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KANSAS

United States Senate
OFFICE OF THE MAJORITY LEADER
WASHINGTON, DC 20510

May 6, 1985

TO: Senator Dole

FROM: George Pieler

SUBJECT: Talk to Sen. D'Amato's Local Government Conference

You are scheduled to make a brief talk to Senator D'Amato's Local Government Conference Tuesday morning at 8 a.m. in the ~~Buffet Room of the James Madison Building~~. DIRKSEN SD-106

Their main interest is in having you talk about the agenda for the 99th Congress and your role as leader. Attached is current material on the budget and tax reform.

Attachments

# Key Points on Budget Compromise

- Through spending cuts alone, the plan would reduce the deficit by $52 billion in FY 1986, $99 billion in FY 1987, and $146 billion in FY 1988.

- Cuts of this magnitude--totaling $296 billion over 3 years--would leave remaining deficits of $175 billion in FY 1986, $146 billion in FY 1987, and $98 billion in FY 1988.

- This plan reaches the goal we set of getting the deficit down to 2% of GNP by 1988, without tax increases.

- Every area of the budget is hit hard: the President's defense request is cut in half, 17 programs are terminated and still others are phased out, and permanent entitlement savings are achieved by modifying the calculation of all non-means tested COLAs (a 2% guarantee with a CPI-2 formula if inflation is higher than 4%).

- These are real, meaningful cuts and should have a significant impact on financial markets. Preliminary results from a survey of leading Wall Street financial advisers indicates that we should expect interest rates to drop by 1 or 2 percentage points in the near term and by as much as 3 points in 1988.

- If that happens and keeps the recovery on track, we can expect:

  -almost 7 million new jobs by 1988
  -housing starts back up to the 2 million units/year level
  -inflation staying down at 4% or less
  -national personal income up by $800 billion by 1988
  -potential increase of 18-26% in net income for small business (due to lower interest rates)
  -a potential increase of $2-4 billion in net farm income (due to lower interest rates)

## ESCALATING DEFICIT

The main threat to continued economic expansion is run-away Federal spending.

- o Since 1940, the Federal Government has run deficits in 37 out of the last 45 years. Since 1960, we've run deficits in 24 out of 25 years.
- o In 1985, the gross Federal debt will total $1,841 trillion, an increase of 533% over 1960, 238% over 1975, and 101% over 1980. The total debt in 1985 now stands at 48% of our GNP.
- o With no changes in Federal spending policy, CBO projects that Federal outlays will rise from $950 billion in 1985 to $1,378 trillion in 1990--an increase of $428 billion in five years.
- o If no changes are made, the budget deficit will increase from $214 billion in FY 85 to $300 billion in 1990 and the National debt will increase to $2,786.

## INTEREST ON THE DEBT

This massive increase in debt has itself created one of the largest and fastest growing components of Federal spending--interest on the debt. Constant deficits have put fiscal policy on an endless treadmill of paying for the irresponsibility of previous decades:

- o In 1965, interest on the National debt cost $9 billion and consumed 1.4% of GNP. By 1980, annual interest costs rose to $52 billion--2% of GNP. But the worst was yet to come.
- o In 1985, interest on the National debt will cost taxpayers $130 billion--almost three times the level of five years ago. This represents 3.8% of GNP, 13.5% of the entire 1985 budget, and a 1,450% increase in costs over 1965.
- o $130 billion is equal to the sum total of all Federal spending from 1789--the founding of the Republic--to 1936. It also equals total Federal outlays in 1966, the entire defense budget in 1980, and twice the level of medicare funding today.
- o To put it in even simpler terms, about 40% of all revenue collected by the Federal Government from personal income taxes ($330 billion in 1985) will go to pay interest costs and no Federal services at all.

- Under current fiscal policies, if no action is taken to curb deficits, interest on the debt will rise to $230 billion in 1990, about 15% of the budget. This will equal almost half of all personal income tax revenue.

## Taxes

- The President and the American people have sworn off tax increases as a deficit solution, and no one in Congress seems to want to suggest otherwise. So as far as taxes are concerned, the focus will be on tax reform and ways to improve the distribution of the tax burden.

- There have been a lot of reports and analyses of inequities in the tax code, including one by Joe Pechman on who pays taxes, and one by Ralph Nader's Public Citizen group on corporate loopholes. Despite all the headlines, the bottom line conclusion is one we have known for a long time--payroll taxes and bracket creep raised the tax burden on working people, while the proliferation of tax loopholes cut taxes for the upper incomes and corporations. There, in nutshell, is the source of most of the momentum for tax reform.

- Working people have legitimate concerns in the tax debate: protection of the tax free status of fringe benefits that workers have bargained for, including health insurance--greater equity for the average taxpayer through lower rates and larger personal exemptions. Businesses and workers who don't benefit from rich fringe benefits have legitimate concerns, too, which is why we expect a long and lively debate.

- Clearly tax reform is important, because we must have a tax system that our people believe in and will support without coercion. But unless we deal with the deficit, initiatives such as tax reform will fall by the wayside--because our fiscal crisis will demand all our energy if it gets worse.

- Republicans led the effort to reduce and index tax rates, close corporate loopholes, shut off some upper-income benefits, and improve tax compliance over the past four years. Taken together these changes are the best improvements in tax policy for working people in many years. And without them, scheduled increases in the payroll tax would be pinching workers much more severely than they are. And President Reagan's Treasury Department wants to go further--their reform plan would reduce individual rates, while increasing business taxes by 37 percent.

- The latest report by the Joint Committee on Taxation shows that tax loopholes and preferences will amount to about $424 billion in 1986. Tax loopholes are on a rapid growth path--which is why people are troubled by the unfairness of a "swiss cheese" tax base.