OUTLINE OF REMARKS

CONFERENCE OF MAYORS

January 27, 1983 - L'Enfant Plaza

I. The President and the New Congress

A. In his State of the Union message, President Reagan made clear that he and the 98th Congress must work together to deal with an active agenda. That means action on the deficit, on unemployment, on social security, and attention to the shifting patterns of industry and job creation in our economy. At the same time we have to realize there will be major areas where we will not agree. No one is going to compromise away the gains won towards restraining the growth of spending, controlling the tax burden, and beating back inflation. The American people still overwhelmingly support those goals.

B. The President, the House leadership, and the Senate leadership will have to work together to forge a consensus on major decisions if we are to get the job done. On some issues we simply cannot afford to have a legislative stalemate: social security is one of these, and the President and the Speaker have shown a statesmanlike regard for the public interest in supporting the bipartisan social security package.

C. The President still sets the agenda. On taxes, spending, deficits, employment, and trade the President proposes, and Congress must dispose. Those of us who have ideas of our own will work with the White House to get things done--but leadership still must come from the President. That is why we are unlikely to see any major departure from the principles of government Ronald Reagan has espoused in his first two years in office.

D. There is no coherent alternative to Republican leadership. The people still recognize that our economic problems were a long time in the making, and that the cure will take time too. According to CBS/New York Times voter exit polls in the last election, voters by a 5 to 4 margin blamed our economic problems on past Democratic policies rather than on President Reagan.

II. The Economy

A. Prognosis. We have to realistically assess the state of the economy and the prospects for the next few years. The fact is that the groundwork has been laid for a stable and lasting recovery, without renewed inflation. It is absolutely crucial that we proceed with care at this point, and not throw away the gains already made.

1. Inflation was cut to 3.9 percent in 1982, from 12.4 percent in 1980. This is the lowest inflation rate since 1972.

2. Interest rates are down and still falling. The prime rate is down to 11 percent, way down from the 21 percent that prevailed when President Reagan took office. Home mortgage rates are down 3 points since last year. Long-term rates for business loans are off 3 to 4 points from a year ago.

3. Government spending growth rate is down to 11.2 percent this year from 17.4 percent in 1980. The 1983 budget resolution projects the growth rate of government to fall to 7.5 percent by 1985.

4. Lower taxes with major improvements in tax equity will help buoy the recovery, both on the consumer side and on the investment side. The combined effect of the 1981 and 1982 tax bills has been to lower individual taxes over 3 years by $344 billion, as well as improve compliance and tax fairness. Lower individual rates boost personal income and restore incentive, while favorable capital cost recovery rules should spur investment. Already a significant result of the tax changes has been to boost the savings rate to about 7 percent: additional savings we need to build the capital pool to finance recovery.

B. The Unemployment Problem. Unemployment, of course, is the major negative in the economic picture, and it may continue to rise in the near term. High unemployment costs the Government in lost revenue and lost production, and it has to come down. But it has to come down and stay down without inflationary stimulus--that is what we have failed to do in the past.

o Clearly there is a bipartisan consensus for more jobs. But resuming the inflationary policies of the past will not create lasting jobs, just an illusion of prosperity that leaves us worse off the next time we try to get "off the wagon."

o That means the most important thing we must do is judge carefully the degree of stimulus the economy can and should take, consistent with a firm anti-inflation policy. The Federal Reserve will play a key role, and has already shown a willingness to adjust its short-term goals based on an assessment of the weakness of the economy. We will not allow the recession to continue, but we will not reinflate the economy, either.

o While the main emphasis must remain on the long-term goals of growth with low inflation, there are steps we can take in the short term to deal with the plight of the unemployed. Many things have already been done:

- a new Federal supplemental unemployment compensation program was passed with the 1982 tax bill, providing additional unemployment benefits to about 2 million workers in 38 States. The President will propose extending this by 6 months beyond March 31, 1983.

- The President signed into law the new Job Training Partnership Act, which emphasizes training for permanent employment rather than make-work jobs. New initiatives outlined by the President will focus on the long-term unemployed, youth, and on training or relocating displaced workers who lost jobs due to plant closures or force reductions.

- The targeted jobs tax credit, which was extended for 2 years by the 1982 tax bill, gives employers a real incentive to hire the disadvantaged--about 600,000 workers are certified under the program.

- The enterprise zone legislation reported last fall by the Finance Committee can provide us with an experiment in private-sector job creation in depressed areas, through a combination of Federal tax incentives and State and local efforts to target an area for development with regulatory and tax relief, neighborhood participation, and capital and other improvements.

- The 5¢ per gallon gax tax increase can create over 300,000 jobs by funding much needed repairs and construction of the Federal highway system.

C. <u>The Deficit and Interest Rates</u>.

1. All our economic difficulties are, of course, related--high interest rates and slow growth boost the deficit, and higher deficits create greater uncertainty in the business community as to our future course; will there be more inflation, or less credit available for business expansion?

2. Because of this, it makes sense first of all to chart a path that is most likely to bring stable growth without inflation. Higher growth boosts revenues and cuts unemployment costs, thereby reducing the deficit as well.

3. In the short term, as the President urges, it makes sense to continue to review every part of the Federal budget in an effort to bring the deficit down. This means both defense and entitlements must be under scrutiny to maximize the efficiency of every dollar spent. A balanced deficit reduction program is still our goal. Freezing discretionary programs in real terms may help ensure a broad-based reduction effort.

4. Continued efforts to restrain the deficit by controlling Federal spending will give the Federal Reserve a bit more room to accommodate the potential for <u>real</u> growth that exists in the economy without inflationary pump-priming. But restraint in both fiscal and monetary policy is crucial if we want to maintain long-term confidence in the economic program. That means long-range goals must be carefully reconciled with efforts to respond to particular weaknesses in the economy.

Radical attempts to reverse course would be self-defeating and must be resisted.

III. Social Security

A. Bipartisan cooperation continues to be the key to resolving the social security financing crisis. The National Commission developed a bipartisan package that deserves support. It is not perfect, and everyone had to swallow hard on some items: that is the cost of reaching agreement.

B. The work of the Commission made clear that it is a crisis in social security that we are confronting. The Commission agreed that $150-$200 billion is needed between 1983 and 1989 to ensure the solvency of the system through 1990. This means providing about a 15 percent reserve ratio by 1990 under the pessimistic--some would say realistic--assumptions. This is still a reserve level lower than at any point in history, and does not take into account the medicare program, which will have serious reserve problems by 1990 if nothing is done.

C. The real job is, and always has been, up to Congress. The bipartisan package, including a 6-month delay in cost-of-living adjustments, partial acceleration of scheduled payroll tax increases, coverage of new Federal workers and non-profit organizations, and partial taxation of benefits for higher-income beneficiaries, will be before Congress right away. The Finance Committee has scheduled hearings for February 15.

D. Long-term changes are also needed, of course, and the work of the commission has helped give us valuable guidance. We cannot forget that the payroll tax burden is already heavy and scheduled to increase, and the confidence of young people is critically low. The long-term deficit can be reduced considerably by very gradually slowing the growth of benefits as people come on to the rolls in the future. Another route is to raise the retirement age, again very gradually, for people retiring some 20 or 30 years from now. In either case ample time would be available for people to adjust their savings and retirement decisions.

E. Major Features of the Package

1. COLA Delay

Even with the 6-month delay of the cost-of-living increase, benefits for 1984 for the average retired couple will be about $330 higher than their benefits for 1983, assuming an inflation rate of 4 percent.

2. Taxation of Benefits Above Threshhold

Many low and moderate income retired taxpayers are already taxed on their pensions, dividends, interest, and other income. Basic fairness requires that individuals with substantial amounts of other income should at least treat some of their social security benefits as income subject to income tax. One-half is an appropriate amount and should not cause undue hardship.

Taxation of benefits above the threshhold should only affect about 11 percent of all social security beneficiaries, so the great majority of social security recipients will not be affected by this change.

3. Payroll Tax Acceleration

The acceleration of the payroll tax increase will only increase payroll tax revenues by $9 billion between now and 1988. Half of this amount--the employee portion--will be offset by an income tax credit. The other half--the employer portion--will be deductible on the employer's income tax return. The net effect will only be to take about $3 billion out of the economy--an insignificant factor in a 3 trillion dollar economy.

By removing the enormous amount of misinformation and uncertainty which has scared the elderly people of the country, the bill will improve confidence, both among the elderly and in the financial markets. These should have significant positive economic effects.

F. Benefits vs. taxes

- Of the $169 billion financing package, one can view the largest component as being on the benefit side through slowing the rate of future benefit growth and partial taxation of benefits for the highest-income beneficiaries.

o Benefit slowdown and recapture	$70 billion - 41%
COLA adjustments	($40 billion)
Recapture of benefits through tax systems	($30 billion)
o Expansion of coverage and repayment of military service obligation	$41 billion - 24%
Coverage of Federal and nonprofit employees	($23 billion)

Military service debt	($18 billion)
o <u>Tax speedup and restructuring of self-employment tax</u>	$58 billion - 34%
Tax speed up	($40 billion)
Self-employment restructuring	($18 billion)
	$169 total

o Even though one-third ($58 billion) of the package is comprised of payroll tax changes, the real impact on the economy will be less because of the tax credit to employees, the deductibility of employer payroll taxes and the tax deduction provided for the self-employed will reduce the total tax burden by about $18.5 billion. Thus the real additional payroll tax burden will be slightly below $40 billion over the period 1983-1990.

IV. <u>Revenue Sharing/Federalism/IDBs</u>

A. General revenue sharing, which provides $4.6 billion per year in fiscal assistance to localities each year, expires at the end of September. The President has indicated that he will ask for a continuation of revenue sharing consolidated with the entitlement portion of the Community Development Block Grant program.

B. Issues for Congress will be the funding level for such a consolidated block grant; whether a two- or three-year, or longer, extension of revenue sharing is appropriate; and what the long-term future of the program may be in connection with any revenue-turnback scheme the administration may propose. But clearly there is strong support in both the administration and Congress for continuing general-purpose assistance to localities and increasing the discretion recipient governments have over the use of Federal funds.

C. <u>IDBs</u>. In the 1982 tax equity bill Congress made significant changes in the use of tax-exempt industrial development bonds, including a sunset of the small-issue exemption after 1986. There are no indications the administration will propose additional restrictions on IDBs. This is an area the tax-writing committees seem unlikely to get involved with again this year--<u>provided</u> the common-sense restrictions agreed to last year, such as the sunset, the anti-double dip rule with ACRS, the requirement for greater input from State and local governments, are preserved intact. If efforts are made to roll back the 1982 changes, then all bets may be off with regard to the future of IDBs.

D. Federalism. Revenue sharing renewal will be proposed by the Reagan administration as part of a new Federalism package involving creation of four new block grants. Congress will certainly give close attention to any legislative proposals to increase the ability of local governments to decide how to best utilize grant funds, and hopefully a realistic Federalism package could see legislative action this year. Removing the question of where to administer major income security programs from the Federalism agenda should make it much easier to reach agreement.

V. Taxes and the Budget

A. If we need additional revenues in the out-years, it has to be done consistent with the goal of reducing the deficits as recovery proceeds: a goal that everyone agrees is essential.

B. There are lots of ways to raise revenue, but our job is to choose ways that are fair and consistent with good tax policy. We should resist the temptation to undo the progress that has been made in providing greater incentives for savings, work, and investment: those incentives will become more important as recovery proceeds. There are many base-broadening measures still to be considered that would improve the equity and efficiency of the tax code; and there are a number of ways in which you could fashion a temporary add-on tax without undermining a commitment to lower tax rates and a broader-based, fairer tax system.

C. Indexing. There seems to be a growing clamor for repeal of the tax indexing provision of the 1981 tax act, which takes effect in 1985. We all know that we have to compromise to get things done, but this is one area that we ought to leave alone if we are interested in sound tax policy and honesty in government. We can raise revenues, and we may have to--but why resort once again to back-door revenue increases generated by inflation? Tampering with indexing further risks sending a signal that we are prepared to reinflate the economy and generate revenues through bracket creep to deal with the deficit. That would mean undoing all the progress we have made over the past two years, and it would be a tremendous mistake.

D. Outyear tax increases. It is not clear why we would need to use a "trigger" device to raise taxes based on deficit levels: if we estimate that the revenues will be needed, we can agree that any tax increase we provide for will be temporary, whether it be a surtax or a package of miscellaneous changes. It seems unlikely that a "trigger" mechanism would create the kind of reassurance on the deficit that the country is looking for.

If growth and revenues turn out better than now projected, we can always reduce taxes to the extent that becomes fiscally desirable. One possibility is to enact some additional base-broadening measures--improvements in equity and eliminating tax provisions that are economically inefficient--then provide for further rate reductions if the deficit is brought under control more rapidly than is now expected. This would maintain the momentum for a lower-rate, broader-based tax system that has been built over the last two years. It is also consistent with the administration's consideration of a streamlined and simplified tax structure with lower rates.

E. Tax Issues of Continuing Concern

A number of issues that have been around for some time ought to receive attention from the 98th Congress.

1. 6-month holding period. Efforts to reduce the capital gains holding period to 6 months will continue. There is very strong support for this change, because it can give a boost to capital markets at a time when greater savings and investment is vitally important to sustained economic recovery. This change was approved by the House in 1981 and by the Senate on three separate occasions in 1982, so it is time to get it enacted into law.

2. Education and/or Housing Savings Account. An idea that has been around for several years and may receive attention in the new Congress is to use an IRA-type arrangement to encourage savings for college education or advanced vocational training. Contributions to an account set up for this purpose would be tax-free subject to limits on the use of the funds for the stated purpose. In the area of education of one's children, in particular, the President has a strong interest in this initiative. It could provide support for education with a free-market approach, which has a lot of appeal.

3. Fringe Benefits. The moratorium on IRS fringe benefit regulations expires on December 31, 1983, having been extended to that date by ERTA. This issue has been with us since 1978, when the moratorium was first imposed, and it may be time to deal with it. The Congressional Budget Office estimates that about $500 million could be generated by taxing so-called "nonstatutory" fringe benefits provided to employees--e.g., free airline travel, recreational facilities, etc. While theoretically taxable, these benefits raise difficult issues of valuation and allocation to individual employees. Still, fringe benefits are "compensation" and, to prevent erosion of the revenue base, something may have to be done.

4. Life Insurance Taxation. The temporary life insurance company taxation provisions of TEFRA expire at the end

of 1983. The Finance Committee and Joint Committee staffs, as well as GAO, are looking at permanent changes in the taxation of the life insurance and casualty insurance industries. If the temporary rules were simply extended, a substantial revenue loss would result, probably in excess of $1 billion per year.

5. Mortgage Subsidy Bonds. In 1980 Congress legislated restrictions on the use of tax-exempt mortgage revenue bonds. Under the terms of that 1980 compromise, the authority to issue tax-exempt mortgage revenue bonds terminates on December 31, 1983. There will probably be some interest in extending mortgage revenue bonds in some form beyond that date: Senator Durenberger already has indicated such an interest.

G. Possible Administration Tax Initiatives

A number of initiatives were not acted on in the 97th Congress, and the administration may be expected to make similar proposals in the 98th.

1. Tuition Tax Credits. Although the Finance Committee fashioned a compromise tuition tax credit proposal last year after extensive consideration, the bill received no further action last year. But the Committee's efforts could form the basis for legislation in the 98th Congress.

2. Caribbean Basin Initiative. The administration's proposal to provide trade and certain tax incentives for economic development in the Caribbean Basisn made substantial progress in the 97th Congress, but still awaits final action. This is likely to be a priority item for the administration.

3. Enterprise Zones. The Finance Committee reported out a modified version of the administration's enterprise zone proposal in September, but no further action was taken. The proposal is likely to come up again in connection with discussion of job-creation and economic development proposals, and possibly could be acted on with further refinements. A major question is whether the House will take an interest in the idea, which they did not in the 97th Congress.

4. DISC. While no specific DISC proposal was made in the 97th Congress, the issue was extensively discussed--particularly the question of legality under the GATT. The search is clearly on for an alternative way to encourage exports, and the administration is likely to be active.

VI. Conclusion

The months and years ahead must not be dominated by rigid ideologies on either side--but neither can the President or the Republican leadership be expected to cast aside the principles of Government the American people so soundly endorsed in 1980. Those principles--a more restrained Government, a freer economy, greater accountability to the American people--are as valid today as they ever were, and there is no indication that the people have changed their commitment to these same principles. Guided by these principles, we will try to work together to build on the sound foundation for recovery that has already been laid.

EMERGENCY URBAN RECOVERY PROGRAM

Reauthorization of Existing Programs

• Community Development Block Grant (increased for inflation)	$5 billion
• General Revenue Sharing (increased for inflation and restoration of state share)	$7.5 billion
• Countercyclical Fiscal Assistance (restoration)	$2 billion
subtotal	$14.5 billion

New Programs

• Urban Infrastructure/Jobs Program	$10 billion
• Reconstruction Finance Corporation (capitalization of Corporation; spent out on multi-year basis; loans and interest subsidies)	$5 billion
• Emergency Assistance for Food and Shelter	$2 billion
subtotal	$17 billion

GRAND TOTAL	$31.5 billion