United States Senate
COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

TO: SENATOR DOLE

FROM: SAM RICHARDSON

RE: BACKGROUNDER ON AMERICAN GAS ASSOCIATION SPEECH

DATE: MONDAY NOVEMBER 28, 1983

A.G.A. IS A NATIONAL TRADE ASSOCIATION OF 300 GAS DISTRIBUTION AND TRANSMISSION COMPANIES. THE FIRMS DELIVER GAS ENERGY FROM THE WELLHEAD AND VARIOUS SUPPLEMENTAL SOURCES TO THE BURNER TIP. THEY SERVE AN ESTIMATED 160 MILLION CONSUMERS AND ACCOUNT FOR 85 PERCENT OF ALL GAS ENERGY DELIVERED BY THE REGULATED GAS INDUSTRY IN THE NATION.
THE 65-YEAR-OLD ASSOCIATION ACTS AS CLEARINGHOUSE ON GAS ENERGY INFORMATION, AS A SELF-STYLED CATALYST IN TECHNICAL AND ENERGY POLICY MATTERS AND AS SPOKESMAN FOR THE REGULATED GAS INDUSTRY.
THE A.G.A.'S BANKERS ADVISORY COUNCIL WAS ESTABLISHED IN 1978 TO PROVIDE A FORUM FOR THE EXPANSION OF THE RELATIONSHIP BETWEEN GAS AND BANKING INDUSTRY EXECUTIVES. THE BANKERS ORIGINATE PROGRAMS WHICH BRING CURRENT INFORMATION ABOUT THE GAS INDUSTRY AND ITS EFFECT ON THE COUNTRY'S ECONOMY TO THE ATTENTION OF KEY BANKING EXECUTIVES.
A RECENT A.G.A. STUDY ESTIMATED THE UTILITY INDUSTRY AND ITS AFFILIATED PRODUCTION COMPANIES WILL NEED $283 BILLION BETWEEN NOW AND THE TURN OF THE CENTURY. THE STUDY SUGGESTED AN ESTIMATED $520 BILLION WILL BE NEEDED BY GAS AND OIL PRODUCERS OVER THE SAME PERIOD.

It suggested the emerging picture of a more capital-intensive international energy future is drawing gas industry and financial exeucutives into closer collaboration.

POSITION: The A.G.A. position on gas pricing legislation, in relation to old gas, is that the very small supply response of across-the-board decontrol does not justify the inevitable consumer price impact of its decontrol--thus, the A.G.A. "steadfastly" opposes decontrol of old gas prices.

On mandatory carriage, which is advanced by Senator Bradley, the A.G.A. sees a "new distraction which has been advanced as a simple panacea for all of the problems in today's gas markets." The association suggests mandatory carriage has been labeled contract carriage, implying the "benefits of free enterprise at its best." A.G.A. doesn't see it that way. A.G.A. notes that it is strongly opposed to such enactment, as are theKansas Power and Light Co. and Kansas Public Service Co.

On future price projections, A.G.A. forecasts that prices during the next five years will just about track inflation, which would be an improvement over the 20 percent of the past five years.

The A.G.A. president has written you suggesting a broad-based energy tax would be among the most regressive and sunsetting dividend reinvestment plans earlier than intended would be unfair to investors.

12/1/83

PROPOSED ACROSS-THE-BOARD TAX ON ENERGY

- One of major components of the deficit reduction package that the Finance Committee has been considering is a 2 1/2% tax on the value of all forms of energy to take effect in 1985.

- Like all of the tax increases being considered (other than pure loophole closers), this tax will take effect only if the spending reduction targets are achieved.

- It is estimated that this 2 1/2% energy tax will raise about $20.9 billion over 3 years (FY 1985-87).

- This energy tax will be imposed on 2 1/2% of national average value of the following energy products:

  (1) Oil -- tax imposed on the first sale of a refiner. (Imports of petroleum products would be taxed at the border.)

  (2) Natural Gas -- tax imposed on the sale of gas to local distribution company or direct sale to end user of natural gas.

  (3) Natural Gas Liquids -- tax would be imposed on sale by a gas processing plant.

  (4) Coal -- tax would be imposed on sale to a major fuel burning installation.

  (5) Electricity -- tax would be imposed on the sale of electricity to users.

- This energy tax would exempt feedstock use and energy produced for exports.

- This tax spreads the burden beyond oil to all fuels, so that it should have a more even regional impact than the Administration's proposal to put a $5 per barrel excise tax on oil.

- The 2 1/2% energy tax will raise gasoline prices by about only 2 to 3 cents per gallon.

- A portion of the revenue from the tax on coal will be dedicated to a acid rain trust fund.

SCOPE OF THE DEFICIT PROBLEM.

• The current cost of servicing the national debt--the interest expense--is about $140 billion. That is more than the entire Federal budget was in 1967--just 16 years ago.

• If we do nothing to cut the deficit, by 1988 the cost of servicing the national debt will be $200 billion each year--a figure larger than the entire Federal budget for 1970, which was $195 billion.

• Looked at another way, under current projections we will have budget deficits of $200 billion or more each year for the rest of this decade--even with strong economic growth. Each of those yearly deficits alone is larger than the 1970 Federal budget.

• Debt service and spending cuts. According to CBO, the 1981 and 1982 budget reductions in nondefense (domestic program) spending total $105 billion over the three-year period, 1983-1985. At the same time, net interest costs to the Federal government for financing our debt have risen by $91 billion--our failure to control the national debt has wiped out all but $14 billion of the spending cuts.

• If this trend continues--if we do nothing to cut the deficit and reduce interest costs to the Federal government--by 1987 those higher interest costs will have wiped out all the spending reductions made in 1981 and 1982.

• The message from these statistics is that unless we rein in budget deficits as soon as possible, the cost of servicing our national debt will undo all the progress made in restraining spending, from the standpoint of total Federal spending.

• Deficit burden and tax cuts. Our failure to match tax cuts with spending restraint means that we have simply been shifting from taxing to borrowing to finance a given level of spending. The 1981 and 1982 tax bills taken together netted about a $344 billion tax reduction over the period 1983-1985. But with roughly $200 billion deficits in both 1983 and 1984, that tax reduction is more than matched by government borrowing over those two years alone.

• Looked at another way, the tax reduction from ERTA was estimated at $750 billion over 5 years. But deficits over that same five-year period are estimated at significantly over that amount. Between 1982 and 1985 alone Federal deficits will cumulate to more than $750 billion, unless our budget path is changed.

• In addition, the added interest cost on the national debt just means even higher taxes or even more borrowing in the future to pay for it. The cost of financing an additional $1 trillion in debt that would be added over the next five years would amount to 20% of all receipts from the personal income tax.

TALKING POINTS ON REDUCING THE DEFICIT NOW

- In its midyear budget review, the Reagan Administration estimated that the Federal budget deficit would be roughly $200 billion for each of the next 6 years.

- Over that 6-year period, unless something is changed these deficits will cumulate to $1.2 trillion--just about doubling the national debt.

- Without action on the deficit, deficits for each of the next 6 years will exceed 4 percent of our Gross National Product--that is a postwar record previously matched only in 1976.

- Assuming a $200 billion deficit has to be financed at a 10 percent interest rate--a reasonable assumption given prevailing conditions--the interest alone on a deficit of this size amounts to $20 billion. That is enough to finance all of the Medicaid program at current funding--it is 2-1/2 times the cost of the AFDC program, or of the SSI program--it is over four times the cost of General Revenue Sharing.

- Over the next 5 years financing costs for the interest on this additional debt would amount to $100 billion.

- In addition, if nothing is done to prevent this $1.2 trillion addition to the national debt, interest payments on this additional debt alone would amount to $100 billion a year after 1988. That is nearly double the present cost of interest on the national debt, and is equal to over 20 percent of all the personal tax revenue we expect to collect in 1988.

- All of this additional debt, and the interest we pay on it, has to be paid for in some way--in higher interest premiums or inflation, in higher taxes, or more severe spending cuts. The longer we wait, the higher the cost of deficit reduction will be.

- Lowering outyear deficits now should help bring down interest rates; that can stimulate investment to keep recovery going. That means a stronger economy in the outyears when further spending reductions and tax increases we enact now would be coming in place. But absent such a boost to the economy, the economy may be too stagnant in those outyears to sustain a sudden restraint on fiscal policy--which means we would be compounding the problem and risking a downward economic spiral.

- o Interest rates that are kept high by the size of anticipated deficits matter not just for government finance and the taxpayer--they matter for the homebuyer, who has seen rates creep back up to the 13+ percent range, and for the small businessman or entrepeneur trying to get started. High interest rates can cut short a promising economic future for everyone.

- o The $1.2 trillion increase in the national debt over the next six years will add $5,217.39 in new debt for each man, woman and child now living in the U.S. This would come on top of the over $6,000 debt per capita already outstanding.

- o Escalating deficits leading to higher interest rates do not just pose the threat of mortgaging our future. Higher interest rates mean lower capital formation and less long-term growth; more pressure for raising domestic barriers to free trade; and bad news for our basic industries, because the need for upgrading heavy plant and equipment means those industries are very sensitive to interest costs.

- o In addition, the stronger dollar that tends to result from higher U.S. interest rates makes it more difficult for American companies to compete with low-cost imports and to secure a foothold in overseas markets.

- o High deficits and interest rates retard capital formation and pose a real risk of 'disinvestment' in the United States, implying a much more fragile American economy. A low-growth path could condemn many citizens to poverty who might ottherwise be able to find productive and useful employment.

TALKING POINTS ON DEFICITS

- o As Martin Feldstein, President Reagan's chief economic adviser, has said, if we don't do anything about controlling this deficit now, it will cost one-fifth of all personal income taxes collected by the Federal Government just to service the interest costs of the $1 trillion of new debt accumulated over the next five years.

- o If we wait just one year to do something about controlling the increase in the deficit, it will require deeper spending cuts and higher tax increases.

  For every dollar in spending cuts needed this year, it will require 1.10 next year.

  For every dollar we raise taxes this year to accomodate the deficit, we will have to raise them $1.10 next year.

o Since 1981, we have brought about spending cuts amounting to $1Ø9 billion for the 1983, 1984 and 1985 budget years.

But over the same period of time, we have seen the budget deficit increase by $91 billion.

That means that the deficit has wiped out 83 percent of all the savings we have realized through our reductions in Federal spending.

ECONOMIC TALKING POINTS

- The recovery is on track despite early projections of a weak and "fragile" expansion. The best measure of this is the strong expansion of real GNP. The nation's production of goods and services rose 9.7% in the second quarter, followed by a 7.9% increase in the third quarter. By this measure, the current recovery is the strongest since 1961.

- Factory output and utilization are up. Industrial output rose 1.5% in September--the tenth consecutive monthly increase. Factory utilization rose by 1.0 percentage point in September. The current level of utilization is 78.1%, and we are nearing the normal maximum capacity of 85%. This means that firms will have to start stepping up investment in plant and equipment soon.

- The payoff to the business expansion is the rapid drop in unemployment. The nation's civilian unemployment rate for October fell to 8.8%, a half of one point drop that is the largest since the Korean War. Since the recovery began in December of 1982, the unemployment rate has fallen a full two percentage points, 2.8 million new jobs have been created, and the number of unemployed has fallen by 2.1 million. Again, this is the strongest labor market recovery since 1961.

- The index of leading economic indicators advanced a healthy 0.9% in September. This was the 13th consecutive monthly gain, and suggests that the strong recovery will continue into 1984.

- The best news about this recovery is that it is non-inflationary. The consumer price index has increased at an annual rate of just 3.7% so far this year. The GNP deflator registers a 3.4% annual rate of inflation. Producer prices rose just 0.3% for October, suggesting that inflation will continue to be moderate.

- Housing starts are running at a rate of 1.6 million per year. While the rate for September was below August's four-year high performance, housing starts still are 46% above the level of September 1982.

OUTLINE OF POSSIBLE DEFICIT REDUCTION PACKAGE

- The total deficit reduction package will amount to about $150 billion over 4 years--but will principally fall in three years-- FY 1985-86.
- The package will be evenly balanced between spending restraint and revenue increases--$75 billion of each.
- All tax increases (except pure loophole closers) will be made expressly contingent on the spending cuts being achieved.
- The Finance Committee will undertake to propose 1/2 of the total spending reductions and all of the revenue increases.
- The Finance Committee will look to the other Senate committees to make the half of the spending cuts--for example, out of restraint on farm program spending, defense and discretionary spending.
- Any savings in social security will be dedicated to the Medicare Trust Fund to shore up that failing system.
- This program, together with cuts already made, exceeds the President's recommendations for total spending restraint.
- Measured over fiscal years 1984-1986 the total tax increase figure in the Finance Committee deficit reduction package ($46 billion) is less than the $58 billion in tax increases recommended by the President in his 1984 budget.