REMARKS OF SENATOR DOLE

PACKAGING MACHINERY MANUFACTURERS INSTITUTE

September 19, 1984--1:15 p.m.--Washington Marriott

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.

- By 1989 it would take half of all individual income tax payments just to pay the interest on the debt; the interest cost would be $250 billion, or about $1,100 for every American.

- 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.

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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NATIONAL MULTI-HOUSING COUNCIL

September 19, 1984--EVENING FUNDRAISER

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TALKING POINTS: REAL ESTATE

- The imputed interest controversy is an unfortunate situation resulting from twenty years of inflation, rising interest rates, and the failure of the Treasury Department to face up to the problem in its regulations.

- Imputed interest rules have been in the tax code since 1963. The major changes effected by the new tax act are requiring that the interest rates reflect economic reality, and putting almost all business transactions on the accrual method of accounting for interest. That's the point of the so-called O.I.D. rules.

- The accounting method change could only be mandated by statute. And in some senses this change was overdue. Some very abusive transactions involving accrued but unpaid interest were quite properly closed down.

- The interest rate changes are another matter. Treasury, of course, could have adjusted the interest rates by issuing regulations, as they did twice since 1963. But Treasury was not willing to take the political heat, and so the Administration proposed a statutory formula requiring a test rate of 110 percent of Federal borrowing costs and an imputed rate of 120 percent.

- You may be unaware that the original staff recommendation was to require a test rate of 120 percent, but I was able to convince the Administration to reduce it to 110 percent.

- Historically, of course, these rates can be justified. The original Treasury imputed interest rate of 5 percent in 1964 was approximately 120 percent of the yield on 10 year Treasury securities. And the yield on new home mortgages in 1964 was even higher, 5.8 percent.

- Today, of course no one can borrow at 9 or 10 percent. And the unfortunate problem is that seller financing at below market rates became a way of life during the last 20 years, as bank rates kept rising, and the Treasury Department's imputed interest rate kept lagging behind the market. It's understandable that many people feel that a sudden adjustment--even to a theoretically "right" rule--may be disruptive.

- That's why I sponsored an amendment that exempted all but the most expensive principal residences, and farm land worth less than $1 million. I believe there is still a need for more adjustments for other transactions and I hope a compromise can be worked out.

- Senator Melcher has unfortunately sought to negotiate in the media. I should say that I have been very willing to sit down, and understand the problems. The Finance Committee staff has developed options, identified concerns, and tried to keep up a dialogue. The concerns we have been raising have unfortunately been mischaracterized and misunderstood. There will be more work done, and I hope we can work out a satisfactory compromise.

- One area that may deserve some liberalization is vacation homes. Also, the original provision of the Melcher bill, liberalizing the rules for sales of business property in connection with the sale of a business may be an idea worth looking at.

- Another problem we are looking at is the concern about so-called "phantom income" -- requiring taxes to be paid before interest income is actually received. Some adjustments may be possible to address that problem.

Real Estate Tax Preferences

- Other concerns that I understand you have relate to various tax preferences for rental housing and other real estate investments. I know that these are "hot buttons." I recognize that even mentioning the words "at risk", "minimum tax" and "recapture" may upset someone's appetite.

- But these issues won't go away.

- Senator Moynihan's proposal to toughen the minimum tax by reducing the extent to which real estate exceptions from the "at risk" rules could be used to avoid the minimum tax, attracted some interest from a number of Finance Committee members, and the new tax act will require a Treasury report on these issues in connection with its Fundamental Tax Reform project.

Fundamental Tax Reform

- Rather than nibbling around the edges of existing tax preferences with minimum taxes, or reevaluation of recapture rules, there may well be a direct examination of the preferences themselves, in the context of proposals for a fundamental reform of the income tax system. The ball is clearly in the Administration's court, with its pending study of tax simplification and reform.

- A flat tax on true economic income, or anything like it, is simply not going to happen. But the Bradley Gephardt bill, the Kemp-Kasten bill, and other proposals are being looked at seriously.

- I should say, that there is a very important point that has not been given sufficient attention. That is the possibility of pressure to increase direct spending, to make up for tax subsidies that are eliminated or scaled back in any major reform.

  For example, there is no question that some of the tax subsidies for rental housing keep rents down. If the Bradley Gephardt bill were enacted, and Congress wanted to preserve existing rent levels, a direct subsidy program might be needed. And that would require <u>higher</u> tax rates.

- While there may be support for lowering the rates and broadening the tax base, there isn't much support for broadening the tax base and <u>raising</u> the tax rates.

- A doctrinaire approach to tax reform--based on the dogma that the tax code should never be used to subsidize economic behavior--is short sighted as a matter of policy and unrealistic politically. But for many Members of Congress, the burden may be on the beneficiaries of tax preferences to demonstrate that the tax code is the best way to provide a subsidy or to intervene in the economy.

- For example, tax-exempt bonds are almost universally recognized to be an inefficient way to subsidize business investment. But the same arguments may not hold true for accelerated depreciation or rehabilitation tax credits.

<u>Owner Occupied Housing</u>

- Owner occupied housing remains, and will continue to remain the favored child of the Congress. The Congress has repeatedly emphasized its support for the mortgage interest deduction as the key to promoting homeownership. Although talk of tax simplification and fundamental reform raises questions about all tax deductions, most of the new tax proposals preserve a favored place for owner occupied housing.

- Unfortunately, owner occupied housing is still beyond the reach of many because of high interest rates. The only real solution to this problem is reducing the deficit and getting interest rates down. Extravagant band-aids like mortgage subsidy bonds really haven't been used well to help those truly in need. In some states these Federally subsidized loans are given away with no income limitations, and on a first-come, first-served basis. Unless more responsibility is exercised by State and local officials, the program will continue to appear wasteful and ineffective.

Conclusion

- Housing and development are important, bread and butter issues for all Americans. So is fairness, and the appearance of fairness, in the tax system. And it doesn't make much sense to demand that fraud, waste, abuse, and inefficiency be banished from our military and social spending programs, but tolerated or encouraged in the tax system.