REMARKS BY SENATOR BOB DOLE
COMMODITY CLUB OF WASHINGTON
MAYFLOWER HOTEL
APRIL 24, 1984

THANK YOU VERY MUCH. I WILL TRY TO KEEP MY REMARKS BRIEF FOR TWO REASONS. FIRST, MOST OF YOU ARE ALREADY FAMILIAR WITH OUR CURRENT EFFORTS TO GRAPPLE WITH THE BUDGET DEFICITS, AND WITH THE "MINI" FARM BILL WHICH PRESIDENT REAGAN SIGNED INTO LAW EARLIER THIS MONTH. SECOND, I KNOW THIS GROUP ONLY INVITES SPEAKERS WHEN IT FEELS THEY NEED SOME SPECIAL ADVICE. SO I'LL BE INTERESTED IN GETTING YOUR VIEWS AND INPUT WHEN I'M DONE.

POSITIVE SHORT-TERM OUTLOOK

I WANT TO START BY BEING OPTIMISTIC ABOUT THE SHORT-TERM OUTLOOK FOR THE ECONOMY. MOST OF THE VITAL SIGNS OF ECONOMIC HEALTH -- GNP GROWTH, INFLATION, EMPLOYMENT, INDUSTRIAL CAPACITY UTILIZATION -- ARE IN GOOD SHAPE. THE 8.3% JUMP IN GNP IN THE FIRST QUARTER OF 1984 FAR EXCEEDED EXPECTATIONS, AND THE BALANCE OF THE YEAR SHOULD SEE CONTINUED EXPANSION.

FIRST CAUSES FOR CONCERN

AT THE SAME TIME, THERE HAVE BEEN SOME FIRST CAUSES FOR CONCERN ON THE ECONOMIC HORIZON. INTEREST RATES, WHICH ARE BECOMING PUBLIC ENEMY NUMBER ONE, HAVE NUDGED BACK UP FROM A 10½% PRIME SIX MONTHS AGO TO 12%. THE COST OF FIXED RATE HOME MORTGAGES IS JUST ABOVE THE PSYCHOLOGICAL BARRIER OF 14%, AND NEW HOUSING STARTS ARE DOWN SHARPLY FROM 1983. SO I THINK THAT THE MONETARY AND FISCAL POLICIES AND FORCES THAT FUELED THE CURRENT ECONOMIC RECOVERY HAVE TAKEN US ABOUT AS FAR AS THEY CAN WITHOUT SOME FURTHER "GOOD NEWS" FROM WASHINGTON.

DEFICIT REDUCTION EFFORTS

AS MOST WASHINGTON OBSERVERS KNOW, CONGRESS HAS BEEN BUSY DESIGNING ALTERNATIVE PLANS TO REDUCE THE RATE OF GROWTH OF THE FEDERAL BUDGET DEFICITS OVER THE NEXT THREE YEARS. PRIOR TO THE EASTER RECESS, THE SENATE PASSED A FINANCE COMMITTEE BILL THAT

WOULD CONTRIBUTE $71 BILLION IN SAVINGS, PRIMARILY FROM CLOSING TAX LOOPHOLES AND THROUGH SPENDING REDUCTIONS. OTHER PROPOSALS WOULD ACHIEVE SAVINGS BY RAISING TAXES, CUTTING DEFENSE, OR TINKERING WITH SOME OF THE ENTITLEMENT PROGRAMS. ALL OF THESE PLANS ARE ESTIMATED TO REDUCE DEFICITS IN FY-85/87 BY ANYWHERE FROM $143 TO $203 BILLION.

HOPEFULLY, AS WE MOVE TO CONFERENCE ON OUR BILL AND CHOICES HAVE TO BE MADE, BOTH PRESIDENT REAGAN AND TIP O'NEILL WILL BE READY TO SHOW SOME FLEXIBILITY. WE'VE COME A LONG WAY SINCE THE PRESIDENT GAVE THE GO-AHEAD IN HIS STATE OF THE UNION ADDRESS AND TIP, AFTER GRIPING ABOUT LOSING THE DEFICITS AS A GOOD CAMPAIGN ISSUE, AGREED TO HELP OUT. IF WE CAN JUST FINISH THE JOB AND GET A PACKAGE IN THE NEXT FEW WEEKS, THEN EVERYONE CAN GO BACK TO BLAMING EACH OTHER FOR THE LION'S SHARE OF THE DEFICIT WE DON'T REDUCE.

MORE DEFICIT REDUCTION IN 1985

AT $1.4 TRILLION, THE NATIONAL DEBT IS ALREADY REQUIRING ANNUAL INTEREST PAYMENTS OF $135 TO $140 BILLION. EVEN WITH A DOWNPAYMENT PACKAGE THIS YEAR, WE WILL STILL ADD ABOUT $180 BILLION IN NEW DEBT NEXT YEAR, AND THE COST OF DEBT SERVICING WILL JUST KEEP GOING UP. SO I THINK WE WILL BE BACK AGAIN IN 1985, AND PROBABLY FOR SEVERAL YEARS AFTER THAT, FOR AN EVEN MORE CONVINCING EFFORT.

MOUNTING FOREIGN TRADE DEFICITS

UNFORTUNATELY, THE GROWTH OF OUR BUDGET DEFICITS AT HOME IS CONTRIBUTING TO RECORD U.S. DEFICITS IN FOREIGN TRADE BY KEEPING INTEREST RATES -- AND THUS THE VALUE OF THE DOLLAR -- AT HIGH LEVELS. LAST YEAR, THE U.S. MERCHANDISE TRADE DEFICIT TOTALLED $69.4 BILLION. IN 1984, THE FIGURE IS EXPECTED TO TOP $100 BILLION, AND COULD BE AS HIGH AS $120 BILLION AS IMPORTS SURGE AND EXPORTS FLAG. IN THE PAST DECADE, THE U.S. HAS GENERALLY ENJOYED A SURPLUS IN ITS CURRENT ACCOUNTS POSITION, WHICH INCLUDES SERVICES AND TRANSFER PAYMENTS AS

WELL AS MERCHANDISE TRADE. IN 1982, HOWEVER, THERE WAS A $11.2 BILLION DEFICIT, FOLLOWED BY $40.8 BILLION IN RED INK IN 1983. IF THE TRADE DEFICIT INCREASES ANOTHER $40 BILLION IN 1984, AS EXPECTED, THE TREND WILL OBVIOUSLY BECOME EVEN MORE WORRISOME.

HIGH U.S. INTEREST RATES ARE ALSO ATTRACTING A MASSIVE INFLUX OF FOREIGN INVESTMENT, WHICH HAS BEEN PARTIALLY RESPONSIBLE FOR THE STRENGTH AND BREADTH OF THE RECOVERY. HOWEVER, THE CONTINUING OVERVALUATION OF THE DOLLAR AS A RESULT OF HIGH RATES IS INHIBITING THE COMPETITIVENESS OF AMERICAN EXPORTS, DESPITE SOME RECENT IMPROVEMENT IN WORLD ECONOMIC ACTIVITY. AS A RESULT, EXPORT-RELATED INDUSTRIES, INCLUDING AGRICULTURE AS WELL AS MANUFACTURING, ARE LOSING JOBS AND JOB OPPORTUNITIES GENERATED BY THE RECOVERY IN DEMAND.

DEBT CRISIS IN DEVELOPING COUNTRIES

COMPOUNDING OUR POOR TRADE PERFORMANCE IS THE CONTINUING RECESSION IN MANY DEVELOPING COUNTRIES, AND THE SHARP REDUCTION IN

THEIR IMPORTS OVER THE LAST THREE YEARS. IN ADDITION, A NUMBER OF THESE COUNTRIES, AS WELL AS SOME OF THE NON-MARKET ECONOMIES IN EASTERN EUROPE, ARE COMING PERILOUSLY CLOSE TO NOT BEING ABLE TO MAKE INTEREST PAYMENTS ON THEIR FOREIGN DEBT. WE HAVE ALREADY SEEN FOUR COUNTRIES DEFAULT ON CCC-BACKED LOAN GUARANTEES TOTALLING $431 MILLION. ANOTHER $1.2 BILLION IN ADDITIONAL DEFAULTS ARE ANTICIPATED IN THE NEXT YEAR, AND THAT FIGURE COULD BE CONSERVATIVE. THE WORLD IS CURRENTLY FAILING TO CARRY A TOTAL OF SOME $700 BILLION IN FOREIGN DEBT, AND THERE IS NO END IN SIGHT TO THE CURRENT CYCLE OF REFINANCING NEW LOANS AND CREDITS. CONTINUED "BACKDOOR" FINANCIAL ASSISTANCE THROUGH OFF-BUDGET PROGRAMS MAY BE THE ONLY SHORT-TERM ALTERNATIVE TO WIDESPREAD INSOLVENCY IN "PROBLEM" COUNTRIES. BUT IT SHOULD NOT HAVE THE EFFECT OF FURTHER DELAYING

A MORE COMPREHENSIVE AND LONG-RANGE EFFORT TO FOCUS ASSISTANCE ON STIMULATING ECONOMIC GROWTH IN THE DEVELOPING WORLD.

THIRD DEBT CRISIS IN U.S. FARM ECONOMY

THERE IS A THIRD DEBT CRISIS GROWING THAT MAY NOT BE AS BROAD-BASED AS OUR NATIONAL BUDGET DEFICITS OR THE FOREIGN DEBT PROBLEMS OF THE DEVELOPING WORLD, BUT IT IS MUCH CLOSER TO HOME. FROM A LEVEL OF $65 BILLION IN 1970, U.S. FARM DEBT NEARLY DOUBLED TO $115 BILLION IN 1982 AS FARMERS BORROWED AGAINST LAND VALUES. SINCE 1979, LOWER COMMODITY PRICES AND HIGHER INTEREST RATES HAVE TURNED ANNUAL BORROWING FOR OPERATING EXPENSES INTO PERENNIAL DEBT INCREASES FOR MANY PRODUCERS, AND PARTICULARLY FOR NEW FARMERS. AND WITH LAND

PRICES IN CERTAIN AREAS BEGINNING TO SAG OR FALL, BANK EXAMINERS ARE REQUIRING RURAL BANKERS TO TIGHTEN UP THEIR LENDING PRACTICES. THE RESULT HAS BEEN A FURTHER EROSION OF LAND VALUES THIS YEAR, AND SERIOUS DIFFICULTY FOR BANKS TRYING TO CARRY THEIR FARM BORROWERS THROUGH SPRING PLANTING.

MORATORIUM ON FARMLAND SALES

AS A STOPGAP MEASURE, FARM LENDERS MAY WANT TO CONSIDER GETTING TOGETHER AND AGREEING TO A MORATORIUM ON SALES OF FARMLAND UNTIL LAND PRICES RECOVER TO SOME PREDETERMINED LEVEL. IF THERE WERE CONCERTED ACTION BY MAJOR CREDITORS, INCLUDING THE FARMERS HOME ADMINISTRATION, THE FARM CREDIT ADMINISTRATION, AND THE PCA'S, IT MIGHT BE POSSIBLE TO BREAK THE CURRENT NEGATIVE MARKET PSYCHOLOGY FOR LAND PRICES. I DON'T BELIEVE MOST LENDERS WANT TO TAKE ON ADDITIONAL FARMLAND THROUGH DEFAULT ANYWAY.

LONGER-TERM SOLUTIONS

IN THE LONGER TERM, THE PROBLEMS FACING U.S. AGRICULTURE -- AND THEIR POSSIBLE SOLUTIONS -- ARE INEXTRICABLY TIED TO THE OTHER

NATIONAL AND INTERNATIONAL DIFFICULTIES I HAVE MENTIONED. UNLESS WE GET CONTROL OF OUR DEFICIT SPENDING, GOVERNMENT BORROWING WILL CONTINUE TO PRESS INTEREST RATES UPWARD. AT 15 OR 16 PERCENT MONEY, EVEN FARMERS WHO CAN GET FINANCING CAN'T MAKE A PROFIT. IN ADDITION, THE U.S. FARM ECONOMY CANNOT FULLY RECOVER UNLESS AND UNTIL THERE IS GENERAL ECONOMIC RECOVERY IN THE DEVELOPING WORLD. THE RAPID EXPANSION IN U.S. AGRICULTURAL EXPORTS IN THE 1960'S AND 1970'S WAS CLOSELY TIED TO GROWING DEMAND BY DEVELOPING COUNTRIES IN THE SOUTHERN HEMISPHERE. U.S. FARMERS ADDED 20% TO OUR ACREAGE BASE DURING THE 1970'S IN RESPONSE TO THAT SURGE IN DEMAND. UNFORTUNATELY, THE COLLAPSE OF THE INFLATION AND CREDIT CYCLE, COMBINED WITH RISING FOREIGN COMPETITION, HAS LEFT MANY OF THOSE ACRES WITH NO MARKET OTHER THAN THE FEDERAL GOVERNMENT. THE ONLY GOOD LONG-TERM ANSWER IS TO WORK AT STRENGTHENING THE ECONOMIES OF DEVELOPING COUNTRIES IN ORDER TO RESTORE THEIR BUYING POWER.

NONE OF THESE PROBLEMS CAN BE SOLVED OVERNIGHT. DEFICIT REDUCTION IS LIKELY TO BE AN ANNUAL HEADACHE FROM HERE ON OUT. ROLLING OVER FOREIGN DEBT TO AVOID DEFAULT IS ALREADY A PERENNIAL CLIFF-HANGER THAT RIVALS SOME OF THE AFTERNOON SOAP OPERAS. AND DIGGING OUR FARMERS OUT OF DEBT WON'T HAPPEN UNTIL SUPPLY AND DEMAND ARE IN BETTER BALANCE.

THERE IS ALREADY A LOT OF INTEREST ON THE PART OF THE ADMINISTRATION, THE CONGRESS, AND THE PRIVATE SECTOR TO PREPARE FOR NEXT YEAR'S DEBATE ON FARM LEGISLATION. I WOULD JUST SUGGEST THAT THE FOCUS OF THE DISCUSSION WILL ALSO HAVE TO BE ON HOW WE ARE GOING TO PAY ALL THE DIFFERENT BILLS THAT ARE COMING DUE. FINALLY, I WOULD MENTION SEVERAL POINTS THAT ARE LIKELY TO BE CONSIDERED WHEN WE PUT A FARM PACKAGE TOGETHER.

LONG-TERM FARM POLICY

FIRST, THERE IS BROAD AGREEMENT THAT AGRICULTURAL POLICY NEEDS TO BE PUT ON A MORE LONG-TERM BASIS. RECENT FOUR-YEAR FARM BILLS

HAVE USUALLY BROKEN DOWN INTO ONE YEAR PROGRAMS, AND HAVE OFTEN FAILED TO PROVIDE DETAILS TO WINTER WHEAT FARMERS BEFORE FALL PLANTING.

ONE WAY TO GET AROUND THIS YEAR-TO-YEAR CYCLE WOULD BE TO MAKE CERTAIN PROGRAM PROVISIONS EFFECTIVE OVER A LONGER TERM. FOR EXAMPLE, PRICE SUPPORT LOAN RATES BASED ON MULTI-YEAR PRICE AVERAGES WOULD BE LESS SUBJECT TO POLITICAL INFLUENCES. VARIABLE LOANS WOULD ALSO BE SOMEWHAT LESS PREDICTABLE, AND WOULD MAKE IT MORE DIFFICULT FOR OUR FOREIGN COMPETITORS TO MAKE THEIR OWN LONG-RANGE PRODUCTION AND MARKETING PLANS. SO WOULD A FIVE OR TEN YEAR FLEXIBLE LAND RETIREMENT PROGRAM TO BID PRODUCTION ACREAGE OUT WHEN CROPS ARE IN SURPLUS. FINALLY, THE U.S. COULD MAKE A LONGER-TERM COMMITMENT TO A HIGHER LEVEL OF FOOD ASSISTANCE THROUGH P.L. 480 OR UNDER THE FOOD AID CONVENTION OF THE INTERNATIONAL WHEAT AGREEMENT.

PROTECTING FOREIGN MARKETS

SECOND, THE U.S. MUST CONVINCE ITS INTERNATIONAL COMPETITORS THAT IT INTENDS TO REMAIN THE DOMINANT SUPPLIER OF AGRICULTURAL PRODUCTS TO FOREIGN MARKETS. AS LONG AS SUBSIDIES ON FARM PRODUCTS ARE PERMITTED UNDER THE GATT, THERE IS NO REASON TO EXPECT OTHER EXPORTING COUNTRIES TO VOLUNTARILY ABANDON THEM AND ACCEPT SOME ALTERNATIVE STANDARD OF TRADE CONDUCT. BY NOT ESCALATING OUR OWN DOMESTIC COMMODITY SUPPORTS, THE U.S. HAS MADE SOME INITIAL PROGRESS IN BREAKING DOWN THE EUROPEAN COMMUNITY'S HIGHLY SUBSIDIZED COMMON AGRICULTURAL POLICY. IF WE PERSEVERE, AND RESPOND IN-KIND TO NON-COMPETITIVE TRADE PRACTICES PERMITTED UNDER WORLD TRADING CONVENTIONS, WE WILL EVENTUALLY FORCE OTHER EXPORTERS TO NEGOTIATE SOME CONTROLS OVER THEIR USE.

FARM PROGRAM SAFETY NET

THIRD, WE NEED TO EXPLORE WAYS TO REDUCE THE IMPACT WHICH THE INCOME SAFETY NET IN FARM PROGRAMS HAS ON AGRICULTURAL PRODUCTION,

AND MARKET PRICES. THE ANALOGY OF HAVING ONE FOOT ON THE ACCELERATOR AND ONE ON THE BRAKE HAS BEEN ONLY TOO ACCURATE IN RECENT YEARS. LOOK AT THE FARM PROGRAM WHICH WE HAD TO REPLACE THIS YEAR -- BOTH THE TARGET PRICE AND THE ACREAGE REDUCTION REQUIREMENT UNDER THE 1984 WHEAT PROGRAM WERE UNJUSTIFIABLY HIGH. THERE IS NO WAY THE GOVERNMENT CAN CONTINUE TO OFFER FARMERS SO MUCH INCENTIVE TO PRODUCE CROPS, AND SO MUCH INCENTIVE NOT TO PRODUCE THEM. IF WE NEED TO PROTECT THE SMALL FAMILY FARM -- A BELIEF THAT HAS MUCH SUPPORT IN CONGRESS -- THEN WE SHOULD DECIDE WHAT LEVEL OF COMMITMENT WE CAN AFFORD AND PROVIDE IT AS INDEPENDENTLY AS POSSIBLE OF THE REGULAR FARM PROGRAM.

CONCLUSION

FINALLY, AND TO RETURN TO AN EARLIER POINT, THERE IS NO WAY WE CAN MANDATE PROSPERITY IN THE U.S. AGRICULTURAL ECONOMY SOLELY BY OUR ACTIONS HERE IN WASHINGTON. WE CANNOT AFFORD TO SUBSIDIZE ENOUGH

EXPORTS, BUY ENOUGH LAND OUT OF PRODUCTION, OR PAY ENOUGH IN INCOME SUPPLEMENTS ON A PERMANENT BASIS. WE CAN PROVIDE SOME PROTECTION, BUT WE CANNOT ALLOW IT TO DEVELOP INTO PROTECTIONISM. WE CAN BRIDGE PART OF THE SUPPLY-DEMAND GAP THROUGH INCREASED FOREIGN ASSISTANCE, BUT FOOD AID ALONE CANNOT PROVIDE THE ENTIRE SOLUTION. WE MUST FIND SOME WAY TO STIMULATE RENEWED GROWTH IN THE WORLD ECONOMY WITHOUT UNDERWRITING EVERY DEVELOPING COUNTRY'S SUCCESS.

IT MAY BE THAT THE NEXT CHAPTER IN U.S. FOREIGN MARKET DEVELOPMENT WILL SEE A SHIFT IN EMPHASIS FROM THE PAST PREOCCUPATION WITH THE ACTUAL OR POTENTIAL MARKET TO A NEW AND BROADER DEFINITION OF DEVELOPMENT. THE ADMINISTRATION RECENTLY INDICATED SUPPORT FOR A THREE-YEAR PROGRAM TO TARGET $500 MILLION FOR PRIVATE SECTOR-DIRECTED PROJECTS IN SELECTED SUB-SAHARAN AFRICAN COUNTRIES. IF WE CONTINUE TO EXPAND OR EVEN MAINTAIN CURRENT U.S. FARM PRODUCTION CAPACITY, WE NEED TO CONCERN OURSELVES WITH ASSURING THAT THERE WILL BE PAYING CUSTOMERS IN THE WORLD TO BUY IT.

REMARKS OF SENATOR DOLE

COMMODITY CLUB OF WASHINGTON

Tuesday, April 24, 1984--1:00 p.m.--Mayflower Hotel, Washington, D.C.

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.

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 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.

Deficit downpayment in 1984

- The President took the lead to begin a deficit-reduction effort in 1984 by calling for bipartisan negotiations on a package to reduce the deficit by $100 billion over 3 years. Now he has worked with congressional Republicans to outline a $150 billion package including defense savings ($40 billion), nondefense cut

($43 billion), revenue increases ($48 billion), and debt service savings ($18 billion). As the President suggests, we can work with a variety of modest spending reductions, and tax reforms that raise revenue, to enact a significant deficit "downpayment" in 1984.

- Even though election-year politics makes it difficult to launch the kind of major assault on the deficit that we really need, that is no reason to do nothing. Making a noticeable dent in the deficit will make our job easier in the years ahead. Even more importantly, it will demonstrate that we can face up to the deficit problem even in an election year.

- The Senate has adopted the Finance Committee's proposals on spending and revenue options just within its jurisdiction that achieve about $74 billion of the "downpayment" goal. To do that we draw on a number of proposals that have been on the table for some time, including some that were already in the legislative "pipeline":

  -Items included in the FY 1984 reconciliation bill, S. 2062

  -Treasury-endorsed proposals on tax shelters and other abuses

  -Administration -proposed spending cuts that were not followed through on last year

  -Administrative savings and other proposals made by the Grace Commission

  -Additional proposals considered in the Finance Committee last fall

- Target. With an overall goal of $150 billion in savings, we can achieve $21.4 billion from revenue from in S. 2062, $3.8 billion in spending reduction from Finance Committee programs in S. 2062, $3.1 billion from Grace Commission recommendations, $9.6 billion in debt service savings, and the remainder from additional spending and tax changes aimed at desirable policy reforms.

- Feasibility. The key is to keep following the President's suggestion and concentrate on relatively non-contentious items, avoiding things like the third-year tax cut and indexing, mean-tested entitlements, social security, and the like. Our effort must be bipartisan and balanced to do the job: Democrats and Republicans alike will benefit by cooperating to take swift action on the deficit. Time is of the essence if we are to make a beginning this year.

- Initial Action. On February 23, the Finance Committee began action to reduce the deficit. The Committee bill agreed to by the

Senate includes changes in health care programs that save about $7 billion between now and 1987, over and above the provisions in S. 2062. In addition, the Committee agreed to tax reform and modest revenue raisers that generate $48.1 billion between now and 1987, provided at least that amount of spending reduction can be achieved. The House has also approved a $50 billion tax bill, so we are on our way.

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 2.2 million units a year, and jumped 11.2 % in February.

- Industrial output in 1983 rose 6.5%, and factory utilization is up to 80.7%--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 16%--this is 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% last November to 7.8% in February. Overall, this means unemployment has dropped 2.9 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 4.9 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.

HIGHLIGHTS OF SENATE DEFICIT REDUCTION DECISIONS

(Savings estimates are for period 1984-87, and include outlay savings in S. 2062)

Spending Restraint

- Medicare Part B Premium. Stablize the premium as a percent of program costs between 1985 and 1990. ($1.2 billion)

- Delay initial Medicare eligibility until month after an individual's 65th birthday. ($630 million)

- Working age. Non-working spouses age 65 to 69 could elect primary medical coverage under spouse's employer health plan rather than Medicare regardless of working spouse's age. ($1.1 billion)

- Physican freeze. Continue until July 1986 a freeze on physican's fees for those unwilling to accept assignment for all services to Medicare patients. ($2.8 billion)

- Fee schedule for lab services. Payments for clinical lab services would be held at 62 percent of prevailing charge levels through October 1987 ($1.0 billion)

- Limit on hospital costs. For FY 1985 and FY 1986 increases in hospital cost payments under Medicare would be limited to one-half percent less than the hospital wage and price index increase. ($1.1 billion)

- Grace Commission. Improved cash management techniques (e.g. faster deposits of receipts to the government), improving income verification procedures for benefit programs, and using IRS refund offsets to collect debts owed the government would be implemented. ($3.1 billion)

- Debt service. $9.6 billion.

Revenue Increases

- Tax reform. New rules would be applied to limit tax shelters in such areas as partnership allocation of expenses and income interest deductions on discount obligations, transactions between related parties, current deductions for future liabilities, and corporate deductions for extraordinary dividends received. ($10.2 billion)

- Tax benefits. Where a taxpayer receives a refund or other recovery for State taxes or other situations that previously gave rise to a deduction, the tax benefit portion of the deduction would be brought back into income first. ($800 million)

- Real Estate. Depreciation rules (20 years for all structures in FY 1984, 19 years in FY 1985, 18 years in FY 1986 and thereafter, new or used), and recapture rules for real property would be adjusted. ($4.4 billion)

- Freeze. Expensing for small business investment would be frozen at $5,000, the cost of used property eligible for the ITC would be frozen at $125,000, and the foreign earned income exclusion would be frozen at $80,000. ($1.9 billion)

- Distilled Spirits. Federal excise tax would be increased $2.00 per proof gallon ($1.0 billion)

- Income Averaging. The base period for determining the income averaging threshold would be reduced to 3 years and the formula slightly modified. ($1.6 billion)

- Earnings and Profits. The definition of earnings and profits would be modified so that it more closely reflects a corporation's economic income rather than its taxable income. This change will reduce a corporation's ability to pay tax-free dividends. ($1.7 billion)

- Add-Ons. In addition to miscellaneous items, the Committee agreed to phase in spousal IRAs; an R&D package; foundation tax changes; extend the targeted jobs credit for 3 years; enterprise zones; increase the earned income credit; Foreign Sales Corporations; energy credit extension with credit reordering; and others.

March 23, 1984

PRELIMINARY ESTIMATES OF THE SENATE FINANCE COMMITTEE PACKAGE

SPENDING	1984-87 Total (Savings in $ billions)
Reconciliation (S. 2062)	
Finance Committee provisions	3.8
Additional Spending Reductions	
*Part B Premium	0.4
*Delay in Initial Eligibility for Medicare	0.6
Working Aged	1.1
*Physician Freeze	0.8
Hospital Market Basket	1.1
Lab Fee	0.9
Medicaid Reduction	1.4
Alcohol Rebate	0.9
Revaluation of Assets	0.3
Lesser of costs of charges	0.3
Competitive Bidding/Claims	0.1
Round Part B Payments	0.2
SNF Rates	(0.1)
Grace Commission	3.1
Debt Service	9.6
Total	24.5

	1984-87 Total (in $ billions)
Reconciliation Tax Provisions (S. 2062)	21.4
Additional Revenue Items:	
Tax shelter, accounting abuse, and corporate reform	10.2
Tax Federal Home Loan Mortg. Corp.	0.3
Tax benefit rule	0.8
Alcohol and tobacco collections	0.5
Freeze ACRS expensing, ITC for used prop. and foreign income exclusion	1.9
Postpone finance lease rules	2.7
Extend telephone-excise tax	3.2
Modification of Sec. 1231	0.2
Factoring of trade receivables	1.4
Source of shipping income	0.2
Recharacterization of U.S. income as foreign source income	0.3
Trust distributions	0.7
Income averaging modification	1.6
Delay in ESOP	0.4
Corporate preference exclusion increase	0.5
Increase distilled spirits tax	1.0
Deferred rent on real and taxable property	1.7
Repeal dividend reinvestment	0.4
Installment sale recapture rule	0.2
20-year life for structures	4.2
Other miscellaneous revenue increase proposals	2.6
Major Revenue Loss Provisions:	
Spousal IRAs	-.9
Enterprise zones	-1.3
R&D credit extension and expansion	-2.0
R&D foreign source allocation	-0.2
Targeted jobs tax credit	-1.6
Life insurance tax change	-1.3
Earned income tax credit	-0.4
Mortgage revenue bond extension-IDB package	-0.6
Grand Total	$48.1