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Betty

OUTLINE OF REMARKS
AMERICAN GAS ASSOCIATION

April 27 - 12:00 noon - Hyatt Regency Hotel - Wash D.C.

I. The Economic Recovery Program

A. Sticking to the Fundamentals

1. Concerns about threatened deficits are very real and are justified. But they are not a consequence of the Reagan program, which is fundamentally sound--we must follow through on its principles of spending reduction, lower taxes to restore economic incentive, a firm but fair monetary policy, and a strong defense.

2. We can act to cut the deficit without undermining the recovery program or putting additional 'drag' on the economy during the recession. We are aiming at sustaining recovery after the recession: that is what the debate is all about. No one seriously advocates tax increases or other fiscal tightening during the recession.

3. There are positive signs in the economy. Inflation in 1981 dropped to 8.9%, the lowest since 1977. In February and March producer prices dropped for the first time in 6 years, and the CPI rose at only an annualized 3.6% rate in the first quarter, the lowest rate since 1972.

4. Furthermore, while interest rates remain much too high, they have come down. 16 1/2% is better than 21%. Most projections now show a continuing, but erratic, downward trend in rates during 1982. That trend must be sustained by cooperation between the President and Congress to demonstrate a consistent, steady course--the will to keep spending under control--and by keeping in place the tax changes that encourage savings, work, and investment.

B. The Recession

1. The recession is the reason why we need to make adjustments: it has driven down revenues and driven up spending, while lower inflation has the immediate effect of cutting revenues but a lagging effect on moderating spending.

2. There are two aspects to the downturn: first, the Carter administration tried to prime the pump in 1980 after experimenting with monetary restraint--the


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subsequent clampdown proved that the 'recovery' from that recession was a false one. Only now are the full effects of the (resumed) 1980 recession being felt.

This time around we must have a real, sustained recovery.

3. Compounding our difficulties are long-term problems in autos and housing, partly induced by the rampant inflation of recent years and partly due to inconsistent policies on energy, taxes and productivity. The Reagan administration is working full time to deal with these underlying problems, and progress is being made. We are seeing hard bargaining between labor and management in the auto industry that bode well for a more rational industrial policy.

4. Major shifts in policy are bound to bring instability and uncertainty as we make the transition--particularly when we are moving out of a period of double-digit inflation. But we must make the transition, for the only alternative is inflation and stagnation. We must improve our chances for stable growth by acting swiftly to control projected deficits.

II. Time is Short

A. Congress.

1. Congress cannot evade the fact that it is the source of the main problem--the uncontrolled growth of Federal spending in recent years. That spending momentum, aggravated by inflation and recession, is the cause of the expected deficits.

2. The deficit problem must be dealt with right away, and there are not that many opportunities to do it. At the outside we must enact a deficit-reduction package by the time we are obliged once again to raise the debt ceiling. That means we must act by summer, before the political season brings us to a stalemate.

3. Some progress has been made, and hopefully the President and the Speaker can be brought on board promptly. We have to accelerate the movement toward bipartisan agreement. That means our package must tackle all aspects of the budget problem: appropriations, entitlements, defense, and revenues.



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A deficit reduction package must be balanced, and it must be fair.

4. Congress does have an obligation to suggest concrete alteratives if it does not want the President's budget. But it cannot do the job alone.

B. The President.

1. The President has sent us a 1983 budget that, while it advances his goals in a realistic manner, was less realistic about the prospects in Congress, and it is open to the charge that it does not share the burden of deficit reduction in an equitable way.

2. Even those who disagree with the President must admit that we need to reduce the deficit by at least as much as the President recommends: over $40 bilion in spending cuts and management changes in FY 1983, and over $30 billion additional revenue over two years.

3. The President is a realistic man--he must realize that he will have to deal with Congress if we are to get action on the deficit. He is right to stress firmness on the fundamentals of his program. But there are many ways to increase revenues, deal with entitlements and appropriations, and moderate defense spending without sacrificing those fundamentals. There is a margin for compromise available, but it must be taken advantage of before it disappears.

4. The President must deal now--he has to give us room to run. We cannot have ultimatums on either side--we need flexibility. Not because we disagree with the President's aims--but because we have to be realistic about how much we can achieve this year, consistent with the essential goal of getting the deficit down.

III. Policy Options

A. Basic Principles.

1. There are many ways we can attack the deficit problem, but there is no way to do it unless we have some parameters--some guidelines. The sooner we narrow the range of options, the better.

2. One thing we must not do is allow the need for some revenue increases to be an excuse to uncork the spending bottle. Too often Congress has shown deficits are not cut by tax increases, because



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Congress always spends more. That cannot be allowed to happen.

3. Along the same lines, the individual tax cut ought to be out of bounds: it is mainly an offset for bracket creep in any event, and we do not need further resort to the inflation tax as a budget device.

4. Defense spending must increase, but perhaps it can increase at a slower pace, by balancing our most urgent defense need against long-term priorities.

5. Spending must be brought down--there is no other way to get a handle on the deficit. That means entitlements and so-called uncontrollables have to play a role.

B. Revenues.

1. There are several ways to proceed: the President proposed management changes, user fees, and some loophole closings. All of those will play a role, and they should in the interest of ensuring everyone pays a fair share of taxes.

2. Likely candidates for action include corporate and individual minimum taxes, reductions in the safe-harbor leasing provision of the 1981 tax act, and efforts to narrow the compliance gap in the income tax--as in the Dole-Grassley bill, S. 2198.

3. Another option, consistent with the goals of individual rate reductions enacted last year, would be to accelerate tax indexing to July 1, 1983, in place of the 1983 rate cut. Lower inflation means less rate reduction than we anticipated is needed to offset bracket creep. If the inflation trend continues, this option could bring marginal rates to about where they were expected to be when we passed the tax bill, yet raise about $17 billion over two years.

4. Some have suggested new taxes on energy. Proposals include taxes or fees on imported oil, or all oil. Other ideas include a tax on all energy sources or on gasoline. At this time, no consensus exists on any energy tax proposal.

5. Since the President decided not to seek accelerated decontrol of natural gas this year, there obviously isn't any talk of an excise tax on deregulated natural gas. The whole gas deregulation issue,


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including the tax ramifications, will probably not be considered until well into next year.

C. Entitlements.

1. Reform of basic entitlement programs is needed to bring the budget in line. Administration proposals for 1983 would save about $52 billion over 3 years. We should try to meet or exceed that figure.

2. Partly due to cost-of-living adjustments, entitlements (other than social security) rose 412% between 1970 and 1981. We cannot sustain that kind of growth.

3. As an example, Medicare is expected to cost $50 billion in 1982, and Medicaid $32.5 billion. Hospital cost rose 18.6% between October 1980 and October 1981. We cannot afford this rate of increase, and must consider reforming reimbursements, more private sector options, and greater competition in the health care industry.

4. COLA's must be reconsidered, even in the social security area. In the 1970's social security cash benefits grew at a pace of 14.2% each year. That is cause for concern. Real savings can be made consistent with keeping social security recipients on a par with wage earners in our society. For example, moving to a 2/3 CPI adjustment could save as much as $5.4 billion in 1983, $50 billion by 1986.

IV. Some Perspective on Our Situation

A. A Growing Economy

1. By 1986 the administration expects the economy to grow from $2.8 trillion to $4.6 trillion. Such growth means a better ability to finance our defense needs and critical social programs, without taxing the life out of the economy.

2. If we have slower growth, then we have to reexamine our options. CBO and the administration are in basic agreement on economic trends: this is the time to strike a prudent, but optimistic, balance. But clearly $100 billion deficits are unacceptable, economically or politically.


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B. 1981 Tax Act and the Deficit

1. The 1981 Tax Act, though the largest tax cut in history, just stabilizes the tax burden. Revenues still will rise from about $600 billion in 1981 to about $800 billion in 1985. Receipts by 1987 should be 18.7% of GNP--the same as the average between 1963 and 1973. Without action, receipts would have been a crushing 24% of GNP in 1987.

2. The question is how high a deficit can be tolerated without "crowding out" or threatening a resurgence of inflation. Increased savings due to tax changes and the drop in inflation should ease pressure in financial markets. We must do more to ease that pressure without undermining the economic program.

3. Many provisions of the tax act aid capital formation and innovation: R & D tax credits, capital gains reduction to 20%, IRA and other savings incentives. These coupled with rate cuts and accelerated depreciation, form the framework for regeneration of business activity.

V. Future Agenda for Tax and Fiscal Policy

A. Revenues

1. Thrust of future tax legislation will be to eliminate abuses and obsolete incentives and improve tax administration and collection. The 1981 Tax Act shows this trend, as in closing the commodity straddle loophole.

2. The administration proposes raising over $30 billion over 2 years by tightening in these areas, and by new enforcement devices. Depending on the size of spending cuts we can agree to, Congress may want to increase this figure.

   - Completed contract method for multiyear defense contracts. ($6.3 billion over 2 years.)

   - Cut back business credits that duplicate conservation efforts of decontrol ($.4 billion over two years). (Congress is not sympathetic to this).

   - Industrial development bonds (restrict, require matching efforts from State or locality, etc.) ($0.1 billion over two years).


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- Eliminate insurance industry loophole (modified coinsurance). ($4.1 billion over two years).

- Capitalization of construction period interest and taxes. ($1.5 billion over two years).

3. Underground Economy

a. The Compliance Gap

The IRS estimates that $100 billion is lost annually though noncompliance with the federal income tax laws and that amount will rise to $133 billion by 1985.

b. The Proposal

S. 2198, the Dole-Grassley bill, would improve the current system of information reporting. A companion bill has been introduced in the House by Representative Barber Conable. 9 to 16% of interest and dividends paid go unreported. We can improve the reporting system by including federal debt and bearer obligations and impose real penalties on those who refuse to comply.

c. The Administration

The administration has proposed 5% withholding--an option that we cannot rule out, but that has been unpopular. All aspects of noncompliance, including, for example, underreporting of tips and capital gains, may be addressed by better information reporting. The administration supported S. 2198 at hearings held on March 22.

d. Coverage

In addition, new penalties would hit the sophisticated tax avoider and the fraudulent corporate tax manager. The interest rules would be revised to reduce current incentives to defer paying taxes.

Also, a new Dole independent contractor bill, S. 2369, would improve tax compliance among the self-employed.

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e. Revenue Effect

The legislation is expected to generate about $3 billion in 1983, $8.1 billion in 1984, and $9.3 billion in 1985.

4. Minimum Tax

a. Current Law

Current law includes three very complex minimum taxes, two on individuals and one on corporations. These taxes raise only $1.5 billion and still permit significant numbers of taxpayers to pay no tax.

b. Administration Proposal

The Administration would address this problem by creating a new alternative minimum tax on corporations. This would raise about $2.3 billion in the first year, rising to the $4 billion range.

c. The Dole Proposal

The proposal being considered would completely revise and simplify the minimum taxes. In lieu of the overlapping alternative and add-on taxes on preference items, the minimum taxes on corporations and individuals would be a flat rate of, perhaps 15% on a comprehensive, economic income base.

d. The Tax Base: Individuals

Included in the tax base for individuals might be adjusted gross income and items like excess accelerated deductions, contributions to IRA's and Keoghs, the stock option preference, intangible drilling costs, certain excluded items and other items.

e. Corporations

Corporations' tax base will begin with taxable income and add-back similar preference items of accelerated depreciation, certain deferred income, and excluded items.

f. The minimum tax is fully consistent with the 1981 tax cut. That tax cut provided incentives by


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reducing marginal tax rates. The marginal tax rate of a minimum tax will only be 15%: all taxpayers with substantial real income ought to pay some income tax.

g. Revenue Effect

The proposal is tentatively expected to produce approximately $2 billion annually from the individual tax and $6 billion annually from the corporate tax.

5. Leasing

a. Some revenues may be generated by cutting back on the safe-harbor leasing provisions of the 1981 Tax Act. Those provisions are now expected to cost about $30 billion over six years, and the figure may go higher when Treasury analyzes its reports on leasing transactions.

b. Possible options, aside from outright repeal, include offsets in other tax preferences, application of strengthened minimum tax, or direct limits on tax sheltering.

C. Social Security

1. We have restored the minimum benefit and authorized temporary interfund borrowing. Now the President's Task Force, chaired by Alan Greenspan, is preparing to address the long-term problems of social security. Some action may be necessary before the Task Force completes its work.

2. Only if the economy performs considerably better than in the past 5 years could social security remain solvent beyond 1984 or 1985. Even then:

- Under the most recent projections by the Social Security Board of Trustees, the combined reserves of the system fall dangerously low (below 14 percent of outlays) in 1985. The system would be unable to pay benefits beyond 1987 (when reserves fall below 9 percent of outlays).

- Under more pessimistic economic assumptions--more like recent experience--social security would be broke by late 1983.

3. The trust funds already are seriously depleted--reserves equal 23 percent of outlays or barely 2 to 3


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months' worth of benefit payments. The history of the trust funds indicates that reserves equal to <u>100 percent or more</u> were the norm prior to 1970.

4. Further tax increases, beyond those legislated in 1977, are not the solution. The long-term cost of social security must be brought into line with taxpayers' willingness and ability to pay for it.

V. <u>Enterprise Zones</u>

1. The President also wants to establish enterprise zones to benefit from targeted tax incentives and, hopefully, Federal, State, and local regulatory relief. The notion of unleashing free enterprise makes sense: but there are difficulties.

2. There is a risk that zones may put businesses outside the zone at a competitive disadvantage. We do not want to drain business activity from the periphery of zones.

3. Shifting economic resources around would not be enough. We ought to have some assurance that <u>new</u> activity is likely to be generated.

4. The selection of zones--if limited to 25 per year for three years, as proposed--will be a touchy matter. If it is to have any meaning, this should be an experiment in free enterprise, not a new pork barrel.

5. The President's proposal includes a new 10% investment tax credit for construction or rehabilitation of commercial, industrial, or rental housing structures within a zone. This could help meet housing and commercial needs in depressed areas.

6. Primary emphasis must remain on the general economic growth we need to create jobs across the land.

VI. <u>Summary--Where We Are Now</u>

A. <u>A Watershed Year</u>. The recession makes this a tough year <u>for Congress and</u> the President. There are <u>no</u> easy or palatable options available. That means we have to establish our priorities swiftly but with care: not an easy task. But if we show that we can work together to deal <u>now</u> with problems that have been building over many years, we will have a <u>major</u> breakthrough in favor of economic recovery.



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B. Shared Effort. The economic problem can only be addressed by a joint effort all around--Congress and the President, Democrats and Republicans. Those who would seek partisan advantage from our economic dilemma are mistaken. If we hang, we all hang together, regardless of party. The people will not care who prevented action, if nothing is done. What we need are results.

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