

Public confidence is key to tax cut success, says U-M prof

President Reagan's proposed 1981 income tax cut may pay for itself, but only if people regain some of the confidence they have lost in the government and the economy, says a University of Michigan economist.

Dr. George Katona offers in the February-March issue of Public Opinion magazine a comparison of the proposed 1981 tax cut with the Kennedy-Johnson tax cut made in 1964.

He concludes that the task confronting the Reagan administration "is much more difficult" than that which the Johnson administration faced in 1964.

"It is not impossible that over several years, a tax cut in 1981 would 'pay for itself,'" Katona said. In order for this to happen, confidence in the success of the government's economic policies and optimism regarding the progress of the economy must be established.

"THIS WILL be a difficult task because early in 1981, a substantial proportion of Americans are discouraged, uncertain and skeptical."

Comparison of people's attitudes in the two different periods is made possible by data obtained by the U-M Institute for Social Research in the Surveys of Consumer Attitudes over the past 35 years. Katona originated the surveys in 1946.

Even before Congress passed the tax cut of 1964, "Optimistic consumers expecting a tax cut stepped up their discretionary purchases of houses, automobiles and other durable goods."

"For these purposes, they borrowed money at an increasing rate. After the tax cut went into effect, the rate of saving increased."

The 1964 study resulted in this summary:
 • American consumers experienced sizable real increases in before-tax as well as disposable income after the enactment of the tax cut in 1964.

• An unusually large proportion of consumers viewed their income gains as enduring rather than transitory.

• Families feeling better off and expecting to maintain or even improve their favorable situation stepped up their purchases of durable goods and their rate of borrowing, as well as their rate of adding to liquid reserves.

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— Dr. George Katona

"WE COULD not determine whether the gains in incomes before taxes were due to the tax cut," the U-M economist said.

"Yet the sequence of developments make it probable that the tax cut contributed to improved business conditions, higher incomes and larger expenditures."

"The analysis of the economic developments in 1964 justifies the conclusion that the tax cut of that year paid for itself" in improved economic conditions, higher personal incomes and business profits, and resulting higher tax revenues compensating for effects of the lower tax rates.

"Probably the single most influential factor in that 1964 result, Katona said, was the spread of consumer optimism and confidence, which was itself significantly affected by the 1964 tax cut.

Can we expect the experience of 1964 to be repeated in 1981?

"Both economic conditions and the socio-psychological climate have changed drastically in the last 10 years."

"THE 1970S represented an era of inflation and unemployment on the one hand and a lack of confidence, spreading doubts in enduring growth, uncertainty and volatility on the other."

"The dismal climate contributes to inflation and unemployment because the widespread belief in enduring inflation and volatile business trends is enhanced by lack of confidence in the government, thought to be incapable of fighting the economic malaise."

"While in 1964 a gradual and steady increase in consumer expenditures was thought to be most beneficial, an upsurge in demand in 1981, if it should occur, could be viewed as adding fuel to inflation."

"This threat may be mitigated by the experience of the last several years about a spread of the affective component of people's economic attitudes from one area to another.

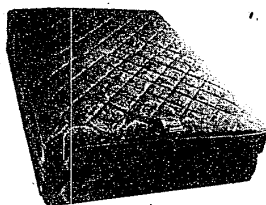
"The onset of a new recession, and even the anticipation of a recession, may today arouse inflationary fears because one evil is associated with other evils in the minds of many people. Of course, so may an expected economic upswing be linked to the expectation of reduced inflation."

If the 1981 tax cut is to "pay for itself," people must regain their confidence in the success of the government's economic policies and in the progress of the economy, he said.

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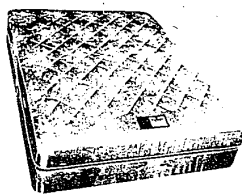


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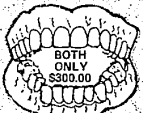
Former CIA Director William E. Colby will visit Oakland University April 1 to lecture on world events.

Colby's 2 p.m. address in the Oakland Center is \$1.50, with \$1 admission available to groups of 20 or more. Call OU at 377-2000 for ticket information.

Colby, who served in the Office of Strategic Services in World War II, later served with the CIA in Stockholm, Rome and Saigon. He was chief of the Far East Division and CIA executive director, controller prior to serving as director from 1973-76.

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