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Joyce

March 11, 1986

Ms. Betty Meyer
Personal & Appointment Secretary
Office of Senator Robert Dole
141 Hart Senate Office Building
Washington, D.C. 20510

Dear Ms. Meyer:

This will confirm Senator Dole's acceptance of our invitation to have him speak at our Executive Committee lunch, Friday, March 14 at the Hunt Room of Bullfeathers, 406 First Street, S.E. Senator Dole should arrive promptly at 12:15.

We will begin with a few minutes for Senator Dole to meet and have pictures taken with our luncheon participants (it is a small group), and then would like him to talk to the group briefly and answer questions. The Senator is welcome to stay for lunch, but we have arranged our schedule to permit his visit and departure before lunch is served.

By way of background, our association is big (126,000 agents, 220,000 employees), broadly-based (small business members in 50 separate state associations and hundreds of local boards), and politically active (our PAC last election cycle raised and spent about $500,000, including a generous contribution to Campaign America).

Individually, our members are politically active too, typically involved in local and community activities, state and federal politics, and often serving as campaign and finance committee operatives for congressional candidates. At our lunch, Senator Dole will be talking to our association's national governing and legislative committees, and our national PAC chairman.

Legislatively, our guiding principle is the state regulation of insurance. In congress, that translates into opposing or moderating efforts to insert the federal government into the insurance business. Our other great passion is keeping the banks out of the insurance business (our reasons are in the enclosed materials -- it isn't as selfish as it sounds). Senator Dole should be familiar with this issue if only to answer the inevitable question he'll get from the audience.

The other two big preoccupations this congress are tax reform (we like the idea, but not the taxes on us), and insurance availability (the courts and congress have conspired to render certain risks uninsurable, and those risks are now asking congress for help).

Apart from passing reference to these issues (perhaps to register his support for our positions), I would urge the Senator not to make this an insurance speech (good grief, anything but that!). He should cover the broad issues of the day from a perspective only he can bring to them. Our Executive Committee luncheon participants are accustomed to getting the inside story, and would be eager to hear Senator Dole frame the Republican side of the debate for the issues on the national agenda.

Please call if you have any questions.

Cordially,

Roger

Roger N. Levy
Vice President-Government Affairs

RNL:imr

Enclosures

THE LIABILITY CRISIS

- Probably the biggest domestic problem after the Federal budget deficit is the so-called "liability crisis."

- In our society, we have a basic preference that in many situations it is appropriate to spread the cost of a catastrophe broadly, rather than leaving the victim to bear the burden alone. That is the whole concept behind insurance, as you know better than I.

- Sometimes it just doesn't make sense for the user of a product for example, to insure himself against the possibility that he may be hurt. Rather, we assume that the risk can be more appropriately spread by having the producer of a product assume the liability which he can in turn insure against. He can then spread the cost of the liability among all his customers in the form of higher prices.

- However, in recent years, we have a number of major changes in the concept of liability have come together to cause a real crisis.

- First, we are seeing a trend toward strict liability, regardless of fault or negligence of the producer of a product or performer of a service and regardless of contributory negligence on the part of the person who has been harmed.

- Second, we have seen a trend to larger and larger jury awards which include more than just compensation for economic loss. They also often include pain and suffering and punitive damages. While some of these amounts make sense as true compensation for loss, some of these amounts are disguised attorney's fees and some are really fines against the defendent. This confusion in what is being compensated is making it difficult for insurance companies to price premiums and is causing shrinking coverage, as well as higher premiums.

- That is not to say that the insurance industry has played no role in the probleme. There are probably some pretty good argument that insurance companies have been more interested in increasing market share then in pricing their premiums realistically. Now consumers are paying the price in higher premiums.

- There are no easy solutions to these problem. No one should think that there are. We have to analyze some basic tenants of our tort system to see if they are appropriate in our increasingly complex society. At the same time, we will have to review our insurance system as well as to see if improvements can be made.

INSURANCE TAX ISSUES

- As I am sure you know by now, Senator Packwood's tax package includes tax reforms for property/casualty insurance companies along the lines suggested by the various industry trade groups.

- While the Committee bill may not be precisely the same as either Senator Packwood's initial proposal or the industry suggestions, I am confident that we will be able to agree on something, both in Committee and the Senate floor, that the industry can accept.

- Obviously, that still leaves the problem of what will happen in conference. I know the industry is united in its opposition to the House provision, and that should help when we get to conference. Assuming that revenue estimates for both the House and Senate provisions are similar, industry support may make a major difference in how this issue is resolved.

THE ECONOMY IN 1986

- No one can really predict the course of the economy in 1986, although of course we have to take a stab at it to guide our budget decisions. But it is increasingly clear that the economy began picking up late last year. Leading indicators rose 0.9% in December, the eighth month in a row. Unemployment is down to 6.7%, the lowest since 1979.

- There are forces at work that improve the prospects for strong growth this year. One of these is the drop in oil prices, which acts like a tax cut for energy users and helps moderate inflationary pressures that might build as a result of the dollar's decline. Coupled with the monetary stimulus the Federal Reserve provided in the last six months of 1986, and the prospect for improvement in our balance of trade later in the year (as the effects of the dollar decline are felt), this means we have a good chance for healthy growth in 1986.

- Clearly the number one threat to maintaining a healthy economy remains the U.S. budget deficit. If it's not reduced sharply this year, we won't meet the commitment we made to our trading partners to secure their agreement to ease the dollar down. What's more, we would put an unconscionable burden on the Federal Reserve to keep the recovery going by pumping more money out in order to keep interest rates down. That's a sure recipe for inflation.

- We've created 9 million jobs with a near record economic recovery. We've got inflation down to the lowest levels in two decades. Let's not throw it all a way by punting on the deficit issue. The fact is that <u>all</u> the economic pundits we've been hearing in recent years have been wrong: the economy is more resilient than many believed, but not so strong as to be able to sustain huge deficits this late in the recovery. It's time for everyone to "give" a little in the interest of a deficit-reduction plan that will steer us safely through the potentially treacherous waters ahead.

Gramm-Rudman, the Dollar, and Inflation

- Gramm-Rudman should help us meet the commitment we made last September to our trading partners: to reduce the deficit as part of our effort to moderate the value of other dollar.

- By the same token, the risk of inflation should be reduced if we bring down the deficit under Gramm-Rudman, because the pressure to pump up the money supply to keep interest rates down will ease considerably.

Gramm-Rudman: Challenge to the Established Fiscal Order

- The first actions in response to the new Gramm-Rudman deficit control reform will be taken early in 1986. For those of you who missed it, late last year the Congress imposed a new fiscal straightjacket on itself. The new law sets firm deficit targets for each of the new five years, and mandates automatic across the board spending cuts if the deficit exceeds the target. The first round of automatic cuts under the proposal will take effect March 1 unless Congress comes up with a better way to meet the target.

- In addition, President Reagan's budget for fiscal year 1987 is due to Congress by February 5. So we will have reconsideration of the 1986 budget proceeding simultaneously with our first shot at the 1987 budget.

That is a tall order, but is one we ought to be able to fill. Difficult as it seems, we should remember that the Gramm-Rudman law contains new procedures designed to make it easier to meet the deficit targets. We explicitly bring loan programs and other 'off-budget' items into the budget process; set a point of order against legislation from committees that have not met their budget savings allocation; and rule out of order legislation inconsistent with the deficit targets.

Possible Problems. We know there will be a rocky road ahead in implementing Gramm-Rudman. Congressmen Synar and others already have won the first round in their suit claiming it is unconstitutional, and the Reagan Administration also has some problems with the role of the Congress' General Accounting Office in mediating the deficit forecasts. The Supreme Court will have to give us a final ruling on all that in a few months. Even more important, what Congress can legislate, Congress can back out of. That's why we need a constitutional mandate for budgetary restraint, as well as a statutory one.

TAX REFORM EFFECTIVE DATES

- Last December the Senate passed my resolution urging that the effective date for most provisions of tax reform legislation should be January 1, 1987. The reason for making tax reform "prospective only" is to eliminate the cloud of uncertainty that pending tax reform legislation leaves over many economic decisions that are influenced by tax policy.

- The House also passed an "effective date" resolution, urging the chairman of the tax-writing committees to agree on some determination of effective dates other than the January 1, 1986 date in the House-passed bill.

- Unfortunately, since last December little progress has been made in clarifying the effective date issue. Chairman Rostenkowski has made it fairly clear that he thinks the House bill effective dates are appropriate, although he is willing to remain open to selective changes in those dates.

- Last week eleven members of the Finance Committee sent a letter to Senator Packwood urging that markup of tax reform legislation be delayed until the effective date issue is resolved. I am not sure that is the best strategy, but it is another indication of how much members are concerned about the effective date problem.

- There is still some hope that Rostenkowski, Packwood, et al. can agree on a statement to resolve some of the uncertainty on effective dates. The closer we get to Senate action on the tax bill, the more likely it becomes that Senate's decision on effective dates will be the most important signal we give to the business community of our intentions on the issue.

March 12, 1986

Tax Reform Talking Points

- The President's tax plan and the House bill are similar in concept--they both shift more of the tax burden to corporations and reduce the tax burden on individuals. But the bills are very different in how they make the change.

- 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, but the President's plan repealed many more of the overly complicated provisions of the tax code than the Ways and Means Committee effort. The House bill just modifies, but leaves in place, many complex tax rules.

- The House bill falls far short of the President's on fairness grounds. Fringe benefits and itemized deductions are major causes of differing tax liabilities, and unlike the President's proposal, the House retained the State and local tax deduction, did less to limit interest-paid deductions, and did nothing on fringe benefits. This means that taxpayers with equal incomes can still have substantially different tax liabilities.

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

- The Senate Finance Committee now is expected to begin action on tax reform around March 19. A lot of difficult decisions await the Committee if it is to make significant progress towards the goals the President has outlined: lower tax rates, a $2,000 personal exemption for everyone, and more incentive for saving and capital investment.

- The 'Packwood draft' of tax reform goes a long way toward meeting the President's goals, including a top rate of 35% and a $2,000 personal exemption for all but the wealthiest taxpayers. Still there are many controversial points that will be closely scrutinized.

--the deduction for State and local sales and personal property taxes would be repealed, and that for income taxes would be available only through the first two brackets.

--Interest deductions would be more severely limited than in the House bill, including a $1,000/$2,000 limit on the consumer interest deduction.

--The minimum tax would have a lower rate and a broader base than in the House bill, but is still likely to be controversial.

--Excise taxes would be increased significantly including those on beer and wine.

o On the plus sides, from the viewpoint of many taxpayers--

--The nonitemizer charitable deduction would be made permanent without adopting the floor under the charitable deduction included in the House bill.

--Investment credit repeal would not take effect until March of this year.

--ACRS would remain the basic depreciation system, with a limited inflation adjustment allowed.

--The R&D credit would be made permanent.

--The amount of new equipment costs small businesses can expense would be dramatically increased.

o All in all, the Packwood draft does a better job of lowering tax rates while encouraging new investment and a productive climate for business.

- So Gramm-Rudman hasn't made our options any easier: but if it works as planned, it will force us--and the President--to make some decisions and choose among the various deficit-reduction options. That means everyone's cherished spending programs will be put to the test of fiscal responsibility.

<u>Spending the Key</u>. Finally, let me emphasize that Gramm-Rudman is a device for reducing Federal <u>spending</u>. It is <u>not</u> a tax increase plan, or a subterfuge for one. If we fail on the spending front, we can look at other options. But the sooner we entertain any revenue options, you can bet the pressure for spending cuts will drop fast.

<u>The Deficit and the Average American</u>

- Unless we follow a deficit reduction path like that mandated under Gramm-Rudman, 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. That is what the Gramm-Rudman-Hollings initiative is all about.

- Most economists believe that enactment of deficit reduction measures that eliminate the deficit by the end of the decade 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: relative to what they <u>otherwise</u> would be.

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

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

  -- In 1985, 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.

Interest on the Debt

The 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 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.

But _if_ we can adhere to the deficit-reduction goals we've set for ourselves, 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.

COMPARISON OF HOUSE-PASSED TAX REFORM BILL (HR 3838) AND PACKWOOD PLAN *

Individual Taxes

	HR 3838	Packwood Plan
Individual tax rates	Four rate brackets set at 15, 25, 35, and 38 percent, indexed	Three rate brackets set at 15, 25, and 35 percent, indexed
Capital gains rate	22-percent effective rate	Retain 20-percent rate
Personal Exemptions	$2,000, indexed; $1,500 for itemizers	$2,000, indexed; phased down to zero for agi's between $100,000 and $200,000
Zero bracket amount:	New standard deduction:	New standard deduction. Details unavailable
Single	$2,950	
Joint	$4,800	
Heads of household	$4,200	
Two-earner deduction	Repeal	Same as HR 3838
Earned income credit	Increase (700 maximum)	Same as HR 3838
Fringe benefits:		
• Health	Not taxed	Same as HR 3838, but self-employed may deduct 50 percent of amount paid
• Group-term life insurance, legal services, dependent care, education assistance, van pooling	$50,000 exclusion for life continued; legal services, education assistance extended through 1987; $5,000 cap on dependent care; van pooling not extended	Same as HR 3838, except legal, education aid made permanent, no dependent care cap
Wage Replacement		
• Unemployment compensation	Taxed	Same as HR 3838
• Workers' compensation	Not taxed	Same as HR 3838
Itemized Deductions:	No overall cap	Allowed only against 15- and 25-percent rates; exceptions for home mortgage interest, real property taxes, and charitable donations
• State and local income, property, and sales taxes	Deductible	Income taxes fully deductible for most taxpayers, real property taxes deductible, personal property and sales taxes not deductible
• Charitable contributions	Deductible for itemizers; non-itemizers keep deduction above $100 floor	Same as HR 3838, but full deduction for non-itemizers made permanent
• Mortgage	Deductible for principal residences, second homes	Same as HR 3838
• Other interest	Limited to $10,000 individuals, $20,000 joint filers plus net investment interest; cap includes limited partnership interest	Same as HR 3838, but dollar limits set at $1,000 and $2,000
Meals and entertainment expenses	Deductible up to 80 percent	Same as HR 3838

THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037

COMPARISON OF HOUSE-PASSED TAX REFORM BILL (HR 3838) AND PACKWOOD PLAN * (cont'd)

Individual Taxes

	HR 3838	Packwood Plan
Retirement savings:		
• IRA limit	$2,000	Same as HR 3838
• Spousal IRA	$250	Same as HR 3838
• 401(k) plans	$7,000 limit with first dollar-for-dollar offset of IRA cap	$7,000 limit with last dollar-for-dollar offset of IRA cap
Minimum tax	25 percent rate, adding preferences, including tax-exempt interest on non-governmental bonds, losses from passive investments, untaxed appreciated property contributed to charities	20 percent rate, adding preferences, including tax-exempt interest on all bonds, phase-in passive losses, no preference for appreciated property
At-risk rules	Extend to real estate, with third-party financing exemption	Same as HR 3838
Generation-skipping taxes	Flat tax of 55 percent, dropping to 50 percent in 1988. Direct transfers would be taxed	Current law
Tax compliance		
• Estimated tax payments	Lesser of 100 percent of previous year or 90 percent of current year's liability	Detail unavailable
• Information returns	$100,000 top penalty; $5 penalty for incorrect information	
• Fraud penalty	75 percent of underpayment due to fraud	
Excise taxes	Generally, same as current law	Equalize beer and wine tax; increase alcohol, tobacco, and motor fuel as prices increase

Corporate Taxes

	HR 3838	Packwood Plan
Corporate tax rate	36 percent top rate, graduated rates for small businesses: 15% —Below $50,000 25% —$50,000 to $75,000 Phase out over $140,000	35 percent top rate, graduated rates for small businesses same as House bill
Excise tax deduction	Retain	No deduction for federal excise taxes and tariffs
Dividend relief	Exclusion repealed; 10 percent dividends-paid deduction; phase-in over 10 years beginning in 1987	Exclusion repealed, but no dividends-deduction

COMPARISON OF HOUSE-PASSED TAX REFORM BILL (HR 3838) AND PACKWOOD PLAN * (cont'd)

Corporate Taxes

	HR 3838	Packwood Plan
Timber	Repeal special capital gains rate for corporations, reforestation tax breaks, special amortization rules for preproduction costs, except for small producers	Current law
Financial institutions:		
• Special bad debt deduction	Repeal only for banks with over $500 million in assets, tighten for thrift institutions	Repealed for all banks; tighten for thrifts
• Deduction for interest to carry tax-exempts	Repeal	Generally, same as HR 3838
• Exemption for credit unions	Retain	Retain
Insurance companies:		
• Deferral for life insurance and annuity income	Retain	Same as HR 3838
• Life insurance reserve deduction	Retain	Same as HR 3838
• Special life insurance deductions	Repeal	Same as HR 3838
• Tax-exempt status of Blue-Cross, Blue-Shield; TIAA-CREF	Repeal	Retain
• P&C reserve deductions	Retain current law, but include 20 percent of unearned premium reserves in income annually; include a portion of tax-exempt bond interest in income; special minimum tax takes effect in 1988.	Discount reserves, using 5-percent rate; include 20-percent of unearned premiums in income
• Deduction for additions to protection against loss account	Repeal	Repeal
Municipal bonds	Limit projects funded by private-purpose bonds; reduce volume caps but expand types of bonds under caps, including small-issue IDBs, multi-family housing bonds, mortgage revenue bonds; add new arbitrage restrictions	Retain current law volume caps but expand to include multi-family housing bonds; make mortgage revenue bonds permanent; tighten arbitrage rules
Minimum tax	New alternative tax with 20 percent rate; add preferences, including tax-exempt bond interest, FSC income	Same as HR 3838, but use 20-percent rate; add dealer installment reporting, capital construction funds as preferences
Net operating Losses	Replace 1976 rules with provision for stock purchases, tax-free reorganizations; allow parent firm to absorb NOLs at rate based on long-term tax-exempt bond rate	Adopt most provisions of staff subchapter C project
General Utilities Doctrine	Repealed	Same as HR 3838, but also modify rules for taxation of mergers, acquisitions, and other transactions as was proposed by staff subchapter C project

* Prepared by Bureau of National Affairs, Inc

PREMLIMINARY

ESTIMATED REVENUE EFFECTS OF THE SENATE FINANCE COMMITTEE STAFF TAX REFORM OPTION, FISCAL YEARS 1986-1991,
Prepared by the Joint Committee on Taxation
Released March 13, 1986
[Billions of Dollars]

Individual	-184
Corporate	110
Nondeductibility of excise and tariffs	62
Excise	13
Employment	-2
Total	*

* Less than $500 million

PERCENTAGE TAX CHANGE BY INCOME CLASS UNDER VARIOUS PROPOSALS, 1988

Income Class (Thousands of 1986 Dollars)	Administration Proposal	House Bill	Finance Committee Staff Option
Less than $10	-67.1	-74.7	-77.2
$10 - 20	-16.3	-22.8	-23.0
20 - 30	-8.1	-9.7	-9.7
30 - 40	-6.3	-9.3	-9.3
40 - 50	-6.1	-7.9	-6.7
50 - 75	-6.3	-7.8	-7.3
75 - 100	-9.9	-6.0	-5.1
100 - 200	-10.1	-7.5	-4.2
200 and above	-13.6	-6.0	-5.9
Total	-9.8	-9.1	-8.4

Note: These figures do not take account of certain provisions affecting individuals. Thus, the total tax reductions are somewhat different from what is indicated in this table.

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ENVIRONMENT: SUPERFUND CONFEREES MAY HAVE TO WORK INTO EASTER BREAK TO FINISH BILL, SEN. STAFFORD SAYS

Superfund conferees may be forced to work into Congress' Easter spring break scheduled to start March 26 to attempt to finish reauthorization of the hazardous waste cleanup law, Sen. Robert Stafford (R-Vt) said at a March 13 meeting of the conferees.

The conferees reached agreement on 16 outstanding issues between the House and Senate version of the measure (HR 2005), to extend the Comprehensive Environmental Response, Compensation, and Liability Act (superfund law) for another five years, including hazardous