# OUTLINE OF REMARKS

## BUSINESS GOVERNMENT RELATIONS COUNCIL

June 23, 1982 - 12 Noon - University Club

I. The Budget--Continuing Need for Action

A. Both Houses have approved budgets, and it is clear that the cause of deficit reduction is more, not less, urgent. The President agrees with that--the Senate agrees with that--the Speaker agrees with that. That is why there is still reason to be optimistic that we can work out an agreement to tackle the red ink this year.

B. The President stresses maintaining the fundamentals of his program, and there are many ways to increase revenues, deal with entitlements and appropriations, and moderate defense spending without sacrificing those fundamentals. The margin of compromise that is available ought not to be allowed to slip away.

C. Congress cannot evade the fact that it is the source of the main problem--the uncontrolled growth of Federal spending in recent years. That spending momentum, aggravated by past inflation and current recession, is the cause of the record deficits now projected.

D. We should get a reconciliation mandate once the budget resolution is agreed to. We cannot stop now: only prompt and convincing action to implement the budget will ease the fears of financial markets.

II. The Economic Recovery Program

A. Sticking to Fundamentals

1. The deficits are not a result of the Reagan program, but of deep-rooted economic problems, some of which were underestimated by the administration. But we have to follow through on the administration's fundamentally sound principles of spending reduction, lower taxes to restore incentive, a firm but fair monetary policy, and a strong defense.

2. We must aim at sustaining recovery after the recession. That is what the debate is all about. No one advocates tax increases or further 'drag' on the economy while recession persists.

3. Significant progress is being made on the economy. Inflation in 1981 drooped to 8.9%, the lowest since 1977. Producer prices dropped in both February and March, and in March the CPI declined by three-tenths of

a percent--the first such decline since 1965, and the largest drop since 1953. This is dramatic progress on what everyone considered to be our number one economic problem.

4. Interest rates remain too high, but they have come down. 16 1/2 percent is better than 21 percent, and there is reason to expect a continuing, if gradual, downward trend this year.

B. The Recession

1. The recession is the reason our problems are more acute than anticipated. It has driven down revenues in the short run (lower inflation and slower growth) but has a lagged effect on slowing spending, while in the near term unemployment and related costs increase.

2. In 1980 the Carter administration tried to prime the pump after experimenting with monetary restraint--the subsequent clampdown proved that the 'recovery" from that recession was a false one. Only now are the full effects of that same recession being felt. The important thing this time is to ensure a sustained, real recovery.

III. Options Before Us

A. Basic Principles

1. We cannot proceed without parameters--guidelines. The sooner we narrow the range of options, the better.

2. We cannot, for instance, allow the need for revenue increases to justify uncorking the spending bottle. Too often Congress has used tax increases to spend more, not cut the deficit.

3. For the same reason the individual tax cut should be kept out of bounds. It is mainly an offset for bracket creep, and we do not need further resort to the inflation tax as an excuse to avoid responsible budgeting.

4. Spending must be brought down--there is no other way to get a handle on the deficit. That means entitlements and so-called uncontrollables have to play a role.

B. Entitlements.

1. Reform of basic entitlement programs is needed to bring the budget in line. Administration proposals for 1983

would save about $52 billion over 3 years. We should try to meet or exceed that figure.

2. Partly due to cost-of-living adjustments, entitlements (other than social security) rose 412% between 1970 and 1981. We cannot sustain that kind of growth.

3. As an example, Medicare is expected to cost $50 billion in 1982, and Medicaid $32.5 billion. Hospital cost rose 18.6% between October 1980 and October 1981. We cannot afford this rate of increase, and must consider reforming reimbursements, more private sector options, and greater competition in the health care industry. The budget agreement would save $18.2 billion in Medicare over 3 years and $2.2 billion in Medicaid.

4. At some point COLA's must be reconsidered. In the 1970's social security cash benefits grew at a pace of 14.2% each year. That is cause for concern. Real savings can be made consistent with keeping social security recipients on a par with wage earners in our society. For example, moving to a 2/3 CPI adjustment could save as much as $5.4 billion in 1983, $50 billion by 1986.

IV. How We Need to Raise Taxes

A. Many people are perplexed at the fact that we are considering sizeable tax increases this year, when we passed a tax reduction program last year that was supposed to restore certainty to the tax laws. The budget deficit problem is one major reason for the shift, of course: but many of the revenue options we are talking about are needed irrespective of the deficit problem. They are needed in the interest of fairness, simplicity, and economic efficiency.

B. We can get more revenue out of the present tax code. By improving compliance--which has dropped off in recent years because of inflation, high marginal rates, and the proliferation of special tax privileges--we can raise about $20 billion over three years. By cutting back on the inefficient tax leasing provision, we can raise a few more billion. And there are many other loopholes and preferences that no longer serve an important purpose, and which should be cut back or eliminated: tax breaks for self-employed pension savings, industrial development bonds, and insurance industry loopholes.

C. There is a consensus that we should concentrate on improving our tax laws before we slap on new taxes. This is the approach the Reagan Administration has taken in proposing revenue options. Everyone must pay fair share of tax: it is hard to justify new taxes, or cutting back the tax cut for working people, while we continue to let special exceptions turn our tax base into swiss cheese.

D. Once we have done all we can to increase revenues within our present tax structure, we can turn to additional taxes if necessary to reach our targets. But we should remember that our committment to individual rate reduction and capital investment incentives should not be undermined.

V. <u>The 1983 Tax Cut</u>

A. There has been a lot of talk about using the 1983 tax cut to raise revenue because that is "the path of least resistance." The President disagrees, and I disagree. That cut is needed to help American workers--it is needed to offset bracket creep and payroll tax hikes. And it is a firm promise we made to the American people.

B. <u>Who is helped</u>. There has also been a lot of criticism of the individual tax cut on the grounds it helps the rich at the expense of the average worker. There are even some reports that the Deomocratic Party, at its upcoming mini-convention, will attack the tax cut on these grounds, while shying away from attacking the third year. Maybe the word is getting around that the American people want to keep their tax cut. In any event, the 'rich man' allegation is <u>false</u>. 36.6% of the 1983 cut goes to people with incomes between $10 thousand and $30 thousand. 53.7% of the tax cut goes to Americans earning $20 thousand to $50 thousand. 70% goes to those under $50,000.

C. In addition, it is worth noting who would be hurt <u>worst</u> by tampering with the third year. The group whose tax liability would rise the MOST is that $20-$30 thousand income class--in other words, the average working American. If this is a rich man's tax cut, explain it to the working man.

VI. <u>1981 Tax Act and the Deficit</u>

A. 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.

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

C. Many provisions of the tax act aid capital formation and innovation: R & D tax credits, capital gains reduction to 20%, IRA and other savings incentives. These coupled with rate cuts and accelerated depreciation, form the framework for regeneration of business activity.

D. Tax Indexing. Indexing is the major tax reform of 1981, and it is here to stay. It is also the most progressive change, and the most meaningful for working Americans. Indexing just means that congress is accountable for tax increases--we cannot rely on tax inflation to keep the budget afloat to the tune of $1.7 billion or more per point of inflation. In Senate consideration of the budget resolution we defeated a move to repeal indexing by 56-34. Repealing tax indexing would risk signaling we intend to reinflate the economy.

VII. 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 over $30 billion over 2 years by tightening in these areas, and by new enforcement devices. (The Senate budget assumes raising $107.2 billion over 3 years.)

- 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.) ($0.1 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 $100 billion is lost annually though noncompliance with the federal income tax laws and that amount will rise to $133 billion by 1985.

b. The Proposal

S. 2198, the Dole-Grassley bill, would improve the current system of information reporting. A companion bill has been introduced in the House by Representative Barber Conable. 9 to 16% of interest and dividends paid go unreported. We can improve the reporting system by including federal debt and bearer obligations and impose real penalties 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. The administration supported S. 2198 at hearings held on March 22.

d. Coverage

In addition, new penalties would hit the sophisticated tax avoider and the fraudulent corporate tax manager. The interest rules would be revised to reduce current incentives to defer paying taxes.

e. Revenue Effect

The legislation is expected to generate about $3 billion in 1983, $8.1 billion in 1984, and $9.3 billion in 1985.

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 add-back similar preference items of accelerated depreciation, certain deferred income, and excluded items. Of particular interest to banks is a rule which disallows interest deductions to the extent that tax-exempt instruments are included in a bank's investment portfolio.

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 $6 billion annually from the corporate tax.

5. Leasing

a. Some revenues may be generated by cutting back on the safe-harbor leasing provisions of the 1981 Tax Act. Those provisions are now expected to cost about $30 billion over six years, and the figure may go higher when Treasury analyzes its reports on leasing transactions.

b. Possible options, aside from outright repeal, include offsets in other tax preferences, application of strengthened minimum tax, or direct limits on tax sheltering.

VIII. Flat Rate Tax

A. Growing frustration with our complex tax system and desire to ensure fairness are increasing interest in a flat-rate, or low-rate, simplified tax. More people believe that the complexity of the tax law puts a premium on getting sophisticated legal and accounting advice to take advantage of loopholes--and that seems to benefit the wealthy at the expense of the average taxpayer.

B. Several flat tax proposals have been made, and there is no question that in the years ahead we will be working to simplify taxes, eliminate obsolete tax provisions, and bring rates down in exchange. At the same time, there is no comprehensive scheme we could implement right away--we need input from the Treasury, which is reviewing the issue. Most proposals leave some progression in rates, allow for certain highly popular deductions, and exempt low incomes. When it comes to a comprehensive tax base, everyone has their favorite exemption they want to protect.

C. There will always be some complexity: we do have to define "income", and our work with the minimum tax may help us reach a more comprehensive definition. But we can agree on the principles of equity, balance, and simplicity in taxes, and work to improve the system. These are the issues the Finance Committee will review in hearings later this year.

IX. Balanced Budget Amendment

A. Our acute fiscal imbalance and signs of deterioration in the budget process are increasing support for constitutional restraints on fiscal policy. The Senate will soon have an opportunity to vote on S.J. Res. 58, a proposal the President has endorsed.

B. S.J. Res. 58 requires Congress to adopt a balanced budget unless overridden by 3/5 vote. It also requires an actual majority to raise taxes over the previous year as a percentage of national income. This means we will be obliged to balance and coordinate decisions on spending and taxation--a sort of 'truth in government' provision.

C. No one wants to resort to the Constitution unnecessarily, but Congress has proved too often that it will not maintain long-term fiscal restraint. We need strong measures to redress that balance, and only the Constitution can provide them. We have tried statutory controls: they have not worked.

D. There is no 'perfect amendment' and there are other ideas that merit consideration; a two-year budget cycle, an item veto for the President, and different accounting systems to clarify how we are spending taxpayers' dollars. But S.J. Res. 58 is as good a proposal as we have developed, and it deserves a chance to work. Enforcement legislation, and cooperation between the President and Congress, will be crucial to the success of this fiscal reform.

X. Summary--Where We Are Now

A. A Watershed Year. The recession makes this a tough year for Congress and the President. There are no easy or palatable options available. That means we have to establish our priorities swiftly but with care: not an easy task. But if we show that we can work together to deal now with problems that have been building over many years, we will have a major breakthrough in favor of economic recovery.

B. Shared Effort. The economic problem can only be addressed by a joint effort all around--Congress and the President, Democrats and Republicans. Those who would seek partisan advantage from our economic dilemma are mistaken. If we hang, we all hang together, regardless of party. The people will not care who prevented action, if nothing is done. What we need are results.