent the conversion of ordinary income into capital gains for tax reasons. As for corporate income taxation, it recommended (1) Reducing corporate tax rates while tightening definitions of business expenses and net income, (2) Liberalizing depreciation allowance by revising of schedules of useful lives while taxing gains from sale of depreciable assets as ordinary income in the interest of equity and to prevent tax avoidance, and (3) Eliminating the tax bias against equity financing in favor of debt financing. CWM recognized that these measures would meet the principle of sound tax system that (1) Should generate sufficient revenues to finance all necessary government expenditures and contain contra-cyclical tax flexibility,[18] (2) Should tax people equal both horizontally and vertically,[19] (3) Must be as simple as possible for the government and the taxpayer, (4) Should be as neutral as possible in its effects on private economic decision-making. Then they maintained that the tax revision (1) Would remove the

---

Compendium of Papers on Broadening the Tax Base, Vol. 1-3 (Washington, D.C.: U.S. Government Printing Office, 1959). Total number of pages is over two thousands.

[18] The Report described contra-cyclical tax flexibility meant the ability of "Generating substantial surpluses under boom conditions to offset the inevitable and beneficial deficits occurring in periods of decline in business activity."

[19] It was argued that sound tax system "Should tax people in like economic circumstances alike, but not people in different economic circumstances discriminatorily in relative tax burdens."

impediments to efficiency and growth, (2) Would improve the productivity of capital, (3) Would release or restore incentives to personal effort, and (4) Would increase savings and risk-taking. Finally, CWM concluded that every recommended tax change would have to be coordinated with other simultaneous changes in tax structure “as one package” constructive tax reform to construct tax system with contra-cyclical tax flexibility, horizontal and vertical equity, simplicity, and neutrality to economy.[20]

It appeared, however, to need a long time to propose it. The consensus among those testifying on the way to accomplish tax reform was loss apparent. In the panel discussion, while some experts believed that several provisions of existing law gave undue advantage to particular groups or activities, others were just as convinced that they were essential to tax fairness and to promote desirable economic or social objectives.[21] In the last day of panel discussion, “Before any plan can be developed,” then Mills stated, it would be necessary for the staffs of CWM, Joint Committee on Internal Revenue Taxation (JCIRT) and the Treasury “to review and analyze the various suggestions which have been made to us and give the Committee the benefit of their views as to their feasibility and practicability.” “It will not be possible for the staffs to complete this analysis in the remainder of this Congress,” he went on, “thus it will not be possible for the Committee on Ways and Means, itself, to give specific consideration in 1960 to any broad proposals of tax revision based on these discussions.”[22] Douglas H. Eldridge of TAS also conveyed Fred C. Scribner Jr. that to propose an inventory of discussed suggestions for tax revision “at that time would seem very

[20] “Tax Policies for Economic Growth,” December 17, 1959, NACP, RG 56, OTPSF, Box 68, File Folder #56: Suggestions for TAX REFORM Submitted to Treasury for Comment, 1959.
[21] Fred C. Scribner, Jr. to Wilbur D. Mills, December 18, 1959, NACP, RG 56, OTPSF, Box 68, File Folder #55: Tax Legislative Program for 1959-1960, Mills Subcommittee, 1959-1962.
[22] “Closing Statement of Chairman Wilbur D. Mills, Committee on Ways and Means, at the End of Five Weeks of Panel Discussions on Tax Reform,” December 18, 1959, NACP, RG 56, OTPSF, Box 68, File Folder #55: Tax Legislative Program for 1959-1960, Mills Subcommittee, 1959-1962.

unwise."[23] Then Scribner conveyed Mills "We concur in your view that this analysis by the staffs will necessarily take time."[24] Thus it was decided that crafting and proposing be put off after Kennedy's inauguration.

II. Economic Conditions and the Argument for Stimulating Investment

Table 3. Annual Rates of Growth of Real Gross Domestic Fixed Capital Formation, 1948-57

(percent)

Country	1948-50	1950-53	1953-57	1948-57
OEEC total	10.0	4.8	7.9	7.3
Selected Countries				
France	5.3	1.2	9.6	5.8
Germany	-	8.5	9.7	9.2
Italy	5.3	9.4	8.6	8.1
Netherlands	6.3	3.2	8.5	6.2
Sweden	4.6	4.4	4.0	4.3
United Kingdom	6.6	3.5	5.7	5.1
United States	5.7	1.5	3.6	3.4

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, "Affirmative Brief for President's Recommendation for Investment Tax Incentive Credit," April 28, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit.

The recession of 1960-61 after the discussion over future tax reform and the presidential campaign in 1960, however, confronted with the plan to propose comprehensive tax reform bill. American economy had often fluctuated in late 1950s. From 1955 to the third quarter of 1957, the new investments for machinery and equipment had increased excessively, which developed the mechanization and automation. But its amount started to decline sharply from the fourth quarter of 1957, which brought about the decline of

23 Douglas H. Eldridge to Fred C. Scribner, Jr., "Draft of the 'Tax Policies for Economic Growth'," December 21, 1959, NACP, RG 56, OTPSF, Box 68, File Folder #56: Suggestions for TAX REFORM Submitted to Treasury for Comment, 1959.

24 Fred C. Scribner, Jr. to Wilbur D. Mills, December 18, 1959 NACP, RG 56, OTPSF, Box 68, File Folder #55: Tax Legislative Program for 1959-1960, Mills Subcommittee, 1959-1962.

economic activity. Though economic activity and industrial production restored from second quarter of 1958 to the end of 1959, they declined from 1960 to the first quarter of 1961.

Meanwhile, there was the problem with respect to fixed capital formation in the United States.[25] Table 3, comparing the growth rate of real gross domestic fixed capital formation in the United States with selected European countries, shows the growth rate in the area of the investment for plant and equipment and of new construction was generally substantially lower. The reasons for it were the leveling off or actual decline in business expenditures on plant and equipment, and the increase in depreciation and obsolescence of the stock existed those days. Other countries, in contrast to the United States, had been lowering the average age of their fixed capital.[26] The lower increase in fixed investment brought about the issue of balance of payments. Higher prices of products of the United States than those of other countries such as France, West Germany, and Japan, and the slowdown of industrial production induced the deterioration of balance of trade and the position of the United States in the export market.[27] Both long- and short-term capital had continued to outflow due to the lower short-term interest rate and the movement of firms of the United States to foreign countries through private direct investments.[28] The balance of transfer account deficit had also expanded through the increase in foreign military

---

[25] Office of Tax Analysis, "Affirmative Brief for President's Recommendation for Investment Tax Incentive Credit," April 28, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit.

[26] As the most spectacular example, the proportion of capital equipment and plant under 5 years of age in Germany grew from one-sixth of the total in 1948 to two-fifths in 1957.

[27] In the period from 1953 to 1960, whereas the industrial production of countries affiliated to European Economic Community (EEC) had increased by 76%, and of Japan had increased it by 180%, that the United States had increased only 17%. See United Nations, *Statistical Yearbook (*New York and Geneve, 1961), pp. 66-68; Fatemi, N, Saint Phalle, T and Keeffe, Grace, M., *The Dollar Crisis: The United States Balance of Payments and Dollar Stability* (Fairleigh Dickinson University Press, 1963), p. 38, 54.

[28] Because of the slow progress of economic activity in the United States while EEC countries' rapid development, the short-term interest rates of the United States had progressed around a level of 2% while that of European countries had not declined below 3%. *January 1961 Economic Report of the President and the Economic Situation and Outlook,* p. 423. Long-term capital outflow had occurred mainly due to the movement of firms of the United States to foreign countries through private direct investments. Fatemi et al, *The Dollar Crisis*, pp. 152-153; Pizer, S. and Culter, F., "Expansion in U. S. Investments Abroad," *Survey of Current Business,* Vol. 42, No. 8, August, 1962, p. 20.

expenditures and foreign economic assistance.[29] These problems of balance of payments ultimately led to the outflow of gold and the instability of dollar value.

Solving these economic problems was the goal of Senator John F. Kennedy and his economic advisers at the time of presidential election in 1960. Some eminent economists, led by Paul A. Samuelson and James Tobin, worked to help for drafting platform of Kennedy. For instance, in a meeting regarding the outline of the economic platform for the campaign on August 3rd, 1960,[30] Samuelson indicated that the platform had to suggest returning to fuller utilization of unemployed or underemployed human and capital resources as one of most important paths to higher growth. Easy money was not the prescription for them because of the balance of payments problem. Thus in the meeting economists recognized the expansion of both private and public capital formation through tax reform such as accelerated depreciation or investment allowance.[31] In the same period, businesses argued for the measure to stimulate the investment for machinery and equipment.[32] The argument for stimulating investments came out from the political economic situation in the face of presidential campaign.

Pursuant to these arguments, Taxation Task Force of Kennedy led by Stanley S. Surrey started to devise the measure to stimulate private investment from 1960.[33] In the report about tax policy on December 31, 1960, to meet the arguments, they rejected accelerated depreciation because they regarded it as the measure to benefit only larger firms that could afford investing plant and equipment. Instead, they proposed the measure that

---

[29] *Ibid.,* p. 424.

[30] Attendances were John K. Galbraith, Seymour E. Harris, and Samuelson.

[31] Paul A. Samuelson to Archibald Cox, "August 3 Meeting of Galbraith-Harris-Lester-Samuelson with Senator Kennedy," August 8, 1960, HSC, HLSL, SSSP, Box 127, File No. 91-2D: Investment Credit (Tax Incentive 1), 1960-1961.

[32] Imrie de Vegh, "The Economic Problem of the Sixties," August 19, 1960, HSC, HLSL, SSSP, Box 127, File No. 91-2D: Investment Credit (Tax Incentive 1), 1960-1961.

[33] Task Force included Mortimer Caplin, Richard Musgrave, Norman Ture from Joint Economic Committee, Cary Brown, and Adrian DeWind who was a New York attorney who had specialized in tax matters and who had served as Chief Counsel on the House Ways and Means Subcommittee on Internal Revenue Administration in 1951-52. In February 1961, Surrey assumed Assistant Secretary of the Treasury for Tax Policy, and Caplin became Commissioner of Internal Revenue Services (IRS).

would enable corporation to deduct from its tax bill a percentage of the amount by its investment in new plant and equipment during the year exceeded its current depreciation deduction - "excess over depreciation allowance" approach.[34] After Kennedy took the office, OTA and Tax Legislative Counsel (TLC) in the Treasury started to devise the detail of investment credit bill. They preferred the "excess over depreciation allowance" approach to "across-the-board" approach that could be applied to the certain percentage of investment expenditures.[35] Brown and Musgrave, worked with both the Treasury and the Council of Economic Advisers (CEA), also recommended Surrey the "excess" approach.[36] This proposal was aimed at being of benefit and providing some of the financing techniques available to especially smaller firms. Most of them in those days didn't have access to the security markets in their financings, and couldn't obtain term loans. Then they used lease financing in order to obtain their capital equipment.[37] The Treasury finally chose to recommend the investment credit with the excess approach as the way to meet the arguments of economic advisers and businesses.

At the same time, they recommended that $2 billion in offsetting funds was to be retrieved by closing certain minor leakages either long on the Democratic agenda or thought not to be too controversial.[38] The decline from 1960 to 1961, Bureau of Budget of White House estimated, would turn the consolidated budget in fiscal 1961 to the deficit $2.3

[34] Taxation Task Force, "Tax Policy for 1961: Contents, Listing, of Matters Covered, Brief Summary of Recommendations, Detailed Discussion of Recommendations," December 31, 1960, John F. Kennedy Library (JFKL), Papers of John F. Kennedy, Pre-Presidential Papers, Transition Files (JFKTRAN), Task Force Reports 1960 (TFR1960), Box 1072, File: Taxation Task Force Report.
[35] "Alternative Approaches to an Investment Incentive Allowance," Undated, HSC, HLSL, SSSP, Box 127, File No.: 91-2A, File: Investment Credit (Tax Incentive 1), 1960-1961.
[36] E. Cary Brown and Richard A. Musgrave to Stanley S. Surrey, "Choices on Investment Credit Approach," February 24, 1961, HSC, HLSL, SSSP, Box 127, File No.: 91-2A, File: Investment Credit (Tax Incentive 1), 1960-1961.
[37] For instance, in the study completed by the Federal Reserve Bank of Boston of the New England region, it was learned that, where lease financing was used to obtain the use of equipment, 97% of such leasing were done by smaller companies with less than 500 in personnel. Kenneth W. Bergen to Stanley S. Surrey, January 18, 1961, HSC, HLSL, SSSP, Box 127, File No.: 91-2C, File: Investment Credit (Tax Incentive 1), 1960-1961.
[38] Taxation Task Force, "Tax Policy for 1961: Contents, Listing, of Matters Covered, Brief Summary of Recommendations, Detailed Discussion of Recommendations."

billion from the surplus of $0.8 billion.[39] Then the task force argued for the combination of investment credit and some of reform measures discussed since 1950s.

III. The Proposal of Tax Reform Bill 1961

Kennedy Administration proposed their first tax reform bill in "Special Message to the Congress on Taxation" on April 20th, 1961.[40] The first section, "Tax incentive for modernization and expansion," recommended the investment tax credit that took "three-step-scale-excess" approach.[41] Several restrictions for application of investment credit were also proposed.[42] This measure would involve $1.7 billion of revenue loss. Second part, "Tax treatment of foreign income," recommended the reform of foreign income taxation.[43] It was estimated that these measures would raise $ 250 million of tax revenue. The third section, "Correction of other structural defects," proposed the reform of (1) The treatment for dividends and interest (increasing revenue by $1,050 million),[44] (2) The

[39] *The Budget of the United States Government for the Fiscal Year Ending June 30 1963,* p. 8.
[40] *Public Papers of the Presidents, John F. Kennedy, 1961,* pp. 292-300.
[41] It would provide (1) 15% of all new plant and equipment investment expenditures in excess of current depreciation allowances, (2) 6% of such expenditures below this level but in excess of 50% of depreciation allowances, with (3) 10% on the first $5,000 of new investment as a minimum credit.
[42] The contents were as follows: (1) Investment credit would be taken as an offset against the firm's tax liability up to an overall limitation of 30% in the reduction of that liability in any one year, (2) It would be available to the investment expenditures for new plant and equipment with a useful life of 6 years or more in the United States after January 1st of 1961, and (3) Investments by public utilities other than transportation would be excluded, as would be investment in residential construction including apartments and hotels.
[43] The contents were as follows: (1) Taxation on each year American corporations on their current share of the undistributed profits realized in the year by subsidiary corporations organized in economically advanced countries, (2) The elimination of tax deferral privileges for the profits earned by the operation in the "tax haven" countries, (3) Taxation on the income derived through foreign investment companies in the same way as income from domestic investment companies, (4) Termination of the total tax exemption in those days accorded the earned income of American citizens residing in economically advanced countries, limitation of this exemption to $20,000 for those residing in the less developed countries, and termination of the exemption of $20,000 of earned income accorded those citizens who stayed abroad for 17 out of 18 months, and (5) Termination of the exclusion from the estate tax accorded real property situated abroad.
[44] On the treatment for dividends and interest, two measures were proposed as follows: (1) 20% withholding rate on corporate dividends and taxable investment type interest, and (2) The repeal of the exclusion from income of the first $50 of dividends received from domestic corporations and a 4% tax credit against of dividend income in the excess of $50.

measures on expense accounts (increasing revenue by $250 million),[45] and (3) The measures for capital gains on sale of depreciable business property (increasing revenue by $200 million).[46] It was estimated that this tax reform bill as a whole would increase tax revenue by $50 million.

The proposal of investment credit had two purposes. On the one hand, it was aimed to improve the productivity, to reduce the production costs, to promote the rate of economic growth, and to improve the balance of payments.[47] On the other hand, three-step-scale-excess approach of investment credit proposal had the significant role against inequity among corporations. In 1958, while the percentage of corporate returns under $25,000 was 83% of whole taxable corporations, the percentage of the amount of the income class was only 7%.[48] It was estimated that financing investments was more difficult for the firms of this income class than for large corporation. Therefore, investment credit of 10% on the first $5,000 of new investment as a minimum credit was aimed to benefit the firms under $25,000 such as small and new businesses in need of new investment to modernize plant and equipment. It was expected that a majority, especially new and growing firms, would be induced to make new investments by tax credit of 15% of all new plant and equipment investment expenditures in excess of current depreciation allowance. The 6% credit for firms whose new investment expenditures would be between 50% and 100% of their depreciation allowances was designed to afford some substantial incentive to the

---

[45] The contents were as follows: (1) The disallowances in full of a tax deduction for the cost of business entertainment and the maintenance of entertainment facilities such as yachts and hunting lodges, and (2) The restrictions on the deductibility of business gifts, expenses of business trips combined with vacations, and excessive personal living expenses incurred on business travel away from home.

[46] The items were as follows: (1) The elimination of the treatment for the gains from the disposition of depreciable assets as capital gains to the extent which depreciation had been deducted for such property by the seller in previous years, (2) Permitting only the excess of the sales price over the original cost to be treated as a capital gain, and (3) Treatment for the remainder as ordinary income.

[47] Douglas Dillon, the Secretary of the Treasury, argued in the memorandum for Mills that the aim of investment credit was not only to increase economic growth and productivity, but “To strengthen our competitive position in world markets…An important aspect of its potential benefits for our international position is its reinforcement of the recent improvement in the balance of payments.” Douglas Dillon to Wilbur D. Mills, August 2, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit.

[48] *The Federal Revenue System: Facts and Problems, 1961*, p. 28.

depressed or hesitant firm knowing it couldn't yet achieve the 15% credit.[49] The proposal of investment credit had the role not only as one of measures to improve the problem both of domestic economy and the balance of payments. Investment credit was designed to induce intensively small, new and growing businesses to make investments as much as possible.

The reform measures of "Foreign income tax treatment" and "The correction of other structural defects" had significant role. From the viewpoints of OTA and TLC, "A sound tax system is essential if we are to carry out our defense program and provide the public services which are so necessary in our present society." The existing tax structure, however, they thought, "Contains a number of provisions which grant special treatment to certain types of taxpayers." Then their objective "Should be to remove these tax preferences in any case where they are not clearly justified." "These changes, while making a beginning toward the comprehensive tax reform program mentioned above, will provide sufficient revenue gains to offset the cost of the investment tax credit and keep the revenue-producing potential of our tax structure intact."[50] Besides, the removal of preferential provisions, they thought, "Will result in a broader tax base which will make it possible to reduce the present tax rates for all taxpayers without a loss of revenue."[51] Surrey was also in favorer of base-broadening tax reform than rate-cuts or the addition of preferential treatments to improve progressivity and both vertical and horizontal equity of Federal income tax system which had mainly favored unearned incomes and higher-income classes, and to smoothen rate structure without revenue losses.[52] "As a first step toward the goal of greater uniformity and

---

[49] *Public Papers of the Presidents, John F. Kennedy, 1961,* p. 293.
[50] *Ibid.,* p. 297.
[51] R. A. Klayman, "Remarks on President's Tax Message," April 19, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit.
[52] Stanley S. Surrey, "Summary Statement of Stanley S. Surrey for Hearings on Broadening The Tax Base, House Committee on Ways and Means November 16, 1959, The Federal Income Tax Base for Individuals," Undated, HSC, HLSL, SSSP, Box 39, File No. 28-1: Ways and Means Committee, 1957-1960. Before he assumed the position in the Treasury, Surrey had already developed an intellectual commitment to closing loopholes in the income tax. In 1989, in response to an interviewer's question regarding his selection of Surrey for the Shoup mission, Shoup recalled how hostility to tax preferences shaped his choice of colleagues: "My own prejudices determined the selection of the members of the Tax Mission, and if Surrey had been an advocate of tax preferences,

equity in our tax system," from the viewpoints of the Treasury's staffs, "the adoption of these reforms would serve as a prelude to the more extensive tax reform which should follow later."[53] This tax reform bill weren't necessarily crafted on the basis of "Keynesian theory." The investment credit and revenue-raising structural reforms appeared from different context, and were combined unexpectedly.

IV. The Defects of Tax Structure Related to Revenue Act 1962

As described above, the criteria "one package" constructive tax reform, though it was ultimately divided, were contra-cyclical tax flexibility, horizontal and vertical equity, simplicity, and neutrality to economy.[54] To clarify why reform measures tax reform bill 1961 contained were to be chosen along these principles, this section will view the defects of tax structure about which the Treasury was concerned.

Foreign Income Taxation. Since 1950s, federal corporate income tax law granted U.S. corporations operating through foreign subsidiaries to use some preferential treatments for their tax liabilities. Profits earned abroad by American firms operating through foreign subsidiaries were subject to United States tax only when they were returned to the parent company in the form of dividends. The number of firms operating through foreign subsidiaries had increased since 1950s, especially in tax havens such as Switzerland, Bermuda, Bahamas and Liechtenstein. Under this provision, in those countries where income

---

I might not have asked him to join the mission." M. Ramseyer, Carl S. Shoup, "Japanese Taxation: The Shoup Mission in Retrospect: An Interview," *The Japan Foundation Newsletter 1989*, vol. 16 (4), pp. 5-6.

[53] R. A. Klayman, "Remarks on President's Tax Message," April 19, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit.

[54] Though it had not succeeded till 1986, there was a strong tradition of support within the Treasury, going back to the 1930s, for base-broadening reforms. It seems the public finance experts kept this tradition alive. See Joseph J. Thorndike, *Their Fair Share: Taxing the Rich in the Age of FDR* (Washington, D.C.: The Urban Institute Press, 2013). It is generally said that the ideas of Robert Murray Haig were very influential to them. See W. Elliot Brownlee, "Tax Regimes, National Crisis, and State-building in America," in Brownlee, ed., *Funding the Modern American State*, pp. 37-104.

taxes were lower than in the United States, the ability to defer the payment of the United States tax by retaining income in the subsidiaries provided a tax advantage for companies operating through overseas subsidiaries that were not available to companies operating solely in the United States. These firms attempted to exploit the multiplicity of foreign tax systems and international agreements in order to reduce their tax liabilities sharply both at home and abroad, and to maximize the accumulation of profits.[55] A number of investment companies created abroad had also contributed to the capital outflow from the United States. Besides, many American investors properly made use of this deferral in the conduct of their foreign investment. As a result, the administration regarded these provisions led to the balance of payments problem.

Treatment for Dividend and Interest. While federal income tax law adopted the combination of withholding and voluntary reporting on wages and salaries under the individual income tax, the income from dividend and interest were not withheld. This provision resulted in substantial amounts of improper tax evasion on such income, especially interest.[56] The higher income classes usually received these incomes, which meant it was patently unfair to those who had to as a result bear a larger share of the tax burden on the earners of wage and salary. “Recipients of dividends and interest,” TAS thought, “should pay their tax no less than those who receive wage and salary income, and the tax should be paid just as promptly. Large continued avoidance of tax on the part of some has a steadily demoralizing effect on the compliance of others,”[57] and that “this has been a source of weakness in our tax system to which the Congress and the Treasury have given attention over

---

[55] *Public Papers of the Presidents, John F. Kennedy, 1961,* pp. 294-295.
[56] According to the estimation of the Treasury, the amount of unreported dividend was $900 million in 1958, and of unreported interest was $3-4 billion. And the Treasury estimated that the amount of loss of tax revenue was $300 million due to unreported dividend, and $500-800 million due to unreported interest. Treasury Department, Tax Analysis Staff, “Dividend and Interest Reporting,” January 17, 1961, NACP, RG 56, OTPSF, Box 68, File Folder #61: Tax Reform, 1961-1962.
[57] *Public Papers of the Presidents, John F. Kennedy, 1961,* p. 297.

the years."[58]

Federal income tax law also provided for an exclusion from income of the first $50 of dividends received from domestic corporations and for a 4% credit against tax of such dividend income in excess of $50. These preferential treatments for income from dividends were introduced in 1954 so as to alleviate double taxation both on the stage of corporations and shareholders, and to encourage capital formation through equity financing. However, the revenue losses resulting from these provisions were spread over a large volume of outstanding shares rather than being concentrated on new shares. The stimulating effects of the provisions were thus diluted, resulting in relatively little increases in the supply of equity funds and relatively slight reduction in the cost of equity financing. As table 2 shows, the amount of equity financing had not so much increased and accounted only for less than 10% of total corporation funds. TAS, IRS and some members of Joint Economic Committee of the Congress had incorporated since 1955. In the report they submitted to JEC, "Stockholders," they pointed out, "do not base their decisions with respect to stock purchases on the basis of pretax corporate earnings per share, but rather on the basis of after-tax earnings available for distribution. Accordingly, it was argued, shareholders take full account of the corporate income tax in determining the price they offer for a corporation's stock."[59] Finally, these provisions for dividends caused inequity of tax burden.[60] Dividend credit and exclusion gave more benefits to taxpayers of middle- and high-income classes intensively, and eroded both progressivity and equity of income tax structure.

---

58 Treasury Department, Tax Analysis Staff, "Draft Material on Tax Program," February 1, 1961, NACP, RG 56, Office of Tax Policy: Legislative History Files (OTPLHF), Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit.

59 *The Federal Revenue System: Facts and Problems, 1961*, p. 30.

60 In the tax message on April 20th, it was estimated that about 80 % of dividend income accrued to 6.5% of taxpayers whose incomes exceed $10,000 a year, while only about 10% of it accrued to those with incomes below $5,000. Similarly, by 1961, dividend income had sharply risen, accounted for about 1% of all income from all sources for those taxpayers with incomes of $3,000 to $5,000. But it constituted more than 25% of the income for those with $100,000 to $150,000 of income, and about 50% for those with incomes over $1,000,000. *Public Papers of the Presidents, John F. Kennedy, 1961,* pp. 297-299.

Table 4. Souces of Corporate Funds, 1949-1959

(Percentage distribution)

	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959
Tax rates	21-38	23-57	28.75-80.75	30-82	30-82	30-52	30-52	30-52	30-52	30-52	30-52
Source of Corporate Funds											
Internal sources	96.1	47.1	48.0	57.8	64.8	89.2	52.9	58.0	65.9	85.7	57.6
Retained profits	50.3	29.4	25.3	24.0	26.0	28.4	21.7	21.9	20.9	19.9	17.1
Depreciation and Amortization	45.8	17.6	22.7	33.8	38.8	60.8	31.2	36.1	44.9	65.8	40.5
External long-term sources	27.7	9.5	19.7	30.5	25.0	28.8	17.1	23.2	28.2	35.5	18.3
Stocks	10.3	3.8	6.8	9.7	7.6	9.5	5.4	6.7	8.2	11.7	7.0
Bonds	21.3	4.5	9.1	15.9	15.8	17.1	8.4	9.8	16.7	19.2	8.1
Other debts	-3.9	1.1	3.8	4.9	1.6	2.3	3.4	6.7	3.3	4.6	3.2
Short-term sources	-23.9	43.4	32.3	11.7	10.2	-18.0	30.0	18.8	6.1	-20.8	23.9
Bank loans	-11.0	4.8	9.8	5.2	-0.3	-5.0	7.4	4.6	0.7	-7.8	4.0
Trade payable	-1.9	19.9	6.8	8.8	1.3	-0.9	10.9	11.5	5.6	-4.9	11.9
Federal income tax liabilities	-14.2	16.5	10.9	-10.0	2.0	-14.0	7.6	-3.5	-5.2	-7.8	4.5
Other	3.2	2.3	4.8	7.8	7.2	1.8	4.2	6.3	4.9	-0.3	3.6
Total sources	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: *The Federal Revenue System: Facts and Problems, 1961,* 32-33.

Expense Accounts. Deductions for expense accounts also evaded individual and corporate income tax base. In those days, too many firms and individuals had devised the means of deducting too many personal living expenses as business expenses, which resulted in the huge amount of Federal tax revenue losses. For instance, according to the research of Audit Division of IRS (AD), in many industries it was customary to give gifts to customers and purchasing agents as well as to government employees such as highway inspectors, and policemen. Income tax law at that time allowed these expenses for gifts deductible against taxable income if it was necessary for business. But very often taxpayers failed to comply with the examining officer's request to furnish the names of the donees. In many of these cases taxpayers had claimed that the amount of each gift was nominal although the total amount of these gifts might have been substantial. These conditions made it extremely difficult to separate out if or not it was pseudo-business expenditures. The amount that the use of the expense account for tax avoidance charged to Federal tax revenues was

$1.5-2.1 billion per year. Thus AD claimed for new legislation to deal with this problem.[61]

The proposal of expense accounts aimed to eliminate the abuses in the expense account area by disallowing as a tax deduction certain expenditures for entertainment, facilities, gifts, club dues, food and beverages, and travel. Table shows the revenue effect of proposed legislation. As it demonstrates, beneath the proposal, some of entertainment expenditures would be disallowed in full, and the others in part. Complete elimination was applied to the expenses IRS judged as pure entertainment expenditures unnecessary for business. On the other hand, the disallowance in part was given to the expenditures difficult to distinguish if or not it was really necessary for business.[62]

[61] D. J. Barrow to Michael A. Waris, Jr., "Substantiation of Business Gifts," March 28, 1961, NACP, RG 56, OTPLHF, Box 12, File Folder #18B: H.R. 10650 (Section 4) – Disallowance of Certain Entertainment, etc., Expenses.

[62] "Detailed Proposals to Implement the President's Recommendations in the Expense Account Area," Undated, NACP, RG 56, OTPLHF, Box 12, File Folder #18B: H.R. 10650 (Section 4) – Disallowance of Certain Entertainment, etc., Expenses.

Table 5. Entertainment Expenditures and Revenue Effect of Proposed Legislation

(In millions of dollars)

Item	Estimated total expenditures	Disallowed		Revenue Estimates
		Percent	Amount	
Eliminate comletely				
Tickets	50	100	50	20
Club dues	130	100	130	52
Hunting lodges	15	100	15	6
Working ranches	25	100	25	10
Fising camps	10	100	10	4
Resort properties	15	100	15	6
Yachts or boats	25	100	25	10
Other similar facilities	10	100	10	4
Total	280	100	280	112
Eliminate partly				
Food and beverages -- entertainment	400-1,000	25	100-250	40-100
Conventions	300	10	30	12
Gifts	200	20	40	16
Apartments and suites	20	20	4	2
Airplanes	100	10	10	4
All other	200	20	40	16
Total	1,220-1,820		224-374	90-150
Grand total	1,500-2,100		504-654	202-262

Source: D.H. Leahey to Stanley S. Surrey, "Estimated Revenue Effect of Limitation of Entertainment Expenditures," March 29, 1961, NACP, RG 56, OTPLHF, Box 12, File Folder #18B: H.R. 10650 (Section 4) – Disallowance of Certain Entertainment, etc., Expenses.

Capital Gains on Sale of Depreciable Business Property. Under Federal income tax law, gains and losses arising from the sale or exchange of depreciable property held over 6 months were subject to special treatment. Where the total gains from such sales or exchanges exceeded the total losses, the net gains were treated as capital gains, subject to tax at a maximum rate of 25%. Where losses exceed gains, however, the net losses were treated as ordinary losses, fully deductible from income. When these treatments for depreciable property, on the other hand, the law provided the method of computing depreciation called "the straight-line method." But in 1954, "double-declining balance method" and "sum-of-the years-digits method" applied for depreciable assets acquired after 1954 which had longer useful life than 3-year.[63]

These provisions afforded a substantial tax advantage to taxpayers making extensive use of depreciable property in the production of their income as compare with those whose income producing activities involve little dependence on such facilities. This advantage arose from the fact that depreciation deductions are chargeable against income at ordinary income tax rates, while upon disposition of the property, the gains which may be nothing more than the result of accelerated reduction of the asset's basis for tax purposes were taken into income as capital gains, taxable at a maximum rate of 25%.[64]

V. The Objections to Investment Credit Bill

Large businesses including manufacturers objected to the investment credit proposal. For instance, on the basis of the fact that the rate of economic growth was relative to the amounts of depreciation allowances of economically developing countries, National Association of Manufactures (NAM) argued that lower rate of depreciation allowance of the United States was the reason for the relative slack of economy. Besides, NAM maintained that the promotion of reinvestment for plant and equipment was more significant than that of new investment.[65] Then CWM recommended that the Treasury modify the proposal. At first, CWM argued that "Three-step-scale excess" approach should be changed into "The across-the-board" approach. The argument was based on the claim that industries having high depreciation base, such as steel and auto industries, would be excluded. Secondary, the repeal of the 30% limitation was recommended because it would press against

---

[63] *The Federal Revenue System: Facts and Problems, 1961*, pp. 71-73.
[64] *The Federal Revenue System: Facts and Problems, 1961*, p. 85.
[65] The American Economic Foundation, "Depreciation and National Economic Health," July 26, 1961, HSC, HLSL, SSSP, Box 128, File No.: 92-1A, File: Investment Credit (Tax Incentive 4), 1961.

small businesses to invest for plant and equipment, while it would be in favor of investment of large firms and stable industries. Third, it was argued that revenue loss of $1.7 billion was not sufficient to stimulate investment incentives and had to be expanded by combining with the depreciation rule reform. Finally, the bill adopted "Placed-in-service" rule which investment expenditure only for working plant and equipment would be eligible for tax credit. But CWM argued that the rule might delay any immediate relief needed at that critical time, and recommended the adoption of "When-spent" rule which investment credit would be applied at the time businesses made investment expenditures. In order to attempt to respond to the requirement of businesses, "The principal arguments made against the credit, i.e., that the plan was complicated and discriminatory," Mills felt, "would be eliminated."[66]

In response to these arguments, OTA and TLC began to revise of investment credit bill. Surrey conveyed their plan to Dillon in the memorandum on June 7th, 1961. At first, on the structure of the credit, he suggested two alternative plans: (1) The credit of 10-12% on all investment in excess of 50% of depreciation, and (2) 7 or 8% across-the-board credit on all qualifying investment. Secondary, they decided to retain 30% limitation in the bill. This provision was aimed to insure that the investment credit would not consistently eliminate all tax liability for some classes of taxpayers. Without this limitation, this would occur, for example, in the case of many oil and mining companies whose tax liabilities were generally low in relation to earnings because of the combination of other tax advantages. On the limitation to new property, it was indicated the possibility to extend the credit to used machine tools which have a remaining useful life of six years in the hands of the purchaser. Moreover, it was decided to adopt "When-spent" approach to count

[66] "Comments, Questions, and Attitudes of Committee Members Concerning the Investment Credit," June 8, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit. As described above, Mills had been eager to accomplish constructive tax reform. And demonstrated later, the schedule of CWM discussion was so heavy. On the ground of these facts, though I have not found the clear evidence, I guess he desired quick passage of investment credit bill even with the compromise to business's oppositions and requirements.

expenditures as made, or to allow the credit for all expenditures, including those made before 1961, on assets placed in service in 1961 and 1962.[67]

CWM restarted the discussion over investment credit bill on the basis of the revision suggested by the Treasury. CWM on July 17, 1961, announced that it had tentatively adopted a proposal granting a credit against tax of 8% of investment expenditures with certain limitation. Meanwhile, the eligibility for the credit was limited to the machinery and equipment used in production in specified industrial activities to maintain the credit rate, to reduce the revenue loss, and to cover the greater and most vital part of the investment field.[68] It was estimated that these changes would reduce the amount of revenue loss provided by investment credit to $1.45 billion.

In addition, the Treasury decided to carry out the reform of depreciation in 1962. Since late 1950s, the Treasury had attempted to craft depreciation reform bill through the hearings held with CWM. The subject on depreciation reform was to revise the table of a useful life of depreciable asset - "Bulletin F" enacted in 1942. The useful lives of depreciable assets for tax accounting were determined through the negotiation between IRS and a corporation, and then Bulletin F was utilized as the criterion of the negotiation. Although these were not binding upon the taxpayers, it was alleged that taxpayers encountered strong pressures on capital investments, and considerable difficulty in establishing useful lives of their assets other than those indicated in the Bulletin F.[69] As a result, the Treasury proposed the revision of Bulletin F as follows: (1) The contracting of useful lives in Bulletin F, and (2) The simplification of notation. It was estimated the addition of depreciation reform would increase revenue losses by tax reform bill.

[67] Stanley S. Surrey to C. Douglas Dillon, "The Investment Credit – Policy Questions Which Are Being Reexamined As A Result of the Recent Hearings," June 7, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit.

[68] Office of the Secretary of the Treasury, Office of Tax Analysis, "Why the Investment Credit is Applied to Machinery and Equipment but Not Buildings," March 30, 1962, NACP, RG 56, OTPLHF, Box 15, File: Revenue Act of 1962 – Briefing Material Prepared for the Secretary in Connection with His Appearance before SFC on April 2, 1962.

[69] *The Federal Revenue System: Facts and Problems, 1961*, p. 88.

Tax reform bill passed through the House on March 29th, 1962, by 219 to 196. The rate of investment credit was reduced from 8% to 7%. The portion of the investment of public utilities eligible for the credit was reduced from 1/2 to 3/7, which reduced the effective rate for utilities from 4% to 3%. The limitation on the amount of tax liability for a particular year that the credit would eliminate (formerly $100,000 plus 50% of the tax in excess of that amount) was reduced to $25,000 plus 25% of the tax in excess of $25,000. These changes were estimated to reduce the gross revenue loss from the investment credit for a full year at current levels to $1,175 million.[70] Senate Finance Committee decided to add some revisions to the House bill in a row as follows: (1) To reduce the base amount of investment credit applied to all of the eligible investment, (2) The rejection of the application of investment credit for reinvestments, (3) The repeal of investment credit for livestock, and (4) Three year's carry-back of unused investment tax credit. These revisions were estimated to reduce the revenue loss to $1,020 million. Though revenue loss by investment credit consequently reduced, it was estimated accelerated depreciation would instead add the revenue reduction by about 3.5 billion. Finally, the revenue loss investment credit would provide was reduced because of the changes of the eligibility and the limitation for credit.

VI. The Objections to Tax-Preferences Reforms

While the revision of investment credit bill and depreciation were crafted, the Treasury decided to add further structural reform measures to the proposal.[71] The first was the elimination or curtailment of preferential treatments for mutual banks and savings and loan associations (increasing revenue by $365 million). Of two issues over the taxation on it, the first was the treatment for "Conduit principle" which undertook to tax

[70] "Ways and Means Committee Action on Investment Credit," March 23, 1962, HSC, HLSL, SSSP, Box 128, File No.: 92-2A, File: Investment Credit (Tax Incentive 5), 1962.
[71] The items of these proposals about mutual banks and savings and loan associations and mutual fire and casualty companies have been not found yet. It is the subject remained to author.

distributed income the members and the balance, retained earnings in excess of reserves for bad debts, to the mutual organizations. In this way, income originating in a mutual organization would be taxed at either the individual or the organizational level. It was more favorable treatment than corporate income, which was taxed twice, once at the corporate and once at the stockholder level. Second issue was the correct size of the bad debt deduction allowed these organizations. The mutual savings organization might add to bad debt reserves the lesser of (1) Income before bad debt allowances, or (b) The excess of 12% of deposits at end of the year over surplus, undivided profits, and reserves at the beginning of the year. Commercial banks might also deduct interest paid to depositors and additions to reserves, but in their case bad debt reserves were limited to three times their average bad debt experience during any consecutive 20-year period since 1927, applicable to eligible loans.[72] Consequently, under these preferential treatments, mutual savings banks and savings and loan associations added $3.2 billion to reserves and undivided profits considered available to pay bad debt losses while paying only $50 million in income tax during 1952-1958.[73] As Table 2-1 shows, tax law was in favor of mutual thrifts in opposition to commercial banks and firms subject on normal corporate income tax.

[72] Treasury Department, Tax Analysis Staff, "Issues in the Taxation of Mutual Savings Institutions," January 22, 1960, NACP, RG 56, OTPSF, Box 68, File Folder #55: Tax Legislative Program for 1959-1960, Mills Subcommittee, 1959-1962.

[73] Treasury Department, Tax Analysis Staff, "Mutual Savings Banks and Savings and Loan Associations," January 19, 1961, NACP, RG 56, OTPSF, Box 68, File Folder #61: Tax Reform - 1961-1962.

Table 6. Allocation of Total Income of Insured Commercial Banks, Mutual Saving Banks and Savings and Loan Association, 1952-1958

(Dollar amounts in billions)

Item	Commercial banks		Mutual savings banks and savings and loan associations			
			Mutual savings banks		Savings & loan associations	
	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution
Total income	20.3	100.0	5.9	100.0	9.0	100.0
Payments to depositors and stockholders	9.6	47.4	5.1	86.3	6.5	72.5
Federal income tax associations	5.9	29.2	0.015	0.2	0.035	0.4
Additions to reserves and undiv. Profits	4.8	23.4	0.8	13.5	2.4	27.1

Source: Treasury Department, Tax Analysis Staff, "Mutual Savings Banks and Savings and Loan Associations," January 19, 1961, NACP, RG 56, OTPSF, Box 68, File Folder #61: Tax Reform - 1961-1962.

Second measure was concerned with mutual fire and casualty companies (raising revenue by $50 million). The tax provisions applicable to mutual fire and casualty insurance companies enabled them to avoid and alleviate their tax liabilities. Many of these companies, organized on the mutual or reciprocal basis were taxed under a special formula which didn't take account of their underwritings gains and thus resulted in an inequitable distribution of the tax burden among various types of companies.[74] Especially, OTA put emphasis on the elimination of tax avoidance in the field of foreign insurance and reinsurance.[75]

Third measure was the taxation on cooperatives. Two measures were proposed to restrain these benefits received by cooperatives and patrons as follows: (1) All earnings should be taxable to either the cooperatives or their patrons, assessing the patron on the earnings allocated to him as patronage dividends or refunds in scrip or cash, (2) Withholding principle should be applied to patronage dividends or refunds (increasing

[74] *Public Papers of the Presidents, John F. Kennedy, 1961,* p. 300.
[75] Treasury Department, Tax Analysis Staff, "Taxation of Fire and Casualty Insurance Companies," January 18, 1961, NACP, RG 56, OTPSF, Box 68, File Folder #61: Tax Reform - 1961-1962.

revenue by $ 35 million).[76] Taxation on cooperatives also caused the problem of tax system. Substantial income from certain cooperative enterprises, reflecting business operations, was not taxed either to the cooperative organization itself or its members. This situation provided inequity between cooperatives and competing businesses. This inequity had resulted from court decisions held by patronage refunds, which was the payment or distribution to the patrons, to be non-taxable. Where patronage refunds were not paid in cash, cooperatives were able to retain earnings on which they paid no tax. While the Treasury held that patronage refunds not paid in cash was supposed to be reported by the recipients as income in the year in which such noncash allocations were received, provided the patronage was the result of business transactions, it was quite customary for patrons to defer reporting noncash patronage refunds as income until such time as the refunds were redeemed in cash.[77]

The Treasury and CWM in late 1950s treated these additional proposals to close loopholes, and the Treasury had already started to devise them in late 1950s. However, the Treasury decided to postpone their proposal till 1962 because the Treasury and CWM couldn't reach to the agreement through the hearings in late 1950s. From the viewpoints of the Treasury, the extra revenue loss which depreciation reform would create had to be offset. On the basis of the change of international situation and the consequent expansion of Federal budget expenditures, Dillon described in the letter for Mills that "I would urge that your final consideration of this legislation provide an approximate balance in over-all revenue effect, preferably through the addition of further revenue raising measures implementing the President's recommendations on closing loopholes including a possible revision of the special tax provisions relating to mutual savings banks and savings and loan associations, or if need be through a small reduction in the 8 percent level of the investment

[76] Treasury Department, Tax Analysis Staff, "Cooperatives," January 23, 1961, NACP, RG 56, OTPSF, Box 68, File Folder #61: Tax Reform - 1961-1962.
[77] Treasury Department, Tax Analysis Staff, "Cooperatives," January 23, 1961, NACP, RG 56, OTPSF, Box 68, File Folder #61: Tax Reform - 1961-1962.

credit, or perhaps through some combination of both."[78] Besides, TLC insisted that it would be so difficult for the Treasury to proposal these changes later if they were excluded from the bill.[79] The Treasury chose to propose these reforms to follow original purpose, as a step for constructive tax reform to propose later, and to offset revenue loss from investment credit and depreciation reform.

Despite the retrenchment of revenue loss created by investment credit, however, tax reform bill as a whole was enacted as tax reduction because of the elimination and curtailment of reform parts. The most damaging modification was the elimination of the repeal of dividend credit and exclusion on the House floor, and the curtailment of withholding dividends and interest. Just after tax reform bill was proposed in 1961, this part generated the intense opposition from the organizations of manufacturer, finance institution and investment companies for fear that it would result in discriminatory double taxation and discouraging equity financing while making debt financing more attractive.[80] The reform of foreign income taxation had been opposed by businesses, especially manufacturers such as Twin Disc Clutch Company and The American Mining Congress.[81] On the reform for business accounts, which would reduce corporate internal funds on which most of corporations had relied for investments, Henry Rothschild, at the business lunch, argued that

---

78 C. Douglas Dillon to Wilbur D. Mills, August 2, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit.

79 Tax Legislative Counsel, February 14, 1962, NACP, RG 56, OTPLHF, Box 11, File Folder #15C: H.R. 10650 (Section 2) – Investment Tax Credit.

80 Office of Tax Analysis, "Summary of the Hearings conducted by the Ways and Means Committee on the President's Tax Message: Repeal of Dividend Credit and Exclusion; Incidental Remarks on Tax Withholding Proposals," May 11, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #9: The Revenue Act of 1962: Summaries of Hearings Held by the Ways and Means Committee, 1961.

81 For instance, Twin Disc Clutch Company, many of whose subsidiaries operated in tax havens such as Liechtenstein and Switzerland, argued that this measure would be detrimental for American firms to meet foreign competition and for the benefits they gave to U.S. domestic economy, on the ground (1) That the profits earned in tax havens actually benefited the U.S. Internal Revenue because earnings remitted to U.S. parents or associates were subject to taxation under federal income tax law, and (2) That the excess of foreign source dividend inflow over investment outflow during the past ten years amounted to about $8.6 billion. The American Mining Congress opposed this proposal on the ground that taxation on undistributed profits would withdraw the tax incentive for capital investments granted by foreign countries. J. B. Schubeler to Wilbur D. Mills, "Administration Proposals on Foreign Source Income Taxation," June 8, 1961, NACP, RG 56, OTPLHF, Box 12, File Folder #14D: Revenue Act of 1962 – General, March, 1962 - May, 1962.

the deductions of business accounts were “So deeply embedded in our way of life that it cannot be legislated out of existence as a deductible business expense without the most far-reaching implications,” and that “To put forward a general disallowance bill may discredit the entire program.”[82] Organizations of advertising and hotel fervently opposed to the reform of expense accounts that this measure had the adverse effect on many businesses depending on business entertainment and convention for their businesses, and that it would deteriorate the unemployment in the hotel and restraint businesses. Advertising Association emphasized that promotional activity through entertainment expenditures would be restricted by this proposal. Besides, the Chamber of Commerce criticized that it would increase the production costs imposed on the corporations and give an added advantage to foreign competitor in American market who would not be limited.[83] The proposal to mutual banks and savings loan association was opposed by saving banks and saving and loan leagues for fear that it would discriminatorily impose tax liability on those kind of institutions on the ground that the authorized commercial bank rate was 4% and the typical savings and loan rate was 4 ¼%.[84] In terms of economic condition, the Administration had to deal with unemployment and increase both domestic sales and exports of products of American firms. Thus the Administration had to avoid the situation that would be possible for both of them to be deteriorated.

Economic condition and the schedule of CWM also worked as an obstacle to the passage of reform measures. In memorandum for Mills on August 2, 1961, though “The importance of vigorous growth of our producing capacity has been enhanced by

[82] V. Henry Rothschild to Stanley S. Surrey, "The Quiet Business Lunch, and Entertainment Generally," March 28, 1961, NACP, RG 56, OTPLHF, Box 12, File Folder #18B: H.R. 10650 (Section 4) – Disallowance of Certain Entertainment, etc., Expenses.

[83] “Summary of the Hearings conducted by the Ways and Means Committee on the President’s Tax Message: Expense Accounts,” May 19, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #9: The Revenue Act of 1962: Summaries of Hearings Held by the Ways and Means Committee, 1961.

[84] “Comments on Statements Made by Representatives of the Mutual Savings Industry, Part 4, Hearings before the Senate Finance Committee on H.R. 10650,” April 12, 1962, NACP, RG 56, OTPLHF, Box 13, File Folder #20: H.R. 10650 (Section 6) – Mutual Savings Banks & Savings & Loan Associations.

the additional demands imposed by world situation," Dillon described, "domestic tool orders by American industry are lagging in part because of uncertainty regarding the timing of the enactment of the investment credit."[85] Meanwhile, after Surrey had the meeting with Frank Ikard, a member of CWM, Surrey conveyed Dillon that "as Mr. Ikard pointed out, in 1962 Mr. Mills and the Committee [CWM] have every excuse not to consider these special bills in view of the very heavy schedule of the Committee."[86] Businesses had secured certain net profits through these provisions the Treasury desired to reduce or abolish. Besides, there was the urgency that investment credit bill be enacted because of the balance of payments problem for the Treasury, and of the rate of domestic economic growth through investments for the economic advisers of Kennedy. These conditions might be the reason that the Treasury compromised the reduction of reform measures on the political and economic situation.[87] Consequently, as table 5 shows, the tax reform bill was legislated as tax reduction at the cost of the accomplishment of reform measures expected to set out the step to larger tax reform bill thereafter.

---

[85] C. Douglas Dillon to Wilbur D. Mills, August 2, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #15B: H.R. 10650 (Section 2) – Investment Tax Credit.
[86] Stanley S. Surrey to C. Douglas Dillon, "Special Tax Bills," December 27, 1961, NACP, RG 56, OTPLHF, Box 11, File Folder #14A: Revenue Act of 1962 – General, 1961-1962.
[87] This is the situation that the Treasury was often in throughout the post-World War II era—having to sacrifice base-broadening reform in the face of business lobbying for protecting or expanding capital-favoring reforms. The Tax Reform Act of 1986 was a major break in the pattern.

Table 7. Comparison of Revenue Effect of Tax Reform in 1962

(In millions of dollars)

	Treasury proposal in 1961	Treasury proposed changes in 1962	House	Senate
Investment tax credit	-1,700	-1,450	-1,175	-1,020
Capital gains on depreciable property	200	180	100	100
Withholding on dividends and interest	600	650	650	240
Expense accounts	250	250	125	60
Mutual banks and savings and loan associations	-	365	200	205
Mutual fire and casualty companies	-	50	40	35
Cooperatives	-	35	35	35
Foreign items	250	310	145	140
Repeal of the dividend credit and exclusion	450	475	-	-
Miscellaneous provisions	-	-	-	-35
Total	50	865	120	-240

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, “Estimated Increase in Receipts, Fiscal Year 1962, from Revenue Raising Provisions of the Tax Program under Different Assumptions as to Effective Date,” April 1, 1962, “Estimated Revenue Effect of H.R. 10650, When Changes Are Fully Effective, Without Taking Account Its Stimulative Effects on the Economy,” March 27, 1962, “Estimated Revenue Effect of H.R. 10650,” September 27, 1962, NACP, RG 56, OTPLHF, Box 11, File Folder #1: Budget Figures Revenue Effect of Tax Program, 1961-1962.

3

Kennedy-Johnson Tax Cut Killed Keynes: The Idea of Keynes, Comprehensive Tax Reform Proponents, and "Keynesian," and Federal Tax Reform 1964

Introduction

After tax reform bill 1961 was proposed, thought it included several structural reform measures so as to offset revenue loss made by investment credit, the staffs of the Treasury led by tax experts such as Stanley S. Surrey and Harvey E. Brazer, and Mills didn't abandon their ideal tax reform proposal – "one package" comprehensive tax reform – and still continued their effort for its accomplishment. But the CEA and their economic consultants, who have been called "Keynesian," appeared at the center of policymaking stage, and they interfered with the devisal of tax reform bill of the Treasury. In January, 1963, Kennedy administration proposed second tax reform. But it was eventually enacted in 1964 as has been often cited as the largest postwar tax reduction until 1981 – "Kennedy-Johnson tax cut." It provided huge rate cuts of individual and corporate income tax, and a few structural reforms. Though their explanation have differed somewhat, all scholars who discussed the tax cut have concluded that it marked a major departure in using tax policy as an economic stimulant incorporating Keynesian ideas. And they viewed that the relatively roles of the CEA economists, who argued for tax cut to stimulate consumption demand, were in a "Keynesian" fashion, the Treasury staff, who emphasized the importance of supply-side rational, and Mills, who played important role to the accomplishment of the tax cut.[1]

As Introduction and this chapter demonstrate, however, the argument about tax policy of "Keynesians" was largely different from the one that Keynes and American his contemporaries really suggested. They emphasized the boost of vertical and horizontal equity, progressivity, contra-cyclical tax flexibility and the ability of government to finance their policy through income tax system. Compared with their idea, the Treasury, tax experts, and Mills emphasized similar points in terms of the defects the federal tax system contained. "Keynesian" in this period, by contrast, increasingly focused on revenue-raising ability of tax system, while ignored how tax policies would change the structure of tax systems. In terms of domestic economic condition since 1950s, they viewed the federal tax system had a strong revenue-raising capacity that had produced so much "full-employment budget surplus" as a "fiscal drag." And they argued that it should be eliminated by tax cuts as a "fiscal dividend." The two different ideas conflicted on the existing tax system and desirable tax policies. In the end, the Treasury and Mills, the ones who argued for tax reform similar to the suggestion of Keynes and American his contemporaries, were defeated by the argument of "Keynesian."

---

[1] Steuerle, *Contemporary U.S. Tax Policy*; Brownlee, *Federal Taxation in America*; Julian E. Zelizer, *Taxing America: Wilbur D. Mills, Congress, and the State, 1945-1975* (Cambridge University Press, 1998); Iwan W. Morgan, *Deficit Government: Taxing and Spending in Modern America* (Chicago: Ivan R. Dee, Inc., 1995); Ronald F. King, *Money, Time, & Politics: Investment Tax Subsidies & American Democracy* (New Haven & London: Yale University Press, 1993); Cathie Jo Martin, *Shifting the Burden: The Struggle over Growth and Corporate Taxation* (Chicago and London: The University of Chicago Press, 1991); John F. Witte, *The Politics and Development of the Federal Income Tax* (The University of Wisconsin Press, 1985); W. Elliot Brownlee, *Dynamics of Ascent: A History of the American Economy, 2nd ed*. (Alfred A. Knopf, Inc., 1979); Herbert Stein, *The Fiscal Revolution in America* (Chicago and London: The University of Chicago Press, 1969); Edward S. Flash, Jr., *Economic Advice and Presidential Leadership: The Council of Economic Advisers* (New York: Columbia University Press, 1965). It should be noted, however, that Stein changed his assessment on the 1964 tax cut: "The idea that domesticated Keynesianism had become the accepted national policy by 1964, when the Kennedy-Johnson tax cut was passed, was wrong and naïve. From here that action does not look like the end of an evolution toward 'rationality' but merely looks like one episode in a history that was, and still is, far from completed." See Herbert Stein, "The Fiscal Revolution in America, Part II," in in Brownlee ed., *Funding the Modern American State, 1941-1995*, 197.

I. Wilbur D. Mills and His Tax Idea[2]

In response to the 1954 tax reform, during 1950s, Wilbur D. Mills, inside and outside of CWM, studied the tax issues, and learned the economic and political functions of the income taxation. From 1954 to 1957, Mills chaired the subcommittee on fiscal policy for the CWM and the Joint Economic Committee (JEC) in order to conduct studies on the economic implication of tax-break reform and the manipulation of tax rates. On CWM, Mills helped to organize a series of congressional studies and hearings on the possibilities of tax reform. Meanwhile, through his activity in 1950s, he helped making the connection among economic experts, political parties and interest groups. Also, he made the network among himself, economic experts, and business leaders, and the Treasury. His works and several accomplishments enhanced his reputation within Congress as being the brain behind CWM. Following his predecessor, Mills became chairman of CWM.[3] Then Mills used these fruits to enhance his role within Congress and build his professional reputation within Washington.

Through his activity in 1950s, he developed his tax idea. At first, the studies of CWM's subcommittee produced the Technical Amendment Act proposed by CWM in July 1957.[4] Then Mills argued for closing as many tax breaks as possible and sound rate reduction. Secondary, he learned from JEC subcommittee's studies that permanent rate reduction benefiting middle- and upper-income brackets was essential to achieving long-term growth.[5] Lastly, he emphasized the

---

[2] My description in this section relies on Julian E. Zelizer, *Taxing America,* 82-176.

[3] The former chairman, Jere Cooper (D-TN) died on December 18, 1957.

[4] According to Zelizer, the subcommittee's studies were helped by law and economic scholars, including Stanley S. Surrey, Harvey E. Brazer, Thomas Atkeson, Randolph Paul, Richard Musgrave, and Joseph Pechman. Ibid., 96.

[5] The Subcommittee included Senator Paul Douglas (D-IL), Representative Thomas Curtis (R-MO), and Senator Barry Goldwater (R-AZ). Ibid., 101.

revenue-raising and automatic stabilizing functions of federal income taxation. During his chairmanship of CWM, Mills advocated that a permanent rate reduction tied to expenditure control and revenue-raising reform would eliminate the drag of high taxes on private investors, consumers, and also improve equity of tax burden.

II. The Idea about Tax Policy of the Treasury

Soon after the inauguration of President John F. Kennedy, Stanley S. Surrey assumed the position of Assistant Secretary of the Treasury for Tax Policy. Surrey was a tax attorney who had graduated from the Columbia University Law School in 1932 and the next year joined the administration of FDR and subsequently became Tax Legislative Counsel of the Treasury. After serving in the U.S. Navy, Surrey returned to the Treasury and in 1947 became a professor of law at University of California, Berkeley. In 1949 and 1950, Surrey joined the American Tax Mission to Japan under the chairmanship of Professor Carl Shoup of Columbia University (the "Shoup Mission"), and in 1951 he joined the Harvard Law School faculty as a law professor.[6] During the 1950s, Surrey had actively convened several conferences of economists and tax attorneys to discuss the issues of tax structure and tax administration.[7] Throughout late 1950s, while joining Mills' subcommittee, he had advised members of CWM regarding tax reform proposals.[8]

---

6 As to Surrey's background, see, e.g., Mirit Eyal-Cohen, "Preventive Tax Policy: Chief Justice Roger J. Traynor's Tax Philosophy," *Hastings Law Journal,* March 2008, Vol. 59; Erwin, N. Griswold, "A True Public Servant," *Harvard Law Review,* December 1984, Vol. 98, No. 2; "Stanley S. Surrey, 74; Taxation Law Expert," *The New York Times*, August 28, 1984. As to the Shoup Mission and Surrey's contribution to it, see W. Elliot Brownlee, Eisaku Ide and Yasunori Fukagai ed., *The Political Economy of Transnational Tax Reform: The Shoup Mission to Japan in Historical Context* (New York: Cambridge University Press, 2013).

7 Stanley S. Surrey, "The Relationship of Revenue Administration to Fiscal Policy with reference to Underdevelopment Countries," November 15, 1956, HSC, HLSL, SSSP, Box 35, File No. 26-3: Tax Administration Conference; Henry S. Bloch to Stanley S. Surrey, "Preparatory Meeting for the Conference on Tax Administration in Under-developed Countries," February 8, 1957, HSC, HLSL, SSSP, Box 35, File No. 26-3: Tax Administration Conference. From 1958, Surrey served with Shoup on

At the hearing of CWM on November 16th, 1961, Surrey presented his ideas concerning tax reform. Surrey stated that preferential treatments for certain types of income brought about an overly narrow tax base, excessively high marginal rates and low effective rates, and an inequitable tax burden among types of income. “The combination of such a [rate] reduction and the elimination of upper bracket differentials,” then Surrey argued, “would materially improve our income tax and would not necessitate a revenue loss.” With respect to the significant differentials between the middle and lower brackets, Surrey believed “Their elimination would likewise be far easier in the context of a general revenue revision involving compensating decreases in rates, a splitting of the first bracket, or increases in exemptions.” Any tax reform, whether tax reductions or increases, Surrey went on to say, “should be accompanied by structural improvement and elimination of as many differentials as possible” to widen the base of the income tax. “Even [if] tax increases are in order,” Surrey emphasized, “every effort should be made to widen the base of the income tax rather than simply to raise the rates and thus squeeze harder those who today are unfairly treated [earned-income taxpayers].” Otherwise, “The opportunity to

---

a tax assistance mission to Venezuela. See Brownlee eds., *The Political Economy of Transnational Tax Reform*, 431-438.

8 Stanley S. Surrey to Frank Ikard, November 17, 1959, HSC, HLSL, SSSP, Box 39, File: Ways and Means Committee, 1957-1960; Stanley S. Surrey to Lee Metcalf, November 17, 1959, HSC, HLSL, SSSP, Box 39, File No. 28-1: Ways and Means Committee, 1957-1960; Stanley S. Surrey to Lee Metcalf, January 15, 1960, HSC, HLSL, SSSP, Box 39, File No. 28-1: Ways and Means Committee, 1957-1960; Stanley S. Surrey to Frank Ikard, January 15, 1960, HSC, HLSL, SSSP, Box 39, File No. 28-1: Ways and Means Committee, 1957-1960; Stanley S. Surrey to John W. Byrnes, January 15, 1960, HSC, HLSL, SSSP, Box 39, File No. 28-1: Ways and Means Committee, 1957-1960. In addition, in late 1958, in a memorandum for the chairman of CWM, Representative Wilbur Mills (D-AR), Surrey recommended that the CWM reexamine in 1959 and 1960 the structure of the income tax structure in 1959 and 1960, make the revision of the income tax base as its most important subject, study whether a broadening of the tax base would permit a reduction of the rates of income tax in all brackets, and utilize outside experts, largely chosen from universities, on a topic-by-topic basis. Stanley S. Surrey to Wilbur D. Mills, “Memorandum re General Tax Revision Activities of House Committee on Ways and Means, 1959-1961,” December 24, 1958, HSC, HLSL, SSSP, Box 14, File No. 40-5: Hon. Wilbur D. Mills, 1956-59.

improve our income tax system," he thought, "may never come."[9] What Surrey emphasized was the necessity to improve progressivity and the equity of tax burden among the type and amount of income, and to smoothen rate structure without revenue losses.[10]

It seems Surrey's idea inherited the tradition of the tax experts of the Treasury. There was a strong tradition of support within the Treasury, since the 1930s, for base-broadening reforms.[11] While Surrey assumed his position, Seymour Harris, professor of Economics of Harvard University, assumed the senior consultant to the Secretary of the Treasury.[12] His tax idea resembled Surrey's one. In the report he prepared in 1956,[13] while he argued taxes were "'the price of civilization'," a "dreary process of erosion and evasion under present law" had created privileged classes of taxpayers paying less than their fair share of the cost of government. Then he argued for the necessity for broadening tax base and boosting progressivity and horizontal equity.[14] The Office of Tax Analysis of the Treasury (OTA), a bureau traditionally in charge of advising the Assistant Secretary for Tax Policy and analyzing tax policies and

---

9 Stanley S. Surrey, "Summary Statement of Stanley S. Surrey for Hearings on Broadening The Tax Base, House Committee on Ways and Means November 16, 1959, The Federal Income Tax Base for Individuals," Undated, HSC, HLSL, SSSP, Box 39, File No. 28-1: Ways and Means Committee, 1957-1960.

10 William Andrews, who was Eli Goldston Professor of Law, Harvard Law School, described in retrospect as follows: "This unity [of Surrey's thought and action] resulted partly from the single-mindedness of Stanley's concern for a fair, progressive tax system; wherever he was working and whatever he was doing, he was bound to be continuing the crusade for that objective." See William D. Andrews, "A Source of Inspiration," *Harvard Law Review,* December 1984, Vol. 98, No. 2, 332.

11 Joseph J. Thorndike, *Their Fair Share: Taxing the Rich in the Age of FDR* (Washington, D.C.: The Urban Institute Press, 2013). It is generally said that the ideas of Robert Murray Haig were very influential to them. W. Elliot Brownlee, "Tax Regimes, National Crisis, and State-building in America," in Brownlee, ed., *Funding the Modern American State*, 37-104.

12 He worked as one of economic advisers to JFK in the presidential campaign in 1960. After Kennedy took the office, he convened the Treasury consultants' meetings regarding the policies of tax, monetary, debt, and government expenditures after Kennedy took the office.

13 It's not obvious to whom Harris wrote this report. But I surmise it was for Wilbur Mills on the ground of the title of the file. Seymour E. Harris, "Where Is the Money Coming From?" October 8, 1956, HSC, HLSL, SSSP, Box 14, File No. 40-5: Hon. Wilbur D. Mills, 1956-1959.

14 Harris wrote as follows: "The base of the tax should be as broad as possible…the tax must be truly progressive…we should aim at subjecting all incomes of equal amounts to the same rates of tax."

problems, led by director, Harvey E. Brazer,[15] mainly worked with Surrey to study the issues of tax structure and to devise tax reform bill.[16] As for their tax ideas, "In the Treasury in the late 1960s," Surrey described in retrospect, "I faced the task of articulating why the Treasury opposed the widespread use of the tax incentives."[17] The Treasury and its staffs had aimed at accomplishing constructive tax reform with focusing on the issue of tax structure.

III. CEA's Idea of Tax Policy

The member of the CEA - Walter Heller, James Tobin and Kermit Gordon – had different idea over tax policy from them.[18] They defined the most

---

[15] Harvey E. Brazer, born in Montreal, received a Bachelor of Commerce degree from McGill University in 1943. After his graduation, during WWII, he served for three years as an artillery and infantry officer in the Royal Canadian Army. After the war, he received master (1947) and doctoral degrees (1951) at Columbia University and taught economics at Rutgers (1947-48), finance at Lehigh (1948-50) and Wayne State universities until 1957, when he joined the Michigan faculty as an associate professor. He became a professor in 1960. He served the Treasury as a deputy assistant Secretary of the Treasury and director of the Office of Tax Analysis under Kennedy from 1961-1963. According to "Faculty History Project of University of Michigan," his special realm was public finance, and this involved the examination of various methods of raising money to pay the cost of operating government and its numerous public service programs. Among other things, his students studied ways to distribute tax burdens equitably among income groups. See, e.g., "Harvey E. Brazer, 68, Professor of Economics," *The New York Times*, May 18, 1991; Faculty History Project of University of Michigan (http://um2017.org/faculty-history/faculty/harvey-e-brazer).

[16] OTA staff members made numerous reports about tax structure or the distribution of income necessary for tax reform. A lot of materials I use in this paper were written on behalf of the OTA.

[17] I will elaborate in last section what was Surrey's responsibility and role inside the Treasury when he thought this.

[18] Heller was born in Buffalo in 1917, the son of immigrants from Germany. He earned his bachelor's degree at Oberlin College in Ohio in 1935, and his master's (1938) and doctorates (1941) in economics from the University of Wisconsin. After he taught at University of Wisconsin (1941-42), and served the Treasury as a fiscal economist (1942-46), he started to teach at University of Minnesota from 1946. "Walter Heller, 71, Economic Adviser in 60's, Dead," *The New York Times*, June 17, 1987. Tobin was born in Champaign in 1918. At Harvard University, he received his bachelor's degree in 1939 and master's in 1940. After serving Office of Price Administration and Civilian Supply and War Production Board as an economist (1941-42), and U.S. Navy (1942-46), he received Ph.D. in economics from Harvard in 1947. After working as a Fellow at Harvard (1946-50), he took the position of Assistant Professor at Yale in 1950. Before assuming CEA (1961-62), he was a Visiting Research Associate of Survey Research Center of University of Michigan. See his curriculum vitae (http://cowles.econ.yale.edu/faculty/vita/cv_tobin.pdf). Gordon was born in Philadelphia in 1916. After he received the bachelor's degree from Swarthmore College in 1938, and studied at Oxford as a Rhodes Scholar (1938-39), he served Harvard University as an Administration Fellow (1940-41), Office of Price Administration (1941-43), 2nd Lieutenant of U.S. Army (1943-45), and Special Assistant of Office of Assistant Secretary of Economic Affairs, Department of State (1945-46), he became Faculty member of Williams College (1946-62). After working as a member of CEA, he assumed the director of Bureau of

important economic problem as a 4% unemployment rate that demanded tax and spending measures that would close the gap between full-employment output and actual output. Heller estimated that tax system had the capability to increase federal tax revenue by $7-8 billion per year automatically in ordinary time. In a slack economy, this "fiscal drag," as he called it, would kill the possibility for expansion. Then CEA utilized the concept of "full-employment budget surplus,"[19] and suggested that it be offset by "fiscal dividends" through tax cuts or government expenditure increases.[20] From the viewpoint of CEA, it was necessary to eliminate full-employment budget surplus by creating $10 billion of fiscal dividends through tax cuts or expenditure increases in the face of actual budget deficit.

Based on their theory, CEA derived a different approach to tax reform than that favored by the Treasury staff. Lagging consumer demand behind the productive capacity, CEA viewed, led the economy into the recession in 1960. But "Added expenditure programs," as Heller wrote, "faced very great resistance." Then "The political complex" that "required an approach to expansionary policy which would not be rejected on grounds that it necessarily meant bloated budgets," and tax system in those days completely ruled out the creation of $12 to 13 billion of budget deficits they thought necessary for recovery.[21] Then Heller recommended an approach for writing an address Kennedy planned to make in April 1961 regarding tax issues. He urged the President to emphasize that economic output was far below its potential

---

Budget (1962-65). See Finding Aid of Kermit Gordon Personal Papers (http://www.jfklibrary.org/Asset-Viewer/Archives/KGPP.aspx?f=1). The latter two were later replaced by Gardner Ackley and John Lewis.

[19] This concept means the difference between the balance of actual budget and of full-employment budget that is the notion that is assumed when economy is at the level of full-employment.

[20] Heller, *New Dimensions of Political Economy*, 82-83. Total budget balance of general and trust fund was the surplus in 1960 (about $800 million), and the deficit in 1961 (about $2.3 billion), while estimated balance of full-employment budget was the surplus of $13 billion in 1960, and about the surplus of $10 billion in 1961. In 1966, Heller wrote: "The $13 billion full-employment surplus in 1960 was an oppressive economic drag, a major force pulling us down into the recession of 1960-61." Ibid., 67.

[21] Ibid., 113.

output even when compared with the trough of the 1958 recession, that the consumption-stimulating deficit would be inadequate without a tax cut, that Congressional reluctance and administrative slowness would constrain increases in governmental spending politically, a tax-cut-stimulated economy would provide the sizable feedback of revenues.[22] By tax reform bill was proposed in 1963, CEA and several economists, including Paul Samuelson and Robert Solow, persistently educated and persuaded Kennedy the importance of deliberate deficit financing.[23]

IV. Crafting the Original Tax Reform Bill in 1961

By the time Kennedy delivered his first public mention over the administration's plan of tax policy by Kennedy appeared in "Special Message to the Congress on Taxation" on April 20, 1961, crafting original tax reform bill had already started inside the Treasury. In a report circulated on April 22th, 1961, Surrey recommended a set of tax reform measures as follows: (1) Reducing the top marginal rate from 91% to 65% while smoothing down low and middle income tax rates to appropriate progression;[24] (2) Reversing normal corporate income tax rate (30%) and surtax rate (22%) so as to favor small corporations (causing a revenue loss of $400

---

[22] Walter Heller to James Tobin and Kermit Gordon, "Eventual Memo to the President on Tax Cuts," February 20, 1961, JFKL, WWHPP, Box 21, File: Tax Cut 11/24/60-3/29/61.

[23] It has been frequently referred that Kennedy didn't master economic knowledge at all. Special aide for Kennedy, Arthur M. Schlesinger, Jr. wrote: "Kennedy had received his highest grade and only B in freshman year at Harvard in the introductory course in economics. The course made no deep impression on him. Indeed, he remembered his grade as C, or so at least he liked to tell his economists in later years" (Schlesinger, Jr., *A Thousand Days*, 621). Although Kennedy appointed Heller, Gordon and Tobin - all of whom have been called "Keynesian" - to the CEA, when Berlin Crisis broke out in August 1961, Kennedy at first suggested a tax increase of $3 billion to finance additional defense outlays. Heller described its choice had made CEA feel themselves at "A low point" (Heller, *New Dimensions of Political Economy*, 32).

[24] The rate structural reform measures Surrey suggested were as follows: (1) Reducing the rate in each bracket by 5 percentage points (decreasing revenue by $9.5 billion), (2) Splitting the first $2,000 bracket into two brackets of $1,000 each with applying 15% rate for the first bracket, and (3) Reducing the rates for other brackets by 3 percentage points (decreasing revenue by $7.4 billion), or by 2 percentage points ($6.2 billion decreasing revenue).

million) while combining 2 % rate reduction (revenue loss by $800 million); (3) Possible structural reform measures as displayed in Table 3.[25] In his message, Kennedy argued following points: (1) The individual income tax, supplemented by the corporation income tax, had moved from a selective tax imposed on the wealthy to a mass-based tax; (2) The large number of tax preferences interfered with business decisions, distorted the efficient functioning of the price system, treated preferentially specific income groups, and made high rates necessary by narrowing the tax base. The tax reform program, Kennedy argued, should be aimed at providing a broader and more uniform tax base with an appropriate rate structure to accomplish the goal of a higher rate of economic growth, a more equitable tax structure, and a simpler tax law. There would be no net loss of revenue was involved in this set of proposals, Kennedy predicted. Lastly, he urged considering the reform proposals as a coherent package.[26] These points suggest that the idea of Surrey and the Treasury prevailed at that time.

Several tax experts aided the Treasury staffs' work as part-time consultants. On April 22th, 1961, the meeting was held in Surrey's office.[27] Most of consultants agreed on the reduction and simplification of itemized deductions, and taxation of capital gains on assets under five-year with constructive realization at death or gift. "This will presumably gain some revenue," Solow wrote about the reform parts on the memorandum for CEA, "then you decide on the degree of progression you want and make revisions in rate structure. There is a constraint here that the cut in rates at the low end must be more than trivial, or else you'll never get the drastic lowering of nominal high rates to about 65%." "It is generally agreed," Solow went on, "some overall reduction in revenue is a price that must be paid for tax reform." Then he

[25] Stanley S. Surrey, "Preliminary Statement of Tax Reform Program for 1962," April 22, 1961, JFKL, WWHPP, Box 22, File: Tax Cut 4/61-11/61.

[26] *Public Papers of the Presidents, John F. Kennedy, 1961,* 290-291.

[27] Douglas Eldridge, other staff members from OTA, Cary Brown, Richard Musgrave, Robert Solow and Joseph Pechman attended the meeting.

suggested that the price be limited to $3 to $4 billion.[28] At the meeting on June 10, the consultants agreed on reforming individual and corporate income taxes and estate and gift taxes with revenue losses by $3 billion, $5 billion, and no losses, respectively; imposing floors on deductions for medical care, charitable contributions, casualty losses, state and local taxes, tightening the exclusions for sick pay, social security retirement benefits, and the interest from state and local securities, eliminating various tax credits, and splitting the first income bracket to reduce the maximum marginal rate.[29] Also, consultants urged capital gains taxation of unrealized gains left at death, raising the rates of capital gains taxation, liberalizing the loss deduction, lengthening the holding period, and restricting the definition of allowable capital gains.[30] At the meeting on November 24, attendances reached the agreement that tax reform bill aimed would be proposed in 1962 or 1963 to improve equity, to reform tax structure and to promote the growth.[31]

---

28 Robert Solow to Walter W. Heller, Kermit Gordon and James Tobin, "Tax Reform in 1962," April 24, 1961, JFKL, WWHPP, Box 22, File: Tax Cut 4/61-11/61.

29 Otto Eckstein, Richard Goode, Joseph Pechman, Carl Shoup, and Seymour Harris attended the meeting.

30 "A Summary of the Views of Tax Consultants Eckstein, Goode, Pechman, and Shoup on the Tax Reform Issues Discussed at the Treasury Department on June 10, 1961," October 26, 1961, HSC, HLSL, SSSP, Box 59, File No. 208-3A: Consultants Prof. Seymour Harris, 1961-1962.

31 Surrey, Eldridge, and Brazer from the Treasury, Robert Turner from Bureau of Budget of White House, and Arthur Okun from CEA attended the meeting. Arthur Okun to Robert Solow and Joseph Pechman, "Tax Meeting of November 24," November 25, 1961, JFKL, WWHPP, Box 22, File: Tax Cut 4/61-11/61.

Table 1. A Possible Tax Reform Program Reported on April 21st, 1961

(In billions of dollar)

Item	Tax Revenue Involved	
	Less Probable	More Probable
Elimination of Sick Pay Exclusion	0.125	0.125
Personal Deductions		
Elimination of deduction for States sales taxes[1]	0.500	0.050
Elimination of deduction for States property taxes[2]	1.200	0.850
Elimination of Personal interest deduction	1.600	0.800
Minimum floor on casualty loss deduction	0.050	0.050
Reduction in standard deduction[3]	1.200	0.600
Capital Gains		
Definitional changes	0.100	0.100
Eliminate alternative rate and substitute the inclusions in income	0.750	0.400
Tax Exempt Securities		
Elimination of exemption of outstanding issues	0.250	0.000
Elimination of exemption on new issues	0.025	0.025
Treatment of Aged		
Inclusion in income of Social Security and Retirement Pension	0.600	0.000
Elimination of retirement income credit	0.125	0.000
Changing Additional exemption for persons over 65 to a credit	0.050	0.050
Percentage Depletion		
Reducing percentage depletion benefits by 50%	0.100	0.000
Total	6.700	3.000

Source: Stanley S. Surrey, "Preliminary Statement of Tax Reform Program for 1962," April 22, 1961, JFKL, WWHPP, Box 22, File: Tax Cut 4/61-11/61.

V. Tax Reform Bill Arrived on the Stage

While the discussion over the tax reform proceeding, however, the political and economic conditions surrounding the Kennedy administration had largely changed. Soon after Kennedy inaugurated, Kennedy carried out a series of appointments to the regulatory agencies, and the appointment of Luther Hodges as Secretary of Commerce to break down the cozy relationship between Business Advisory Council and the Commerce. But these moves outraged businessmen who had grown used to regarding regulatory agencies and the relationship as the adjunct of their own trade associations.[32] In addition, a serious conflict between the Administration and steel industries over steel prices broke out in 1962. The Republican congressional leadership called the action of the Administration "a display of naked political power never seen before in this nation."[33]

The rate of economic growth consistently increased in 1961. Since the first quarter of 1962, however, the rate began declining.[34] In April 1962, stock prices, which had risen since December 1961, fell sharply. The biggest losers in the selloff were growth issues that had been selling at fancy multiples of earnings. International Business Machines, for instance, lost 55 points in two days. On May 28, 1962, just after steel fight concluded, the stock market again declined shapely. Businesses, investors, and analysts worried that the recovery would be over and recession would ensue as a consequence of the disorder in the stock market.[35]

Then the CEA attempted to persuade Kennedy of the importance of tax cut. On June 5, 1962, to help head off a recession, the CEA suggested a temporary across-the-board 3% cut in the individual income tax that would take effect on July 1 or September 1, 1962 (with revenue losses of $3.7 billion) and terminate on July 1, 1963, and a 3% cut in the corporate income tax that would take effect on January

---

[32] Schlesinger, Jr., *A Thousand Days,* 631-633.

[33] The administration conflicted with steel industry over the price of steel. The administration regarded the rise of price of steel would significantly influence into the prices of other products and the economy as a whole so that they sent major steel companies letters to admonish them to earn profits without price increase. In April, 1962, steel companies approved this recommendation. Nevertheless, just after the approval, U.S. Steel, the biggest company in steel industry, and other five major companies including Bethlehem Steel issued a declaration the raising of price. Then the administration put great pressure on these companies to take back raising price, so that they finally had no choice but obeying. Schlesinger, Jr., *A Thousand Days,* p. 638; Walter Heller to John F. Kennedy, "The Price Situation in General (and Steel Prices in Particular)," August 2, 1961, JFKL, WHPC, Box 5, File: Memo to JFK 8/61; Walter Heller to John F. Kennedy, "The Price Situation in General (and Steel Prices in Particular)," August 2, 1961, JFKL, WHPC, Box 5, File: Memo to JFK 8/61.

[34] The growth rate of GNP in each quarter processed as follows: 1960 IV – 61I, -1%; 61I – 61II, 2%; 61II – 61III, 1.5%; 61III – 61IV, 2.8%; 61IV – 62I, 0.8%; 62I – 62II, 0.7%; 62II – 62III, 0.2%; and 62III – 62IV, 1.2%. *Economic Indicators, February 1961*, p. 1; *Economic Indicators, February 1963*, p. 2. I author calculated the growth rate on the basis of these sources.

[35] "Wall Street Takes a Dim View," *Business Week*, May 5, 1962.

1, 1963 (with revenue losses of $1.5 billion). The CEA expected that a tax cut would appeal to both business and labor. In addition, the CEA argued that the temporary rate reduction "should be geared to the permanent cuts planned in the major tax reform."[36] But these permanent cuts and the accompanying tax increases through base broadening would be delayed. The CEA recommended that the permanent rate cuts would take effect January 1, 1963, and "the bitter pills of base tightening would have [to wait] to be swallowed till January 1st, 1964" to alleviate the predictable opposition to deliberate creation of budget deficit (two-stage approach).[37] Pursuant to their instruction, Kennedy declared the Administration's intention to propose comprehensive tax reform "as net tax reduction" on June 7, 1962.[38] In addition, his speech at Yale, the attempt to disprove "the myth and reality" in national economy, gave strong impression that the administration would use fiscal and monetary policy to make the economy progress in the face of creating budget deficit without inflationary pressure.[39] CEA persuasion turned Kennedy from a spokesman for comprehensive tax reform to an advocate of tax cuts.

Several economists and businesses favored CEA's position. Musgrave argued for the immediate accomplishment of individual income tax rate reduction, mainly for lower income classes, to stimulate consumption, and of corporation rate reduction "to have reduction recommendation as uncontroversial as possible" in terms of political as well as fiscal criteria (revenue losses by $5 billion at least). He thought the proposed rate cuts would be the step toward the constructive tax reform that would be proposed later involving with permanent rate reduction and basis

36 The Council Economic Advisers, "Proposals for Tax Reduction," June 5, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62.

37 Walter Heller to John F. Kennedy, "Where We Stand on Budget and Tax Policy Decisions," June 9, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62.

38 *Public Papers of the Presidents, John F. Kennedy, 1962,* p. 457.

39 *Public Papers of the Presidents of the United States, John F. Kennedy, 1962*, pp. 470-475.

broad.[40] Paul Samuelson and Solow also recommended Kennedy the immediate tax cut because they concluded "the steam of the advance is already dissipating" based on their estimate that the production and order of vehicle and house constructing decreased in July.[41] Gerhard Colm of National Planning Association also emphasized Heller an immediate tax cut.[42] Meanwhile, Heller met with the members of Conference of Business Economists (CBE) on July 12, 1962. The CBE estimated that GNP would decline by $5-10 billion from 4th quarter of 1962 or 1st quarter of 1963 and maintained that the slow rate of retail sales, construction, and business fixed capital investments pointed toward economic decline and reflected uncertainty and loss of confidence of consumers. The CBE recommended the permanent reduction of individual and corporate income taxes of $7-10 billion to last at least 1-1/2 to 2 years, effective October 1, 1962. And the CBE recommended any quick tax cut not involve any structural reform.[43] Other business organizations, such as the Chamber of Commerce, also required an immediate reduction of individual and corporate income taxes.[44]

A tax cut was appealing to the Kennedy administration for both political and economic reasons: To keep Democratic tradition on the one hand, to avoid the conflict with businesses on the other. On July 17, 1962, "The last Gallup poll," Schlesinger wrote to Kennedy, "showed a troubling decline in the belief that the Democratic party is the one to handle economic difficulties." Schlesinger was concerned about the possibility that the enactment of tax cut 1962 "Might lead some to

---

40 Richard Musgrave, "Fiscal Policy Outlook," June 28, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62.

41 Paul A. Samuelson and Robert M. Solow to John F. Kennedy, "The Final Decision August Look at the Case for an Immediate Tax Cut," August 10, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 8/62.

42 Gerhard Colm to Walter Heller, July 11, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62.

43 Walter W. Heller to John F. Kennedy, "Business Economists on the Economic Outlook and Tax Policy," July 12, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62.

44 Walter W. Heller to John F. Kennedy, June 29, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62; Walter Heller to John F. Kennedy, "Report from Scattered Sectors – Economic and Tax Front," July 20, 1961, JFKL, WWHPP, Box 22, File: Tax Cut 4/61-11/61.

think that we are abandoning the ancient Democratic faith in the support of demand and are instead trying to fight the stagnation on the trickle-down theory." Though "There is a notable political risk in asking Congress for tax reform," then he argued, "the risk of not doing so and thus of appearing to let the economy slide into recession is even greater than the risk of losing the Congressional fight." Then, he urged the adoption of a tax cut to restore the public's belief in the Democratic Party "As the party which can be relied on to take action against recession."[45] Meanwhile, Kennedy stated at the press conference on July 24: "Consumer purchasing power has held up. What has been particularly disappointing has been investment, and we have to consider whether a tax cut, and if so, what kind of tax cut, would stimulate investment."[46] Unexpectedly, in early 1962 the tax reform bill discussed since 1950s was taken up for discussion as tax cut to restore the confidence of the Administration, and to progress American economy.

VI. Treasury's Disagreement to CEA's View

The Treasury, however, disagreed to the tax cut recommendation favored by the CEA, economists and businesses. As Douglas Dillon, Secretary of the Treasury, argued in the report, the Treasury side questioned CEA's proposal on the ground that the economy would continue to move forward by 1963 and a loss of revenue and a substantial budget deficit would only serve to increase foreign doubts as to the course of domestic economy and balance of payments.[47] In fact,

---

[45] Arthur M. Schlesinger, Jr. to John F. Kennedy, "Tax Cut," July 17, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62.

[46] Arthur Okun to Walter W. Heller, "Yesterday's Press Conference," July 24, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62.

[47] Dillon wrote: "Even though it included a loss of revenue and a substantial budget deficit, provided it was understood that this was geared to an effort to improve the overall state of the economy…any indication of over-hasty action or undue concern at this time would only serve to increase foreign doubts as to the course of the American economy and could well lead to very dangerous reactions on our balance of payments." C. Douglas Dillon, "The Current Economic Situation and Proposals to Meet It," June 6, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62. This is a blind report.

economic trend in July have shown some improvement from the slowdown in the spring.[48]

Warren Smith, one of consultants for the CEA, told Heller the detailed Treasury's position.[49] The Treasury was situated to hold the following accounting relationship: "Personal Saving + Gross Business Saving = Gross Private Domestic Investment + Net Exports + Government Deficit." As a consequence of this relationship, any increase in government deficit had to be accompanied by (1) an increase in personal or business saving, or (2) a contraction in gross private domestic investment or net exports sufficient to release existing saving. But the percentage of the amount of export of the United States to that of international level declined from 23.5% in 1948 to 17.0% in 1961.[50] Under the accounting relationship, then Smith argued, "An increase in the deficit must necessarily be financed 'out of saving'." Marginal tax rate reduction would be the measure to create private savings then. But Smith was concerned that separate accomplishment of rate reduction would bring about revenue losses before feedback effect of tax cut much larger than necessary, and the possibility that "The saving that is generated or released from other uses to cover the increased deficit will, in effect, be embodied in the financial assets – money, intermediary claims, or Government debt of various maturities – that are generated as a result of the method used to finance the deficit." Meanwhile, Smith informed Heller that Federal Reserve would not increase supply reserves in the near future. Then if budget deficit increased through tax cuts, bank purchases of Treasury securities would have to be accomplished by a cutting down on bank acquisitions of private debt. Subsequently, it would raise short- and long-term interest rates and increase the demand for money and credit to the

48 "Kennedy Bars Tax Cuts Now, Citing Upturn," *New York Times,* August 14, 1962.
49 Warren Smith to Walter W. Heller, "Financing of a Deficit Resulting from a Tax Cut," August 7, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 8/62.
50 N. Fatemi et al, *The Dollar Crisis: The United States Balance of Payments and Dollar Stability* (Fairleigh Dickinson University Press, 1963), p. 38-39, 54.

extent which tax reduction would increase income, which would further raise interest rates. Then the cost on corporate finance would increase while the availability of credit to private borrowers would decrease, which would reduce private demand for houses, automobiles, plant and equipment, and thereby dilute the expansive effect of the tax cut. Then the "feedback" effects of tax cut on tax revenues would be smaller so that the ultimate deficit resulting from the tax cut would be larger. Moreover, the rise in interest rates would not only increase the cost that the Treasury would have to pay on the new securities and outstanding debt as it matured and had to be refunded, but also complicate the balance of payments problem.[51]

The public and economic trend did not immediately support the proposed tax cuts. Financial interests such as Connecticut General Life Insurance Company contended that a tax cut should be enacted only when signs of an economic decline were stronger.[52] In the Gallup Poll results Heller sent Kennedy on July 31, 1962, only 19% of the American people supported a tax reduction while 72% opposed. Favoring a tax cut were 15% of Republicans, 18% of Democrats, and 26% of Independents. When asked whether they considered their income tax payments "about right" or "too high," respondents split about evenly. But only 31% of the group that considered their tax burden too large favored tax reductions.[53] In August 1962, CWM concluded, "No tax cut was needed at this time" because "excessively black picture had been painted by business for self-serving reasons, and too much pressure for cut had been generated by Administration figures." Mills felt strongly that "Tax cut now [is]

---

[51] As to this point, Smith argued as follows: "We must continue to keep our interest rates adjusted to those prevailing in foreign money centers in order to prevent…outflows of capital which complicate our balance of payments problem. However, interest rate increases beyond those required for balance of payments reasons are clearly undesirable under present conditions (whether taxes are cut or not) and should be avoided." Ibid.

[52] Frazer Wilde to Walter Heller, July 11, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62; Frazer Wilde to Walter Heller, July 27, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62.

[53] Walter Heller to John F. Kennedy, July 31, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 6/62-7/62.

not desirable… 'Nothing has convinced me – I cannot see it.' [It] Feels House would reject it."[54] Eventually, on August13, in a thirty-minute television and radio address from his office, Kennedy stated, immediate tax cut "could not now be either justified or enacted."[55]

VII. Proposal of Tax Reform Bill 1963

The Treasury, CEA and White House continued the discussion over tax reform proposal. On August 9, 1962, Heller recommended the administration should propose a tax reform bill at the beginning of next session, and adopt a two-stage approach in recommending tax cuts.[56] On November 9, 1962, at a meeting of the CEA with business economists, while 80% of business economists agreed with substantial tax cut even if it involved with the expansion of budget deficits or Federal expenditures, the economists generally opposed the reform measures because they thought they would impede passage of tax cuts. They also preferred a two-stage approach: making tax cuts first and taking up reform second.[57] Also in November, representatives of the AFL-CIO met with Ackley and argued that a tax reform bill would not pass unless the tax cut and reform pieces were separated.[58] The CEA and representatives of both labor and businesses still maintained that the economy needed tax cut, and put more emphasis on tax cut than reform measures.

---

54 Lee Preston to Walter Heller, "Dillon Testimony before Ways and Means Committee," August 7, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 8/62.

55 New York Times on August wrote: "Without a 'clear and present danger' – as the President expressed it – the Administration felt that it could not excite Congress into emergency action. It is a fact, contradicting the popular notions about politicians and tax cuts in election years, that neither the Congress nor the public has been aroused by all the recent tax-cut talk." "Kennedy Bars Tax Cuts Now, Citing Upturn," *New York Times,* August 14, 1962.

56 Walter W. Heller to John F. Kennedy, "The Range of Tax-Cut Choices before Us," August 9, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 8/62.

57 Walter W. Heller to John F. Kennedy, "Business Views on the Economic Outlook and Tax Cuts," November 10, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 11/62.

58 Gardner Ackley to John F. Kennedy, "Your Meeting with AFL-CIO Economic Policy Committee," November 8, 1962, JFKL, WWHPP, Box 22, File: Tax Cut 11/62.

However, Mills was unwilling to agree to separate the rate cuts from tax reform. At the meeting with Dillon in November, Mills argued, there was no evidence of a near-term recession as forecast by various economists in the summer, and that current economic developments were favorable to the economy due to the prospective increase in capital expenditures, the level of auto sales and inventory accumulation. And he regarded the existing tax rate structure as a drag on economic growth and higher employment, and he favored a permanent reduction of individual and corporate rates. But he argued that it be accompanied by base-broadening measures and a commitment to hold down increases in non-defense expenditures to a minimum while the rate reductions took effect in order to avoid destroying confidence for the fiscal responsibility of the government and to maximize the possibilities of legislative success with the program.[59]

CEA, the Treasury and its staffs, and Kennedy worked on crafting a compromise. On November 19, 1962, Robert Wallace, Special Assistant Secretary of the Treasury, wrote: "With pressures continuing for tax cuts first and reforms later on the one hand and congressional resistance to a large deficit on the other," it was necessary for the Treasury "to consider a compromise." He argued that "This may be especially appropriate in view of the continuing business improvement which will blunt the standard arguments of the economists." As the compromise, he suggested a two-package approach. The Treasury would propose that the bulk of the tax cuts along with the simplest reforms be presented for early action. The rest of the cuts and the more controversial reforms could be considered later.[60] The Treasury's staffs

---

[59] Henry H. Fowler to the Files, "Conference with Chairman Wilbur Mills re Tax Program," November 15, 1962, JFKL, Record of Department of Treasury Microfilm Print Outs (RDTMPO), Roll 48, File: 1964 Revenue Act Mr. Surrey's Memos to the File 2/27/62-6/15/63.

[60] Wallace presented the following package of the combinations as a tentative code: (1) Corporate rate cuts and speed up corporate collections, and (2) Individual rate cut, eliminating dividend credit and exclusion, sick pay exclusion, and setting 4% floor on casualty losses. Robert A. Wallace, "Possible

did not intend to abandon the constructive tax reform as they desired. Nor did the administration's initial portrayal of the tax reform bill taking two-package approach attempt to justify the failure of the Administration of the quickie tax cut, and to appease Mills. The ones who actually abandoned their ideal bill were the Treasury and Mills. The Treasury believed the two-package approach would make more likely the eventual adoption of tax reform.[61]

On January 24, 1963, in "Special Message to the Congress on Tax Reduction and Reform" the Administration finally proposed a tax reform bill. The key tax cuts would be reductions in the range individual rates from 20-91% to 14-65% over a 3-year period.[62] Corporate rate cuts would take place in three stages.[63] Structural reforms, as displayed in Table 3 (below), would be proposed at the same time but not take effect until January 1, 1964. Rate reductions would be aimed at relieving the barrier to full-employment of manpower and resources and enhancing consumer demand and investment. The aim of structural reform measures were: (1) to avoid an overly sharp drop in budgetary receipts for fiscal 1964-65; (2) to reduce inflationary pressures; (3) to reduce the economic burden of the rate structure; (4) to encourage taxpayer cooperation and compliance by eliminating inequities and complexities. The measures to relieve "hardship" and encourage "growth" were aimed at providing relief to low-income taxpayers. Those of "Base broadening and equity" and "Revision of capital gains taxation" were designed to eliminate or tighten preferential treatment

---

Compromise on Tax Package," November 19, 1962, JFKL, RDTMPO, Roll 40, Folder 2 of 2, File: Asst. Secy. of Treasury (Robert A. Wallace), Troika, September –December 1962.

[61] Cathie Martin assessed the form of the proposal as neoclassical form (Martin, *Shifting the Burden*, pp. 72-73). But nor do I think of the initial tax reform bill proposed in 1963 as neoclassical form.

[62] Individual tax rate reductions would take place over a 3-year period: rate schedule ranging from 18.5% to 84.5%, with reducing withholding rate from 18% to 15.5% in calendar 1963; cutting rate schedule from 15.5% to 71.5% with reducing withholding rate to 13.5% in calendar 1964; permanent rate cut ranging from 14% to 65% in calendar 1965.

[63] The normal rate of 30%, applicable to the first $25,000 of taxable corporate income would drop to 22% while the surtax rate would rise to 30% in 1963. The surtax rate would drop to 28% in 1964, and 25% in 1965.

favored higher-income taxpayers and unearned income.[64] On the reform of capital gain taxation, Surrey told undersecretary of the Treasury, Henry H. Fowler, that it would be included as the step toward the accomplishment of estate and gift taxes reform.[65] Moreover, while the proposed bill would attempt to smooth the differences in tax rates among each bracket, it would also increase the number of bracket from 24 to 25 by splitting the first $4,000 bracket.[66] The bill aimed to stimulate consumption and investment, and to boost tax progressivity and equity.

[64] *Public Papers of the Presidents, John F. Kennedy, 1963,* pp. 73-92.

[65] Henry H. Fowler to Russell B. Long, January 28, 1963, HSC, HLSL, SSSP, Box 84, File No. 71-1(C): Estate and Gift Tax (1), 1961-1967; Stanley S. Surrey to Henry H. Fowler, January 24, 1963, HSC, HLSL, SSSP, Box 84, File No. 71-1(C): Estate and Gift Tax (1), 1961-1967.

[66] The Research Institute of America, Inc., "Tax Research Report to Executive Members," January 24, 1963, JFKL, WWHPP, Box 22, File: Tax Cut 1/16/63-1/31/63.

Table 2. Estimated Revenue Effect before Feedback[1], Full Year 1964 when all Proposals Are Fully Effective

(In millions of dollars)

	Full Year
Individual	
Rate reduction	-11,040
Structural reforms	
Relief of hardship and encouragement of growth	
Allow minimum standard deduction	-220
Liberalize child care deduction	-20
Revise tax treatment of older people	-320
Income averaging	-30
Liberalize exclusion of moving expenses	-20
Raise limitation on certain charitable contributions	*
Total, relief of hardship and encouragement of growth	-610
Base broadening and equity	
5% floor under itemized deductions	2280
Flat 4% floor on medical deductions	30
4% floor under casualty losses	90
Repeal allowance of unlimited charitable contributions	10
Repeal sick pay exclusion	110
Repeal exclusion of premiums on group term insurance	60
Repeal of the dividend credit and exclusion	460
Revise taxation of natural resources	10
Total, base broadening and equity	3,050
Total, structural reforms	2,440
Total, individuals	8,600
Corporations	
Rate reduction	
Rate reduction and change in normal and surtax rates	-2,670
Limit surtax exemptions of affiliated groups	120
Repeal 2% consolidated returns	-50
Total, rate revision	-2,600
Structural reforms	
Relief of hardship and encouragement of growth	
Allow expensing of certain research and development costs	-50
Base broadening and equity	
Revise taxation of natiral resources	240
Amend tax treatment of personal holding companies	10

Total, base broadening and equity	250
Total, structural reforms	200
Total, corporations before acceleration of payments	-2,400
Acceleration of payments	1,500
Total, corporations including acceleration of payments	-900
Revision of taxation of capital gains and losses - individuals and corporations	
Reduce inclusion percentage and extend holding period	-440
Allow indefinite carryover of losses	-20
Tax net gains or allow net losses accrued at time of death or gift	360
Change definition of capital gains	200
Induced effect of capital gains revision - individuals and corporations	100
Total (before induced effect of capital gains revision)	700
Total, capital gains and losses	800
Total - before acceleration of corporation payments	
Rate reduction and revision	-13,640
Structural reforms including capital gains and losses	3,440
Total	-10,200
Total - including acceleration of corporation payments	-8,700

* Negligible

1. At levels of income estimated for the calender year 1963.

Source: The Treasury Department, "The Attached Tables Were Prepared to Accompany the President's Tax Message and Must Be Held for Release at 12:00 Noon, Est Thursday, January 24, 1963," Januray 23, 1963, JFKL, WWHPP, Box 21, File: Tax Cut 1/16/63-1/31/63.

VIII. The Dispute over the Passage of Tax Reform Bill

Despite the compromise of the Treasury and Mills, the proposed structural reforms were attacked fervently and resulted in impeding the passage of the tax bill. Businesses opposed key elements of the proposed structural reform, especially to the repeal of dividend credit and exclusion, 5% floor and capital gains tax. The United Community Funds and Councils of America argued that the floor on itemized deduction for charitable contributions was dangerous in that it could invite further changes that might do great damage to the country’s voluntary system of health, welfare, education, religious and cultural organization.[67] The United States Trust Company of New York argued that the floor on itemized deductions and capital gain taxation were deliberate measures to squeeze middle- and high-income classes who received capital income.[68] Keith Funston of New York Stock Exchange maintained that the reform of capital gain taxation would hit not only shareholders but also small businessmen and farmers, and that the repeal of dividend credit and exclusion would create full double taxation of dividends.[69] The Director of Chamber of Commerce of the United States declared that the structural reforms would take away most of the benefits to be derived from rate revision in middle- and high-brackets.[70] Vincent P. Moravec insisted in a letter to Kenneth O'Donnell, special assistant to the president, that the reform measures, particularly 5% floor on itemized deductions for charitable contributions and $1,000 maximum standard deduction, would put pressure on homeowners and investors in middle- and high-income classes and dry up the sources of contributions.[71] Belden L. Daniels of the Pennsylvania Bankers Association argued for the maintenance of dividend credit and exclusion and the withdrawal of taxation on capital gain at death and gift.[72]

Many newspapers also carried articles opposing structural reforms. *Business Week* charged that loophole-closing reforms were not really "simple

---

[67] Lyman S. Ford to United Funds, Community Chests and Community Welfare Councils, January 25, 1963, HSC, HLSL, SSSP, Box 63, File No. 194-2: Deductions – General, 1962-1963.

[68] J. Sinclair Armstrong to Stanley S. Surrey, April 24, 1963, HSC, HLSL, SSSP, Box 92, File No. 194-1A: Five Percent Floor, 1963.

[69] Office of the Secretary of the Treasury, Office of Tax Analysis, "Answers to Specific Points Raised by Mr. G. Keith Funston, President of the New York Exchange," March 11, 1963, HSC, HLSL, SSSP, Box 81, File No.: 194-4: Dividend Credit Exclusion, 1963-1964.

[70] "For Release Sunday Morning Papers, January 27, 1963: Statement by the Board of Directors of the Chamber of Commerce of the United States," January 26, 1963, JFKL, WWHPP, Box 22, File: Tax 1/16/63-1/31/63.

[71] Vincent P. Moravec to Kenneth O'Donnell, February 13, 1963, JFKL, WWHPP, Box 22, File: Tax 2/13/63-2/27/63. I couldn't identify Moravec.

[72] Belden L. Daniels, "Resolution on Tax Reduction," April 8, 1963, JFKL, WWHPP, Box 23, File: Tax 4/63. This is a blind mail. But I surmise Daniels wrote it to Heller on the ground of the title of this material and the fact that I found it in a file of Heller personal papers collection.

revenue raising," but, rather, "a barely concealed cancellation of a substantial part of the cut that the revision of rates appears to give."[73] The *St. Louis Post* criticized that "the inequity of the present tax system would be compounded by inequity in the 'reform'…It would simplify enforcement by reducing the number of returns to be audit. If this is accomplished at the cost of depriving taxpayers of deductions to which they are justify entitled, equity would suffer for the sake of the tax collector's convenience."[74] *The Washington Post* reported that 5% floor had been variously misinterpreted as a deduction ceiling, as a takeaway of all deductions, and a bar against specific deductions.[75]

Congress and the nation did not favor the tax cut bill just after the Kennedy administration proposed it.[76] In the House, structural reform then faced strong opposition. In February, Secretary Dillon, during the second day of his testimony before CMW, underwent a barrage of attacks by Republicans regarding the proposal for a 5% floor and capital gain tax at death. The Republican members of the committee argued that those measures would put excessive pressure on higher income classes (over $10 thousand), on investments, and on those who owned their own homes and paid local estate tax.[77] Representative John W. Byrnes (R-WI) charged that Kennedy's administration "seeks to favor the person who doesn't own his own home, who doesn't pay real estate taxes, who doesn't support his church, who doesn't give to the Community Chest."[78] Then Mills, who had been one of the most imminent

[73] "The Right Remedy but Late and Little," *Business Week*, January 26, 1963.
[74] "Compounding Tax Inequity," *St. Louis Post*, January 28, 1963.
[75] "5 Per Cent Tax Deduction," *Washington Post*, February 14, 1963.
[76] Joseph F. McCaffrey to Walter W. Heller, January 23, 1963, JFKL, WWHPP, Box 22, File: Tax 1/16/63-1/31/63; *Meet the Press: America's Press Conference of the Air*, Vol. 7, Number 5, February 10, 1963, JFKL, WWHPP, Box 22, File: Tax 2/1/63-2/12/63; "If Taxes Are Cut – the Chances of a Boom," *U.S. News & World Report*, February 11, 1963.
[77] "Dillon Defends Curbs on Deductions as Allowing Across-Board Tax Cuts," *The Wall Street Journal*, February 7, 1963.
[78] "5 Per Cent Tax Deduction," *The Washington Post*, February 14, 1963.

proponents of comprehensive tax reform, turned his role from comprehensive tax reform protector to that of tax cut. On the House floor in 1963, “The route I prefer,” he stated, “is the tax reduction road which gives us a higher level of economic activity and a bigger and more prosperous and more efficient economy with a larger and larger share of the enlarged activity initiating in the private sector of the economy.”[79] On the House floor, the capital gain tax and the repeal of dividend credit and exclusion faced the arguments that the reforms would damage capital markets and dilute the effect of rate reductions.[80] The bill passed the House 271 to 155 on September 25, 1963, but except for modified capital gain taxation, the first $100 exclusion of dividend, and a few minor reform provisions, the House bill had dropped most of structural reform measures. Mills, with his inconsistent attitude, couldn’t protect the original bill.

Ultimately, the administration abandoned the surviving reform parts in exchange of quick passage of the bill. Soon after Lyndon B. Johnson succeeded to Kennedy, “No act of ours,” Johnson addressed to the Congress, “could more fittingly continue the work of President Kennedy than the early passage of the tax bill for which he fought all this long year” to “increase our national income and Federal revenues, and to provide insurance against recession.”[81] OTA regarded the House bill as having the various defects. The reduction of the inclusion rate on long-term capital gains and alternative tax rate would reduce taxes on long-term capital gains when the taxpayer’s taxable income did not exceed $44,000 (married) or $22,000 (single).[82] The deletion of

---

79 Stein, *The Fiscal Revolution in America*, pp. 449-450. Stein cited Mills’ Statement from U.S., Congress, House, *Congressional Record,* 88th Cong., 1st Sess., 1963, Vol. 109, Pt. 13, 17908-17909.

80 Stanley S. Surrey to Edward J. Patten, January 8, 1964, HSC, HLSL, SSSP, Box 81, File No. 194-4: Dividend Credit Exclusion, 1963-1964.

81 *Public Papers of the President of the United States, Lyndon B. Johnson, 1963-1964,* bk. 1, 9-10.

82 The House bill reduced the inclusion rate on long-term capital gains from 50% to 40% and the alternative rate from 25% to 21%. Individual taxpayers below these income levels didn’t use the alternative tax but instead included only 50% of the gain in taxable income. If the inclusion factor was reduced to 40%, then OTA insisted, these taxpayers would get reductions both from the lower inclusion factor and from the lower tax rates, or a total tax reduction would be about 35% on their capital gains. In

taxing appreciation of capital gains at death would maintain a serious inequity.[83] The new tax rates on realized gains favored high-income earners.[84] As Table 5 shows, the effective rates the House bill provided would be much lower than those of original administration proposal. Also, the original proposal would produce more revenue than the House bill.[85] Finally, the House bill would increase the complexity of the income tax system.[86] Therefore, OTA concluded that the Treasury should recommend "that these reductions [of capital gain taxes] not be enacted until the law is amended to deal with the problem of unrealized appreciation at death either by taxing the transfer at death or by a carryover basis." "If neither of these are done in the present bill," OTA went on, "the capital gain rate reductions should be deleted."[87] Finally, they decided to

---

addition, because over 96% of tax returns having capital gains reported those gains on the percentage inclusion method, 96% of capital gain recipients would enjoy tax reduction equivalent to other taxpayers if the Treasury recommendation was accepted.

83 Under existing law, though the assets transferred at death received an increase in basis to the value at death, the appreciation would never be subject to capital gains tax even when realized by the heirs. OTA contended that much of lock-in arouse from the knowledge that the capital gains tax could be completely avoided if the appreciated asset was held until death. Due to these two issues, OTA argued that it would be unreasonable to reduce the capital gains tax simply to deal with a lock-in problem arouse largely from the fact that appreciation held until death was never subject to capital gains taxes.

84 For most taxpayers the capital gains rate was only 27% of the top rate while capital gains, more than other incomes, were concentrated in the top brackets. For many taxpayers the capital gains rate was almost the only tax that they paid because they could use all of their deductions against ordinary income. It was estimated the effective tax rate on capital gains were about 9%.

85 Under the revenue estimates given in the House Committee report, the Treasury recommendation would provide a revenue gain in the long run of $140 million. It would, however, reduce revenue in the first year by $210 million and in the second year by $80 million. Since the revenue estimates for the House bill had been made, several new sources of information have become available suggesting that the House provisions reducing capital gains rates would cost more than previously estimated. Under the revised estimate, the first year revenue loss from removing the House bill provision was $130 million. This change would provide revenue gains in the other year, however, of $10 million in 1965 and increasing to a gain of $230 million in 1968 and the long run.

86 The House bill recognized that the assets held less than two years would not be taxed by the new lower capital gains rates, but continue the 50% inclusion and 25% alternative rate as under existing law. OTA contended this would add about two pages to the capital gains tax form to guide the taxpayer through the problem of which gains to be matched against which losses when there were gains or losses in the various categories.

87 Office of the Secretary of the Treasury, Office of Tax Analysis, "The Treasury Recommendation for Deleting Provision H.R. 8363 Reducing the Percentage Inclusion and Alternative Rate on Net Long-Term Capital Gain," January 16, 1964, HSC, HLSL, SSSP, Box 53, File No. 48-1: Capital Gains, 1961-1968.

recommend the Senate Finance Committee to retain the existing tax treatment of capital gains.[88]

Table 3. Changes in Effective Tax Rates form Present Law, under the House Bill, and under House Bill Modified by Retaining Current Capital Gains Provisions (%)

	Tax under present law	Tax under House bill	Tax under Treasury proposal	Tax reduction as percent of present law tax	
Adjusted gross income	Percent of realized income			House bill	Treasury proposal
120,000					
Low capital gain	39.6	34.8	34.9	12.2	12.1
Mid. Capital gain	32.0	28.1	29.1	12.1	8.9
High capital gain	27.6	24.2	25.9	12.2	6.3
170,000					
Low capital gain	42.2	37.0	37.2	12.4	11.9
Mid. Capital gain	31.6	27.8	29.2	11.8	7.5
High capital gain	25.4	22.4	24.5	11.9	3.6
300,000					
Low capital gain	48.2	41.3	41.6	14.0	13.5
Mid. Capital gain	30.5	27.1	28.9	11.2	5.4
High capital gain	22.4	19.6	22.3	12.5	0.4
700,000					
Low capital gain	47.6	39.9	40.6	16.3	14.8
Mid. Capital gain	26.3	23.1	25.4	12.3	3.5
High capital gain	20.1	18.1	21.1	10.4	-4.5
2,000,000					
Low capital gain	56.7	46.0	46.4	19.0	18.2
Mid. Capital gain	30.2	25.7	28.0	14.9	7.3
High capital gain	20.9	18.5	21.3	12.6	-1.9

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, "The Treasury Recommendation for Deleting Provision H.R. 8363 Reducing the Percentage Inclusion and Alternative Rate on Net Long-Term Capital Gain," January 16, 1964, HSC, HLSL, SSSP, Box 53, File No. 193-1A, File: Capital Gains, 1962-1964.

The Senate passed the tax bill on February 7, 1964, and Johnson signed it on February 26. The range of individual income tax rates was reduced to

88 Stanley S. Surrey to K.H. Koach, February 6, 1964, HSC, HLSL, SSSP, Box 53, File No. 193-5: Capital Gains, 1963-1964.

16-77% in 1964 and to 14-70% in 1965. The withholding rate was cut down to 14% in 1964. The normal rate of corporate income tax was reduced to 22% in 1964, while the surtax rate was raised to 28% in 1964, and reduced further to 26% in 1965. With regard to structural reform, the new act increased the deduction for retirement income and the minimum standard deduction. Both of these measures cut taxes and revenues. But most of raising revenue elements of the original administration proposal had disappeared. As a consequence, the new legislation did not strengthen the progressivity of the tax system.[89] In 1964, the new legislation would result in a revenue loss of $11.5 billion.[90] In sum, the new legislation contained almost no structural reform and was little more than a huge tax cut. The original impetus for tax reform vanished.

---

[89] Richard Goode demonstrates the particular result and effect tax reform 1964 gave to individual income tax system. See Goode, *Individual Income Tax, 1st ed.*, 236.

[90] *Annual Report of the Secretary of the Treasury on the State of the Finances for the Fiscal Year Ended June 30, 1964*, 36.

4

Austerity Won: The Development of Federal Expenditure Restraint during JFK Administration

Introduction

Instead of the tax cuts, the CEA could have chosen social program expansion involving government expenditure increases as a “fiscal dividend.” As many scholars argued, however, Kennedy administration failed to accomplish the attempt to expand budget expenditures for social programs such as training, education, and medical service in order to deal with the transformation of society, domestic economic situation and the demand of the country after WWII. Previous studies attributed the failure to the following two points: The fiscal conservatives and businesses opposed the administration plan that would increase government expenditures and budget deficits on the one hand;[1] on the other, the policy-makers such as the CEA desired the accomplishment of high rate growth and the alleviation of poverty and economic inequality through tax cuts and minimum government expenditures.[2]

As Chapter 1 demonstrated, however, we have already seen that Kennedy administration did plan the social program expansion involving

---

1 Julian E. Zelizer, *Taxing America: Wilbur D. Mills, Congress, and the State, 1945-1975* (Cambridge University Press, 1998); Iwan W. Morgan, *Deficit Government: Taxing and Spending in Modern America* (Chicago: Ivan R. Dee, Inc., 1995); Herbert Stein, *The Fiscal Revolution in America* (Chicago and London: The University of Chicago Press, 1969); Edward S. Flash, Jr., *Economic Advice and Presidential Leadership: The Council of Economic Advisers* (New York: Columbia University Press, 1965).

2 Theda Skocpol, *Social Policy in the United States: Future Possibilities in Historical Perspective* (Princeton: Princeton University Press, 1995); Margaret Weir, “The Federal Government and Unemployment: The Frustration of Policy Innovation from the New Deal to the Great Society” in Margaret Weir, Ann S. Orloff, and Theda Skocpol ed., *The Politics of Social Policy in the United* States (Princeton: Princeton University Press, 1988); Herbert Stein, *Fiscal Revolution in America* (Chicago: The University Press of Chicago, 1969).

expenditure increase. Nevertheless, they could not accomplish the expansion of vocational training, education and medical services, all of which would be operated on general fund. The administration attempted to carry out them through increasing deficit finance. But businesses and farmers opposed the deficit-finance for fear that it would increase inflationary pressure and the production cost they burdened. Inside the administration, the Cabinet, Kennedy, and the CEA didn't reach the agreement over unemployment, economic recovery situation, and the expansion of social programs. Tax revenue didn't increase more than the BOB estimated because of the continuation of slack. Then the debt limit was raised several times, but the margin of raised fund was mostly used for the increase in defense outlays. Moreover, tax reform bill was proposed as net tax cut in 1963, nondefense expenditures on general fund was restrained in order to secure the same amount of source as curtailed by tax cut, and to pass tax cut bill through the CWM and Senate Finance Committee (SFC). Finally, social expenditure for the programs the administration emphasized was restrained more than the administration expected.

I. Budget Expenditure Restraint in 1961

In the early 1961, the CEA and the BOB led the observation of economic trend, and the discussion over what kind of programs should be taken as economic policy. Though "We are in an upturn," the CEA and the BOB regarded, "it is not yet vigorous" enough to "shrink unemployment and the output gap to tolerable levels by the end of 1961 or even the middle of 1962."[3] According to the outlook of the CEA, though it was expected that GNP would rise from \$500 billion in the first quarter of 1961 to \$555 billion in the second quarter of 1962, unemployment rate

[3] Walter Heller to John F. Kennedy, "Basic Facts on U.S. Economic Outlook," May 27, 1961, JFKL, WWHPP, Box 5, File: Memo to JFK 5/61.

would not decline below 6% in the same period. Then, Heller argued "The economy does need the added stimulus of further government programs" through adding "$3 to $4 billion to Federal budget totals for the next 18 months (a) without generating unmanageable inflationary pressures and (b) without worsening the prospect for a fiscal 1963 surplus."[4] From the outside of the administration, Paul A. Samuelson sent a memorandum and advised Kennedy to adopt the recommendation of Heller.[5]

Since Kennedy's administration started, however, industries and farmers had opposed the increase in government expenditures. They thought the expansion of OASDI, unemployment insurance through increasing payroll taxes would increase their burden of production cost, while decreasing their profit gaining.[6] Industries and farms argued that their production costs for services and raw materials had been keeping upward trend. They criticized that deficit spending would intensify inflationary pressure, which would increasingly raise the cost burden. Then, they argued for the cuts in both individual and corporate income tax so as to relieve the heavy tax burden for business and middle- and higher-income classes, to stimulate private investment, and to restore economic activities.[7]

Inside the administration, there was the conflict of additional programs and the distribution of resources. In the meeting on June 12, 1961, only Henry Fowler, the Under Secretary of the Treasury, had not agreed on the view of other participants that it would be sound economics to enact the recommendations which would permit early initiation of public works and conservation projects as a further boost to recovery and growth because he thought that the programs would be

---

4 Walter Heller to John F. Kennedy, "Economic Background of the Second-stage Economic Program," May 10, 1961, JFKL, WWHPP, Box 5, File: Memo to JFL 5/61.

5 Paul A. Samuelson to John F. Kennedy, "Who's Right: Heller or Burns?" June 5, 1961, JFKL, WWHPP, Box 5, File: Memo to JFK 6/61.

6 *January 1961 Economic Report of the President and the Economic Situation and Outlook,* 173.

7 *January 1961 Economic Report of the President and the Economic Situation and Outlook,* 173, 193-195, 200.

inefficient and ill-timed. And in the meeting, there were two conflicting views on the politics of the issue: On the one hand, by promptly requesting Congress to enact a standby program that the President could put into effect next fall if unemployment continued at high levels, the administration should seek to avoid the charge that they had not asked Congress for enough action in the face of continuous high unemployment and the mounting bitterness; on the other, in the face of brisk recovery, and political vulnerability of a public works type of program, no attempt should be made to get such legislation at that time.[8] In the meeting on June 26, however, "most of the participants had serious doubts about the political wisdom of asking Congress to enact Clark-type legislation now…As the recovery proceeds, the anomaly of persisting unemployment is eclipsed in public thinking by growing optimism about the economic outlook; the climate does not appear to be receptive to new proposals for emergency programs t put the unemployed to work. The growing tension over Berlin has made the climate even less receptive."[9] Then, in August, Kennedy finally decided not to propose these programs and budget distribution to Congress in 1961 and to keep observing the economic activity and the rate of growth.[10] Then Kennedy and his staffs expected that the programs already started in the early 1961 and the increase in defense outlays to deal with Berlin Crisis might restore the economy and accelerate the rate of growth.[11]

II. Kennedy Administration and Business

---

[8] Walter W. Heller to John F. Kennedy, "Agency Views on Principles of the Clark Community Facilities Bill," June 19, 1961, JFKL, WWHPP, Box 5, File: Memo to JFK 6/61.

[9] Walter Heller to John F. Kennedy, "Second Report of Agency Views on the Clark Community Facilities Bill (S. 986)," July 6, 1961, JFKL, WWHPP, Box 5, File: Memo to JFL 7/61.

[10] John F. Kennedy to Joseph S. Clark, August 7, 1961, JFKL WWHPP, Box 5, File: Memo to JFK 8/61.

[11] Walter W. Heller to Richard Wagner, August 15, 1961, JFKL, WWHPP, Box 3, File: CEA General 61, Feb. 16-64, Sep. 2.

Contrary to the expectation of the administration, however, the rate of growth of economy and tax revenue did not increase from late 1961 to early 1962. GNP grew less than expected, which meant to the CEA that output gap did not close. And Unemployment rate had been over 5%. From fiscal 1961 to fiscal 1964, the amount of general budget receipt of every fiscal year had been less than expected.[12] Though the ceiling of the amount of debt had been raised since late 1950s, the margin had gone to the resources of the defense outlays on the ground of the East-West relations.[13] In the meeting of the CEA and the BOB held on May 29th, 1962, Cohn and Turner, staffs of BOB, argued: "[We] doubt that $2 billion could be added (apart from lending programs). [It] depends on military policy and programs – current $400 million DOD [the Department of Defense] speedup for FY 1962 hurts chances of a major acceleration in FY 1963."[14] In the face of this situation, the fear that the rate of economic growth might never speed, and to make matters worse, the economy might go into another recession in the middle of 1962 had spread out in the administration, especially around the CEA and the economists around the CEA.[15]

Political situation had also taken a turn for the worse. Just after the administration started, the personnel change of chairman and director was taken place in the competent authorities such as Securities and Exchange Commission, Federal Transportation Board, National Labor Relations Board, Federal Power Commission, and Federal Trade Commission. But this step made businessmen hostile

---

12 For instance, in January, 1962, though it was estimated that general budget receipt in fiscal 1963 would be $93 billion, which would generate the budget surplus, and enable the administration to retire then accumulated debt somewhat, the actual revenue was $86.376 billion.

13 *The Budget of the United States Government for the Fiscal Year Ending June 30, 1963*, 22-23; *The Budget of the United States Government for the Fiscal Year Ending June 30, 1964*, 29.

14 Arthur Okun to the Records and James Tobin, "BOB-CEA Meeting of May 29," June 1, 1962, JFKL, WWHPP, Box 4, File: Heller Council 4/62-7/62.

15 Walter W. Heller to John F. Kennedy, "What It Takes to Get to Full Employment," March 3, 1962, JFKL, WWHPP, Box 5, File: Memo to JFK 3/3/62; Walter W. Heller to John F. Kennedy, "The Slowdown in the Recovery and Its Implication for Policy," March 21, 1962, JFKL, WWHPP, Box 5, File: Memo to JFK 3/6/62-3/31/62.

to the administration because they regarded these authorities as the assistance for their society. The change of Secretary of Commerce to Luther Hodges generated the hostility of business to the administration.[16]

Secondary, the administration conflicted with steel industry over the price of steel. The administration regarded the rise of price of steel would significantly influence into the prices of other products and the economy as a whole so that they sent major steel companies letters to admonish them to earn profits without price increase.[17] In April, 1962, steel companies approved this recommendation. Nevertheless, just after the approval, U.S. Steel, the biggest company in steel industry, and other five major companies including Bethlehem Steel issued a declaration the raising of price. Then the administration put great pressure on these companies to take back raising price, so that they finally had no choice but obeying. However, this event made the conflict serious, and the Republicans in Congress expressed a series of administration's behaviors as "the emergence of political power with no disguise which have ever been seen in this country."[18]

Just after the conflict over steel price concluded, the administration attempted to restore the relationship between business and them. However, stock market suddenly declined sharply then, which made the opposition of business and conservatives much stronger, and induced the criticism of business that the president's unwise behaviors had brought about a series of economic disorders.[19] In addition, as their opposition became harder, the same view as the business and

---

[16] Schlesinger, *A Thousand Days,* 631-634.

[17] Walter Heller to John F. Kennedy, "The Price Situation in General (and Steel Prices in Particular)," August 2, 1961, JFKL, WWHPP, Box 5, File: Memo to JFK 8/61, Walter Heller to John F. Kennedy, "The Price Situation in General (and Steel Prices in Particular)," August 2, 1961, JFKL, WWHPP, Box 5, File: Memo to JFK 8/61.

[18] Schlesinger, *A Thousand Days,* 634-640.

[19] *Ibid.*, 640-643.

conservatives argued spread among the people in the United States.[20]

In face of these political situations, there was the need for the administration to settle the hostility of business and conservatives. On May 29, 1962, the next day of the stock market decline, Kennedy, Dillon, Heller and William M. Martin, Jr. started to discuss the measure to prop up economy and the confidence to the administration. In this meeting, immediate income tax cut was taken up for discussion. Before this meeting was held, CEA had already referred to the need of temporary and large tax cut to dissolve fiscal drag and to avoid the recession in the near future. In the meeting of the CEA and the staffs of BOB held on the same day, the CEA argued: "Urgency of prompt action depends on whether expansion goes on at a sufficient rate to be sustainable. With our 'alternative estimate' of a $578 billion fourth quarter, there probably would be time for action in early 1963. But feedback from stock market may cost $2-$4 billion in year-end GNP…Given present program, the odds favor an abortive recovery."[21]

Businessmen put pressure on the administration to take the reduction of individual and corporate income tax as the measure against the stock market disorder.[22] As Heller reminisced, "The Whole political complex in its broadest sense required an approach to expansionary policy which would not be rejected on grounds that it necessarily meant bloated budget. Added expenditure programs faced very great resistance."[23] Finally, June 7, 1962, Kennedy described that "A comprehensive tax reform bill which in no way overlaps the pending tax credit and loophole-closing bill offered a year ago will be offered for action by the

---

[20] Stein, *Fiscal Revolution in America*, 407-408.
[21] Arthur Okun to the Records and James Tobin, "BOB-CEA Meeting of May 29," June 1, 1962, JFKL, WWHPP, Box 4, File: Heller Council 4/62-7/62.
[22] *The Washington Post,* June 2, 1962
[23] Heller, *New Dimensions of Political Economy*, 113.

next Congress, making effective as of January 1 of next year an across-the-board reduction in personal and corporate income tax rates which will not be wholly offset by other reforms – in other words, a net tax reduction."[24]

III. The Shortage of Tax Revenue and the Debt Limit

The shortage of tax revenue and the debt limit also prevented the administration from succeeding in social program expansion. The estimated amount of general fund in each fiscal year from 1961 to 1964 was less than the actual amount. This shortage of tax revenues brought about the increase in the amount of debt accumulation, and the necessity to raise the debt limit.[25] In June 1961, the limit of fiscal 1962 was raised temporarily from $285 billion to $298 billion. But the margin was consumed for additional defense outlays for Berlin crisis occurred in July 1961, which made it difficult for the administration to distribute the rest of margin to the functions.[26] Then the administration raised the debt limit to $305 billion for fiscal 1963. In the meeting of the CEA and the BOB on May 29, 1962, however, "Current addition of $40 million in fiscal 1962 by the Defense Department," a staff of the BOB argued, "will kill the possibility of substantial additional expenditures in fiscal 1963."[27] The temporary raise of the federal debt limit for fiscal 1963 was accomplished on the assumption that the expansion of economy and tax revenues would be enough to balance federal budget. In *Budget of the United State Government for fiscal 1964*, however, it was estimated that the general fund revenue ($81.4 billion) and trust fund revenue ($24.3 billion) would not reach the level estimated in

---

[24] *Public Papers of the Presidents, John F. Kennedy, 1962,* 457.
[25] Ira O. Scott, Jr., *Government Security Market* (New York: McGraw-Hill, 1965), 14.
[26] *The Budget of the United States Government for the Fiscal Year Ending June 30, 1963*, 22-23.
[27] Arthur Okun to the Records and James Tobin, "BOB-CEA Meeting of May 29," June 1, 1962, JFKL, WWHPP, Box 4, File: Heller Council 4/62-7/62.

previous fiscal year.[28] In short, additional defense outlays bore on the expansion of nondefense outlays the administration desired.

IV. Tax Cut and the Attack against Expenditure Increases

As Chapter 3 demonstrated, tax reform bill was proposed as substantial net tax cut. In the face of the difficulty with the passage of the bill, however, the CEA and the CWM led by Mills argued for the passage of tax cut even at the cost of other government programs. While discussing over reforms proposal, the CWM negotiated for the restraint of budget deficit through reducing nondefense expenditures. Then Mills claimed for the restraint of government expenditures to reduce budget deficit from tax reform and budget expenditures. Republican in CWM also contended the restraint of budget deficit.[29] There was the tendency among the public to criticize the budget deficit that would be created by tax reduction and budget expenditures. American Bankers Association claimed that the expansion of budget deficit would deteriorate the dollar value.[30] New York Times carried the article which described that the deliberate creation of budget deficit by tax reduction conflicted with the economic wisdom those days, and that would be the objective of political derision.[31] Some economists criticized the enlargement of government actions and of deficit financing.[32] In addition, one congressman reported Heller that several letters that had reached Congress from the public had argued that "don't cut taxes if you can't cut

---

[28] *The Budget of the United States Government for the Fiscal Year Ending June 30, 1964*, 29.
[29] Julian E. Zelizer, *Taxing America*, 195.
[30] *President's 1963 Tax Message, 88th Cong. 1st Sess.*, 2379-2303.
[31] "On the Art of Tearing up McGuffy's Reader," *The New York Times International Edition*, January 23, 1963.
[32] Arthur, F. Burns, "An Economist Looks at the President's Tax Program," *Tax Review*, February, 1963, Vol. 26, No. 2; John L. McClellan, "The Crime of National Insolvency," *Tax Review*, January, 1963, Vol.26, No.1.

government spending."[33] Kermit Gordon, new director of the BOB, had expressed the restraint of nondefense expenditures to offset budget deficits made by tax reduction. In the face of these conditions and the delay of discussion over tax reform bill, however, July 29 1963, Mills advised Dillon that tax bill would pass through the Ways and Means Committee only if Kennedy had admitted further expenditure restraint.[34] Then, cabinet meetings were held several times to discuss the issue, and Kennedy and the Treasury sent memorandums to Mills to inform him their acceptance of his advice.[35]

After Kennedy was assassinated, Lyndon B. Johnson and his staffs had to conciliate Byrd to approve the passage of the tax bill. Johnson had the meeting with Eisenhower on November 23, and with Robert B. Anderson, the Secretary of the Treasury of Eisenhower's administration. Then he urged Johnson that the reduction in budget expenditures and government debts was the best step to restore the harmony and confidence of the national.[36] On November 25, Johnson had the meeting with officers of Treasury, the CEA, and the BOB.[37] In the meeting, while the CEA and the BOB proposed the restriction of budget to $101.5 billion, Dillon warned that the tax bill was the main factor holding back the private economic decision-making that was needed to assure confidence in the long-range prospects for the economy, and argued that the failure to enact the tax legislation would also have disastrous effects on international exchange markets, the stability of the dollar, and the stock market. Then

---

33 Joseph F. McCaffrey to Walter W. Heller, January 23, 1963, JFKL, WWHPP, Box 21, File: Tax 1/16/63-1/31/63.

34 Julian E. Zelizer, *Taxing America*, 201.

35 Gardner Ackley to Theodore C. Sorensen, "Letter to Chairman Mills," August 15, 1963, JFKL, WWHPP, File: Tax Cut 8/15/63-8/31/63.

36 Rowland Evans and Robert Novak, *Lyndon B. Johnson: The Exercise of Power* (New York: The New American Library, 1966), 370.

37 The staffs attended this meeting were, Dillon and Fowler from Department of Treasury, Heller and Gardner Ackley from the CEA, and Kermit Gordon, new director of the BOB, and Elmer Staats from the BOB. Rowland Evans and Robert Novak, *Lyndon B. Johnson*, 370.

he insisted that budget expenditure should be restricted less than $100 billion.[38] Johnson described that "we won't even get it to the Senate floor unless we tell Congress that the new budget will be about one hundred billion dollars."[39] Then he agreed with the proposal of the Treasury. Finally, tax cut was enacted at the cost of government expenditure expansion.

[38] Julian E. Zelizer, *Taxing America*, 202.
[39] Rowland Evans and Robert Novak, *Lyndon B. Johnson*, 371.

Conclusion

By the early 1960s after WWII, the United States revealed its two faces: The “economically” affluent society on the one hand, and the depressed society on the other. Many changes occurred in both terms of economic conditions such as industrial structure, labor market and mechanization on the one hand, and of the social affairs such as the movement of middle- and higher-income classes to suburbs, the expansion of demand for education, the depression of rural areas, the inflow of population - mainly African American and Latino - to cities, and the terribly blighted environment of urban America such as unemployment, poverty and disadvantaged education on the other.

State and local governments, however, had already lost fiscal capability to deal with the situation through providing social programs. State and local government deficits had increased in 1950s. Diversified State and local tax system, mainly consisted of property taxes and indirect taxes, supplemented by individual and corporate income taxes, didn’t raise revenues enough to finance their expenditures, and provide the difference of tax revenue among States and localities. Intricate structure of metropolitan areas that consisted of several cities or counties made it vague which authority should be responsible for dealing with the issues the areas faced. Federal grants system, which could have been effective in the situation, provided too small amount of grants for State and local governments, and the difference of the amount of its distribution among regions and programs. Under the circumstance, the Treasury recognized that State and local government had not capability to dissolve the problems solely. And State governors and ACIR recommended federal government be more responsible to the conditions.

Kennedy administration devised their social programs and budget and federal grants distribution projection in terms of social and economic affairs and the hardship of State and local government finance. Kennedy administration devised the combination of the income security programs such as public assistances and public works and vocational training, and the expansion of federal aids to the programs such as education and medical services. They recognized the issues of intergovernmental relations, and State and local governments became fiscally gridlocked. Then through the expansion of federal expenditure and federal grants distribution to State governments that would mainly operate these programs, they attempted to dissolve the change of industrial structure and labor market, and the social affairs of both urban areas and rural areas. The administration regarded the programs such as vocational training, urban renewal and education as the long-term project that would build better and faster growing economy that would be paid out money "after a considerable delay." In addition, the fact that Heller sent Kennedy the survey result of voter attitudes clarified that the administration crafted their social programs with attempting to grasp what kind of programs the public needed and desired.

Kennedy administration also focused on the issue of intergovernmental relations. Before Kennedy took the office in 1961, State and local government deficits had kept increasing, and made State and local government finance gridlocked, though the demands for public services such as welfare, training, medical care, and education had continued rising. State governors and ACIR called federal government for supporting them and alleviating their financial hardship. Then through federal grants distribution, Kennedy administration devised attempted to deal with the both affairs of the rural areas that was depressed economically, and of the urban areas that faced with the inflow of nonwhite, the outflow of the wealthy, tax base reduction, lower-paid work, poverty and unemployment.

The point that should be emphasized regarding federal grants programs Kennedy administration devised is that they aimed at accomplishing both financial aids for and increasing the discretion of State and local governments. Existing studies regarding intergovernmental relations have regarded (a) “Creative Federalism” of Johnson administration through using categorical grants as a germination of “Coercive Federalism” emerged later, and (b) the consolidation of categorical grants into block grants accomplished by Reagan administration as a catalyst of progress of “Competitive Federalism.” In contrast, this chapter uncovered that after Kennedy took the office or thereabout, BOB projected the budget increase and its distribution to the programs that “Special Message” of February 2 referred on the basis of the ideas that (a) the programs should deal with the difference of needs and characteristics among regions, (b) minimize the possibility that State and local governments might rest on federal grants, (c) correct the difference of the ability to raise revenue among State and local governments, and (d) increase the discretion of State and local governments. Moreover, BOB argued that these requirements could be met not by using categorical grants but by general or block grants. It has been said Johnson administration carried out the social program expansion for “War on Poverty” based on the idea of social programs formulated by Kennedy administration. And it has been generally described Reagan administration used the idea of block grants to accomplish the curtailment of the amount of federal grants to State and local governments and federal direct social expenditures. The attempt to use general or block grant program aimed at expanding social programs devised by Kennedy administration, however, as this chapter demonstrated, was definitely in the different direction from the policies of Johnson and Reagan administration, though Kennedy administration attempted to take the same measures as they did. In the sense, it can be concluded that the attempts of Kennedy administration could provide the watershed that the history of intergovernmental relations and social policy of the United States might follow absolutely different path from the one it has actually done.

The conclusion of Chapter 1 provided us with the subject to be examined –the ability to finance through the federal tax system. But we found Kennedy administration chose the way of tax cuts in the early 1960s. In the tax message of 1961, as to long-range tax reform discussed in 1959 and ultimately proposed in 1963, Kennedy stated its major goal was to construct "A tax system that is more equitable, more efficient and more conducive to economic growth" by "broadening the tax base and reconsidering the rate structure."[1] When Kennedy Administration ultimately proposed the other tax reform bill as substantial tax cut on January 24, 1963, however, Kennedy stated the intent of tax reform bill originally proposed in 1961 was depreciation reform and investment credit that "I pledged two years ago would be only a first step."[2] It means the part proposed as a first step toward tax reform proposed in 1963 was replaced from foreign income tax reform and the other structural reform measures. And in the same message, it was argued, the tax reform proposal "Is crucial" to the achievement of the goals "to end the tragic waste of unemployment and unused

---

1 *Public Papers of the Presidents, John F. Kennedy, 1961,* 291.
2 *Public Papers of the Presidents, John F. Kennedy, 1963,* 74.

resources – to step up the growth and vigor of our national economy – to increase job and investment opportunities – to improve our productivity,"[3] and to "lead the way to strong economic expansion and larger revenue yield."[4] Moreover, in presidential statement on economic issues for the Presidential campaign in 1964, Lyndon B. Johnson, who took over the presidency after Kennedy's sudden death, described the Administration enacted the most far-reaching tax reductions in the history in 1962 to help industry modernize its facilities.[5] The result that the 1961 tax reform bill was ultimately enacted as tax cut vanished both the 1959 agreement, and its original purpose of the 1961 structural reform - to set out the step toward comprehensive tax reform – from Federal tax history.

Kennedy's death and the sharp acceleration of growth rate seemingly enhanced its reputation. When signed the bill, Johnson stated: "This legislation was inspired and proposed by our late, beloved President John f. Kennedy."[6] The rate of economic growth sharply accelerated after this tax cut was enacted. Economists, mainly Heller and Samuelson, repeatedly referred to this tax reform as tax cut that contributed to this economic boost. Heller concluded: "Early returns – and circumstantial evidence – show the economy to be responding well to the tax cut."[7] He noted that the growth rate of GDP from 1965 to 1966 was 16.3% - the highest level ever

[3] *Public Papers of the Presidents, John F. Kennedy, 1963,* 73-74.

[4] *Ibid.,* 79. Richard Goode demonstrates the particular result and effect that the 1964 tax reform gave to individual income tax system. See Richard Goode, *Individual Income Tax, 1st ed.* (Washington, D.C.: Brookings Institution, 1964), 236.

[5] Office of the White House Press Secretary, "Presidential Statement #5 on Economic Issues: Further Tax Reduction," October 27, 1964, HSC, HLSL, SSSP, Box 53, File No. 91-2D: Campaign, 1964.

[6] Lyndon B. Johnson: "Radio and Television Remarks Upon Signing the Tax Bill," February 26, 1964, Online by Gerhard Peters and John T. Woolley, *The American Presidency Project* (http://www.presidency.ucsb.edu/ws/?pid=26084).

[7] Walter W. Heller to Lyndon B. Johnson, "Economic Impact of the Tax Cut," June 2, 1964, JFKL, WWHPP, Box 23, File: Tax 6/63.

recorded for one year. These conditions convinced much the nation that the Kennedy-Johnson tax cuts represented one of the most important legacies of the Kennedy administration.

Soon after Kennedy-Johnson Tax Cut was carried out, both Democrat and Republican took up tax cut on their platform. During the 1964 contest between Johnson and Barry M. Goldwater (R-AZ) for the presidency, Johnson recommended a consumption tax reduction, and another income tax cut, despite the accelerating economic recovery.[8] Meanwhile, Goldwater, although he voted against tax cut in 1964 on the ground that it would be fiscally irresponsible in the face of a budget deficit, proposed a far larger tax reduction (25% over five-year period) through across-the-board rate cuts.[9] Acceleration of economic activity and the argument of economist for tax cut 1964 eventually forced the Republican to change their attitude to tax policy in the face of budget deficits.

In the face of the 1964 campaign, though they didn't adopt a new orthodoxy, the Treasury's staffs had to justify the result of tax reform and their effort for legislation because of the importance of the Kennedy-Johnson tax cut to the image of the Democratic administration. Though he continued working on crafting tax reform based on his fiscal belief till he returned Harvard,[10] "The Revenue Act 1964," Surrey

---

[8] Office of the White House Press Secretary, "Presidential Statement #5 on Economic Issues, Further Tax Reduction" October 27, 1964, HSC, HLSL, SSSP, Box 53, File No. 187-5: Campaign, 1964.

[9] "Goldwater's Tax Cuts," *The Washington Post,* September 14, 1964; Robert A. Wallace to Myer Feldman, "Goldwater Tax Proposal," September 8, 1964, HSC, HLSL, SSSP, Box 53, File No. 187-5: Campaign, 1964.

[10] Surrey served his position until 1968. Before he returned to Harvard, while in the Treasury, he had conducted the preparation of a major study on tax reform that was published early in 1969. This study, according to Surrey, essentially regarded the task of tax reform as that of restoring "fairness" to the federal tax system by ending both the escape of many well-to-do individuals and large corporations from the burdens of that system and the ironic contrast of placing an income tax on those sill in the poverty class. This study became the basis of the Tax Reform Act of 1969. At Harvard, "with the benefit of hindsight," he sought to link tax reform to the concept of tax expenditures in order to consider the criteria in choosing

excused in the letter to a congressman, "contains many revenue raising and revenue reducing provisions, primarily intended to provide more equity and uniformity and to reduce hardship."[11] Despite his criticism that Goldwater's tax cut would result in fiscally irresponsible, Wallace recommended Deputy Special Counsel to the President, Myer Feldman that "I think the best approach to the Goldwater proposal from a fiscal standpoint is 'Welcome to the club! You have finally recognized your error in voting against the tax cut by proposing an even bigger one'."[12] The tax idea of the comprehensive tax reform proponents, the Treasury's staffs, was more similar to the idea of Keynes, Hansen and Lerner than that of the "tax cut" proponents who are nowadays called "Keynesian." But tax cut argument finally won. Then, ignoring real Keynes thought, the victorious CEA and other economists promoted the popularity of the Kennedy-Johnson tax cut, as a part of "the completion of Keynesian revolution," despite the fact that it was certainly not structural tax reform and had little to do with the true content of Keynesian ideas. Finally, their promotion influenced the argument of many studies that uncritically viewed this tax cut, recommended by the economists who emphasized the creation of budget deficit through it to stimulate consumption, as "Keynesian tax policy."

This eventuality germinated Federal fiscal issues happened later. From late 1960s to 1970s, budget deficit persistently accumulated through the expansion

---

between tax incentives and direct expenditures. Stanley S. Surrey, *Pathway to Tax Reform: The Concept of Tax Expenditures* (Harvard University Press: Cambridge, Massachusetts, 1973), vii-viii.

11 Stanley S. Surrey to Thomas G. Morris, March 12, 1964, HSC, HLDL, SSSP, Box 81, File No. 194-4: Dividend Credit Exclusion, 1963-1964.

12 Wallace regarded the Goldwater's tax cut program as irresponsible for the following reasons: (1) The idea that the potential increase in revenues could possibly do all the thins expected by Goldwater was patently absurd; (2) The Goldwater proposal would seal in a tax cut for future years when the economic situation facing the country may require retrenchment; (3) It would give too large a proportion of the tax cuts to corporations (46% of the total tax cut) and upper income individuals (54% of the cut to individuals with less than $10,000). Robert A. Wallace to Myer Feldman, "Goldwater Tax Proposal," September 8, 1964, HSC, HLSL, SSSP, Box 53, File No. 187-5: Campaign, 1964.

of government expenditures while inflationary pressure grew. As existing studies demonstrated, however, the increase of social expenditure during Kennedy's period resulted in being restrained. Though Johnson administration succeeded in social programs expansion, they mainly used categorical grants. Nixon administration introduced GRS, but it has been evaluated that the institution could not resolve social problems, especially those of metropolitan areas. Reagan administration attempted to curtail social expenditures through abolishing GRS and blocking existing categorical grants. And, today, as the case of Detroit revealed, State and local governments are fiscally gridlocked without the support of federal government.

If the proponents of comprehensive tax reform had won, tax system might have been the code that could deal with the problems. Until 1981, the argument that tax cuts would stimulate economy and finally increase tax revenues had been dominated. In 1978, when James Carter administration worked round to tax cut both to stimulate domestic demand and to meet the official commitment to "locomotive strategy," tax cuts, then it was argued, would stimulate consumption demand and finally increase tax revenues.[13] In 1982, Joint Economic Committee prepared the report titled "The Mellon and Kennedy Tax Cuts: A Review and Analysis." As to tax cut in 1964, it concluded that "The Kennedy tax cuts…facilitated increased saving, investment, production, employment, ultimately, tax revenues…by slashing marginal rates government can unleash strong economic forces capable of generating economic

[13] U.S. Finance Committee on Finance, Hearings, Tax Reduction and Simplification Act of 1977, 95th Congress, 1st Session, 127-129. As to the locomotive strategy and the commitment of United States, see Carl W. Biven, *Jimmy Carter's Economy: Policy in an Age of Limits* (Chapel Hill & London: The University of North Carolina Press, 2002).

recovery, with minimal short-term revenue loss."[14] The Tax Reform Act of 1986 enacted during the administration of Ronald Reagan represented broadening-base and revenue neutral tax reform, but during the 1990s the William Clinton administration several times increased tax expenditures instead of direct social expenditures. And in 2001 George W. Bush launched the first of his administration's five tax cuts. When Bush signed "The Economic Growth and Tax Relief Reconciliation Act of 2001" on June 7, 2001, he stated: "Across the board tax relief does not happen often in Washington, DC. In fact, since World War II, it has happened only twice: President Kennedy's tax cut in the sixties and President Reagan's tax cuts in the 1980s. And now it's happening for the third time, and it's about time." by invoking the model of the Kennedy-Johnson tax cut.[15] The 1964 tax cut set back a movement toward the kind of tax reform that might have been helped solve subsequent fiscal problems, and gave posterity the impression that tax policy is the tool to stimulate economy.

---

[14] Joint Economic Committee, *The Mellon and Kennedy Tax Cuts: A Review and Analysis*, 97th Congress, 2nd Session, 1982, 27.

[15] See "Remarks on Signing the Economic Growth and Tax Relief Reconciliation Act of 2001," *The American Presidency Project, The Public Papers of the Presidents*, June 7, 2001 (http://www.presidency.ucsb.edu/ws/index.php?pid=45820&st=&st1=).