REMARKS OF SENATOR DOLE

EMPLOYERS' NATIONAL JOB SERVICE COMMITTEE

Thursday, February 23, 1984--12:40 p.m.--Quality Inn - Capitol Hill

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 foreseable future, unless drastic action is taken.

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

FY 1985	FY 1986	FY 1987	FY 1988
$180 billion	$177 billion	$180 billion	$152 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 projected deficits would be:

FY 1985	FY 1986	FY 1987	FY 1988
$202.6 billion	$236.7 billion	$270 billion	$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 because 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 may 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

- On the tax side, the Administration will likely propose some tax reforms that will raise revenue, including cutbacks in tax shelters Treasury has endorsed.

- While none of these proposals involve huge numbers given the size of our deficits, when they are combined with pending reconciliation measures and additional items, they can provide a substantial 'down payment' on the deficit.

What about defense spending?

- It is expected the Administration will reccommend $305 billion in defense spending for FY 1985--a 13% real increase over the 1984 defense spending level.

- This sharp increase in defense spending is $16 billion over the substantial increase provided for FY 1985 in the most recent Congressional budget resolution.

- Over the period FY 1985-1987, the Administration's defense recommendation is about $65 billion higher than the 5% real growth path that Congress last year set as adequate for a strong defense.

- The Adminstration's defense recommendation is a first offer that sets its opening bargaining position. I believe that the final defense number for FY 1985 will be close to the $289 billion figure contained in last year's budget resolution.

- Even at a $289 billion level, defense spending will have increased 91% since 1981, the first year of the Reagan Presidency.

WHY SHOULD WE ACT THIS YEAR ON THE DEFICIT

- 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 3 years, making a recession in 1985 or 1986 likely.

- 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, it may be difficult to cut the deficit without further weakening the economy. Our choices would become very difficult indeed.

- Of course, failure to reduce the deficit in 1984 makes a recession likely to come sooner, as interest rates are forced up by private credit demands clashing with Treasury borrowing needs.

- By postponing action of the deficit, we increase the risk of recession. 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.

- 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.

- 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.

- Failure to reduce the deficits in 1984 may 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, equity and bond prices may 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 Lawrence 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 studies indicate that current and prospective budget deficits may have helped to overvalue the American dollar. If the deficits are not reduced, the problem of overvaluation could become worse, weakening the competitive position of American exports and costing the U.S. jobs in such industries as steel, electronics, and agriculture.

RECOVERY--WHAT PROGRESS HAVE WE MADE

Strength of recovery

- A strong recovery is on track and appears to be moderating to a pace that can be sustained in the years ahead. As an indication, look at the expansion of real gross national product. It grew by

9.7% in the second quarter of 1983, 7.9% in the third quarter, and an estimated 4.5% in the fourth quarter. By this measure, the recovery is the strongest since 1961.

- Housing starts are running at a rate of about 1.7 million units a year, and new home sales are up by 91% over the recession low.

- Industrial output in 1983 rose 6.5%, and factory utilization is up to 79.4%--the highest level in two years, and close to the normal capacity of 82%.

- The Commerce Department's survey of business plans for 1984 show that business plans to increase capital investment by 9.4%--this is a rate about 2% higher than that seen at comparable points in previous postwar recoveries.

Inflation

- The best news about this recovery is that it is noninflationary. In 1983 the producer price index rost just 0.6%--the lowest increase since 1964. The CPI for 1983 was 3.8%, the lowest since 1972. Continued moderation in producer prices indicates low inflation will continue.

Creating Jobs

- People are going back to work, and the pace of job creation has been unusually high for a postwar recovery. On January 6 the Labor Department announced the civilian unemployment rate dropped from 8.4% to 8.2% in December. Overall, this means unemployment has dropped 2.5 percentage points over the past year.

- The continued strength of the recovery shows that recent growth in employment has not just been a statistical fluke, but shows a real turnaround in the labor market. Unemployment fell 230,000 in December, and there have been 4 million jobs created in the last year.

- What is more, the growth in jobs is broad-based. While manufacturing industries showed the most dramatic gains, all industries other than government and agriculture showed dramatic drops in unemployment.

DEFICIT DOWN PAYMENT IN 1984

• The President has taken the lead to begin a deficit-reduction effort in 1984 by calling for bipartisan negotiations on a package to reduce the deficit by $100 billion over three years. As the President suggests, we can work with a variety of modest spending reductions, and tax reforms that raise revenue, to enact a significant deficit 'down payment' in 1984.

• Even though election-year politics makes it difficult to launch the kind of major assault on the deficit that we really need, that is no reason to do nothing. If we set reasonable expectations, we should be able to make a noticeable dent in the deficit that will make our job easier in the years ahead. Even more importantly, it can demonstrate to our citizens and to economic decision-makers in the private sector that we <u>can</u> face up to the deficit problem even in an election year.

• The Finance Committee is considering spending and revenue options just within its jurisdiction that can achieve the $100 billion 'down payment' goal. To do that we are drawing on a number of proposals that have been on the table for some time, including some already in the legislative 'pipeline':

- Items included in the FY 1984 reconciliation bill, S. 2062, which awaits Senate action

- Treasury-endorsed proposals on tax shelters and other abuses

- Administration-proposed spending cuts that were not followed through on last year

- Administrative savings and other proposals made by the Grace Commission

- Additional proposals considered in the Finance Committee last fall

• <u>Target</u>. We can aim at $100 billion in savings--$21.2 billion in revenue changes pending in S. 2062, $21.1 billion in spending reduction from Finance Committee programs in S. 2062, $7 billion or so from Grace Commission recommendations, $9.5 billion in debt service savings, and the remainder from additional spending and tax changes aimed at desirable policy reforms. The goal is a roughly 1-for-one balance between spending and revenue changes.

• <u>Feasibility</u>. The key is to follow the President's suggestion and concentrate on relatively non-contentious items, avoiding things like the third-year tax cut and indexing, mean-tested entitlements, social security, and the like. Our effort must be bipartisan and balanced to do the job: Democrats and Republicans alike will benefit by cooperating to take swift action on the deficit. Time is of the essence if we are to make a beginning this year.

PAYING FOR UNEMPLOYMENT COMPENSATION

- o TEFRA increased the Federal taxable wage base and the Federal unemployment tax (FUTA). The wage base for FUTA taxes was raised from $6,000 per year to $7,000, and the FUTA itself was increased, beginning January 1, 1983, from 3.4 percent to 3.5 percent. On January 1, 1985, the FUTA tax will increase to 6.2 percent. Employers receive credit for up to 90 percent of this tax if the State unemployment compensation program meets Federal requirements and has not suffered a credit loss due to delinquent loans. The net tax (0.8 percent) collected by the Federal government finances State and Federal administrative costs, the Federal share of the Extended Benefits program, and provides a loan fund for States that exhaust their funds to pay benefits.

- o While it was not an easy thing to increase taxes on employers, the Congress was convinced that we need to increase the solvency of State unemployment programs. The Unemployment Insurance System was bankrupt in the summer of 1982, and by the end of June of that year, 19 States owed the Federal Treasury over $8 billion. Of the four States having over one billion dollars in outstanding loans, only one (Illinois) had a wage base equal to the level proposed. Many States which had not borrowed in the past were beginning to borrow. Additional revenue was essential--to pay for current benefits, to repay loans, and to begin to build the necessary trust fund reserves.

- o The tax increases were spread over a number of years so that the impact would not be severe. Also, it should be remembered that the wage base had been at $6,000 per year since 1978. The effective FUTA tax rate of seven-tenths of one percent had been in place since 1976. The condition of the State Unemployment Trust Funds and the Federal loan and EB fund demonstrated the necessity for change.

- o The Department of Labor "UI Outlook" for fiscal years 1984 and 1985 indicates that the tax changes have been effective in encouraging the States to bring their trust funds closer to solvency. Of course, also contributing to the State reforms have been the provisions of the 1981 Reconciliation Act which require States to pay interest on Federal loans received after April 1, 1982.

- o The Labor Department estimates that the trust funds will finally experience a positive <u>balance</u> of some $3 billion during fiscal year 1985. State borrowing is projected at a lower level than had been expected, indicating that the economy is improving, of course, but also indicating that many State trust funds are nearing solvency.

- o Especially good news for employers is the fact that the old 1970's extended benefits debt should be repayed in 1987. This means that the effective FUTA rate will drop from eight-tenths of one percent to six-tenths of one percent in 1988.

- o It is unlikely that the Congress will return to the issue of Federal unemployment taxation this year. The changes in the 1981 Reconciliation Act, the 1982 tax bill, and the general improvement in the economy has brightened the outlook in this area considerably. States seem to be recognizing the deficiencies in their programs which led to the excessive borrowing of the 1970's. Should unemployment shoot up again unexpectedly, most of the States should be in good shape to handle the increased benefits.

TARGETED JOBS TAX CREDIT

The targeted jobs tax credit expires on December 31, 1984. Any eligible individual who begins work before January 1, 1985, can qualify the employers for the full 2 years of the credit.

The job credit is available to employers who hire members of certain targeted groups. The credit is $3,000 in the first year of employment and $1,500 in the second year. There are nine targeted groups: economically disadvantaged youth in cooperative education programs, beneficiaries of state and local general assistance, economically disadvantaged youth, handicapped persons in vocational rehabilitation programs, disadvantaged Vietnam veterans, SSI recipients, disadvantaged ex-convicts, AFDC recipients, and terminated CETA employees.

Senator Heinz has introduced legislation extending the program for 5 years, the administration has proposed a one-year extension. A hearing is scheduled for March 2 in Senator Heinz' subcommittee.

Possible Changes. A number of tightening changes have improved the jobs credit in recent years: in particular, in 1981 Congress eliminated retroactive certifications, which allowed employers to count payrolls for qualified individuals and claim credit.

Other changes that could save money might include:

- Cutting back the targeted groups, such as the cooperative education participants, who are the largest group certified under the program and tend to be hired in 'fast food' establishments.

- Reducing the amount of the credit.

- Finding ways to ensure that certified employees are really eligible, such as by mandating Labor Department review of a representative sample of certification proceedings (this was recommended by Congress in extending the program in 1982).