TALKING POINTS: SENATOR DOLE

Education, Investment, and the Tax Code

Investment in Education Is a High Priority

- About one year ago, a sobering judgment was given on the state of American education, by the National Commission on Excellence in Education.

- According to the report, "Our nation is at risk. Our once unchallenged preeminence in commerce, industry, science, and technological innovation is being overtaken by competitors throughout the world..."

- Why is this happening? The report cites, among other reasons, "the educational foundations of our society are presently being eroded by a rising tide of mediocrity that threatens our very future as a nation and a people."

- The Commission's recommendations to the education community were not surprising or upsetting--

  --strengthen high school graduation requirements

  --toughen college and university admission and performance standards

  --emphasize the educational basics

  --improve teaching standards

- The Commission also asked for elected officials to provide leadership to support these reforms, and for citizens to provide fiscal support to implement them.

Educational Issues In Perspective

- The Commission report was clearly not "good news", but, from my perspective, this is an area in which the American people cannot afford to ignore the facts and continue business as usual. Another area where we cannot afford to ignore the facts is the federal deficit.

- The Congress is struggling to come to grips with the problem of growing Federal budgetary deficits and the mounting burden of the national debt.

- In the Finance Committee, we have been implementing tax and spending policies that echo the basically conservative philosophy of the National Commission on Excellence in Education.

  --emphasize the basics by ensuring that our tax system performs its fundamental function of raising needed revenue fairly, without loopholes and wasteful give aways

  --strengthen the standards by which we evaluate the efficiency and fairness of present and proposed expenditures--both direct expenditures and tax expenditures.

- I am certain that financial professionals like yourselves can understand how difficult this process can be.

- But fiscal standards are as critical to our nation's future as educational standards.

- Fairness in tax policy is as critical to our Democracy as equality in the classroom.

- Above all, fiscal responsibility requires a commitment to deal with reality as it is, not as we might wish it to be.

- Unfortunately, it is not enough for a program, activity, or tax expenditure to claim to serve a worthy purpose, anymore than a student can be given a passing grade without taking and passing a final examination.

- For example, this year the Finance Committee approved spending cuts in important programs providing health care for the elderly and income assistance to the poor, and also reduced tax expenditures for real estate investment and industrial development bonds. Not surprisingly, each affected industry and interest group is happy to see deficit reduction, as long as it comes out of someone else's program. But Congress has the difficult and unpopular task of setting overall priorities.

<u>Fiscal Investment In Education</u>

- Despite the serious problem of federal budgetary deficits, I believe fiscal investment in education should continue to be a high priority for the Congress. But to continue investing in education at the levels needed, we must invest carefully and prudently, choosing the most effective and efficient financial tools at our disposal.

- I have supported a number of key initiatives to increase investment in education.

- I introduced legislation to establish educational savings accounts, similar to Individual Retirement Accounts, to provide incentives for parents to save for their children's higher educations.

- I supported the President's proposal to provide tuition tax credits for lower income families sending their children to private elementary and secondary schools.

- Unfortunately, largely because of fiscal constraints, these initiatives have not been enacted.

- However, the Finance Committee's Deficit Reduction act did include several provisions to encourage educational investment. The Senate bill would

  --extend for two years the exclusion from income of employee educational assistance programs.

  --increase the tax credits for corporate cash expenditures for basic research at colleges and universities.

  --increase the charitable contribution deduction for corporate contributions of scientific equipment to colleges and universities.

  --expand income tax exclusions for scholarships for graduate students in the sciences.

  --create new deductions and tax credits for vocational educational assistance.

<u>Tax-Exempt Financing And Education</u>

- Perhaps the most controversial tax issue faced by the Finance Committee and Ways and Means Committee this year is the growing revenue losses from tax-exempt bonds. The President's budget for 1985 recommends a state-by-state volume cap on Industrial Development Bonds and student loan bonds. The House has adopted the President's recommendations, while the Senate has approved different restrictions on bonds--in some ways more restrictive than the House bill, but with no overall per capita volume cap.

- The debate on the issue of bonds has often been phased as whether a particular use for tax-exempt bonds is a "public" purpose or a "private" purpose. Unfortunately, this guideline for policy is neither clear, nor very useful.

- For example, where people need jobs and industrial development, the local officials view federal subsidies for private business as a "public" purpose and may view student loans as a "private" purpose. On the other hand, where there is a shortage of loan capital for students but plenty of industry, local officials may view subsidies for students as a "public" purpose and subsidies for business as a "private" purpose.

- Particularly in the area of student loans, another touchstone of federal policy is needed. Student loan bonds are only one way of financing loans under the Guaranteed Student Loan program. Traditional taxable financing, with direct federal interest subsidies paid by the Educational Department, should continue to be the financing method of first choice.

- This policy makes sense because tax-exempt financing is more costly to the federal government, without providing any reduction in student borrowing costs compared to the cost of a loan financed with taxable bonds. Tax-exempt borrowing for student loans can only be justified where it is needed to provide access to loans in areas where commercial lenders are unwilling to participate in the program.

- This policy is now part of the Educational Department's guidelines for implementing the Guaranteed Student Loan program under the 1983 Educational Amendments.

- In addition, Congress must ensure that tax-exempt bonds are not being issued just to earn arbitrage profits. Currently, student loan bond issuers can earn extremely high returns--because of the combination of generous arbitrage rules in the tax code and generous Education Department direct subsidies. This problem has resulted from the failure of the tax writing committees and the Education committees to review the Guaranteed Student Loan program together.

- The Senate bill deals with this problem by requiring the Treasury Department to write new arbitrage rules that will take effect in approximately 2 years, unless a revised statutory arbitrage rule is adopted by Congress.

- This, of course, is not a solution but only a commitment to find a solution in the future. Unfortunately, some representatives of bond issuers were unwilling to negotiate an immediate solution and this is the best we could arrive at.

- I know there are some bond issuers who are unhappy about the existence of new rules in the Education Department's Guaranteed Student Loan bond regulations, dealing with various technical and financial issues traditionally dealt with by the IRS arbitrage rules. But if issuers are unwilling to sit down and negotiate what the IRS rules should be, they cannot justifiably complain about the rules issued by the Education Department.

- The Senate bill also imposes a moratorium on the development of a very new tax-exempt bond program under which bonds are issued to make low interest loans to high income families who are ineligible for the Guaranteed Student Loan program, or to students who attend schools that cost much more than the Guaranteed Student Loan program allows.

- These programs were started, in part, in response to reductions in direct federal aid, but they were never approved by Congress. The Senate bill restrains their growth until Congress can study the issue and decide whether to allow such bond programs.

Conference On The Tax Bill

- In conference one of the major issues will be tax-exempt financing. The Senate has rejected the concept of a state-by-state volume cap, but the House can be expected to fight hard to retain the cap. Part of the motivation for the cap is the frustration of the Treasury Department and the House leadership with the unwillingness of bond issuers to negotiate reasonable restrictions that do not involve a volume cap.

Conclusion

- Where significant federal subsidies are involved there must be effective federal controls. This is true regardless of the high purposes being served by a program. Education is important, but so is health care for the elderly, income assistance for the poor, continued vitality of the housing industry, industrial development, and many other areas that are the subject of stricter rules in the new tax bill.

- If we are to continue to provide a high level of fiscal support for educational excellence, we must return to the basics of public finance. Federal aid must be as efficient, as effective, and as well targeted as we can make it. To oppose such financial reforms dealing with the means to an end, is only to hand a powerful weapon to those who oppose the goal of aid to education, regardless of the means.

REMARKS OF SENATOR DOLE

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS

Tuesday, May 1, 1984--8:00 a.m.--Shoreham (Ambassador Room)

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.

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 raise $48 billion in revenue, save $40 billion in defense, and save $43 billion in nondefense programs, including $24 billion in spending reduction from Finance Committee programs such as $3.1 billion from Grace Commission recommendations, and $9.6 billion in debt service savings. The remainder consists of additional spending changes and controls on appropriated funds.

- 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 over $10 billion between now and 1987, the $3.1 billion in Grace Commission savings, and $9.6 billion in reduced debt service. In addition, the Senate agreed to tax reform and modest revenue raisers that generate about $48 billion between now and 1987. 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)

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