Remarks of Senator Dole

The 50 Club of Cleveland--Union Club

January 6, 1986
7:45 p.m.

Challenge for Congress in 1986

• In some respects 1985 was a year for setting goals and planning the policy agenda for the remainder of the 1980's. So the challenge of 1986 is to follow through: to make sure that the difficult goals the Congress has set for itself are met, and don't just become empty promises without substance to back them up.

• In domestic policy, our most pressing problems remain on the economic front: deficit reduction, tax reform, and a more realistic U.S. trade posture for an increasingly aggressive, competitive world economy.

• Specific legislation in each of these areas is pending in Congress and will be dealt with in 1986. On the deficit, the first round of 'automatic' cuts under Gramm-Rudman would come as early as March 1. In addition, the budget reconciliation bill that we left unfinished in December is a live item.

On tax reform, the House-passed bill is ready for consideration by the Finance Committee, which is expected to begin consideration in February.

On trade, there are three major items that deserve the Senate's attention: the Danforth bill on trade with Japan, the telecommunications bill, and the 'omnibus' trade bill designed to strengthen the President's hand in bargaining with our trading partners and require decisive U.S. responses to unfair trade practices.

Other major legislation

In addition to these major economic issues, the Senate will take up the balanced budget constitutional amendment early in the new session. The first order of business when the Senate reconvenes will be the proposed sale of Conrail. We still have the Superfund toxic-waste cleanup legislation to deal with, even though the Senate did its best to get a bill to the President in 1985. We may want to take another shot at the line-item veto, the genocide convention, and school prayer, as well. And as always, events here and abroad can shape the Senate's agenda in ways no one can predict.

Gramm-Rudman

• The first actions in response to the new Gramm-Rudman deficit control reform will have to be taken early in 1986. As of January 10, an estimate of the fiscal 1986 deficit will have to be made, and squared against the Gramm-Rudman deficit target of $171.9 billion. The first round of automatic cuts under the proposal would have to be announced on February 1, and those cuts would take effect March 1 unless Congress comes up with a better way to meet the target. Cuts under this first round of Gramm-Rudman could not exceed $11.7 billion, and would be equally divided (as in each year) between defense and non-defense spending.

• In addition, President Reagan's budget for fiscal year 1987 is due to Congress by February 5. So we will have reconsideration of the 1986 budget proceeding simultaneously with our first shot at the 1987 budget.

• That is a tall order, but it is one we ought to be able to fill. Difficult as it seems, we should remember that the Gramm-Rudman law contains new procedures designed to make it easier to meet the deficit targets. We explicitly bring loan programs and other 'off-budget' items into the budget process; sets a point of order against legislation from committees that have not met their budget savings allocation; and rules out order legislation inconsistent with the deficit targets.

Possible problems. We know there may be a rocky road ahead in implementing Gramm-Rudman. Congressmen Synar and others have filed suit claiming it is unconstitutional, and the Reagan administration has some problems as well with the role of the GAO in mediating the deficit forecasts. The courts will have to guide us on all that. Even more important, what Congress can legislate, Congress can back out of. That's why we need a constitutional mandate for budgetary restraint, as well as a statutory one.

• So Gramm-Rudman hasn't made our options any easier: but if it works as planned, it will force us--and the President--to make some decisions and choose among the various deficit-reduction options. That means everyone's cherished spending programs will be put to the test of fiscal responsiblity.

Spending the key. Finally, let me emphasize that Gramm-Rudman is a device for reducing Federal spending. It is not a tax increase plan, or a subterfuge for one. If we fail on the spending front, we can look at other options. But the sooner we entertain any revenue options, you can bet the pressure for spending cuts will drop fast.

THE DEFICIT AND THE AVERAGE AMERICAN

- Unless we enact a large deficit reduction package in each of the next three years, 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. That is what the Gramm-Rudman-Hollings initiative is all about.

- Most economists believe that enactment of deficit reduction measures that eliminate the deficit by the end of the decade 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: relative to what they otherwise would be.

- With a 2% drop in interest rates, the monthly payment on a median priced home ($80,000) would 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 our deficit reduction efforts falter. 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 adhere to the deficit-reduction goals we've set for ourselves, 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.

- o Since 1940, the Federal Government has run deficits in 37 out of the last 45 years. Since 1960, we've run deficits in 25 out of 26 years.

- o In 1986, the gross Federal debt will top $2 trillion, eight times more than in 1960, nearly four times greater than in 1975, more than twice what it was in 1980. The total debt in 1986 will approach 50% of GNP.

- o With no changes in Federal spending policy, Federal outlays would 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 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.

Possible Senate Schedule

- It will probably take until July or August before a tax bill can work its way through the Senate, conference, and be sent to the President.

- Actual markup in the Finance Committee will not begin until after the Lincoln Birthday break which end February 17th.

- Senator Packwood probably will try to get a bill out of Committee by the Easter break which is tentatively scheduled to begin March 27th.

- There will need to be some time for drafting before we can schedule the measure for Senate floor action. Thus, although it is possible that we could begin floor action after the Easter break, it may have to be delayed a little.

- To be realistic, we probably will have to spend most of June on the Senate floor, leaving the time between the 4th of July and the August recess for conference and final passage.

Tax Reform Talking Points

- The Reagan tax plan and the Ways and Means Committee bill are similar in concept--they both shift more of the tax burden to corporations and reduce the tax burden on individuals. But the bills are very different in how they make the change.

- Each bill substantially reduces tax rates for individuals (the President to a maximum of 35%; Ways and Means to 38%) and for corporations (President 33%; Ways and Means 36%). But the Ways and Means rates take effect at much lower income levels: the 35% rate clicks in at $43,000 for married couples, as opposed to $70,000 under the Reagan plan.

- Neither plan gets an A+ for the major objectives of tax reform--simplification and fairness, but the President's plan repealed many more of the overly complicated provisions of the tax code than the Ways and Means Committee effort. The House bill just modifies, but leaves in place, many complex tax rules.

- The House bill falls far short of the President's on fairness grounds. Fringe benefits and itemized deductions are major causes of differing tax liabilities, and unlike the President's proposal, the House retained the State and local tax deduction, did less to limit interest-paid deductions, and did nothing on fringe benefits.

- The House retained many of the politically popular big-ticket items. Unless we want to tackle those, the Senate will have limited flexibility in trying to enhance investment and savings incentives.

- I have personally long favored income tax reform and, as Chairman of the Senate Finance Committee, led the fight over a number of years to plug unjustified tax loopholes.

- Nevertheless, I know that many of my Senate colleagues have no enthusiasm for the President's version of tax reform and even less for the House bill, which they view as even more likely to have harmful economic effects. In the Senate, with its more open procedures, it is easier for a determined minority to block or slow down a bill they oppose.

- It is possible that the Senate might be able to fashion its version of a tax reform bill by June, but only with

intensive effort by the President to push the bill and reshape it along the lines he favors.

Effective Date Resolutions

- On December 17, the House agreed to a Sense of the House resolution offered by Congressman Michel instructing the chairman and ranking member of the Ways and Means to work with the chairman and ranking member of the Finance Committee and the Secretary of Treasury to prepare and make public by the end of this year a list of tax reform items which should not become effective until January 1987.

- To date, the principals have not sat down to discuss possible items which should have a prospective effective date. Their staffs have not yet been instructed to get together for any preliminary discussions either.

  Senator Packwood is evidently concerned about possible "run on the bank" if a joint statement were released indicating that certain changes will not be effective until some future date.

- On December 19, the Senate also agreed to a resolution on effective dates. The resolution which I offered for myself and 55 of my colleagues says that our goal generally should be an effective date of January 1, 1987. If we have to differ from that date to protect taxpayers or the Treasury from unintended affects caused by major changes in tax policy, then we will do it. But, in general, people should be able to go on about their business relying on present law while we deliberate its future.

HOUSE TAX REFORM BILL

Anti-business ?

- The House bill raises corporate taxes by $141 billion over 5 years.
- The President's proposal raises corporate taxes by $131 billion over 5 years.
- The House bill sets a 36% maximum corporate rate.
- President's proposal sets a 33% maximum corporate rate.
- Both proposals repeal the investment tax credit.
- The House bill reduces depreciation deductions more than the President's proposal which stretches the deductions over a longer period, but provides the same present value for the deductions because of the full indexing feature.
- The House bill provides a 20% research and development credit.
- The President provides a 25% credit.

Anti-family?

- Both bills substantially lower real income tax liability, not just rates, for individuals in every income category. Both give the biggest percentage reduction to lower income individuals.
- The House bill raises the personal exemption from $1,080 to $2,000 for nonitemizers and to $1,500 for itemizers.
- The President's proposal raises the personal exemption to $2,000 for everyone.
- The House bill benefits families who itemize by retaining the state and local tax deduction and more interest paid deductions (interest on mortgage on second home plus $20,000 cap on other interest for married couples).

- The President would limit interest paid deductions to interest on a mortgage on a principal residence plus $5,000.

- However, families will reach the 35% bracket $22,000 sooner under the House bill than under the President's proposal, adjusting for computational differences.

Anti-savings?

- The House bill reduces the maximum annual deferral of compensation under a 401(k) plan from $30,000 to $7,000. A 401(k) plan is a profit sharing plan which allows employees to elect to defer part of their compensation.

- The President's plan would repeal the 401(k) plan provision entirely.

- The House bill does not provide any spousal IRA and, in fact, reduces IRA's for employees who participate in a 401(k) plan.

- The President would provide for an additional $2,000 maximum deduction for contributions to an IRA on behalf of a spouse who works in the home.

- The House bill reduces the amount of annual deductible contributions to company pension and profit-sharing plans. But, importantly, it reinstates indexing of these limits. It is difficult to say that funding for a $77,000 annual retirement benefit is not a sufficient tax-advantaged start to a good retirement. People still can save more on an after-tax basis.

- The President has not proposed reducing the annual contribution limits.

- The House bill raises the effective maximum individual tax rate on long-term capital gains from 20% to 22%.

- The President's proposal lowers the long-term capital gains rate for individuals to 17.5%.

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- The House bill falls far short of the President's on fairness grounds. Fringe benefits and itemized deductions are major causes of differing tax liabilities, and unlike the President's proposal, the House retained the State and local tax deduction, did less to limit interest-paid deductions, and did nothing on fringe benefits. This means that taxpayers with equal incomes can still have substantially different tax liabilities.

- The House retained many of the politically popular big-ticket items like tax-free fringe benefits and the State and local tax deduction. Unless we want to tackle those, the Senate will have limited flexibility in trying to enhance investment and savings incentives.

- I have personally long favored income tax reform and, as Chairman of the Senate Finance Committee, led the fight over a number of years to plug unjustified tax loopholes.

- Nevertheless, I know that many of my Senate colleagues have no enthusiasm for the President's version of tax reform and even less for the House bill, which they view as even more likely to have harmful economic effects. In the Senate, with its more open procedures, it is easier for a determined minority to block or slow down a bill they oppose.

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BOB DOLE
KANSAS

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

December 23, 1985

TO: SENATOR DOLE

FROM: RICH BELAS

SUBJECT: PRESIDENT'S TAX REFORM LETTER

The President assured Congressman Kemp on the following minimum requirements for a tax reform bill:

1. $2,000 personal exemption for both itemizers and nonitemizers, "at least for those individuals in the lower and middle income tax brackets."

   - Thus, the President leaves the door open for compromise. The House provision of a $2,000 exemption for nonitemizers and $1,500 for itemizers would reduce revenues by $147.56 billion over 5 years.

   - The President's $2,000 exemption would reduce revenues by $176.5 billion over 5 years.

2. Basic tax incentives for American industry, including capital-intensive companies.

   - Since both the President's proposal and the House bill would repeal the investment tax credit, the issue is depreciation.

   - The House bill would reduce the cost of capital cost recovery incentives by $25 billion over 5 years. The President's proposal would reduce these incentives by $21.6 billion over 5 years.

3. Effective dates which erase doubt for those who must plan now for investments in 1986.

   - Both the House and Senate have proposed resolutions addressing the prospective dates.

4. A minimum tax which allows no individual or business to escape paying a fair share of the overall tax burden.

- This seems consistent with the House bill. The House individual minimum tax would raise $19.1 billion over 5 years. The House corporate minimum tax would raise $5.8 billion over 5 years.

— The President's individual minimum tax would raise $2.4 billion over 5 years. His corporate minimum tax would raise $2.8 billion over 5 years.

5. A rate structure with a maximum rate no higher than in the President's proposal.

- The President has a maximum individual rate of 35% and maximum corporate rate of 33%. The House bill has a maximum individual rate of 38% and corporate rate of 36%.

- It is difficult to determine precisely what the revenue effect of just lowering the top rates would be.

- However, without revising the brackets across-the-board, there would be a benefit for higher income individuals, rather than all taxpayers.

6. Tax brackets that are fully consistent with the President's desire to reduce taxes for middle income working Americans.

- The House bill and the President's proposal are very similar in their percentage reduction in tax liability for middle income taxpayers. However the President would accomplish this by reducing rates enough to make up for repeal of the State and local tax deduction limitation of the interest paid deductions and taxation of some fringe benefits.

- The House bill does nothing significant in fringe benefits and leaves the State and local tax deduction intact, and tightens the interest paid deduction less. Therefore, it cannot reduce rates as much.

The President's rate proposal for individuals would reduce revenues by $305.2 billion over 5 years. The House rate proposal would reduce revenues by $134.2 billion over 5 years.

The President's rate proposal for corporations would reduce revenues by $137.1 billion over 5 years. The House corporate rate change would reduce revenues by $87.8 billion over 5 years.

TABLE 1.—DISTRIBUTIONAL DATA ON PRESIDENT'S PROPOSAL AND WAYS AND MEANS COMMITTEE BILL, FOR INDIVIDUALS BY INCOME CLASS, 1987

(Preliminary)

Income Class (thousands of 1986 dollars)	Percentage Change in Income Tax Liability		Percentage Change in Social Security and Income Tax Liability		Percentage Change in After-Tax Income	
	President	Ways & Means	President	Ways & Means	President	Ways & Means
Less than $10.....	-72.4	-76.1	-17.5	-18.5	1.0	1.0
$10-20............	-18.0	-23.4	-9.8	-12.8	1.2	1.5
20-30.............	-9.3	-9.9	-5.8	-6.1	.9	1.0
30-40.............	-6.6	-8.9	-4.2	-5.6	.7	1.0
40-50.............	-7.3	-8.4	-4.8	-5.6	1.0	1.1
50-75.............	-5.9	-7.2	-4.3	-5.3	1.0	1.2
75-100............	-8.9	-5.6	-7.5	-4.6	1.9	1.2
100-200...........	-10.1	-7.2	-8.8	-6.4	2.7	1.9
200 and above.....	-15.2	-5.8	-14.7	-5.7	4.9	1.9
Total.........	-10.5	-9.0	-7.6	-6.5	1.5	1.3

Note: These figures do not take account of certain proposals affecting individuals. Thus, the total tax reductions under both the Administration proposal and the Ways and Means bill are somewhat different from what is indicated in this table.

Joint Committee on Taxation
November 26, 1985

THE WHITE HOUSE

WASHINGTON

December 16, 1985

Dear Jack:

In my recent letter on tax reform, I strongly urged all members "to vote for tax reform -- the Republican alternative or, should it not prevail, the Ways and Means bill." I stated then what seems to me to be the straightforward case: A vote against moving a House bill forward would doom our efforts to achieve real tax reform for the American people. We must not allow that to happen.

I understand the concern that many members have with a strategy that depends upon improvement of the House bill in the Senate. From my perspective, it would be totally inappropriate to give up at this stage -- to fail to seek improvement in the Senate. But in order to help reduce concern about this approach, let me state my position with respect to the type of bill I might ultimately accept.

Like you, I believe that increasing incentives for economic growth and jobs, and greater fairness for individual Americans and their families, are fundamental objectives toward which our tax reform deliberations must be oriented. I will veto any tax bill that fails to meet these objectives.

In order that there can be no misunderstanding concerning my views on any ultimate bill, let me say that the minimum requirements for a tax reform bill I am willing to sign are as follows: a full $2,000 personal exemption for both itemizers and non-itemizers, at least for those individuals in the lower and middle income tax brackets; basic tax incentives for American industries, including those which depend upon heavy capital investment in equipment and machinery; effective dates which erase doubt and apprehension in the minds of those who must begin now to plan for 1986 investments; a minimum tax which allows no individual or business to escape paying a fair share of the overall tax burden; a rate structure with a maximum rate no higher than in my proposal; and tax brackets that are fully consistent with our desire to reduce taxes for middle-income working Americans.

These requirements can be met, and should be met as the legislative process moves forward. Getting a bill out of the House is now the essential step we must take in order to keep the process alive, and preserve the chance to achieve true tax reform. I ask for your support.

Sincerely,

Ronald Reagan

The Honorable Jack Kemp
House of Representatives
Washington, D.C. 20515

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intensive effort by the President to push the bill and reshape it along the lines he favors.

TAX REFORM

Possible Senate Schedule

- Senator Packwood seems not to be all that interested in using the House bill as a starting point. However, it will be difficult to address some of the more popular special benefits in present law that the President wants to modify but the House left unchanged. He believes, as I do, that while or flexibility may be more limited than we would prefer, we can do at least a little better in the Senate than the House did.

- It will probably take until July or August before a bill can work its way through the Senate, conference, and be sent to the President.

- Actual markup in the Finance Committee will not begin until after the Lincoln Birthday break which ends February 17th.

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- There will need to be some time for drafting before we can schedule the measure for Senate floor action. Thus, athough it is possible that we could begin floor action after the Easter break, it may have to be delayed a little. May is a short month because of Senator Packwood's primary election on May 20th and the Memorial Day break.

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WAYS AND MEANS TAX REFORM GENERALLY

- The Ways and Means bill is consistent with the President's proposal, although it suffers from comparison because of the political compromises Chairman Rostenkowski was forced to make to get a bill.

- Both proposals reduce individual and corporate rates significantly. The top rates under the President's plan are 35% for individuals and 33% for corporations. The top rates under the Ways and Means bill are 38% for individuals and 36% for corporations. Both compare favorably with the top rates in present law 50% for individuals and 46% for corporations.

- Both proposals reduce actual income tax liabilities, not just rates, for individuals in all income brackets, and both give the greatest percentage reduction to lower income individuals.

- Both proposals will make corporations pay a larger share of the overall tax liability. Over 5 years, the Ways and Means bill would increase corporate taxes by $141 billion. The President would raise corporate taxes by $131 billion over 5 years.

- Both proposals can raise these taxes, despite reducing corporate tax rates, by cutting back on specific subsidies such as those used by large defense contractors and capital-intensive industries to avoid paying any income tax at all.

- However, the President's plan is subtantially simpler. Instead of cutting back on many special tax benefits, he would repeal them. (For example, business entertainment expenses other than meals, at-risk exception for real estate, bank loan loss reserves, rehabilitation tax credits.)

- Also, the President's bill addresses directly some of the major tax provisions which cause people with similar incomes to pay widely different amounts of tax. He would repeal the state and local tax deduction, substantially limit interest paid deductions, and tax all or part of certain fringe benefits like life and health insurance.

- People seem to think that exotic tax shelters are the cause of different levels of taxliability. These shelters contribute to the problem, but the big revenue items are itemized deductions and fringe benefits. Employer-provided health insurance alone reduces revenue by about $24 billion a year. And the deductibility of state and local taxes reduces revenues by $25 billion a year. You could provide a lot of rate reduction if you didn't have these benefits in the tax code.

- The Ways and Means Committee chose to do less directly and more by indirectly strengthening the individual and corporate minimum taxes. This won't do much for simplicity, but it should catch some of the worst cases.

Remarks of Senator Dole

The 50 Club of Cleveland--Union Club

January 6, 1986
7:45 p.m.

Challenge for Congress in 1986

• In some respects 1985 was a year for setting goals and planning the policy agenda for the remainder of the 1980's. So the challenge of 1986 is to follow through: to make sure that the difficult goals the Congress has set for itself are met, and don't just become empty promises without substance to back them up.

• In domestic policy, our most pressing problems remain on the economic front: deficit reduction, tax reform, and a more realistic U.S. trade posture for an increasingly aggressive, competitive world economy.

• Specific legislation in each of these areas is pending in Congress and will be dealt with in 1986. On the deficit, the first round of 'automatic' cuts under Gramm-Rudman would come as early as March 1. In addition, the budget reconciliation bill that we left unfinished in December is a live item.

On tax reform, the House-passed bill is ready for consideration by the Finance Committee, which is expected to begin consideration in February.

On trade, there are three major items that deserve the Senate's attention: the Danforth bill on trade with Japan, the telecommunications bill, and the 'omnibus' trade bill designed to strengthen the President's hand in bargaining with our trading partners and require decisive U.S. responses to unfair trade practices.

Other major legislation

In addition to these major economic issues, the Senate will take up the balanced budget constitutional amendment early in the new session. The first order of business when the Senate reconvenes will be the proposed sale of Conrail. We still have the Superfund toxic-waste cleanup legislation to deal with, even though the Senate did its best to get a bill to the President in 1985. We may want to take another shot at the line-item veto, the genocide convention, and school prayer, as well. And as always, events here and abroad can shape the Senate's agenda in ways no one can predict.

Gramm-Rudman

• The first actions in response to the new Gramm-Rudman deficit control reform will have to be taken early in 1986. As of January 10, an estimate of the fiscal 1986 deficit will have to be made, and squared against the Gramm-Rudman deficit target of $171.9 billion. The first round of automatic cuts under the proposal would have to be announced on February 1, and those cuts would take effect March 1 unless Congress comes up with a better way to meet the target. Cuts under this first round of Gramm-Rudman could not exceed $11.7 billion, and would be equally divided (as in each year) between defense and non-defense spending.

• In addition, President Reagan's budget for fiscal year 1987 is due to Congress by February 5. So we will have reconsideration of the 1986 budget proceeding simultaneously with our first shot at the 1987 budget.

• That is a tall order, but it is one we ought to be able to fill. Difficult as it seems, we should remember that the Gramm-Rudman law contains new procedures designed to make it easier to meet the deficit targets. We explicitly bring loan programs and other 'off-budget' items into the budget process; sets a point of order against legislation from committees that have not met their budget savings allocation; and rules out order legislation inconsistent with the deficit targets.

Possible problems. We know there may be a rocky road ahead in implementing Gramm-Rudman. Congressmen Synar and others have filed suit claiming it is unconstitutional, and the Reagan administration has some problems as well with the role of the GAO in mediating the deficit forecasts. The courts will have to guide us on all that. Even more important, what Congress can legislate, Congress can back out of. That's why we need a constitutional mandate for budgetary restraint, as well as a statutory one.

• So Gramm-Rudman hasn't made our options any easier: but if it works as planned, it will force us--and the President--to make some decisions and choose among the various deficit-reduction options. That means everyone's cherished spending programs will be put to the test of fiscal responsiblity.

Spending the key. Finally, let me emphasize that Gramm-Rudman is a device for reducing Federal spending. It is not a tax increase plan, or a subterfuge for one. If we fail on the spending front, we can look at other options. But the sooner we entertain any revenue options, you can bet the pressure for spending cuts will drop fast.

THE DEFICIT AND THE AVERAGE AMERICAN

- Unless we enact a large deficit reduction package in each of the next three years, 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. That is what the Gramm-Rudman-Hollings initiative is all about.

- Most economists believe that enactment of deficit reduction measures that eliminate the deficit by the end of the decade 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: relative to what they otherwise would be.

- With a 2% drop in interest rates, the monthly payment on a median priced home ($80,000) would 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 our deficit reduction efforts falter. 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 adhere to the deficit-reduction goals we've set for ourselves, 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 runaway 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 25 out of 26 years.

- o In 1986, the gross Federal debt will top $2 trillion, eight times more than in 1960, nearly four times greater than in 1975, more than twice what it was in 1980. The total debt in 1986 will approach 50% of GNP.

- o With no changes in Federal spending policy, Federal outlays would 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 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.

Tax Reform Talking Points

- The Reagan tax plan and the Ways and Means Committee bill are similar in concept--they both shift more of the tax burden to corporations and reduce the tax burden on individuals. But the bills are very different in how they make the change.

- Each bill substantially reduces tax rates for individuals (the President to a maximum of 35%; Ways and Means to 38%) and for corporations (President 33%; Ways and Means 36%). But the Ways and Means rates take effect at much lower income levels: the 35% rate clicks in at $43,000 for married couples, as opposed to $70,000 under the Reagan plan.

- Neither plan gets an A+ for the major objectives of tax reform--simplification and fairness, but the President's plan repealed many more of the overly complicated provisions of the tax code than the Ways and Means Committee effort. The House bill just modifies, but leaves in place, many complex tax rules.

- The House bill falls far short of the President's on fairness grounds. Fringe benefits and itemized deductions are major causes of differing tax liabilities, and unlike the President's proposal, the House retained the State and local tax deduction, did less to limit interest-paid deductions, and did nothing on fringe benefits.

- The House retained many of the politically popular big-ticket items. Unless we want to tackle those, the Senate will have limited flexibility in trying to enhance investment and savings incentives.

- I have personally long favored income tax reform and, as Chairman of the Senate Finance Committee, led the fight over a number of years to plug unjustified tax loopholes.

- Nevertheless, I know that many of my Senate colleagues have no enthusiasm for the President's version of tax reform and even less for the House bill, which they view as even more likely to have harmful economic effects. In the Senate, with its more open procedures, it is easier for a determined minority to block or slow down a bill they oppose.

- It is possible that the Senate might be able to fashion its version of a tax reform bill by June, but only with

intensive effort by the President to push the bill and reshape it along the lines he favors.

HOUSE TAX REFORM BILL

Anti-business ?

- o The House bill raises corporate taxes by $141 billion over 5 years.
- o The President's proposal raises corporate taxes by $131 billion over 5 years.
- o The House bill sets a 36% maximum corporate rate.
- o President's proposal sets a 33% maximum corporate rate.
- o Both proposals repeal the investment tax credit.
- o The House bill reduces depreciation deductions more than the President's proposal which stretches the deductions over a longer period, but provides the same present value for the deductions because of the full indexing feature.
- o The House bill provides a 20% research and development credit.
- o The President provides a 25% credit.

Anti-family?

- o Both bills substantially lower real income tax liability, not just rates, for individuals in every income category. Both give the biggest percentage reduction to lower income individuals.
- o The House bill raises the personal exemption from $1,080 to $2,000 for nonitemizers and to $1,500 for itemizers.
- o The President's proposal raises the personal exemption to $2,000 for everyone.
- o The House bill benefits families who itemize by retaining the state and local tax deduction and more interest paid deductions (interest on mortgage on second home plus $20,000 cap on other interest for married couples).

- The President would limit interest paid deductions to interest on a mortgage on a principal residence plus $5,000.

- However, families will reach the 35% bracket $22,000 sooner under the House bill than under the President's proposal, adjusting for computational differences.

Anti-savings?

- The House bill reduces the maximum annual deferral of compensation under a 401(k) plan from $30,000 to $7,000. A 401(k) plan is a profit sharing plan which allows employees to elect to defer part of their compensation.

- The President's plan would repeal the 401(k) plan provision entirely.

- The House bill does not provide any spousal IRA and, in fact, reduces IRA's for employees who participate in a 401(k) plan.

- The President would provide for an additional $2,000 maximum deduction for contributions to an IRA on behalf of a spouse who works in the home.

- The House bill reduces the amount of annual deductible contributions to company pension and profit-sharing plans. But, importantly, it reinstates indexing of these limits. It is difficult to say that funding for a $77,000 annual retirement benefit is not a sufficient tax-advantaged start to a good retirement. People still can save more on an after-tax basis.

- The President has not proposed reducing the annual contribution limits.

- The House bill raises the effective maximum individual tax rate on long-term capital gains from 20% to 22%.

- The President's proposal lowers the long-term capital gains rate for individuals to 17.5%.

Effective Date Resolutions

- On December 17, the House agreed to a Sense of the House resolution offered by Congressman Michel instructing the chairman and ranking member of the Ways and Means to work with the chairman and ranking member of the Finance Committee and the Secretary of Treasury to prepare and make public by the end of this year a list of tax reform items which should not become effective until January 1987.

- To date, the principals have not sat down to discuss possible items which should have a prospective effective date. Their staffs have not yet been instructed to get together for any preliminary discussions either.

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Possible Senate Schedule

- It will probably take until July or August before a tax bill can work its way through the Senate, conference, and be sent to the President.

- Actual markup in the Finance Committee will not begin until after the Lincoln Birthday break which end February 17th.

- Senator Packwood probably will try to get a bill out of Committee by the Easter break which is tentatively scheduled to begin March 27th.

- There will need to be some time for drafting before we can schedule the measure for Senate floor action. Thus, although it is possible that we could begin floor action after the Easter break, it may have to be delayed a little.

- To be realistic, we probably will have to spend most of June on the Senate floor, leaving the time between the 4th of July and the August recess for conference and final passage.

BUSINESS TRANSFER TAX

- Although Senator Roth has labeled his proposal a "business transfer tax," it is, in fact, a value-added tax.

- The BTT is a flat rate tax on "net receipts" from the sale of goods and services in this country. "Net receipts" means gross receipts minus purchases of raw materials and other imports. However, salaries, interest payments and dividends would not be subtracted from gross receipts. Salaries and interest payments would continue to be deductible against the minimum tax.

- This tax on the difference between a firm's sales and its nonlabor purchases of goods is a tax on "value-added." Essentially, it is a sales tax that is collected piecemeal at each stage of production.

- Receipts from exports would be exempt from the tax and imports would be taxed as they entered the country at the full BTT rate.

- Consumers would not explicitly pay the tax as they do with a European-style VAT, but businesses certainly would attempt to pass through as much of the tax as possible, making it a de facto VAT. (This is also true of the Superfund tax).

- Senator Roth has suggested, in the alternative, that the BTT either be deductible against income taxes or creditable against payroll taxes. Obviously, corporations prefer the dollar-for-dollar credit over the income tax deduction since the BTT would in many cases, not increase their total tax liability.

- The income tax deduction alternative, which would raise more revenue than a BTT with the payroll tax credit, could raise over $100 billion per year at a rate between 7 and 10 percent.

- The principal arguments in favor of the BTT are (1) that it would allow reduction in income tax rates and would allow greater savings and investment incentives and (2) it would have a favorable trade impact.

- Certainly, the goals of reducing the income tax burden are laudable, but there is no assurance that it would be a "package deal." The U.S. could end up with a VAT without the benefits of a 25 percent top individual rate or enhanced investment incentives. The VAT rate could be quickly increased above its initial level and increases in prices of the goods and services could offset much of the rate reduction for consumers. Perhaps the BTT would make more sense if the balanced budget/tax limitation amendment were already in place.

- The trade benefit is also overstated. If the BTT directly replaces a present law tax, such as Senator Roth's payroll tax credit alternative would provide, there might be some short-term trade benefit. Prices of domestically produced goods should not increase in the U.S., but prices of imports subject to the BTT would become more expensive. (Of course, the higher cost of foreign-produced goods could allow U.S. producers to raise prices also, to increase profits).

- However, whether or not the BTT is GATT-legal, we should expect our trading partners to retaliate fairly quickly.

- Finally, the BTT suffers from the traditional criticisms of a VAT. It is unfair to lower income individuals who have to spend more of their incomes than wealthier taxpayers. It is a new, hidden tax that can be easily increased. And it is administratively complex. The IRS estimates it would need $700 million more per year and 20,000 new employees to administer a VAT.

- It was problems like these that caused the President to reject a VAT as part of his tax reform package.