REMARKS OF SENATOR DOLE

MID-CONTINENT OIL & GAS ASSOCIATION

Friday, February 10, 1984--9:00 a.m.--Four Seasons, Salon A

What is the Federal deficit likely to be?

- The estimates of future Federal deficits are quite sensitive to one's economic assumptions. Yet even under the most optimistic of economic assumptions, the deficit will remain at historically high $200 billion levels over the foreseeable future, unless drastic action is taken.

- Assuming an extremely strong recovery (4% real growth of GNP) is sustained over the next few years and all of the Administration's proposed spending cuts and revenue proposals are enacted, the deficits are still projected to be:

FY 1985	FY 1986	FY 1987	FY 1988
$180 billion	$177 billion	$180 billion	$152 billion

- If economic growth is not so strong (3% real GNP growth) and interest rates are slightly higher (9% T-bill rate), and Administration's spending cuts are not enacted, the projected deficits would be:

FY 1985	FY 1986	FY 1987	FY 1988
$202.6 billion	$236.7 billion	$270 billion	$290.1 billion

- If we have an economic downturn during this period, we may be facing $300 plus billion deficits.

Why worry about the deficit--What does it mean to the average American?

- If nothing is done to reduce deficit spending over the next five years, the total Federal debt will nearly double to over $10,000 for every man, woman and child in America.

- At this level, by 1989 it will take one-half of all Americans' personal income tax payments just to pay the Federal Government's interest bill.

- By 1989 the annual Federal interest cost will amount to $250 billion--about $1,100 for every American.

- That $1,100 per person interest cost is equal to 40% of each person's annual expenditure for food.

- Virtually all economists agree that the sustained enormous deficits that we are facing will be economically harmful.

- Many Americans will find home-buying more difficult with higher deficits. Consider a family purchasing a home at today's current interest rate, averaging about 12-1/2%, with a $55,000 mortgage. If the deficits push interest rates up, total interest costs over the 30 year term will be $15,500 more for each one percentage point increase.

- All Americans will directly feel the results of high deficits if they lose jobs as a result of a business slowdown resulting from a crowding out of private investment, or if they lose jobs to imported products made more competitive because of an abnormally strong dollar or if they end up paying higher prices because inflation is rekindled.

<u>What about the Adminstration budget proposals for FY 1985</u>

- The Administration reproposes many of the domestic spending cuts from its 1984 budget that have not been acted upon.

- The Administration proposes only about $5 billion in net domestic cuts for FY 1985, but that figure is larger in the out years:

FY 1985	FY 1986	FY 1987	FY 1988
$5 billion	$10 billion	$12 billion	$16 billion

- On the tax side, the Administration has proposed some tax reforms that will raise revenue, including cutbacks in tax shelters Treasury has endorsed. These would raise about $34 billion over three years.

- While none of these proposals involve huge numbers given the size of our deficits, when they are combined with pending reconciliation measures and additional items, they can provide a substantial 'down payment' on the deficit.

What about defense spending?

- The Administration recommends $305 billion in defense spending for FY 1985--a 13% real increase over the 1984 defense spending level.

- This sharp increase in defense spending is $16 billion over the substantial increase provided for FY 1985 in the most recent Congressional budget resolution.

- Over the period FY 1985-1987, the Administration's defense recommendation is about $65 billion higher than the 5% real growth path that Congress last year set as adequate for a strong defense.

- The Adminstration's defense recommendation is a first offer that sets its opening bargaining position. I believe that the final defense number for FY 1985 will be close to the $289 billion figure contained in last year's budget resolution.

- Even at a $289 billion level, defense spending will have increased 91% since 1981, the first year of the Reagan Presidency.

WHY SHOULD WE ACT THIS YEAR ON THE DEFICIT

- If we fail to deal with the deficit now, the problem will become worse. Current projections showing deficits holding in the range of $200 billion probably are optimistic, as they are based upon assumption of steady economic growth through 1989. However, postwar experience suggests that the average recovery lasts only 3 years, making a recession in 1985 or 1986 likely.

- If we postpone action until 1985 and we do suffer another recession, the deficits would then hit the $300-$400 billion range. At that point, it may be difficult to cut the deficit without further weakening the economy. Our choices would become very difficult indeed.

- Of course, failure to reduce the deficit in 1984 makes a recession likely to come sooner, as interest rates are forced up by private credit demands clashing with Treasury borrowing needs.

- By postponing action of the deficit, we increase the risk of recession. The average increase in the unemployment rate during a postwar recession is about three points, or three million jobs. By acting to reduce the deficit, we can significantly lower the risk that three million workers will lose their jobs in 1985 and 1986.

- The rise in interest rates will depress auto sales, housing starts, and capital goods orders. It is widely recognized that sustained economic recovery will be impossible unless these key sectors are healthy.

- Alternatively, the Fed could offset the deficits' impact on interest rates by "monetizing" the debt, leading to a resurgence of inflation in 1985. If we do nothing, we will force the Fed to choose between high interest rates and recession, or inflation.

- Failure to reduce the deficits in 1984 may also depress the stock market. A key factor in determining equity and bond prices is investors' confidence that Congress and the Administration can produce a sound fiscal policy. If we send the signal that the deficit problem is secondary to politics, equity and bond prices may fall.

- The exploding cost of servicing the Federal debt will make controlling spending more difficult each year, unless the deficits are reduced soon. Each year that we add $200 billion in new Federal debt adds about $15 billion to the next year's interest costs.

- The economy is now on a path where more and more of its resources go just to pay off the debt. According to economist Lawrence Summers, "It's a case where the miracle of compounding (interest) works against you."

- In 1976 net interest accounted for just 7% of total outlays But if we do nothing, by 1988 the total Federal debt will be more than half of total GNP, and the net interest cost of servicing this debt will reach 14% of all spending. Each year that we do nothing, the share of Federal spending that we can control gets smaller.

- Recent studies indicate that current and prospective budget deficits may have helped to overvalue the American dollar. If the deficits are not reduced, the problem of overvaluation could become worse, weakening the competitive position of American exports and costing the U.S. jobs in such industries as steel, electronics, and agriculture.

RECOVERY--WHAT PROGRESS HAVE WE MADE

Strength of recovery

- A strong recovery is on track and appears to be moderating to a pace that can be sustained in the years ahead. As an indication, look at the expansion of real gross national product. It grew by 9.7% in the second quarter of 1983, 7.9% in the third quarter, and an estimated 4.5% in the fourth quarter. By this measure, the recovery is the strongest since 1961.

- Housing starts are running at a rate of about 1.7 million units a year, and new home sales are up by 91% over the recession low.
- Industrial output in 1983 rose 6.5%, and factory utilization is up to 79.4%--the highest level in two years, and close to the normal capacity of 82%.
- The Commerce Department's survey of business plans for 1984 show that business plans to increase capital investment by 9.4%--this is a rate about 2% higher than that seen at comparable points in previous postwar recoveries.

Inflation

- The best news about this recovery is that it is noninflationary. In 1983 the producer price index rose just 0.6%--the lowest increase since 1964. The CPI for 1983 was 3.8%, the lowest since 1972. Continued moderation in producer prices indicates low inflation will continue.

Creating Jobs

- People are going back to work, and the pace of job creation has been unusually high for a postwar recovery. On January 6 the Labor Department announced the civilian unemployment rate dropped from 8.4% to 8.2% in December. Overall, this means unemployment has dropped 2.5 percentage points over the past year.
- The continued strength of the recovery shows that recent growth in employment has not just been a statistical fluke, but shows a real turnaround in the labor market. Unemployment fell 230,000 in December, and there have been 4 million jobs created in the last year.
- What is more, the growth in jobs is broad-based. While manufacturing industries showed the most dramatic gains, all industries other than government and agriculture showed dramatic drops in unemployment.

ENERGY TAX TALKING POINTS

A. Energy Taxes

- The Senate Finance Committee last fall considered a 2 1/2 % ad valorem tax on all forms of energy--oil, natural gas, coal, and electricity.

- This energy tax proposal was a refinement of the Administration's contingency tax proposal for a $5 per tax excise tax on crude oil.

- Since the Administration has abandoned its contingency tax proposal, there is little likelihood of Congressional action this year on any new energy tax.

B. Percentage Depletion on Secondary and Tertiary Oil Production

- Because of a technical drafting error in 1975, all pecentage depletion on production from secondary and tertiary expired at the beginning of this year.

- Last year I introduced legislation to correct this problem and reestablish 15% depletion on such production, as was Congress' original intent.

- It makes no sense to have 15% depletion on primary production, and no depletion on more costly secondary and tertiary oil production.

- A log jam in all tax legislation at the end of the last session prevented our enactment of corrective legislation. Nevertheless, we will include the correction in whatever tax legislation we pass this year.

C. Stripper Well Regulations

- Last year, the Treasury Department proposed regulations to implement the "independent stripper" exemption that took effect in 1983.

- These proposed regulations caused concern on the part of both independent producers and royalties.

- We have been active in trying to iron out a practical and equitable solution to the definitional problems presented, so both independent producers' and royalty owners can live with the result.

- Since independent producers are totally exempt on stripper oil, but taxed on newly discovered oil, it is obviously advantageous for them to classify as much oil as possible as stripper oil.

- Royalty owners have the opposite incentive -- for them stripper oil has a 60% tax rate and newly discovered oil only on an 22.5% tax rate.

- I believe the solution we worked out with the IRS is fair -- new wells to a different reservoir will be classified as newly discovered until they can independently qualify for stripper well status. It may be that the IRS will develop a better solution that benefits both independent producers and royalty owners.

- Production for existing stripper wells that are perforated at another reservoir will be treated as all stripper oil because of the practical difficulty in estimating the source of commingled production.

- We will continue to be concerned about this problem and will follow the course of the final regulations and any rulings that are issued. We expect the final regulations to be issued in about a month.