OUTLINE OF REMARKS

SMALL BUSINESS WINNER AWARDS DINNER

May 11, 1983--7:30 p.m.-Capitol Hilton

I. The President and the Congress

A. President Reagan has made clear that he and the 98th Congress must work together to deal with an active agenda. Already that has meant constructive action on social security. Next to be dealt with are the deficit, unemployment, and the shifting patterns of industry and job creation in our economy. At the same time we have to realize there will be major areas where we will not agree. It makes no sense to compromise away the gains won towards restraining the growth of spending, controlling the tax burden, and beating back inflation. The American people still overwhelmingly support those goals.

B. The President, the House leadership, and the Senate leadership will have to work together to forge a consensus on major decisions if we are to get the job done. That doesn't mean there won't be a lot of hard bargaining on all sides; but on some issues we simply cannot afford to have a legislative stalemate.

C. The President still sets the agenda. On taxes, spending, deficits, employment, and trade the President proposes, and Congress must dispose. Those of us who have ideas of our own will work with the White House to get things done--but leadership still must come from the President. That is why we are unlikely to see any major departure from the principles of government Ronald Reagan has espoused in his first two years in office.

D. The fact remains that there is no coherent alternative to Republican leadership. The people still recognize that our economic problems were a long time in the making, and that the cure will take time too. According to CBS/New York Times voter exit polls in the last election, voters by a 5 to 4 margin blamed our economic problems on past Democratic policies rather than on President Reagan.

II. The Economy

A. Prognosis. We have to realistically assess the state of the economy and the prospects for the next few years. The fact is that the groundwork has been laid for a stable and lasting recovery, without renewed inflation. It is absolutely crucial that we proceed with care at this point, and not throw away the gains already made.

No one should doubt that we are making progress. In March the index of leading economic indicators jumped 1.5 percent--the seventh straight such increase, and the 10th increase out of the last 11 months. In addition, industrial output rose 1.1 percent in March, and economists agree we are in a broad based recovery.

1. Inflation was cut to 3.9 percent in 1982, from 12.4 percent in 1980. This is the lowest inflation rate since 1972. And the trend is continuing: consumer prices rose less in the first quarter of 1983 than in any quarter since 1965.

2. Interest rates are down and still falling. The prime rate is down to 10 1/2 percent, way down from the 21 percent that prevailed when President Reagan took office. Home mortgage rates are down 3 points since last year. Long-term rates for business loans are off 3 to 4 points from a year ago.

3. Government spending growth rate is down to 11.2 percent this year from 17.4 percent in 1980. The 1983 budget resolution projects the growth rate of government to fall to 7.5 percent by 1985.

4. Lower taxes with major improvements in tax equity will help buoy the recovery, both on the consumer side and on the investment side. The combined effect of the 1981 and 1982 tax bills has been to lower individual taxes over 3 years by $344 billion, as well as improve compliance and tax fairness. Lower individual rates boost personal income and restore incentive, while favorable capital cost recovery rules should spur investment.

5. In January, industrial production was up 0.9 percent; housing starts were up 36 percent; the stock market is up 450+ points over last August. These are tangible evidence of recovery. Consumer confidence is rising and auto sales were up in the first 10 days in April.

B. Unemployment. The January drop in unemployment to 10.4 percent was followed by a further decline to 10.3 percent in March and to 10.2 percent in April. That is major good news, and the decline has not been reversed, although there may be a few "blips" upward. Unemployment, of course, remains the major negative in the economic picture. High unemployment has to come down and stay down without inflationary stimulus--that is what we have failed to do in the past.

o Clearly there is a bipartisan consensus for more jobs. But resuming the inflationary policies of the past will not create lasting jobs, just an illusion of prosperity that leaves us worse off the next time we try to get "off the wagon."

o That means the most important thing we must do is judge carefully the degree of stimulus the economy can and should take, consistent with a firm anti-inflation policy. The Federal Reserve will play a key role, and has already shown a willingness to adjust its short-term goals based on an assessment of the weakness of the economy. We will not allow the recession to continue, but we will not reinflate the economy, either.

o While the main emphasis must remain on the long-term goals of growth with low inflation, there are steps we can take in the short term to deal with the plight of the unemployed. Many things have already been done:

- A new Federal supplemental unemployment compensation program was passed with the 1982 tax bill, providing additional unemployment benefits to about 2 million workers in 38 States. The House and Senate have agreed to extend this program through September 30.

- The President signed into law the new Job Training Partnership Act, which emphasizes training for permanent employment rather than make-work jobs. New initiatives outlined by the President focus on the long-term unemployed, youth, and on training or relocating displaced workers who lost jobs due to plant closures or force reductions.

- The targeted jobs tax credit, which was extended for 2 years by the 1982 tax bill, gives employers a real incentive to hire the disadvantaged--about 600,000 workers are certified under the program.

- The administration's enterprise zone legislation, reported last fall by the Finance Committee, can provide us with an experiment in private-sector job creation in depressed areas, through a combination of Federal tax incentives and State and local efforts to target an area for development with regulatory and tax relief, neighborhood participation, and capital and other improvements. Hearings were held in the Finance Committee April 22.

- The 5¢ per gallon gax tax increase can create over 300,000 jobs by funding much needed repairs and construction of the Federal highway system.

C. <u>The Deficit and Interest Rates</u>.

1. All our economic difficulties are, of course, related--high interest rates and slow growth boost the deficit, and higher deficits create greater uncertainty in the business community as to our future course; will there be more inflation, or less credit available for business expansion?

2. Because of this, it makes sense first of all to chart a path that is most likely to bring stable growth without inflation. Higher growth boosts revenues and cuts unemployment costs, thereby reducing the deficit as well: already, upward

revisions of growth estimates are being made in light of the economic indicators.

3. In the short term, as the President urges, it makes sense to continue to review every part of the Federal budget in an effort to bring the deficit down. This means both defense and entitlements must be under scrutiny to maximize the efficiency of every dollar spent. A balanced deficit reduction program is still our goal.

4. Continued efforts to restrain the deficit by controlling Federal spending will give the Federal Reserve a bit more room to accommodate the potential for real growth that exists in the economy without inflationary pump-priming. But restraint in both fiscal and monetary policy is crucial if we want to maintain long-term confidence in the economic program. That means long-range goals must be carefully reconciled with efforts to respond to particular weaknesses in the economy. Radical attempts to reverse course would be self-defeating and must be resisted.

III. The Budget: The House and the President

A. We all know that developing a credible, deficit-reducing budget for 1984 and beyond is going to take a lot of hard work and give and take on all sides, Democrat and Republican, liberal and conservative. The President has made his proposal, and the House has adopted a radically different alternative. We are likely to end up with something in between, but we ought to consider for a moment who is closer to the mark in terms of the vital needs of our economy and in terms of national priorities.

B. House resolution. The House-passed budget resolution, engineered by the Democratic leadership, simply is not a credible plan for meeting our priorities and achieving sustained economic growth. The House recommends a $30 billion tax increase in FY 1984 alone. Unfortunately, the Senate Budget Committee has ratified that decision, subject to modification on the floor. That is not only an unreasonable increase in the tax burden as we come out of a recession, it can only mean modification or repeal the third year of the tax cut for the working people. Why run the risk of aborting recovery? Reneging on promises is no way to run the government, and that proposal must be rejected. Even the members of the House Ways and Means committee have expressed strong doubts that any more than $8 billion in revenue can or should be raised in 1984.

C. Defense spending. The President has recommended a 10 percent real increase in defense spending, and the House recommends a mere 4 percent increase: 2.3 percent compared with the President, if you factor out the military pay increase. We all know that defense, like every area of the budget, will have to assume a fair share of the burden of deficit reduction. But surely we ought to take more seriously the President's concern about our national strength vis-a-vis the Soviet Union. We can and probably will have to modify the President's defense request, and the President will have to deal with both the Senate and the House leadership if we are to get agreement. We do have to get more out of each defense dollar spent. But the House-proposed increase is not wise, reasonable, or in the national interest. The Senate Budget Committee has voted for a 5 percent increase exclusive of pay, which is at least closer to the mark.

D. Domestic spending. There is widespread agreement that we cannot let the burden of deficit reduction continue to fall on benefits for lower-income Americans. But that does not mean domestic spending is untouchable--it can and must be reduced, something the Democratic budget fails to acknowledge. The House resolution provides $25 billion more for nonmilitary spending than does the President's budget. $6 billion of that difference is in the health area: and certainly we have reached the point where we should acknowledge that Federal health program costs are not under control, and that changes to control costs are very much in order. The American people do want to share the cost of reducing the deficit in a fair way. But they do not want national security risked, or the tax burden on individuals raised to an unconscionable degree, just because some members of Congress do not want to reexamine programs that may have outlived their usefullness or have become grossly inefficient. Instead, let us work together, and with the President, to reach a bipartisan agreement like that worked out on social security.

IV. The Budget: Tax Issues

A. There are lots of ways to raise revenue, but our job is to choose ways that are fair and consistent with good tax policy. We should resist the temptation to undo the progress that has been made in providing greater incentives for savings, work, and investment: those incentives will become more important as recovery proceeds. There are many base-broadening measures still to be considered that would improve the equity and efficiency of the tax code.

B. Indexing. The House budget assumes repeal of the tax indexing provision of the 1981 tax act, which takes effect in 1985. We all know that we have to compromise to get things done, but this is one area that we ought to leave alone if we are interested in sound tax policy and honesty in government. We can raise revenues--but why resort once again to back-door revenue increases generated by inflation? Tampering with indexing further risks sending a signal that we are prepared to reinflate the economy and generate revenues through bracket creep to deal with the deficit. That would mean undoing all the progress we have made over the past two years, and it would be a tremendous mistake.

C. Outyear tax increases. The President's budget recommends a contingency tax to raise $46 billion in FY 1986, consisting of a 5 percent surcharge and an oil tax, to be triggered if the deficit remains too high despite adoption of major spending cuts. It is not clear why we would need to use a "trigger" device to raise taxes based on deficit levels. It seems unlikely that a "trigger" mechanism would create the kind of reassurance on the deficit that the country is looking for.

If growth and revenues turn out better than now projected, we can always reduce taxes to the extent that becomes fiscally desirable. One possibility is to enact some additional base-broadening measures--improvements in equity and eliminating tax provisions that are economically inefficient--then provide for further rate reductions if the deficit is brought under control more rapidly than is now expected. This would maintain the momentum for a lower-rate, broader-based tax system that has been built over the last two years. It is also consistent with the administration's consideration of a streamlined and simplified tax structure with lower rates.

V. Tax Issues of Continuing Concern

A number of issues that have been around for some time may receive attention from the 98th Congress.

1. 6-month holding period. Efforts to reduce the capital gains holding period to 6 months will continue. There is very strong support for this change, because it can give a boost to capital markets at a time when greater savings and investment is vitally important to sustained economic recovery. This change was approved by the House in 1981 and by the Senate on three separate occasions in 1982, so it is time to get it enacted into law.

2. Tuition Tax Credits. Although the Finance Committee fashioned a compromise tuition tax credit proposal last year after extensive consideration, the bill received no further action last year. But the Committee's efforts could form the basis for legislation in the 98th Congress. Legislation, S. 528, was introduced February 17.

3. Enterprise Zones. The Finance Committee reported out a modified version of the administration's enterprise zone proposal last September, but no further action was taken. New legislation has been sent up by the President, and the proposal is likely to come up again in connection with discussion of job-creation and economic development proposals, and possibly could be acted on with further refinements. A major question is

whether the House will take an interest in the idea, which they did not in the 97th Congress.

4. DISC. While no specific DISC proposal was made in the 97th Congress, the issue was extensively discussed--particularly the question of legality under the GATT. The Administration has committed itself to bringing the DISC into conformity with the GATT and will submit legislation to do so shortly.

VI. Social Security

A. The National Commission developed a bipartisan package that deserves support. It is not perfect, and everyone had to swallow hard on some items: that is the cost of reaching agreement.

B. The work of the Commission made clear that we had to confront the crisis in social security. The Commission agreed that \$150-\$200 billion is needed between 1983 and 1989 to ensure the solvency of the system through 1990. This means providing about a 15 percent reserve ratio by 1990 under the pessimistic--some would say realistic--assumptions.

C. The bipartisan package, includes a 6-month delay in cost-of-living adjustments, partial acceleration of scheduled payroll tax increases, coverage of new Federal workers and non-profit organizations, and partial taxation of benefits for higher-income beneficiaries.

D. We cannot forget that the payroll tax burden is already heavy and scheduled to increase, and the confidence of young people is critically low. The long-term deficit can be reduced considerably by very gradually slowing the growth of the system as people come on to the rolls in the future. The bill raises the retirement age to 67, again very gradually, for people retiring some 20 or 30 years from now. Ample time is available for people to adjust their savings and retirement decisions.

VII. Trade

A. Trade deficit is too large. The size of our trade deficit (which is now projected at \$75 billion in merchandise trade and \$30 billion in current account) alone means Congress will continue to look hard for ways to reform our trade policy. The system of multilateral arrangements has been called into serious question as many believe it fails to meet our needs. Many voters and members of Congress will want to see us approach more of our trade problems on a bilateral basis. The average American simply does not understand why Japanese cars and TV's sell well here but American cigarettes, beef, baseball bats, and cosmetics cannot be sold in Japan. Remedies for this type of situation are certain to be a major focus of attention in this Congress.

B. Export issues. Unfortunately, the GATT ministerial failed to make progress on the question of foreign subsidies for agricultural exports. This will continue if pressure from Congress to resolve this situation through negotiation or for other export promotion actions like the recent wheat flour sale to Egypt. S. 822, recently passed by the Agricultural Committee, would establish several export promotion activities.

I support efforts to equalize the rules under which trade is conducted. This does not mean trade war, but does mean seeking to expand East-West trade, developing a viable substitute for DISC, utilizing Ex-Im Bank resources more adeptly, and enacting the trade reciprocity bill that the Senate approved April 21. Fair access to markets must be a two-way street, and Congress will be under considerable pressure to see that that is so.

C. Import issues. As you know, the House passed "local content" legislation at the end of the last Congress. That is a drastic proposal and likely to be counterproductive in the long run if our goal is to increase access to markets and to gain maximum benefit from the mutual advantages of international trade. There may be other areas, however, where we might make adjustments:

(1) For example, with regard to extension of the Generalized System of Preferences, we will consider requiring specific reciprocal benefits from the major GSP beneficiaries. (2) we will seek to move soon the trade provisions of the President's Carribean Basin Initiative, as those countries offer U.S. exporters a potentially strong market. (3) job training programs which assist our firms and workers to be more competitive with imports will have strong support in the Congress. The President has proposed $270 million for job training, and the Finance Committee will take a look also at trade adjustment assistance programs that are due to expire in September.

It is a good sign that the Japanese have agreed to continue voluntarily to restrain their automobile imports to this market for a third year, until the domestic industry has had an adequate time to get back on its feet. The President's recent decision to provide temporary import relief to Harley-Davison from imported motorcycles is also a clear sign that he will take steps to help firms and workers adjust to imports.

D. Clearly the heat is on when it comes to seeing that American producers get fair treatment under our system of international trade. If we choose our battles carefully to secure an appropriate response from our trading partners, we have an opportunity to making trade freer and fairer, to the advantage of everyone. But we must avoid the two extremes of allowing the world to think only the U.S. will play by the rules of free trade, regardless of disadvantage to our citizens; or, on the other hand, taking extreme unilateral actions that may look good politically but that, in the long run, will provoke severe reaction and deprive us of market opportunities. We need just the right amount of leverage to open more doors, not have them slammed in our face.

VI. Conclusion

The months and years ahead must not be dominated by rigid ideologies on either side--but neither can the President or the Republican leadership be expected to cast aside the principles of Government the American people so soundly endorsed in 1980. Those principles--a more restrained Government, a freer economy, greater accountability to the American people--are as valid today as they ever were, and there is no indication that the people have changed their commitment to these same principles. Guided by these principles, we will try to work together to build on the sound foundation for recovery that has already been laid.

United States Senate

COMMITTEE ON FINANCE

WASHINGTON, D.C. 20510

May 11, 1983

TO: SENATOR DOLE

FROM: TED KASSINGER

SUBJECT: TRADE ISSUES FOR SMALL BUSINESS SPEECH

In addition to the matters covered in your standard speech outline, the following two trade issues may be of particular interest to your audience. Talking points are attached on these and other issues.

1. DISC.--The Administration will send up soon a bill to bring the DISC into conformity with the GATT. Small businesses are concerned that the proposal will adversely affect them because it will require an active off-shore presence in order to qualify for tax benefits. The Administration is considering a "small business exception" to the off-shore rule, and other ways of lessening the burdens on small business.

2. Trade law reform.--Senators Cohen and Mitchell have introduced S. 50, a bill intended to assist small businesses in unfair trade practice cases. In essence, it would eliminate some procedural steps, such as the first level of judicial appeal, and create a Commerce Department office to assist small businesses in such cases. You may recall that Senator Danforth agreed to expeditious consideration of the bill during the reciprocity bill floor debate.

3. Ex-Im Bank.--The Administration has initiated several loan programs aimed at small businesses. These include: (1) a medium term (1-5 years) financing program; (2) a political and commercial risk insurance program; and (3) a small manufacturers discount loan program.

According to the Small Business Administration, at least 20,000 small businesses could be exporting competitively, but are not. This may be attributed to principally concern with the uncertainty and risk of exporting, and lack of experience and in-house capability. Export trading companies created under the Export Trading Companies Act may fill this gap.

TK;o
Attachment

DISC

o Last fall the President committed himself to bring the DISC within the export subsidy rules of the GATT.

o We expect the President in the very near future to submit a bill to accomplish this. The bill is likely to contain the following elements:

(1) a partial tax exemption for certain foreign source income (instead of the DISC tax deferral system);

(2) a requirement that certain significant sales functions will be performed outside of the U.S. (DISCs can be within the U.S.);

(3) Arm's length transfer pricing rules, with a "safe harbor" formula to determine what portion of the profit will be tax exempt;

(4) Forgiveness of current DISC-deferred income, or transference of it to the new corporation; and

(5) A small business exception that would allow small exporters to be deemed to be operating outside the U.S.

o The proposal is designed to be GATT-compatible and revenue-neutral. We expect to move early on the bill once it is submitted.

Cohen/Mitchell Trade Law Reform bill

- The Congress in 1979 was concerned with the lack of procedural rights accorded to petitioners for relief from unfair trade practices. Thus, the Trade Agreements Act incorporated provisions for strict time limits on decisions and extensive judicial review.

- Unfortunately, the cost of bringing dumping or subsidy cases has skyrocketed. Some estimate that it costs $100,000 to complete an antidumping or countervailing duty case.

- The Committee will consider several trade law reform ideas this Congress. Among the first will be S. 50, a bill sponsored by Senators Mitchell and Cohen.

- S. 50 would do the following:

  (1) Establish an office in Commerce to assist small businesses in trade law proceedings;

  (2) provide that trade case expenses be reimbursed up to certain limits; and

  (3) Allow administrative determinations to be appealed directly to the Court of Appeals, by passing the Court of International Trade.

- Streamlining trade relief is an important goal. We will examine S. 50 closely. Two questions are: (1) the expenses; and (2) can the Commerce Department be both advocate and decisionmaker in trade cases?

EX-IM BANK

- The charter of the Ex-Im Bank expires September 30, 1983. In addition, a new authorized credit level must be established for FY84.
- Although the major developed countries have agreed on minimum export credit levels and interest rates, it is clear that some countries, such as France, believe that these agreements should be ignored on occasion when it is in their interest.
- The Administration recognizes this and proposes to increase present direct loan levels by $2.67 billion (to over $6 billion) and will increase commitments for guarantees and insurance programs to $17 billion.
- The Banking Committee has reported a reauthorization bill to the Senate. It includes provisions to encourage greater participation by small businesses in the Bank's programs; for example, by including a small business representative on the Board of Directors.
- The Administration also has instituted the following programs:

  (1) medium term (1-5 year) financing program, funding for which is included in the FY84 request;

  (2) a small manufacturers discount loan program; and

  (3) a political and commercial risk insurance program insuring against nonpayment of loans. The coverage is much higher than commercial companies provide.
- Of course, Ex-Im Bank loans to companies like Boeing result in a great deal of work for small businesses.

Agricultural Exports

- By setting internal support prices too high, and then providing export rebates to diminish the large stocks resulting from overproduction, the EC is unfairly stealing our traditional world markets and lowering world prices to destructive levels.

- The recent wheat flour sale to Egypt with CCC credits got their attention, and we are vigorously pursuing GATT cases.

- S. 822, recently reported by the Agriculture Committee, will also show clearly our intention to protect our farmers from unfair competition. It provides for increased funds and authority for export assistance activities, including $90 million for value-added commodities.

- The President recently announced that he had proposed to the Soviet Union that a new long-term grain agreement be negotiated. THe Finance Committee approved last week S. Res. 95, which calls for LTA with higher minimum and maximum purchase levels and with the inclusion of value-added commodities (i.e., wheat flour and soybean meal) and other bulk commodities (i.e., rice).

Reciprocity

- Danforth-Bentsen bill passed Senate as vehicle for withholding repeal.

- The bill does the following three things:

  (1) Clarifies the President's authority under section 301 of the 1974 Trade Act to retaliate against foreign unfair trade practices.

  (2) Requires the USTR to do an annual inventory of foreign unfair trade practices and state what the Administration intends to do about them.

  (3) Authorizes the President to negotiate on issues regarding trade in services and advanced technology products.