BOB DOLE
KANSAS

Same as Laffer associate.
3/14/86

United States Senate

OFFICE OF THE MAJORITY LEADER
WASHINGTON, DC 20510

March 13, 1986

TO: SENATOR DOLE

FROM: GEORGE PIELER

SUBJECT: TALK TO GEORGETOWN CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES - ADVISORY BOARD

The CSIS Advisory Board (breakfast on March 14) will primarily be interested in tax issues, the budget and the deficit. Current materials are attached.

The breakfast is off the record, but the Board includes some media types who may be present: George Will, Georgie Ann Geyer, Karen Elliott House and Phil Geyelin.

Attachment

KAY
The attachments are the same as we have been giving Dole for the past two weeks.

Joyce

Speak

March 14
Fri. A M.

CSIS

Center for Strategic & International Studies
Georgetown University • Washington DC

Joyce

on Hill

January 24, 1986

The Honorable Bob Dole
United States Senate
141 Hart Senate Office Building
Washington, DC 20510

Dear Bob,

Thank you so much for agreeing to host the CSIS Advisory Board meeting at breakfast on Capitol Hill on the morning of March 14. We checked your calendar to confirm that your schedule was clear of other commitments and will work with your staff to arrange the breakfast and the meeting.

We would be most grateful if you would participate in the meeting with a short discussion of taxes and the budget with Tom Foley, to be followed by questions and answers. We plan to ask Ted Burtis, chairman of the Sun Oil Company, to moderate the session, which is scheduled to last from 8:15 a.m. to 9:30 a.m.

We will send you a meeting agenda as soon as the details are finalized. If you or your staff members have any questions, please call Lind Vaughan at (202) 775-3147 or 775-3157. In the meantime, I am delighted that you will be able to be with us.

Sincerely,

Anne

Anne Armstrong
Chairman
CSIS Advisory Board

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TAX REFORM EFFECTIVE DATES

- Last December the Senate passed my resolution urging that the effective date for most provisions of tax reform legislation should be January 1, 1987. The reason for making tax reform "prospective only" is to eliminate the cloud of uncertainty that pending tax reform legislation leaves over many economic decisions that are influenced by tax policy.

- The House also passed an "effective date" resolution, urging the chairman of the tax-writing committees to agree on some determination of effective dates other than the January 1, 1986 date in the House-passed bill.

- Unfortunately, since last December little progress has been made in clarifying the effective date issue. Chairman Rostenkowski has made it fairly clear that he thinks the House bill effective dates are appropriate, although he is willing to remain open to selective changes in those dates.

- Eleven members of the Finance Committee have sent a letter to Senator Packwood urging that markup of tax reform legislation be delayed until the effective date issue is resolved. I am not sure that is the best strategy, but it is another indication of how much members are concerned about the effective date problem. Senator Packwood wants the Finance Committee to adopt a general effective date of 1-1-87.

- In addition, there is still some hope that Rostenkowski, Packwood, et al. can agree on a statement to resolve some of the uncertainty on effective dates. The closer we get to Senate action on the tax bill, the more likely it becomes that Senate's decision on effective dates will be the most important signal we give to the business community of our intentions on the issue.

March 12, 1986

Tax Reform Talking Points

o The President's tax plan and the House 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.

o Both substantially reduce 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.

o 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.

o 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.

o 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.

o The Senate Finance Committee now is expected to begin action on tax reform around March 19. A lot of difficult decisions await the Committee if it is to make significant progress towards the goals the President has outlined: lower tax rates, a $2,000 personal exemption for everyone, and more incentive for saving and capital investment.

o The 'Packwood draft' of tax reform goes a long way toward meeting the President's goals, including a top rate of 35% and a $2,000 personal exemption for all but the wealthiest taxpayers. Still there are many controversial points that will be closely scrutinized.

--the deduction for State and local sales and personal property taxes would be repealed, and that for income taxes would be available only through the first two brackets.

--Interest deductions would be more severely limited than in the House bill, including a $1,000/$2,000 limit on the consumer interest deduction.

--The minimum tax would have a lower rate and a broader base than in the House bill, but is still likely to be controversial.

--Excise taxes would be increased significantly including those on beer and wine.

o On the plus sides, from the viewpoint of many taxpayers--

--The nonitemizer charitable deduction would be made permanent without adopting the floor under the charitable deduction included in the House bill.

--Investment credit repeal would not take effect until March of this year.

--ACRS would remain the basic depreciation system, with a limited inflation adjustment allowed.

--The R&D credit would be made permanent.

--The amount of new equipment costs small businesses can expense would be dramatically increased.

o All in all, the Packwood draft does a better job of lowering tax rates while encouraging new investment and a productive climate for business.

February 19, 1986

BUDGET FOR FY 1987

- The President's budget for FY 1987 is a blueprint for deficit reduction that Congress will have to take seriously even if we can't agree with it in all particulars. It is important to keep in mind OMB Director Miller's contention that, if we adopt this budget in full, we can meet the Gramm-Rudman targets for the rest of the decade without the need for major additional cuts.

- The 1987 budget plan is designed to get the deficit down to $143.6 billion: just below the G-R-H target of $144 billion. Total spending is projected at $994 billion, and revenues at $850.4 billion. Total interest expense is $206.85 billion, and net interest (exclusive of intra-government payments) is $148 billion.

- The deficit would be reduced by $38 billion in FY 87, and by $166 billion over three years. Defense would still grow by 3% in real terms (increase in budget authority adjusted for inflation). Increased funds would be provided for fighting terrorism, for law and drug enforcement, for the space program, aviation safety, and AIDS research.

- Major new deficit-reduction initiatives include privatization of government activities, ranging from Amtrak to power facilities to Ex-Im bank loans; transferring a few programs to the States, such as the Agriculture Cooperative Extension Service and highway; a wide array of user fees on government services; eliminating programs like EDA, UDAG, SBA, maritime subsidies, and the ICC.

- There are additional receipts in the budget as well: extending the cigarette tax, higher fees for black lung, repealing the gasohol exemption, increased contributions to civil service retirement and the like.

- The CBO indicates that the President's budget may be some $14 billion short of its 1987 goal because of low estimates of defense spending already in the pipeline. That is a legitimate matter for review, but if baseline spending is higher, then any cuts will have more of an impact as well.

THE ECONOMY IN 1986

- No one can really predict the course of the economy in 1986, although of course we have to take a stab at it to guide our budget decisions. But it is increasingly clear that the economy began picking up late last year. Leading indicators rose 0.9% in December, the eighth month in a row. Unemployment is down to 6.7%, the lowest since 1979.

- There are forces at work that improve the prospects for strong growth this year. One of these is the drop in oil prices, which acts like a tax cut for energy users and helps moderate inflationary pressures that might build as a result of the dollar's decline. Coupled with the monetary stimulus the Federal Reserve provided in the last six months of 1986, and the prospect for improvement in our balance of trade later in the year (as the effects of the dollar decline are felt), this means we have a good chance for healthy growth in 1986.

- Clearly the number one threat to maintaining a healthy economy remains the U.S. budget deficit. If it's not reduced sharply this year, we won't meet the commitment we made to our trading partners to secure their agreement to ease the dollar down. What's more, we would put an unconscionable burden on the Federal Reserve to keep the recovery going by pumping more money out in order to keep interest rates down. That's a sure recipe for inflation.

- We've created 9 million jobs with a near record economic recovery. We've got inflation down to the lowest levels in two decades. Let's not throw it all a way by punting on the deficit issue. The fact is that <u>all</u> the economic pundits we've been hearing in recent years have been wrong: the economy is more resilient than many believed, but not so strong as to be able to sustain huge deficits this late in the recovery. It's time for everyone to "give" a little in the interest of a deficit-reduction plan that will steer us safely through the potentially treacherous waters ahead.

TRADE TALKING POINTS

- The international competitiveness of traditional industries in the South (textiles, timber, steel, footwear, petrochemicals and agriculture) is dependent on many factors.

- The enormous U.S. trade deficit of nearly $150 billion in 1985 does not necessarily reflect a lack of competitiveness in these and other industries.

- We have a number of problems facing American industries which have nothing to do with their underlying competitiveness.

- The strong dollar has been the major cause of our trade deficit; we in Congress long ago concluded that the Administration had to take a more active role in managing the exchange rate of the dollar, and I am pleased that Secretary Baker seems to have come to the same conclusion.

- The fact that major debtor countries which were formerly significant U.S. export markets cannot afford to purchase U.S. exports continues to be a major obstacle to U.S. exports; the Administration has been slow to deal with this problem, and even now the "Baker plan" affords little prospect of improvement.

- But traditional southern industries face particular problems which transcend these macroeconomic factors.

- All labor-intensive American industries, such as apparel and footwear, face the continuing challenge of low wage foreign producers; these industries can remain internationally competitive only by increasing their efficiency through labor-saving devices and otherwise.

- Many of these industries face a variety of unfair trade practices; Congress has become more determined to force the Administration to aggressively combat these unfair practices.

- In timber, the flood of Canadian imports which now accounts for over a third of the U.S. softwood market has been generated by Canadian government subsidies; in addition to generating specific retaliatory measures in Congress, the flood of Canadian timber could well derail the Administration's effort to get the Finance Committee to approve a free trade negotiation with Canada.

- In textiles and apparel, the renegotiation of the Multi-Fibre Arrangement, which expires July 31, 1986, will be the focus of congressional pressure; passage by both houses of the Textile and Apparel Trade Enforcement Act of 1985 did put the Administration on notice that we will not tolerate excessive growth of textile and apparel imports.

- The problems we face in steel are partly of our own making, but there is no doubt that the world is awash in over-production of steel and we need to prevent our market from becoming the dumping ground for other countries' excess capacity. The President's steel program, which Congress mandated in 1984, has not been as effective as some had hoped, but it has prevented a surge of steel imports.

- Although unfair trade practices may not account for most of the difficulty faced by these industries, a number of us think that the Administration has been too complacent in dealing with these practices.

- It's pretty hard to stand up for "free trade" if we are the only ones practicing it; combating unfair trade practices is not protectionist; it gives American producers a chance to compete fairly.

TRADE ENHANCEMENT ACT OF 1985, S. 1860
33 Cosponsors
Introduced November 20, 1985

BRIEF OVERVIEW OF MAJOR PROVISIONS IN BILL

1. Section 301 Reform

Requires automatic initiation of Section 301 cases by USTR when another country's unfair trade practices burden, distort or restrict a substantial amount of United States exports.

When an unfair trade practice is identified, after a period of time for negotiation, the bill requires that retaliation take place. Other changes made to Section 301 include transferring the initiation authority from the President to USTR and a new definition of "burden" for purposes of determining whether an unfair trade practice has taken place.

2. Section 201 Reform

Amends the law to require that import relief be given to industries the ITC finds to have been injured.

The bill also requires that an injured industry prepare an adjustment plan that would, over time, result in their altering their methods of doing business or producing a product in order to become more competitive.

3. New Round Authority

Provides authority for President to enter a new round of GATT negotiations, and links to this authority a list of specific negotiating objectives.

4. Dollar/Exchange Rates

Requires President to work with G-5 countries to improve functioning of the international monetary system. In addition, creates a strategic exchange reserve to assist in moderating exchange rate fluctuations, and makes funds available to assist LDC debtor nations.

5. Generalized System of Preferences (GSP)

   Requires the President to establish criteria for the graduation (within 2 years) from GSP of advanced developing countries, (i.e., Hong Kong, Korea, Taiwan).

6. Non-Market Economy Dumping

   Streamlines the procedure for bringing anti-dumping cases against non-market economies.

7. Section 337 Protection (Intellectual Property Rights)

   The bill expands protection for process patents and other intellectual property.

8. Export Promotion

   The bill includes the President's proposal for the establishment of a war-chest and other steps to promote exports including making technical revisions and clarifications in the Foreign Corrupt Practices Act to help companies operating abroad. We incorporated many of these latter changes as a result of our discussions with the Hong Kong Chamber of Commerce.

   The bill does not provide for industry-specific protection such as protection for textiles, shoes, etc., although each of the titles of the bill are likely to contain provisions which are particularly helpful to particular industries.

Gramm-Rudman, the Dollar, and Inflation

- Gramm-Rudman should help us meet the commitment we made last September to our trading partners: to reduce the deficit as part of our effort to moderate the value of other dollar.

- By the same token, the risk of inflation should be reduced if we bring down the deficit under Gramm-Rudman, because the pressure to pump up the money supply to keep interest rates down will ease considerably.

Gramm-Rudman: Challenge to the Established Fiscal Order

- The first actions in response to the new Gramm-Rudman deficit control reform will be taken early in 1986. For those of you who missed it, late last year the Congress imposed a new fiscal straightjacket on itself. The new law sets firm deficit targets for each of the new five years, and mandates automatic across the board spending cuts if the deficit exceeds the target. The first round of automatic cuts under the proposal will take effect March 1 unless Congress comes up with a better way to meet the target.

- 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 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; set a point of order against legislation from committees that have not met their budget savings allocation; and rule out of order legislation inconsistent with the deficit targets.

Possible Problems. We know there will be a rocky road ahead in implementing Gramm-Rudman. Congressmen Synar and others already have won the first round in their suit claiming it is unconstitutional, and the Reagan Administration also has some problems with the role of the Congress' General Accounting Office in mediating the deficit forecasts. The Supreme Court will have to give us a final ruling on all that in a few months. 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 responsibility.

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 follow a deficit reduction path like that mandated under Gramm-Rudman, 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.

  -- In 1985, 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.

Interest on the Debt

The 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 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.

But <u>if</u> 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 <u>without</u> 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.