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BOB DOLE
KANSAS

United States Senate

OFFICE OF THE MAJORITY LEADER
WASHINGTON, DC 20510

May 13, 1985

TO: Senator Dole

FROM: George Pieler

SUBJECT: Talk to Former Members of Congress

You are scheduled to talk to the Association of Former Members of Congress today at lunch on the 9th floor of Hart. They hope to have time for Q & A, and generally just want your thoughts on what is and is likely to be going on in this session. In particular, they have some concern about the increasing partisanship and "decline in civility" (their words) in the House.

Also, they will be giving their annual Distinguished Service Award to Senator Fulbright. About 100 people are expected at the lunch.

Attached is an updated version of your budget materials.

Attachment

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FINAL SENATE BUDGET

PROGRAMS TERMINATED (13)

- o Trade adjustment assistance to firms
- o Conrail (Sale)
- o Appalachian Development Program
- o Economic Development Administration
- o UDAG
- o General Revenue Sharing
- o Export-Import Bank Direct Loans
- o Community Services Block Grant after 1986
- o WIN
- o HODAG
- o Section 312 Rehabilitation Loans
- o U.S. Travel and Tourism Program
- o Direct Treasury Payment for most of Postal Subsidy Program

MAJOR ADJUSTMENTS TO ORIGINAL WHITE HOUSE/LEADERSHIP (WH/L) PLAN (DOLE PACKAGE)

- o Medicare/Medicaid: reduces 3-year savings from $20.1 billion to $17.5 billion
  - No cap on state medicaid reimbursement
  - No Part B premium increase in 1986. Phased up to 30% over next five years vs. 35% in WH/L plan.
- o AMTRAK: 12%/25%/40% cut instead of termination
- o SBA: $2.5 billion 3 year savings compromise instead of total termination of lending programs ($5.0 billion savings)

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- Mass Transit Operating Subsidy: 20% cut instead of 5-year phase out
- Impact Aid Part B: Freeze at 1984 level ($78 million) instead of termination
- Postal Subsidies: Small newspapers and non-profits retain subsidized rates. Substantive legislation to limit program abuses, improve overhead allocations and spread part of subsidy cost over all regular rate users.
- Agricultural Programs: $3.5 billion added back to WH/L plan plus following programs:
  - New export incentive program using CCC stocks to counter foreign subsidies
  - New farm credit interest rate buy-down program
  - $1 billion per year add on for farm credit guarantees
  - No change in Federal crop insurance
  - Soil and water conservation cut reduced from 30% to 15%
  - Compromise on REA
- Job Corps: 30% cut instead of termination
- Student Aid: Freeze on student assistance at 1985 level and $200 million savings in GSL programs. No $8,000 cap on cost of education (Stafford compromise)
- NIH Grants: 6,000 new research grants per year vs. 5500 in WH/L

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KEY POINTS ON SENATE BUDGET

- Through spending cuts alone, the plan would reduce the deficit by $56 billion in FY 1986, and about $295 billion through FY 1988.

- Cuts of this magnitude leave remaining deficits of $171 billion in FY 1986, $145 billion in FY 1987, and $104 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 to zero in 1986, 13 programs are terminated, and permanent entitlement savings are achieved by freezing all non-means tested COLAs for one year.

- These are real, meaningful cuts and should have a significant impact on financial markets. 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 we follow through this package.

- 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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Why the Deficit Matters

- Sustained deficits in the $200 billion+ range are a direct threat of the economy, because they will lead to either higher inflation or stagnation with rising unemployment. Cutting the deficit is the key to creating lasting jobs and restoring our position in international trade.

- The worst risk is that endless deficits will compound themselves: 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 debt makes controlling spending that much more difficult.

- Endless deficits means higher interest rates--make it more difficult for people to own a home, borrow for their children's education, and plan for the future.

White House-Senate Budget Plan

- This is a very tough, very serious budget--no one understimates the difficulty of getting it passed. But it also is a balanced, reasonable package that calls on everyone--and every sector with a stake in the Federal budget--to give a little, to do with less Federal largesse than they would otherwise get.

- To demonstrate how serious this budget is: 13 programs would be eliminated. Defense would be held to an inflation increase in 1986 and to a 3% increase in each of the following two years: much less than the President wanted. And permanent savings would be achieved in all inflation-adjusted, non-means tested entitlement programs by freezing the COLA for the next year.

- In addition, to help lower-income Americans, SSI recipients would get both a full COLA and a $10 per individual/$15 per couple increase.

- All Federal pay, civilian and military, would be frozen for one year.

- The plan meets our goal of reducing the deficit to 2% of GNP by 1988, with reductions totalling about $295 billion over three years.

- This program goes beyond a freeze simply because a freeze is not enough to do the job. A freeze would not address the problem of long-term growth in spending and deficits, which is the key to eliminating fears about the stability of our recovery. In addition, a freeze just postpones making the

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policy decisions--in terms of priorities among spending program--that have to be made if we are serious about the deficit problem.

- Over the past three years deficits have totalled $606 billion: an average of 5.7% of GNP. That is just not sustainable if we want to continue a strong economic recovery.
- If we do nothing, the situation gets much worse, even under optimistic projections: $716 billion in additional deficits over the next three years.
- Under the compromise Deficit Reduction Plan, Federal borrowing as a percent of private savings would decline from an estimated 78% this year to 30% by 1988. That will dramatically reduce pressure on credit markets due to Treasury borrowing--free available capital for private investment and job creation--reduce interest rates, and help our trade position.
- Even with this budget plan, we will still be spending an enormous amount to meet the basic needs of our citizens. Nondefense spending still will increase each year, from $520 billion in 1984 to $583 billion in 1988. Similarly, combined Medicare and Social Security spending will continue to rise--from $232 billion in 1984 and $293 billion in 1988: nearly 7 times the amount that wao spent on those programs in 1970.
- Means-tested safety net programs are kept intact and will continue to grow as scheduled under present law. By 1988, safety net spending will still exceed the 1980 level by 72%.
- Agricultural programs will undergo major reforms, but by 1988 we will still be spending between $13 billion and $15 billion a year--much higher than any year before 1980. And don't forget that over the past three years we spent a record $53 billion on farm programs, while largely doing the agricultural economy more harm than good.

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Senator Betty

MEMORANDUM

TO: SENATOR/BETTY

From: Judy

Re: Kansas events May 17, 18, and 19
Military plane available

FRIDAY
May 17

7:00 p.m.

John Petersen advised me that Texaco would like to have a dinner for you on the 17th in El Dorado. Have checked with them on the possibility of having it Friday, May 10, but they cannot do it then. John indicated they would make their plane available, but since the Air Force plane is also available you wouldn't need it.

Yes____ No____

SATURDAY
May 18

10:00 a.m. to Noon

FORT RILEY - Armed Services Review - Dave Cordova has details.

Yes____ No____

OTHER KANSAS INVITATIONS THAT COULD BE WORKED IN

SATURDAY
May 18

1985 National Institute for Employment Equity Conference - Doubletree Hotel, Overland Park - We wrote a letter of support for Kansas to serve as the host for this conference.

Yes____ No____

Saturday & Sunday, May 18 and 19 - 67th Annual American Legion State Convention - Ramada Inn Downtown - Topeka

Yes____ No____

2:00 p.m. - Saturday - Law School commencemnt - Washburn University Want to present you an Honorary Doctorate Degree.

Yes____ No____

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Saturday Evening - 10-year Anniversary Benefit Banquet celebrating 1- years of emergency medical service to Johnson County - banquet going to benefit National SIDS Foundation. Regency Park - Overland Park.

Yes_____ No__✓__

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Take along

Remarks by John G. Medlin, Jr.
Chairman and Chief Executive Officer
Wachovia Bank and Trust Company, N.A.
Winston-Salem, North Carolina

Memphis Rotary Club
Memphis, Tennessee
May 7, 1985

Rod

When invited to be with you today, it was suggested that I comment on economic and financial trends. These are always timely and elusive subjects which contain enough material for a long dissertation. In the twenty minutes available, I will be able to cover only a few highlights of the economy and financial system.

Today's economic and financial landscape has some unusual features which defy conventional wisdom. Interest rates remain relatively high despite the low rate of price inflation. The federal deficit remains large despite the strong recovery of the economy and tax revenues. The stock and money markets remain erratic and appear skeptical about the future despite the landslide reelection of a popular President with a good record and promise of economic progress.

What are the reasons for these paradoxical circumstances? Are the markets out of step with reality or are they forecasting problems up ahead? The answer probably cannot be found in current business statistics and news headlines which sometimes create a false sense of euphoria or gloom. A better explanation is likely to be provided by examining economic and financial trends in longer perspective.

For two decades, the economy and financial system have been on a journey which can be likened to a trip into space by a team of astronauts. The economic and financial spacecraft has soared in a high orbit with periodic mechanical and steering difficulties. In recent years it has been re-entering the atmosphere of reality and has undergone severe turbulence. I would be sitting less nervously in my seat if our politicians were as skillful at the controls as our astronauts.

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Let's look first at the trends and the state of the financial system. The well-publicized problems of financial institutions in recent years can be blamed to a great extent on the cumulative effects of three progressively severe business and money cycles since the late sixties. The principal villains have been the fiscal mismanagement of the federal government and price inflation which skyrocketed for a decade and abruptly decelerated during the early eighties.

The price spiral of the seventies produced a financial "high." Lenders felt euphoric and were lulled into complacency as loan volume grew rapidly. Risk management practices became relaxed, and weak credits were obscured by the fast-rising value of real estate, petroleum, commodities, and other tangible assets. Most lending officers got their training and experience in relatively easy times and only had a history book acquaintance with the Great Depression.

Inflation drove interest rates above legal maximums established for many loans and deposits of regulated institutions. When market determined rates could not be paid or charged by banks and thrifts, more financial services business started moving through channels like money market funds not subject to such constraints. Thus came interest rate deregulation inspired by undeniable market forces.

In the early eighties, the relaxation of lenders was replaced by shock as inflation decelerated quickly and prices even declined in some sectors. Loans made on the assumption that rapid growth and high inflation would continue indefinitely became problems. As has been apparent, the winding down phase of an inflation cycle can be the most dangerous and damaging for the financial system. This helps explain the failures and problems of some institutions in recent years.

Because of the relatively easy and protected environment of the past, regulated financial institutions had a tendency to get a little fat and complacent in some other ways. As a consequence, the industry developed a high cost structure and excess capacity. There are simply more banks, thrifts, credit unions, brokerage firms, money market funds, and other financial intermediaries around now than can make a good living on the slower-growing volume and narrower spreads of a less inflationary and more competitive climate.

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The reaction of some financial institutions to the increased competitive and profit pressures has been to liberalize credit and pricing standards to maintain volume. One popular way is the financing of corporate takeovers and leveraged buyouts where shareholders' equity is replaced largely by debt. The seeds of future trouble are being sown before completing the harvest of agriculture, energy, international, and real estate loan problems from the past.

As the quality and liquidity of assets in the financial system have deteriorated, the funding structure has become more volatile and vulnerable. Deregulation has made deposits more expensive, less stable, and more unpredictable in cost. Many thrifts have old portfolios of lower fixed-rate long-term mortgages funded with higher variable rate short-term deposits and are losing money. The inflationary period also caused the assets of many institutions to grow faster than capital, resulting in a weakening of equity and loss reserve ratios.

On a larger scale, the financial markets have developed a speculative fever and volatile character which some old-timers say is reminiscent of conditions during the decade of disinflation preceding the Great Depression. Much of the rapidly growing variety and volume of options, futures, repos, and the like seems inspired more by speculative emotion than by business rationale. This sometimes causes behavior and swings in the equity, debt, and foreign exchange markets which bear little relationship to underlying economic factors.

Such developments have brought new elements and added dimensions of institutional and systemic risk. Shock waves can spread quickly and widely as with the closure of seventy savings and loans in Ohio by the failure of one small government securities firm in Florida. There are a lot of wounded soldiers and unexploded mines on the financial battlefield. The potential for bad surprises is great.

Despite these trends, the financial system is still basically sound, but it is more exposed to market variables and shocks than in the past. Many institutions have not succumbed to dangerous temptations, but some embark on the journey into the future with an accumulation of heavy baggage and exotic risks. It is a time when you should be especially careful where you put your money.

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You might want to select depositories which are managed as though there were no regulatory authorities for examination, no federal discount window for liquidity, and no federal insurance for bail-out. These are not intended as substitutes for proper management and capital. It is amusing that some of the most vocal advocates of free enterprise are so dependent on financial "welfare" agencies.

With due respect to financial regulators, they can serve as little more than traffic cops who catch an occasional reckless driver and arrive on the scene after bad accidents have already occurred to help minister to the dead and injured. There are several examples in recent years which illustrate the inadequacy of the regulatory process to prevent and resolve major financial disasters.

Too many people have been given the mistaken impression that their deposits are backed by the federal government rather than an agency thereof with finite resources and limited funding. I wonder if the taxpayers would be willing to dig deeply into their pockets to pay off the deposits of foreign investors or even next door neighbors who had the poor judgment to put their money into badly managed institutions.

As in other businesses, the most sobering discipline on financial institution managements can be provided by consumers and investors in the marketplace. Such discipline is vital to the functioning and survival of the private enterprise financial system. It has been weakened by the misleading safety net of deposit insurance and the misguided belief that regulators can provide the necessary quality control.

This deception may not be over until more people lose their savings, stop putting money in unsafe places, and start imposing more market discipline. To provide better discipline, however, depositors must have more complete, honest, and understandable information than presently is provided on the condition of many institutions. This is an essential ingredient to a sounder financial system.

I emphasize, the financial system is basically sound. It has displayed the strength to survive several crises. The majority of institutions in the Southeast are in good shape. However, you can no longer assume that all banks, savings and loans, brokerage firms, credit unions, and insurance schemes automatically afford safety and security. You should scrutinize carefully their management, financial condition, and fine print. Anything that looks too good to be true probably is.

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As indicated in the beginning, the problems of the financial system can be attributed greatly to an unfavorable economic climate which was inspired largely by the fiscal mismanagement of the federal government. Several years of healthy growth and financial stability will be required to repair the damage. What are the prospects for such conditions in the times ahead?

With so many cross-currents and uncertainties on the current economic and financial scene, it is difficult to forecast the prospects beyond the near horizon. The combination of a stimulative federal deficit and accommodative monetary policy should produce modest economic expansion on average for the rest of 1985, but the risk of stagnation or recession will increase with time.

There are several factors which heighten such risks. The most notable is a federal deficit which is projected to run $200 to $300 billion for the rest of this decade. The national debt is now over $1.5 trillion, and it would double to $3 trillion in seven years through the addition alone of compound interest at a rate of 10 percent. The annual interest bill is now around $150 billion, or almost 15 percent of the federal budget, and is the fastest growing expenditure.

The federal deficit serves to stimulate the economy, but it also preempts around half of national savings, contributes to higher interest rates, and in other ways restrains growth. It has a particularly discouraging effect on housing, capital investment, and job creation which compete with long-term government bonds for long-term savings and financing.

There is a shortfall of about $100 billion in the annual flow of domestic savings needed to meet the combined credit demands of the federal government and the private sector. To assure a steady inflow of sufficient foreign capital to fill this gap requires relative strength in interest rates and of the dollar, which is up 30 percent since the end of 1982. Thus, the federal deficit adds to the already serious problems of agriculture and industry in competing with foreign producers.

Large segments of our economy are being exported overseas as the purchase of manufactured goods and agricultural products shifts from higher cost and stronger currency nations like the United States to others with lower costs and weaker

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currencies. Our trade deficit is expected to total about $125 billion this year. There has been virtually no increase in domestic industrial production over the past nine months as the increase in domestic consumption was met by growing imports.

Under present circumstances there is the ever-present threat of interest rates being pushed upward by either a rise in the economy or a fall of the dollar. Our currency probably will decline in foreign exchange values eventually and help our manufacturers and farmers. However, that may not be altogether good news if the federal deficit is still enormous, if the foreign capital inflow is slowed, and if interest rates are driven up by more intense competition of the federal government and the private sector for the limited supply of domestic savings.

The Federal Reserve has a narrow range of flexibility in monetary policy to continue the difficult and delicate job of simultaneously containing price inflation, restraining interest rates, and sustaining economic growth. The only hope for balancing that equation over time is to reduce the federal deficit. To print money faster would rekindle inflation. Meanwhile, intermittent fits of optimism and pessimism are likely to keep the economy erratic and the money markets nervous.

The gloomier side of eventual possibilities is not pleasant to contemplate. No one knows the longer-term effect of increasing the federal debt and interest costs thereon continually at a rate much faster than the growth of national income or of running foreign trade and payments deficits in excess of $100 billion year after year. Such unusual imbalances are not likely to remain benign for long. Conventional wisdom suggests the growing risk of serious trouble somewhere down the road unless meaningful progress is made in reducing the domestic and international deficits.

Unfortunately, the dilemma today is that sufficient restraint in federal spending to relieve financial pressures could weaken the economy and worsen other problems. Our nation has borrowed much from the future, and repayment must be made eventually through voluntary or imposed austerity. As with the experience of many other nations, reduced domestic spending and a lower living standard ultimately will be forced upon us when our external debt gets so large that the international marketplace stops lending us money. This is a cruel legacy to leave our children.

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Unhappily, the experiences of the past raise serious doubts as to whether the necessary spending control is possible or probable in our nation which is so dominated by political expediency and special interests. There is no painless way to reduce the large deficit, and there is not much precedent in democracies for people voluntarily lowering their standard of living. This usually comes only through necessity bred of crisis, and there is no crisis--yet.

Our nation may be able to survive its economic and financial illness for a while without severe trauma. However, major surgery on federal spending is the only prescription for long-term economic and financial health. The Administration and Senate leaders have proposed an operation to remove $50 billion from the 1986 budget. This carefully crafted package of restraint would be a good first step toward a better economic and financial future for everyone, but key parts of it are being opposed by shortsighted partisans.

If you don't like the uncertainties and dangers in the outlook, you can do something about them. You can write your senators and congressmen and urge them to support the proposal which would reduce the federal deficit by $50 billion. You should do it this week as the Senate considers special interest amendments which could unravel the package. This may be the last chance to prevent the economic and financial spacecraft from crashing as it touches down on the runway.