1984 KANSAS LEGISLATIVE ORIENTATION SESSION

Holiday Inn West . Versailles Room
Dec 3. 1984 - Topeka. Ks,

Tax Changes

- Any major tax reform is likely to have a big impact on Federal-State-local fiscal relations. But at the same time, a successful tax reform effort leading to lower Federal tax rates would open up new options for State and local revenue authorities--and could lead to greater economic efficiency and growth that would benefit everyone.

- The Treasury reform proposal, for example, would eliminate the deduction for State and local taxes paid; end the tax exemption for all private-purpose bonds; and alter basic provisions of the U.S. tax code that many States "piggyback" on, such as depreciation deductions. But other proposals also affect these areas: Bradley-Gephardt would allow only income and real property taxes to be deducted, while Kasten-Kemp would allow deductions only for real property taxes. And both bills end the exemption for interest on private-purpose bonds.

- The impact of these kinds of changes on State and local finances obviously will be a major factor for the President and Congress to weigh in deciding what to propose in the way of tax reform.

Spending Reductions

- Some State and local officials seem alarmed at the prospect of further spending reductions in programs that affect them. But everyone knows that we all have to share in the effort to get deficits and interest rates down, and our State and local officials have shown outstanding leadership on this issue.

- When Congress reauthorized revenue sharing in 1983 it mandated a study, coordinated by the Treasury Department, of Federal-State-local fiscal relations. Because many State and local governments are in good fiscal shape right now, there have been rumors that the study might be used as a basis for justifying major cuts in Federal aid to States and localities.

- Let me say that no one in Congress or the Administration wants to single out any particular sector for a disproportionate share of budget cuts. That is why concepts like a budget freeze have appeal: they affect everybody in more or less the same way, if not identically in real dollar terms.

- At the same time, we cannot ignore the relative fiscal health of States and localities compared with the Federal government. Even if fiscal conditions change in the States, the overriding need is to ensure that our Federal fiscal disaster course is arrested. Unless we get deficits on a downward path relative to the size of the economy, no amount of Federal aid could compensate for the economic stagnation that would result.

- So clearly we have a common cause when it comes to attacking the deficit, and that means cutting spending first and foremost. We will have to look at revenue sharing, at urban development grants, at education grants, and you name-it. But we wil be looking at everything else as well, and we will do our best to be fair. Simply put, the wide array of aid programs to State and local governments cannot be ignored at a time when cuts in basic benefit programs are being considered. Safeguarding economic recovery has to remain our highest priority.

REMARKS OF SENATOR DOLE

1984 KANSAS LEGISLATIVE ORIENTATION SESSION

Monday, December 3, 1984--5:00 p.m.--Topeka, Kansas

1. 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. Even with the slower growth in the 3rd quarter, this is one of our strongest recoveries.

- With national unemployment down to 7.4%, 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 increased by 4.1% in fiscal 1984, and producer prices have declined in each of the last two months.

- 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 11-1/4 to 11-1/2%. The misery index, which peaked at 24.5% in March of 1980, is around 11%. Auto sales and housing starts are up.

2. The Budget And The Deficit

Nature Of The Deficit Problem

- After several years of running budget deficits that approach the $200 billion mark, some people seem to be getting complacent about the problem. Since the economy has continued to do well, with low inflation and strong growth, why worry about the deficit?

- The answer is that everything we have achieved for the economy in the last several years is put at risk unless we deal with the deficit. And part of the problem is that the public can't get very excited about the deficit dilemma. It seems we need to have a crisis on our hands, or some kind of visible faltering in the economy, to convince people of the urgency of reducing the budget deficit.

The Real Point

- We have heard a lot of campaign rhetoric about who or what caused the deficit. That is beside the point: everyone is to blame, because all of us together have put more demands on the government than we are willing to finance through taxes. Unless we lower some of our expectations for government involvement--meaning reduced Federal spending--deficits will persist.

- Sustained deficits in the $200 billion range are a real threat to continued recovery. Unless deficits decline we will either have to absorb Federal borrowing with higher inflation, or accept slow growth and rising unemployment as the Federal government absorbs the bulk of available credit. Without assurance that inflation will remain under control and credit available at acceptable rates of interest, business will not expand through new investment, and jobs will not be available for our sons and daughters when they are ready to enter the workforce.

Risks Ahead

- Time is of the essence, because we are at the point where economic expansion will either continue, competing against heavy Treasury borrowing, or the recovery will slow and possibly slip into recession. In either event the deficit problem will compound itself: each year that we add $200 billion in new Federal debt adds about $15 billion to the next year's interest costs. The exploding cost of servicing the Federal debt will make controlling spending that much more difficult each year.

What Needs To Be Done

- We have to move swiftly to set realistic goals for dealing with the deficit, and we have to agree at the outset that the sacred cow is a thing of the past: everything in the budget has to be on the table, and everything has to be scrutinized for possible cost-savings. It is not acceptable to say that we have done all we can to reduce Federal spending when the budget represents nearly 25% of the gross national product.

Freeze Option

- A lot of people think that 1985 may be the year of the budget freeze, and there is a lot of interest in Congress in the possibility of an across-the-board freeze on spending for a year or two, until we get our fiscal house in order. For example, a 1-year spending freeze, allowing for 5% real growth in defense, could save $150 billion over 3 years. That would be a major step toward establishing a clear downward trend in the size of the deficit.

Attack Spending First

- Spending must remain our first line of attack in reducing the deficit. Spending must be financed by either taxes or borrowing, and either method of finance takes resources away from the private sector and limits our economic potential. At the same time, the revenue option may have to play a role, as President Reagan puts it, as "a last resort". The deficit problem is so large that no option can realistically be ruled out.

All Aboard

- Whatever approach we choose, everyone is going to have to share in the effort to close the deficit gap. We want a strong economy with stable prices, rising productivity, more jobs and more challenging, future-oriented jobs. We are on the verge of achieving that goal, thanks to President Reagan, and we will achieve it if we build public support for deficit reduction. People will accept a limited, short-term sacrifice for the cause of fiscal restraint if they understand that it is the best investment they can possibly make for their own, and their families', economic future. That is what is at stake in the deficit debate, and that is why I am confident we will join together in a bipartisan effort to do the job.

Procedural Changes

- There is a lot to critize in the was we prepare a budget, and it may be necessary to impose some external controls on Congress. The President has asked for a line-item veto, which I support and which could be effective. There is still strong support for some kind of balanced budget or fiscal restraint amendment in the constitution that would help restore a more balanced fiscal posture in the years ahead.

- Still, nothing will work unless Congress and the President have the will to make it work. Unless we forge a consensus in favor of deficit reduction, no budget procedure will do the job.

3. Major Tax Reform

- The Treasury Department has just come out with an innovative, constructive new proposal for reforming our tax system. Some of the proposal will be highly controversial, and the President has to decide whether to endorse it. But the Treasury initiative provides an excellent starting point for the 1985 tax reform debate.

- Under the Treasury plan, there would be just three tax rates: 15, 25 and 35 percent. The personal exemption would double, to $2,000. Rate brackets, the zero bracket, and the personal exemption would continue to be indexed. For corporations, there would be a single rate of 33 percent.

- Major tax breaks that would be dropped include the deduction for State and local taxes, the marriage penalty offset, the investment tax credit, the capital gains exclusion, the tax exemption for private purpose bonds, and the exemptions for employer-provided fringe benefits.

- Tax provisions that would be modified include mortgage interest deductions for second homes (disallowed); the charitable deduction (limited to amounts in excess of 2 percent of adjusted gross income); business expense deductions (limited); and taxation of dividends (a partial dividends-paid deduction).

- Indexing would be extended to capital gains; interest ncome and expense; depreciation deductions; and the earned income tax credit.

- It is important to build a consensus for any far-reaching changes, drawing on the Treasury plan, Bradley-Gephardt, Kemp-Kasten, and other plans. It may be necessary to move gradually, and reform will not be possible without strong Presidential leadership. And the people will have to let us know if they think the kinds of trade-offs being proposed are worthwhile.