REMARKS OF SENATOR DOLE

WASHINGTON NON-PROFIT TAX CONFERENCE

Friday, March 9, 1984--1:00 p.m.--Shoreham

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.

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.

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.

What about defense spending

- 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.

Deficit Downpayment 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 3 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 "downpayment" 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 can 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 "downpayment" 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

- Target. We can aim at $100 billion in savings--$21.4 bilion in revenue changes pending in S. 2062, $13.6 billion in spending reduction from Finance Committee and other programs in S. 2062, $7 billion or so from Grace Commission recommendations, billions in debt service savings, and the remainder from additional spending and tax changes aimed at desirable policy reforms. The goal is a roughly one-for-one balance between spending and revenue changes.

- Feasibility. 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.

- Initial Finance Action: Spending. On February 23, the Finance Committee began action to reduce the deficit. To date, the Committee has agreed to changes in health care programs that save $10.6 billion between now and 1987, over and above the provisions in S. 2062, plus $3.2 billion from implementing some of the Grace Commission management reforms and $900 million from limiting rebates to Puerto Rico on distilled spirits that originate in the U.S. and are shipped to Puerto Rico for redistilling so they be claimed as products of Puerto Rico. Adding in debt service savings of $7.2 billion, plus the provisions of S. 2062, we have agreed to savings of $35.6 billion by 1987.

- Initial Finance Action: Revenues. In addition, the Committee agreed to the goal of raising $50 billion in revenue between now and 1987, provided at least that amount of spending reduction can be achieved. So far the Committee has agreed to $44.6 billion in revenue-raisers, or $23.2 billion over and above the revenue items in S. 2062. The House Ways and Means Committee has also completed markup on a $49 billion revenue package and the bipartisan working group is showing some signs of progress. So we may be on our way.

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 rose 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.

March 8, 1984

ACTION TO DATE BY THE SENATE FINANCE COMMITTEE

SPENDING	1984-87
Reconciliation	13.6 (4.2 Finance)
Additional Spending Reductions	
*Part B Premium	3.3
*Delay in Initial Eligibility for Medicare	.8
Working Aged	1.1
*Physician Freeze	2.0
Hospital MarketBasket	1.1
Lab Fee	.8
Medicaid Reduction	1.2
Alcohol Rebate	.9
Revaluation of Assets	.3
Grace Commission	3.2
Debt Sevice	7.2
Finance Subtotal	26.2
TOTAL	35.6

REVENUES	1984-87
Reconciliation	21.4
*Tax Reform	13.6
Tax benefit rule	0.8
Tax FHLMC	0.3
Freeze $5000 expensing	1.4
Extend telephone tax	3.2
Other freeze items	0.5
Electronic funds transfer	0.5
Individual Minimum Tax	1.4
Modification of Section 1231	0.4
Postpone Finance Lease Rules	2.6
Total	46.1

*in Administration Budget

(Plus $2-3 billion expected from reforms in the real estate tax area)

PRIVATE FOUNDATIONS

- o Because individual donors control the activities of foundations to a greater extent than donors to public charities control their activities, the Internal Revenue Code imposes strict limits on the amount that can be donated to a foundation, and on the transactions between the donor and the foundation.

- o Many of these rules were established in 1969 as a reaction against abuses of foundations, which were cited in numerous select Congressional committee studies on the issue. Examples of abuses included foundations being used to run businesses that competed with taxable entities, or foundations being coerced into putting donor's sons on the payroll.

- o I believe that most of the rules enacted in 1969 have worked well to limit the abuses cited in the late 1960s, and should not be changed.

- o Some persons have argued that some of the restrictions on the deductions for amounts donated to foundations and the reporting and other administrative requirements governing foundations have contributed to a decline in the birth of new foundations. Senator Durenberger and others have introduced S. 1857, which addresses some of these issues. The House Ways and Means Committee has proposed an extensive foundation reform bill that has received much attention.

- o One provision of S. 1857 would allow donors to private foundations to receive the same level of deductions as donors to public charities. Treasury and the American Bar Association oppose this measure, arguing that because of donor control and the foundation's ability to accumulate funds, foundations are different than public charities.

- o Treasury has proposed a compromise on this issue that is contained in the House bill. The compromise would increase the current level of deductible gifts to foundations without putting the foundations on complete par with public charities. I believe that this proposal may have substantial merit.

- o A controversial proposal in the House bill is the so-called "administrative expenses" provision that was apparently intended to put a stop to extraordinarily high trustee fees and other administrative costs (The abuse cited involved a trustee fee of $500,000) but which may in some cases hamper the operation of foundations.

- I expect that we will take a closer look at this provision when the House bill is considered in the Senate, and perhaps with your help we can solve the problem of high trustee fees and other abuses with a less drastic measure.

- Both the House bill and S. 1857 also attempt to take some of the "red tape" out of establishing and running a foundation, which should be useful in helping to stop any decline in foundation activity.

SUBJECT: INCREASE VOLUNTEER MILEAGE DEDUCTION
(Armstrong and Durenberger)

Present Law

In computing their charitable contribution deduction, taxpayers may deduct their actual fuel expenses for a vehicle used to provide services to a charitable organization, or may use a standard rate of $.09 per mile.

Proposal

The rate would be increased to the standard mileage rate authorized for computing the business expense deduction for business use of an automobile. At present, the rate is $.20 per mile for the first 15,000 miles, and $.11 per mile for each additional mile.

Talking Points

- Treasury opposes this proposal. It believes that the charitable deduction under section 170 is properly limited to out-of-pocket expenses (e.g., no deduction for depreciation or a proportionate share of maintenance and repair expenses) and therefore, the distinction between the charitable contribution rate and the general business rate is justified.
- Under current law, a taxpayer may deduct his actual out-of-pocket expenses if they are in excess of the $.09 per mile rate. As a practical matter, however, this may not be a feasible alternative.