SPEECH TO PRODUCERS ADVISORY FORUM

AT 8:00 A.M. FRIDAY, SEPTEMBER 10TH

AT FAIRFAX HOTEL, HUNT ROOM - Wash. D.C.

- Your usual economic speech stressing this year's tax bill will be perfect. They specifically want to know what steps can be taken in the next year to cut spending on social programs and defense, as well as your thoughts on Social Security reform. Also, the likelihood of a revenue raising bill next year, and what specific areas may be targeted in that bill.

- It will be a group of 22 to 25 executives in building material industries, with representatives from the steel, lumber, insulation, and hardware industry, among others.

- They are primarily concerned with future developments in the commercial construction field, as opposed to home building. While they are certainly concerned about interest rate scenarios in the short term, they are as well concerned about other factors that affect the long-term prospects for increased productivity, plant capacity, and business expansion in general.

- The format will be the ususal 15 to 20 minute speech, with questions to follow.

- A list of members expected to be in attendance is attached.

OUTLINE OF REMARKS

WICHITA CHAMBER OF COMMERCE

August 28, 1982--Wichita

I. The Budget--Major Progress and Continuing Need for Action

A. The Congress has moved forward responsibly to implement our budget agreement: the Finance Committee reconciliation bill has been passed, and the reconciliation bill from other committees has been passed. Now that we have taken substantive action on the deficit, the need to maintain control over fiscal policy is more urgent than ever.

B. The President led the fight for the tax reform and spending reduction bill because he knew it would preserve the fundamentals of his program and increase the prospects for lower deficits and lower interest rates, which are crucial for recovery.

C. Congress now has to follow through to implement every part of the budget agreement. Spending has to be brought under control, and appropriations this fall will have to be kept in line with the budget resolution to complete our deficit reduction efforts. That is the only way to act in good faith with our citizens and insure the confidence of the financial community.

D. The reconciliation bill originated by the Finance Committee includes the largest single spending reduction: about $17 billion. It also raises $98.3 billion in revenues from improved compliance, eliminating obsolete tax incentives, insuring that everyone pays their fair share, and modest excise taxes and user fees.

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 are aiming 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 percent, the lowest since 1977. Inflation is running at a 5 or 6 percent rate, 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. 13 1/2% is far 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 insure a sustained, real recovery.

III. Tax Reform Package

A. Many people are perplexed at the fact that we are raising new revenues 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 our tax reform bill makes changes that 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--our bill raises about $28 billion over three years. By cutting back on the inefficient safe harbor leasing provision, we raise over $8 billion. And we cut back 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. We reached a consensus to concentrate on improving our tax laws before we slap on new taxes. This is the approach President Reagan endorsed, because it is fair and it preserves the tax cut for working people. Everyone must pay a fair share of tax: it is hard to justify new taxes, or cutting back the individual tax cut, unless we deal with the special exceptions turn our tax base into Swiss cheese.

D. Out of our tax package, all but $15 billion to $20 billion comes from tax reform and compliance measures. The rest comes from modest excise taxes and user fees, and taxes associated with particular government benefits.

IV. The 1983 Tax Cut

A. A number of Senate Democrats persisted in trying to pare back 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. Who is helped. 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. But the American people want to keep their tax cut. In any event, the "rich man" allegation is false. 36.6% of the 1983 cut goes to people with incomes between $20 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 worst 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.

V. 1981 Tax Act and the Deficit

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 after the 1982 tax bill, should be about 19.4 percent of GNP--close to the average between 1963 and 1973. Without action, receipts would have been a crushing 24 percent 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 continue to do more to ease that pressure without undermining the economic program.

C. Many provisions of the 1981 tax act aid capital formation and innovation: R. & D. tax credits, capital gains reduction to 20 percent, 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.

E. Major Benefits in ERTA. With the talk about deficits and tax increases, some have lost sight of the major--in some cases revolutionary--tax relief and incentives we provided in the 1981 tax cut.

1. Marriage penalty relief. A 10-percent deduction for the lower earning spouse's income eases the tax burden on working couples.

2. Estate tax relief. The credit against estate and gift tax will rise to $600,000 by 1986: this will free many small- and medium-size family estates from any tax, and greatly reduce the burden on all estates. An unlimited marital deduction forever eliminates the "widow's tax"--there is no tax now on transfers between spouses. In addition, special use valuation for farm property was greatly expanded, easing the burden on family farms; and the maximum estate tax rate drops from 70 percent to 50 percent over 4 years.

3. IRA incentives. Every taxpayer can now deduct up to $2,000 per year in contributions for individual retirement. This helps the small saver, can help boost the savings rates, and eases pressure on other private and government retirement programs.

4. Other provisions that provide significant help to the individual taxpayer include an expanded child care credit, an increase to $125,000 of the amount of gain on sale of a principal residence that can be rolled over, tax relief for Americans working abroad, and a charitable deduction for all taxpayers, regardless of whether they itemize. For the first time in years we have a strong pro-taxpayer policy in Washington--that will not change, even though we are obliged to raise significant revenue in the short term to deal with the deficit. Our goal is to maintain tax relief over the long term and improve the fairness of the tax code.

VI. Future Agenda for Tax and Fiscal Policy

A. Revenues and Major Items in Our Tax Reform Package

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

2. Last September the administration proposed tightening in these areas, and by new enforcement devices. Many of these provisions are included in this year's tax package:

   - Completed contract method for multiyear defense contracts.

   - Industrial development bonds (restrict, require matching efforts from State or locality, and sunset).

   - Eliminate insurance industry loophole (modified coinsurance).

   - Capitalization of construction period interest and taxes.

3. Underground Economy

   a. The Compliance Gap

   The IRS estimates that $100 billion is lost annually through noncompliance with the Federal income tax laws and that amount will rise to $133 billion by 1985. Our tax bill raises nearly 30 percent of its revenues, nearly $28 billion, by steps to help close this gap.

   b. The Proposal

   Our bill improves the current system of information reporting. Nine to 16 percent of interest and dividends paid go unreported, as do 44 percent of capital gains. We can improve the reporting system by including Federal debt and bearer obligations and impose real penalties on those who refuse to comply.

   c. Withholding on Interest and Dividends

   The administration proposed withholding, and this has been adopted at a 10 percent rate. Exemptions are provided for the elderly and low income taxpayers, and protections are available to institutions while they make the transition to the new system. Withholding takes effect July 1, 1983, and brings in about $10.5 billion over 3 years without raising anyone's taxes.

   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.

4. Minimum Tax

a. Prior Law

Prior law included three very complex minimum taxes, two on individuals and one on corporations. These taxes raised only $1.5 billion and still permitted significant numbers of taxpayers to pay no tax.

b. Tax Bill Provisions

The provisions in our tax equity bill completely revise and simplify the minimum tax. In lieu of the overlapping alternative and add-on taxes on preference items, the minimum tax on individuals is a flat rate of 20 percent for amounts over $30,000 on a more comprehensive, economic income base. Similarly, certain corporate preferences are cut back 15 percent.

c. The Tax Base: Individuals

Included in the tax base for individuals are adjusted gross income and items like excess accelerated deductions, intangible drilling costs, the "bargain" element of incentive stock options, research and experimental expenditures, deduction for long-term capital gains, interest on all-savers, and other items.

d. Corporations

Certain tax preferences for corporations will be cut back 15 percent. These include DISC, some percentage depletion, intangible drilling costs, interest deductions for banks to the extent that tax-exempt instruments are included in a bank's investment portfolio.

e. The minimum taxes are 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 20 percent, with a 15 percent scaleback for corporations: all taxpayers with substantial real income ought to pay some income tax.

5. Leasing

a. Over $8 billion is generated by cutting back on the safe-harbor leasing provisions of the 1981 Tax Act. Those provisions would otherwise cost about $30 billion over 6 years, and the figure could go higher when Treasury completely analyzes its report on leasing transactions.

b. Changes include a 1983 Sunset, offsets in other tax preferences, and direct limits on tax sheltering.

6. Altogether our tax package paves the way for a broader tax base, a fairer tax system. This is the direction we will have to take in future revenue bills.

VIII. Summary of Revenue Provisions. The Finance Committee bill raises $98.3 billion in new revenues over 3 years, as mandated by the budget resolution. This is not a fly-by-night revenue raiser: it is a carefully drawn, real tax reform bill. Most of the revenues are generated without touching the average taxpayer: in fact, no more than 25 percent of the provisions would be of concern to most taxpayers. This is an equitable tax bill, which emphasizes the following areas:

- Improved tax compliance. These are changes to insure that everyone pays a fair share of tax, before we add on new taxes. Improved information reporting is included, new penalties are imposed, and withholding requirements are strengthened, including withholding on interest and dividends at a flat 10 percent rate and a new allocation rule to help collect tip income.

Revenues raised: about $27.8 billion over 3 years.

- Reagan Proposals to Close Loopholes. This area encompasses the proposals to close loopholes and tighten up on overgenerous tax benefits that were proposed by President Reagan in his budget for FY 1983. The category includes restricting use of accounting loopholes by defense contractors, closing a major loophole used by the life insurance industry, IDB reform, and a minimum tax limitation on certain corporate tax preferences.

Revenues raised: about $24.7 billion over 3 years.

- Improvements in Tax Equity. In addition to the Reagan proposals, the bill focuses on other provisions that have proven to be overgenerous or that need simplification. These include pension tax reform, a stronger individual minimum tax, safe-harbor leasing, tax treatment of foreign oil and gas income, mergers and acquisitions, and reasonable limits on medical and casualty loss deductions to bring those provisions in line with economic reality.

Revenues raised: about $28 billion over 3 years.

- User Fees and Taxes on Those Responsible for Specific Spending. The bill includes higher airport and airway taxes as part of a widely supported package to bolster the Airport and Airway Trust Fund and finance airport and FAA improvements. In addition, Federal employees would be subject to Medicare tax to balance their contributions to Medicare with benefits. Similarly, the unemployment tax is raised to help finance the unemployment system without resorting to general revenues.

Revenues raised: about $11.7 billion over 3 years.

o <u>Excise Taxes</u>. The cigarette tax would be temporarily doubled and the telephone tax would be raised from 1 percent to 3 percent in 1983, 1984, and 1985, dropping to 0 thereafter.

Revenues raised: about <u>$8.2 billion</u> over 3 years.

* <u>Note</u>: Total adds to more than $98.3 billion because of some revenue-losing provisions, such as the jobs credit extension.

IX. <u>Flat Rate Tax</u>

A. Growing frustration with our complex tax system and desire to insure 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 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. We also have to have a sensible relation between the taxation of individuals and the taxation of corporations. 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 late next month.

X. <u>Balanced Budget Amendment</u>

A. Our acute fiscal imbalance and signs of deterioration in the budget process are increasing support for constitutional restraints on fiscal policy. The Senate has approved S.J. Res. 58, a proposal the President strongly 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.

XI. 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 had to establish our priorities swiftly but with care: not an easy task. But we have shown that we can work together to deal now with problems that have been building over many years; if we continue to do so, we will have a major breakthrough in favor of economic recovery.

B. Shared Effort. We are learning that 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 impedes further responsible action; what they care about are results.

BASIC FACTS ON SOCIAL SECURITY

Prepared by Finance Committee Staff

Benefits

- The social security cash benefit programs (old-age and survivors insurance, and disability insurance) spent $145 billion in 1981. Spending on these programs will reach $163 billion this year. Including Medicare, social security will spend $200 billion this year.

- Benefits are provided on a monthly basis to retired workers and their dependents, disabled workers and their dependents, and to the survivors of deceased workers. All cash benefits are adjusted annually to reflect increases in the CPI.

- 36 million people of all ages, and more than 9 out of 10 of the nation's elderly, receive monthly social security benefits.

- One-third of the people receiving social security are under 65.

- Under currrent law, spending on social security and medicare (OASDHI) will amount to $3 trillion in the next 10 years.

Taxes

- 116 million people pay social security taxes.

- Workers pay a tax of 6.7% on the first $32,400 of covered earnings, with an equal amount paid by employers. For the self-employed, the rate is 9.35%

- For one-quarter of America's taxpaying households, social security taxes are higher than income taxes. If, as economists argue, workers end up paying the employer's share of the tax in the form of lower wages, 51% of taxpaying households pay more to social security than to IRS.

- The earnings base increases annually as average wages in the economy grow. The tax rate will be increased again--because of amendments passed in 1977--in 1985, 1986 and 1990.