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Basic Issues in Tax Reform

- While the President's tax reform plan is comprehensive and contains nearly a hundred separate items, it can be enacted in this Congress.
- Both TEFRA with 150 tax provisions and the Deficit Reduction Act with nearly 300 tax provisions were larger. In addition, one-third of the items in the President's proposal would simply repeal provisions in present law. If Congress agrees with these suggestions, they will not be difficult to draft.
- But more importantly, there are very few provisions which are critical to the basic concept of the President's proposal--reducing rates and making the tax system more neutral. There are four principal revenue reducing provisions and nine major revenue raisers.
- The provisions which significantly reduce revenues are individual rate reduction (\$260 billion through 1990), the double personal exemption (\$193 billion), corporate rate reduction (\$154 billion), and corporate dividend relief (\$27.6 billion). Other revenue reducing provisions such as the tax credit for research and development (\$7 billion) and the spousal IRA's (\$4.1 billion), while not insignificant, are much less important from a revenue loss standpoint.
- On the revenue-raiser side, the list of large items is similarly limited: repeal of the investment tax credit (\$165 billion through 1990), repeal of the state and local tax deduction (\$149 billion), recapture of the rate differential on accelerated depreciation (\$57.6 billion), reform of the completed contract and other multiperiod production accounting rules (\$44 billion), reform of the capital cost recovery deduction (\$37 billion), repeal of the two-earner couple deduction (\$34 billion), repeal of income averaging (\$18.7 billion), reform of the tax-exempt bond rules (\$13 billion), and reform of the foreign tax credit (\$13 billion).
- Other items, such as reforming the reserve deductions for property and casualty insurance companies and repealing depository institution bad debt reserve deductions, would raise significant, but substantially less, revenue.
- The remaining provisions will have to be analyzed carefully to decide whether they are important enough, despite the lesser revenue impact, to include in the final package.

Budget Negotiations

- The press has reported that we have an outline for an agreement on the budget, but in reality we are a long way from reaching any meaningful compromise on the 1986 budget.
- In the White House discussions earlier this week, it is reported that we agreed that the budget would include the President's budget authority levels in Defense and that there would be no freeze in Social Security COLAs.
- While this so-called "framework" may please the various constituencies that favor higher defense and Social Security spending, it doesn't do anything to reduce the deficit.
- If Social Security COLAs are taken off the table, then we need to find some way to replace them with other real savings of an equivalent amount.

Need for New Fiscal Tools

- Having struggled since 1974 to make the Congressional Budget process work to reign in the deficit, I am convinced that we need some new fiscal tools to discipline Federal spending.
- I strongly support legislation to establish two such new fiscal tools--a Constitutional amendment to balance the Federal budget and a statutory provision to give the Presidential power to veto individual line items in the Congressional appropriations.
- We are making satisfactory progress moving this legislation in the Senate.

A. Balanced Budget Amendment

- The balanced budget amendment was reported out of the Senate Judiciary Committee yesterday and we hope to have Senate floor consideration in September.
- 32 States have already petitioned Congress for a constitutional convention to draft a balanced budget amendment, and there is a good chance that more will follow (including Michigan). Congress has an obligation to respond to the consensus in favor of a balanced budget amendment, and take the initiative itself.
- The fundamental problem of deficit spending demands a fundamental solution. The balanced budget amendment does not embody any particular economic theory, but just

requires that Congress be specifically accountable for its decisions on fiscal policy.

- The amendment would just require a 3/5 vote to adopt a deficit budget, and an actual majority (51 Senators, 218 Representatives) to raise the level of taxation as a percent of the national income. That is all there is to it: increased accountability, and an appropriate counter to the never-ending pressures on Congress to increase spending and deficits by responding to special interests.
- This is not a partisan issue and it is certainly not a quick-fix: we have to do everything we can right now to reduce spending and deficits. But we also need to reform the basic way we deal with the budget in Congress. The balanced budget amendment would limit our options in a way that is good for us and good for the country.

B. Line item veto

- Senator Mattingly's two-year line-item veto bill has been reported out of the Rules Committee and we expect to take it up on the floor next week.
- The item veto can be an effective device for controlling spending, as the governors of 43 States have found. Such a change could restore some of the original significance of the veto power under the constitution, and discourage the tendency to attach special interest riders to appropriations bills in the hope that the President will suppress his objections to the particular in the interest of enacting the whole package, which he may on balance approve.
- In the case of appropriations bill that cover a wide range of subject matter--like a continuing resolution--the President now lacks the ability to make important choices. He can approve or reject the whole package, but has no ability to weed out the less desirable parts. An item veto would correct that situation, and Congress could still override the veto as it can any veto.
- The case can be made that changes in the appropriations process whereby substantive riders are enacted as part of appropriations bills has altered the balance of power between President and Congress, eroding the veto power as it was understood when originally drafted into the Constitution.

- It has been said that only a small part of the budget could be regulated with this power. That may be true if we ignore defense spending, or the possibility that Congress could reform some "uncontrollable" programs to make them subject to appropriation. But in any event we should not pass off lightly any institutional change that could result in significant long-range savings.