

Draft Legislation

**Federal Reserve
Reform Act
and
A Taxation System
for Capital Formation**

November 14, 1980



Federal Reserve Reform Act

An Act

To amend the Federal Reserve Act of 1913 to provide for credit expansion without inflation, and to restore to Congress the Constitutional power to regulate the currency of the United States of America.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, that the short title of this Act shall be the “Federal Reserve Reform Act.”

Sec. 1. Findings

Congress finds

i. That the monetary and credit policies of the Board of Governors of the Federal Reserve System have caused both higher inflation and higher unemployment in the United States economy, and damaged the standing of the United States as a great industrial nation;

ii. That the action of the Federal Reserve System to cause economic recession through restriction of credit to the productive sectors of the national economy is contrary to the intentions of the framers of the Constitution of the United States, who entrusted the power to regulate the currency to Congress, and of the 63rd Congress, which delegated this power to the Federal Reserve System;

iii. That the Federal Reserve System has failed to distinguish between the productive use of credit in expanding the economy’s capacity to produce tangible wealth, and unproductive and inflationary uses of credit, and has therefore caused a shift away from capital formation in enterprises which produce America’s tangible wealth, viz. manufacturing, agriculture, construction, mining, utilities and transportation;

iv. That the Constitutional obligation of Congress to regulate the currency requires Congress to ensure an orderly flow of credit and currency to private enterprise engaged in the production and transportation of tangible economic wealth, including manufacturing, agriculture, construction, mining, public utilities and transportation;

v. That credit may be expanded without resulting inflation only when all new credit expansion is matched by increases in production of tangible goods, and that the Federal Reserve System’s policies have caused inflation by retarding capital formation and employment in the branches of the American economy which produce tangible goods;

vi. That the Federal Reserve Act of 1913 is deficient in permitting the Board of Governors of the Federal Reserve System to exercise arbitrary judgements on monetary policies in violation of America’s national economic interest and of the intent of the framers of the Federal Reserve Act;

vii. That the responsibility of Congress, therefore, is to set clear guidelines for the Federal Reserve to engage in noninflationary forms of credit expansion only.

Sec. 2. Title II of Public Law 91-151, the Credit Control Act of 1969, is hereby repealed.

Sec. 3. Sec. 14 of the Federal Reserve Act of 1913 as amended, is hereby amended to include the following new paragraph:

“The power of the Federal Reserve Banks to purchase or sell bills, notes and bonds of the United States shall be limited to these functions:

a) “the anticipation of tax revenues accruing not more than one year from the date of purchase of said bills, notes, and bonds, in order to help maintain an orderly flow of disbursements by the United States Treasury;

b) “to maintain an orderly market in the bills, notes, and bonds of the United States, and to meet the temporary liquidity needs of members of the Federal Reserve System;

c) “the purchase of such liabilities of the United States as may be presented by foreign governments for sale to the Federal Reserve System by said governments;

“However, the total holdings of the Federal Reserve Banks of bills, notes, and bonds of the United States shall be set at an annual ceiling as of the date of enactment of this Act. Said holdings may vary in size in the course of each year, but may not increase in size at the end of the year following enactment of this Act and at annual intervals thereafter except as a result of purchases of official liabilities of the United States from foreign governments, i.e., the Federal government may not create money supply by monetizing United States government debt.”

Sec. 4. Sec. 13 of the Federal Reserve Act is hereby amended to read:

“Any Federal Reserve Bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, Federal reserve notes, or checks and drafts upon solvent member banks, payable upon presentation; or, solely for exchange purposes, may receive from other Federal Reserve Banks deposits of current funds in lawful money, or checks and drafts upon solvent member or other Federal Reserve Banks, payable upon presentation.

“Upon the endorsement of any of its member banks, with a waiver of demand, notice and protest by such bank, any Federal Reserve Bank may discount up to 50 percent of the face value of notes, drafts, and bills of exchange arising out of the production of actual tangible wealth or capital improvements for the production of tangible wealth. Any Federal Reserve Bank may also pay in 50 percent of the value of any loan made by any member bank for the purpose of furthering the production of tangible wealth. This shall be defined as the purchase of raw and intermediate materials and capital goods, construction of facilities, or employment of labor to produce or transport manufactured goods, agricultural commodities, and construction materials: to work mines; to build manufacturing, transportation, and mining facilities or dwellings; to produce and deliver energy in all forms; and to provide public utilities for communications. Such definition shall not include notes, drafts, bills, or loans issued or drawn for the purpose of conducting business except in the area so defined, or for carrying or trading in stocks, bonds or other investment securities.

“Any Federal Reserve Bank may discount the full value of acceptances which are based on the exportation of goods, or 50 percent of the value of acceptances which are based on the importation of goods, provided that such goods conform to the restrictions set forth in the preceding paragraph.

“All Federal Reserve Banks shall meet all such requests for discount of or participation in notes, drafts, bills, and loans made by member banks, once the Federal Reserve Bank has determined that the purpose of such credit conforms to the restrictions set forth above. There shall

be no restrictions applied to such discounts in furtherance of tangible wealth creation on the basis of member banks' capital positions.

This Section shall stand as amended in Public Law No. 302, enacted July 21, 1932 (H.R. 9642 Sec. 210).”

Sec. 5. Sec. 19 of the Federal Reserve Act of 1913 shall be amended to include the following new paragraph:

“The above reserve requirements shall apply in the case that member banks maintain 60 percent of their total assets in the form of loans, bills, drafts, and advances to tangible wealth-creating borrowers, of a type eligible for discount under Sec. 4 of the Federal Reserve Reform Act. For every one percent by which the member bank's proportion of tangible wealth-creating assets falls below 60 percent of total assets, the Federal Reserve Banks shall require that member bank to place an additional one percent of demand deposits in reserve with the Federal Reserve Banks. However, to permit an orderly transition to this reserve rule, this formula shall apply only to new assets appearing on the balance sheets of member banks after the date of enactment of this Act.”

Supporting Brief for “Federal Reserve Act of 1981”

In 1929, approximately two-thirds of the American labor force was engaged in production or transportation of tangible goods, and one-third was engaged in services, including government. Now, that proportion is reversed; only one-third of the American labor force works in manufacturing, farming, mining, construction, public utilities, and transportation. That is the core of America’s economic problem. The investment environment has penalized long-term investment in tangible wealth creation in favor of labor-intensive investment in services.

The National Democratic Policy Committee (NDPC) has discussed the decline of the American economy and proposed a solution based on the promotion of high-technology capital formation in a series of policy papers. We address here the deficiencies in the Federal Reserve System that have contributed to this decline and propose a straightforward and obvious remedy.

Two formulations about Federal Reserve System policy, “independence of the central bank” and “control over monetary aggregates,” have served to confuse what the real economic issues at stake are. By the former it is generally meant that the Federal Reserve should have the power to refuse to finance unlimited spending by the Federal Government; yet the Federal Reserve has caused a recession which has added \$60 billion to the Federal deficit in the form of lost revenues and new, obligatory income-maintenance programs. By the latter it is generally meant that the Federal Reserve should adopt the monetary theory associated with Milton Friedman, and reduce the rate of growth of money supply in order to reduce inflation. Yet the Federal Reserve since Oct. 6, 1979, has attempted to do this, and succeeded in provoking a catastrophic decline in tangible economic output along with even higher inflation than prevailed one year ago.

Both critics and defenders of the FRS frequently fail to ask not only, “How much money supply,” but “Whose?” The FRS is the ultimate source of all increases in money supply in the United States, although the actual volume of money supply is determined in the short-run by the actions of commercial banks and their customers. It is axiomatic that no increase in the money supply to which corresponds an increase in tangible wealth can be inflationary. Only such increases in money supply which run in excess of the rate of growth of tangible wealth-creation can be inflationary.

Friedman’s theory takes the rate of real economic growth as a given, between 3 and 5 percent per year, and proposes a fixed rule reducing money supply growth to such a figure. Applied by Federal Reserve Chairman Paul Volcker starting Oct. 6, 1979, the Friedman policy resulted in a sharp contraction of credit to the goods-producing sector of the American economy disproportionate to the total change in credit volume. Hence, the result of the policy was additional inflation. The assertion that there exists a fixed rate of growth of the American economy is a totally arbitrary concoction based on averaging out periods of growth and decline over the last uncertain half-century. The assertion that reducing the rate of money supply growth will reduce inflation makes the equally arbitrary assumption that productive economic activity will not be the worst hit by such a reduction.

To distinguish between inflation-causing and noninflationary credit expansion, it is useful to view the economy as a single manufacturing firm. Of the total revenues of that firm, we call:

V = wages of blue-collar workers actually engaged in producing the firm’s output;

C = replacement (depreciation) of the firm's plant and equipment;

d = all overhead costs, including management compensation, white-collar salaries, taxes, debt-service, and rent;

S' = Net Operating Profit.

Clearly, if the d category increases for whatever reason, net operating profit will diminish. The firm will be able to make fewer investments in the future and will fail to apply new technology and increase productivity. If it does so through mismanagement, it will ultimately lose out to competitors. That is precisely what the United States is doing.

In the case of a single firm, the revenues from the sale of its tangible product include all other payments, including d . The same is true for the economy as a whole. This fact is blurred in Gross National Product Accounting, which adds the income of the "services" and "government" sector to the income of the "goods" sector. In fact, the income of the nongoods-producing sectors is *included* in the income of the goods-producing sector. Gross profits and wages generated by the goods-producing sector are the primary source of all income of the services sector, which absorbs a portion of the gross income of the goods-producing sector. That is the basis of the so-called Keynesian "multiplier," which simply states that an increase in "primary employment" in the goods-producing industries will generate an increase in "secondary" employment and income in the services sector; however, Keynes's terrible mistake was to argue that an increase in *unproductive* investment would increase employment by the same "multiplier" without more-than-offsetting inflation.

In the case of the individual firm, increasing the proportion of new investment in plant and equipment, and hiring and upgrading of the blue-collar labor force, will generate additional gross profit, especially if the new investment brings on line technologies which increase labor productivity. A higher proportion of new investment (i.e. a higher ratio $S'/C+V$) *automatically* generates the income flows to hire additional white-collar workers or meet other additional overhead costs. However, an increase in overhead costs by itself will diminish gross profit, and ultimately undermine the firm's ability even to maintain its existing overhead.

The Federal Reserve is in the position of the treasurer of this hypothetical firm. It can approve either the use of revenues for increasing investment, or increasing overhead, with the consequences of either decision as noted above.

If the majority of revenues are applied to investment, the treasurer will not have to worry about finding the funds to expand the size of management (or in the macro case, increase government expenditures). But if overhead bites into investment, the rate of gross profit will fall off.

Of course, there is one major difference between any government body and the management of an individual firm. The growth of the American economy depends on the enterprise and creativity of tens of thousands of individual firms, who function properly only when free from petty government interference. No government body can properly make all the required investment decisions. It is possible to make considerable progress with a maximum of state direction of investments, as in the case of France; but the French economy is hampered by stagnation in private investment, which limits the impact of the impressive high-technology growth rate in the public sector. France, during the past decade, has done better than the United States; but with the right conditions, American enterprise can do even better than that.

The monetary proposals contained in the Federal Reserve Reform Act, combined with the right tax and energy programs, will reconcile the simultaneous requirement for overall direction of investment into productive activity with the maximum freedom of action for the individual enterprise.

The core of the problem is to be found in the way that the Federal Reserve System

creates money. Simply, the FRS buys debt-paper from the market in return for newly-created fiat-money. It may do this now by purchasing (“discounting”) securities other than government debt-paper from member banks, but in practice it uses the “discount window” only exceptionally. The FRS for the most part buys government securities from the two dozen or so big security dealers who make a primary market in U.S. government debt. These big security dealers then deposit the proceeds of the sale—the new fiat-money of the Federal Reserve—into accounts at one of the top twenty commercial banks. The banks have additional deposits, created out of thin air. They then create more money out of thin air: they loan their deposits to a customer; the customer’s loan is redeposited and becomes a new deposit; and so forth. Reserve requirements limit the “money multiplier,” in practice, to about 2.5 times the original creation of money by the FRS.

In effect, the FRS shares its monopoly powers over money creation with a handful of big money-center institutions. If these institutions made most of their loans to the goods-producing sectors of the American economy, there would be no problem. They do the precise opposite. Half the profits of the top ten commercial banks accrue from the highly speculative Eurodollar market, which has grown seven times faster than world trade over the past decade. The large money-center banks are as likely to lend out the newly-created money they receive from the Federal Reserve into the Eurodollar sinkhole as they are to lend to the American economy.

That explains why the majority of the nation’s 14,700 commercial banks have suffered a deposit shortage during the past two years, even while money supply rose sharply. What the Federal Reserve pumps in does not reach the capillary system of the economy, because the aorta has a leak.

The Federal Reserve’s practice of increasing money supply through open-market operations amounts to collusion with private interests to abuse the public credit of the United States. This makes a joke out of the discussion of the Fed’s “independence.” As we have seen over the past year, the end result of this policy is to force gigantic deficits onto the Federal government, and to ultimately force the FRS to monetize (print money in exchange for) government debt—the consequence that the FRS’s “independence” was to have avoided. The voting public has expressed its opinion of this nonsense, and Congress should find a better way to do business.

The FRS has no business printing money to finance government deficits. For the most part, government is an overhead cost, to be met out of either the taxes or savings of the national economy. The Federal government should spend only what it can tax or fairly borrow from the savings pool, through the capital markets. As Jacques Rueff, Europe’s most respected monetary economist and author of the 1958 French economic miracle, wrote, this is the definition of a “balanced budget.” Taxation or bond issues have the identical impact on the productive economy: they add to overhead costs. The FRS must be able to stabilize the market for government securities in the short-term, and help the Treasury meet seasonal borrowing requirements, but should not monetize debt; that is pure inflation. Therefore we propose a statutory limit on the size of the FRS holdings of government securities at the *end* of each year, while permitting fluctuations in between.

However, the FRS may create new money indefinitely as long as the new money serves to create new wealth. The simple and obvious way to do this is to provide such money directly to individual banks engaged in lending for the creation of tangible wealth. The NDPC therefore proposes a statutory requirement for the FRS to provide such funds through the discount window, but only up to 50 percent of the value of a loan. That limitation is designed to make the private banker stand behind his judgement. He or she will not be able to pass off dubious paper on the FRS, but will only be able to bring the FRS in as a partner. The initiative lies with the private banker and his customer, and the responsibility and exposure remain with him.

To prevent the private banker from using newly-created fiat-currency obtained from the FRS for nonproductive purposes, we add a simple disincentive: if the nonproductive component of the bank’s total assets rises above a certain proportion, its reserve requirements will

simultaneously rise, limiting its ability to create additional new money through the banking “multiplier.”

As Jacques Rueff argued—and proved during his post-1958 stewardship of the French economy—the central bank may create money without limit in discount of “real bills,” i.e. loan paper backed by hard commodities. Some Republican congressional leaders have circulated proposals to change the FRS’s deficit practices by shifting from open market to discount window operations, including an essay by Lewis Lehrman placed into the *Congressional Record* by Jack Kemp (R-N.Y.). The Lehrman plan has merit in that it identifies the hopeless situation of the FRS attempt to manage the quantity of monetary aggregates, and argues that the FRS may create money indefinitely without fear of inflation. However the formula it offers contains an inflationary danger. Lehrman proposes that the FRS should discount all paper presented by member banks at a discount rate in excess of the market rate of interest. This will encourage banks to use the discount facility only when existing cash balances are inadequate, Lehrman argues. However, if the discount facility is employed only to expand sectors of the economy that must be classified as overhead, rather than the tangible goods-producing sector, inflation will still ensue. The proposal is still victim of the GNP double-counting fallacy described earlier. However, it has served a useful purpose by stimulating the right sort of discussion and pointing in the general direction of a solution.

The final feature of the NDPC monetary stabilization plan requires initiative by the administration: that the Treasury dry out the most speculative sector of the dollar credit markets, the Eurodollar market, through the issuance of gold-denomination securities in very large volumes. Such securities, with a gold guarantee of principal and interest, are inflation proof, and may therefore be issued at an interest rate of about the present real rate of interest, i.e. 2 to 4 percent. The proceeds of such securities issues should be employed:

- 1) as an emergency financing measure for the Treasury in the brief transition period following the elimination of FRS monetization of U.S. government debt;
- 2) to massively fund the Export-Import Bank of the United States;
- 3) to reorganize where necessary the foreign debt of America’s trading partners in the developing sector where such reorganization is indispensable for expansion of American exports.

Such action would require the support of America’s allies in the European Monetary System, a gold-reserve currency zone, and ultimately make possible the return of the dollar to gold convertibility and a link between the dollar and the European Monetary System. This action would be intensively counter-speculative and require precise timing; for this reason the NDPC proposes it only in general form, in order not to tip the hand of the new administration. It is sufficient to say that this combination of measures on the domestic and international sides would rapidly bring down both interest rates and inflation, and, combined with appropriate tax and energy policies, put the United States on course for an industrial boom during the 1980s.

**NATIONAL DEMOCRATIC POLICY COMMITTEE
PROPOSAL:**

A Taxation System for Capital Formation

The present American tax system does more than discourage capital formation in industry and other goods-producing sectors of the economy. It actively forces investment out of long-term, productivity-increasing outlays into real estate and similar investments that make no long-term contribution to the tax base. For this reason the aggregate value of real estate holdings in the American economy, at over \$3.5 trillion, is more than five times larger than the value of all plant and equipment in American manufacturing industry. The value of New York City real estate alone is larger than the producing assets of manufacturing corporations.

In line with the credit policy embodied in the proposed Federal Reserve Reform Act, the National Democratic Policy Committee argues that the incentive system of the tax structure must be reversed, to promote the maximum rate of industrial and related capital formation and productivity growth, to remove the crushing tax burden on household income, and to constrict the flight of investment capital into real estate and similar nonproductive tax shelters.

We contrast this program with the across-the-board tax cuts advocated, with varying magnitudes, by members of the President-elect's advisory group on tax policy. The problem in the present tax structure is not merely that it discourages capital formation, but that it enforces capital formation of the wrong kind, i.e., anticipation of capital gains in a fixed resource, land.

Therefore, a simple extension of the present type of capital formation is not only inadequate. It would be inflationary. The tax base will expand to generate additional revenues only if the tax cuts attack the root of economic decay: the decline of productivity in manufacturing, transportation, construction, agriculture, mining, and utilities.

We must provide incentives for corporations and households to invest in higher productivity in the goods-producing branches of the economy, and remove the incentives for investment in inflation-producing branches of the economy.

The following tax-reduction and loophole-closing measures will enable the new administration:

- 1) to substantially reduce the size of the federal budget deficit from \$60 billion to \$25 billion, largely due to a \$50 billion rise in revenues through economic growth;
- 2) in combination with the Federal Reserve Reform Act, which would provide new money supply for account of tangible-goods production expansion only, to reduce the unemployment rate by 2.5 percent, increase industrial production by 8 percent (restore it to 1979 levels), and increase capital investment in manufacturing by 14 percent in real terms during 1981;

- 3) to reduce the rate of inflation to approximately 8 percent during 1981;
- 4) to restore the average growth rate of manufacturing productivity to 1960s growth levels, after six quarters of straight productivity decline to date.

After ten years of inflation at twice the level of our major Western European and Japanese allies and industrial productivity growth at half their level, confidence in long-term industrial investment is at a postwar low. This confidence cannot be restored except through an aggressive plan to restore incentives on the credit, tax, and regulatory fronts. By itself, a cut in taxes will not necessarily lead to a rise in capital formation in the goods-producing branches of the economy, on which an increase in the economy's tax base ultimately depends. Any increased flow of investment into secondary markets in real estate or financial assets will add only to inflation, not to real output. Further growth in the services sector of the economy—which requires less capital investment per worker and hence presents fewer problems in an inflationary environment—cannot be supported without the restoration of productivity in sectors that produce tangible goods.

However, the right combination of tax measures—in combination with the credit policy we have outlined elsewhere and removal of environmentalist and related barriers—will indeed create additional tax revenues through economic expansion based on rising industrial productivity. The following measures are necessary:

1. Increase the personal income-tax exemption to remove all tax liability for families at or below \$20,000 per year gross pre-tax income.

Current personal tax levels prohibit family formation. Present tax data demonstrate that it is not possible to raise children on a present pre-tax income of \$20,000 or less. Of 68.3 million returns filed in 1977 on income of \$20,000 or less, representing 79 percent of all returns filed, 82 percent showed fewer than three exemptions, and 71 percent showed fewer than three exemptions. The overwhelming majority of the American population can no longer afford to have children, and the tax data are an indictment of our capacity to survive as a nation.

Without reversing this trend, the United States cannot hope to maintain a productive labor force.

The NDPC proposes, as a short-term measure, exemption of all income of families of four earning \$20,000 per annum or less—a tax reduction in absolute terms of \$19.3 billion. We further propose a 50 percent reduction of personal tax liability of families of three earning \$20,000 per year or less, a reduction in absolute terms of \$7 billion.

2. Maintain present progressive income tax schedules but with substantial exemptions for productive investment of household income.

Household savings are now only 3.5 percent of disposable income, the lowest savings rate among all the major industrial countries. Savings is the basis for capital formation. The NDPC proposes to encourage households to increase savings, by altering the tax structure to allow higher after-tax income by making the following categories of investment exempt from federal income tax:

- a) Savings accounts at thrift institutions, including savings banks, savings and loan associations, and credit unions. If this exemption raised the volume of savings from \$85 billion to \$120 billion, this measure would return about \$8 billion to individuals, mostly in the higher tax brackets.

- b) Direct investment in capital improvements in manufacturing, transportation, and

agriculture, a measure directed toward supporting family-owned enterprises and other small businesses in goods-producing industry, but excluding secondary-market purchases of shares in such enterprises. The cost of this measure should be offset by taxation at normal progressive tax rates of capital gains arising from secondary-market purchases of financial instruments, equities, land, or other tangible assets, while lowering the capital-gains schedule on capital gains arising from all forms of direct investment in business enterprises and home improvements.

3. A 20 percent investment tax credit on the margin of new investment above 1980 levels coupled with accelerated depreciation of industrial, agriculture, mining, and utilities structures and equipment.

The U.S. economy's potential rate of increase in capital formation during the next year is at least 14 percent, in terms of real capital-goods availability estimated via the most conservative capacity-utilization date for capital-goods-producing industries. Tax policy should aim at encouraging goods-producing branches of the economy to invest at a maximum rate, repeating the 1980 experience with oil-drilling in other branches of the economy. The NDPC estimates that the capital goods sector of the American economy can generate an additional \$54 billion during 1981 (14 percent real growth through full capacity utilization and estimated 8 percent inflation). We estimate that \$17 billion in combined tax credits and accelerated depreciation would generate additional equipments expenditures of \$54 billion and substantial additional new plant expenditures.

According to NDPC estimates, that is the minimum investment level required to halt the obsolescence of American industry, whose average age of plant and equipment has increased in every one of the past fifteen years. That is the basis for a revival of industrial productivity. The combination of full capacity utilization and technological improvement should advance industrial productivity in output-per-manhour terms by more than 3 percent during 1981.

4. Generate additional revenues by increasing tax schedules on income and capital gains on nonproductive investment, principally commercial real estate.

While exempting residential and industrial property from additional taxes, the federal tax system should eliminate the incentive to shelter taxable income in the form of real estate secondary-market and commercial development investments. The incentive orientation of the tax structure should favor capital formation in the productive sectors of the economy, as noted earlier.

The spectacular rise of real estate values since 1974 represents a special problem. While much of the increase represented a factor in rising inflation, a large portion of individual savings and the financial structure of the United States is closely tied to this rise in values. Although sound economic policy dictates that further speculative advance in secondary-market prices must be discouraged, it is also imperative to accomplish this in a fashion that will not fundamentally destabilize the market.

Non-home and non-farm real estate income pays only 5 percent in taxes on income net of interest, cost of sales, and depreciation, the lowest tax rate on any category of investment income. The average tax rate on real estate must be raised, through closing loopholes to the average corporate tax rate, or about 30 percent on income after expenses.

The real estate industry is so protected that neither the Internal Revenue Service nor the Senate Finance Committee have available complete data on revenue lost through such loopholes. However, the 1981 budget estimates that \$7 billion were lost in Fiscal 1981 alone through tax advantages given to the real estate industry, principally accelerated depreciation, through the Tax Reform Act of 1976.

The following loopholes must be closed:

- 1) accelerated depreciation on commercial structures;
- 2) taxation of capital gains on commercial and secondary-market residential real estate transactions at the 28 percent capital gains rate rather than at full progressive income tax schedules;
- 3) expensing rather than amortization of interest costs for tax purposes;
- 4) tax exemptions for rehabilitation of inner-city properties, low-income housing construction, and other speculative investments.

The experience since the passage of the 1976 tax legislation has shown that tax breaks for inner-city real estate investments have not generated additional housing, but merely increased land values and provided upper-bracket investors with another tax shelter. We propose to eliminate such shelters whose economic effect is, on balance, negative, and offer instead shelters in productive investments.

At the same time, all present tax exemptions on primary-market residential property (including both owner-occupied housing and improvements on multi-family dwellings) and on farmland must be retained.

The total revenue generated through tax increases on what classical economics calls "ground rent" would be approximately \$30 billion, or about quadruple the amount lost through the ill-advised 1976 tax incentives to real estate investment. This estimate is based on applying the standard 30 percent corporate tax rate to estimated revenues net of legitimate operating costs to present rent and land income, plus the application of progressive rather than capital-gains tax schedules to the categories of income noted above.

* * *

Projected into the Federal budget for Fiscal 1981, these tax changes produce:

- an estimated tax reduction of \$51 billion, or 10 percent, in line with the President-elect's announced target, on the cited categories of household and corporate income;
- \$111 billion in increased revenues due to, in order of importance, high rates of economic growth, increased taxes on nonproductive real estate income, and 8 percent inflation.

After the effect of estimated 8 percent inflation is taken into account, the federal budget deficit will fall to an estimated \$24.6 billion, as shown in the accompanying table. The increase in basic economic productivity through high industrial and related capital formation will give the United States excellent prospects for achieving a balanced budget by 1983.

1981 Fiscal Year Federal Budget—NDPC Proposed Changes

(Oct. 1, 1980-Sept. 30, 1981)

Increased Revenues

Item	Increased Revenue (\$ billions)
Increased Income Tax	
Of which amount due to “normal” increase in labor force, increase in inflation (8%) and increase of tax bracket creep	\$ 54.48
Increased Corporate Tax	
Of which amount due to 8 percent increase in industrial production	\$ 5.76
Increased Miscellaneous Taxes	
Of which amount due to inflation increase in excise taxes, estate and gift taxes, customs duties and miscellaneous receipts	\$ 12.95
Increased Income Tax	
Of which amount due to reducing unemployment rate from 7.6% to 5%	\$ 5.25
Increased Expenditures Savings	
Of which amount due to either reduction or freeze in budget line expenditures (such as Environmental Protection Agency, social service fundings of National Science Foundation, etc)	\$ 3.00
Increased Real Estate Taxes	
Of which amount due to closing of loopholes on commercial and secondary market residential real estate incomes	\$ 30.00
Increased Social Security Taxes	
Of which amount already legislated to take effect Jan. 1	<u>\$ 20.00</u>
	\$131.44

1981 Fiscal Year Federal Budget—NDPC Proposed Changes

(Oct. 1, 1980-Sept. 30, 1981)

Increased Expenditures

Item	Increased Expenditures (\$ billions)
Increased Net Outlays	
Of which amount due to 8% inflation rate. NB: this represents increase of all budget line outlays	\$46.00
Increased Corporate Tax Cut	\$17.00
Increased Individual Income Tax Cut	
Of which amount due to elimination of personal income tax for families of four or more with annual income of \$20,000 or less	\$19.30
Increased Savings Tax Cut	
Of which amount due to elimination of taxes on personal savings	\$ 8.00
Increased Individual Income Tax Cut	
Of which amount due to reduction of taxes by 50% on families of three with annual income of \$20,000 or less	<u>\$ 6.75</u>
	\$97.05

1981 Fiscal Year Federal Budget—NDPC Proposed Changes

(Oct. 1, 1980-Sept. 30, 1981)

Budget Surplus (+) or Deficit (-)

	(\$ billions)
Net Receipts	\$651.44
Net Outlays	<u>\$676.05</u>
	\$-24.61