BOB DOLE
KANSAS

# United States Senate

OFFICE OF THE MAJORITY LEADER
WASHINGTON, DC 20510

February 27, 1985

TO: Senator Dole

FROM: George Pieler

SUBJECT: Talk to Honeywell group

Attached is an outline of remarks for your talk to the Honeywell General Managers meeting tomorrow at lunch. Tip O'Neill also will be there, and they expect a brief presentation after lunch, with Q & A.

Aside from the deficit and taxes, their main interest right now is in trade. For the 99th Congress, Honeywell's top legislative priority is the Export Administration Act. Talking points on that Act are attached, plus some current talking points on trade policy.

Attachments

## Export Administration Act

• Last year Congress got bogged down on the question of reauthorizing the Export Administration Act, which gives the President authority to restrict exports in security-sensitive cases. Two issues caused the most problems: a dispute between Commerce and Defense on their respective roles in reviewing licenses for export, and House-Senate disagreement on amendments aimed at disinvestment in South Africa.

• The first problem is less likely to arise this year, because Commerce and Defense have reached a formal accord on export licensing arrangements that shares the responsibility between the two departments.

• The second problem, the South African question, is very much alive. The question is whether Congress and the administration will be able to agree on some changes in our approach to South Africa (whether legislative, or through an administration initiative) that would cool off the issue and permit a 'clean' Export Administration Act reauthorization to go through. The administration feels strongly that its constructive engagement approach is working, and that disinvestment would be disastrous for South African blacks. But Congress may need some initiative (milder than requiring disinvestment) to get a piece of the action.

• Proposals that have been circulating include a ban on Krugerrand sales, a competing U.S. gold coin to drive the Krugerrand out of the U.S. market, or some kind of legislative reinforcement for the Sullivan Principles. Hopefully there will be some way to work something out with the administration that would free up the Export Administration Act issue.

• Exporters, particularly in the high-tech area, obviously are concerned about export controls because they make it difficult for them to find and keep markets (since the possibility of U.S. restrictions on their ability to supply the goods is always there). Last year an attempt was made to draft a provision that would have protected exports under a binding contract to be shipped despite subsequent restrictions, but no one was really happy with the provision: some want no provision, others want fewer loopholes in it. As long as we feel export controls are necessary, there probably can be no absolute guarantees that the U.S. will not intervene.

Trade

- The Reagan administration has consistently taken the position that trade must be free and fair. That means that while our goal is to keep international markets as open as possible, where our trading partners impose obstacles to American entry we will respond appropriately.

- Examples of this approach are the negotiations to set levels for steel imports into the U.S.--ongoing discussions with Japan on telecommunications and other advanced technologies--and the new authority granted the President in last year's trade bill to negotiate bilateral free trade agreements, in hopes of inducing more countries to liberalize their trade policies. Overall, we have to remember that trade liberalization, if achieved on a reciprocal basis, creates more jobs in America--it does not export jobs.

- The U.S. does not accept the notion that we should keep our markets open even in cases where other nations blatantly subsidize their exports or impose artificial barriers to American companies that have a good product or service to offer in their markets. We have demonstrated that in many cases, including textiles (vis-a-vis Asia) and agricultural products (vis-a-vis the European community).

- At the same time the U.S. has to weigh carefully any decision to interfere with free markets, and evaluate the real cost in terms of jobs and prices to consumers. The ITC has just reported their finding that auto import limitations with regard to Japan saved 44,000 U.S. jobs, but at a cost to consumers of $15.7 billion. That is over $350,000 per job, and even if those figures may be exaggerated, they give you something to think seriously about.

- The same concern arises with the idea of local content requirements in autos or other manufactured goods. It is all well and good to support American producers and manufacturers, but we have to be smart about how we do it. If requiring domestic content in goods imported into the U.S. brings retaliation against American producers, we will lose jobs, not save them.

- The key is to fight firmly but fairly to keep all markets open to American goods and services and open up those markets that have been unfairly shut off. In his State of the Union address President Reagan called for a new round of trade negotiations to expand trade and strengthen the world economy. After all, more jobs and greater prosperity--in the Third World, for example--creates new markets for American producers.

REMARKS OF SENATOR DOLE

HONEYWELL GENERAL MANAGERS MEETING

Thursday, February 28, 1985 -- 1:30 p.m.

345 CANNON HOUSE OFFICE BUILDING

1. The 99th Congress

- 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.

- 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.

- 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

- 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.

- 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.

- The best news about this recovery is that inflation is staying low. Producer prices in 1983 showed the 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%.

- 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.

- 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

- 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?

- 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

- 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

- 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 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 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

- 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

- 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.

- 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 income 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.

5. International Trade

- 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.

- 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.

- 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.

- It is hoped that the authority to negotiate bilateral free trade arrangements may induce other countries to join in trade liberalization.

- 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.)

- 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.