3/17/86

BOB DOLE
KANSAS

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

March 14, 1986

TO: Senator Dole

FROM: George Pieler

SUBJECT: Talk to General Agents and Managers Conference, National Association of Life Underwriters

Attached are materials for your Monday speech in Baltimore to the General Agents and Managers Conference of the NALU. Their main interest is in tax reform. Included are talking points on the House bill vs. the Packwood Plan on major life/health insurance issues and some pension issues.

This group is comprised of actual owners and managers of agencies, not insurance agents: in other words, these are businessmen and entrepreneurs.

Attachments

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Insurance Tax Reform Issues

- On individual policyholder issues, the House refused to accept any of the principal changes proposed by the President. The Packwood proposal is along the same lines.

- The House bill and the Packwood proposal take the position follows the AALU position that inside buildup on life insurance should remain untaxed. They also generally leave unchanged inside buildup on deferred annuities, with some exceptions.

- On the fringe benefit side, the House bill leaves unchanged the tax treatment of group term life insurance and group health insurance. The Packwood proposal does the same, and also allows the self-employed to deduct 50% of amounts paid for health insurance.

- While the House bill did not repeal section 401(k), as suggested by the President, it did reduce the cap on elective deferrals from $30,000 to $7,000. So does the Packwood proposal.

- In addition, the House bill provides a "first-dollar" IRA offset. Therefore, rather than affecting only a small number of employees,it wll impact nearly everyone who participates in a 401(k) plan. This really does not make much sense from a policy point of view. It seems to be driven by a desire for more revenues, rather than anything else. Fortunately , the Packwood proposal would change that to a "lost-dollar IRA offset (that is, the offset wouldn't begin until you exceed $5,000).

- Setting the maximum amount that can be set aside in a tax-favored pension plan is an arbitrary thing, and it is hard to argue that the House proposal to reduce the maximum annual retirement benefit from $90,000 to $77,000 is obviously inadequate. However, it may be argued that we need to allow these limits to remain untouched and allow indexing to go into effect again so that people can adequately plan for their retirement.

- The Packwood proposal would delay indexing of the dollar limit on additions to a defined contribution plan until the current limit ($30,000) is no greater than 25% of the dollar limit for defined benefit plans.

- The Packwood proposal also imposes a 15% excise tax on aggregate annual distributions from all tax-favored retirement arrangements in excess of the specified dollar amounts (the amount is $112,500 for 1987).

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.

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.

- 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.

Spending the Key. Finally, let me emphasize that Gramm-Rudman is a device for reducing Federal spending. It is not 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.

The Deficit and the Average American

- 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 otherwise 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 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.

  -- 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 <u>if</u> 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 <u>without</u> 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.

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