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BOB DOLE
KANSAS

United States Senate
OFFICE OF THE MAJORITY LEADER
WASHINGTON, DC 20510

May 6, 1985

TO: Senator Dole

FROM: George Pieler

SUBJECT: Talk to Government Research Corporation

Attached are materials for your talk to the Government Research Corporation Foreign Investment Policy Forum on Tuesday, May 7 at 8:30 a.m. The talk will be at the Congressional Hall of Honor of the Reserve Officers Association, 1 Constitution Ave. N.W.

The main interest is in the deficit, tax reform, and the economic summit. Materials attached are on the deficit and the budget plan, tax, trade, and the dollar.

Attachments

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Key Points on Budget Compromise

• Through spending cuts alone, the plan would reduce the deficit by $52 billion in FY 1986, $99 billion in FY 1987, and $146 billion in FY 1988.

• Cuts of this magnitude--totaling $296 billion over 3 years--would leave remaining deficits of $175 billion in FY 1986, $146 billion in FY 1987, and $98 billion in FY 1988.

• This plan reaches the goal we set of getting the deficit down to 2% of GNP by 1988, without tax increases.

• Every area of the budget is hit hard: the President's defense request is cut in half, 17 programs are terminated and still others are phased out, and permanent entitlement savings are achieved by modifying the calculation of all non-means tested COLAs (a 2% guarantee with a CPI-2 formula if inflation is higher than 4%).

• These are real, meaningful cuts and should have a significant impact on financial markets. Preliminary results from a survey of leading Wall Street financial advisers indicates that we should expect interest rates to drop by 1 or 2 percentage points in the near term and by as much as 3 points in 1988.

• If that happens and keeps the recovery on track, we can expect:

-almost 7 million new jobs by 1988
-housing starts back up to the 2 million units/year level
-inflation staying down at 4% or less
-national personal income up by $800 billion by 1988
-potential increase of 18-26% in net income for small business (due to lower interest rates)
-a potential increase of $2-4 billion in net farm income (due to lower interest rates)

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ESCALATING DEFICIT

The main threat to continued economic expansion is run-away Federal spending.

- o Since 1940, the Federal Government has run deficits in 37 out of the last 45 years. Since 1960, we've run deficits in 24 out of 25 years.

- o In 1985, the gross Federal debt will total $1,841 trillion, an increase of 533% over 1960, 238% over 1975, and 101% over 1980. The total debt in 1985 now stands at 48% of our GNP.

- o With no changes in Federal spending policy, CBO projects that Federal outlays will rise from $950 billion in 1985 to $1,378 trillion in 1990--an increase of $428 billion in five years.

- o If no changes are made, the budget deficit will increase from $214 billion in FY 85 to $300 billion in 1990 and the National debt will increase to $2,786.

INTEREST ON THE DEBT

This massive increase in debt has itself created one of the largest and fastest growing components of Federal spending--interest on the debt. Constant deficits have put fiscal policy on an endless treadmill of paying for the irresponsibility of previous decades:

- o In 1965, interest on the National debt cost $9 billion and consumed 1.4% of GNP. By 1980, annual interest costs rose to $52 billion--2% of GNP. But the worst was yet to come.

- o In 1985, interest on the National debt will cost taxpayers $130 billion--almost three times the level of five years ago. This represents 3.8% of GNP, 13.5% of the entire 1985 budget, and a 1,450% increase in costs over 1965.

- o $130 billion is equal to the sum total of all Federal spending from 1789--the founding of the Republic--to 1936. It also equals total Federal outlays in 1966, the entire defense budget in 1980, and twice the level of medicare funding today.

- o To put it in even simpler terms, about 40% of all revenue collected by the Federal Government from personal income taxes ($330 billion in 1985) will go to pay interest costs and no Federal services at all.

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- Under current fiscal policies, if no action is taken to curb deficits, interest on the debt will rise to $230 billion in 1990, about 15% of the budget. This will equal almost half of all personal income tax revenue.

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Taxes

- The President and the American people have sworn off tax increases as a deficit solution, and no one in Congress seems to want to suggest otherwise. So as far as taxes are concerned, the focus will be on tax reform and ways to improve the distribution of the tax burden.

- There have been a lot of reports and analyses of inequities in the tax code, including one by Joe Pechman on who pays taxes, and one by Ralph Nader's Public Citizen group on corporate loopholes. Despite all the headlines, the bottom line conclusion is one we have known for a long time--payroll taxes and bracket creep raised the tax burden on working people, while the proliferation of tax loopholes cut taxes for the upper incomes and corporations. There, in nutshell, is the source of most of the momentum for tax reform.

- Working people have legitimate concerns in the tax debate: protection of the tax free status of fringe benefits that workers have bargained for, including health insurance--greater equity for the average taxpayer through lower rates and larger personal exemptions. Businesses and workers who don't benefit from rich fringe benefits have legitimate concerns, too, which is why we expect a long and lively debate.

- Clearly tax reform is important, because we must have a tax system that our people believe in and will support without coercion. But unless we deal with the deficit, initiatives such as tax reform will fall by the wayside--because our fiscal crisis will demand all our energy if it gets worse.

- Republicans led the effort to reduce and index tax rates, close corporate loopholes, shut off some upper-income benefits, and improve tax compliance over the past four years. Taken together these changes are the best improvements in tax policy for working people in many years. And without them, scheduled increases in the payroll tax would be pinching workers much more severely than they are. And President Reagan's Treasury Department wants to go further--their reform plan would reduce individual rates, while increasing business taxes by 37 percent.

- The latest report by the Joint Committee on Taxation shows that tax loopholes and preferences will amount to about $424 billion in 1986. Tax loopholes are on a rapid growth path--which is why people are troubled by the unfairness of a "swiss cheese" tax base.

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TRADE

Japanese Trade Confrontation

- Senate passage (92-0) of Danforth resolution calling for Administration restrictions on Japanese imports if trade deficit continues to grow is showing results. Prime Minister Nakesone has made strong personal efforts to make his people aware of the need to import as well as export. Liberalized access is being negotiated for pharmaceuticals and medical supplies as well as for telecommunications equipment. Other sectors under review are forest products and electronics.

- Proof will be in the effect of these initiatives on the trade deficit. The 1984 level was $36.8 billion out of the total U.S. merchandise trade deficit of $123.5 billion. Raising the quota for automobile exports from 1.85 million units to 2.3 million (450,000 increase) will need to be offset to prevent the deficit from growing in 1985/86.

- Limited progress was made at the Bonn economic summit with most nations concurring on the need for new trade liberalization talks (France dissenting). Still further Senate action on the Danforth bill to require Administration restrictions may be unnecessary at this time. Nakasone has indicated that further tariff reductions will be announced by the end of June.

- The U.S. should continue to concentrate its efforts on putting its own economic house in order through deficit reduction and not exaggerate the impact of foreign imports or look for scapegoats. The trade gap and the sharp rise in foreign investment in the U.S. are important, but they will be best addressed by getting interest rates and the value of the dollar down.

GATT Trade Negotiations

- The Administation will continue its effort to solidify support from major trading partners. The EEC has agreed, providing the agenda is defined in advance -- meaning they do not want to commit to negotiating the use of export subsidies on primary products, including agriculture. Preliminary talks on a possible agenda for trade talks will start this summer.

- Agriculture groups are suspicious that the negotiations will be used only to delay action in responding to foreign subsidies on farm exports. If agriculture is to be included in the talks, the U.S. should be willing to use the same tactics in the interim.

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The Dollar

- The concern our trading partners have about the dollar is twofold. First, they believe the high value of the dollar is a function of high U.S. interest rates, which in turn result from large budget deficits coupled with a relatively restrictive monetary policy. Our trading partners have to compete with those high interest rates, and high rates tend to inhibit growth and increase unemployment.

- Another concern is that our high rates attract capital into the U.S. out of the other industrialized nations--inhibiting investment that could create jobs there. Actually, capital inflows into the U.S. have not grown substantially since 1981: but capital outflows from the U.S. have dropped substantially (60% in 1983). In other words, we are keeping more of our own capital at home rather than investing it abroad.

- A moderate, gradual decline in the value of the dollar would help both us and our trading partners. It would improve our ability to export, potentially boost growth in the U.S., and add jobs in export-related industries. A main reason for the slow (1.3%) growth in the first quarter of 1985 is the trade deficit, as U.S. demand is satisfied to a large extend by imports. Reducing the budget deficit is the best way to moderate the value of the dollar in a controlled way, by reducing pressure on interest rates. It also reduces the risk that a sudden downturn in our economy might bring the dollar down suddenly, with potential for higher interest rates and inflation here.

- Secretary Baker declined to enter into talks on exchange rates as a precondition for trade talks, and continues to take the position that, for the most part, U.S. intervention in foreign exchange markets will occur only in cases where speculation 'distorts' the market. Presumably we have to intention of returning to the kind of heavy intervention the Carter administration used to try to prop up the dollar when it was weak. We need to focus on economic fundamentals, cut spending, keep inflation down--and encourage our partners to do much the same (coordination of such actions would be an appropriate subject for talks on exchange rates). And economic recovery abroad, lagging behind our own, will strengthen the currencies of our trading partners relative to the dollar.

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Speak

May 7

The Government Research Corporation

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Telephone (202) 223-0222
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April 19, 1985

The Honorable Robert J. Dole
141 Senate Hart Office Building
Washington, D.C. 20510

Dear Senator Dole:

Thank you for agreeing to participate in the meetings being planned for the Fifth Annual Foreign Investment Policy Forum to be held in Washington May 5-8, 1985. As you can see from the enclosed list of those who will be participating in the program, this is an impressive group of corporations being represented. In this regard, we hope you will be able to join us for one of our evening functions, for which invitations have been extended seperately. Should any of the evenings (Sunday, May 5 - Wednesday, May 8) be particularly preferable to you due to your own schedule, please do contact me with that information.

As discussed with your staff, we look forward to hearing your remarks at 8:30 am on May 7th at the Reserve Officers Association of the United States, 1 Constitution Avenue, N.W., in the Congressional Hall of Honor. As mentioned in our March 4 letters, the delegates who are coming this year have already expressed interest in gauging the prospects for tax simplification and deficit reduction, and will be particularly interested in your views in early May.

Again, thank you for participating in the Fifth Annual Foreign Investment Policy Forum. I look forward to seeing you on the 7th.

Sincerely,

Leslie Shields

Leslie C. Shields
Director
Special Projects

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