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REMARKS OF SENATOR DOLE

ECONOMIC POLICY COUNCIL
U.N. ASSOCIATION OF U.S.

September 14, 1984--8:45--Madison Hotel

Our Economic Progress

- Our spectacular recovery remains on track and appears to be moderating to a pace that can be sustained in the years ahead. Real GNP grew 6.1% in 1983, and continued at a 10.1% rate in the first quarter of 1984, and 7.5% in the second quarter. This is the strongest recovery since 1961.

- With national unemployment down to 7.5%, this recovery has created 6.4 million jobs. Factories are operating at the highest capacity levels in 4 years, close to 82%. And the investment needed to sustain future growth is being made: businesses plan to increase spending on plant and equipment by 14.8% this year, the biggest increase in 18 years.

- The best news about this recovery is that inflation is staying low. Producer prices in 1983 showed that smallest increase since 1984. The 1983 CPI increase was just 3.8%, and consumer prices indicate we can sustain strong growth with low inflation. Consumer price increases are running at around 4%.

- Growth, lower inflation, and major tax relief have translated into real income gains for all Americans. Real personal income has risen by $116 billion since the low point of the recession (August 1982). For the first time since 1978, real income is growing.

- All the trends in the economy look good. Most observers believe the recent drop in the economic indicators just show a moderating pace of recovery. Meanwhile the prime rate--which rose from 6.5% to 21.5% under Carter-Mondale--stands at 13%. The misery index, which peaked at 24.5% in March of 1980, is around 11%. Auto sales and housing starts are up.

The Deficit Problem and Sustaining Recovery

- Just about everyone agrees that the deficit remains the number one obstacle to sustaining the strong recovery we have enjoyed to date. If we don't cut the deficit Federal debt will nearly double over the next five years to over $10,000 for every man, women, and child in America.

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• Record deficits cannot be sustained, and they have very real costs. They drive up the cost of home mortgages, they threaten to rekindle inflation or crowd out private investment and lead to a new recession. And they hurt our businessman trying to compete overseas by keeping the dollar high, thus raising the price of goods we try to export.

• We have made a good start on the deficit problem with this year's Deficit Reduction Act. The President took the lead by calling for bipartisan negotiations on a down-payment deficit package. The so-called Rose Garden plan that emerged helped us pass the Deficit Reduction Act, which makes real spending cuts of $13 billion and raises about $50 billion in revenue, largely by reforms to close off tax shelters, plug loopholes, and defer some tax breaks scheduled to come on stream.

• The immediate goal now is to fulfill the entire Rose Garden plan--aimed at saving over $140 billion over three years--by keeping the appropriations bill in line with that budget blueprint. That will ensure that the primary emphasis in deficit reduction remains on spending restraint, where it belongs.

Mondale Deficit Plan

• The Mondale plan to cut the deficit just is not credible and not very specific on the spending side. Where President Reagan puts spending reduction and economic growth first in the deficit battle, Walter Mondale reaches right for the tax increase option as a first resort. By tampering with tax indexing, the Mondale plan would hit between 30% and 40% of taxpayers: those with income over $25,000. The Mondale surtaxes and rate changes for upper incomes are just more of the same kind of backward fiddling with the tax structure that has made our tax code so inefficient. By contrast, with his rate cuts and tax indexing, President Reagan set us on the path toward a lower-rate, broader-based and fairer tax system. Mondale would set tax policy back at least four years.

• On spending, the Mondale plan has very little that is real. $51 billion is saved from hoped-for interest savings, and while $54 billion in spending cuts are proposed, so are $30 billion in new spending. That means $24 billion in real spending cuts by 1989, mostly unspecified (like 'management initiatives'). Of the claimed $176 billion in deficit reduction in this plan, $153 billion comes from tax hikes, interest savings, and economic growth assumptions.

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Major Tax Reform

- There is still a lot of interest in major reforms to make tha tax system simpler, fairer, and economically more efficient. The Treasury Department will report its options in December, and the Finance Committee is holding four days of hearings to hear from the public about possible alternatives.

- Everyone wants to improve the tax code, but it is important to build a consensus for any far-reaching changes, or else the new system begins to unravel again right away. So it may not be possible to jump into a new system in one step: we may have to proceed gradually, indentifying areas of agreement as we go along.

- We need to know how people really feel about the trade-offs they would face under a lower-rate, broader-base, or modified 'flat' tax. Would they really give up their favorite deductions and credits in return for lower rates? Or do they really care most about the bottom line--the size of their tax payment?

- We may be able to agree on some basic principles of tax reform, set a goal, and take initial steps toward that goal. That is why we are examining in some detail the more popular flat or 'quasi-flat' proposals, plus consumption taxes and the like. The important thing is to be sure that we are making an improvement: otherwise it is not worth the effort.

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Economic Policy Council of the U.N. Association of the U.S.

September 14, 1984

International Implications of U.S Economic Policy

- It is clear that high interest rates and a stable (or rising) dollar continue to attract investment from abroad into the U.S. But it is hard to pinpoint a single cause why the dollar is staying so high, or why interest yields in the U.S. continue to be more attractive than those in other developed countries. Clearly the high U.S. budget deficits are a major factor: but so are Federal Reserve policy, and general concerns on the international scene that make the U.S. seem to be a safe haven.

- The attraction of capital into the U.S. has a number of consequences. First, it helps finance our national debt, so that continuing high budget deficits have not yet caused the kind of 'crowding out' or skyrocketing interest rates that many economists feared. But it is not clear how long the day of reckoning can be postponed if our fiscal imbalance is not corrected. Financing our debt abroad, plus major tax relief and strong equity markets that reduce private sector credit needs, have so far helped prevent a crunch. But as other countries experience their own economic recoveries, the situation could change significantly: the foreign investment in our debt could dry up.

- In addition, the attractiveness of the U.S. for investment has a major impact on the balance of trade. A strong dollar makes it more difficult for U.S. producers to sell their goods overseas, and easier for foreign producers to market goods here. This means, at least in the short run, slower growth and fewer jobs in U.S. companies that depend heavily on export markets. But it also means lower costs to U.S. consumers because of competition from imported goods, and increased incentives for U.S. producers to keep costs down and be more efficient. So there is both an impediment to growth in our export industries, a boost to growth for U.S. importers, and an anti-inflationary effect.

- In the long run the present situation--large U.S. budget deficits, restrictive or moderate monetary policy, and a large U.S. trade deficit--probably cannot be sustained. But while there will have to be a correction, it need not be a sudden or drastic change, as many doom-sayers have claimed. We should not forget our recent history, when double-digit inflation and other problems drove down the dollar and undermined our ability to generate the capital needed for stable growth. Lower deficits, low inflation, and higher rates of capital formation and investment remain the keys to a stable, growing economy. That is why we need to tackle the deficit problem now, encourage the Federal Reserve to run a steady course without throttling the recovery, and choose tax and spending policies that favor savings and investment.

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- The key is to work for greater stability in international economic relations and avoid the kinds of sudden shifts and flip-flops that characterized the '70's. We need consistency: it is difficult for the U.S., after all, to argue that third-world nations should use the free market to guide their development strategies and seek overseas markets if we fail to foster stability in international markets. High U.S. deficits and a high dollar are destabilizing because they cannot be sustained in the long run--and they run the risk of fanning the fires of protectionism in this country. That is directly counter to our goals of promoting growth in Latin America and throughout the developing world. Instead we must work, steadily and surely, to reduce our deficits and erode the barriers to trade that frustrate the goal of greater growth and prosperity around the globe.