BOB DOLE
KANSAS

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

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TO: Senator Dole

FROM: George Pieler

SUBJECT: Talk to Former Members of Congress – 12/4

For your talk to the U.S. Association of Former Members of Congress, attached are talking points on the deficit, tax reform, and balanced budget amendment.

Also, they would appreciate any remarks you care to make concerning the work of the Association: their efforts to educate the public as to the role of Congress, as by sending members to conduct classes on college campuses around the country. Any remarks you care to make on how Congress has changed since you first came to Washington (i.e. workload, operating procedures, shift to Sunbelt, being in the majority) would be welcome.

Attachments

Senate agenda

o For the remainder of the year, budget and deficit-control measures will dominate the Senate schedule: plus housekeeping matters that simply have to be done this year. We need to reach a conference agreement on budget reconciliation, to carry appropriations through next year, and to work out a version of the Gramm-Rudman deficit control measure: plus pass a long-term debt limit increase.

o The balanced budget amendment is still high on the agenda, but given time constraints may have to wait until early next year. But the longer we drag on with frustrated attempts to deal with the deficit through the budget process or on the debt limit, the clearer it becomes that an overriding constitutional limitation is needed. With 32 States petitioning for such an amendment, we in Congress have the responsibility to take the initiative.

o In addition, we need to have a farm bill conferenced and signed into law; we may have to deal with expiring tax code provisions; and prepare for major debates next year on comprehensive trade legislation and on tax reform.

Attacking the Deficit

- The deficit remains our number one economic problem: our number one domestic problem, because until we prove we're serious about the deficit, we will have no credibility on any other major issue, either.

- In the Senate, we have been working hard for deficit reduction: not just in supporting the Senate-White House budget, but in working for institutional reforms aimed at reducing deficits over the long term. Those reforms include the Gramm-Rudman-Hollings budget control measure and the balanced budget constitutional amendment.

- We cannot give up now, just because we haven't won all the battles we had hoped to win. Each of the initiatives we have worked for is becoming more and more urgent as time goes on. Unfortunately, the need to reform our fiscal policy may become apparent only when we approach a crisis point.

What is at Stake

- We have made tremendous strides towards putting the economy on a stable growth path without rekindling inflation. The deficit threat is the main threat to a sound economic future.

- The longer we postpone action on the deficit, the greater we increase the risk of either recession, or renewed inflation. The growing debt burden, already near two trillion dollars, simply cannot be financed without increasing costs--and growing risks--to both the American economy and the world economy.

- No one can be sure what the consequences will be if we fail to act on the deficit: and I, for one, don't want to find out. But some things <u>are</u> clear. One is that the deficit problem compounds itself. Each year that we add $200 billion in new Federal debt adds another $15 billion to the next year's interest costs. The exploding cost of servicing the Federal debt makes controlling spending that much more difficult each year. Already interest expense for FY 1986 is expected to reach $140 billion.

THE DEFICIT AND THE AVERAGE AMERICAN

- Unless we enact a massive deficit reduction measure, American families will face either higher interest rates or higher inflation: not to mention the risk of a disastrous new recession throwing millions of breadwinners out of work.

- Most economists believe that enactment of the deficit reduction package as large as the Senate offer will produce a drop of at least 1 percent in interest rates over the short run and 2 to 3 percentage points over the long term: creative to what they otherwise would be.

- With a 2% drop in interest rates, the monthly payment on a median priced home ($80,000) will go down by about $100 a month.

- Conversely, if we don't reduce the deficit to keep rates as low as they are now, homeowners could face that large an increase-or-more in monthly payments.

- A 2% drop in interest rates would mean an additional $4,000 in income for the average wheat farmer with a 1,000 acre operation.

- This year alone, the Federal Government will overspend close to $1,000 for every man, woman, and child in America.

- This $1,000 per head of additional Federal debt will be one more burden for our children to repay in higher taxes or higher inflation in the future.

- I don't believe we can let this budget negotiation fail. If we don't act now on major deficit reduction, the American people will pay the price. By 1989, interest on the debt alone would take up half of all individual income tax payments. The interest cost would be $250 billion or $1,100 for each American.

- If we can get something like this package I am very, very optimistic about the course of the economy. I think we take too much for granted what we have achieved so far: strong growth without inflation. We can keep that going if we reduce the deficit substantially. The way is open to economic performance unprecedented in the postwar period if we have the will to find it.

ESCALATING DEFICIT

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

- 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.

- 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.

- 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.

- 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:

- 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.

- 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.

- $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.

Tax Reform Talking Points

- Conceptually, the President's proposal and the Ways and Means Committee bill are quite similar--they both shift more of the tax burden to corporations and reduce the tax burden on individuals.

- Both substantially reduce tax rates for individuals (the President to a maximum of 35%; Ways and Means to 38%) and for corporations (President 33%; Ways and Means 36%). But the Ways and Means rates take effect at much lower income levels: the 35% rate clicks in at $43,000 for married couples, as opposed to $70,000 under the Reagan plan.

- Neither plan gets an A+ for the major objectives of tax reform--simplification and fairness.

- The President's plan repealed many of the complicated provisions of current law and thus did a better job of simplification than the Ways and Means Committee effort, which modified, but left in place, many of the complex incentives.

- If fairness means having taxpayers with equal incomes pay similar amounts of tax, the Ways and Means Committee did worse than the President. Fringe benefits and itemized deductions are the major causes of differing tax liabilities. Unlike the President's proposal, Ways and Means retained the State and local tax deduction, limited interest paid deductions less, and did nothing on fringe benefits.

- The Ways and Means Committee retained many of the politically popular big-ticket items. Unless we want to tackle those, the Senate will have limited flexibility in trying to enhance investment and savings incentives.

- I have personally long favored income tax reform and, as Chairman of the Senate Finance Committee, lead the fight over a number of years to plug unjustified tax loopholes.

- Nevertheless, I know that many of my Senate colleagues have no enthusiasm for the President's version of tax reform and even less for the Ways and Means bill, which they view as even more likely to have harmful economic effects. In the Senate, with its more open procedures, it is easier for a determined minority to block or slow down a bill they oppose.

- It is possible that the Senate might be able to fashion its version of a tax reform bill by June, but only with intensive effort by the President to push the bill and reshape it along the lines he favors.

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

  - Distribution of Tax Burden. Some are concerned about the break for the top income class--but to address that would require changing the rate structure on the capital gains exclusion, both very sensitive issues. Secretary Baker's proposals to drop inventory indexing, eliminate 401(k)s, and restore the child care credit will help make the case this is a revenue-neutral plan.

  - 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. A compromise that doesn't lose much revenue may be necessary.