(1) Const. Bal. Budget Amendt

(2) Line-Item Veto

OPENING STATEMENT OF SENATOR DOLE TO BOND BUYER'S CLUB

It is a distinct pleasure to appear before this body of distinguished financial leaders. You, more than anyone, understand the importance of winning the battle against budget deficits and clearing the way for lower interest rates and continued economic recovery.

So no doubt you have been following the action of the Senate in the past few weeks in trying to implement the so-called "down-payment" budget. If so, you have probably heard Senators, including Senator Hollings, complain that the package is not big enough. Many of you have similar views and I, too, wish we could do more this year. Nevertheless, I don't believe we should denigrate what is being accomplished in 1984. Some recent historical perspective reminds us why.

Last fall, we were in budget gridlock. The budget resolution was dead, and the prospects for any action to reduce deficits before 1985 appeared remote. The consensus view was that this year's budget battle would be a bloody, partisan standoff, producing nothing more than election year press releases.

But two things turned that bleak outlook around. First, we got together in the Finance Committee and discovered that there was a remarkable consensus that a deficit reduction package of at least $150 billion had to be enacted <u>before</u> the 1984 election. In the best tradition of bipartisan cooperation, last fall's Finance Committee deliberations laid the groundwork for the down-payment budget package.

But for all our hard work, we would not have gotten off the ground had the President not endorsed our approach in his State of the Union message. By calling for a deficit down-payment, he gave us the green light to begin marking up our Finance Committee package in earnest.

The bipartisan spirit of cooperation continued as the $72 billion Finance Committee package was reported out unanimously, and approved by the full Senate two weeks ago by a vote of 76-5. Senator Bradley was one of the Democrats who voted in favor.

But it hasn't been an easy job. Many Congressmen seem to be against deficits in theory, but are hard to please in practice. There are quite a few members who work to establish a budget-balancing reputation. But many of them, in 1982, were unwilling to vote for TEFRA, the biggest deficit reduction package ever. Some of them also opposed the interest and dividend withholding compromise last year, preferring a straight repeal at a cost to

THE TREASURY OF $13 BILLION OVER THREE YEARS. INCREASINGLY WE FIND IT IS ONE THING TO PUT FORTH A BUDGET PLAN, AND QUITE ANOTHER THING TO VOTE FOR THE SUBSTANTIVE MEASURES NEEDED TO REALLY REDUCE THE DEFICIT.

BUT WE HAVE COME A LONG WAY IN SIX MONTHS, AND I BELIEVE THAT WE CAN CARRY OVER THE BIPARTISAN SPIRIT INTO NEXT YEAR AND COMPLETE THE JOB OF CLOSING THE BUDGET GAP. WHO KNOWS? WE MAY EVEN GET TIP O'NEILL TO VOTE FOR DEFICIT REDUCTION.

BOND CLUB

MAJOR TAX REFORM

Q-- What are the prospects for a major overhaul of our tax system--what, realistically are the options?

A--

- When most people talk of a flat-rate tax, they mean not only doing away with the progressive rate structure (so all persons pay the same rate), but also doing away with many credits, deductions, and exemptions that add complexity to the system and tend to subvert the progressive rate structure by allowing the well-advised wealthy individual to pay little tax, all quite legally.

- There are literally scores of special credits, deductions, and exemptions that, if repealed or modified, could allow a much lower general rate; as a few examples:

  -reinvested utility dividends
  -excluded income earned abroad
  -exclusion of a variety of fringe benefits
  -IRA, Keogh, and pension contributions
  -excluded unemployment compensation
  -intangible drilling costs deduction
  -percentage depletion
  -R & D expenses
  -interest deduction
  -jobs credits
  -earned income credit

- The task of broadening the tax base and lowering rates is not simple, however--many deductions serve very popular goals, such as the charitable deduction, the home mortgage interest deduction, and accelerated depreciation.

- Even under the simplest system, substantial problems remain. What fringe benefits would be taxable? What are deductible costs of earning income--expenses in moving to a new job, tickets to entertain clients at the Superbowl? A new, simpler system cannot be designed or implemented overnight, and will require a careful balancing of conflicting interests and a thorough review of the policies and goals of our tax system.

- The other major alternative--a consumption tax--is a matter of serious interest to the Finance Committee, because many believe that we need to do more to encourage savings and capital formation in this way--and because potentially tax compliance could improve. Members have shown an interest in moving towards consumption taxation by suggesting an across-the-board energy tax as a possible deficit reduction measure. The relative merits of taxing consumption versus income are the subject of serious debate, much more so than in the past.

- Bradley-Gephardt. Some of the proposals for an overhaul of the tax system, such as the Bradley-Gephardt so-called "Fair Tax," simply keep the most popular exemptions and deductions while substantially reducing rates. This could improve things if it could be made to stick, but whenever you leave some preferences intact you open the door for other claims for preferential treatment--so you could end up right back where you started. In addition, transition problems are a major concern: how do you treat those with an economic stake in the present system?

THE BOND CLUB

UNDERTAXED

Q-- Are Americans Undertaxed?

A--

- Everything is relative, of course, but I doubt if you could find anyone who would admit to being undertaxed. Everyone would like less taxes. But people are more willing to accept a given tax burden if they think the system is fair, efficient, and distributes the burden equitably. In that regard, we have not done as good a job as we should.

- About 30 percent of GNP is taken up by taxes at all levels of government: Federal, State, and local. Of that, about 19 percent of GNP is taken by Federal taxes. This is pretty much in line with the average Federal take over the past two decades. So despite all the talk about massive tax cuts, all we have really done is stabilize the Federal tax burden.

- Of course many nations levy higher taxes than we do, but most of them have very different economic and social structures and traditions of government involvement that make direct comparisons misleading. Here in the U.S. we should be concerned about raising revenues to meet the spending needs that are truly vital, and to do so in a way that minimizes interference with a productive free economy.

- With taxes, as with budgeting, we do need to make the system more efficient. Taxpayers demand and deserve fair value for the taxes they pay. That is why the drive for a vastly simplified tax system has gained momentum, and why some of us in Congress have been trying to weed out some of the special privileges, loopholes, exemptions and what have you that undermine economic efficiency and cause people to distrust the system.

Question:

Isn't it the case that Congress will have to address the entitlement programs if it is going to make a real dent in the budget deficit?

Answer:

Not many people know it but we have already made substantial savings in entitlement programs. Legislation enacted since 1981 has saved $73 billion in entitlement spending by programs under Finance Committee jurisdiction over fiscal years 1982 through 1986, including $28 billion in Social Security and $22 billion in Medicare.

In addition, the Senate has given preliminary approval to a Finance Committee package of $14.8 billion in entitlement program savings including $10.1 billion in Medicare and Medicaid savings. So we have already exercised some responsibility in this area.

REAGAN TAX CUTS

Q.-- Preliminary 1982 tax data have been cited by both sides in the debate over whether the Reagan tax rate cuts have had positive 'supply-side' effects, or have helped the rich at the expense of the rest. What do you think?

A.-- First of all, it is understandable why people on each side of this issue would want to seize on the evidence to support their point of view. But preliminary data on relative incomes and tax burdens for 1982 can in no way be conclusive on the impact of the 1981 tax cut. This is particularly true when you consider that President Reagan was aiming for a long-term tax policy, with long-term results.

- At the same time, there are some interesting facts that can be gleaned from the 1982 data. It appears that incomes rose for upper-bracket taxpayers, while they fell for lower and moderate brackets, not surprising in a recession. But those higher incomes in the upper brackets produced more taxes from the wealthy, which is something we can all applaud. There is some evidence relating this to the 'unlocking' effect of reducing capital gains taxes. But we will have plenty of time to analyze these figures in more detail.

- The real point is that we have stabilized the tax burden, reduced rates for all taxpayers, and gotten a recovery going without stimulating inflation. That benefits everyone, but working people most of all. Indexing will reinforce the gains for working people, and we have to made sure that the deficit problem does not undo all that has been achieved.

THE FINANCE COMMITTEE'S TRADE AGENDA

- THE CONGRESS WILL SOON COMPLETE WORK ON THE DEFICIT REDUCTION ACT, WHICH WILL MARK A GOOD FIRST STEP TOWARDS ADDRESSING OUR BUDGET DEFICIT.

- WE EXPECT TO COMMENCE WORK SOON ON THE SO-CALLED "TWIN DEFICIT"--THE BURGEONING U.S. TRADE DEFICIT. THE COMMITTEE TOOK ITS FIRST STEP IN THIS DIRECTION ON MARCH 23, WHEN WE HEARD FROM AMBASSADOR BROCK, FEDERAL RESERVE GOVERNOR WALLICH, AND OTHER DISTINGUISHED ECONOMISTS ON THE NATURE AND IMPORTANCE OF THE TRADE DEFICIT.

- THERE IS GENERAL AGREEMENT THAT THE UNITED STATES WILL INCUR A MERCHANDISE TRADE DEFICIT EASILY EXCEEDING $100 BILLION THIS YEAR, UP FROM $28 BILLION IN 1982. THE CURRENT ACCOUNT BALANCE IS SINKING DEEPLY IN THE RED AS WELL.

- THE TRADE DEFICIT IS A SYMPTOM OF MANY COMPLEX, INTERRELATED PROBLEMS, INCLUDING THE HIGH VALUE OF THE DOLLAR (CAUSED IN PART BY THE BUDGET DEFICIT) AND THE COLLAPSE OF U.S. EXPORTS TO DEVELOPING COUNTRIES, FOLLOWING THEIR DEBT PROBLEMS. IRONICALLY, THE STRONG U.S. RECOVERY GENERATES AN ENORMOUS DEMAND FOR CHEAP IMPORTS, EVEN AS THE STRONG DOLLAR INHIBITS U.S. EXPORTS.

o ONE CONSEQUENCE OF THE TRADE DEFICIT IS THE HEIGHTENED CONCERN BY U.S. FIRMS AND WORKERS WITH THE FLOOD OF IMPORTS. STRONG PROTECTIONIST PRESSURES ARE STIRRED BY THE LOSS OF JOB OPPORTUNITIES TO IMPORTS. WALTER MONDALE AND OTHERS HAVE PLAYED ON THESE FEARS IN THEIR QUEST FOR PUBLIC SUPPORT.

o 1984 MARKS THE 50TH ANNIVERSARY OF THE RECIPROCAL TRADE AGREEMENTS PROGRAM, UNDER WHICH THE UNITED STATES HAS PURSUED A LIBERAL TRADE POLICY. ENORMOUS ECONOMIC GROWTH--AND VAST NUMBERS OF JOBS--HAVE BEEN GENERATED BY THAT POLICY. BUT WE MUST REMEMBER THAT IT IS FOUNDED ON <u>RECIPROCITY</u>--A PROMISE THAT TRADE WILL BE FAIRLY CONDUCTED. o THE COMMITTEE IN THE COMING MONTHS WILL REVIEW THIS LONG-STANDING PROGRAM TO DETERMINE IF IT CONTINUES TO MEET OUR GOALS OF ENSURING ECONOMIC GROWTH, JOB CREATION, AND FAIR COMPETITION. I WILL WORK WITH SENATOR DANFORTH, CHAIRMAN OF THE TRADE SUBCOMMITTEE, TO EVALUATE MANY ASPECTS OF U.S. TRADE POLICY. THESE INCLUDE:

1. THE FUNDAMENTAL CONDITION OF IMPORT-SENSITIVE, BASIC INDUSTRIES SUCH AS STEEL, TEXTILES, AND AUTOMOBILES.

2. WHETHER THE UNITED STATES SHOULD PURSUE ITS TRADE INTERESTS MORE ON A BILATERAL BASIS, TO AVOID THE INCREASING DEADLOCK IN THE GATT. IN PARTICULAR, WE WILL CONSIDER AUTHORIZING THE PRESIDENT TO NEGOTIATE A FREE-TRADE AGREEMENT WITH ISRAEL, AND A MORE LIMITED ONE WITH CANADA.

3. RENEWAL OF THE GENERALIZED SYSTEM OF PREFERENCES, AND PERHAPS OTHER STEPS TO REVITALIZE U.S. TRADE WITH DEVELOPING COUNTRIES.

4. THE CONTINUING DISPUTES WITH EUROPE OVER THE INADEQUATE TRADING RULES REGARDING AGRICULTURAL COMMODITIES.

5. PROPOSALS TO STREAMLIME AND SIMPLIFY U.S. TRADE LAWS THAT OFFER RELIEF FROM UNFAIR TRADE PRACTICES.

TALKING POINTS

The DISC Substitute Legislation, The Foreign Sales Corporation Act

- The Finance Committee has included the Foreign Sales Corporation Act (FSC), contained in S. 1804, in its budget deficit reduction package.

- The FSC provision reflects the Administration's proposal to replace the Domestic International Sales Corporation (DISC) with a GATT-compatible method for treating export earnings.

- The FSC provision involves a partial exemption for certain foreign source income (instead of the DISC tax deferral system), and a requirement that certain significant sales functions will be performed outside the United States (DISC's are domestic entities within the United States).

- DISC-deferred income is forgiven in the FSC provision (There is no revenue lost because the DISC deferral was intended to be indefinite; Senator Metzenbaum and others may fight this forgiveness when the bill reaches the Senate floor).

- The FSC provision involves approximately the same loss of revenue as did DISC (approximately $1.1 billion/year), and is expected to stimulate U.S. exports (Treasury estimated that in 1981, DISC stimulated about $7-11 billion in additional U.S. exports).

- Although the European Community has raised questions about the GATT compatibility of the FSC proposal, the Administration and the Committee are satisfied that FSC conforms with the GATT, and expect that enactment of the FSC provision will end the GATT dispute over DISC.

ISRAELI FREE-TRADE AREA PROPOSAL

* During Prime Minister Shamir's visit last November, he and President Reagan agreed to pursue the idea of a U.S.-Israel free-trade area. I have been consulted about such a plan; I fully support it in principle; and I have agreed to sponsor it on the President's behalf.

* A hearing on the proposal is scheduled for next Monday, February 6. Ambassador Brock will testify for the Administration. Other witnesses will include the American-Israel Public Affairs Committee and the American Jewish Committee.

* A free-trade arrangement obviously will reinforce the already close political ties between America and Israel. But it also is fundamentally in the best economic interests of this country:

  (1) The U.S. enjoys a trade surplus with Israel, even though Israeli exporters already enjoy preferential access to the U.S. market under the Generalized System of Preferences. The lowering of tariff barriers in Israel should boost U.S. exports, particularly in the manufacturing sector, which has been taking such a beating in international trade recently.

  (2) The European Community already has a free-trade arrangement with Israel. When it is finally phased in in 1985, U.S. exporters will face an increasing disadvantage compared to their E.C. competitors. The proposed free-trade area will eliminate that disadvantage.

* I expect general support for the proposal in Congress. However organized labor has opposed all import liberalizing measures recently, and may oppose this plan too. Further, import-sensitive sectors will seek exemptions; for example, textiles, jewelry, and certain agricultural products come to mind (i.e., citrus). It may be necessary to provide in the arrangement some safeguard for these industries.

* Trade Data:

  In 1982, total U.S. imports from Israel were $1.2 billion while U.S. exports totaled $1.5 billion. Ninety percent of Israeli exports to the U.S. entered duty-free, either because of the GSP or because of zero-duty rates. About 40 percent of U.S. exports to Israel were dutiable in 1982.

SENATE PROVISIONS ON IDB'S

I. MODIFICATIONS TO COMMITTEE PROVISIONS

1. No Per Capita Volume Limitations

The Senate adopted a sense of the Senate resolution that no per capita limitations on IDB's should be adopted.

2. Extension of Small Issue IDB Program

The Senate agreed to extend for four years the sunset of small issue IDB's. Thus, these bonds can be issued until December 31, 1990.

3. Restrictions on IDB's for Certain Facilities

The Senate agreed to prohibit IDB's where more than 20 percent of the bond proceeds are to be used for any one of the following facilities--(1) office equipment, (2) medical or health facilities (other than hospitals), (3) facilities used by doctors, lawyers, accountants, or similar professions, and (4) parking facilities. This restriction would not apply to facilities receiving UDAG grants.

The Senate also completely prohibited the use of IDB's for health club facilities. (These restrictions are generally effective for bonds issued after April 13, 1984, with exceptions for transactions where construction began, or a binding contract to incur significant expenditures existed before April 14, 1984.)

4. Exemptions from $40 Million User Limitation

The Senate agreed to exempt small issue IDB's for manufacturing facilities and small issue IDB projects receiving UDAG grants from the rule prohibiting the use of small issue IDB's by a beneficiary using more than $40 million of outstanding IDB's.

5. Technical and Transitional Modifications

The Senate agreed to various technical amendments and transition rules for the Committee bond provisions.

II. COMMITTEE PROVISIONS ADOPTED WITHOUT SUBSTANTIAL MODIFICATION

The Senate agreed to accept the other IDB provisions previously reported by the Finance Committee including the following:

1. Anti-double dip Provisions

   ACRS deductions for IDB financed property would be reduced by extending the useful lives of IDB financed property, with exceptions for municipal sewage and solid waste, low and moderate income rental housing, UDAG grant facilities, and certain pollution control facilities.

2. Federal Guarantees

   Tax-exempt bonds could not be guaranteed by Federal deposit insurance. Certain Small Business Administration guarantees on IDB's would require a guarantee fee.

3. Loophole Closers

   IDB projects could not be segmented to avoid the capital expenditure and certain other limitations. Related party rules for IDB users would be expanded to cover partnerships and Subchapter S corporations. Tax Code bond provisions would be extended to bonds whose tax-exempt status is conferred outside of the Code. In addition, new arbitrage restrictions would apply to IDB's.

TALKING POINTS ON TAX INDEXING

- The repeal of deferral of tax indexing would result in a massive tax increase on working taxpayers, with the bulk of the tax increases falling on low and moderate income taxpayers.

- Under indexing, taxpayers with the same real income stay in the same tax brackets and pay the same real tax each year. Without indexing, inflation would push taxpayers into higher and higher tax brackets, resulting in hidden increases for both average and marginal tax rates.

- Even at the moderate inflation rates projected by the Administration, repeal of indexing would result in a tax increase of $136 billion over the next five years. Since higher inflation rates would raise even more revenues, the repeal or deferral of indexing would send a signal to financial markets that Washington is attempting to deal with its budget problems by re-inflating the economy.

Impact on Average Taxpayers

- Low and moderate income taxpayers would bear the brunt of the tax increases arising from the repeal of indexing.

- Seventy-eight percent of the tax increase from the repeal of tax indexing would fall on taxpayers earning less than $50,000 a year. Only 1.2 percent of the tax increase from the repeal of indexing would fall on taxpayers earning $200,000 or more.

- Without indexing, taxpayers earning less than $10,000 would face a 9.5 percent tax increase in 1985. Those earning $200,000 or more would face a tax increase of only 0.6 percent.

- These tax increases would continue to increase every year, without a single Congressional vote, as inflation pushed taxpayers into higher and higher tax brackets.

- For a family of four earning $10,000, the repeal or deferral of indexing would result in a tax increase of $682 between 1985 and 1989, a staggering 35.4 percent tax increase.

- For a medium income family of four, the tax increase between 1985 and 1989 would amount to $2052, a 9 percent increase.

- Fiscal responsibility means making the necessary legislative choices to bring revenues and expenditures as nearly into balance as the state of the economy permits. Tampering with indexing is just an evasion of that responsiblity. Slowly and painfully, Congress is learning to vote to adjust spending and revenues in particular areas in order to reduce the deficit and that is as it ought to be. The people have a right to judge us on actions taken openly and honestly.

United States Senate

COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

April 26, 1984

TO: Senator Dole

FROM: George/Stu

SUBJECT: Bradley and Hollings votes on deficit reductions

Senator Hollings voted against both the Senate bill and the conference report on TEFRA. He also voted against the Dole compromise on withholding on interest and dividends. Hollings did not cast a vote on the Finance Committee package (amendment to the Boat Safety Act) two weeks ago. In 1981 he did vote for the Omnibus Reconciliation Act.

In addition, you might recall that while Senator Hollings offered an elaborate budget 'freeze' plan during consideration of the budget in 1983, when that was defeated he turned around and offered an amendment to increase education spending by $1.5 billion (budget authority; increased outlays of $225 million in FY 1984). That amendment was also defeated.

Senator Bradley voted against the Senate version of TEFRA, but voted for the conference report. In 1981 he voted against the Omnibus Reconciliation bill. However, he supported the Dole withholding compromise in 1983, and voted for this year's Deficit Reduction Act both in committee and on the floor.

Hollings and Bradley both voted against the 1981 tax cut.