REMARKS OF SENATOR DOLE

AMERICAN STOCK EXCHANGE

Wednesday, November 7, 1984--2:30 p.m.--Mayflower Hotel
Washington, D.C.

1. 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 one of our strongest recoveries.

- 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 increased by 4.1% in fiscal 1984, 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%. The misery index, which peaked at 24.5% in March of 1980, is around 11%. Auto sales and housing starts are up.

2. The Budget And The Deficit

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 move swiftly 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.

Procedural Changes

• There is a lot to critize in the was we prepare a budget, and it may be necessary to impose some external controls on Congress. The President has asked for a line-item veto, which I support and which could be effective. There is still strong support for some kind of balanced budget or fiscal restraint amendment in the constitution that would help restore a more balanced fiscal posture in the years ahead.

• Still, nothing will work unless Congress and the President have the will to make it work. Unless we forge a consensus in favor of deficit reduction, no budget procedure will do the job.

3. Major Tax Reform

• There is 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 held 4 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.

4. International Implications of U.S. Economic Policy

- It is clear that high interest rates and a stable (or rising) dollar continue to attract investment from abroad into the U.S. But it is hard to pinpoint a single cause why the dollar is staying so high, or why interest yields in the U.S. continue to be more attractive than those in other developed countries. Clearly the high U.S. budget deficits are a major factor: but so are Federal Reserve policy, and general concerns on the international scene that make the U.S. seem to be a safe haven.

- The attraction of capital into the U.S. has a number of consequences. First, it helps finance our national debt, so that continuing high budget deficits have not yet caused the kind of "crowding out" or skyricketing interest rates that many economists feared. But it is not clear how long the day of reckoning can be postponed if our fiscal imbalance is not corrected. Financing our debt abroad, plus major tax relief and strong equity markets that reduce private sector credit needs, have so far helped prevent a crunch. But as other countries experience their own economic recoveries, the situation could change significantly: the foreign investment in our debt could dry up.

- In addition, the attractiveness of the U.S. for investment has a major impact on the balance of trade. A strong dollar makes it more difficult for U.S. producers to sell their goods overseas, and easier for foreign producers to market goods here. This means, at least in the short run, slower growth and fewer jobs in U.S. companies that depend heavily on export markets. But it also means lower costs to U.S. consumers because of competition from imported goods, and increased incentives for U.S. producers to keep costs down and be more efficient. So there is both an impediment to growth in our export industries, a boost to growth for U.S. importers, and an anti-inflationary effect.

- In the long run the present situation--large U.S. budget deficits, restrictive or moderate monetary policy, and a large U.S. trade deficit--probably cannot be sustained. But while there will have to be a correction, it need not be a sudden or drastic change, as many doom-sayers have claimed. We should not forget our recent history, when double-digit inflation and other problems drove down the dollar and undermined our ability to generate the capital needed for stable growth. Lower deficits, low inflation, and higher rates of capital formation and investment remain the keys to a stable, growing economy. That is why we need to tackle the deficit problem now, encourage the Federal Reserve to run a steady course without throttling the recovery, and choose tax and spending policies that favor savings and investment.

- The key is to work for greater stability in international economic relations and avoid the kinds of sudden shifts and flip-flops that characterized the '70s. We need consistency: it is difficult for the U.S., after all, to argue that third-world nations should use the free market to guide their development strategies and seek overseas markets if we fail to foster stability in international markets. High U.S. deficits and a high dollar are destabilizing because they cannot be sustained in the long-run--and they run the risk of fanning the fires of protectionism in this country. That is directly counter to our goals of promoting growth in Latin America and throughout the developing world. Instead we must work, steadily and surely, to reduce our deficits and erode the barriers to trade that frustrate the goal of greater growth and prosperity around the globe.

5. International Trade

- 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.