

REMARKS OF SENATOR DOLE  
NATIONAL GOVERNORS' ASSOCIATION  
SUNDAY, FEBRUARY 24, 1985--3:45 P.M.  
YORKTOWN ROOM, HYATT REGENCY ON CAPITOL HILL

THANK YOU FOR INVITING ME TO JOIN YOU THIS AFTERNOON, AND WELCOME TO WASHINGTON. WE HAVE SOME COMMON PROBLEMS TO DEAL WITH AND COMMON EXPERIENCES WE CAN SHARE TO EACH OTHER'S BENEFIT.

YOU ARE HERE TO REMIND US THAT WE ARE A UNION OF 50 SOVEREIGN STATES, NOT JUST A NATION WITH 50 POLITICAL SUBDIVISIONS. TOO OFTEN WE HAVE TAKEN IT FOR GRANTED THAT PUBLIC POLICY--WHETHER IT BE BUDGET, TAX, HEALTH, OR EDUCATION--BEGINS IN WASHINGTON AND TRICKLES DOWN TO OUR STATE CAPITALS, COUNTY SEATS, AND CITY HALLS. BUT THAT JUST ISN'T SO. OVER THE PAST SEVERAL YEARS WE HAVE BEEN LEARNING SOME OF THE LIMITS ON EFFECTIVE FEDERAL POLICYMAKING, AND SOME OF THE VIRTUES OF POLICY INNOVATION AT THE STATE AND LOCAL LEVEL. FROM MANAGING THE ENVIRONMENT TO CONTROLLING STREET CRIME TO REVITALIZING ECONOMICALLY DISTRESSED AREAS, STATES AND LOCALITIES ARE LEADING THE WAY. THAT DOESN'T MEAN OUR FEDERAL RESPONSIBILITIES ARE ANY LESS: IT MEANS WE CAN LEARN FROM EACH OTHER THAT THE PUBLIC POLICY TRAFFIC FLOWS BOTH WAYS.

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FISCAL LEADERSHIP

LET ME FIRST URGE YOU TO DISREGARD THE PREMATURE OBITUARIES FOR OUR DEFICIT REDUCTION EFFORTS THAT HAVE BEEN WRITTEN IN SOME QUARTERS. WE ARE RIGHT ON TRACK AND IF WE FOUNDER, I'LL BE THE FIRST TO LET YOU KNOW. IN ADDITION TO THE COMMITMENTS WE HAVE ALREADY OBTAINED FROM COMMITTEE CHAIRMEN ON SPENDING REDUCTION, THERE ARE ONGOING MEETINGS WITH THE SENATE LEADERSHIP, AND BUDGET COMMITTEE ACTION IS SCHEDULED TO BEGIN NEXT WEEK. THIS IS WELL AHEAD OF THE USUAL BUDGET CYCLE AND OUR JOB IS TO KEEP IT THAT WAY.

THOSE OF US WHO ARE TRYING TO GRAPPLE WITH THE PROBLEM OF RECORD FEDERAL BUDGET DEFICITS ARE VERY MUCH AWARE OF THE EXAMPLE THE STATES HAVE SET IN DEALING WITH SIMILAR PROBLEMS IN THE PAST FEW YEARS. THE STATES HAVE, AS A WHOLE, EMERGED VICTORIOUS FROM THE SEVERE SQUEEZE OF THE RECESSION. WE ALL KNOW THAT THE BENEFITS OF ECONOMIC RECOVERY TO DATE HAVE BEEN UNEVENLY DISTRIBUTED AROUND THE NATION. THAT IS TO BE EXPECTED, BECAUSE THE PROCESS OF DISINFLATION WAS BOUND TO BE MORE PAINFUL FOR SECTORS OF THE ECONOMY THAT HAD EXPANDED



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ON THE ASSUMPTION OF CONTINUING INFLATION: AND SOME STATES RELY MORE THAN OTHERS ON THOSE INFLATION-SENSITIVE SECTORS. BUT BY AND LARGE, THE STATES HAVE WEATHERED THE STORM BY TAILORING THEIR PUBLIC SPENDING TO FIT THE RESOURCES THEY HAVE AVAILABLE.

IT IS HIGH TIME THE FEDERAL GOVERNMENT FOLLOWED THAT EXAMPLE AND DID THE SAME.

IF YOU WANT TO LEARN WHY THE FEDERAL FISCAL CRISIS MUST BE RESOLVED, JUST LOOK AT WHAT THE STATES HAVE ACHIEVED. YOUR EFFORTS ARE PAYING OFF. ONE INDICATION OF THAT IS THE SURPLUS THAT YOU, COLLECTIVELY, ARE EXPECTED TO GENERATE IN 1985. ANOTHER SIGN IS THE FACT THAT 14 STATES ARE PLANNING TAX CUTS. AND MANY OTHER STATES ARE PLANNING NEW SPENDING INITIATIVES OR EXTRA FUNDING FOR EXISTING PROGRAMS.

THAT IS THE BRIGHT SIDE. BUT IT IS ALSO THE CONNECTING LINK BETWEEN YOUR BUDGET POLICIES AND THE FEDERAL BUDGET PROBLEM, BECAUSE ANY REDUCTION IN THE NATIONAL DEFICIT IS GOING TO REQUIRE THAT WE CUT THE FEDERAL CONTRIBUTION TO

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YOUR STATE SURPLUSES. YOU MIGHT SAY THAT IS YOUR REWARD FOR DOING SUCH A GOOD JOB WITH STATE FINANCES. YOU HAVE SHOWN FISCAL LEADERSHIP; WE CAN AND MUST DO THE SAME.

DEFICIT FINANCE: THE FEDERAL CASE

EVEN THOUGH WE OUGHT TO LEARN FROM YOUR FISCAL LEADERSHIP, WE HAVE TO RECOGNIZE THAT THE FEDERAL CASE IS DIFFERENT. YOUR BUDGET POLICIES ARE IMPORTANT TO YOUR STATES AND YOUR COMMUNITIES AND TO OTHER STATES AND REGIONS OF THE COUNTRY, I MIGHT ADD. AND MOST OF YOU ARE CONSTRAINED BY LAW TO AVOID PILING UP DEBT--A MATTER I'D LIKE TO DISCUSS A BIT LATER. WITH ALL DUE RESPECT, HOWEVER, YOUR INDIVIDUAL FISCAL POLICIES DO NOT HAVE THE KIND OF IMPACT ON THE NATIONAL ECONOMY AND THE WORLD ECONOMY THAT THE POLICIES OF THE U.S. GOVERNMENT HAVE. FOR THAT REASON, OUR RESPECTIVE BUDGET PROBLEMS, WHILE CLOSELY RELATED, ARE ALSO STRIKINGLY DIFFERENT.

THE FEDERAL DEFICIT ISSUE HAS BECOME CRITICAL. IF THERE EVER WAS ANY DOUBT ON THE MATTER, THEY OUGHT TO BE PUT TO



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REST BY THE DEFICIT FORECASTS VIRTUALLY EVERY ECONOMIST, PUBLIC OR PRIVATE, IS MAKING FOR THE REST OF THIS DECADE. THE FIGURES ARE STAGGERING: THE CONGRESSIONAL BUDGET OFFICE ESTIMATES THAT, IF WE DO NOTHING, DEFICITS WILL RISE FROM \$214 BILLION IN 1985 TO NEARLY \$300 BILLION BY 1990. THAT WOULD ADD NEARLY ONE-AND-A-HALF TRILLION DOLLARS TO THE NATIONAL DEBT OVER THE PERIOD. BY 1988 THE ANNUAL COST OF SERVICING OUR DEBT WOULD BE \$200 BILLION: MORE THAN THE ENTIRE FEDERAL BUDGET IN 1970.

THE FIGURES ALONE ARE JUST AN ALARMING INDICATOR OF A VERY COMPLEX PROBLEM. SIMPLY PUT, THE DEFICIT PROBLEM IS BECOMING MORE CRITICAL BECAUSE WE ARE IN AN ADVANCED STAGE OF A VERY ROBUST ECONOMIC RECOVERY. WE OUGHT TO BE RUNNING A SURPLUS, OR AT LEAST COMING CLOSER TO BALANCE BY NOW--AS YOU ARE DOING. IF WE SLIP INTO RECESSION NOW, WITHOUT HAVING RESTRAINED THE DEFICIT, WE RISK DRAGGING MOST OF THE WORLD ECONOMY DOWN WITH US.

THE WORLD IS RELYING ON OUR ECONOMIC LEADERSHIP--RELYING ON THE DOLLAR AS A PRINCIPLE RESERVE CURRENCY, RELYING ON

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OUR RECOVERY TO LEAD THE WAY TO SUSTAINED ECONOMIC GROWTH, AND RELYING ON OUR DETERMINATION TO EXORCISE THE INFLATION-STAGNATION CURSE OF THE 1970'S. OUR BUDGET DEFICITS PUT OUR LEADERSHIP IN EACH OF THOSE AREAS AT RISK. THEY DRIVE UP INTEREST RATES, IMPEDE OUR EXPORTS BY KEEPING THE DOLLAR HIGH, AND IMPEDE GROWTH ABROAD BY DRAWING AWAY CAPITAL INVESTMENT. THAT MEANS THE CURRENT ECONOMIC SITUATION IS UNSTABLE AND UNSUSTAINABLE. WITH THESE DEFICITS WE FACE EITHER RENEWED INFLATION OR RISING UNEMPLOYMENT--A POOR LEGACY FOR OUR SONS AND DAUGHTERS TO INHERIT AS THEY SEEK TO ENTER THE WORKFORCE AND MAKE THEIR OWN WAY IN LIFE.

WITH EVERYTHING WE HAVE ACHIEVED FOR OUR ECONOMY AT RISK, WHY CAN'T THE PUBLIC GET EXCITED ABOUT THE DEFICIT DILEMMA? SOMETIMES IT SEEMS WE NEED TO HAVE A CRISIS ON OUR HANDS FOR PEOPLE TO DEMAND ACTION. BUT WE ARE EXPECTED TO LEAD, NOT JUST FOLLOW OPINION--AND WE ARE DETERMINED TO DO THE JOB WE WERE ELECTED TO DO.

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WE NEED YOUR HELP

I REALIZE THAT WE MAY HAVE SOME DIFFERENCES ON HOW TO REDUCE THE FEDERAL DEFICIT. BUT I TRUST THAT YOU IN THE STATEHOUSES AND WE ON CAPITOL HILL SHARE A COMMON GOAL: TO REDUCE THE BURGEONING FEDERAL DEFICIT NOW.

WE SHARE THIS GOAL BECAUSE, AS YOU WELL KNOW, WE WILL ALL SHARE THE BURDEN IF WE FAIL. THE CONVERSE, OF COURSE, IS THAT A CONTINUING HEALTHY ECONOMY AUGURS WELL FOR BOTH OF US. AN EXPANDING ECONOMY CREATES MORE GOODS AND SERVICES, PRODUCTS TO EXPORT, MORE JOBS, MORE REVENUE AND LESS DEPENDENCE ON FEDERAL AND STATE SAFETY NET PROGRAMS.

THERE ARE THOSE WHO CONTINUE TO ARGUE THAT ECONOMIC GROWTH WILL TAKE CARE OF THE DEFICIT PROBLEM. I AGREE THAT IT IS AN IMPORTANT PART OF THE SOLUTION--BUT NOT THE PANACEA THAT SOME WOULD HAVE IT.

JUST THIS WEEK RUDOLPH PENNER, THE DIRECTOR OF THE CONGRESSIONAL BUDGET OFFICE, TOLD THE HOUSE BUDGET COMMITTEE



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THAT IT WOULD "TAKE A RECORD-BREAKING PERFORMANCE TO GET A BALANCED BUDGET." EVEN "IF WE HAVE ABSOLUTE HISTORICAL PERFORMANCE," PENNER SAID, "WE'VE GOT A GROWING FEDERAL DEFICIT."

IT IS OUR RESPONSIBILITY TO CONVINCE THE PUBLIC THAT IF EVERYONE--ACROSS-THE-BOARD--TAKES THEIR MEDICINE TODAY, WE CAN PREVENT A SERIOUS ILLNESS IN THE NEAR FUTURE.

THE REAGAN ADMINISTRATION HAS PRESCRIBED A DEFICIT-CUTTING PLAN THAT GIVES US A GOOD FOUNDATION TO BUILD ON.

LIKE THE ADMINISTRATION, MY REPUBLICAN COLLEAGUES IN THE SENATE AGREE THAT THE FIRST ORDER OF BUSINESS IS TO CUT SPENDING. THERE IS NO QUESTION THAT WAS THE MANDATE OF THE 1984 ELECTION. AND I, FOR ONE, INTEND TO SEE THAT WE DO OUR UTMOST TO CARRY OUT THE MANDATE.



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THE APPROACH WE ARE PLANNING TO TAKE--WHETHER IT IS CALLED A FREEZE OR A FREEZE-PLUS, OR WHATEVER--WILL BE TO SPREAD THE PAIN EVENLY, IN A BALANCED WAY, AMONG ALL THOSE WHO BENEFIT FROM FEDERAL AID.

HOLDING DEFENSE SPENDING TO A REALISTIC LEVEL MUST BE PART OF THE PACKAGE. IF FARMERS, VETERANS, AND COLLEGE STUDENTS ARE GOING TO MAKE SACRIFICES, THE PENTAGON CAN FIND WAYS TO TRIM ITS COSTS WITHOUT INJURY TO THE ESSENTIAL MILITARY BUILDUP INITIATED BY PRESIDENT REAGAN IN 1981: THE BUILDUP WHICH IS ONE OF THE KEYS TO OUR ARMS-CONTROL EFFORTS, AND WHICH PROBABLY BROUGHT THE RUSSIANS BACK TO THE NEGOTIATING TABLE.

I KNOW OF YOUR CONCERNS ABOUT AID TO STATE AND LOCAL GOVERNMENTS. AS I TOLD THE NATIONAL COUNCIL OF STATE LEGISLATORS EARLIER THIS WEEK, I BELIEVE THAT SOME OF THE ADMINISTRATION'S PROPOSED CUTS WILL BE REVAMPED AS THEY WORK THEIR WAY THROUGH THE LEGISLATIVE PROCESS.

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BUT THE TRUTH IS THAT EVEN IF THE ADMINISTRATION'S BUDGET WERE IMPLEMENTED EXACTLY AS PROPOSED, STATE AND LOCAL GOVERNMENTS WOULD STILL BE RECEIVING 11 CENTS OUT OF EVERY FEDERAL BUDGET DOLLAR. FEDERAL GRANT-IN-AID OUTLAYS, WOULD DROP IN FISCAL 1986 TO \$100.7 BILLION, DOWN FROM \$107 BILLION, BUT WHILE THEY WOULD CONTINUE TO DECLINE IN FISCAL 1987, IN FISCAL 1988 THEY WOULD BEGIN RISING AGAIN.

THE SACRIFICES THE FEDERAL GOVERNMENT WILL BE ASKING YOU TO MAKE ARE, IN THE SCHEME OF THINGS, A SMALL PRICE TO PAY FOR THE BENEFIT TO BE GAINED FROM SUSTAINING THE BEST ECONOMIC GROWTH RECORD SINCE 1951.

#### THE LONGER RUN

I HAVE TRIED TO OUTLINE WHAT WE NEED TO DO RIGHT NOW TO GET OUR ECONOMY ON A SOUND FOOTING. I HAVE ALSO, I HOPE, GIVEN DUE CREDIT TO THE STATES FOR SHOWING US WHAT NEEDS TO BE DONE AND HOW TO DO IT. YOU HAVE ALSO DEMONSTRATED, OVER THE YEARS, HOW INSTITUTIONAL RESTRAINTS ON FISCAL



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DECISIONMAKING CAN IMPROVE THE OPERATION OF YOUR  
GOVERNMENTS.

MOST OF YOU HAVE THE POWER TO VETO LINE-ITEMS IN YOUR  
BUDGETS, AND MOST OF YOUR STATES MANDATE BALANCED BUDGETS.  
STATUTORY AND CONSTITUTIONAL MANDATES SUCH AS THESE HAVE, I  
BELIEVE, HELPED YOU ACHIEVE YOUR FISCAL SUCCESSES. WE NEED  
THE SAME KIND OF DISCIPLINE AT THE FEDERAL LEVEL, AS  
PRESIDENT REAGAN HAS REQUESTED TIME AND TIME AGAIN. I HOPE  
YOU WILL URGE MY COLLEAGUES IN CONGRESS TO SUPPORT  
CONSTITUTIONAL LIMITATIONS ON OUR ABILITY TO RUN DEFICITS  
AND PROPOSALS TO GIVE THE PRESIDENT A LINE-ITEM VETO. EACH  
OF THESE MEASURES IS CONTROVERSIAL, BUT THE SUCCESS YOU HAVE  
HAD WITH THEM IS THE STRONGEST POSSIBLE ARGUMENT FOR GIVING  
THEM A TRY.

CONTINUE YOUR SUPPORT

FOR THE PAST SEVERAL YEARS, THE NATIONAL GOVERNORS '  
ASSOCIATION HAS BACKED CONGRESS' EFFORTS TO COME TO GRIPS

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WITH THE DEFICIT. NOW THAT I AM MAJORITY LEADER, I ASK FOR YOUR CONTINUED SUPPORT. I KNOW OF NOTHING MORE IMPORTANT-- NOTHING MORE ESSENTIAL TO THE WELL-BEING OF THIS COUNTRY THAN FOR CONGRESS TO APPROVE A MEANINGFUL SPENDING REDUCTION PLAN THIS YEAR.

I DON'T DISCOUNT THE DIFFICULTY OF ACHIEVING THAT GOAL, BUT IN THE SENATE WE REPUBLICANS, AND HOPEFULLY MANY DEMOCRATS, REMAIN DETERMINED TO REDUCE THE DEFICIT THIS YEAR IN A BIG WAY. THERE ARE NO EASY OR PAINLESS SOLUTIONS TO THE DEFICIT DILEMMA. WE DID ALL THE SO-CALLED EASY THINGS IN 1981, 1982, AND 1984.

DURING THE PAST WEEK, I'VE HAD A FEW URGENT PROBLEMS TO COPE WITH--A FILIBUSTER, THE FARM CREDIT CRISIS, CONFIRMING ED MEESE AS ATTORNEY GENERAL. BUT I HAVE NOT LOST SIGHT OF THE MOST CRITICAL ISSUE ON THE SENATE'S AGENDA--THE BUDGET. AND I REMAIN CONFIDENT THAT WE WILL ALL PULL TOGETHER--CONGRESSIONAL REPUBLICANS AND DEMOCRATS,



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AND THE ADMINISTRATION--AND IN THE COMING WEEKS DRAFT  
A DEFICIT PACKAGE THAT WILL BOTH BE FAIR AND GET THE  
JOB DONE.

THAT JOB IS TO GUARANTEE THAT OUR THRIVING ECONOMY,  
WHICH IS BENEFITING MILLIONS OF AMERICANS IN THEIR DAILY  
LIVES, REMAINS HEALTHY AND EXPANDS TO GATHER IN THOSE  
MANY OTHERS WHO HAVE YET TO ENJOY ITS FRUITS. WORKING  
TOGETHER, WE CAN SECURE AN UNPRECEDENTED ERA OF  
PROSPERITY FOR THE UNITED STATES--AND FOR OUR ALLIES ABROAD.

REMARKS OF SENATOR DOLE

STATE OF THE AMERICAN FARM CONFERENCE

Sunday, February 24, 1985 -- 2:30 p.m.

J. W. Marriott Hotel

Washington, D.C.

1. The 99th Congress

- o We face major challenges on the deficit, the MX missile, tax reform, Central America. We can meet these challenges by working with President Reagan on the basis of mutual respect.
- o Congress knows that President Reagan's overwhelming election victory sent a strong message about what the people expect us to do. We already are at work on his agenda, but success will depend alot on mutual recognition that Pennsylvania Avenue is a two-way street.
- o Our top priority is to cut spending to reduce the budget deficit. That is why Senator Domenici and I introduced S. 1, which commits us to getting the deficit down to \$100 billion or less by 1988. The vital issue of tax reform should proceed on a separate track to allow us to sort out the options and see if we can build a consensus without losing momentum on the urgent problem of the deficit. Other issues that require attention in 1985--a new farm bill, Superfund, national defense, and arms control--will not be neglected.

2. Our Economic Progress

- o Economic recovery remains on track and is moderating to a pace that can be sustained in the years ahead. Real GNP grew 6.1% in 1983, and continued at 6.8% in 1984, peaking at a 10.1% rate in the first quarter last year. That is the highest real growth rate since 1951. This remains one of our strongest recoveries.
- o With national unemployment down to 7.4%, this recovery has created over 7 million jobs. More people are working than ever before. Factories are operating at the highest capacity levels in 4 years, close to 82%. Housing starts in January rose 15% to an annual rate of 1.83 million.
- o The best news about this recovery is that inflation is staying low. Producer prices in 1983 showed the



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smallest increase since 1964. The CPI rose just 3.8% in 1983 and 4% in 1984. We can sustain strong growth with low inflation: especially if productivity keeps rising, as it did in 1984--by 3.6%.

- o Growth, lower inflation, and major tax relief have increased real personal income by over \$116 billion since 1982. Real after-tax incomes grew 6.8% in 1984--the biggest increase in over a decade.
- o Trends in the economy still look good. The prime rate--which rose from 6.5% to 21.5% under Carter-Mondale--stands at 10-1/2%. The misery index, which peaked at 24.5% in March of 1980 is around 11%.

### 3. The Budget And the Deficit

#### Nature of the Deficit Problem

- o After several years of budget deficits that approached 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?
- o 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

- o Sustained deficits in the \$200 billion range pose an imminent threat to the recovery, because they will lead to either higher inflation or slow growth and rising unemployment. 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.

#### What Needs to be Done

- o The sacred cow is a thing of the past: everything in the budget must be scrutinized for possible savings. We have not done all we can to reduce Federal spending when

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the budget still represents nearly 25% of the gross national product.

#### Spending "Freeze Plus"

- o The President's FY 1986 budget proposes to freeze total spending plus reform some programs and terminate others that have outlived their usefulness. That would cut \$50 billion from the deficit next year: the minimum we need to sustain a healthy recovery, according to Paul Volcker and other experts.
- o Congress will change some of the President's budget priorities, for example, by cutting a bit more from defense. And Senate Republicans want to go a little further in the outyears to get the deficit down to 2% of gross national product by 1988.
- o In the Senate, we are moving toward a major spending cut package. The Budget Committee has begun work on the President's plan, and our committee chairmen have already pledged about 60% of the needed domestic cuts--contingent on getting a balanced package that includes defense. We are working on an expedited scheduling and hope to have a budget approved by March.

#### Popular Support

- o The people want spending cut. The Los Angeles Times poll shows that by a 5 to 1 margin, Americans prefer cutting government spending over tax increases to deal with the deficit.
- o The Gallup poll shows that 54% of Americans believe the deficit is a very serious problem: but it's tough to translate that into action because the public has varying views on which spending should be cut.
- o Experts also agree that spending reduction is the way to go. In January, distinguished experts such as Alan Greenspan, Charles Schultze, and Martin Feldstein told the Finance Committee that cutting spending by \$50 billion or more in 1986 will reduce interest rates, keep inflation down, and ensure continued recovery.

#### Risks Ahead

- o 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. That is why



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Senate Republicans moved ahead of schedule to work out a budget plan. The risk is that 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.

#### All Aboard

- o Everyone must share in the effort to close the deficit gap. People will accept a limited, short-term sacrifice for fiscal restraint if they understand that it is the best investment they can possibly make for their own, and their families', economic future.

#### 4. Major Tax Reform

- o The Treasury Department has proposed an innovative, constructive new plan for reforming our tax system, and the President made tax reform a high point of the State of the Union address. Some of the proposal is highly controversial, and the President no doubt will modify some things. The Treasury initiative provides an excellent starting point for the 1985 tax reform debate.
- o 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.
- o 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.
- o 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).
- o Indexing would be extended to capital gains; interest income and expense; depreciation deductions; and the earned income tax credit.



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- o 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.

## 5. International Trade

- o Another major challenge is to keep international markets as free and open as possible in an era of record U.S. trade deficits. Reducing the budget deficit will be a tremendous help, because it will help moderate interest rates and the value of the dollar.
- o So far we have done well in keeping avenues of trade open. It is especially significant that last year's trade bill extended for 8 1/2 years, the Generalized System of Preferences, which provides duty-free treatment for certain imports from the underdeveloped world.
- o In a similar trade liberalizing vein, the bill authorized the negotiation of free-trade zones, specifically with Israel, and the reciprocal reduction of tariffs on semiconductors.
- o It is hoped that the authority to negotiate bilateral free trade arrangements may induce other countries to join in trade liberalization.
- o The trade bill recognized, for the first time, the importance of trade in services (including banking); The President is directed to negotiate reduction in barriers to trade in services (a sector in which the U.S. has the competitive advantage and which represents a major portion of our GNP.)
- o At the same time, the U.S. must be prepared to use what leverage it can when markets are unfairly closed to American producers. That is why we are reviewing overall trade relations with Japan to help remove artificial barriers to American entry to the Japanese market.