BOB DOLE
KANSAS

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

June 21, 1985

TO: Senator Dole

FROM: George Pieler

SUBJECT: Talk to Health Insurance Association of America

You are scheduled to talk at 9:20 a.m. on Monday, June 24. They are mainly interested in your views on the course of the economy, budget, and tax reform.

Attached are materials on the Senate and House budget offers and their respective budgets; talking points on health that Sheila prepared; Rich's talking points on taxing health insurance benefits; and general talking points on tax reform.

You might want to say a few words about the 50th anniversary of social security:

- Social security is our largest domestic program, dispensing nearly $15 billion in benefits each month to about 36 million Americans. Over 116 million workers pay the payroll tax, and expenditures for the program this year will exceed $200 billion.

- In this 50th anniversary year the challenge presented by social security is still the same: how to provide a guaranteed, reasonable income supplement for older Americans to increase their chance for financial security after retirement. And we need to do that without overburdening our working-age citizens with such a high tax burden that they cannot provide for their own families. Social security is a program that should bind generations together, not separate them.

- The system has seen some rough times in recent years, but things are getting better. In 1983 we agreed to bipartisan reforms that prevented a financial crisis in social security and should reinforce confidence in the short-term and long-term viability of the system. We can be proud of social security--and proud that we have had the courage to do what is needed to keep the program sound without onerous tax increases.

Attachments

# House-Senate Budget Conference

• After days of meeting with little progress in sight, House and Senate budget conferees have begun to get down to business. The Senate made a very serious, bold offer to the House which cuts even more than our original plan--about $302 billion over three years. Unfortunately, the House responded with a counter-offer that evades all the serious issues. We ought to expect a more credible effort from our House colleagues, because the deficit is everyone's problem.

• Senate conferees proposed to meet the House halfway on defense outlays, to add another $2.1 billion to offset the freeze in the social security COLA on low income beneficiaries, and increases 17 so-called poverty-related programs. The Senate offer rejects the House-proposed 'savings' from contracting out services, which are unrealistic anyway, and retains most Senate cuts in non-poverty programs.

• The House counter-offer is hard to take very seriously. It would not touch COLAs in <u>any</u> benefit program--it sticks to the House defense figure--and it accepts a some additional cuts beyond the House budget resolution -- for instance, another $1 billion reduction in Ag programs.

• The House isn't just ignoring the tough issues, like defense and COLAs--it won't even consider most of our major reforms of programs that have no relation to need or income status, many of which are hard to justify in this era of record deficits.

• At least it appears that the bargaining has begun in earnest. But the fact remains that the Senate is facing up to the major issues, and the House conferees really aren't putting their cards on the table.

# KEY POINTS ON SENATE BUDGET

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

- o Cuts of this magnitude leave remaining deficits of $171 billion in FY 1986, $145 billion in FY 1987, and $104 billion in FY 1988.

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

- o 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.

- o 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. Rates have already trended downward--the prime is down 1/2 point to 10%.

- o 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)

## House Budget

- The House budget doesn't do enough, in a credible way, to keep the economy on an even keel and reassure financial markets.

- First of all, the House plan doesn't even aim as high as the Senate budget. It claims savings of only about $250 billion over three years, as opposed to the nearly $300 billion in the Senate plan. The House would leave the deficit nearly 20% higher in 1988 than the Senate.

- The House budget really undermines the National defense at a time when our defense posture is critical to the success of arms control talks. The Senate plan already freezes defense in 1986, allowing no real increase: there just isn't any room for further cuts without jeopardizing security. The President is absolutely adamant on this point.

- About 50% of total savings in the House budget come from defense even though defense only accounts for 28% of the Federal budget.

- THe House plan avoids major savings in entitlement programs. It also terminates only <u>one</u> program--revenue sharing--where the Senate ends 14 programs and makes significant reforms in many others. That proves the House plan doesn't bite the bullet--it doesn't do anything to ensure the long-term savings that will reassure investors and shore up business and consumer confidence.

- The House budget also is full of smoke and mirrors. $12.2 billion in savings are assumed from reducing spending for contracting out services. But most analysts view contracting out as a cost saving device. $3.7 billion is saved in "offsetting receipts" that will probably not be realized.

# Fringe Benefits

## Talking Points

- As you know, outside the retirement incentives, the only significant statutory fringe benefits from a revenue standpoint are employer-provided health care and term life insurance. The Joint Tax staff estimates that the exclusion for employer-provided medical care will reduce revenues by nearly $24 billion in 1986 and the exclusion for employer-provided group term life insurance will reduce revenues by $2.2 billion.

- Obviously, those individuals who benefit from having this compensation excluded from income tax oppose any change in current law. On the other hand, it is also clear that these individuals receive a benefit that other individuals who pay for their own health care and life insurance with after-tax dollars do not receive.

- The President's plan would impose a $300 per year floor on the exclusion for employer-provided medical care ($120 for employee only coverage) instead of the cap included in the original Treasury proposal. This is a disappointing decision. The floor would raise less revenue than the cap as originally proposed. But that is not an excuse to prefer a floor. The cap could have been raised to a level which would have had the same revenue impact as the floor.

- The major problem with the new proposal is that its only virtue is that it taxes a small part of previously untaxed compensation and allows a little more rate reduction. However, if only a portion of this income should be taxed, a cap is preferable from both a health policy and general social policy perspective. A floor will do nothing to encourage cost containment because, unlike a cap, individuals having plans with the richest levels of employer-provided benefits will receive the most from the tax exclusion. There is no benefit from increasing copayments or instituting other cost saving measures because it is the <u>first</u> dollars that are taxed rather than the last.

- On a more general level, it is likely that we will find that the floor would be fairly regressive both in the sense that a higher percentage of a less generous plan will be taxed and in the sense that employees with less generous plans are likely to be in companies which provide comparatively less compensation generally.

- In conclusion, although a good case can be made for limiting the exclusion for statutory fringe benefits in return for lower tax rates, a cap rather than a floor is a much fairer way to impose such a limit.

## 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.

- 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.

# Reagan's Tax Reform

- The President has proposed a striking and historic revision of the income tax laws. His plan would make the system both simpler and fairer.

- The present 14 brackets would be replaced by just three: 15%, 25%, and 35%. The maximum corporate rate would drop to 33% (with graduated rates for small business).

- The plan as a whole would shift the tax burden away from working people and toward businesses that have a lot of income but haven't paid their share of tax. Total taxes paid by individuals would drop 7 percent, while corporate tax payments would rise about 9 percent.

- Distributional Offset. Under the Reagan plan, families with incomes of $10,000 or less would get a 35.5% tax cut; $10,000 to $15,000, a 22.8% tax cut; $15,000 to $20,000, a 13.5% tax cut; $20,000 to $30,000, an 8.7% tax cut; $30,000 to $50,000, a 6.6% tax cut; $50,000 to $100,000, a 4.2% tax cut; $100,000 to $200,000, a 4.1% tax cut; and $200,000 or more, a 10.7% tax cut (the larger-than-average break for the top income group results from the lower top rate of 35% and the lower top capital gain tax rate of 17.5%).

- Return Free System. Under the Reagan plan, only 33% of taxpayers are expected to itemize. In addition, more than half of all taxpayers would be able to get their tax bill or refund without filing a return (if they so choose).

- Protection for Low Income. The plan would remove from the tax rolls virtually all families, married couples, single heads of households, and older Americans at or below the poverty line. This would result from the combination of increasing the personal exemption, zero bracket, earned income credit, and the new consolidated credit for the blind, elderly, and disabled.

- Indexing Protection. The plan retains the indexing protection for rate brackets, the personal exemption, and the zero bracket which we pioneered in 1981. Most plans that claim to do more for middle incomes (like Bradley-Gephardt) do not protect taxpayers against inflation and would do less for them in the long run. President Reagan also expands the indexing concept to the earned income credit, protecting the working poor, to depreciation and to capital gains (in 1991).

- Business and Growth. President Reagan proposes a system of business taxation that is more neutral and will reduce tax-motivated distortions that skew economic decisions. Repealing the ITC and revising depreciation schedules mean greater neutrality among different investment categories. Other changes that will limit economic distortions include limiting real estate tax breaks to the amount at risk, and tightening the minimum tax with regard to oil and gas tax breaks (intangible drilling costs).

- Issues to Watch. Congress will give the President's plan a very close look, and no doubt many Members will have particular changes they want to propose. In particular, there will be focus on:

  - Distribution of Tax Burden. If Treasury's estimates hold up, this is a very fair plan. Some may be concerned about the break for the top income class--but to address that would require changing the rate structure or the capital gains exclusion, both very sensitive issues.

  - Neutrality/Investment. Any perceived deviation from "neutral" tax treatment for different industries will bring demands for change from other industries. In addition, those industries most heavily subsidized by the current code--like those which benefit from the ITC because they are capital-intensive--will want to minimize the effect of the plan.

  - State and Local Taxes. Secretary Baker has said that eliminating the deduction for State and local taxes is a sort of "acid test" for serious tax reform. This is a $40 billion item over the projected phase-in period, and that amount would be difficult to make up. If high-tax States can fight off this change--even in the context of much lower tax rates and other benefits that ease the tax take on their citizens--progress may be difficult.

## Talking Points

## Rural Health Care

- Of particular concern to those of us in the midwest are the health care needs of those of our citizens who reside in rural communities.

- Rural health care needs are different than those of large urban centers. And the needs of the rural elderly are most dramatically different.

- Rural air, noise levels, and scenic beauty help combine to make the rural residents more satisfied with their community. They view their neighborhoods as safer, yet, in other aspects of their lives, the needs of elders are exacerbated by their rural residence. For example, emergency care needs are compounded by the fact that the elderly have to travel longer distances to reach medical care services.

- A reduced number of alternative living/housing arrangements for elders in rural areas may contribute to premature institutionalization.

- When our rural elderly do experience crises in their lives, help or support services are often less available and narrower in range.

- In many rural areas, the effects of distance are compounded by harsh weather, poor road conditions, and rising fuel costs.

- Comparisons of all rural non-metropolitan counties in 1980 indicated that the West North Central States (Kansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota) had the higher mean percentage of their populations (17.9%) over 65 years of age and Kansas is the highest (19.9%). So all of us in the midwest must work toward developing an appropriate mix of income support and service availability to foster maximum independence for the rural aged.

- Rural areas have only 12 percent of the nation's doctors, 14 percent of its pharmacies, and 18 percent of its nurses, yet they contain 30 percent of its total population.

- With respect to Federal initiatives, when the medicare prospective payment system was first enacted, I supported special efforts to address the concerns of small, rural hospitals. Because of the wide variation in daily census of patients and the declining hospital census in general, many of these hospitals have experienced considerable difficulty.

- However, rural hospitals are already making significant strides to meet the needs of the elderly. The swing bed program that allows rural hospitals to also provide skilled nursing care is one example.

- Some rural hospitals are broadening their services beyond traditional acute inpatient care. They are adding rehabilitation and elderly retirement centers with complete geriatric services including home care, to their vital role.

**HEALTH
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Linda Jenckes
Vice President—Federal Affairs

May 22, 1985

The Honorable Robert J.Dole
U. S. Senate
SH-141
Washington, D. C. 20500

Dear Senator Dole:

Congrats on a wonderful budget victory with many more to come! I also hope that our support through the Deficit Reduction Coalition letter supporting the Senate Leadership and White House compromise provided at least a smidge of help.

I am writing to you on behalf of the Health Insurance Association of America to be the keynote speaker at our upcoming 1985 Individual Insurance Forum/Disability Insurance Seminar. The meeting will be held in Washington at the J. W. Marriott Hotel on June 23-26. We would like you to speak on Monday, June 24 from approximately 9:20 a.m. to 10:00 a.m.

We would like you to discuss the tax reform and deficit reduction proposals in general. Your personal views about the Senate and the Administration's long-range economic goals and any impact they might have on business in general and insurance in particular would also be most welcome.

Also, since we are celebrating the 50th anniversary of the Social Security system, any thoughts you would have on the success of this private/public initiative would be appreciated.

William O. Bailey, President of Aetna Life & Casualty, and 1985 HIAA Chairman of the Board, will open the meeting at 9:00 a.m. prior to your remarks. We are most willing to accommodate your busy schedule should you want to start earlier. I will be happy to coordinate the specifics with Betty and also, provide you with an honorarium.

I would just like to add that the session will be attended by over 400 insurance executives--CEOs, officers and senior management, all of whom are most interested and affected by many proposals under consideration by you and the Administration. We hope you can make it. We know it will be the highlight of our Forum. We look forward to hearing from you soon.

Best regards,

Linda

LJ:cjm
cc Betty Meyer