United States Senate

COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

January 12, 1983

TO: Senator Dole

FROM: George Pieler

SUBJECT: Edison Electric Institute talk

Attached are materials for your appearance for the Edison Electric Institute at 3:15 this afternoon: discussion of the deficit problem, short description of the proposed Finance Committee package, and talking points on specific issues that may be of interest to the group--IDBs and the energy tax.

The group, as you know, is also interested in keeping in place (or expanding on) the dividend reinvestment rules adopted in ERTA. They will not be surprised if you continue to regard that as a possible target of any deficit reduction package.

Another item of interest, on a narrower topic, is a bill introduced by Sam Gibbons, H.R. 2820, which allows current deductibility of additions to a reserve established to cover the costs of decommissioning nucler power plants. The rationale for the bill is that regulatory commissions permit, or in some cases require, such reserves, and allowing a current deduction could facilitate lower utility rates by allowing the reserves to be accumulated out of pre-tax dollars.

We do not have a revenue estimate on the bill; it has a majority of Ways and Means as cosponsors, but comparable legislation has not been introduced in the Senate.

Attachments

REMARKS OF SENATOR DOLE

EDISON ELECTRIC

Thursday, January 12, 1984--U.S. Chamber of Commerce

What is the Federal deficit likely to be?

- The estimates of future Federal deficits are quite sensitive to one's economic assumptions. Yet even under the most optimistic of economic assumptions, the deficit will remain at historically high $200 billion levels over the foreseeable future, unless drastic action is taken.

- Assuming an extremely strong recovery (4% real growth of GNP) is sustained over the next years and all of the Administration's proposal spending cuts are made, the deficits are still projected to be:

FY 1985	FY 1986	FY 1987	FY 1988
$185 billion	$195 billion	$199 billion	$179 billion

- If economic growth is not so strong (3% real GNP growth) and interest rates are slightly higher (9% T-bill rate), and Administration's spending cuts are not enacted, the projects deficits would be:

FY 1985	FY 1986	FY 1987	FY 1988
$202.6 billion	$236.7 billion	$270billion	$290.1 billion

- If we have an economic downturn during this period, we may be facing $300 plus billion deficits.

Why worry about the deficit--What does it mean to the average American?

- If nothing is done to reduce deficit spending over the next five years, the total Federal debt will nearly double to over $10,000 for every man, woman and child in America.

- At this level, by 1989 it will take one-half of all Americans' personal income tax payments just to pay the Federal Government's interest bill.

- By 1989 the annual Federal interest cost will amount to $250 billion--about $1,100 for every American.

- That $1,100 per person interest cost is equal to 40% of each person's annual expenditure for food.

- Virtually all economists agree that the sustained enormous deficits that we are facing will be economically harmful.

- Many Americans will find home-buying more difficult with higher deficits. Consider a family purchasing a home at today's current interest rate, averaging about 12-1/2%, with a $55,000 mortgage. If the deficits push interest rates up, total interest costs over the 30 year term will be $15,500 more for each one percentage point increase.

- All Americans will directly feel the results of high deficits if they lose jobs as a result of a business slowdown resulting from a crowding out of private investment, or if they lose jobs to imported products made more competitive because of an abnormally strong dollar or if they end up paying higher prices bacause inflation is rekindled.

<u>What do you think the Adminstration will propose in its FY 1985 budget to deal the with deficits?</u>

- Clearly the Administration will repropose many of the domestic spending cuts from its 1984 budget that have not been acted upon.

- Based on the figures I have seen, the Administration will propose only about $6 billion in net domestic cuts for FY 1985, but that figure is larger in the out years:

FY 1985	FY 1986	FY 1987	FY 1988
$5.6 billion	$13.7 billion	$17.0 billion	$22.1 billion

- Unfortunately, I am afraid that the effect on these domestic spending cuts will be undercut by proposed increases in defense spending.

- On the tax side, I do not think the Administration has decided whether to propose some form of contingency tax increase like that included in last year's budget.

- Thus, at this point I do not see very much in the way of deficit reduction included in the FY 1985 budget Adminstration submission.

January 11, 1984

CONSEQUENCES OF FAILURE TO ACT SOON TO LOWER BUDGET DEFICITS

o If we fail to deal with the deficit now, the problem will become worse. Current projections showing deficits holding in the range of $200 billion probably are optimistic, as they are based upon assumption of steady economic growth through 1989. However, postwar experience suggests that the average recovery lasts only three years, making a recession in 1985 or 1986 likely.

o If we postpone action until 1985 and we do suffer another recession, the deficits would then hit the $300-$400 billion range. At that point, the economy may be too weak to sustain tough deficit-reduction measures, and the country could be plunged into an economic "black hole,' from which it would be difficult to escape.

o Of course, failure to reduce the deficit in 1984 makes a recession in 1985 that much more likely, as interest rates will be forced up later this year when private credit demands clash with Treasury borrowing needs.

o By postponing action of the deficit, we increase the risk of recession and the great costs that go with it. The average increase in the unemployment rate during a postwar recession is about three points, or three million jobs. By acting to reduce the deficit, we can significantly lower the risk that three million workers will lose their jobs in 1985 and 1986.

o The rise in interest rates will depress auto sales, housing starts, and capital goods orders. It is widely recognized that sustained economic recovery will be impossible unless these key sectors are healthy.

o Alternatively, the Fed could offset the deficits' impact on interest rates by "monetizing" the debt, leading to a resurgence of inflation in 1985. If we do nothing, we will force the Fed to choose between high interest rates and recession, or inflation.

o Failure to reduce the deficits in 1984 will also depress the stock market. A key factor in determining equity and bond prices is investors' confidence that Congress and the Administration can produce a sound fiscal policy. If we send the signal that the deficit problem is secondary to politics, we can expect equity and bond prices to fall.

- The exploding cost of servicing the federal debt will make controlling spending more difficult each year, unless the deficits are reduced soon. Each year that we add $200 billion in new federal debt adds about $15 billion to the next year's interest costs.

- The economy is now on a path where more and more of its resources go just to pay off the debt. According to economist Larence Summers, "It's a case where the miracle of compounding (interest) works against you."

- In 1976 net interest accounted for just 7% of total outlays But if we do nothing, by 1988 the total federal debt will be more than half of total GNP, and the net interest cost of servicing this debt will reach 14% of all spending. Each year that we do nothing, the share of federal spending that we can control gets smaller.

- Recent sutdies indicate that current and prospective budget deficits have helped to overvalue the American dollar by 20-25%. If the deficits are not reduced, the problem of overvaluation will become worse, weakening the competitive position of American exports and costing the U.S. jobs in such industries as steel, electronics, and agriculture.

November 29, 1983

BASIC COMPONENTS OF PROPOSED FINANCE COMMITTEE
DEFICIT REDUCTION PACKAGE

Overview

- The Finance Committee has aimed for $150 billion in total deficit reduction over the next 4 fiscal years, with most of the savings coming in fiscal years 1985 through 1987.
- The package will have at least one dollar in guaranteed spending cuts for each dollar of revenue increases.
- The Finance Committee will undertake to enact one-half of the spending reductions, and look to the other Senate Committees to produce an equivalent amount of savings.
- Any new revenue increases (other than pure loophole closers) will be expressly contingent on a certification that spending cuts have been achieved and will be triggered off if Congress later reneges on these spending cuts.

I. Spending Reduction Proposals Within the Jurisdiction of the Senate Finance Committee

The total package, including provisions totalling $5.3 billion in savings incorporated in the Reconciliation Act of 1983 as reported by the Budget Committee, would result in a savings of $38 billion over 4 years. The majority of the proposals would have an effective date of January 1, 1985.

- Rounding of Social Security COLA. Proposal modifies the COLA paid in 1985, 1986 and 1987 by rounding the increase to the next lower whole percentage amount.

  FY 1984-87: $5.1 billion

- Modify timing and rate of increase in Part B Premium. The premium would be permitted to increase each year until it reached 35% by 1990. (Modification of 1983 Administration proposal)

  FY 1984-87: $2.9 billion

- Delay In Initial ~~Eligibility for Medicare~~ Entitlements. Delays eligibility ~~for both Parts A and B~~ of Medicare to the first day of the month following the month of the individual's 65th birthday. (1983 Administration proposal)

FY 1984-87: $1.0 billion

- Restructure Medicare Cost Sharing/Apply Co-Pays to Hospital Days and Provide Unlimited Hospital Days. Modifies cost sharing on hospital stays and nursing home stays and provides catastrophic protection under Part A of Medicare. (Modification of 1983 Administration proposal)

  FY 1984-87: $1.6 billion

- Modification of Working Aged Provision. Modifies 1982 provision which made Medicare benefits secondary to benefits under employer group health plans. (Strongly supported by OMB and HHS)

  FY 1984-87: $1.2 billion

- Participating Physician Program. Freezes certain physician fees for 2 years and creates incentives for physicians to take assignment. (Modification of 1983 Administration proposal)

  FY 1984-87: $2.2 billion

- Limit Increase in Hospital Costs Per Case. Limits increases in hospital costs per case to the increase in the hospital market basket price index. (Modification of 1983 Administration proposal)

  FY 1984-87: $2.9 billion

- Fee Schedule for Clinical Laboratory Services. Establishes fee schedule for payment to all laboratories for services provided to Medicare patients.

  FY1984-87: $0.9 billion

- Extend Reduction in Federal Payments. Extends the existing reduction in Federal Medicaid payments to States for 2 years. (Modification of 1983 Administration proposal)

  FY 1984-87: $1.0 billion

- Debt Service. The reduced outlays and increased revenues would decrease interest on the Federal debt by $13.9 billion over FY 1984-87.

II. Revenue Provisions

The total package, including provisions totalling $21.1 billion incorporated in the Omnibus Reconciliation Act of 1983 as reported by the Budget Committee, would increase revenues by $72.8 billion over 4 years.

A. Contingent Revenue Increases

The following revenue provisions, totalling $59.8 billion over 4 years, would take effect on January 1, 1985 only upon verification that the required reductions in Federal outlays have, in fact, been achieved:

- Energy Tax. A two and one-half percent tax would be imposed on the sale of sources of energy consumed in the United States.

  The President's 1984 budget included a $5 per barrel excise tax on domestic and imported oil.

  FY 1984-87: $20.9 billion

- High Income Individual Surchage. A surcharge of two and one-half percent would be imposed on income above approximately $60,000 for joint returns ($42,000 for single returns).

  The President's 1984 budget included a surcharge on individuals approximately equivalent to one percent of taxable income.

  FY 1984-87: $5.1 billion

- Tax on Corporate Economic Income. A two and one-half percent tax would be imposed on the economic income (over $100,000) of corporations.

  The President's 1984 budget included a surcharge on corporations of approximately one percent of taxable income.

  FY 1984-87: $14.5 billion

- Rounding Down of Indexing. Indexing of brackets, exemptions, and the zero bracket amount would be computed with reference to the Consumer Price Index rounded down to the next lower full percentage point. This proposal would be consistent with the modification of Social Security COLA's.

  FY 1984-87: $5.6 billion

- Zero-Bracket Amount (ZBA) Increased. The ZBA (formerly the "standard deduction") would be increased by $100 ($200 for joint returns) in 1985. Heads of households would be given a ZBA halfway between simple and married taxpayers, with a new rate schedule.

FY 1984-87: $7.4 billion

B. Treasury-Supported Revenue Reforms.

The deficit reduction package would include proposals, totalling $13 billion, supported by Treasury testimony to the Finance Committee limiting tax shelters and accounting abuses and reforming the taxation of corporations.

FY 1984-87: $13.0 billion

III. Summary

	Fiscal Years 1984-1987
Spending Restraint Already Agreed to by the Finance Committee	5.3
Spending Restraint Proposals Within Finance Committee Jurisdiction Contained in Proposed Package	32.7
Spending Restraint Requirements Within the Jurisdiction of Other Committees	37.5
Revenue Increase Already Agreed to by the Finance Committee	21.1
Revenue Increase Proposals in Proposed Package	51.7
TOTAL	148.3

Industrial Development Bonds

- The Treasury began to be concerned about tax-exempt bonds for private businesses and other private purposes in the late 1960's. Since then, although Congress has tried to limit IDBs, their growth has far outstripped the efforts of Congress to preserve the benefits of tax-exemption for traditional public purposes.

- Long-term public purpose bond issuance grew from $24 billion in 1975 to $41 billion in 1982, not even doubling in 7 years. In contrast, small issue IDB issues grew from $1.3 billion to $13.7 billion over the same period, a 10-fold increase.

- As a result of this growth, the volume of private purpose long-term tax-exempt bond issues in 1982 actually exceeded the volume of public purpose bonds.

- Industrial development bonds have unquestionably served a useful purpose in many cases. Obviously, business subisidies can spur development and create jobs. But their uncontrolled growth is problematic for the Congress, who must pay the bill for exempting wealthy investors from taxation on bond interest.

- Uncontrolled IDB growth is also increasingly problematic for cities and States who issue the bonds. Now more and more cities and States understand how to use bonds to compete with other cities and States. Bidding wars can develop where the true beneficiary is not the cities or States but the corporation that gets an interest rate subsidy, even in cases where the company would have built a new plant without the subsidy. IDB's can also be used to lure jobs away from other cities and States, without any actual increase in overall business activity.

Legislative Options

- The House Ways and Means Committee has approved state-by-state volume limitations as the primary method of limiting volume and imposing discipline on issuers.

- The Senate Finance Committee is considering provisions similar to those approved in TEFRA, which would limit the ACRS allowance for IDB financed property. This would reduce volume somewhat, but also recoup some of the cost of IDBs by reducing depreciation deductions. The Finance Committee is also considering limiting the total amount of small issue IDBs used by a single business. The proposed limit would be $40 million of outstanding bonds.

- The Senate Finance Committee is also considering a variety of anti-abuse provisions, such as banning IDBs for liquor stores and skyboxes. In general, the Finance Committee provisions will probably be perceived as less restrictive than the House Ways and Means bill.

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.