

OUTLINE OF REMARKS

THIRD ANNUAL WASHINGTON CONFERENCE ON ALCOHOL

October 18, 1983

8:30 a.m. -- The Sheraton Crystal City Hotel

I. The Need for a Budget Summit

A. Many of you may know that I called the First Concurrent Budget Resolution a dead cat. Very little has changed in recent weeks. In my view, the budget process will not be resurrected and the economic recovery secured until our leaders, from the President and the Congress to our State and local officials and business and civic leaders, pull together in order to safeguard the domestic economy. We cannot allow progress toward recovery to lull us into acquiescence.

B. That is why I have called for a budget summit and one where the President plays a key role. Just as Congress must put spending in order, the President must make clear his priorities on the budget. We need his leadership and his approval, because we know he can get the job done. He has done it before: all he needs is a clear sense of purpose.

C. The summit concept will have to begin with the President and with the Congress, but it should not stop there. All decision-makers in our economy, including business and labor, have a vital stake in what happens. We cannot please everybody, but only if we agree on the absolute priority of cutting the deficit in a way that advances our shared economic goals will we have a fighting chance to succeed. We cannot tax our way out of recession, and we cannot devastate the social and benefit programs that so many Americans depend on. But we can make adjustments on both sides of the ledger that boost the odds in our favor.

II. The Economy

A. Prognosis. We have to realistically assess the state of the economy and the prospects for the next few years. Recovery is well under way, and the groundwork has been laid for stable and lasting growth 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. The GNP for the second quarter of 1983 grew at a 9.2 percent rate: The greatest quarterly expansion since 1975. The index of leading economic indicators jumped 11 months in a row. Industrial output rose 2.1 percent in April; the highest monthly rise in 8 years, 1.2 percent in May, 1.0 percent in June, and 1.8 percent in July. The moderation in the pace of recovery--indicated by the 0.1 percent drop in the August economic indicators--hopefully indicates the recovery will be sustained over the long term.

1. Inflation was cut to 3.9 percent in 1982, from 12.4 percent in 1980. This is the lowest inflation rate since 1972. Consumer prices rose just 2.4 percent in the 12-month period ending July 1983, the lowest since 1966. Inflation in 1983 so far is running at annual rate of 3.2 percent. Even with an upward "blip" in producer prices, the inflation picture remains very good. Labor productivity rose 5.7 percent in the second quarter, contributing to further progress on inflation.

2. Interest rates are down. Although the prime rate is at 11 percent, it is still way down from the 21 percent that prevailed when President Reagan took office. Home mortgage rates are down since last year. Long-term rates for business loans are off about 3 points from a year ago.

3. 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.

4. Housing starts are up. At an annual rate of about 1.7 million in June and July, down slightly from May, new housing starts are the highest in 3 years.

o Sales of new one-family houses in June were at an annual rate of 638,000. While this is slightly below the May rate, it is up 73 percent from a year ago. Following a surge in the latter half of 1982, sales activity has moderated in the last 6 months.

o During the first 6 months of 1983, 326,000 houses were sold, up 68 percent from same period in 1982. About 56,000 new houses were sold in June.

5. Consumers are showing confidence in the recovery. Auto sales in the first part of October were up 45% over last year; retail sales rose 1.6 percent in September.

B. Unemployment. The July unemployment rate fell from 10.0 percent to 9.5 percent, the largest monthly decline since December 1959. Unemployment in September declined further, to 9.3 percent. Total civilian employment now stands at 101.6 million, the highest level in our history. These figures indicate that the recovery is anything but anemic. According to Janet Norwood, Commissioner of the Bureau of Labor Statistics, the growth in employment at this point in the recovery is stronger than in any of the previous six recoveries. The number of unemployed has declined by 1.3 million since December 1982.

o High unemployment has to come down and stay down without inflationary stimulus--that is what we have failed to do in the past. 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 its assessment of the economy. We will not allow the recession to continue, but we will not reflate the economy, either.

In addition, constructive steps have been taken:

- A new Federal supplemental unemployment compensation program was passed with the 1982 tax bill, providing additional unemployment benefits to almost 3 million workers. This program will extend through September 30.
- The new Job Training Partnership Act emphasizes training for permanent employment rather than make-work jobs.
- The targeted jobs tax credit, which was extended for 2 years by the 1982 tax bill, gives employers an incentive to hire the disadvantaged--about 600,000 workers are certified under the program.
- The administration's enterprise zone legislation, which was approved by the Senate, could 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. House hearings have been promised.

C. The Deficit and Interest Rates.

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 our economic progress and indications of further improvements.

3. 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. The reappointment of Chairman Volcker at the Federal Reserve is a good move towards maintaining public confidence.

III. The Budget Resolution

A. Conference Agreement. The conferees on the budget resolution tried hard to reach a reasonable agreement, but it is not clear that the result is the best way to reduce the deficit, or even that it will bring significant deficit reduction. Of the proposed deficit-reduction measures, 88 percent is within the jurisdiction of the Finance Committee--and 86 percent is due to proposed tax increases, not to spending restraint. The resolution proposes a \$73 billion tax increase over three years, \$12 billion in 1984, \$15 billion in 1985, and \$46 billion in 1986.

B. Real Choices. Because so much in the way of spending programs is left out-of-bounds, the real choice proposed for us is to raise taxes or accept for now the high deficits that result from our spending decisions. That is not an agreeable choice to make, particularly when the budget resolution provides a so-called "contingency fund" to allow for new spending if Congress decides it is needed--to the tune of \$8.5 billion. In addition, this puts the Budget Committee in the position of determining specific spending policies, not just overall targets.

C. Implementation. One relevant question in evaluating the budget agreement is whether the votes exist to implement it. Many members who supported the resolution might not be as willing to vote for the tax increases needed to implement the conference agreement. If so, it does not help financial markets to propose a resolution that will not be acted on in any event.

D. Domestic spending. While we cannot let the burden of deficit reduction fall on benefits for lower-income Americans, we should not assume that domestic spending is untouchable. Even the budget conferees agree that, for example, Medicare is a proper source for savings. Certainly we have to acknowledge that Federal health program costs are out of control, and that changes are very much in order. (The resolution proposes about \$1.7 billion in Medicare savings). If the contingency fund is included, domestic spending would be up \$10 billion next year.

E. Alternatives. Even if we fail to implement the resolution, that does not mean the fight against the deficit is over. I have proposed that we try to work out a \$70-\$80 billion deficit reduction package, balanced between spending and revenue changes, and will try to work towards some common ground with Chairman Rostenkowski.

IV. Taxes: Third Year and Indexing

A. The President has said time and time again that he will fight to retain tax indexing, and many of us will continue to support him, even if a veto is required. Thirty-four Senate Republicans and 146 House Republicans have signed letters to that effect. The reasons are quite simple: these measures are good for the economy, they are fair, and they give long-needed real tax relief to the hard-pressed middle income American.

B. Third year. Why was the third year of the 1981 tax cuts so important? First, most economists agree that the timing of this last stage of President Reagan's individual tax program is excellent in terms of giving the economy a boost on the consumption side as we emerge from recession. This is a sharp contrast with the past, when tax changes to counter recession were too little and too late.

Equally important, the third year was needed in the interest of fairness. Only the third year gives a full measure of tax relief to working people. For taxpayers with incomes \$10,000 or less, repeal of the third year means a tax increase averaging 13.9 percent. For those between \$20,000 and \$30,000 in income it means a 12 percent jump in taxes. 72 percent of the benefit goes to Americans making \$50,000 or less.

In dollar terms, repealing the third year would have cost a taxpayer at \$15,000 income \$112 in FY 1984; at \$20,000 income, it would cost \$203 in 1984; at \$30,000 income, taxes would be \$410 higher in 1984.

C. Indexing. Indexing is crucial not just because it provides tax relief, but because it insures truth in government: tax changes will have to be voted on openly and directly, rather than having Congress rely on inflation to raise revenues through the deception of bracket creep. Whatever attitude you take on the question of generating new revenues, it makes sense to keep indexing in place.

In addition, indexing is an important symbol of our commitment to fight inflation. Repealing it only generates significant revenues if you assume inflation will persist at fairly high levels. If we de-index, we send a signal that we are not committed to beating inflation--and that means bad news for financial markets, for interest rates, and for consumers and investors alike.

Finally, the tax relief provided by indexing is real and sustained. Indexing means \$98 billion in tax relief between 1985 and 1988, assuming modest inflation. \$78 billion of that goes to taxpayers earning under \$50,000. This group now pays about 66 percent of taxes, but will get 80 percent of the benefit--proving that indexing is a truly progressive tax reform.

A median income family of four would pay \$1,000 in additional taxes between 1985 and 1988 if indexing were repealed (assuming they earn \$24,000 in 1982). Remember that consumers are homebuyers as well, and their after-tax income is as important as interest rates in determining whether they will buy.

V. Other Tax Issues

A. Mortgage Revenue Bonds. The Finance Committee held hearings on proposals to eliminate the scheduled sunset of single-family issues at the end of this year. Some continued availability of these bonds after this year is likely at least for lower-income single family housing. I have proposed legislation to give states the option to issue tax credits for first time home buyers, rather than issue mortgage bonds. The Finance Committee just held hearings, and the Treasury has indicated support.

B. Flat Rate Tax. The idea of a flat-rate or greatly simplified tax system continues to be quite attractive, as we see continued taxpayer frustration with the complexity of our system and with the idea that special exemptions or credits enable the well-to-do to 'game' the system in their favor. Walter Mondale has endorsed the Bradley-Gephardt so-called "Fair Tax," so at least some believe the idea has political appeal.

C. Individual Housing Accounts. There have been suggestions that Congress adopt an IRA-type approach to encouraging savings for purchase of a principal residence through a tax deduction or deferral. This was the subject of Dole legislation in the 96th and 97th Congresses. The idea still has appeal both from the standpoint of encouraging savings and stimulating home ownership. Again, the cost to the Treasury will be a major issue--but if that can be kept under control, the idea could gain support.

The issues remain difficult to resolve, because any major changes in the tax burden or in basic tax incentives mean taking from one group and giving to another--always a tough thing for Congress to do. The Bradley proposal is a careful political compromise designed to keep the most popular deductions and roughly duplicate the present distribution of the tax burden--but it is not clear whether this less-graduated system would stay that way (particularly when it is not indexed, and liable to bracket creep). What we need to do is continue to build towards consensus on a simpler system by better-informing the public and testing their attitudes. But everyone does seem to agree that we need to move toward lower rates and a broader base--the direction marked out by the 1981 and 1982 tax bills.

VI. Trade

A. Trade deficit is too large. The size of our trade deficit (which is now projected at \$60 billion or more 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. 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: in considering extension of the Generalized System of Preferences, there may be an interest on the part of some members of the Finance Committee to seek some reciprocal benefits from the major GSP beneficiaries. The enactment of the President's Caribbean Basin Initiative partly reflects the fact that those countries offer U.S. exporters a potentially strong market. It may be difficult to renew the President's general authority to negotiate tariff reductions on a limited basis. 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, although the question of whether there will be negotiations for a fourth year is a matter of concern.

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.

VII. 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.

ROBERT J. DOLE, KANS., CHAIRMAN

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United States Senate

COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

RODERICK A. DEARMENT, CHIEF COUNSEL AND STAFF DIRECTOR
MICHAEL STERN, MINORITY STAFF DIRECTOR

October 17, 1983

TO SENATOR DOLE

FROM ROD DE ARMENT
HARRY GRAHAM

Attached you will find an outline of general economic and tax matters and an outline of items of special interest for your October 18, 1983 speech before the Third Annual Washington Conference on Alcohol.

Attachment

ITEMS OF SPECIAL INTEREST TO RENEWABLE FUELS INDUSTRY

Energy Tax Credits Generally

- In 1978 and again in 1980 a vast array of energy tax credits were added to the Tax Code.
- Indeed, we enacted energy tax incentives for approximately 66 different categories of equipment and facilities. We currently have energy credits for items ranging from home insulation to solar cells; from small scale hydroelectric projects to intercity buses. This year the total estimated revenue loss from these provisions will amount to about \$2 billion.
- These tax incentives were intended to encourage energy conservation and the production of energy from alternative sources to make us less dependent on imported petroleum. It was hoped that these tax incentives would spark private industry to develop new and advanced technologies by reducing some of the risk to initial investors.
- In addition, it was argued that these the tax incentives would be the most efficient way of providing the necessary aid for high risk projects that demonstrate the commercial potential of new energy technologies.
- I think that experience has shown that some of these energy credits have worked and some have not.
- Several recent studies have questioned the effectiveness of particular credits. For example, a study recently completed by the Office of Technology Assessment generally concluded that the credits for industrial energy conservation have had little direct influence on capital allocation decisions of large American firms, and thus have had little or no influence on energy conservation.

Ethanol Fuel Incentives

- One set of tax incentives that I believe experience has clearly proven to be economically efficient are the incentives for the domestic production of alcohol fuels.
- I am proud to have one of the original authors, along with Senators Carl Curtis and Birch Bayh, of the legislation in 1978 that established the exemption for alcohol fuel from the 4-cent per gallon gasoline tax.
- Since 1978 we have improved on the original excise tax exemption.
- In 1981, we extended the 4-cent per gallon alcohol fuel exemption through 1992, added an optional production tax

credit for alcohol fuels, extended the energy tax credit for alcohol fuel production equipment and streamlined some of the regulatory requirements that had proven to be an impediment to expanding alcohol fuel production.

- Last year as part of the gas tax bill, we are able to increase the alcohol full exemption to 5 cents per gallon.
- The response to these tax incentives has proven to be nothing short of miraculous since we have witnessed the birth of a significant and growing new energy industry.
- Since these incentives were enacted, the alcohol fuels industry has invested hundreds of millions of dollars in nearly 100 commercial facilities. Fuel ethanol blend sales will exceed 4 percent of the total gasoline pool in 1983, with over 5 percent or 5 billion gallons expected to be sold in 1984.

Energy Legislation in this Congress

A. General Energy Credits

- Except for long-term energy projects, the general 10-percent business energy investment tax credit expired at the end of 1982. In addition, certain business energy credits, such as the 15-percent credit for solar, wind or geothermal property and the 10 percent credit for biomass property will continue through 1985.
- A number of bills have been introduced that would extend and expand the existing energy tax credits.
- For example, S. 1396, introduced by Senator Domenici, would extend the termination date through 1992 for the energy credits for synthetic fuel coal conversion, solar, wind, and geothermal equipment, provided an affirmative commitment has been made for the equipment. S. 1396 would also expand existing energy credits by broadening the definition of shale oil and synthetic fuel equipment and covering tarx sand property.
- More recently Senator Wallop has introduced S. 1939 to consolidate the approaches of all the major tax credit bills and to respond to concerns raised during hearings. Nevertheless, I suspect S. 1939 still involves a substantial revenue loss.
- These bills, however, are quite expensive and are perhaps overly ambitious in terms of the expansion of the current energy credits that they seek.

- For example, the Treasury Department estimates that S. 1396 would cause a revenue loss for the period 1983 to 1988 of anywhere from \$1.2 to 2.8 billion.
- At a time when the Federal deficit is running close to \$200 billion, we need to carefully examine all of the energy credits and narrowly target those that are beneficial and cost effective.
- Energy independence and alternative energy sources are still a high priority of our nation. However, this priority cannot be met by using the taxpayer's money to encourage development of energy sources that are inefficient and result in very small energy savings.
- Consequently, I suspect the current energy credit bills will have to be substantially pared back if they are to have any chance of success.

B. Alcohol Fuels

- In addition, I know that many of you are interested in S. 1931, the Renewable Fuels Tax Incentive Act, introduced by Senator Durenberger.
- S. 1931 would increase the excise tax exemption for alcohol fuel blends to 9 cents per gallon and would reimburse the Highway Trust Fund for the revenue loss of the increased exemption from the "Windfall Profit Tax" account of the general fund.
- I have long supported increasing the alcohol fuel excise tax exemption to 9 cents per gallon. The Senate version of the gas tax bill passed last December increased the exemption to 9 cents, but that figure was reduced in conference to 5 cents because of strong House opposition.
- I continue to strongly support increasing the alcohol fuel exemption to 9 cents. Nevertheless, achieving this legislative goal will not be easy.
- Every legislative effort to assist the alcohol fuel industry has originated in the Senate.
- If we are going to be successful in increasing the exemption, this industry is going to have to neutralize the intense opposition of senior members of the House Ways and Means Committee.

Conclusion

- There have been many uncertainties, and many more challenges lie ahead, but I share your confidence that you are moving steadily toward the achievement of a key national objective: displacement of foreign oil with cost effective domestically produced liquid fuels.
- In addition, you are providing an additional market for feedgrains and other agricultural products which currently have inadequate markets.
- In the process of providing a renewable alternative liquid fuel you are meeting motorists' need with an environmentally safe, high quality octane enhancer that also benefits refiners by providing a cost effective alternative to lead.
- There are also many side benefits that stem from alcohol fuels industry's growth. One such benefit was recently identified by the Center for Strategic and International Studies in a study that I understand will be reviewed here today, which found that a 2 billion gallon per year fuel ethanol industry would improve the U.S. trade balance by at least \$2.36 billion annually.
- Clearly, however, even these substantial paybacks do not justify the continuance of the existing incentives indefinitely. Good tax policy incentives should stimulate progress toward free market competitiveness without government subsidy.
- It is imperative that your industry continue its progress through increased research and development and technological advancement in order to assure that the 1992 expiration date of current tax incentives looks upon an industry that has reduced its production costs and can stand alone.

Federal Supplemental Compensation
Compromise Building Blocks
October 1, 1983 - March 31, 1985

	\$B
Senate Compromise Basic Program.....	3.774
(14, 12, 10, 8, 6 weeks)	
<u>Add-ons</u>	
5.5% Rolling trigger for 14 weeks.....	.229
4.5% Rolling trigger for 12 weeks.....	.219
Pay 8 weeks in lowest unemployment States vice 6 weeks.....	.086
Subtotal.....	4.308
5 week reachback for those who began FSC on or after April 1, 1983 and used up all their weeks of FSC before October 1, 1983....	<u>.330</u>
Total.....	4.638

Other elements of program:

- o No phaseout. All benefits end March 31, 1985.
- o The number of weeks of FSC available in each State will change no more often than once every 13 weeks. At that time, a State's increase or decrease in the number of FSC weeks payable to new FSC claimants will be limited to no more than 2 weeks ("symmetrical limiter").
- o Beginning October 1, 1983, an individual's entitlement to a specific number of weeks of FSC will be determined when the individual starts on FSC. After that the individual's number of weeks would remain unchanged, even if the number of weeks for the individual's State goes up or down.

Effect of
5.5% IUR
Rolling Trigger

States which meet the 5.5% rolling trigger criterion would pay 14 weeks of FSC to new FSC claimants in the affected quarter. Those States which benefit from the 5.5% rolling trigger are shown below. (Without the 5.5% rolling trigger, they would pay less than 14 weeks of FSC to new claimants in the affected quarter.)

States which benefit at outset of new FSC program (FY 84, Q-1):

Alabama
Alaska
Arkansas
Idaho
Illinois

Kentucky
Michigan
Mississippi
Ohio
Oregon

Pennsylvania
Rhode Island
Washington
Wisconsin
West Virginia

States which benefit some time later in FSC program (FY 84: 2-4; FY 85: 1-2):

Alaska
Idaho
Illinois
Kentucky
Michigan

Mississippi
Ohio
Oregon
Pennsylvania
Puerto Rico

Rhode Island
Washington
West Virginia
Wisconsin

OUTLINE OF POSSIBLE BUDGET PACKAGE

I. Short-Term Deficit Reduction

A. <u>Spending Reductions</u>	<u>FY84</u>	<u>FY85</u> (in billions)	<u>FY86</u>	<u>FY84-86</u>
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Finance Committee

1. Medicare	.4	.6	1.1	2.2
2. Medicaid	*	*	*	--
3. AFDC	.1	.2	.2	.5
4. SSI/CSE	*	*	*	--
Subtotal	<u>.6</u>	<u>.8</u>	<u>1.3</u>	<u>2.6</u>
(Attachment A)				

Other Committees (to date)

Small Business				1.2
Veterans Affairs				0.5
Government Affairs				<u>7.0</u> (tentative)
Subtotal				8.7
Total Spending Reductions				11.3

B. Tax Increases

Loophole closing package (Attachment B)	1.9	5.5	8.0	15.4
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II. Long Range Deficit Reductions

A. Enhanced recession authority (Attachment C)	N/A	N/A	N/A	N/A	
B. Possible Contingency Tax (Attachment D)	--				26 41 --- 67
C. Possible COLA Options (Attachment E)	--	0-5.1	4.2-13	4.2-18.1	