OUTLINE OF REMARKS

FUTURES INDUSTRY ASSOCIATION

March 6, 1982 - Boca Raton Hotel

I. The Economy -- Where We Stand Now

A. Economic Recovery Program Remains Our Only Real Alternative

1. The President's policies have just begun to take hold, and we have made dramatic progress on inflation, which dropped to 8.9 percent in 1981. That is the lowest since 1977.

2. We must stay the course. Returning to stability and prosperity will take time. High-tax, high-spending policies got us where we are - there is no hope if we return to that route.

3. High interest rates in part reflect market skepticism in view of past policy flip-flops. Nevertheless, interest rates have shown a significant downward trend that must be sustained: 16 1/2% is better than 21%. We have to show the financial community a consistent, steady course, keep spending under control, and keep in place the tax changes that encourage greater savings, work, and investment.

B. Economic Downturn

1. The resumption of monetary restraint, following a too-late attempt by the Carter administration to gin up the economy, has combined with long-term problems in autos, housing, and other sectors to induce recession. There is sound reason to expect a decisive upturn this year.

2. No one deliberately induces recession. But major shifts in policy can bring unsteadiness in the economy as we make the transition. The only alternative is the inflation roller-coast, accompanied by stagnation.

3. The President's program should leave the economy well poised for recovery and stable growth. For once changes in tax and fiscal policy will be timed aid growth while inflation is being wringed out of the economy. We can improve our chances by acting promptly to moderate projected deficits.

II. The 1983 Budget

A. This is a credible budget. While some may prefer a different 'mix' of spending cuts and tax changes, the proposed budget advances the President's plan in a realistic manner.

B. The President recommends additional spending cuts and management changes saving over $40 billion in fiscal year 1983. Even those who prefer a different mix must agree that the overall level of spending cuts is the minimum we should do, in face of triple-digit deficits. Congress must cooperate, but we believe no area is exempt from cuts, even defense: because no area is free from waste.

C. It is clear we will have to raise some revenues, as the President acknowledged by recommending $32 billion in loophole-closings and administrative tightening over 2 years. We should raise revenues only for the goal of offsetting the deficit. It is not an excuse for avoiding spending cuts: we have found that higher taxes do not balance the budget so long as Congress is always inclined to spend more.

D. The projected deficits--$98.6 in 1982, $91.5 in 1983, $82.9 in 1984--are too high. But if we do nothing, the figures will be worse. In addition, the numbers do show a steady downward trend in the deficit as the economy expands. That is the goal we have to achieve. Remember, the steady decline in inflation is one of the major reasons why the deficits are larger. Inflation is expected to drop to the 4% range by 1984.

III. Some Perspective on Our Situation

A. A Growing Economy

1. By 1986 the administration expects the economy to grow from $2.8 trillion to $4.6 trillion. Such growth means a better ability to finance our defense needs and critical social programs, without taxing the life out of the economy.

2. If we have slower growth, then we have to reexamine our options: what is most important in the budget, and where we could raise revenues with the least harm. CBO and the administration are in basic agreement on economic trends: this is the time to strike a prudent, but optimistic, balance. But clearly $100 billion deficits are unacceptable, economically or politically.

B. 1981 Tax Act and the Deficit

1. The 1981 Tax Act, though the largest tax cut in history, just stabilizes the tax burden. Revenues still will rise from about $600 billion in 1981 to about $800 billion in 1985. Receipts by 1987 should be 18.7% of GNP - the same as the average between 1963 and 1973. Without action, receipts would have been a crushing 24% of GNP in 1987.

2. The question is how high a deficit can be tolerated without "crowding out". Increased savings due to tax changes and the drop in inflation should ease pressure in financial markets. We can do more to ease that pressure without undermining the economic program.

IV. Future Agenda for Tax and Fiscal Policy

A. Revenues

1. Thrust of future tax legislation will be to eliminate abuses and obsolete incentives and improve tax administration and collection. The 1981 Tax Act shows this trend, as in closing the commodity straddle loophole.

2. The administration proposes raising $32 billion over 2 years by tightening in these areas, and by new enforcement devices. Depending on the size of spending cuts we can agree to, Congress may want to increase this figure.

- Completed contract method for multiyear defense contracts. ($6.3 billion over 2 years.)

- Cut back business credits that duplicate conservation efforts of decontrol ($.4 billion over two years). (Congress is not sympathetic to this.

- Industrial development bonds (restrict, require matching efforts from State or locality, etc.) ($1 billion over two years).

- Eliminate insurance industry loophole (modified coinsurance). ($4.1 billion over two years).

- Capitalization of construction period interest and taxes. ($1.5 billion over two years).

3. Underground Economy

a. The Compliance Gap

The IRS estimates that $70 to $80 billion is lost annually though noncompliance with the federal income tax laws.

b. The Proposals

Proposals being finalized by the Finance Committee staff would improve the current system of information reporting. 9 to 16% of interest and dividends paid go unreported. We can improve the reporting system and impose real penaties on those who refuse to comply.

c. The Administration

The administration has proposed 5% withholding -- an option that we cannot rule out, but that has been unpopular. All aspects of noncompliance, including, for example, underreporting of tips and capital gains, may be addressed by better information reporting.

d. Coverage

In addition, new penalties would hit the sophisticated tax avoider and the fraudulent corporate tax manager.

e. Revenue Effect

The draft proposals are expected to generate between $3 and $5 billion annually.

4. Minimum Tax

a. Current Law

Current law includes three very complex minimum taxes, two on individuals and one on corporations. These taxes raise only $1.5 billion and still permit significant numbers of taxpayers to pay no tax.

b. Administration Proposal

The Administration would address this problem by creating a new alternative minimum tax on corporations. This would raise about $2.3

billion in the first year, rising to the $4 billion range.

c. The Dole Proposal

The proposal being considered would completely revise and simplify the minimum taxes. In lieu of the overlapping alternative and add-on taxes on preference items, the minimum taxes on corporations and individuals would be a flat rate of, perhaps 15% on a comprehensive, economic income base.

d. The Tax Base: Individuals

Included in the tax base for individuals might be adjusted gross income and items like excess accelerated deductions, contributions to IRA's and Keoghs, the stock option preference, intangible drilling costs, certain excluded items and other items.

e. Corporations

Corporations' tax base will begin with taxable income and addback similar preference items of accelerated depreciation, certain deferred income, and excluded items.

f. The minimum tax is fully consistent with the 1981 tax cut. That tax cut provided incentives by reducing marginal tax rates. The marginal tax rate of a minimum tax will only be 15%: all taxpayers with substantial real income ought to pay some income tax.

g. Revenue Effect

The proposal is tentatively expected to produce approximately $2 billion annually from the individual tax and $5 billion annually from the corporate tax.

5. Another option is to accelerate indexing in lieu of the 1983 rate cut. As inflation drops less rate reduction is needed to offset bracket creep. This could raise $18 billion over two years.1983 rather than proceed with the 10% rate cut and index later. This option could raise $17 billion or more over two years.

6. Capital Gains--6 Month Holding Period

1. In 1981, House version of ERTA contained a reduction in the holding period for long-term capital gains from 12 months to 6 months. However, the provision was not agreed to in conference.

2. Still considerable interest in the investment community for a shorter capital gains holding period, and it is an issue Congress will want to examine. Arguably a shorter holding period could greatly increase realizations of gains and need not mean any signficant revenue loss.

3. At the same time, we should remember that Congress just cut the capital gains rate to a maximum 20% in 1981, and we may want to evaluate the results of that change before proceeding to further modify the taxation of capital gains.

4. We should also remember that one of the reasons we tax capital gains at a lower rate is the notion that such gains are accumulated by the holding of assets over an extended period, and that they should therefore not be taxed as though they were all income in one year: hence the lower rate. This rationale would not apply if the holding period were made as short as 6 months.

5. Clearly Congress is interested in any proposal that would have a positive effect on economic activity, and the 6-month holding period will be reviewed with that in mind.

B. Entitlements and Social Programs

1. Reform of basic entitlement programs, which will be necessary to hold budget in line. Administration proposals in the 1983 budget would save about $52 billion over 3 years. Finance Committee will try to work with administration to reach agreement.

2. Some reconciliation savings already made in these areas for fiscal year 82:

AFDC	$1.1 billion
SSI	107.0 million
Unemployment Compensation	786.0 million
Title XX Social Services	700.0 million
Medicaid	944.0 million

3. Between 1970 and 1981, entitlements other than social security rose 412% - 15.6% per year.
That cannot be sustained.

4. Medicare will likely cost $50 billion in 1982, and Medicaid $32.5 billion. Hospital costs rose 18.6% between October 1980 and October 1981. This cannot be sustained. Reforming reimbursements, more private sector options, and greater competition all should be considered.

C. Social Security

1. We have restored the minimum benefit and authorized temporary interfund borrowing. Now the President's Task Force, chaired by Alan Greenspan, is preparing to address the long-term problems of social security. The recently announced deterioration in the medicare trust fund confirms that social security is seriously underfinanced. Some action may be necessary before the Task Force completes its work.

2. Only if the economy performs considerably better than in the past 5 years could social security remain solvent beyond 1984 or 1985. Even then, chronic and severe deficits are likely to become apparent by the end of the decade.

- Under the most recent projections by the Social Security Board of Trustees, the combined reserves of the system fall dangerously low (below 14 percent of outlays) in 1985. The system would be unable to pay benefits beyond 1987 (when reserves fall below 9 percent of outlays).

- Under more pessimistic economic assumptions -- more like recent experience -- social security would be broke by late 1983.

3. Even today, the trust funds are seriously depleted -- with reserves equal to 23 percent of outlays or barely 2 to 3 months' worth of benefit payments. The history of the trust funds indicates that reserves equal to 100 percent or more were the norm prior to 1970.

4. Even if we take the steps necessary to shore up the system in the 1980's, there is still a long-term deficit of $6 trillion short of expenditures in the next 75 years, measured in current dollars.

5. Further tax increases, beyond those legislated in 1977, are not the solution. The long-term cost of social security must be brought into line with taxpayers' willingness and ability to pay for it.

IV. Private School Tax Exemption

A. Background

1. On January 8, the Treasury Department reversed its position in the Bob Jones and Goldsboro cases pending in the Supreme Court.

2. Treasury concluded that the Government lacked legal authority to continue its ten-year policy of denying tax exemption to private schools that racially discriminate, despite court rulings indicating consitutional problems with granting such exemptions.

B. Legal Issue

1. The policy of denying tax exemptions has been upheld as a proper interpretation of the Code, read in conjunction with other laws, by two U.S. Courts of Appeals.

2. There are also important issues of religious freedom involved in these cases. The issue arises when religious schools claim that they discriminate because of religious beliefs.

C. Legislative Prospects

While legislation has been proposed, the administration now has asked the Supreme Court to resolve the two pending cases that could give Congress the guidance it needs.

"New Federalism"

A. Program Swap with the States

1. The President recommends sweeping changes involving Medicaid, AFDC, Food Stamps, and grant programs along with earmarking excise tax receipts for the States. This program swap will be a major concern of the Finance Committee, which has jurisdiction over revenues, AFDC, Medicaid, and revenue sharing. In

addition, the Nutrition Subcommittee will be involved in the Food Stamp proposal.

2. This is a bold move, but it is easier said than done. The States want to know how the resources they are gaining will match up with the new program responsibilities. Dialogue between Governors and the administration shows there is room for compromise.

3. This is a good opportunity to really examine which functions are most appropriate to the Federal government. For example, we must determine whether food stamps can be adequately administered by 50 States, and some safeguards against inequities are needed.

B. Trust Fund/Revenue Sharing

1. The President wants to phase out a number of grant programs that may be more sensible for State and local governments to administer. Federal excise taxes will be set in a trust fund to help States assume these new responsibilities. The fund and the taxes will be phased out over a period of years so that by the end of a decade the Federal government will have ended these programs and the excise taxes at the Federal level.

2. Crucial questions must be answered: who will be the winners and losers? What formula will determine the allocation of trust fund receipts to the States? How strong will be the obligation to pass through funds to local governments?

3. These are difficult questions, but there is merit in sorting out the wide array of grant programs, not all of which serve a national purpose. The notion of encouraging States to opt out of Federal grant programs is similar to the grant-trading proposal I introduced during the revenue sharing debate in 1980.

C. Enterprise Zones

1. The President also wants to establish enterprise zones to benefit from targeted tax incentives and, hopefully, Federal, State, and local regulatory relief. The notion of unleashing free enterprise makes sense: but there are difficulties.

2. There is a risk that zones may put businesses outside the zone at a competitive disadvantage. We do not

want to drain business activity from the periphery of zones.

3. The extent to which local commitments made to secure zone designation are binding on the locality must be made clear -- we cannot lure enterprises into depressed areas under a promise that cannot be enforced.

4. Shifting economic resources around would not be enough. We ought to have some assurance that new activity is likely to be generated.

5. The selection of zones -- if limited to 25 per year for three years, as proposed -- will be a touchy matter. If it is to have any meaning, this should be an experiment in free enterprise, not a new pork barrel.

6. There is no panacea for urban blight. At most we can give localities some new tools to work with in redeveloping neighborhoods. AT the same time, our primary emphasis must remain on the general economic growth we need to creat jobs across the land.

V. Conclusion

As in 1981, a bipartisan cooperative effort is needed, involving the President, the Congress, and State and local leaders. Contrary to what some may think, if we hang, we all hang together. The future of the economy -- jobs, industry, trade, and development for the good of all -- is at stake. This is no time for partisanship or "quick fixes".