Speak

Joyce

October 28
Mon.

TIMMONS AND COMPANY, INCORPORATED
1850 K STREET, N.W. WASHINGTON, D.C. 20006 (202) 331-1760

WILLIAM E. TIMMONS
President

TOM C. KOROLOGOS
Executive Vice President

HOWARD G. PASTER
Vice President

KENNETH M. DUBERSTEIN
Vice President

WILLIAM H. CABLE
Vice President

MARY A. SIDLEY
Vice President

MICHAEL J. BATES
Director of Research

September 23, 1985

Dear Senator:

We are delighted that you are able to be our luncheon speaker on Monday, October 28. The event will be held in the Suite of the Americas of The International Club, 1800 K Street, N.W., with cocktails at 12:00 noon and lunch at 12:30.

I'll introduce you after the meal and suggest you speak for approximately ten minutes, after which we'll have some question and answer time. Your remarks will be off the record and can be off the cuff, so don't prepare anything. I know our clients will be interested in hearing your views, as Leader, on the tax bill and how much the Senate can tackle before the end of the session.

Generally, a principal attends from each of our client organizations. Among our clients are:

- Amoco Corporation
- Anheuser-Busch Companies, Inc.
- American Broadcasting Companies, Inc.
- American Inland Waterways Committee
- American Petroleum Institute
- Association of Trial Lawyers of America
- The Boeing Company
- Major League Baseball
- Brown Group, Inc.
- Chrysler Corporation
- Eastern Air Lines, Inc.
- H. J. Heinz Company
- Middle South Services, Inc.
- Morgan Stanley & Co., Inc./Capital Markets Group
- National Rifle Association
- Northrop Corporation
- G. D. Searle & Co.

We'll provide you with a list of those attending ahead of time. We'll also provide transportation to and from the event if interested. You can plan on being back to the Capitol by 2:00 p.m.

Many thanks for agreeing to be with us. We look forward to seeing you on October 28th.

With warm regards,

Sincerely,

Tom

Tom C. Korologos

The Honorable Robert J. Dole
United States Senate
141 Senate Hart Office Building
Washington, D. C. 20510

How Gramm-Rudman would work: scenario for FY 1987

The central innovation of the Gramm-Rudman-Hollings plan is to set firm limits for the deficit for 1987-1991, and provide strong new mechanisms for ensuring that those limits are adhered to.

As an illustration of how the plan will work, let's examine the likely scenario for the next fiscal year: FY 1987. For 1987, Gramm-Rudman--

- specifies a maximum deficit of $144 billion,
- requires the President to submit a budget that does not exceed that deficit, or allow an increase in public debt or borrowing beyond the maximum deficit level,
- requires the congressional budget to also adhere to the $144 billion deficit limit. It would not be in order for Congress even to consider a budget resolution for FY 1987 that had a deficit greater than $144 billion.
- In addition, committees would be allocated their share of budget authority, outlays, or new entitlement authority consistent with the $144 billion deficit limit, and it would not be in order to consider legislation that violates those allocations (unless the Appropriations Committee certifies actions to be taken to prevent violating the deficit limit).
- Any amendment to a reconciliation bill or to the budget resolution would be out of order if it increased outlays or reduced revenues, unless at least a dollar-for-dollar offset is provided by the amendment.

automatic deficit reduction for FY 1987

The most striking feature of Gramm-Rudman is the new automatic procedure it requires for the President and Congress to keep the deficit within the prescribed limit.

For example, the limit for 1987 is $144 billion; the estimated 1987 deficit (projected by the budget resolution for 1986) is $154.7 billion (assuming the 1986 budget is fully implemented, and its economic projections are on the mark.

The difference between the deficit limit and the expected deficit, then, is $10.7 billion. This overage would have to be eliminated by Presidential order at the beginning of FY 1987: just about a year from now.

On September 25, 1986, OMB and CBO would have to jointly report the size of the deficit they anticipate for FY 1987 (which begins October 1, 1986). Let's assume that they find the deficit will be $154.7 billion, as the 1986 budget resolution projects.

In that case, the President will have 14 days to issue an order making the automatic reductions needed to eliminate the $10.7 billion 'overage'. Half that amount, or $5.35 billion, would have to come from automatic spending increases (like COLAs). The other $5.35 billion would have to come from controllable programs (appropriations and non-entitlement spending).

To the extent automatic spending increases could not provide enough savings to meet the $5.35 billion, further cuts in controllables would have to be made.

The President must issue the order and notify Congress, but he may also propose an alternative way to get back within the deficit limit. Congress would have 10 days to affirm the President's order or substitute for all or part of his plan, provided they meet the same level of deficit reduction.

Note: preliminary estimates of the pool of automatic spending increases that the President would have to reduce for FY 1987 indicate that there would be enough--about $6 billion--to comply with Gramm-Rudman. Remember that the President cannot cut into basic benefit levels in individual entitlements.

Exceptions

Among automatic spending programs, social security cannot be touched. Among controllable expenditures, outlays from increases in program participation rates could not be touched, nor could interest on the debt or outlays from prior-year obligations. Payments pursuant to outstanding contracts could not be touched if the penalty provision of the contract would mean a net loss to the government, or if reduction would violate a legal obligation of the government.

For some programs, there is still disagreement as to which 'pool' they would fall into: AFDC and food stamps, for example.

THE DEFICIT AND THE AVERAGE AMERICAN

- Unless we enact a massive deficit reduction measure, American families will face either higher interest rates or higher inflation: not to mention the risk of a disastrous new recession throwing millions of breadwinners out of work.

- Most economists believe that enactment of the deficit reduction package as large as the Senate offer will produce a drop of at least 1 percent in interest rates over the short run and 2 to 3 percentage points over the long term: creative to what they otherwise would be.

- With a 2% drop in interest rates, the monthly payment on a median priced home ($80,000) will go down by about $100 a month.

- Conversely, if we don't reduce the deficit to keep rates as low as they are now, homeowners could face that large an increase-or-more in monthly payments.

- A 2% drop in interest rates would mean an additional $4,000 in income for the average wheat farmer with a 1,000 acre operation.

- This year alone, the Federal Government will overspend close to $1,000 for every man, woman, and child in America.

- This $1,000 per head of additional Federal debt will be one more burden for our children to repay in higher taxes or higher inflation in the future.

- I don't believe we can let this budget negotiation fail. If we don't act now on major deficit reduction, the American people will pay the price. By 1989, interest on the debt alone would take up half of all individual income tax payments. The interest cost would be $250 billion or $1,100 for each American.

- If we can get something like this package I am very, very optimistic about the course of the economy. I think we take too much for granted what we have achieved so far: strong growth without inflation. We can keep that going if we reduce the deficit substantially. The way is open to economic performance unprecedented in the postwar period if we have the will to find it.

ESCALATING DEFICIT

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

- 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.
- 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.
- 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.
- 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:

- 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.
- 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.
- $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.

- 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.

TRADE

- Historically, free trade has spurred U.S. economic growth, and fair competition from abroad has encouraged our industries to be more efficient. As a Senator from an agricultural State, I appreciate the importance of world markets for U.S. farmers. But, the United States cannot be the world's only free trader any more than we can unilaterally disarm.

$150 BILLION TRADE DEFICIT

- Last year, as you know, we faced a record shattering $123 billion merchandise trade deficit and this year it could reach $150 billion. Our deficit with just four of the places I recently visited--Japan, Korea, Taiwan, and Hong Kong--will amount to $70 billion this year.

- This gross imbalance has devastated important sectors of our economy, particularly manufacturing which is costing us millions of jobs, offsetting employment gains in the service sector. In the last ten years, it is estimated that the United States has lost over 600,000 jobs in just three industries alone: textiles and apparel, steel and footwear. And this trend has now spread to such high technology areas as telecommunications and semiconductors.

IMPACT ON AGRICULTURE

- The deterioration in the U.S. trade position has been equally pronounced in the agricultural sector. From a record high of $43.5 billion in 1980, farm exports has plummeted $10 billion in the past five years.

- To a large extent, our trade woes are self-inflicted. American business can be faulted for not being more aggressive in pursuing export markets. The U.S. economy also has recovered from the worldwide recession more quickly and vigorously than the economics of our major trading partners. The biggest culprit, however, is the overvalued dollar, which has made U.S. goods 40% more expensive over the past four years--and at the root of this problem is our inability to control budget deficits.

- The best known of the trade bills include the Thurmond/Jenkins bill, which establishes annual limits on the growth of all imports of textiles and apparel, except for goods from the EC and Canada. With 53 cosponsors in the Senate and over 290 in the House, passage must be considered a strong possibility. Another major contender is the Danforth/Finance Committee bill responding to Japanese Unfair Trade Practices, which mandates U.S. retaliation unless Tokyo acts to remove trade barriers. A similar nonbinding resolution passed the Senate by a vote of 92-0 in the spring. There is also the Bentsen/Rostenkowski bill, which provides for a 25% surcharge on all imports from Japan, Taiwan, Korea and Brazil.

OPTIONS

- Section 301 authority permits the Administration to respond by imposing tariffs, import quotas, or other restrictions, when an unfair foreign trade practice is burdening U.S. commerce. But Section 301 has only been used in two cases sinces its enactment in 1974. There are indications the Administration has recognized this need.

Some of the options available to Congress would include:

- More active and coordinated exchange rate policy.
- A temporary and generalized increase in U.S. tariffs to offset the effects of the overvalued U.S. dollar and reduce the U.S. budget deficit.
- A review of the Generalized System of Preferences (GSP) to eliminate some of the better-off beneficiary countries.
- Reform of U.S. trade remedy laws to make them more responsive to complaints by U.S. industry and encourage more expeditious adjustment to foreign competitors.

The Dollar and the Economy

- The new Reagan Administration initiative to moderate the value of the dollar involves commitments by the U.S., Japan, West Germany, France, and Great Britain. The agreement among these five nations was worked out by the finance ministers and central bankers of the five: Paul Volcker and James Baker representing the U.S.

- The major new factor in the agreement is the U.S. commitment, at least in principle, to coordinated intervention in foreign exchange markets to moderate the value of the dollar. That commitment can have a major psychological impact that could ease the dollar down (obviously no one wants the dollar to crash). In addition, this commitment by the U.S. explicitly acknowledges the role the high dollar is playing in undermining the U.S. trade position.

- In addition, Japan and the European parties to the agreement commit to boost growth in their countries, thereby increasing their domestic demand (including demand for U.S. products and services), and hopefully strengthening their currencies.

- Finally, the U.S. commits to reduce our budget deficits further and resist 'protectionism'. These steps clearly are aimed at reducing the U.S. need to import capital (which requires a dollar that attracts investment) while keeping the engines of world growth going.

- These are all positive developments, and the agreement is a major step forward just in acknowledging, by common consent, the nature of the economic problems we share with the other major developed nations. But we have to realize that there is only so much that can be achieved by 'jawboning' about the high dollar, and by exchange market intervention to control 'blips' in the dollar's value. The real meat of this agreement is in its focus on economic fundamentals--that is where it will be most difficult to follow through, and where it is critically important that we do so.

- We, the U.S., have to dramatically reduce our budget deficits. That means resuming, as soon as possible, the budget battle that we seem to have put aside for now. It also means pursuing every avenue the President outlined in his trade address, in order to fight unfair trade barriers without falling into the protectionist trap. And it means we must continue to coordinate closely with our friends abroad to see that they make progress towards <u>their</u> economic goals of speeding up their rates of economic growth and pursuing stable monetary and fiscal policies.

- The worst problem is that the present situation is unsustainable, and there is a lot of worry that an abrupt change--a run on the dollar, renewed inflation, a new recession--could be disastrous. What we need is a moderate, carefully--managed correction of the deficit and dollar problems. That means keeping a firm hand on monetary policy to control inflation, reducing the budget deficit as much as possible in the near term, and continue efforts to remove trade barriers and open up export markets for American goods and services.

- If we can reduce the deficit and keep inflation low, the situation should correct itself as economic recovery proceeds abroad and our trading partners pursue a responsible anti-inflationary course (which they must constantly be encouraged to do).