REMARKS OF SENATOR DOLE

BUSINESS INTERNATIONAL CORPORATION

Friday, October 26, 1984--6:30 p.m.--Doral Country Club
Miami, Florida

Our Economic Progress

- Our spectacular recovery remains on track and appears to be moderating to a pace that can be sustained in the years ahead. Real GNP grew 6.1% in 1983, and continued at a 10.1% rate in the first quarter of 1984, and 7.5% in the second quarter. Even with the slower growth in the 3rd quarter, this is the strongest recovery since 1961.

- With national unemployment down to 7.4%, this recovery has created 6.4 million jobs. Factories are operating at the highest capacity levels in 4 years, close to 82%. And the investment needed to sustain future growth is being made: businesses plan to increase spending on plant and equipment by 14.8% this year, the biggest increase in 18 years.

- The best news about this recovery is that inflation is staying low. Producer prices in 1983 showed that smallest increase since 1984. The 1983 CPI increase was just 3.8%, and consumer prices indicate we can sustain strong growth with low inflation. Consumer price increases are running at around 4%, and producer prices have declined in each of the last two months.

- Growth, lower inflation, and major tax relief have translated into real income gains for all Americans. Real personal income has risen by $116 billion since the low point of the recession (August 1982). For the first time since 1978, real income is growing.

- All the trends in the economy look good. Most observers believe the recent drop in the economic indicators just show a moderating pace of recovery. Meanwhile the prime rate--which rose from 6.5% to 21.5% under Carter-Mondale--stands at 12 1/2%. The misery index, which peaked at 24.5% in March of 1980, is around 11%. Auto sales and housing starts are up.

The Deficit Problem and Sustaining Recovery

- Just about everyone agrees that the deficit remains the number one obstacle to sustaining the strong recovery we have enjoyed to date. If we don't cut the deficit Federal debt will nearly double over the next five years to over $10,000 for every man, women, and child in America.

- By 1989 it would take half of all individual income tax payments just to pay the interest on the debt; the interest cost would be $250 billion, or about $1,100 for every American.

- Record deficits cannot be sustained, and they have very real costs. They drive up the cost of home mortgages, they threaten to rekindle inflation or crowd out private investment and lead to a new recession. And they hurt our businessman trying to compete overseas by keeping the dollar high, thus raising the price of goods we try to export.

- We made a good start on the deficit problem with this year's Deficit Reduction Act. The President took the lead by calling for bipartisan negotiations on a down-payment deficit package. The so-called Rose Garden plan that emerged helped us pass the Deficit Reduction Act, which makes real spending cuts of $13 billion and raises about $50 billion in revenue, largely by reforms to close off tax shelters, plug loopholes, and defer some tax breaks scheduled to come on stream.

- The immediate goal now is to fulfill the entire Rose Garden plan--aimed at saving over $140 billion over three years--by keeping future appropriations in line with that budget blueprint. That will ensure that the primary emphasis in deficit reduction remains on spending restraint, where it belongs.

<u>Mondale Deficit Plan</u>

- The Mondale plan to cut the deficit just is not credible and not very specific on the spending side. Where President Reagan puts spending reduction and economic growth first in the deficit battle, Walter Mondale reaches right for the tax increase option as a first resort. By tampering with tax indexing, the Mondale plan would hit between 30% and 40% of taxpayers: those with income over $25,000. The Mondale surtaxes and rate changes for upper incomes are just more of the same kind of backward fiddling with the tax structure that has made our tax code so inefficient. By contrast, with his rate cuts and tax indexing, President Reagan set us on the path toward a lower-rate, broader-based and fairer tax system. Mondale would set tax policy back at least four years.

- On spending, the Mondale plan has very little that is real. $51 billion is saved from hoped-for interest savings, and while $54 billion in spending cuts are proposed, so are $30 billion in new spending. That means $24 billion in real spending cuts by 1989, mostly unspecified (like 'management initiatives'). Of the claimed $176 billion in deficit reduction in this plan, $153 billion comes from tax hikes, interest savings, and economic growth assumptions.

Major Tax Reform

- There is still a lot of interest in major reforms to make tha tax system simpler, fairer, and economically more efficient. The Treasury Department will report its options in December, and the Finance Committee is holding four days of hearings to hear from the public about possible alternatives.

- Everyone wants to improve the tax code, but it is important to build a consensus for any far-reaching changes, or else the new system begins to unravel again right away. So it may not be possible to jump into a new system in one step: we may have to proceed gradually, indentifying areas of agreement as we go along.

- We need to know how people really feel about the trade-offs they would face under a lower-rate, broader-base, or modified 'flat' tax. Would they really give up their favorite deductions and credits in return for lower rates? Or do they really care most about the bottom line--the size of their tax payment?

- We may be able to agree on some basic principles of tax reform, set a goal, and take initial steps toward that goal. That is why we are examining in some detail the more popular flat or 'quasi-flat' proposals, plus consumption taxes and the like. The important thing is to be sure that we are making an improvement: otherwise it is not worth the effort.

- Contrary to the uninformed assertions of the Mondale campaign, the Reagan Administration is not planning to propose a national sales tax or a so-called Value Added Tax. Treasury Secretary Don Regan has said repeatedly that those are among the least-favored tax options. Besides, do not forget that the President wants tax reform--not tax increases, which he continues to oppose.

TAX REFORM

Tax Reform Is Needed

- In view of the complexity, unevenness and declining revenue base of the present tax system, basic tax reform is certainly well-justified.
- Any basic tax reforms must address international, as well as domestic, transactions. But the issues are more complex when the taxation of international transactions is examined.
- In addition to the general goals of lowered rates and broadened tax base, we would have to examine the impact of changes on the ability of our companies to compete in the international marketplace as well as whether the tax laws encourage investment either in the U.S. or elsewhere.
- Our tax laws today do not have a consistent policy toward export of jobs or capital, though the explicit decisions of Congress seem generally to encourage investment in the U.S. rather than elsewhere.
- For instance, we give better ACRS treatment for property used in the U.S. and generally only allow the investment tax credit for U.S. property. However, on the other side, we have the possessions credit to encourage investment in the possessions and the foreign earned income exclusion for U.S. persons working abroad.
- It would seem to make sense that we should decide on our goals before we undertake to reform the system.

Some Basic Issues of International Tax Reform

If we do address basic tax reforms we have several basic tax issues.

1. We now tax our citizens and residents on worldwide income -- with some exceptions such as the partial exclusion for foreign earned income (Sec. 911), the possessions credit (Sec. 936) and the Foreign Sales Corporation provisions.

   We will have to decide whether worldwide taxation continues to make sense and, if so, what exceptions are appropriate.

2. If worldwide income continues to be the base, the foreign tax credit rules should at least be reviewed to see if the rule can be made to work more efficiently to accomplish

the purpose of the foreign tax credit -- avoidance of double taxation -- without influencing where a company invests.

3. Our current system also allows a certain amount of deferral of tax on foreign income. The purpose behind this deferral would have to be examined along with an examination of the types of activities which should receive this benefit.

<u>Most of the Tax Reform Proposals Now Before Congress Would Substantially Reduce Corporate Incentives</u>

- In an effort to simplify the tax system and broaden the base, most of the so-called "flat" tax or modified flat tax proposals would repeal or undercut the current tax incentives designed to make U.S. industry competitive in the international market.

- Indeed, there does not seem to be much thought or analysis given to the effect of many of these tax changes on international business.

- Under these bills, most of the capital formation tools would be eliminated or blunted.

- For example, all of the major tax reforms contenders -- Kemp-Kasten, Bradley-Gephart, Roth-Moore -- would repeal the Investment Tax Credit and the Bradley-Gephart bill would dismantle the ACRS system enacted in 1981.

- All of the major tax reform contenders would repeal the Research and Development Credit, which the Senate voted this year to make permanent.

- Many of these proposals would radically alter the current taxation of income earned abroad.

- For instance, the Bradley-Gephart bill would abolish the deferral of U.S. tax on controlled foreign corporations, the Section 936 possessions corporation credit, and the Section 911 exclusion for income earned abroad.

- Both the Bradley-Gephart, and the Kemp-Kasten bills would repeal the DISC system (and presumably also the new FSC system) and the maritime construction fund exclusion.

- I would hope that all of you focus carefully on the international implications of these proposals before Congress gets into the legislative battles on them next year.

Nature of the Deficit Problem

- After several years of running budget deficits that approach the $200 billion mark, some people seem to be getting complacent about the problem. Since the economy has continued to do well, with low inflation and strong growth, why worry about the deficit?

- The answer is that everything we have achieved for the economy in the last several years is put at risk unless we deal with the deficit. And part of the problem is that the public can't get very excited about the deficit dilemma. It seems we need to have a crisis on our hands, or some kind of visible faltering in the economy, to convince people of the urgency of reducing the budget deficit.

The Real Point

- We have heard a lot of campaign rhetoric about who or what caused the deficit. That is beside the point: everyone is to blame, because all of us together have put more demands on the government than we are willing to finance through taxes. Unless we lower some of our expectations for government involvement--meaning reduced Federal spending--deficits will persist.

- Sustained deficits in the $200 billion range are a real threat to continued recovery. Unless deficits decline we will either have to absorb Federal borrowing with higher inflation, or accept slow growth and rising unemployment as the Federal government absorbs the bulk of available credit. Without assurance that inflation will remain under control and credit available at acceptable rates of interest, business will not expand through new investment, and jobs will not be available for our sons and daughters when they are ready to enter the workforce.

Risks Ahead

- Time is of the essence, because we are at the point where economic expansion will either continue, competing against heavy Treasury borrowing, or the recovery will slow and possibly slip into recession. In either event the deficit problem will compound itself: each year that we add $200 billion in new Federal debt adds about $15 billion to the next year's interest costs. The exploding cost of servicing the Federal debt will make controlling spending that much more difficult each year.

What Needs To Be Done

- We have to set realistic goals for dealing with the deficit, and we have to agree at the outset that the sacred cow is a thing of the past: everything in the budget has to be on the table, and everything has to be scrutinized for possible cost-savings. It is not acceptable to say that we have done all we can to reduce Federal spending when the budget represents 25% of the gross national product.

Freeze Option

• A lot of people think that 1985 may be the year of the budget freeze, and there is a lot of interest in Congress in the possibility of an across-the-board freeze on spending for a year or two, until we get our fiscal house in order. For example, a 1-year spending freeze, allowing for 5% real growth in defense, could save $150 billion over 3 years. That would be a major step toward establishing a clear downward trend in the size of the deficit.

Attack Spending First

• Spending must remain our first line of attack in reducing the deficit. Spending must be financed by either taxes or borrowing, and either method of finance takes resources away from the private sector and limits our economic potential. At the same time, the revenue option may have to play a role, as President Reagan puts it, as "a last resort". The deficit problem is so large that no option can realistically be ruled out.

All Aboard

• Whatever approach we choose, everyone is going to have to share in the effort to close the deficit gap. We want a strong economy with stable prices, rising productivity, more jobs and more challenging, future-oriented jobs. We are on the verge of achieving that goal, thanks to President Reagan, and we will achieve it if we build public support for deficit reduction. People will accept a limited, short-term sacrifice for the cause of fiscal restraint if they understand that it is the best investment they can possibly make for their own, and their families', economic future. That is what is at stake in the deficit debate, and that is why I am confident we will join together in a bipartisan effort to do the job.

International Trade

Talking Points

- One of the significant accomplishments of the 98th Congress was the passage of the Trade and Tariff Act of 1984 (TTA).
- The significance of the TTA lies in what it omits as much as what it includes.
- After all the talk about domestic content legislation, steel, shoe and copper quotas, trade reorganization and a host of other controversial measures, the TTA contains no hint of any of these provisions.
- In light of an anticipated $130 billion trade deficit this year, it is especially significant that the bill extended for 8 1/2 years, the Generalized System of Preferences, which provides duty-free treatment for certain imports from the underdeveloped world.
- In a similar trade liberalizing vein, the bill authorizes the negotiation of free-trade zones, specifically with Israel, and the reciprocal reduction of tariffs on semiconductors.
- It is hoped that the authority to negotiate bilateral free trade arrangements may induce other countries to join in trade liberalization.
- The TTA recognizes, for the first time, the importance of trade in services (including banking); The President is directed to negotiate reduction in barriers to trade in services (a sector in which the U.S. has the competitive advantage and which represents a major portion of our GNP.)
- Not included in the TTA were controversial changes in U.S. trade laws involving natural resource subsidies and downstream dumping.
- Since we are likely to continue accumulating a large trade deficit in 1985, I would expect that there will be renewed pressures from various sectors for protection; we in Congress will have to face again the budget deficit as a significant contributing factor to the trade deficit.

Congress and the World Debt Crisis

Talking Points

- The struggle over the IMF quota increase in the 98th Congress reflects the congressional desire to impose greater discipline on the U.S. lending institutions which have the greatest exposure in the debt crisis.
- Congress was persuaded to contribute $8.4 billion to the IMF quota increase in exchange for the adoption of measures which enhance the safety and soundness of the banking system, such as a system of special reserves for banks which have experienced protracted loan repayment problems.
- But other consequences of the debt crisis were not addressed by the IMF legislation and are becoming more evident, almost certainly requiring congressional attention in the coming months.
- The debt crisis has aggravated the U.S. trade deficit as the debtor countries accumulate larger trade surpluses with the U.S. in order to pay their external debt.
- The trade deficit in turn reflects the burdens placed on U.S. exporters and on U.S. producers who compete with imports and spawns protectionist pressures.
- In spite of recent favorable rescheduling of Latin American debt, it appears that the debt burden on the Latin American debtor nations will continue to absorb an unbearably large proportion of their resources, thus inhibiting their economic growth and aggravating their social and political instability.
- Although no concensus has emerged in Congress, there are some obvious options which will probably be considered next year:
    - Inaction; that is, hoping that private bank rescheduling and continued economic growth will resolve the crisis. This seems to be the Administration's strategy.
    - Legislating government-to-government negotiations to reduce (temporarily or over long-term) the interest charges borne by the loans and to change the terms of repayment.

- Legislating inducements to the banking community (through the tax code or otherwise) to make further concessions on the debt of the debtor countries.

- Of course, Congress could make a great contribution to the world debt crisis by reducing budget deficits which are believed to contribute to the high interest rates that are such a burden on the debtor countries; but when it comes to the debt situation, we must remember that the debtor countries will not be aided by cuts in our Federal budget deficit that push this economy into a recession.

- Congress can also make a great contribution to the debt crisis by avoiding protectionist measures which prevent the debtor countries from exporting to this market; in this respect, the Trade and Tariff Act of 1984 was a notable acccomplishment. (See talking points on international trade.)