FEDERAL BUDGET CRISIS

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

JUNE 10, 1982

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FEDERAL BUDGET CRISIS

THURSDAY, JUNE 10, 1982

U.S. SENATE,
SENATE FINANCE COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 9:38 a.m., in room 2221, Dirksen Senate Office Building, Hon. Robert J. Dole (chairman) presiding.

Present: Senators Dole, Long, Byrd, Bentsen, Boren, Bradley, Danforth, Chafee, Wallop, Durenberger, and Grassley.

Also present: Senator Nicholas Brady of New Jersey.

[The press release announcing the hearing and background material relating to the need for action on the Federal budget crisis follows:]

Press Release No. 82-141

PRESS RELEASE

FOR IMMEDIATE RELEASE
June 4, 1982

UNITED STATES SENATE
COMMITTEE ON FINANCE
2227 Dirksen Senate
Office Building

FINANCE COMMITTEE ANNOUNCES HEARINGS ON THE NEED FOR ACTION ON THE FEDERAL BUDGET CRISIS

Chairman Robert Dole (R., Kansas) announced today that the Committee will hold a hearing on Thursday, June 10, 1982 on the need for Congress to take prompt action to reduce the projected deficits in the Federal budget.

The hearing will begin at 9:00 a.m. in Room 2221 of the Dirksen Senate Office Building.

The Committee has scheduled the following witnesses to appear:

- Representatives of the bipartisan group of former Cabinet officials who made an appeal to Congress to reduce the budget deficits including the Honorable W. Michael Blumenthal and the Honorable Peter G. Peterson;

  A representative of The Business Roundtable;

  A representative of the American Business Conference;

  A representative of the National Federation of Independent Business

  A representative of the National Association of Realtors

Written statements.--Any person who desires to present views to the Committee is urged to prepare a written statement for submission and inclusion in the printed record of the hearing. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, not later than Tuesday, June 15, 1982.

P.R. #82-141

May 24, 1982

**A BI-PARTISAN APPEAL
TO
THE PRESIDENT AND THE CONGRESS OF THE UNITED STATES**

The Hon	The Hon	The Hon	The Hon	The Hon	The Hon
W. Michael Blumenthal	John B Connally	C Douglas Dillon	Henry H Fowler	Peter G Peterson	William E Simon
Sec. of Treasury	Sec of Treasury	Sec of Treasury	Sec of Treasury	Sec of Commerce	Sec of Treasury
1977-1979	1971-1972	1961-1965	1965-1968	1972-1973	1974-1976

The budget crisis can wait no longer. The huge budget deficits now in prospect are crippling today's economy and could lead to years of financial turbulence and industrial stagnation.

This is no time for politics as usual and it is certainly no time for a budget stalemate. The national interest demands strong and continuing leadership—by the President and Congress working together—to restore financial sanity.

THE DEFICITS IN PROSPECT . . .

The federal budget is dangerously out of control Without swift legislative action, it will produce a succession of ever-widening deficits In Washington, there is finally a broad consensus and genuine concern about the magnitude of the problem.

- The current year deficit is running in the range of $100 billion.
- Unless laws and trends now in place are changed, the deficit could explode into the $175-$200 billion range in FY 1983.
- By FY 1985, the annual deficit could be in the $250 billion range, and heading upward.
- The deficits now in prospect could well exceed 5% of GNP, year after year. Federal borrowing would devour virtually every penny of household savings and would divert capital from productive investment at a record rate.

Peacetime deficits this big have no precedent in our history. Though recent years have seen too much red ink, really large deficits have typically occurred only as the result of recessions and have narrowed swiftly with the resumption of economic growth. But the spending and tax laws now in place would produce a continuous flood of gigantic deficits even if the economy now recovered and enjoyed sustained growth. As now structured, the federal budget might never achieve balance—it would more likely sink deeper into the red with each passing year

THE PROBABLE RESULTS . . .

Huge deficits risk denying Americans any chance at sustained prosperity in the new decade—after a decade in which real median family income showed little or no increase.

- Recovery from today's recession could be feeble and temporary as a result.
- Interest rates would remain abnormally high, holding back new investment and pushing thousands of sound businesses and farms into bankruptcy
- Job creation would continue to stagnate, making higher unemployment a fixed feature of the industrial landscape.
- Dollar exchange rates would remain artificially high, choking off American exports, sucking in imports, destroying hundreds of thousands of U.S. jobs, and pushing us toward full-scale protectionism.
- Low investment would erode our long-term productivity growth, retarding living standards at home, crippling our competitive ability in international markets, and shrinking America's stature and influence in the world.

PRINCIPLES FOR SOLUTION . . .

The budget crisis transcends conventional politics; no solution is possible through partisan maneuver. We, the undersigned, rarely stand together on political and economic issues. But we believe Americans must now rally to the common cause of fiscal responsibility.

There are five crucial principles for budget reform:

- **Realism:** The financial markets are telling us that it does no good to "cut" the deficits by using unrealistic economic and revenue forecasts, or by underestimating expenditures, or by relying on vague and speculative "savings" to be proposed in the future.
- **Speed:** Action is necessary right now: Delay would permit election year politics and momentum of federal spending to lock in huge deficits all the way to mid- decade. With each week of delay, the problem is getting worse—and harder to solve.
- **Long-term Impact:** The financial markets—and the American people—are worried by today's deficit but much more by the huge deficits now in prospect for 1983, 1984, 1985 and beyond. Today's budget actions must cut those out-year deficits substantially; the reforms adopted must be equal to the size and duration of the problem. The reforms must be large, structural, and permanent.
- **Fairness:** Balancing the budget on the backs of just one group or one set of programs, is not feasible, and trying to do so is not fair. Federal spending has grown excessively in many categories for many years. The growth rate has recently been cut for certain means-tested programs aimed at the poor, such as Medicaid, AFDC, Food Stamps, and legal assistance. It is now time for a wider sharing of burdens—for focusing fiscal reform on the major spending programs which confer benefits on middle and upper income groups.

• **Focus on investment**: The chief vice of uncontrolled spending and big deficits is that they rob the future—by absorbing investment capital needed to build up productive jobs and real income for tomorrow. The 1980's should be a decade of investment, not a decade of red ink. Budget reform should protect the future we must squeeze down the share of GNP taken up by Federal spending, concentrating the cuts on public consumption, not public investment, and the needed tax increases should fall chiefly on consumption, not on private savings and investment

• **THE GOAL . . .**

We must put the budget on a multi-year path toward balance. This means cutting the FY 1983 deficit to below $100 billion and squeezing down the deficit further in each year thereafter To achieve even minimal credibility in the financial markets, the program of fiscal reform must cut the projected deficits

- **by about $75-100 billion in FY 1983**
- **by about $125-150 billion in FY 1984**
- **by about $175-200 billion in FY 1985**

If we do less than this, future deficits will likely remain well above 2% of GNP for years to come—which would make the nation's financial and investment situation in the 1980's even worse than it was in the 1970's The last decade was bad enough for America's economic performance To invite a further drop in our economic performance would be totally irresponsible

A PROGRAM FOR IMMEDIATE ACTION . . .

We can meet these targets without gutting our military security, without starving private savings and investment, and without putting harsh burdens on the poor. But meeting the targets does require us to address head-on each of the three major sources of runaway deficits—the growth of the large entitlement programs, the growth of defense spending, and the inadequacy of tax revenues If any of these areas is placed "out of bounds" no fair or effective solution to the problem is possible

1. **Entitlements and other non-defense programs**: We should now slow down the growth in non-defense spending so as to reduce the deficit by about $60 billion in 1985 The best place to begin is with a one-year freeze in benefits flowing from the large, broad-based entitlement programs—Social Security, Medicare, veterans' benefits, Civil Service and military retirement, and other non-defense subsidies and payments. Thereafter, there should be limits on the automatic inflation-indexing of benefits (e g., by capping inflation adjustments at 4% a year, or by providing adjustments only for inflation exceeding 3% a year) However difficult politically, controlling the budget requires controls on the large entitlement programs and on the inflation indexing process that drives the cost of those programs upward If those programs are instead placed off limits, it will be impossible to make budget savings of the magnitude now necessary for financial stability Similar restraint is required on all transfers, subsidies and programs other than those essential to the needy; these measures can be carried out in ways which protect those citizens truly in need

2. **Defense**: The defense budget increases now planned should be moderated so as to save about $25 billion in FY 1985 This would still provide for a major and sustained defense buildup, and it would also encourage more explicit planning for that buildup and lead to wider public support for a strong defense posture

3. **Taxes**: Revenues should be increased by about $60 billion in FY 1985 This can be done through a variety of permanent and temporary tax measures; e.g , new taxes on oil, gasoline, and natural gas consumption, such as a tax on imported oil, or a gasoline tax or decontrol of natural gas with a windfall profits provision (which would also prolong the current world oil glut and assure further energy conservation and production activity by the private sector); modifying corporate tax provisions (e g , safe harbor leasing) which distort business investment flows; and by increasing federal excise taxes, such as on alcohol and tobacco, and by imposing user fees for the government's commercially valuable services Modifying, delaying or stretching out of the income tax cuts scheduled for 1983 has the unanimous consent of the undersigned only in the context of a prior agreement on the kind and magnitude of spending cuts referred to in parts 1 and 2 of this program.

These steps, if undertaken now, would cut the FY 1985 deficit by about $145 billion. This in turn could lead, through less federal borrowing and lower interest rates, to a further deficit reduction of $30-55 billion, meeting the overall target of about $175-$200 billion in FY 1985 deficit reductions

After the November elections, the President and Congress must turn to fundamental reforms of the fiscal structure, e.g , developing a multi-year budget control system to guarantee realistic, long-term discipline on spending and tax decisions; making structural changes in the Social Security system, to assure the system's long-term affordability and financial integrity, and giving serious consideration to a new and general consumption-based tax But the difficulty of such basic reforms must not divert us from the need to take major steps right now to cut future deficits

LEADERSHIP . . .

The program we suggest would require tangible sacrifices from many middle and upper income citizens—but the sacrifices would not be severe. And they are simply necessary to avoid economic chaos and stagnation. Inaction would exact enormous—and unnecessary—sacrifices from every American

The budget crisis is a national crisis Only a united leadership in Washington—extending across both parties, and embracing liberals and conservatives alike—can avert a fiscal disaster. Let us work together, as Americans, to rescue the future of our economy . . .and of our country.

DRAFT

REPORT ON PRESS CONFERENCE—BI-PARTISAN APPEAL TO THE PRESIDENT AND CONGRESS ON THE BUDGET SITUATION

National Press Club Washington, D.C.
May 24, 1982, 10 A.M.

The Hon	The Hon	The Hon	The Hon	The Hon	The Hon
W Michael Blumenthal	John B Connally	C Douglas Dillon	Henry H Fowler	Peter G Peterson	William E Simon
Sec of Treasury	Sec of Treasury	Sec of Treasury	Sec of Treasury	Sec of Commerce	Sec of Treasury
1977 1979	1971 1972	1961 1965	1965 1968	1972 1973	1974 1976

Peter G. Peterson: Good morning, ladies and gentlemen I guess you know by now that Bill Simon is in London, by phone, we hope.

When I speak of all these very distinguished colleagues, they're not only distinguished individually, but it seems to me they are even more so collectively We know that each of them has served as the nation's highest economic policy officer under each of the last five presidents of the United States They represent a remarkable diversity of experiences, typically they have held an equally remarkable diversity of views In fact, a wag from the press, if you will forgive the redundancy, indicated to me that he didn't think this group agreed on anything Today they do stand together

First of all, by way of introduction, I'd like to indicate a few things we are not here to do We are not here to criticize Congress endlessly In the first place, if we the voters have made it an act of political self-destruction to take what we consider being the necessary fiscal medicine, we can hardly blame our representatives for representing us

In the second place, I think our group wants to commend those on both sides of the aisle who deserve our thanks for helping to get agreement at last on the true magnitude of this problem It took political courage from both sides of the aisle in both houses to make some of the proposals that were made in the last few months

Nor are we here to criticize or slow down the budget reconciliation process I think I speak for all of our colleagues to indicate that while the budget reconciliation process may not be a sufficient step, it is clearly a necessary first step and a constructive one Needless to say, the actual appropriations are a decisive next step

Nor are we here to give you a detailed line by line item for closing the budget gap This is not a job for outsiders and at any rate it seems to all six of us that the problem today is not one of detail It simply does not reside there, but rather in very basic and hard realities Compromise is the essence of politics, but a compromise is not good enough, if it evades the basic realities, the hard issues, thereby producing an inadequate result And it seems to us that that's approximately where we are today.

So much for why we're not here Why are we here? What are we trying to do? It seems to me from my discussions with my colleagues that we are here partly because like nearly everyone, we are deeply concerned about the current near crisis in our economic situation To take but one melancholy symptom, one need only read the Wall Street Journal of today that talks about the bankruptcy wave in America I think it is nearly unprecedented, at least in my experience, that we have the number of household corporate names in America that may be quite close to the brink, if current conditions continue for an extended period into the future

We are even more concerned, however, about something that truly is unprecedented, and that is that we now have spending and tax laws in effect that even if the economy were in a sustained growth mode, we would still have an enormous and, to us, utterly unacceptable deficit

So our focus today is not on '83 but on '84, '85 and beyond

Now what's been the response to this near crisis situation? Lately, all of us have noticed that there seem to be about as many budgets as there are political factions and the worse the economic news gets, the more factions there are We already, I understand, have about seven proposals, and we're still counting These budgets have certain things in common Each one, it seems to us, has a major untouchable With some it is the major social entitlement programs, with others it is defense, with others it is taxes And in the meantime, the financial markets are saying that all of these budgets are big deficit budgets, unacceptably big

There is one other thing that these proposals have in common, which is a contempt for the high interest rates for which we are all at least partly responsible

So that's led us to two conclusions First, that a bi-partisan effort might be quite useful in trying to get this resolved in a way in which the political burdens could be both reduced and shared Secondly, we conclude that the deficit problem is so large that there is no solution that does not involve significant political pain, that does not include a major contribution from all three areas—the big entitlement programs, defense, and taxes

In my view, at least, the financial markets will believe it when they see it For example, the financial markets will believe it when they see the so-called untouchable, uncontrollable big entitlement programs including social security, federal pensions, military pensions and the like both touched and controlled

Let me now move to our goals You will notice that we indicate that we would like to put the budget on a multi-year path toward balance Why is that? It is because all of us in this group who have studied the rather dolorous economic performance of the United States in the last decade share a common view that we must find a significant additional investment in plant, equipment and research and development to get our economic act together and that means more investment, less deficits

We want to express our appreciation once again for those in the Congress and Executive Branch who finally have brought realism to the point that the numbers that our goals state here are now widely accepted goals, that in 1985, we're looking at a $175 to $200 billion reduction if we are to achieve our goal It might be said that with those kinds of deficits, we are running the government like nobody's business

This particular group agreed early on that there were certain principles that would guide us. Very briefly, let me take you through them Realism Part of the problem in financial markets, a very important part of the problem, is the credibility problem There has been a history of promises, over promises, broken promises, all kinds of promises that have not been delivered on So in our particular proposals, we have resisted rosy economic forecasts; we have resisted underestimating expenditures or overestimating revenues, and we have resisted phantom savings

Secondly, speed We have a fiscal and ultimately a political disease that I think is a progressive one The longer we wait, the worse the effects, the more painful the treatment If eventually it is inevitable that we face some of these difficult issues, why not now? And if not now, the sooner the better. Nonetheless, we know we are embarked on a long-term effort

Next, our analysis of our current fiscal problems suggests that they are structural in character, long term in character, permanent in character The solutions must be similarly structural, long-term and permanent, if we are to regain control of the budget

Next a focus on investment We are unanimous in the view that we must invest more if we are going to get our economic act together To invest more, we must by definition spend and consume less It is an essential principle, therefore, that we want to discourage government spending and encourage investment

And finally, I think a principle that brings us together, that made it possible to have a bi-partisan group, was the principle of fairness I think we can demonstrate that both simple equity and simple arithmetic lead us to the same conclusion There must be a wider sharing of burdens among those of us in the middle and upper income groups Let me elaborate on that We have in this Table 1 a breakdown in the current reductions in spending growth I think it is important that we analyze where the reductions have been You will notice that we have all the programs broken down into need-related and not need-related You will notice that, in every category, entitlements, non-entitlements, transfer payments, and other programs, the cuts in the rate of increase of these need-related programs have been roughly three times or more than the non need-related programs We think, therefore, that simple equity alone requires, if we are to have a bi-partisan solution, that the rest of us share more in the reductions in future spending growth

Let us now move on to look at what the 1985 Budget outlook suggests for us, Table 2. I think the first thing to observe is that the 1985 budget projection hits over one trillion dollars by 1985 I guess, Doug Dillon, you and Joe Fowler were in an administration where the hundred-billion dollar threshold was crossed, very tentatively We're now at ten times that level

I'd like to look at several aspects of this trillion dollar Budget Earlier I said that the need-related programs*, as a matter of both simple equity and simple arithmetic, were not where we were going to solve a problem of the magnitude of a reduction of a hundred seventy-five to two hundred billion dollars in the 1985 deficit. You will notice that the entire expenditure of those need-related programs in 1985 is $87 billion.

You will also notice that the grants to state and local governments in 1985 are not only relatively small, but have stabilized during this period in nominal terms, and, of course, have gone down in real terms. Besides, cuts here may often increase state and local taxes and what we should be focusing on are net spending and net tax reductions Next, you'll notice that for "other federal operations" roughly the same pattern exists

Therefore, unless someone is going to propose highly draconian solutions and in my view highly unacceptable solutions, that would involve some combinations of major additional slashes of the need-related and the grants to state and local governments, and closing down the federal government operations, it seems obvious that we are not going to get deficit reductions of the magnitude we're talking about without looking elsewhere.

And clearly, where we must look is in the transfer payments area, a good deal of that in the non-need-related area, in defense and of course, all this resulting in a significant reduction in net interest You'll notice that the aggregate of those two items alone—$385 billion in non-need-related transfer payments and $278 billion in defense—$650 billion—is 65% of the budget and if we add interest we're up to over 80% of the budget.

So, in those three areas will fall the principal burden for doing something about this problem Now, you're going to hear a lot from us today about Social Security. Let me start by saying, that to show you the budgetary importance of Social Security, that if you look at that $385 billion, 3/4's of that item in 1985 will be represented by Social Security alone.

Now it has been said by some that it may make political sense to exclude Social Security However, I think the evidence would suggest that it's close to an economic absurdity.

It has been said that it is politically impossible to do anything about Social Security Impossible is an absolute term. I think it would be our view that the current pattern presents us with a fiscal impossibility Therefore, we will see what happens when the irresistible force and the immovable object meet

*Need-related programs are defined as those for which a majority of the funds are distributed on the basis of some test of need or current income.

One other general comment about the needy and need-related versus the non need-related programs. In our appraisal of what is going on in the country, too many people seem to use the word "needy aged" as though it were a single word, a redundancy. Likewise they feel that unneedy aged is some kind of a contradiction in terms. Obviously if you think about it, many, yes most aged persons are not really needy by most accepted definitions. Most of these ballooning big entitlement programs do not go to the truly needy at all. One recent estimate suggests, for example, that of all the Social Security benefits only something like 10% go to those at the poverty levels or below. Those needy recipients can be protected.

Therefore, it is our conclusion that if we are to attain our 1985 budget deficit goals, we need a balanced program in which we must meet head on each of these three areas. Entitlements and other defense programs $60 billion, defense $25 billion, taxes $60 billion, and lowering interest costs by $30 to $55 billion now—which comes to our goal of $175-$200 billion.

This necessarily brings us to the entitlements area which is in our judgment the single most important area It is a place where our bi-partisan program is obviously different from some of the others You will notice that our program includes a one-year freeze on cost of living adjustments for all of the major entitlement programs, including Social Security It includes a cap on indexing thereafter and it includes similar restraints on other programs that are not truly essential to the needy We are convinced that we can devise a variety of ways to respect our commitment to the truly needy and still achieve these objectives

Let's move on now to the Social Security situation. Earlier I talked about the fiscal impossibility vs. the political impossibility Before judging the politically impossible question prematurely, something we think the American public must come to grips with is what the alternatives are Recently it has been agreed that we have $40 billion of Social Security solvency that must be taken care of by 1985. We asked our staff people to tell us how big a tax increase would be required in '83 in order to solve that solvency problem by tax increases, something incidentally our group is adamantly against It's a 1% of pay increase which added to a .7% increase that is not widely remembered by the public would give us a 15.1% Social Security tax simply to keep the system solvent in the 1983-1985 period. But as we will see, these huge tax increases, the largest in our history, are just the beginning

Next, we have presented some material on some interesting questions and answers about Social Security because we think an absolutely essential part of this political process is an education process

Question number one: Within what time period will current retirees receive their Social Security benefits equal to their total contributions? Many people have said to us, "It is my money" Answer: A single person gets all of his social security contributions back in one and a half years The average wage earner with a homemaker spouse within 11 months

A second question: The life expectancy at age 65 was 12 8 years in '40 What is it now? Answer 16 6 years, which means that these payments which are eaten up in a year or year and a half, must be paid for over 16 years

Next, what about the demographics, which are changing radically Fifty years ago 4% of the people were over 65 Today 11%, twenty-five million people. By the year 2030 we're looking at 25% of our population or about 65 million people on Social Security.

Next, we have fewer and fewer workers who are supporting the system 16½ in 1950 per recipient, only 3 2 now

Next, the increases in Social Security benefits have been significant. The workers who contribute to Social Security have had an average increase of 30% in the last three years, before taxes Social Security beneficiaries have received 40% during that period of time after taxes

Social Security—what part of our budget does it represent? 28% or over $200 billion, including Medicare, of course

I said earlier the short-term problem may be difficult enough to grasp Let's look at the long term problem As you know, Social Security people have made projections into the future In the past—and you can read those studies as well as I—you will find out that the so-called pessimistic projections, so-called, have generally turned out to be optimistic

As early as 1995, we could easily see 19.4% of pay going into Social Security John Connally made the interesting suggestion to us He said, "I wonder if we could calculate how much money that is likely to represent in terms of one year's taxes to pay for the 1995 benefits " The number in current dollars is $415 billion If you assume only 6% inflation, we will be seeing an annual tax requirement of 1 trillion dollars, and heading north, in other words, up Our computer probably would have broken down if we tried to make the calculation of these other numbers ranging up to 57% of pay Clearly those numbers are also politically and economically unsustainable

It is for those reasons that we believe the Social Security issue simply must be part of any solution to this problem and we come down clearly on the side of phased reduction in the growth of benefits, not those impossible tax increases

There are others here who can speak on the issue of defense better than I Three of our group have special expertise John Connally, of course, was Secretary of the Navy Joe Fowler and Doug Dillon are Co-Chairmen of the Committee on the Present Danger They will speak to the basic point that a credible, sustained defense budget requires most of all a credible and strong economy What we have done in the next table is to show what our bi-partisan program would leave in real growth terms and in defense budget This $25 billion 1985 reduction would still provide an overall increase of 7% in real terms, other than a brief period in the Viet-Nam era still provides significant sustained buildup If you look at defense equipment and purchases alone, and assume that something is done to restrain military pay—something in virtually all the various budget proposals, the real growth in defense equipment and purchases is obviously significantly more than that

Taxes are, unfortunately, the third part of the program I guess something that differentiates our program is that we feel energy taxes must play a significant role—it's at the top of our list, and of course, U S energy taxes, gasoline taxes, for example, are generally far, far lower than in Japan and Europe We are, after all, at a time where we have softer prices in energy than we have had for years We think there has never been a better time to try to prolong the glut, promote more energy conservation—we are still highly vulnerable to very uncertain supplies—and to stimulate production Also, the classic agrument that we've used in the past against energy taxes is that it would have a terrible effect on inflation This clearly is less valid at this point We go through the other tax categories which we can discuss on the chart, excise taxes, safe-harbor leases, and user fees You ll notice that the income tax is last on the list I think it is important to say that in order to get unanimity in this bi-partisan group on modification in the 1983 tax cut, it was acceptable only in the context of prior agreement on the spending cuts of the magnitude and the type that we were talking about in parts 1 and 2 of the program, that is on entitlements and defense We have here the breakdown of the various taxes and their revenue possibilites We do not have a line-by-line tax proposal However, this gives you an idea of the kinds of things we would be considering

Finally, there is an obvious question How does our bi-partisan proposal compare with those that are currently on the Hill We think there are some significant differences Our defense cuts obviously fall somewhere in the middle However, you will notice that our cuts in non-defense spending growth are substantially higher than any of the other programs, most particularly in the entitlements area This represents our belief that the big entitlement programs are at the heart of solving this fiscal situation

You will also notice that we have no "management savings" and "miscellaneous reductions" that are now present in the various budget proposals This represents our deep commitment to realism and conservatism. We would suggest that you view those particular proposals very carefully. You will find for example I believe that they have $18 billion in off-shore oil and gas receipts The best year ever was $10 billion in 1981 in an oil market that was firm and rising We would raise a question as to whether it is prudent planning to assume those kinds of offshore revenue increases in the kind of ambiguous oil market that we are dealing with at the present moment So-called management savings also include "waste and fraud" in times past, which have often been counted twice; once in the departmental budget and another time in this catch-all category

Next, you'll notice that the interest on the debt is, in all the other proposals, $54 to $57 billion, our range is much wider than that. Let us be sure you understand why On the interest in the debt estimates in the other proposals, those very large savings come from two sources. First, from the reduction in the deficit and secondly, from the assumption that interest rates, as a result of those budget deficits, would have a major additional downward thrust It is presumed that the reduction of the budget deficit would lower the interest rates 2½ percentage points below the so-called base case So that we can all be sure we grasp the quantitative signficance of that, the base case assumes interest rates in 1985 of 9 4% In order to attain the magnitude of interest savings in those other proposals, it is not only essential to get the deficit reductions, it would be necessary for interest rates to come down two and a half additional percentage points to 6 9% to get that aggregate amount of deficit reduction We question whether that is prudent planning

I would now like to introduce, on an alphabetical basis, thereby establishing the bi-partisan aspect of this effort, Mr Mike Blumenthal, Secretary of Treasury, of course, in the Carter Administration Mike, could we hear from you?

W. Michael Blumenthal: Thank you, Mr Peterson I can be very brief because I think that Mr. Peterson's statement has been very full and complete I think the element of importance is that whatever is done, look beyond merely the next year, at 1984, 1985 and beyond because the problem that we face is not really amenable of solution within one year

And, that any course of action has to be based on the element of realism—on real numbers, on achievable numbers, and on a program that with the requisite courage and leadership can be achieved. The goal that we have in mind is to bring interest rates down, to bring monetary and fiscal policy into better balance and without a realistic program based on several years' hard work and sacrifice, that will not be achieved.

It seems to me that to have a program that involves management savings that any fundamental analysis leaves one to conclude are highly unlikely to be achieved is to be kidding ourselves and to be kidding the people at large To assume levels of interest rates that are highly unlikely to be achieved is to be doing the same. And to exclude from the formula of putting this economy back on a sound course, major areas such as Social Security and other entitlement programs and these spending programs that represent as Mr. Peterson has said the very large proportion of the total budget, is simply to avoid a realistic appraisal of the very serious situation that we are in. All of us are agreed that the goal has to be to provide a balanced situation in the economy for several years so that investment can be undertaken by the business community on a basis of confidence which investment will lead, once again, and must lead to an increase in productivity and the economy as a whole. It is that which will keep inflation under control and none of this is possible without bringing interest rates down and removing the threat of these ballooning deficits So, I feel very strongly that this is something that has to be faced and that the Congress, not only in this budget resolution and beyond, with the cooperation of the Executive branch, must look at some of these more fundamental issues that we have highlighted here Thank you very much.

Peter G. Peterson: Next, John Connally, Secretary of Treasury, of course, in the Nixon Administration, prior to that, Secretary of the Navy John Connally

John B. Connally: Thank you, Pete Well, ladies and gentlemen, there's not much that I probably should address myself to that has not been adquately covered by Mr Peterson and by Mr Blumenthal I do, however, want to add a word or two with respect to the cuts in defense spending which we have recommended in the presentation which we've made this morning As a former Secretary of the Navy, as one of the founders of the Committee on the Present Danger, I've long been concerned about the adequacy of the defense effort in this nation We are, nevertheless, recommending a cut of $25 billion for 1985 in the defense budget But, if you'll look carefully at that that still would anticipate a 7% real growth in defense spending over the period of time between now and 1985 Now we think, that under all the circumstances when we're asking the entitlements programs, including Social Security be cut and heavily cut, what we're asking for new in order to reduce the deficit and support the programs that we think have to be sustained in this country, then we think defense has to take part of the dilution, if you will, of part of the cuts that we think are absolutely essential to reduce the deficits and to bring about a creditable situation with respect to our Federal budget

In a representative form of government, I personally do not believe that you're going to long support a military establishment to the degree that I think it's necessary to do, not to the extent that we're presently undertaking, unless the economy itself and unless the budget tself anticipates a sound economic base on which to build that defense posture In my judgment, no representative form of government no society such as ours, is long going to sustain a military support program such as we feel is necessary, such as I feel is necessary, unless we have a sound base on which to build it That's going to be one of the first things that's cut That's why we're recommending that it be not an untouchable, but one of the three touchables

We recommend and recognize that we're going to have to deal with new taxes, that we are going to have to cut entitlements including Social Security, and that we are going to have to cut defense, at least in the light of the present recommendations

We're not here to pick a fight with anyone We're not here to criticize the President On the other hand, I want to personally commend the President because he has indeed turned the country around with respect to the commitment on defense and even with our cuts that we are recommending, we will still have the largest support for defense establishment that has existed in this country in modern times saving except a limited period of time during the Vietnam War

But I think it's fair to say that all of us, if we had our wish this morning, it would be to bring to the realization of the American people and thus to the Congress of the United States that they cannot, they cannot any longer overlook nor disregard the elements in this budget that are putting it beyond control They talk in terms of this 76% or a certain percent of the budget that is untouchable In our judgment, nothing is untouchable That's the point we're trying to make nothing is untouchable We can touch defense, we can touch taxes, we can touch the entitlements programs, and indeed we must and part of our message today is imploring the Congress to forget partisanship

We're not talking here today about Democrats or Republicans or Independents We're here today talking about this nation and what it needs We're here talking about a nation that is under pressure from within and from without We're here talking about a society that is under enormous pressure to increase its productivity in order to compete with the emerging nations of the world that have us under enormous economic pressure And we're here to say that you cannot do it unless first you get your own house in order and that means bringing these deficits down, bringing interest rates down to provide the investment incentive that is going to be so critical to the future of America and the people of this Country

Peter G. Peterson: I would like to present Douglas Dillon who, of course, was Secretary of Treasury in President Kennedy's and Lyndon Johnson s administrations

C. Douglas Dillon: I regret that I have to go, so I can't answer questions but I'm delighted to be down here to be part of this group making this statement because my feeling is that with the deficits that we are facing in the three or four years out and all the way to 1985 on are $250 billion plus, the situation is so serious that unless it is drastically corrected by attacking all the items that have been labelled untouchable such as the entitlements programs and increased tax revenues and defense spending, all three of them and attacking them head on, we will be putting ourselves in a position condemning ourselves to continued very high interest rates which in turn will lead to a continued recession of the type that I feel could widely be possibly labelled and could only be realistically labelled a depression and that will continue The only alternative relieving these things would be to start the printing presses, which is inconceivable So we really have to do this and everything I can give to helping our government and our people realize that nothing can remain untouchable in the interest of the nation's future

Peter G. Peterson: Thank you, Doug Joe Fowler, who of course was Secretary of Treasury in the 1965-1968 period under President Lyndon Johnson Joe Fowler

Henry H. Fowler: Thank you, Mr Peterson and ladies and gentlemen I recognize it's a hard act to follow John Connally and Mike Blumenthal and Pete Peterson and my old colleague in the Treasury, Doug Dillon whom I worked as his number two man in the 1961-1964 era

I'm very happy to be joining with my colleagues here today because they do have roots in both of our major political parties and we are basically trying to present what is labelled a bi-partisan program In this period of gloom about the outlook, I think we should recognize that 1982 presents an opportunity, an opportunity to hammer out in 1982 a bipartisan program to pull this nation back from the series of budget deficits that have been accelerating over the last 10-12 years to a state of being out of control Now this pattern, as Doug Dillon has indicated, of accelerating deficits, unless arrested now by a fiscal and budgetary program that will bring this budget into a state of balanced equilibrium from which in the light of our experience we would hope to be able to maintain, it's going to bring economic and financial disaster It will be even more severe than the difficulties of the last decade in which real median income, family income, showed little or no increase, and the rates of national productivity and our ability to compete around the world in the production and supplying of goods and services and the overall rate of economic growth have sunk to a frightening low And unemployment has reached its highest levels since the great depression

Now this program as several of my colleagues have indicated, must be a long term one You can't solve this kind of a problem with a quickie, a one year, a one shot effort It has to be projected over at least a three year span and thereafter, hopefully on a long term basis Now that's why and I want to come back to this one basic proposition that it's important in 1982 that what comes out is a bi-partisan program One's that removed from the usual vagaries of politics as usual and therefore will have a chance of enduring over the next year and the year following and the year following regardless of a change of control of a particular party in the House or the Senate or in the Administration

Now that does not mean the program must embody a series of weak flaccid compromises that fail to come to grips with the real underlying problem, which is why the main focus of the presentation that Mr Peterson has made to you goes to the question of are we going to grapple with this problem of the so-called uncontrollables or the entitlements programs behind which this whole process of escalating deficits over the past decade has hidden

Now, in order for this program to endure, it must be supported by substantial elements in both political parties That does not mean it has to be a majority of one and a minority of another It just means that is has to have a substantial footing on both sides of the aisle in the House and in the Senate My own personal experience in the two major fiscal efforts in which I was involved, namely the Tax Reduction Acts of 1963 and 1964 and then the Revenue Production Act of 1968 both designed to arrest and correct a fiscal maladjustment that was apparent leads me to believe that you simply have to have a bi-partisan approach and a bi-partisan support to make fiscal programs of this character and magnitude work, particularly where they involve a degree of national and individual sacrifice on the part of broad cross-sections of the body politic

I think that this is not only true of fiscal questions, it's true of the great national issues that confront this country from time to time If you think back of the years right after World War II with the emergence of the Marshall Plan, the emergence of NATO, it was because they were bi-partisan programs The spirit and attitude that motivated those programs and has been supportive of the multi-lateral development and the International Monetary Fund and the whole era of international economic and financial cooperation that marked the 50's and the 60's and to some degree, at least in part the 70's, and all of which has produced this great miracle, this great economic miracle and political miracle of, by and large, peace from major wars and growing prosperity These were the result of the fact that men like Senator Vandenburg on the Republican side and many of his other colleagues were willing to join with a Democratic president and then they were solidified in the 1950's when men like Lyndon Johnson and Sam Rayburn leading the House and Senate worked hand in hand with President Eisenhower to make these programs meaningful I think we're at another such period in history in which out of this painful process, we would hope to have a bi-partisan coalition which would put this program into effect and sustain it over the years that are ahead Thank you

Peter G. Peterson: Thank you very much, Joe I guess it's Bill Simon that may have a hard act to follow and Bill, if the miracle of electronic satellites and whatever else technology is working, I want you to know that we have a fine group here in Washington We have a photograph of you in front of the seat you would have occupied that, in my judgment, flatters you a bit, but you may not have the same view We would now love to hear from you, if we could from London Bill Simon

William E. Simon: Well thank you very much, Pete And I'm delighted to be with all of you, albeit over the airwaves and I'm sorry I can't be with you in person to add emphasis to the seriousness and the magnitude of the crisis that we all face And it could only be a crisis of this magnitude that has indeed alarmed a group of people who quite often or most times even, approach economic and financial problems from a different side of the fence I'm not going to add to all of the statements that were made today, that I'm just in 1000% agreement with

My position on budget deficits is certainly well-known to everybody in that room, my concern stemming not only from the severe inflationary effects but also the very extreme financial effects which for too many years have been ignored by academic economists You know, Mark Twain in talking about the weather once said, that everybody talks about it but nobody does anything about it Well, unlike the weather, this budget crisis that we have today is a problem that's manmade and therefore it can be solved by men. But unfortuantely it's going to take some political courage and statesmanship One day I was pleading for statesmanship in testifying before the Senate Finance Committee and Russell Long said to me ''Mr. Secretary, do you know what a statesman is? That's a dead politician '' Well, I hope that that is not correct because the time for rhetoric, as Pete said, is past and action, urgent action, is required because the time is very, very short if we're to avoid a financial disaster. Thank you, Pete

Peter G. Peterson. Thank you, Bill Now a few final words about where we go from here, then we will all, including Bill, be prepared to take your questions

We're going to go from here, literally, to meet with Secretary Regan who has indicated to us that he would certainly welcome us We then intend to go to the Hill, where we plan to see Speaker O'Neill, and a number of the important Committee Chairmen Then, at 2 o'clock, I believe we go to see Howard Baker and a similar bi-partisan group on the Senate side

As to where we go from a longer term stand point, it seems to me that the one common message that these gentlemen have given is that while what we're dealing with here on the surface is a fiscal problem, that down deeper is clearly a political problem

Our political leaders need to be reminded that there are still many more voters who are and will be forced to pay for these big programs than there are voters receiving them To be sure, those paying contributors are far less informed less involved, less organized, less likely to vote and certainly less vocal

So, what is required here is some massive political education I hope that's not a contradiction in terms, that is, political and educational, and in the coming weeks, and months, because we know it is a long term process, our small group is going to do what it can to foster that process We hope to get hundreds, even thousands, of leaders from all sectors and all political parties to join in this effort We are not naive We know that no small group of ex-public officials, however bi-partisan, can easily or quickly resist what up to now have been irresistable forces, or move what up to now have been immovable objects

I got some of my academic training at the University of Chicago There used to be a professor there who said if you have no alternative you have no problem A very melancholy thought It seems to us that as we consider the alternative, which is the current budget and spending outlook, it is simply an unacceptable alternative Therefore, in that sense, we have no problem, we have no alternative, but to try to change the environment and the basic structure of the spending and fiscal patterns in the United States

Thank you very much Our group, including Bill Simon, is now prepared to take any questions that you might have

Q: Is a budget deficit of $116 billion in FY 1983 a way of meeting the problem or is that too large?

Peter G Peterson: I think we would all prefer to see it smaller than that Our goal would be to try to keep it under $100 billion Again, I suspect it's going to be difficult to do that and you're probably tired of hearing this theme song over and ov again, unless the major entitlement programs are included in that effort But do I speak for the rest of you in feeling that we would like to see it attain the goal of $100 billion headed south? (heads nodding yes)

Henry H. Fowler: I just would add the headed south point is terribly important

I think, as Mr Blumenthal has indicated, the business and financial community and those responsible for making private investment decisions ought to be sure that this effort is not just a one year one shot effort, but carries over into the period ahead, 1984 and 1985, so a pattern of declining deficits that moves us down within reach of a budgetary equilibrium is the real objective

W. Michael Blumenthal: May I just add to that, that is seems to me that the actual number for 1983, important as it is, is no more important than the credibility of the number that finally emerges A number that upon, even cursory examination, makes assumptions that are clearly not realizable does not have much meaning And I think credibility, as far as observers are concerned, is as important as the absolute level

Peter G. Peterson: Thank you Next question, please

Q: Secretary Connally, you and the other former Secretaries spoke of the financial crisis disaster that might occur if this kind of action is not taken What specifically are you talking about?

John B. Connally: Well, I think number one you're witnessing day by day a deterioration of the whole economic base of the country You're seeing unemployment rise, you're seeing economic activity stifled, you're not seeing the investment in plants and facilities that are necessary in order to replace obsolete and obsolescent equipment You're seeing America become more and more non-competitive in the production of goods and services as a result of the failure to do the research, to modernize the plants and facilities and to make possible a greater productivity of American workmen There's a fear, there's an uncertainty in the minds of Americans today and this is what Secretary Blumenthal is talking about in terms of credibility The people who control the resources are not going to commit those resources until they can more clearly see where this country is headed from an economic standpoint So when we talk about a crisis, we mean precisely that, in all aspects of this nation in which we live

Q: Suppose there was some melding of what has passed in the Senate and what is being considered—let's say—by the House Democrats, presently posed and they actually passed appropriations as well, but there's no Social Security what is the outlook for these budgets?

Peter G. Peterson: The question was, I take it, that if what is being talked of about now in the senate, I assume you mean, what if something like the Senate bill was passed by the House, was not only achieved in a reconciliation bill but ultimately achieved in appropriation Is that your question, that is including appropriations that are consistent with those kinds of budget reductions, what would be the effect on the economy and on interest rates Mike, do you want to take a crack at that one?

W. Michael Blumenthal: I think that if the programs are first of all in the budget resolution and then in the appropriations process, are realistically and credibly affected and a point that Secretary Fowler has made is also achieved in that there is, can be, a realistic expectation that the process will continue in the following two or three fiscal years the impact on interest rates is going to be quite favorable and fairly clear and precise I think it's, I hope that we have made it clear that

that process is really only likely to occur if along the way, soon, the entitlement issue and the other two aspects that we've mentioned, defense and taxes, are handled in this kind of a real and believable way

Q: You didn't answer the question I'm asking you I'm asking you What is the outcome if they don't do that to go on the road they're going on without Social Security, without larger tax increases with their management savings and so forth?

W. Michael Blumenthal: Well, I think one of the rules that I followed, I'm sure my colleagues did, too, that to predict interest rates with any degree of precision is a very hazardous thing I would say that the other side of the coin is obvious That if that does not happen, I at least, speaking personally, do not see any realistic prospect for a decline in these unacceptable interest rates with all of the negative consequences that that implies

Henry W. Fowler: And one of the real factors you have to think about is that even though you might get a temporary decline over the next six months of interest rates, both short and long term, investment decisions are not going to be made in terms of an outlook for interest rates over the next two, three, four years And what the market fears and what investment decision-makers fear is that interest rates after a rather temporary dip of relatively minor proportions compared to some historical processes, will with the resumption of any degree of recovery, those interest rates will bottom out and move back up again to the levels that have caused the present situation and we'll be back in this pattern that Doug Dillon referred to of recession after recession after recession Which ultimately leads to the kind of outlook that Secretary Connally referred to which is expressed today in the **Wall Street Journal** front page story of accumulating bankruptcies

Q: Do you gentlemen see, if we don't discontinue this course, do you see a collapse in the capitalistic system?

Peter G. Peterson: John, do you want to take that?

John B. Connally: Now, I hope before we see a collapse of the capitalist system that we see a structural change in the political system I think frankly we are at rather a crossroads in this country Whether or not our process, and our system of government permits individuals to exercise a degree of statesmanship that's required to face up to what is obviously a problem today and a bigger problem tomorrow You know,and it's well to excuse it by saying, well that's just not politically possible It is politically possible And the real problem that we have again is whether or not the incentive is there in our political system in order to meet the changing demands of economic conditions that exist in the world today. And we can't overlook the fact that we're not an isolated country I alluded to it a moment ago by simply saying that we were going to have to compete with other nations around the world in every type of production of goods and services and we're not prepared to do that in America today. And we're permitting the political process to be abused because we're not facing up to the reality of the circumstances that confront us today And that's basically what we're here saying today that we don't have any choice but to face up to the realities of the times

Peter G. Peterson: Since Bill Simon has not only spoken, but written a great deal about capitalism, perhaps he should be an appropriate person to respond to that Bill

William E. Simon: John's answer is 100% on track That, we're at a crossroads and the support for our capitalist-free enterprise system requires the support from the people But if the people view the system as not being equitable and not providing shared benefits for the people, then indeed a system will not receive the support from the prople and indeed it will collapse Now, several questions have been asked You know about the "crisis" and what's the matter with everything that's going on today Well, in short, you know, inflation destroys balance sheets and the bankruptcies that we're all talking about today at the highest level since the great depression, we're very, very prone to a financial accident, a dislocation as an economist would describe it, a financial crisis, yes indeed we're close

And as far as interest rates are concerned, if I could just touch on that for a moment, you know Joe Fowler spoke about it The markets are from Missouri, The expectations in the financial community are for business as usual I think it's rather ludicrous that Washington continues to talk seriously about getting a budget deficit—"gee, we've got to get the budget deficit down to $100 billion or just below $100 billion " I think $100 billion deficit is absolute incredible There are two Secretaries of the Treasury sitting in that room that remember when the budget was $100 billion, not the deficit But what the markets want and when interest rates will react and when expectations will change, is when the political rhetoric ceases and everybody knows that credible actions are going to be taken and there is no way out of the room unless Social Security, the entitlements, the COLA's, all of the quote "politically tough" programs are dealt with. When that happens, you'll see a dramatic resurgence and a change in the expectation and people can then look forward to non-inflationary growth in the United States once again

Henry H. Fowler: I'd like to add one little technical point to your question about capitalism A rather significant event has occurred in the last few weeks or few months, for those that are interested in statistics and that is that for the first time since the records after World War II indicate—and I don t know what they were before that—the net interest is a larger share of our national income than profits Now, I've used the word profits Profits are the basis for whatever we have today It's a very striking fact to think of that for the first time since 1946, net interest is a bigger portion of our national income than the profits that the corporations and partnerships and individual businesses earn in the first quarter of this year. If you look at these curves, you see a very, very marked decline in this ratio of profit to overall net income And what does that tell a businessman? It tells him that the thing to be is a lender and not a borrower and an investor

Q: You will be moving the budget in a direction of restraint very substantially with these changes for several years, starting from a point at which the economy is very deep in recession. Should you offset that restraint with an easier money policy—is that part of your proposal?

Peter G. Peterson: The question, and I want to be sure Bill Simon hears this in London, the question is that clearly the thrust of our program is on the side of restraining expenditures at a time when the economy is already in a soft situation Does our program contemplate some easing on the monetary side to compensate in some way for the deflationary effects of the spending cuts? Let's see if I speak for the group I think our group would probably be unanimous that an easing of monetary policy at this time would be inappropriate Among other things, it would send out a signal that is directly contrary to one of our basic purposes here which is to reduce inflationary expectations I think we also feel that if these fiscal measures are taken and the interest rates do indeed come down, particularly if we strike at the heart of the fiscal problem, that monetary policy will tend to come into better balance with fiscal policy Therefore I think the group as a whole would think it is inappropriate at this time and counterproductive to ease monetary policy The people are nodding, I think they're nodding yes John Connally, did you want to elaborate on that?

John B. Connally: I want to elaborate only to the extent that we think, I at least think, it's inappropriate because we don't think you can sustain it Now I think we desperately need lower interest rates in this country, but to insist now that the Fed merely lower interest rates, not withstanding the failure of the Congress to deal with the fiscal policies, is going to be a short-lived experience in my judgment and then interest rates will be higher than ever and I think it will be an abortive thing and ultimately very, very destructive So, don't let us confuse you We're all for bringing interest rates down in this country We just don't think now is the appropriate time to do it through monetary easing because you can't sustain it

Peter G. Peterson: I would like to just add a comment on interest rates I think all of us would agree that if too much of the focus of this meeting was on 1983 and 1983 deficits and so forth we would have failed in our fundamental mission As Joe Fowler pointed out, investment requires long-term interest rates on a much happier road than they are on now Wall Street, Joe, has been much maligned for many things. But the numbers that we've presented today on future spending patterns out into 1985 are not secrets to the sophisticated people of this country Therefore, it is my view and I think your view at least from Wall Street, that until the credible, structural, big longer term spending reductions are seen, out there in the out years, which does require doing something about these major entitlement programs, you're not going to see the long-term confidence to really bring long-term interest rates down which will bring investment up Do you agree with that, Joe?

Henry H. Fowler: Yeh

Q: How did your group get organized and reach agreement on proposals?

Peter G Peterson. The question is how did our group get organized and reach agreement on proposals Well we're dealing here with a group that sees each other in a variety of contexts I guess originally, Mike, you and I serve on a board together and we started talking about the seriousness of our economic problems We found that in spite of the fact that we're in different political parties that we had a common sense of the seriousness of the problem and at least a few basic directions that the solution had to take We drafted a statement at my place and Mike reviewed it The product seemed like something that was acceptable to him We then broadened the group to include other Secretaries of Treasury. Everyone had, I suppose, particular areas of interest, and particular areas where each was willing to compromise Joe, I recall a long discussion with you in which you as co-chairman of the Committee on the Present Danger, you had a very significant interest in the defense area We had a similar conversation with Doug Dillon who's in a similar role I think, John Connally, you and I never discussed this in person We discussed most of it over the phone in several discussions And I don't want to suggest for a moment that this was a particularly difficult exercise It would be easy to dramatize it What was remarkable, I think, was that a group from this many different orientations could rather quickly agree in a matter of only two or three weeks

Henry H. Fowler: I'd like to just add a footnote to what our Chairman has said here today If I heard him correctly, then I disagree with him on one point, namely, that it's difficult to get this group together on a program of this sort Ex-Secretaries of the Treasury have become accustomed to being national hair shirts They have developed a habit pattern of telling people to do what they don't want to do, and not to do what they want to do So, we weren't very hard to recruit on a sensible well-knit program of this sort

Peter G. Peterson: Joe, I think I said that it was not very difficult and am not going to dramitize it at all After all we got together in 2-3 weeks

Q: Did your group attempt to meet with President Reagan?

Peter G. Peterson: No, there was not an attempt to meet with President Reagan This is a bi partisan effort We of course, have informed the Executive and Congressional branches about our activity We hope as I've indicated, to meet with anybody in the Administration that would like to meet with us But in the spirit of the bi-partisan proposal, we thought it was essential that we come up with our view within the group first But we would be happy, obviously, to consult with the President or anyone he designates As I indicated, we are going to see Secretary Don Regan now I suspect that both the President and Don Regan would share many of the goals, at least, that we have in this group

Q: Two questions Was there anybody that you approached who didn't feel they could sign on to this effort, and secondly, what specific kinds of signs, if any, are you looking for from your meetings today to see if this idea is catching on?

Peter G. Peterson: We did not have any turndowns of anyone that was asked In the spirit of candor, since it's a question that's logical, one might say, what about the presence of George Shultz? George Shultz is a good friend, I know, of all of ours and someone we respect enormously It was our net judgment that George as Chairman of the President's

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Economic Policy Board, as someone who is now involved in an enormously important mission abroad for the President, would understandably find it very difficult to join any group of this type at this point We felt it was not appropriate, therefore, to ask him Bill Miller has been in China Nobody turned us down that we approached, which I think is in itself very significant

Q: Have you thought of approaching the three living ex-Presidents?

Peter G. Peterson: The question is how do we feel about approaching the three living ex-Presidents I would have to say that's an idea that we haven t discussed but it might be a good one And as we reach out, I believe the cliche is outreach, I think that's probably something we ought to think about

John B. Connally: I think they have all personally and privately expressed their own views, some not incompatible with the views that we express here today I notice recently former President Ford talked about defense cuts certainly said that that should not be an untouchable and other Presidents I think have taken similar views, but I think it's an excellent idea

Q: You seem to be coming into this budget game in about the ninth inning or eighth inning, maybe Why did it take you so long, because it was evident pretty early that the budget stalemate existed somewhere a few days after the budget was presented in February?

Peter G. Peterson: The question is why did we come in the eighth inning when it's been obvious for some time that there might be a stalemate Would I reflect the views of the group of at least questioning whether it is the eighth inning Let's start with that assumption We aren't even past the budget reconciliation process and no one knows when that will happen there Thereafter, there's an enormous amount of work that needs to be done to come up with the particular spending proposals and tax changes Furthermore, we are certainly not talking about just this year. The theme of what we're talking about is programs for '84, '85 and beyond Ladies and gentlemen, I suspect we're going to be at this for some time because the magnitude of this assignment, its long term nature and its political difficulty are not going to be overcome in the next few months So I would say we're not in the eighth inning Anybody else want to add anything to that? Next question

Q: To pick up on that What do the '83 budget and budget resolutions have to look like to fit into your long-term goals?

Peter G. Peterson: Well, I think we can indicate what we'd like them to look like We'd like them to look like roughly like something we talked about there in which each of the three major areas are met head on The entitlement programs, the defense area and the tax areas

Q: The proposals that are now on the House floor, this week, none of them come close to your proposal They all contain these numbers that you suggested are really not credible in your view. The Senate has passed a budget resolution that also contains those alleged non-credible numbers, and the Administration has ignored that What specifically will you be asking Speaker O'Neill and Senator Baker today to do this week? Are you writing off this year's budget resolution and looking to fiscal '84 for next year's process?

Peter G. Peterson: No, we're not, we're certainly not writing it off because it is step one of an important process. There's an enormous amount of work to be done after that and there is still the question of the specific implementing of the appropriation and tax bills in the future No, we're certainly not writing them off We're going to do everything we can to try to encourage a credible fiscal package as soon as possible whether it's this month, next month or early '83 or whenever it is, that conforms generally to the matrix that we've presented there

Henry H. Fowler: On this question of lateness, you also ought to have in mind that I think it's my understanding at least that the ultimate budget resolution for the fiscal year 1983, which is the one being milled about now on both sides of the aisle will come to a conference between the Budget Committee of the Senate and the Budget Committee of the House And all of us that have been around this town know that a great deal can happen in a conference and sometimes a great deal constructive can happen in a conference and I recall Revenue Production Act of 1968 was actually became a reality because of action in a conference The Senate passed a very meaningful bill to increase, add, surtaxes to the tune of 10% and to reduce budget expenditures for the fiscal year coming up to the tune of about $6 or $7 billion, which was a meaningful amount at that time. That had not been in the House legislation at all, but there was a minor bill which had passed the House The conference on those two measures resulted in the Revenue Production Act of 1968 which gave us our last surplus in the budget for the fiscal year beginning July 1 of 1968

Q: Are you suggesting, for example, that if the House and the Senate, if neither side contains any language on Social Security, the Congress could nevertheless put that in?

Henry H. Fowler: Well I'm not going to take the role here today of being an expert on what procedures are that can be followed but I can assure you that resourceful men dealing with this kind of a problem on the Hill could resolve a 1983 budget resolution and action therefrom along the lines we've indicated here It's not too late for that

W. Michael Blumenthal: Could I just add it's not only the conference on the budget It's also the appropriations actions thereafter which provide opportunities certainly in these actions The committees could go further if they wish. Moreover after that process, there are going to have to be other budget resolutions looking beyond '82, so I think the whole thrust of what we have been saying is to emphasize the fact that this is the beginning and must be the beginning of a process and that it is not definitive in and of itself for determining the course of the economy over the next several years

Q: In terms of education, how are you going to go about convincing the politicians and people that whatever fiscal or financial accident that you can see ahead is more serious than the threat of having Social Security cut?

Peter G. Peterson: Well, we have some of the more effective political leaders in the country on this group

Henry H. Fowler: If I were to answer your question, if anybody asked me for an answer, and I doubt that they will because I never run for office, therefore I'm not an expert I'd have to refer to John on that I got the feeling that somewhere along the line, somebody's going to begin to think about the role of being incumbents, whether they are a Republican incumbent or a Democrat incumbent, it would seem to me that this is an election year, where an incumbent who comes in without a very, very solid record of trying to do something along the lines we've indicated here, may be a sitting duck for a good active opponent

Q: Basically, what do you see as the concrete threat to the people, in the minds of most Americans, failing a Social Security cut? What's going to happen if Social Security is not cut? It's that simple

Peter G. Peterson: I think there are two ways of looking at it One, to look at it in terms of what would happen if the changes were to be made and John, you're probably better equipped than the rest of us to speak to this point, but I would like to suggest that there's the other side to the equation What would happen in this country if the 3½ times as many people who are contributors, if the young people of this country who are going to have to pay these taxes and risk seriously not getting their money out of Social Security, if the literally millions of Americans who up to now have been relatively uninformed, relatively uninvolved, relatively not in the political process, were to learn more about this situation On a personal basis, and I don't know the experience of my colleagues here, but when I review some of these facts with many Americans that I talk to, I find many of them are shocked For example, there is the common view that Social Security is my money and I am simply getting my money back When people hear that they're getting their money back in a year, or a year and a half, most of them are very, very surprised What we didn t indicate today is that even if you include interest and the company contributions most people are getting ''their'' Social Security money back in three to six years Now the obvious implication of that is that those who are paying these taxes are going to have to pay enormous taxes in the future to support this system I think getting that story across, getting the tax paying non-recipients involved in this political process, is inevitably part of the political solution

Finally, I do not want to disparage the recipients Again, I don't know what the experience is here But I've talked to many recipients of these programs who really have not understood the facts, who really did think they were getting only their money back and that they indeed did have that kind of contract, they wrongly felt that the only alternative would be instant slashes rather than gradual reductions in the growth of benefits and eligible ages None of us are here to suggest it's easy, it's going to be an extemely difficult assignment But we have no alternative

Thank you very much for this opportunity to talk with you

A BI-PARTISAN APPEAL TO THE PRESIDENT AND THE CONGRESS OF THE UNITED STATES

Some Proposals to Resolve The Budget Crisis

The Goals

- Put the budget on a multi-year path toward balance
- Reduce the projected deficit by:
  - $75-100 billion in FY 1983
  - $125-150 billion in FY 1984
  - $175-200 billion in FY 1985

Principles for Solution

- Realism
- Speed
- Long-term impact
- Focus on investment
- Fairness

Table 1

Reductions In Spending Growth As A Result Of 1981 Budget Reconciliation Act

	1982	1983
Total–Need Related	**–12.1%**	**–15.1%**
Total–Not Need Related	**– 4.6%**	**– 5.3%**
Entitlements– Need Related (See Table 1a)	-7.3%	-7.6%
Entitlements– Not Need Related	-2.8%	-2.7%
Other Benefit Payments– Need Related	-8.1%	-11.6%
Other Benefit Payments– Not Need Related	-2.4%	-5.2%
Other Non-Defense Programs– Need Related (See Table 1b)	-32.7%	-41.6%
Other Non-Defense Programs– Not Need Related	-7.7%	-9.7%

*Need related programs are defined as those for which a majority of the funds are distributed on the basis of some test of need or current income.

Source: Congressional Budget Office
Federal Reserve Bank of New York

Table 1a
Benefits Payments to Individuals
Change to Current Policy baseline* in 1981 Reconciliation Act
(By fiscal year, in millions of dollars)

	1982		1983	
Entitlements	Baseline	Change	Baseline	Change
Need Related				
Medicaid	18,016	-932	17,914	-912
Child Nutrition	4,032	-1,370	4,439	-1,471
Funds for strengthening markets	377	-	384	-
Women, Infants, Children	949	+16	1,081	+3
Aid to Families with Dependant Children	8,588	-1,158	8,956	-1,398
Supplemental Security Income	8,238	+150	8,689	+242
Earned Income Tax Credit	1,115	-	1,031	-
Veterans Administration pensions	3,937	-	4,109	-
Subtotal, need related	45,252	-3,294	46,603	-3,536
Percent change	-7.3%		-7.6%	
Not need related				
Social security and railroad retirement	164,566	-2,398	182,516	-4,108
Military retirement	15,470	-431	16,948	-363
Civil service retirement	20,025	-544	22,217	-416
Workmens compensation	344	-	389	-
Other Government retirement	554	-	612	-
Veterans Administration service connected compensation	9,541	-	10,452	-
Unemployment compensation	21,466	-2,778	19,015	-1,537
Medicare	48,297	-1,486	55,069	-1,122
Student Loan Insurance	3,277	-323	3,955	-766
Veterans education	2,027	-23	1,729	-28
Coal miners, special benefits	1,101	-	1,143	-
Black Lung Disability	785	-	650	-
Workmens Compensation	19	-	20	-
Veterans Administration burial benefits	193	-75	202	-80
National Service Life insurance	1,063	-	1,134	-
US Government Life Insurance	63	-	58	-
Subtotal, not need related	288,791	-8,058	316,109	-8,420
Percent change	-2.8%		-2.7%	
Not Entitlements				
Need Related				
Subsidized housing	6,984	-116	8,196	-335
Low-income housing	1,129	+135	1,279	+284
Other housing	143	-13	146	-20
Food Stamps	11,736	-1,708	12,031	-2,096
Special Milk	124	-103	130	-96
Food Donations	143	-	152	-
Refugee Assistance	784	-27	699	-68
Low income energy assistance	2,247	-372	2,547	-672
Student Assistance (Higher Education)	4,600	-54	4,553	-432
Subtotal, need related	27,890	-2,258	29,733	-3,437
Percent change	- 8.1%		-11.6%	

* Baseline as of August 1981. This was the CBO estimate of what spending in 1982 and 1983 would be without any changes to laws and policies in effect at that time. The change columns reflect CBO's estimate of the effect of the Reconciliation Act of 1981, Public Law 97-35.

Source: Congressional Budget Office
Federal Reserve Bank of New York

Table 1a (continued)

	1982		1983	
	Baseline	Change	Baseline	Change
Not need related				
Indian Health service	633	-	665	-
Indian Health Facilities	82	-	90	-
Health Services	1,334	-169	1,441	-365
St. Elizabeth's Hospital	100	-	104	-
Construction St. Elizabeth's Hospital	10	-	1	-
Alcohol, Drug Abuse, Mental Health Administration	720	-67	760	-174
Veterans medical care	6,973	-18	7,186	-19
Veterans construction-major	356	-	641	-
Veterans construction-minor	93	-	125	-
Other	1,260	-29	1,197	-80
Subtotal, not need related	11,561	-283	12,210	-638
Percent change	-2.4%		-5.2%	
Grand Total, Benefit Payments	373,494	-13,893	404,655	-16,031
Percent change	-3.7%		-4.0%	

Source: Congressional Budget Office
Federal Reserve Bank of New York

Table 1b
Other Changes in 1981
Reconciliation Act
(By fiscal year, in millions of dollars)

	1982		1983	
	Baseline*	Change	Baseline*	Change
Need related				
Aid to Disadvantaged Students	3,475	-38	3,810	-689
Temporary Employment	1,118	-1,092	1,209	-1,209
Employment Training Assistance	8,338	-3,407	8,959	-4,488
Grants to States for social services	3,085	-699	3,198	-755
Subtotal, need related	16,016	-5,236	17,176	-7,141
Percent change	-32.7%		-41.6%	
Not need related				
Non-defense purchases, grants, subsidies	180,852	-13,985	186,584	-18,107
Percent change	-7.7%		-9.7%	

*Baseline as of August, 1981

Source: Congressional Budget Office
Federal Reserve Bank of New York

Table 2

Federal Spending Projections Under Current Spending Programs

	1981 Actual		1982 Estimate	1983 Projection	1985 Projection	
National defense 1/	$146.0B	(22.2%)	$175.8B	$207.7B	$278.0B	(27.5%)
Benefit payments for individuals (See Table 2a)						
Need related	66.9	(10.2%)	68.4	75.0	87.0	(8.6%)
Not need related	263.4	(40.1%)	299.3	325.7	385.5	(38.1%)
Sub-Total	330.3	(50.3%)	367.7	400.7	472.5	(46.7%)
Grants to state and local governments 2/ (See Table 2b)	54.8	(8.3%)	49.8	49.7	53.2	(5.3%)
Other federal operations (See Table 2c)	57.4	(8.7%)	63.1	60.3	61.7	(6.1%)
Net interest	68.7	(10.5%)	86.0	108.6	147.1	(14.5%)
Total	657.2	(100.0%)	742.3	827.0	1,012.8	(100.0%)

Source: Congressional Budget Office
Federal Reserve Bank of New York

1/ Excludes payments to defense military retirees, which are considered part of benefit payments to individuals.

2/ Excludes grants to state and local governments for benefit payments to individuals (such as medicaid) which are included in the benefit payments category.

*Projections assume no change in current tax laws and a continuation in current spending policies. For spending, this means no changes in current laws for entitlements (other than those already enacted in the 1981 reconciliation Act), a maintenance of real purchasing power for discretionary nondefense programs, and the President's February, 1982 program for national defense.

Table 2a

Benefits Payments to Individuals
Baseline Projections Under Current Policies
(By fiscal year, in millions of dollars)

	Actual	Estimate	Projection	
Entitlements	1981	1982	1983	1985
Need Related				
Medicaid	16,833	17,874	20,082	25,132
Child Nutrition	3,438	3,020	3,286	3,974
Funds for strengthening markets	290	365	365	365
Women, Infants, Children	930	980	1,025	1,141
Aid to Families with Dependant Children	8,503	8,073	8,294	8,977
Supplemental Security Income	7,192	7,983	9,071	9,479
Earned Income Tax Credit	1,318	1,252	1,213	1,081
Veterans Administration pensions	3,755	3,607	3,490	3,420
Subtotal, need related	42,259	43,154	46,826	53,569
Not need related				
Social security and railroad retirement	143,500	161,318	177,020	208,024
Military retirement	13,729	15,037	16,464	19,411
Civil service retirement	17,694	19,776	21,914	26,748
Workmens compensation	238	345	394	472
Other Government retirement	498	588	664	799
Veterans Administration service connected compensation	8,426	9,452	10,373	12,083
Unemployment compensation	18,356	23,668	21,257	19,376
Medicare	42,489	49,748	58,191	78,088
Student Loan Insurance	2,259	3,068	3,720	3,608
Veterans education	2,395	2,045	1,596	1,047
Coal miners, special benefits	1,091	1,095	1,115	1,151
Black Lung Disability	680	745	674	684
Workmens Compensation	17	15	16	19
Veterans Administration burial benefits	208	164	147	164
National Service Life insurance	965	964	1,027	1,108
US Government Life Insurance	70	63	58	51
Subtotal	252,615	288,091	314,630	372,833
Not Entitlements				
Need Related				
Subsidized housing	5,747	6,772	8,220	10,698
Low-income housing	929	1,261	1,267	1,801
Other housing	99	130	87	89
Food Stamps	11,253	11,489	12,543	13,926
Special Milk	104	29	30	36
Food Donations	104	137	147	162
Refugee Assistance	726	503	578	669
Low income energy assistance	1,734	1,752	1,878	2,255
Student Assistance (Higher Education)	3,906	3,163	3,418	3,843
Subtotal, need related	24,602	25,236	28,168	33,479

Source: Congressional Budget Office
Federal Reserve Bank of New York

Table 2a (continued)

Not need related	Actual 1981	Estimate 1982	Projection 1983	Projection 1985
Indian Health service	590	597	620	674
Indian Health Facilities	90	84	57	54
Health Services	1,298	1,270	1,054	1,126
St. Elizabeth's Hospital	179	93	96	98
Construction St. Elizabeth's Hospital	5	10	10	10
Alcohol, Drug Abuse, Mental Health Administration	712	539	467	501
Veterans medical care	6,320	6,929	7,175	7,676
Veterans construction major	308	296	315	408
Veterans construction minor	96	93	113	116
Other	1,226	1,260	1,197	1,979
Subtotal	10,844	11,171	11,104	12,642
Grand Total	330,320	367,652	400,728	472,523

Source: Congressional Budget Office
Federal Reserve Bank of New York

Table 2b
Federal Grants-in-Aid to State and
Local Governments[1/]
Baseline Projections Under Current Policies
(By fiscal year, in millions of dollars)

	Actual 1981	Estimate 1982	Projection 1983	1985
Need Related				
Compensatory Education for the Disadvantaged	3,345	2,808	2,774	3,362
Social Service Block Grants	2,646	2,748	2,826	3,113
Temporary Employment Assistance	852	26	0	0
Employment and Training Assistance	5,926	3,290	3,189	3,550
Subtotal, need related	12,769	8,872	8,789	10,025
Not Need Related				
Federal-aid Highways Trust Fund	8,641	7,871	7,906	9,194
State and Local Government Fiscal	5,137	4,573	4,573	5,210
Community Development Grants	4,042	4,128	3,739	3,782
Environmental Protection Agency Construction Grants	3,881	4,030	3,740	2,940
Urban Mass Transportation	3,741	3,803	4,084	4,128
Services to Selected Groups	2,707	2,107	2,228	2,520
Education for the Handicapped	1,023	1,024	1,034	1,134
Unemployment Trust Fund: Training and Employment	730	617	666	769
Vocational Adult Education	723	804	748	840
Impact Aid, School Assistance in Federally Affected Areas	683	500	465	504
Community Services Administration	576	262	0	0
Energy Conservation	480	478	377	322
Airport and Airway Trust Fund	469	482	484	495
Bureau of Land Management Permanent Appropriations	436	646	704	851
Commodity Credit Corporation	409	817	398	285
Economic Development Assistance Payments	408	334	189	228
Urban Development Action Grants	371	500	575	528
Work Incentives, Health and Human Services	368	232	250	288
Federal Payment to the District of Columbia	365	402	434	501
Funds Appropriated to the President: Appalachian Regional Development Programs	329	330	268	230
Law Enforcement Assistance	307	213	84	80
Extension Service, Department of Agriculture	301	310	308	304
Environmental Protection Agency: Abatement, Control and Compliance	300	254	215	214
Forest Service Permanent Appropriations	241	232	269	334
Internal Revenue Collections for Puerto Rico	240	245	259	296
All Other (miscellaneous grant programs less than $300 million)	5,123	5,734	6,914	7,198
Subtotal, not need related	42,031	40,928	40,911	43,175
Grand Total	54,800	49,800	49,700	53,200

1. Does not include grants that are used for benefit payments to individuals (for example, medicaid).

Source. Congressional Budget Office
Federal Reserve Bank of New York

Table 2c
Other Federal Operations
Baselines Projections Under Current Policies
(By fiscal year, in billions of dollars)

	Actual	Estimate	Projections	
	1981	1982	1983	1985
Civilian agency pay	28.0	29.5	31.8	36.5
Commodity Credit Corporation	4.1	11.2	7.4	4.1
International Affairs	11.1	11.1	12.0	13.0
Other	14.2	11.3	9.1	8.1
Total	57.4	63.1	60.3	61.7

Source: Congressional Budget Office
Federal Reserve Bank of New York

Must address head-on each of the 3 major sources of runaway deficits.

	1985 Deficit Reduction Target
1. Entitlements and other non-defense programs	$ 60B
2. Defense	25B
3 Taxes	60B
These 3 areas of deficit reduction would lower the Federal interest costs by	30-55B
Total 1985 Reduction:	**$175-200B**

1. Entitlements and Other Non-Defense Programs

1985 Deficit Reduction Target
$60B

- 1 year freeze on cost of living adjustments for major entitlement programs
  (Social Security, Civil Service, (Military, Veterans, etc.)
- Cap on indexing thereafter
- Similar restraint—other programs not essential to needy

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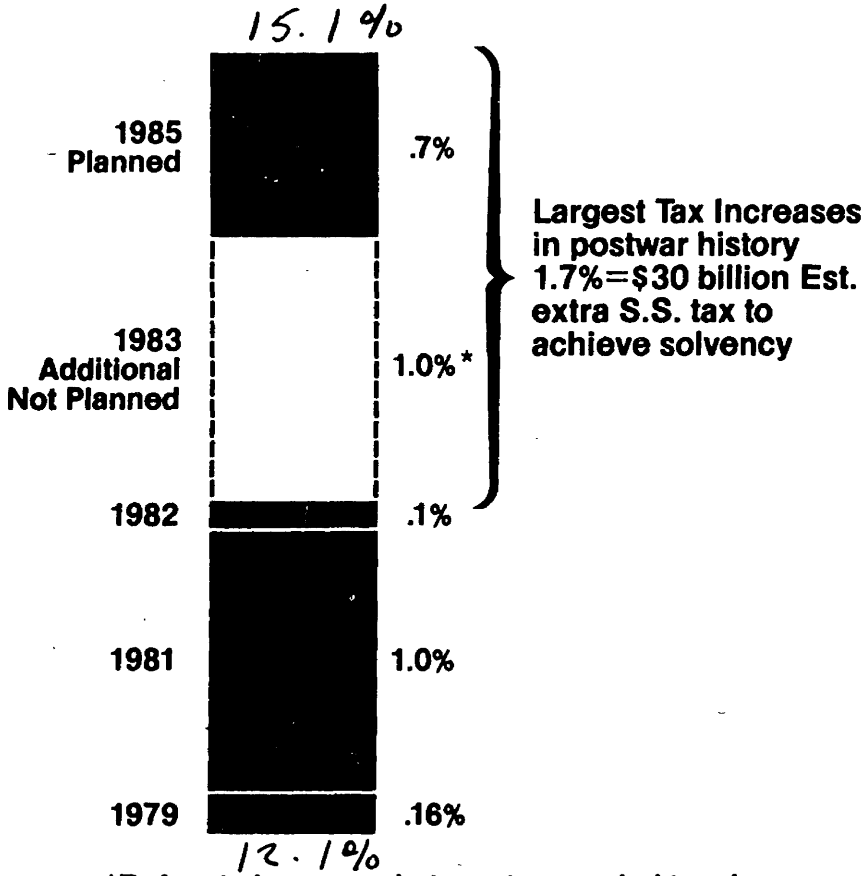
Tax Increases Needed If Social Security Solvency Is Achieved By Tax Rate Increases



*Refers to increases in tax rates needed to raise $40 billion in revenues by 1985–$6 billion in 1983, $17 billion in 1984 and in 1985–figures originally reported by the Senate Budget Committee as the solvency requirement.

SOME INTERESTING QUESTIONS AND ANSWERS ABOUT SOCIAL SECURITY

- Within what time period will current retirees, on average, receive social security benefits equal to their total contributions? Answer: Single person -- 1½ years. Average wage earner with a homemaker spouse -- 11 months.*

- The life expectancy of a person age 65 in 1940 was 12.8 years. How many years can a person now age 65 expect to live? Answer: 16.6 years.

- In 1930, 4 percent of the people were over 65. What is the percent today? Answer: 11 percent (about 25 million people).

  What is the percent likely to be in the year 2030? Answer: 20 percent (about 65 million people).

- In 1950, 16.5 workers supported each social security beneficiary. How many workers now support each beneficiary? Answer: 3.2 workers.

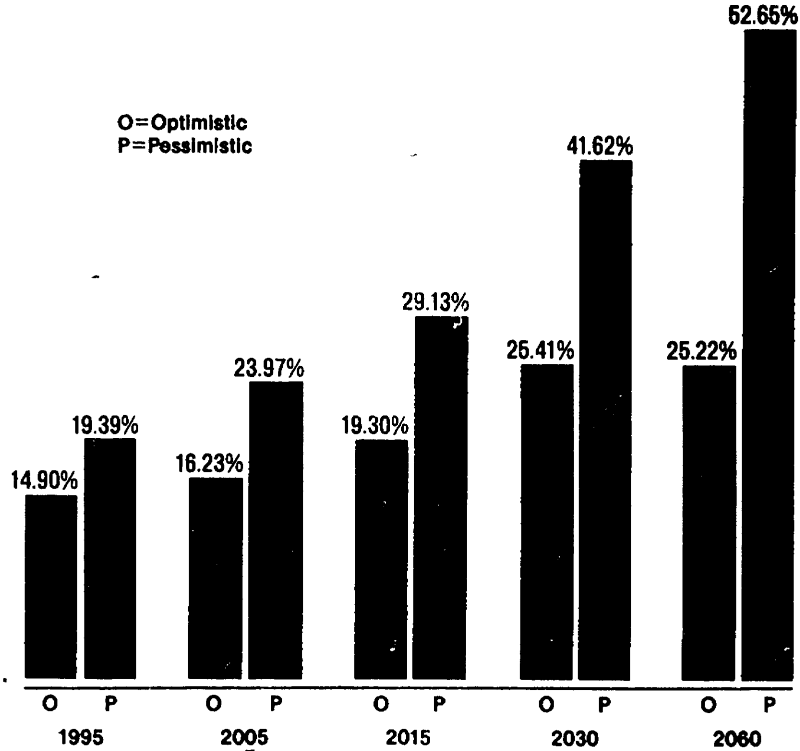
- During the past three years, average wages increased by 30% (before taxes). During this period, by what percent did social security benefits increase? Answer: 40 percent (after taxes, of course).

- Social security payments in fiscal year 1982 represent how much of the federal budget? Answer: 28 percent or over $200 billion.

*(The maximum taxes that could have been paid by someone who participated in the program from the beginning in 1937 through 1981 would be $14,767 and his first year benefit, if he had a spouse, would be $14,206.)

The Long Term Problem

Projected Social Security Tax Rates Needed To Retain Solvency If Benefits Not Reduced



(See Table 3 for further information.)

Source: Social Security Administration
Federal Reserve Bank of New York

Table 3 1/
Projectei Combined Social Security Tax Rates
"The Long Term Problem"

	Optimistic 2/	Pessimistic 3/
1995	14.90%	19.39%
2005	16.23	23.97
2015*	19.30	29.13
2030*	25.41	41.62
2060*	25.22	52.65

1. Tax rates refer to the combined employer-employee contribution needed to maintain trust fund solvency without a change in current laws for benefits

2. This refers to alternative II-A in the 1982 Social Security Trustees Annual Report. Real GNP growth is assumed to average between 4 and 5 percent annually in 1983-1990, tapering down to 3 percent by 2000 and remaining at that level thereafter. Inflation is assumed to average about 5 percent per year through 1985, and to taper down to 3 percent by 2000 and thereafter. (The most optimistic alternative, alternative I, assumes even more real growth and less inflation).

3. This refers to alternative III-A in the 1982 Social Security Trustees Annual Report. Real GNP growth is assumed to average between 2.5 and 3.0 percent, tapering down to about 2 percent by 2000 and remaining at that level thereafter. Inflation is assumed to average about 8.5 percent in 1983-1990 and to taper down to 5.0 percent by the year 2000 and thereafter. For this alternative, less optimistic demographic assumptions (lower fertility and mortality rates) are also assumed.

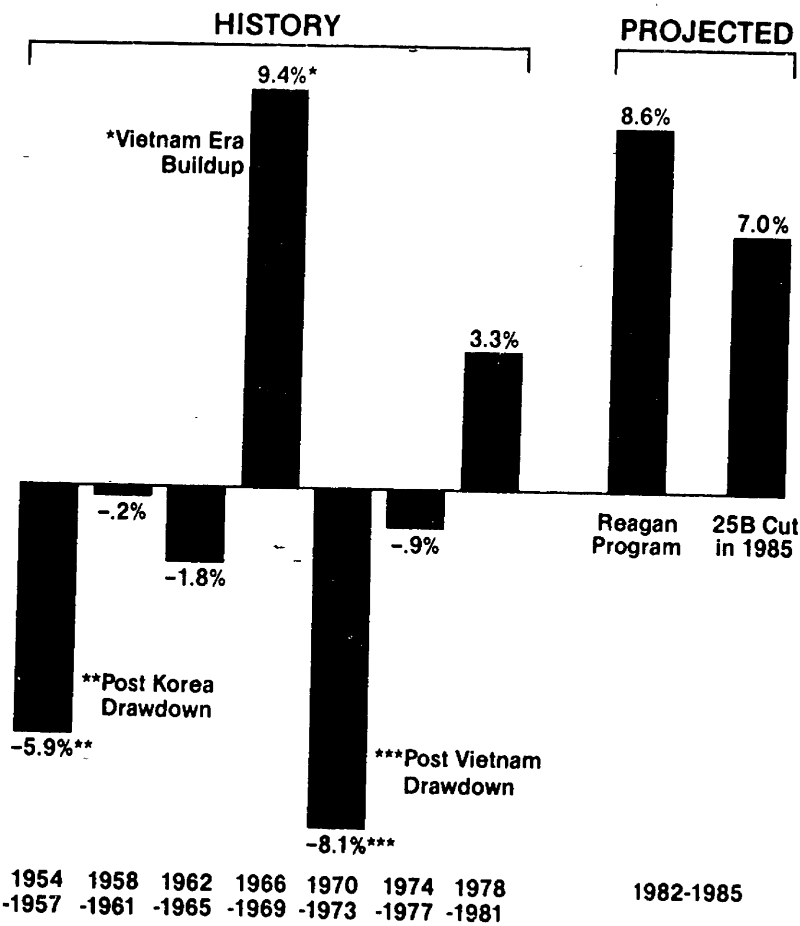
* Tax rates for the Hospital Insurance (HI) are not available for years after 2005. For this analysis, the assumption was made that the tax rate for HI would have to rise after 2005 at the same speed as the tax rates for Old Age and Survivors Insurance (OASI).

Source: Social Security Administration
1982 Annual Trustees Report April, 1982

1985 Deficit
Reduction
Target
$25B

2. Defense

Real Growth in Defense
(Average Annual Rate)



(See Table 4 for further information.)

Source: Office of Management and Budget
Congressional Budget Office
Federal Reserve Bank of New York

Table 4
The Meaning of a
$25 Billion Cut in Defense

	Real Growth %
Real growth (1982-1985 average) -- Reagan February, 1982 proposal (Assuming CBO estimate of 7.0% average inflation*)	8.6%
Real growth (1982-1985) with $25 billion cut in 1985	
with 7.0% inflation average	7.0%
with 5.0% inflation average	8.5%
with 6.0% inflation average	7.9%
with 8.0% inflation average	6.6%

*Inflation measures cited are the GNP deflator average annual rate of growth. Computations for defense real growth assume that the defense purchase inflation rate will exceed the GNP deflator growth rate by 0.5-1.0 percentage points per year.

Source: Congressional Budget Office
Federal Reserve Bank of New York

3. Taxes — 1985 Deficit Reduction Target $60B

- **Energy Taxes**
  (e.g., imported oil, gasoline tax, decontrol of natural gas-windfall profits)
- **Excise Taxes**
  (e.g., alcohol, tobacco)
- **Corporate Taxes**
  (e.g., modify safe-harbor leasing)
- **User Fees**
- **1983 Income Tax Cut**
  (Modify, delay, or stretch out)

(See Table 5 for further information.)

Table 5

Potential Tax Increase Options

(By fiscal years, in billions of dollars)

	1983	1984	1985
Energy Taxes			
$5/barrel oil import fee (10¢ per gallon increase in gasoline prices)	8.6	12.2	11.6
Gasoline tax (increase from 4¢ per gallon to 25¢ per gallon)	14.4	21.3	20.6
Natural gas decontrol and 50% windfall profit tax 1/	3.0	10.0	8.0
Excise Taxes			
(Double taxes on beer, wine, distilled spirits and tobacco)	3.8	5.4	5.8
User Fees	2.0	2.0	2.0
Modify Safe-Harbor Leasing 2/	0.3	0.5	0.7
1983 Income Tax			
Eliminate July 1, 1983 cut	7.5	32.9	35.9
Eliminate July 1, 1983 cut and indexing	7.5	32.9	46.8
Substitute indexing for July 1, 1983 cut	4.2	12.7	12.3
Reduce July 1, 1983 cut to 5%	3.9	16.4	17.8
Reduce July 1, 1983 cut to 5% and postpone to October 1, 1983	7.5	16.4	17.8
Delay July 1, 1983 cut by 3 months	7.0	0.6	—
Delay July 1, 1983 cut by 6 months	7.5	7.3	—
4% surcharge ($40,000 starting point)	4.0	5.0	5.0

1/ Tax is applied to the difference between prices projected under current law and prices projected under decontrol. Assumed rate is 50%.

2/ This might include limiting the amount of current year liability that leasing can offset, not allowing leasing to be used to offset prior year tax liabilities, and setting limits on the combined reductions on tax liabilities from leasing and foreign tax credits.

Source: Joint Committee on Taxation
Senate Committee on the Budget
Federal Reserve Bank of New York

TABLE 6

Comparison of Alternative Proposals

1985 Deficit Reductions

	Senate		House Budget Committee (Democrats)		House (Republicans)		Bi-Partisan Appeal	
Defense	18		31		18		25	
Entitlements and other Non-Defense Programs	39		26		47		60	
—COLA's	6		3		3		25-35	
—Pay (Civilian Agencies)	5		3		3			
—Other	28	33	20	23	41	44		25-35
Management Savings and Miscellaneous Reductions	12		16		17		0	
Tax Increases	45		68		43		60	
Interest on the Debt	54		57		54		30-55	
Total 1985 Deficit Reductions	168		198		179		175-200	

Source: House Committee on the Budget
Senate Committee on the Budget
Federal Reserve Bank of New York

[From the New York Times, May 24, 1982]

SIX EX-CABINET OFFICERS OUTLINE BIPARTISAN PLAN TO CUT DEFICIT

(By Jonathan Fuerbringer)

WASHINGTON, May 23.—A bipartisan group of former top economic officials plan to outline a program of sharp Federal spending cuts and large tax increases to slash projected budget deficits over the next three years.

The six-man group says it is concerned that neither Congress nor the Administration is considering programs strong enough to bring Federal deficits under control.

They said that, on Monday, they would propose cuts in entitlement programs for middle- and upper-income people, including Social Security, while stopping or slowing the reductions in programs for the poor. Both Congress and the Administration have dropped consideration of Social Security cuts this year.

The group consists of five former Treasury Secretaries and a former Commerce Secretary who served in administrations from President Kennedy through President Carter. It said it could support, under certain conditions, a delay or modification of the third year of President Reagan's income tax cut for individuals. The President and the Senate have rejected any change in the third year of the tax cut. The group also said it wanted to raise much of its proposed revenue through energy taxes.

The spending cuts and new tax revenue could reduce the deficits through 1985 by $375 billion to $450 billion.

The group, which includes officials who normally would have sharply differing views, was brought together by Peter G. Peterson, a Secretary of Commerce in the Nixon Administration. The five former Treasury Secretaries are C. Douglas Dillon, from the Kennedy and Johnson Administrations; Henry H. Fowler, from the Johnson Administration; John B. Connally, from the Nixon Administration; William E. Simon, from the Ford Administration, and W. Michael Blumenthal, from the Carter Administration.

"I think the economy in general and what is going on in Congress is very worrisome," said Mr. Blumenthal in an interview today, explaining why he joined the group. "Everyone is being very political," he added, because of the refusal to cut Social Security and to trim the President's tax cuts.

Mr. Blumenthal said that the proposals he sees developing in Congress "are not good enough" and will not result in a sharp drop in interest rates. The agreement among the group, he added, is aimed at saying: "Don't fool the American people. Be realistic. Bite the bullet."

He said the deficits now projected for 1983 were about $110 billion—even with tax increases and spending cuts—and were too high. The group wants the 1983 deficit under $100 billion. The 1985 deficit, if its program were carried out, would be between $30 billion and $60 billion, instead of the currently proposed figure of about $233 billion.

The six officials are especially concerned about the loss of new investment in plant and equipment because of the continued high level of interest rates and the sluggish performance of the economy.

In addition to immediate action on cutting the budget, the group calls for Congress and the Administration, after the election next fall, to restructure the Social Security system to assure its long-term soundness, to design a new system of multiyear budget controls and to consider moving to a consumption-based tax.

The budget proposals now being considered in the House and the Senate, said Mr. Peterson in an interview today, "still appear to be avoiding most of the big middle- and upper-income entitlement programs."

The overall program is slightly larger than the proposals now being considered in the House and the Senate. The top three-year total for deficit reductions in the group's plan is $450 billion. The Senate-approved budget resolution and the House Budget Committee plan are just over $400 billion.

But on domestic spending, the group's proposal would cut more than any plan in Congress, assuming a reduction of $60 billion just in the fiscal year 1985 in entitlements and other nondefense programs. The group provided a breakdown only of their aggregate savings for fiscal 1985. Although they provided no figures for reductions in this area for 1983 and 1984, members of the group acknowledged that their proposal cuts more deeply over the three years than plans in Congress would.

According to the group's calculations, the $60 billion is about twice what the House Budget Committee approved and about $13 billion more than the plan put together in the House by Republicans and conservative Democrats.

The key difference is the group's proposal for reducing the cost-of-living increases in Social Security and other programs. Their plan calls for a one-year freeze on increases in Social Security benefits, a move that is opposed by House Democrats. The original Senate Budget Committee program, which was endorsed by President Reagan, included cuts in Social Security benefits, but it was then dropped.

The new plan also calls for a freeze on veterans' benefits, Medicare and civilian and military retirement benefits. After the first year, he proposal would put a limit on cost-of-living increases (such as a 4 percent cap) for Social Security and the other programs. Some of the plans now being considered in Congress would freeze civilian and military retirement benefits and would cut some entitlement programs.

On tax increases, the group's plan is closer to the proposal of the Democrats on the House Budget Committee. By 1985, the plan calls for about $60 billion in tax increases, just slightly less than the Democrats' plan does. The new proposal also suggests that there should be only a delay or modification of the third year of President Reagan's tax cut scheduled for July 1, 1983, if there is first an agreement on the spending cuts in the group's plan.

Among revenue increases suggested by the group are taxes on oil and gasoline, a windfall tax on the decontrol of natural gas, restrictions on the tax-leasing provisions in last year's business tax cut and increases in excise taxes on tobacco and alcohol.

The reductions in military spending would be $25 billion in 1985, which is close to the $31 billion in the House Budget Committee proposal. The reductions in the Senate plan are about $18 billion in 1985.

Unlike the proposals being considered in Congress, the group's plan does not assume any savings from improved management. In addition, it assumes smaller savings from lower interest rates and the cost of Government borrowing.

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THE MACNEIL-LEHRER REPORT

Budget Business

In New York

ROBERT MacNEIL .... Executive Editor
PETER PETERSON .... Former Secretary of Commerce
MICHAEL BLUMENTHAL .... Former Secretary of Treasury

In Washington

JIM LEHRER .... Associate Editor
JOHN CONNALLY .... Former Secretary of Treasury
HENRY FOWLER .... Former Secretary of Treasury

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Videotape courtesy of Independent Network News

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THE MacNEIL-LEHRER REPORT **Air Date:** May 24, 1982

Budget Business

[Tease]

ROBERT MacNEIL *[voice-over]*: As the House of Representatives starts serious debate on rival budgets, senior officials from past administrations called for drastic changes to avert fiscal disaster.

[Titles]

MacNEIL: Good evening. President Reagan and House Speaker O'Neill escalated the war of words over the budget today. Speaker O'Neill called in reporters to accuse the President of breaking a personal commitment to America's senior citizens by supporting cuts in Medicaid funds. The President used a televised news briefing to accuse O'Neill of sheer political demagoguery. This was the backdrop as the House began a week of debate and voting on no less than seven different budget proposals and 68 amendments. The Senate has already passed a budget satisfactory to the President. Mr. Reagan urged House Democrats to support a similar Republican budget in the House to show the Western economic summit in June that the U.S. is committed to get spending under control once and for all. But a far more urgent call came today from an unusual group of six officials from past administrations: five former secretaries of the treasury and one secretary of commerce said the administration and Congress must abandon partisanship and cut deficits more drastically than anyone has yet proposed. Otherwise, they said, the country faced economic chaos and stagnation. Tonight, with four members of the group, the grim warning. Jim?

JIM LEHRER: Robin, the six former officials are unlikely bedfellows, which they conceded and emphasized in their statement today saying, "We the undersigned rarely stand together on political or economic issues." The former secretary of commerce is Peter Peterson of the Nixon administration, and the five former secretaries of the treasury are C. Douglas Dillon from the Kennedy administration; Henry Fowler, who worked for Lyndon Johnson; John Connally, Treasury head under Richard Nixon; William Simon of both the Nixon and Ford administrations; and Michael Blumenthal from the Carter administration. They say the current budget crisis transcends conventional politics and conventional solutions. They want the projected federal deficits cut $75 to $100 billion next year, by at least $125 billion in 1984, and by at least $175 billion in 1985. They want it cut by tackling the politically difficult — entitlement programs such as Social Security and Medicare, defense spending and taxes on middle- and upper-income people, among other things. Four of the six are with us tonight. Mr. Peterson, now chairman of the Wall Street investment firm, Lehman Brothers Kuhn and Loeb; Mr. Blumenthal, now chairman of the Burroughs Corporation; Mr. Connally, a Houston attorney; and Mr. Fowler, a partner in the investment banking firm of Goldman Sachs. Gentlemen, you came together out of a sense of crisis over this budget. How serious is that crisis, Mr. Connally, in your opinion?

JOHN CONNALLY: I think it's extremely serious. No question about it. I think, frankly, the budget's out of control. And I think unless Congress gets hold of the budget again, recaptures control of spending in this country, the crisis is going to widen and deepen.

LEHRER: Do you agree, Mr. Fowler? Do you think it is widened and deepened, and if so, widened and deepened with what results?

HARRY FOWLER: Well, I think it will widen and deepen. I think we've been through a decade in which there has been no real increase in real family income, and in which there has been a declining pattern of national productivity and competitiveness, and now a record rate of unemployment — the greatest since the Great Depression. And that has created an atmosphere in which we can go into a long series of recessions, crippled as we will be by an inability to increase private investment because of the sucking up of the money and credit available by the accelerating pattern of deficits.

LEHRER: Mr. Peterson, I understand you were the moving force behind getting the six of you together. You've called for nonpartisanship. You heard what Robin said, what the news of the day is: the President has said this about Mr. O'Neill, and Mr. O'Neill has responded to all kinds of things. Do you think that's a realistic call, for nonpartisanship on this budget right now?

PETER PETERSON: Well, life is a choice among more or less unpleasant alternatives. If the alternative is no solution and watching another decade of what Joe Fowler just described, and giving away any chance of making the kind of investment in plant equipment, research and development because we're going to use all of that up making up these enormous deficits, I say that's no alternative. So we have to try something different.

LEHRER: Mr. Blumenthal, you have been there most recently of all six of the people in this group. Do you think it's realistic to think that Speaker O'Neill and the President and White House and the Democrats and the Republicans in Congress are now going to take a nonpartisan attitude on this issue?

MICHAEL BLUMENTHAL: I think it's absolutely essential that that be done, and that a process be begun that will certainly have to continue for some time, because we're not only dealing with the budget for 1983, we have to deal with this problem beyond that year in 1984 and 1985. Unless there is a sense of realism, unless the numbers that come out of this next budget resolution, which is very important to pass, and the numbers beyond that can be believed and can be credible to the markets, interest rates won't come down, investment won't occur, productivity can't be increased, and then I think the very serious situation that we're worried about is going to become a reality. So I think it's absolutely essential.

LEHRER: Mr. Connally, before we get to some specifics, you of course are and have been a big supporter of President Reagan. Do you believe that Reaganomics is not going to work or is not working? Is that what you're saying by joining this group?

Mr. CONNALLY: I'm saying that it really can't work so long as interest rates remain as high as they are. With a prime rate of 16½%, the investments are not going to be made to bring about the revival of economic activities the President called for and that we might normally expect from the reduction in taxes. That was the theory and the basis on which he made his proposals to begin with. Now, all of his hopes have been thwarted by high interest, and it's going to continue in my judgment so long as we have these enormous deficits and so long as we do not have a creditable answer for the American people on how we're going to get control of this budget. And as Mr. Blumenthal says, we're not talking about just '83; we're talking about '84, '85, where it really becomes astronomical unless we deal with the three central elements that we're talking about. One is defense, two is entitlements, three is taxes. It's going to have to be a combination of all three of those that ultimately will provide the answer to the problems that we face today.

LEHRER: Mr. Peterson, of course you're on Wall Street, and a major figure on Wall Street; and Wall Street is often mentioned as the place that could and should bring down interest rates if they get the right signal. What signal do they need now from this budget and from this Congress and from this President before anything's going to happen, in your opinion?

Mr. PETERSON: Well, if I had to pick one signal, it would be these massive entitlement programs that are part of what John Connally's talking about — a budget out of control. By 1985 these transfer payment programs that have nothing to do with need will be approaching $400 billion. They've been growing 15% a year for the last 15 to 20 years, and principal among those of course is Social Security as well as other pensions. Social Security is now 28% of the budget, and I think what Wall Street is waiting for is a credible signal that these very important ballooning programs that have been called politically untouchable, that have been called uncontrollable, are going to be touched and controlled. And that signal is the single most important signal, if I had to pick one.

LEHRER: Robin?

MacNEIL: Yes, let's pursue that. First of all, starting with you, Mr. Blumenthal. You all say that there must be cuts in these entitlement programs, politically sensitive as they are, in the domestic programs. And you say in your joint statement that "fairness demands widening and cutting beyond cutting programs for the poor." Can you explain that premise, first of all?

Mr. BLUMENTHAL: Well, the analysis of the Social Security recipients, for example, indicates that only a relatively small portion of those getting Social Security are at or below the poverty line. Most Americans who draw Social Security are not at the poverty line. We are in any case not suggesting that Social Security be cut. We're only saying that some limit be put on the increases, the cost-of-living increases. And I think that's a very important concept, because otherwise the only alternative is that taxes be raised and raised and raised, and in the end, Social Security taxes by those who have to support those that retire will be an enormous burden on the economy.

MacNEIL: Mr. Fowler, on the business of fairness, is it the feeling of the group that the cuts in programs identified with the poor, for which there is a need or means test, have gone far enough, that both in fairness and in practicality you can't get much more savings out of them? Is that the feeling of the group?

Mr. FOWLER: Well, that's part of it, but I think there's a more overriding reason and that is that we do need a lot more cuts in the prospective spending levels over the next three to four years. And you really cannot get a meaningful set of cuts unless you tackle the problem of entitlements. And that's where the area of increased growth in spending over the next three years just stands in the way. The budget is out of control, as Secretary Connally said; the so-called uncontrollables — which are not uncontrollable; they're fixed by law — and the Congress that fixed them can change them. And that is essential if we are going to recapture control of the budget.

MacNEIL: Mr. Connally, what is it you want to do to these programs? You list Social Security, Medicare, veterans' benefits, civil and military retirement pay. What do you want to do to those?

Mr. CONNALLY: Well, I think the first thing we would recommend would be that we freeze all of 'em for at least one year. Basically what we're talking about is not depriving people of Social Security benefits or payments, for heaven's sakes; what we're talking about is stopping the rate of increase in these entitlement programs. What the Congress has done over the last several years is index many of these programs. So, as one of 'em described it to us today, these programs are now on auto pilot; they're flying themselves.

MacNEIL: You mean as inflation goes up, they've gone up correspondingly.

Mr. CONNALLY: Absolutely, and they've gone up more than the rate of inflation.

MacNEIL: But with inflation slowing down, Mr. Peterson, wouldn't that automatically take care of the indexing? Because inflation is now down in the early months of this year to somewhere between one and three percent.

Mr. PETERSON: Well, there is some other cruel arithmetic. Quite apart from the indexing, the demographics of course are working in another direction. Fifty years ago 4% of the population were over 65. It's now 11%. In another 50 years it'll be 20%, or 65 million people. People— those old people, older people, are now living 16.6 years at age 65; it used to be about 12 years. So we're paying longer benefits to many, many more people who are staying healthier. So it is not just the indexing that is a key factor; it is the changing demographics of our society.

MacNEIL: So you want to freeze the benefits for one year in all these things that I listed, and then you want to slow down or cap the rate of inflationary increase in these programs. Suppose the President tomorrow said, "Yes, I buy your plan," and the Congress said yes too, how much would you save in doing all this?

Mr. BLUMENTHAL: If the plan that we have proposed would be accepted, then through these entitlements we could save by 1985 around $60 billion, and that would be a major contribution to that total of eventually $175 to $200 billion we have to save.

MacNEIL: Mr. Connally, you've been a politician on the national scene as well as a secretary of the treasury and in other government departments. You've seen the furor that's recently happened over proposals to trim the increases in Social Security. Is this in any way politically feasible in this year?

Mr. CONNALLY: Oh, I think it's politically feasible. I think the problem that we have today is no one wants to hit the cold water by themselves. The Democrats understandably don't want to get bushwhacked and neither do the Republicans. Each of 'em want to walk hand in hand down the aisle, in effect, even though it's a shotgun wedding, if they're going to deal with something as politically sensitive as Social Security benefits. But let me make one point when we're talking about this. Every recipient, almost, of Social Security feels like and says and believes that he's just getting out of the program what he paid in. Nothing could be further from the truth. And the American people should realize that the average recipient of Social Security today receives in one and a half years, an individual receives one and a half years what he's paid in to that program during his entire lifetime. And if he has a spouse, he gets everything he paid into the program throughout his lifetime back in 11 months. Now, take that and add that with what Mr. Peterson said a moment ago that the average person today anticipates living 16.6 years beyond the age of 65. So in effect for 15½ years he's going to be living off of someone else's contributions to the Social Security program. That's one reason why it's out of hand, and the American people have to understand it, the young people have to understand it, the wage earners in America today have to understand that what they're doing is paying for what essentially is an actuarially unsound and a basically unfair Social Security program as it exists today.

MacNEIL: What is the— do you gentlemen have confidence that there is the political leadership today or the combination to create that shotgun wedding that Mr. Connally just talked about? Does such leadership exist?

Mr. BLUMENTHAL: I think in a very politically charged atmosphere of the moment clearly nobody wants to get out in front, as Mr. Connally has said. I think those numbers are so persuasive. The other number that you can mention is that there used to be 16 people working for every recipient; pretty soon there'll be three working for every recipient. The burden on the people is so great. The total budget today is no greater than the total cost of funding that system would be 10, 12 years from now. I think the political will will be there, and I think the kind of information that we are providing will be very useful to that process.

MacNEIL: Well, thank you. Jim?

LEHRER: Mr. Fowler, yes, you wanted to say something.

Mr. FOWLER: I want to say something, bring this back to the question you raised earlier about partisan politics. Now, this basically, what we're trying to focus on is a long-term program to bring the budget back under control and maintain it in some kind of equilibrium. Now, if you're going to try to achieve a long-term program, a three-, four- or five-year program, you need to have a bipartisan support for that particular program. Because there are going to be changes of the parties in power in the House or in the Senate or in the administration during that period of time. So if these gentlemen in the government wish to achieve a successful program to recapture control of the budget, they're going to have to look down the road for a number of years and they're going to have to realize that it's only a bipartisan program that is likely to prevail over a long period of time. Now, our experience in past fiscal crises — in the Tax Reduction Act of '63 and '64 and the Revenue Act of 1968 which gave us our last surplus in the budget for the fiscal year that followed — these were the result, a lot of partisan talk early in the game, lots of that on one side and the other, but in the

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final analysis men of good will, men of responsibility came through and we did forge an effective program with bipartisan support. And I think this is where the President and the leadership in the Congress, Democratic and Republican, is going to come out, hopefully, before the end of the summer.

LEHRER: Well, let's move to defense. You want $25 billion cut from the defense budget in 1985; in goodly amounts, I understand, over these next two years. Mr. Connally, the President was asked about this today, about you all's suggestion, and he said, words of this effect, "Those fine men wouldn't say that if they knew what I knew in terms of what effect those kind of cuts would have on our national defense."

Mr. CONNALLY: Well, we obviously view it from a different perspective from what the President does. But let me remind you that— well, let's start with the basic elements. We're talking about 1985. Nineteen eighty-five we anticipate the budget of the United States will be one trillion dollars. Of that trillion dollars, defense, Social Security — including Medicare, and interest, those three items alone will comprise $810 billion of the one trillion. Now, if you're going to get this budget under control you're going to have cut defense; the entitlements programs: Social Security, Medicaid; and you're going to have to reduce interest some way. Now, yes, we recommend cutting $25 billion out of defense, but that still leaves in 1985 a 7% real growth as compared to the President's 8.6% real growth. Now, that's all we're talking about. And I think we can do that.

LEHRER: And without hurting the nation's defense?

Mr. CONNALLY: Well, yes, I think so. Let me remind you that even with that 7% this will be the only time that we've had any substantial buildup in the defense capabilities of this nation since the Vietnam War, since nineteen hundred and about sixty-eight, '67 and '68. This'll be the only time. Every other year under every other administration we've been under the line, so to speak, in support of the military establishment. We recognize, Joe Fowler and Doug Dillon are co-chairmen of the Committee on the Present Danger; I'm one of the founding members of the Committee on Present Danger. I think we all are committed to a strong defense effort, but we also know full well that no democratic society, no representative form of government is going to long support a military establishment unless you have a sound economy to support it.

LEHRER: I assume you agree with that, Mr. Fowler.

Mr. FOWLER: I do, and I must say that it is with great reluctance that we come to a conclusion that $25 billion should be reduced from the defense budget by 1985. Standing alone, if that were put to us, we would all say no. But what we have here is a situation in which in order to affect the result, every basic element in the budget has to be moved down — that is, the spending elements — have to be moved down in order to effect this bipartisan consensus that we're talking about and provide a long-term program that the country will live with. So we're strong supporters of President Reagan's effort to increase our defense posture, and have been and thoroughly approve of it. But we're saying we are ready to concede in a minor way, not in a reduction in the defense spending, but a reduction in the projected increase in defense spending in what I believe is a relatively minor and doable figure.

LEHRER: Mr. Peterson, does this recommended cut in defense spending bother you or give you any concern? Or are you 100% behind it as well?

Mr. PETERSON: I'm 100% behind it.

LEHRER: Mr. Blumenthal?

Mr. BLUMENTHAL: Absolutely.

LEHRER: And you don't believe that the country's defense, as the President said today, would be in jeopardy if that in fact was done?

Mr. BLUMENTHAL: I really believe the point that has been made, which is that you can't have a strong defense — and we all want one, we know we need one — on a weak economic foundation. They go hand in hand, and a 7% real increase I think gives us the resources to do it.

LEHRER: I see.

Mr. PETERSON: I would also make another point, that as John Connally pointed out, this allows for 7% real growth over a sustained period in total. But if as everybody agrees we're going to have to start slowing down the military pay side, that means that on the purchases of hardware and equipment you can have a substantially larger real increase than 7%.

LEHRER: I see. Robin?

MacNEIL: Let's move on to the tax increases, or the increased revenue you propose. You want to raise taxes a total of $60 billion in 1985. Where does that come from, Mr. Blumenthal?

Mr. BLUMENTHAL: Well, there are any number of possible sources. The one that we have put first is various kinds of energy taxes. We are in a period at the moment when the markets have been soft. Here we can raise substantial amounts of money through decontrol and putting some taxes on of various kinds which would on the one hand further stimulate production exploration in this country and at the same time make up some of the gap that we need. Now, there are other ways of doing it. There are excise taxes that can be looked at, and it's really a matter for the Congress and the administration deciding where they think it's most advisable. But in total, about $60 billion are going to be required.

MacNEIL: Isn't the most sensitive part of what you're proposing, Mr. Connally, modifying or delaying the third year of the individual income tax cut?

Mr. CONNALLY: Yes, it is, but remember, if you'll read carefully what we said. We do not want to touch the third year of the tax cuts unless and until two other things have happened. Namely, unless the entitlements program has been controlled and reduced, and unless and until defense has been reduced to the level that we recommended. Then and only then would we be willing to consider changing, altering, modifying the tax cuts now scheduled for the third year.

MacNEIL: Hasn't Mr. Reagan pretty well indicated that he's adamant in not changing that?

Mr. CONNALLY: Yes, he has. And I can understand that. And any man in his position must fight for his recommendations and for his achievements, because he's already achieved that tax cut. On the other hand here we're talking about something that has to rise above partisanship; we're talking about something that in the interest of this nation we have to come to grips with. We have to get control of this budget. If we don't, the President is going to be in trouble, all of us are going to be in trouble; we can't stand a constantly increasing number of unemployed, of continued high interest rates such as we have today, stagnation in the industrial base of this nation, and loss of productivity and loss of markets to overseas competitors for goods and services. You just can't do it.

MacNEIL: Mr. Fowler, doesn't what you all are saying come down, when you reduce it to its fundamentals, you're saying to the Democrats, "You're going to have to accept some Social Security cuts," which they've been very reluctant to do in this year especially, but aren't you also saying to Mr. Reagan, "If you want higher defense expenditure and you want to cut taxes, your Reaganomics just isn't going to work"? Isn't that what this message is?

Mr. FOWLER: No, I don't think so. I think that what we're saying is that we have to stretch out, we have to approach the reduction of the excessive levels of taxation that the economy has suffered under over recent years, particularly the business section of the economy; you have to do it on a somewhat gradualistic basis. And I don't think any of us here on the program would like to see the so-called third year eliminated. The question is, if you can get in return for a tackling of this entitlements program in a meaningful way some temporary deferral of some part of that third year cut, maybe it's worth cutting a deal.

Mr. PETERSON: I wonder if I can take a crack at the tax—

MacNEIL: Could you do it briefly?

Mr. PETERSON: Very briefly. I wonder if the American people understand that if we don't reduce the growth of Social Security benefits, we're going to have to next year increase Social Security taxes by 1% on top of another .7% of pay by '85. That'll be the biggest tax increase in the history of this country. It is not being talked about at the present time as an alternative. We would argue that if we will moderate the growth of benefits we are avoiding an enormous tax increase.

MacNEIL: I'd just like to ask each of you very briefly — may not be time for all of you. Starting with you, Mr. Blumenthal. In a few words, what happens to this economy, in the most graphic terms you can express, if we don't do what you're proposing?

Mr. BLUMENTHAL: We won't invest, we will not increase productivity, unemployment will remain, our competitiveness internationally will be increasingly impaired, and we will not get inflation permanently under control; we'll fall further and further behind.

MacNEIL: Mr. Peterson?

Mr. PETERSON: I would add only two things to that list. First, I'm afraid that you will see more bankruptcies than we've seen in a long time, including probably some household corporate names that are near the brink. I think also you will see exports falling as they have, because the dollar is very overvalued because of high interest rates, which is costing us hundreds of thousands of jobs.

MacNEIL: Well, we have to leave it there. Mr. Fowler, Mr. Connally, thank you for joining us in Washington; Mr. Blumenthal, Mr. Peterson in New York. Good night, Jim.

LEHRER: Good night, Robin.

MacNEIL: That's all for tonight. We will be back tomorrow night. I'm Robert MacNeil. Good night.

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The CHAIRMAN. While we are waiting for other members to come I would like to make a brief comment before we begin. Senator Byrd also may have a comment. We hope to have between 10 and 14 members here, and I would just say at the outset that we are certainly pleased to welcome this morning two distinguished former Cabinet officers, Peter G. Peterson and W. Michael Blumenthal, as well as representatives of the Business Roundtable, the American Business Conference, National Federation of Independent Business, and the National Association of Realtors.

The cause that brings these witnesses before us this morning is the state of the Federal budget and the budget deficit. I believe the need for drastic deficit reduction has become more, not less, urgent as we move closer to the beginning of fiscal year 1983. And I hope that the witnesses will address the urgency of this problem as it relates to the state of our economy.

One reason we invited our distinguished witnesses to join us today is the bipartisan appeal issued by six former Cabinet officers on May 24. That appeal was issued by two of our witnesses this morning, Mr. Blumenthal, who served as Secretary of the Treasury under President Carter, and Mr. Peterson, who was Secretary of Commerce under President Nixon.

The presence of these gentlemen here this morning clearly demonstrates the bipartisan nature of the concern we share. Also joining this bipartisan appeal are former Treasury Secretaries John Connally, Henry Fowler, C. Douglas Dillon, and William E. Simon. Although these distinguished public figures were unable to join us today, we certainly welcome their support and their participation and they are ably represented this morning by two of their colleagues.

I was particularly impressed by the nature of the appeal issued on May 24. In their statement issued on that date, the former Cabinet officer said, "The budget crisis can wait no longer. This is no time for politics as usual and it is certainly no time for a budget stalemate. The national interest demands strong and continuing leadership by the President and the Congress working together to restore financial sanity." It seems to this Senator that that is exactly right. The time to act is now and the need for action is absolutely compelling. This is a matter that vitally affects our prospects for economic recovery, for putting people back to work, and for getting interest rates back into a range that will help revitalize investment and production. But as compelling as these goals are, they are only part of the story. Without dramatic reductions in the deficit expected over the next 2 years, we risk squandering our hard won gains against inflation. We risk perpetuating the economic stagnation of recent years. We risk a no-growth and no-hope economy in the years ahead.

I would ask that the balance of my statement be made a part of the record.

[The prepared statement of Senator Dole follows:]

STATEMENT OF SENATOR DOLE

THE URGENT NEED FOR DEFICIT REDUCTION

THE COMMITTEE IS PLEASED TO WELCOME THIS MORNING TWO DISTINGUISHED FORMER CABINET OFFICERS, PETER G. PETERSON AND W. MICHAEL BLUMENTHAL, AS WELL AS REPRESENTATIVES OF THE BUSINESS ROUNDTABLE, THE AMERICAN BUSINESS CONFERENCE, THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS, AND THE NATIONAL ASSOCIATION OF REALTORS. THE OCCASION--OR PERHAPS I SHOULD SAY THE CAUSE--THAT BRINGS THESE WITNESSES BEFORE US THIS MORNING IS THE STATE OF THE FEDERAL BUDGET AND THE BUDGET DEFICIT. I BELIEVE THE NEED FOR DRASTIC DEFICIT REDUCTION HAS BECOME MORE, NOT LESS, URGENT AS WE MOVE CLOSER TO THE BEGINNING OF FISCAL 1983. I HOPE THAT OUR WITNESSES WILL ADDRESS THE URGENCY OF THIS PROBLEM AS IT RELATES TO THE STATE OF OUR ECONOMY.

"NO TIME FOR POLITICS AS USUAL"

ONE REASON WE INVITED OUR DISTINGUISHED WITNESSES TO JOIN US TODAY IS THE BIPARTISAN APPEAL ISSUED BY SIX FORMER CABINET OFFICERS ON MAY 24. THAT APPEAL WAS ISSUED BY TWO OF OUR WITNESSES THIS MORNING, W. MICHAEL BLUMENTHAL, WHO SERVED AS SECRETARY OF THE TREASURY UNDER PRESIDENT CARTER; AND PETER G. PETERSON, WHO WAS SECRETARY OF COMMERCE UNDER PRESIDENT NIXON. THE PRESENCE OF THESE GENTLEMEN HERE THIS MORNING CLEARLY DEMONSTRATES THE BIPARTISAN NATURE OF THE CONCERN WE SHARE. ALSO JOINING IN THIS BIPARTISAN APPEAL WERE FORMER TREASURY

SECRETARIES JOHN B. CONNALLY, FROM THE NIXON ADMINISTRATION; HENRY H. FOWLER, FROM THE JOHNSON ADMINISTRATION; C. DOUGLAS DILLON, FROM THE KENNEDY AND JOHNSON ADMINISTRATIONS; AND WILLIAM E. SIMON, FROM THE FORD ADMINISTRATION. ALTHOUGH THESE DISTINGUISHED PUBLIC SERVANTS WERE UNABLE TO JOIN US TODAY, WE VERY MUCH WELCOME THEIR SUPPORT FOR AND PARTICIPATION IN A MAJOR EFFORT TO GET THE DEFICIT UNDER CONTROL; AND CERTAINLY THEIR GROUP IS ABLY REPRESENTED BEFORE THIS COMMITTEE.

I WAS PARTICULARLY IMPRESSED BY THE NATURE OF THE APPEAL ISSUED ON MAY 24. IN THEIR STATEMENT ISSUED ON THAT DATE, THE FORMER CABINET OFFICERS SAID, "THE BUDGET CRISIS CAN WAIT NO LONGER. . . THIS IS NO TIME FOR POLITICS AS USUAL AND IT IS CERTAINLY NO TIME FOR A BUDGET STALEMATE. THE NATIONAL INTEREST DEMANDS STRONG AND CONTINUING LEADERSHIP--BY THE PRESIDENT AND THE CONGRESS WORKING TOGETHER--TO RESTORE FINANCIAL SANITY."

IT SEEMS TO THIS SENATOR THAT THAT IS EXACTLY RIGHT. THE TIME TO ACT IS NOW, AND THE NEED FOR ACTION IS ABSOLUTELY COMPELLING. THIS IS A MATTER THAT VITALLY AFFECTS OUR PROSPECTS FOR ECONOMIC RECOVERY, FOR PUTTING PEOPLE BACK TO WORK, AND FOR GETTING INTEREST RATES BACK INTO A RANGE THAT WILL HELP REVITALIZE INVESTMENT AND PRODUCTION. BUT AS COMPELLING AS THESE GOALS ARE, THEY ARE ONLY PART OF THE STORY. WITHOUT DRAMATIC REDUCTIONS IN THE DEFICITS EXPECTED OVER THE NEXT FEW YEARS, WE RISK SQUANDERING OUR HARD-WON GAINS AGAINST INFLATION; WE RISK PERPETUATING THE ECONOMIC STAGNATION OF RECENT YEARS; WE RISK A NO-GROWTH AND NO-HOPE ECONOMY IN THE YEARS AHEAD. MANY OF US BELIEVE THAT IN THE 1980 ELECTION THE AMERICAN PEOPLE REJECTED THIS SCENARIO.

IT IS UP TO ALL OF US TO SEE TO IT THAT THE ECONOMY DOES NOT FOUNDER: THAT WE RETURN TO A STABLE, PREDICTABLE, NON-INFLATIONARY GROWTH PATH. WE CANNOT DO THAT IF THE THREAT OF EVER-EXPANDING, RECORD DEFICITS CONTINUES TO HANG OVER THE ECONOMY.

WHY IT MATTERS

PEOPLE CAN AND DO DISAGREE ABOUT THE RELATIVE SIGNIFICANCE OF DEFICITS IN A NORMAL ECONOMIC SITUATION, BUT NO ONE CAN DOUBT THAT TRIPLE-DIGIT DEFICITS, PROJECTED TO EXPAND INDEFINITELY INTO A RECOVERY PERIOD, THREATEN TO UNDERMINE ALL THAT WE CAN OTHERWISE ACHIEVE IN A FREE MARKET ECONOMY. SUCH DEFICITS NOT ONLY CHOKE OFF CAPITAL THAT WOULD BE AVAILABLE FOR PRIVATE INVESTMENT, THEY REKINDLE FEARS OF INFLATION BECAUSE OF UNCERTAINTY ABOUT HOW THEY CAN POSSIBLY BE FINANCED. THEY RAISE FEARS OF MASSIVE TAX INCREASES THAT COULD RETARD THE ECONOMY. MOST FUNDAMENTALLY OF ALL, THEY APPEAR TO REFLECT A LACK OF OFFICIAL RESPONSIBILITY THAT UNDERMINES CONFIDENCE IN THE ABILITY OF OUR GOVERNMENT TO COPE WITH A MODERN ECONOMY OR EVER REGAIN THE KIND OF ECONOMIC STRENGTH WE DEMONSTRATED IN PAST DECADES. FOR ALL THESE REASONS, THE IMPENDING FISCAL CRISIS MUST BE DEALT WITH NOW.

ASSUMING THERE IS GENERAL AGREEMENT ON THE SCOPE OF THE DEFICIT PROBLEM AND THE NEED FOR SWIFT ACTION--AND I BELIEVE SUCH AGREEMENT EXISTS--WHY HAS NOTHING BEEN DONE? THE PROBLEM MAY BE TWOFOLD: PEOPLE DISAGREE ON THE PROPER MIX OF TAX AND SPENDING MEASURES NEEDED TO DO THE JOB; AND THEY DISAGREE ON

ON THE STRENGTH OF THE MEASURES WE HAVE TO TAKE IN ORDER TO CONVINCE THE NATION, INCLUDING THE FINANCIAL MARKETS, THAT THE DEFICIT WILL BE CONTROLLED IN THE YEARS AHEAD. BY THIS I MEAN THAT ONE-YEAR CUTS, RESCISSIONS, ASSUMPTIONS OF MANAGEMENT SAVINGS, AND THINGS OF THAT NATURE WILL NOT DO THE JOB. WE HAVE TO ADDRESS THE SENSITIVE AREAS OF THE BUDGET IN ORDER TO DO THE JOB. THE MARKETS ARE BETTING THAT CONGRESS DOES NOT HAVE THE WILL TO DO THAT--THAT IS WHY WE MUST DO IT IF WE ARE TO SUCCEED. RECENT DEVELOPMENTS IN THE HOUSE APPEAR TO CONFIRM THE FEARS OF THE MARKETS: WE MUST AND, I BELIEVE, WILL REVERSE THAT.

LONG-TERM RESTRAINT

WHAT ALL THIS BOILS DOWN TO IS THAT WE MUST DEMONSTRATE LONG-TERM CONTROL OVER THE BUDGET. WE CANNOT DO THAT WITHOUT TOUCHING ALL AREAS--APPROPRIATIONS, GRANTS-IN-AID, DEFENSE, ENTITLEMENTS, AND REVENUES. TO PUT ANY OF THESE AREAS OFF BOUNDS WILL UNRAVEL THE WHOLE PROCESS. I KNOW THAT THE BIPARTISAN GROUP OF CABINET OFFICERS STRESSES, AMONG OTHER THINGS, THE NEED FOR ACTION ON SOCIAL SECURITY. THAT APPEARS TO BE OFF THE AGENDA FOR NOW, BUT WE WILL HAVE TO DEAL WITH IT SOON ENOUGH WE HAVE NO CHOICE. OTHER ENTITLEMENTS HAVE TO BE ADDRESSED ONE WAY OR ANOTHER. THERE IS GREAT RELUCTANCE TO TOUCH CIVIL SERVICE RETIREMENT AND HEALTH CARE PROGRAMS, BUT WHERE COSTS HAVE RISEN BEYOND REASONABLE BOUNDS--TO THE POINT WHERE THEY UNDERMINE THE ORIGINAL PROGRAM GOALS, NOT TO MENTION THE GENERAL WELFARE--THEN ACTION MUST BE TAKEN. MEDICARE WAS

ORIGINALLY EXPECTED TO COST $9 BILLION BY 1990. ALREADY IT COSTS ABOUT $50 BILLION. MEDICAID COSTS $35 BILLION AND IS ONE OF THE FASTEST-GROWING FEDERAL PROGRAMS. WE HAVE TO GET A HANDLE ON THIS, AND WE HAVE TO DO SOMETHING ABOUT HEALTH CARE COSTS. WE DON'T IMPROVE THE NATION'S HEALTH BY FEEDING INFLATION IN THE HEALTH CARE INDUSTRY. AND THESE ARE JUST A FEW OF MANY EXAMPLES THAT COULD BE CITED OF THE PROBLEMS WE FACE.

REVENUES MUST ALSO PLAY A ROLE--PARTLY TO ENSURE AN EQUITABLE PROGRAM OF DEFICIT REDUCTION, AND PARTLY BECAUSE THE ONSET OF RECESSION HAS UNDERMINED OUR REVENUE BASE IN A WAY THAT COULD NOT HAVE BEEN PREDICTED LAST YEAR WHEN WE PASSED THE TAX CUT. THE TAX CUT IS NOT AT FAULT--AN INCOME TAX BASE RIDDLED WITH EXCEPTIONS AND SPECIAL PRIVILEGES IS. THAT IS WHERE WE OUGHT TO LOOK, FIRST AND FOREMOST, TO INCREASE REVENUES. NO OPTIONS ARE RULED OUT, BUT I HAVE SAID--AND THE PRESIDENT HAS SAID--THAT THE INDIVIDUAL TAX CUT, PLUS INDEXING, IS THE LAST PLACE WE OUGHT TO LOOK. THAT IS THE ONLY SIGNIFICANT RELIEF WE HAVE GRANTED THE AVERAGE TAXPAYER IN RECENT YEARS, AND WITHOUT AIDING OUR WORKING PEOPLE WE CANNOT SET THE STAGE FOR RECOVERY.

A PROPER PROGRAM

THE NEED FOR SWIFT DEFICIT REDUCTION IS CLEAR--AND THE PARAMATERS OF AN APPROPRIATE DEFICIT REDUCTION PROGRAM ARE BECOMING CLEARER. THAT PROGRAM MUST BE BALANCED AND IT MUST BE BIPARTISAN. WE ARE ALL IN THIS TOGETHER, AND NO SEGMENT OF THE POPULATION SHOULD BE LEFT OUT OF THE DEFICIT REDUCTION EFFORT. TAX BREAKS

FOR THE WEALTHY NEED THE SAME SCRUTINY AS FOOD STAMPS, FEDERAL RETIREMENT, STUDENT LOANS AND FOREIGN AID. NO ONE SHOULD BE OUT TO GET THE WEALTHY, OR TO GET THE POOR, OR TO GET THE MIDDLE CLASS--BUT ALL OF OUR CITIZENS HAVE A STAKE IN SOME PROGRAM OR OTHER, AND THEY ALL HAVE TO RECOGNIZE THAT WE CANNOT AFFORD TO HAVE SACRED COWS ANY MORE. I BELIEVE THE AMERICAN PEOPLE ARE MATURE ENOUGH AND RESPONSIBLE ENOUGH TO UNDERSTAND THIS: I ONLY HOPE THE CONGRESS IS MATURE ENOUGHT TO ACKNOWLEDGE THAT FACT.

I HAVE STRESSED BEFORE, ~~AND I STRESS~~ AGAIN, THAT THE PRIMARY EMPHASIS MUST BE ON REDUCING FEDERAL SPENDING. THE BUILT-IN SPENDING MOMENTUM OF RECENT YEARS IS THE PRIMARY SOURCE OF OUR PROBLEMS, AND IT MUST BEAR THE MAIN BURDEN OF DEFICIT REDUCTION. WE CANNOT BE PARTY TO RECORD-HIGH TAXES AS AN ANSWER TO ALL OUR PROBLEMS. THAT WOULD BE AN EVASION, AND WOULD CONVINCE NEITHER THE FINANCIAL MARKETS OR THE MAN ON THE STREET. AT THE SAME TIME, WE CANNOT AVOID REVENUE INCREASES. THE DIMENSIONS OF THE PROBLEM ARE JUST TOO GREAT TO DO THAT, AND WE HAVE TO RECOGNIZE THAT NOT EVERY PROVISION OF THE TAX CODE IT PRISTINE FROM A POLICY STANDPOINT. WERE THAT SO, WE WOULD NOT SEE GROWING SUPPORT FOR A SIMPLIFIED OR FLAT RATE TAX. BUT WE CAN AND WILL RAISE REVENUES WITHOUT UNDERMINING THE INCENTIVES FOR GROWTH AND INVESTMENT THAT WE AGREED TO LAST YEAR.

BIPARTISANSHIP IS NEEDED NOT TO PULL ANYONE'S IRONS OUT OF THE FIRE, BUT BECAUSE THIS IS TRULY A SHARED PROBLEM. WE ARE ALL AT FAULT FOR ALLOWING SPENDING AND DEFICITS TO GET OUT OF CONTROL,

AND WE ALL MUST COOPERATE IN A SOLUTION. I KNOW THERE ARE SOME WHO THINK THE TAX CUT IS THE MAIN PROBLEM--AND WE ARE AGREEING TO RAISE SUBSTANTIAL REVENUES, ALTHOUGH SOME OF US WOULD MAINTAIN QUITE STRONGLY THAT THE PROBLEM IS INDEPENDENT OF THE TAX CUT. BUT, AS I SAY, WE ARE LEAVING NO AREAS OF THE BUDGET UNTOUCHED IN THE INTEREST OF REACHING AGREEMENT. SIMILARLY, THERE ARE THOSE WHO BELIEVE DEFENSE SPENDING, OR ENTITLEMENTS, ARE THE SOLE SOURCE OF THE PROBLEM. BUT LET'S FACE IT: THE PROBLEM IS ALL OVER THE PLACE, AND WE CANNOT MEET OUR RESPONSIBILITY TO THE AMERICAN PEOPLE WITHOUT CUTTING A WIDE SWATH ACROSS THE BUDGET.

FINALLY, I WOULD NOTE THAT WE STILL AWAIT HOUSE ACTION ON A BUDGET RESOLUTION; WE DO NOT KNOW WHETHER THERE WILL BE AN EFFECTIVE RECONCILIATION MANDATE; AND WE FACE THE IMMINENT PROSPECT OF RAISING THE DEBT CEILING. GIVEN THIS SITUATION, THE LEGISLATIVE UNCERTAINTIES INVOLVED, AND THE NEED FOR IMMEDIATE ACTION, I HOPE THE WITNESSES TODAY WILL COMMENT ON APPROPRIATE LEGISLATIVE ROUTES THE CONGRESS MIGHT PURSUE. SOME OF US HAVE OUR OWN IDEAS, NOT THAT WE DENIGRATE THE BUDGET PROCESS, BUT BECAUSE TIME IS RUNNING OUT.

I LOOK FORWARD TO HEARING THE TESTIMONY FROM THIS DISTINGUISHED GROUP.

The CHAIRMAN. I would say to our witnesses—again I want to thank them for making a special effort to be here—we hope we can do the right thing in this committee. We have done that in the past under the superb leadership of Chairman Long. And with his help and the help of others on both sides, I hope we can put together a genuine deficit reduction package with emphasis on spending reduction and revenue increases where necessary, and we hope to start that process next week. Senator Long.

Senator LONG. I am pleased to see, Mr. Chairman, that you have listed here Mr. Mike Blumenthal as your first witness. I think for the record that it might be worth noting that Mr. Blumenthal wrote an article about in October of last year suggesting and hoping that President Reagan would not make the same mistakes that were made under the Carter administration.

I was so impressed by that article that I cornered Bob Dole and showed it to him. He went and read it and he was sufficiently impressed, that he passed it around among a bunch of his Republican associates. And we undertook to try to see to it that the President would read the article. I know we got it to his desk several times. [Laughter.] I took it down there personally, finally.

Mr. Blumenthal's ideas, I think, were right. And if I had my way, we would have been moving in the direction you were suggesting, Mr. Blumenthal, even before the Congress adjourned last year because I think that the article you wrote back at that time had prophetic wisdom to it. I hope you can tell us again what our path ought to be from this point forward.

The CHAIRMAN. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman. I just want to welcome the witnesses who are outstanding business leaders, and, in the case of two of them, have been outstanding Government officials. I think they are rendering a service to come before this committee and to present their views on what I believe to be an economic crisis of some major proportions which is facing our Nation today.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. Let me say I read both Mike Blumenthal's article and Pete Peterson's article, and I am very pleased to have them here. I think they are highly intelligent men, probably because we think alike on most of these issues.

The CHAIRMAN. Bill.

Senator BRADLEY. No questions, Mr. Chairman.

The CHAIRMAN. Senator Danforth.

Senator DANFORTH. No questions.

The CHAIRMAN. Senator Durenberger.

Senator DURENBERGER. No questions.

The CHAIRMAN. I might say while we have the members here that we have been working on a number of items for the past several months, and we would hope to make the information we have developed available to everyone. I hope that I can get it to you today or tomorrow, different ideas we have about revenue raising measures. And we would be very happy to brief the members or the staff. I am not suggesting all the proposals we suggest will finally be approved by the committee, but there are a number of options that we think we should make available to the members. And you may have options of your own.

Senator BENTSEN. Mr. Chairman, a little pro tem, if you will excuse. I have the pastor of my hometown here opening the Senate, and he has wanted to pray for me for a long time here, and I have got to go over there.

The CHAIRMAN. He came at a timely time. We will first hear from Mr. Blumenthal.

STATEMENT OF HON. W. MICHAEL BLUMENTHAL, FORMER SECRETARY OF THE TREASURY AND PRESENTLY CHAIRMAN AND CHIEF EXECUTIVE OFFICER, BURROUGHS CORP., DETROIT, MICH.

Mr. BLUMENTHAL. Thank you very much, Mr. Chairman, Chairman Long, distinguished members of the committee. I must say it brings back many memories to sit here and to face you all. Some of them fond, others not so fond. [Laughter.]

And I just wish that the circumstances of my return to appear before this committee were less somber than I believe them to be at the present time. Just opening the paper this morning gives ample weight to this statement. The stock market, which is just one measure of what is happening in the country, is down below 800, probably close to or at the low for the year, and there is no indication that it is likely to go north very soon. And the dollar is hitting new highs, therefore continuing to erode our competitiveness in world markets and losing us jobs because that really means lost export jobs and jobs lost through import competition.

I will not belabor the general situation. It is really very scary, I would say. Our bipartisan appeal was put together and subscribed to by six former Cabinet officers. The initiative came from my good friend, Secretary Peterson, who recognized that there was perhaps a contribution we could make here. And we hope others will associate themselves in coming weeks with our effort. Mr. Peterson has a more extensive statement with charts which will I think illustrate rather graphically some of the key points we tried to make. I think that statement will speak for itself, so I will be relatively brief. But when I say that the economic situation is somber, you need merely look at the unemployment numbers and the fact that they are unfortunately continuing to rise rather than to drop.

My home State of Michigan is probably the hardest hit in that regard, but it is not the only State that faces something like 15 percent unemployment. I cite just one additional statistic, Mr. Chairman. In Detroit where the headquarters of my company are located, the Burroughs Corp., unemployment for young blacks, for minorities, is about 60 percent. The last time I looked it was 66 percent. Two out of three young blacks in the city of Detroit are unable to find work. It is going to be a long hot summer. And, clearly, that is the sort of situation that is very serious indeed.

The number of bankruptcies, not just of larger companies and perhaps some household names that you know about but many, many small ones is also an indicator. The thrift institutions, the postwar lows of the housing and construction industry, the machine-tool industry, and so on—all are in trouble. It is a serious situation.

We believe that one of the principal reasons why that situation is not reversing itself and moving in the right direction is because the country sees the prospect of large, rising, and essentially uncontrolled budget deficits, not only in fiscal year 1983 but increasingly so in the out years. And, incidentally, that is why we took fiscal 1985 as our focus. Not that we don't believe that some real action needs to be taken this year to make a beginning on this, but we focused on fiscal 1985 because it really has to be a multiyear program that the Congress must address itself to.

Unless these prospects for increasing budget deficits are dealt with in some positive way, we don't believe there is any realistic prospect that interest rates are going to come down. No one is going to lend money long for a number of years if there is not some reasonable assurance that the economic situation is going to stabilize itself; that there is going to be growth; that there is going to be the prospect for profitable returns on these kinds of funds invested over the longer run. Thus interest rates cannot come down in our judgment unless and until there is evidence that the budget situation is brought under better control. So we are in a precarious situation. Every index shows that. We were hoping for a recovery this year. I would now think, based on the reports that I have seen, that if there is any positive growth at all in the third quarter it is likely to be very weak. And I have seen increasing evidence that the fourth quarter will in fact show a decline. So that the overall year will, at best, be flat if not down. And we may, unless action is taken at the end of the year, look back and have to say there was no recovery at all, with only a blip perhaps in the third quarter.

So the prospects for an early end to this deep recession appear, unless you take some action, to be very poor. And obviously that will mean additional hardships for those who are already suffering.

The six Secretaries represent very different philosophies: three served under a Republican administration, and three served under Democratic administrations. Our differences in philosophy are rather well known and yet we were as one in the kind of statement that we put out, in the appeal to the Congress and to the President we issued.

We were as one in our view that quick action is needed; that speed is of the essence; that decisive action is needed; that it requires a bipartisan approach; that politics as usual is not acceptable any longer; that the action must be realistic; and that the sacrifices which necessarily and unavoidably are going to be borne by people, must be fair and equitably distributed.

It is absolutely essential to get the budget under control. The budget is out of control at the present time. It has to be brought back under control, and that is why we looked at fiscal year 1985 to see what needs to be done because we do not believe that a quick fix in fiscal year 1983 is sufficient. It is a beginning, but it is not sufficient. We believe that it has to be done in a fundamental way. The markets and other financial observers are sufficiently sophisticated that they recognize padding and plugged numbers, Mr. Chairman.

Management savings which give the appearance of having the numbers come out right but which are really window dressing are quickly going to be recognized for what they are. So, you will see in our proposal that we have not counted on management savings which we consider to be highly questionable, which in any case may be double counting because we presume the different agencies have already included them in their individual budgets. And we have tried to be realistic about our projections with regard to relevant interest rates because they make a major difference in the out years, and thus have not assumed very low interest rates, which again, of course, would only yield illusory numbers for the future.

We have also come to the conclusion that it is not possible any longer to just look at one part of the budget. We have to look at all parts, both at the expenditure and at the income side. And that is why we have focused in particular on those areas in which the major expenditures can be saved and the major sources of revenue generated. We cannot look at 20 percent of the budget. We don't believe that you can just get the necessary revenue savings by looking only at those areas that are needs related. We have to look at all areas.

Thus also, defense and, very importantly, entitlements, on which Secretary Peterson has some very interesting numbers and illustrations to show you, are absolutely essential for consideration for this purpose.

Now, the specifics I think are very clear. We are suggesting that in 1985 there be a saving from the base line of $25 billion on defense expenditures. The information that we have given to you indicates that this would still involve an increase in defense expenditures of 7 percent in real terms which, of course, is as high as any increase that we have had in the postwar period, save I believe a year or two during the Vietnam war.

Our group includes Secretary Connally, who was Secretary of the Navy, as well as Secretaries Fowler and Dillon, who were cofounders of the Committee on the Present Danger, which certainly has argued very strongly for a strong defense. But they fully accept and support the proposition that a 7-percent real increase is really all that we can absorb. And it is elementary to us that, in any case, we could not have a strong defense if it is not based on the foundation of a strong economy to support this buildup.

Entitlements are absolutely a key. We are suggesting—in fact, we are convinced—that at least $60 billion have to be found in 1985 in order to bring the budget closer into balance. And Secretary Peterson will spend a great deal of time explaining why that is and what the key ways are of doing that. And then, of course, there absolutely have to be additional sources of revenue. We have calculated that you will require $60 billion in additional revenue in fiscal year 1985, building up to that figure in fiscal year 1985.

There is a whole menu of possible ways of doing that which we have suggested. Our list is not meant to be all inclusive. Obviously, there are other ways, additional ways in which more revenue can be generated. We have suggested that the area of energy may be a logical one for you to look at very closely because we may be able to kill two birds with one stone. We are in a period, and have been in a period, of relatively soft energy prices: We could generate more revenue by taxing energy. And this would also have the effect of promoting more exploration, more domestic production, and insulating us somewhat further from the vagueries of foreign supplies of oil, particularly in the unstable areas of the Middle East.

We suggest that there are some energy taxes and some excise taxes that you might look at. And there are obviously other things that can be done. There are some loop holes that can be plugged. I know that you have a whole list of these possibilities available to you.

We are suggesting that in the context of taking action on entitlements and on the budget, if it becomes necessary, we would also support taking a look at the third year tax cut. This is not our preferred way of doing it. It is not the way that we recommend you start. But you have got to find $60 billion in 1985. And if it takes going to the third year tax cut in the context of doing all these other things, we would agree that even that ought to be considered.

I would say, in conclusion, Mr. Chairman, that what we are telling you is that there is no longer any place to hide. The situation is serious. Monetary policy will not ease; and interest rates cannot come down until budget action is taken. Budget action requires a bipartisan effort dealing with all of these issues. And when that happens we are convinced, based on the perspective that we have—I as someone who is responsible for a large corporation; Mr. Peterson as an investment banker; similarly Mr. Fowler and Mr. Dillon, and others from their particular vantage points—if it is believable and realistic and attacks the fundamentals—that we will see a substantial change in interest rates and in the confidence level and in investments and, therefore, in increased productivity that is needed in the country. Until that is done, and if the program that you enact is not believable and not realistic, we are very skeptical that any real change will occur. That is why we have made this appeal with such a sense of urgency. And we earnestly request that the Congress and this committee give it very serious consideration.

Thank you.

The CHAIRMAN. Thank you. Secretary Peterson.

STATEMENT OF HON. PETER G. PETERSON, FORMER SECRETARY OF COMMERCE AND PRESENTLY CHAIRMAN OF THE BOARD, LEHMAN BROS. KUHN LOEB, NEW YORK, N.Y.

Mr. PETERSON. Chairman Long, if I may also——

Senator LONG. Wait a minute. I am not the chairman. [Laughter.]

Mr. PETERSON. Well, I like to believe that old Secretaries never die. [Laughter.]

If Chairman Dole will forgive this reference. Chairman Long, which I will continue to think of him as do you, has been quoted as saying that a statesman can be defined as a dead politician, or something to that effect. [Laughter.]

If our group establishes nothing else, Chairman Long, is that we are not running for office. We are here to tell you what we honestly believe. That is point No. 1. Point No. 2, you might wonder what some of us were thinking about by making it bipartisan. I think you are going to find us, since we are not politician or running for office, quite candid. I think we believe, gentlemen, that this problem is so serious that it has passed the point of pointing fingers

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and scapegoats and so forth. I am here as a Republican, and as a Republican Cabinet Officer, to say that the fact that this budget out of control is of bipartisan origin. And we are not going to get anywhere by pretending that one group or another is principally responsible. I am embarrassed to remind myself at times that I was in the administration at a time when some of these huge entitlement programs about which I am going to speak today were certainly supported. Therefore, we are not pointing any figures at either side of the aisle, and we will have nothing to do with that particular approach to the problem. We think we have got a national problem of bipartisan origin, and there is plenty of blame to go around for the fiscal mess that we are in at the present time.

Let me briefly let you look at the numbers, although Mike has covered these. I want to remind you of our proposal $60, $25 and $60 billion for non-defense and defense cuts and for tax increases, respectively. And what encourages me enormously, gentlemen, is for a long time we were kidding ourselves about the size of these deficits. I would commend you, Chairman Dole, and your colleagues. I think the one thing we are all agreed to now is that we have got to reduce the 1985 deficit by about $175 to $200 billion. The first step on the road to sanity is to understand the magnitude of the problem. But we want to get there credibly.

You will notice, for example, in the area of deficit reduction that comes from lowering interest rates; our number is substantially below what is shown in the current proposals on both sides of the aisle. As Mr. Blumenthal has indicated, this is an example of the realism principle that guides us. Those assumptions that gets you up to $55 billion deficit reduction assume that interest rates in 1985 will be 6.9 percent. If that happens, God bless us all. But we are not here to come up with a budget proposal that depends upon interest rate assumptions that we do not think are prudent. Therefore, if we are really going to get this deficit number good in 1985 of $175 to $200 billion it means that both the spending cuts and tax increases must be substantially larger than some people have proposed. As a Republican it bothers me to say this because I don't like tax increases. It means that the tax aspect has to be larger if we are going to credibly get to where we want to get.

Next, we have taken a quick look at where the spending cuts have been made up to now, or the cuts in growth. The entire transfer payments program that you know better than I is at the heart of a lot of this problem, is broken down into need related and non-need related programs. We have classified all of these programs by whether they are need related or not need related. We would make two points for your consideration. Those that are need related have been cut by about three times as much as the ones that are not need related. We are a bipartisan group that wants a sense of fairness. We want a sense of equity. And we question whether as a matter of arithmetic or equity you are going to find numbers like $175 to $200 billion by continuing to focus so much on the need related programs.

Now I think this becomes even more vivid as you look to 1985. We have looked at what the budget will look like by 1985. You will notice that of a trillion dollar budget in 1985, three items account for over 80 percent of that budget. And there is no way we are going to get numbers of this sort without looking at all three of them. If you take national defense, the non-need related transfer payments for individuals, and interest payments, you come up with $812 billion, which is 81 percent of this budget. I know of no way that you are going to get anything like the amount you need without focusing here and, importantly, at the non-need related programs of $385 billion. You will notice the total of the need-related programs in 1985 is $85 billion.

I am going to have some things to say about social security today which will demonstrate further that we are not running for office.

This number here is further supported by the fact that social security in 1985 is roughly three-fourths of that number. So our logic takes us to the position that if you are really serious about getting this number, you cannot overlook those items in a significant way.

Senator LONG. Could you move those charts a little bit closer so we could see them a little better?

Mr. PETERSON. Whatever you say, Mr. Chairman.

Senator LONG. I am having difficulty seeing them where you are.

Mr. PETERSON. It might be more pleasant if you can't see them, Mr. Chairman. [Laughter.]

I was making the point that there is no way that you can get at this budget, in our view, without looking at the non-need related transfer payment program, as painful as that may be.

In the Defense area, I would quickly just indicate what Mr. Blumenthal indicated. If you look at what we are proposing, it is still a 7-percent real growth. The only time in the recent history of this country we have had a sustained build up of that kind was pre-Vietnam.

I would now like to make a political point that you gentlemen are much better able to make than I am. We question, as a group, whether this country will politically support a sustained defense build up over a 5-year period—and all of us are unanimous in wanting such a build up—if our economy is not strong and if interest rates continue at this level. So we don't come to this conclusion easily. We simply say defense has to be part of the package, in our view.

On the tax side, as Mike indicated, we have a $60 billion amount. You will notice we go through this particular list—you can ask us any questions you want—we think there must be cuts in all spending areas, or increases in all tax areas if it is to be fair.

Now I would like to compare our proposals to those on the chart. And you will see that they are significantly different than many of the others. We are dead serious as we hope you are about the goal in each case. We arrived at it, however, in very different ways. You will notice that our Defense cut is approximately halfway between the Republican and Democratic proposals that we have had. You will notice that the cuts in the non-Defense programs, particularly the entitlement programs that go principally to the middle and upper income groups, are much higher than any group, because we do not think this problem can be solved until those programs are looked at. Now in terms of the indexing, we propose a year freeze, we then propose putting caps on indexing, because we do not believe we can get long-term control of this budget until those indexed programs are really looked at seriously.

You will notice we have zero for management savings and reductions. Now we would have liked to have had that be a big number. But what we are trying to suggest to you is financial markets are terribly sophisticated. They are sick and tired of looking at blue sky, rosy colored forecasts. One of the reasons that Wall Street is not reacting favorably is that they look at the numbers and don't believe them. We have looked at those numbers. And to be very blunt with you, we don't believe them. [Laughter.] They have 18 billion dollars' worth of revenues from the sales of offshore oil leases in 1985. The best year we have ever had in the country was $10 billion when oil prices were going up. We do not believe interest rates are going to be 6.9 percent in 1985. If they are, what a wonderful thing to contemplate. We will be on the way to a balanced budget that much sooner. But you will notice that in those items we are substantially more conservative than anyone.

Alas, and unfortunately, I faced some fair amount of heat from my Republican friends to say, what are you doing supporting a tax increase of this magnitude? What I say to them is something very simple, Mr. Chairman. There is no way we are going to get investment in the economy that we desperately need at 15 and 16 percent long-term interest rates. There is no way you are going to get long-term interest rates down until the financial markets see a long-term budget that they believe with deficits coming down. There is no way, therefore, that we can see how you can attain that number which still leaves us with a deficit, as you recall, in a range of $50 to $75 billion unless when they total up the numbers they add up on a conservative basis. So if you accept this formulation we think it would lead to that kind of effect.

Now let's move on to the question of social security. And I would like you to know where I am coming from. Part of our principle here is is there can't be any sacred cows. There are going to be some sacred cows slaughtered. There are going to be, if I can mix my metaphors, some oxen gored. The problem is too big for that not to happen. I may also say I have two parents who are both living in Nebraska in their eighties. They both receive these benefits. I am subjected to the same kind of pressures you are. But nonetheless we have got to take the long range view.

Now I have a bias and I would like you to know what it is. I have spent whatever free time I have had in the last several years looking at what is gone wrong with this economy over the last 10 to 20 years, or what has happened to our competitive position. And I conclude that one of the most serious problems this country has is that it is seriously underinvesting in new plant equipment, and research and development, and that by my calculations, we have got to find 3 to 4 percent more of the gross national product to put into new plant equipment and research.

I just came back, Mr. Chairman, from Japan. The Foreign Minister there was kind enough to invite me to visit with a number of executives there. I visited facilities all through Japan. I see now what they are doing with their investment sources. Last year, they spent more money in absolute terms on new plant and equipment with an economy less than half the size of the United States than we did. They have average plant equipment of 8 to 10 years; ours is 16 to 18 years. We have been fooling ourselves in this country by suggesting that Japan's miracle is due to the fact that we rebuilt the Japanese industry after the war. We are all pretty good at arithmetic. The war was over 37 years ago. And if their plant averages 8 to 9 years, they have done it several times since then.

I, therefore, come at this problem with a special interest of asking all of us the question: Where are we going to get the money to invest in our economic future? And it is a fiscal maxim that if you spend money, it is not available to investment.

Now, to me, the social security issue, as difficult as it is, is at a vortex of the problem we face. Now let's see what I am talking about. This is the percent of the gross national product that we are now putting in social security payments. I will say more about the trend in a moment. But we are now at 6 percent. This is the net investment in the United States in plant and equipment and research by the private sector. We are now at the point where we are spending more on the social security program than we are on all net investment in plant, equipment, and research and development. I submit to you that if we are really serious about increasing investment, we simply must look at that program, as difficult as it is.

Now we are the beneficiaries of a lot of forecasts by the social security people. And you see so-called optimistic projections, you see so-called pessimistic projections. I would like to come at this problem first from a numbers standpoint and then just a commonsense standpoint. I think you will arrive at the same conclusion. Here are the previous projections that went into the social security report. Yet, the 1976 report had a 5.2-percent real growth; the 1978, 4.1; the 1976 pessimistic, so-called, had 3.7, 3.5 for this 1975 to 1985 period. Here is where we are now, 2.8 percent, substantially below even the pessimistic forecast for the last 10 years.

Here is the cost of living. The same picture. Now what I am trying to say is that if you look at history, the so-called pessimistic social security projections have turned out to be optimistic later.

In 1977, the social security tax increase that was put into effect I think people sincerely believed would solve the problems. And here, only several years later, we are back, you know, in a situation where we are currently having serious solvency problems. Now let's see where this leads.

In the forecast for the future, what is being included in these forecasts? Here are the real growth rates that are being assumed: 3.8, 2.7. Here is the inflation figure. Now I submit to you, given our track record over the last 10 years, that these pessimistic numbers don't look all that pessimistic to me, based on the track record of our country over the last 5 to 10 years. And, therefore, we would question whether a prudent man should refer to them as pessimistic.

Now where does that leave you? Let's examine what would happen if the pessimistic projections were indeed to materialize. They have more than materialized in the last 10 to 15 years. This shows the kind of deficits we have been facing. And this is why I say that until the financial markets see some long-term structural fundamental things happening, they are going to worry about this pattern. This is the deficit alone from the social security program in the absence of increased taxes out into the future. I would hope you would agree that they are intolerable numbers in terms of having any money left for investment.

Next, if you want to achieve so-called short-term solvency—I will get to the long-term problem in a moment—what would it take to do it by the tax increase route? I think, Mike, I speak for all of us, we are unanimously opposed to solving the social security problem by increasing taxes, because all that does is it says more spending, less investment. We cannot have it both ways. Social security is a spending program. But in order to achieve short-term solvency—and I wonder if the American people really understand it—it will take a 1-percent increase in percent of pay, we estimate, in the social security tax next year to keep the program solvent over the short term. That would be the largest tax increase in the history of the country. We don't see how people can say they are for tax cuts and be seriously contemplating that kind of a social security tax increase.

Over the long run, I think these forecasts of what it would take to keep the program solvent are absolutely unsustainable, both from an economic and a political standpoint. We are looking down, as you know, out here 20, 30 years at social security tax rates that are in the range of 25 to 30 percent of pay and even higher. There is no way that this country could do the investment needs with payroll taxes at that level. And I will leave it to the politicians to examine the politics of what happens when the young people of this country fully contemplate what kind of tax is it going to take to keep this system viable.

Next—and I will be through in just a moment—these have been the statistical projections looking at this social security program. Let's now use a commonsense approach and see where we are headed. It is my argument, Mr. Chairman, that they used to say about cake mixes, if eventually, why not now? Because the problem is a progressive disease. It is getting worse. Here is the estimate of the growth in recipients. I am not sure I know what pessimistic or optimistic means here. But here is where we are heading. We have 12 million aged at this point. We have doubled now. We are looking at numbers on the so-called optimistic numbers. There would be 65 million recipients receiving it. So there is going to be an enormous increase in the demand for social security money just for the increased numbers of recipients.

Now when I talked to my parents about this program, like so many other recipients, they say with all sincerity the Government had a contract with me and it is my money. I have gone back, as I trust you have, to look at whether it is their money or not. And what we do here is to say, what do you mean by their money? And I had this debate with my father. First, if what you mean is to get back their contributions only, the average wage earner who is single gets his money back in a year and five months. If he has got a nonworking spouse, he gets his money back in 11 months. If you say, what you mean by their money, is their money plus interest, because they ought to be paid interest on it, it is 3 years here, and 2 years here. Now if you take the most expansive definition that I can imagine of their money, which is the employer contribution, the employee contribution, plus interest, they still get all their money in the range of 4 to 6 years. Now how long are we going to be paying those benefits? Not 11 months. Not 2 years. Not 4 years, but 16.9 years. Now, again, you don't have to be a genius in arithmetic to figure out that if you are paying out these benefits for 10, 12, 14 years more than has been contributed, you have got a problem even if the numbers weren't going up so much in the older age category.

The next question: What is happening to the people that are going to be contributing this money? And you know these numbers as well as I do. We have a rapidly expanding base of recipients. We have these programs indexed. And here we are on what is happening on the contributions side. The optimistic assessment is that we will have gone from 16½ to 3.3 to 2, 2, that is, contributors per beneficiary. Now this may not seem, Mr. Chairman, as a great big change. I remind you, however, that if two people are now paying what 3.2 people have to pay, that, relatively speaking, implies a very large tax increase to support it. And I submit to you that the politics of this issue have not really yet fully dawned on the taxpayers of this country as to what we are talking about.

Medicare, which I know you are looking at, I don't know much about medicare, but I decided our group should get the numbers. What is responsible for the big increases? Is it the increase in beneficiaries or an increase in disbursements? Up to now the beneficiaries have been at this level. It is perfectly obvious that the disbursements for beneficiaries have just gone up dramatically and are the principle source of the spending problems we are now having in this program.

Earlier I told you that this country's net investment in plant equipment is about 3 percent of GNP. Our investment in research and development by our companies is about 1¼ percent. Where are we headed here? On the medicare program we are looking at estimates out here in the range from 2½ to nearly 4 percent of the gross national product just for that effort, or as much as the entire investment of this economy in plant and equipment. And I submit to you that we cannot have it both ways. We can't say we want this investment and still be taking that sort of approach on these huge spending programs.

Now if I may be blunt about this, let's get to the issue of the politics or the public understanding or whatever. It has been said that social security is a case of the irresistible force and the immovable object. The implication is that it is either impolitic or impossible to grasp this issue. I have gotten a hold of a survey here of the Gallup Poll people that I have not seen before. I thought you would be interested in if you haven't studied it. If you haven't studied it, I urge you to study it because I know you are hearing a great deal from many current recipients, but this is the first cross-section I have seen.

Remember my talking earlier about the potential long-term political problems. The question here is: What is the confidence in the future of the social security system? To me, a stunning 70 percent of the young people between the ages of 18 and 34 do not believe they are going to receive any social security benefits upon retirement. And I think it is going to be very hard to sustain a system in which someone's taxes are going up dramatically and they do not believe that they are going to receive the benefits that come from that.

There has been a lot of talk about indexing. To what extent does the public—I am not talking about the recipient people and organized groups that communicate with you, I am talking about the public at large—know about indexing? Sixty percent of almost every category believes that social security has gone up less than the cost of living in the last few years in spite of all of these discussions that have taken place about 100 percent CPI indexing.

The next piece of information on public knowledge. What kind of index does the public say it would prefer? Well, it is interesting to me that nearly as many people would like to leave indexing to you annually, and I know that is where you started. And I know a little bit about how you have gotten where you are among the retired. Of those who are paying the bills, the workers, more would like to see it not automatic and would like to see it approached based on a current basis. The interesting question is then raised: If it is automatic, what do you think is the fair way to indexing? It is interesting here that a substantial number believes that the preferred and fair way to index is some relationship to the COLA's that are in the private sector on wage contracts on both categories. Now, how have the increases that recipients have enjoyed lately compare to what is happening? And we have gone back, gentlemen, and we have looked at the COLA clauses in the private sector versus the social security increases, and in every year it is perfectly obvious that a COLA system that the public is saying they think is the fair one, that is, that the people contributing the money got certain increases—what about us—are much larger on social security than they are among the wage earners. And yet people say at least that this principle is a fair one. I am simply submitting this to encourage you to explore indexing alternatives because I think large parts of the public that you are not hearing from are willing to listen to other approaches to this indexing problem that could save the budget enormous sums of money.

Now, some might say, well, what if you include all of the wage increases? In other words, never mind the COLA's, but the total increases. If you look at it before and after taxes, it is clear that the social security recipients are getting substantially more in increases after taxes than the total increases of workers. Now, on this particular point, and why we believe a 1-year freeze is not an unfair idea, given what has happened during the last 3 years and as I go around the country talking to people, people are shocked to hear this. An interesting question. During the past 3 years average wages increased by 30 percent before taxes. During this period, by what percent did social security benefits increase? The answer is 40 percent after taxes. Now, I think equity suggests that there is some significant room there in a humane way for taking care of our elderly but slowing down the growth. And what encourages me enormously, Mr. Chairman, and what I know is a very difficult subject politically, is every study I have ever seen suggests that a few changes put into effect over a period of time in the area of increasing retirement ages gradually, in taxing the half that has not been taxed, in the indexing area, and in the universality of the coverage will take care of this problem and release these desperately needed resources to the private sector. I am sorry to take so long, but I wanted to focus on this subject. Thank you.

The CHAIRMAN. We will follow the early bird rule as I remember it. I know Senator Byrd was here first. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman. I think that was a very interesting and significant presentation. As I visualize it, both Secretary Blumenthal and Secretary Peterson feel that the budget and Government spending is totally out of control. Am I correct in that assessment?

Mr. BLUMENTHAL. You are certainly correct.

Mr. PETERSON. Correct.

Senator BYRD. And that you feel that the key to our problem really is to get spending under control.

Mr. PETERSON. Absolutely.

Senator BYRD. And that, of course, has not been done. I must say I was not even aware of this until several weeks ago. But the increase in spending for this current fiscal year will be 13 percent, and that compares to the increase last year of 14 percent. So we have made very minute progress in getting spending under control.

Now, let me ask this. Under the Senate budget resolution during the next 3 years and 5 months the Government will spend $468 billion more than it takes in. My question is: Is the business community aware of this? And, if so, what is the reaction?

Mr. PETERSON. I think the stock market gives you a reaction. I think interest rates give you a reaction, and I think bankruptcies give you a reaction. I think exchange rates give you a reaction. I think we have got enormous evidence, Senator, that the markets are reacting very adversely.

Senator BYRD. The national debt will increase by 44 percent in 3 years and 5 months; namely, from $1,065 million to $1,533 million which is another way of saying that spending over and above revenues will go up by that amount, namely, 44 percent in 3 years and 5 months. Will that not lead to a rekindling of inflation?

Mr. BLUMENTHAL. Senator, I think it is clear that the budget is out of control, that spending has to be brought under control, and that whatever levels of spending are enacted are backed up by raising the revenue to pay for it. I recall that you used to be very critical when I appeared before you when I was in the Treasury when we were talking about budget deficits of between $30 and $60 billion and a level of the debt substantially lower than it is at the present time. It is clear that with respect to the kind of numbers that we are talking about now, and that I have referred to and Secretary Peterson has illustrated, the markets are telling us that that is an unsustainable situation. And that is why the long-term rates don't come down, because exactly, as you see, the expectation of continued inflation down the road is clearly prevalent. So unless you take these actions that we are suggesting, the expectation of more inflation and the fear of the implications of the budget being out of control—spending and revenues being out of control—will not enable us to get back on an even keel.

Mr. PETERSON. Senator Byrd, if I could take a quick crack at that. If you project the kind of deficits we are talking about in the mideighties, those numbers turn out to be 5 to 5½ percent of the entire gross national product of the United States.

As you have detected by now, I am a nut on increasing investment in plant and equipment, research and development. Why don't we think of those deficits as negative savings because they have to be taken out of the savings pool. I am shocked to hear some of my colleagues say these kind of deficits are not all bad because the Japanese have these kind of deficits. The Japanese have a savings pool at the private-sector that is four times ours. This number would soak up most of the net private savings in the entire country. And if you do it that way, sir, there is no way you are going to have it available for plant and equipment growth, and research and development growth.

Senator BYRD. My feeling is that our Nation is facing an economic crisis of major proportions. Am I overstating the case?

Mr. BLUMENTHAL. Well, crisis is a word that scares a lot of people. But, clearly, if action is not taken, we will be in a very, very deep crisis. And I think we are facing one. But I think the opportunity exists right now in this year, 1982, to make a beginning on correcting this and looking over the next 3 years to avoid a real crisis from occurring. That is really what we are saying.

Senator BYRD. I have just two brief questions. We are in full agreement that spending is out of control and we need to tackle, first, spending. But let me ask this. Should the third year of the personal income tax reduction be deferred? And, if so, what would be the reaction in the business community?

Mr. BLUMENTHAL. I will try it and perhaps Mr. Peterson would like to respond also. We are not recommending that that be the first step or the preferred step that the Congress take. We are saying that $60 billion in additional revenue needs to be raised. We are suggesting a number of ways in which that can be done. Energy taxes are one example where a substantial amount can be raised. Certain kinds of excise taxes, all kinds of closing of tax loopholes or tax preferences, elimination of various kinds. You are going to have to add up to see what you have.

If you find—and you may—that there is no way to get to at least the $60 billion without also dealing in some way with the third year tax cut, and you are prepared to act on the rest of this program, then we say that may be necessary. But only in that context.

Senator BYRD. So it is really—what you are really telling this committee and telling the American people, what we need to do is to tackle spending. That is the key to it, is to tackle spending and get spending under control. Then if we do that——

Mr. PETERSON. Senator Byrd, you may notice that our statement says here that as far as the tax side is concerned—maybe you can help me find it, Mike—that the stretching out or delaying of the tax cuts for 1983 has the unanimous consent of the undersigned only in the context, only in the context, of prior agreement on the kind and magnitude of spending cuts referred to in parts 1 and 2 of this program. To me, a reduction in spending growth is vastly to be preferred, because it releases the money to tax increases. So that must be where the priority is.

Mr. BLUMENTHAL. But I think we also have to point out that our own calculations indicate that you have got to deal with entitlements and the nonneeds related programs first to get spending under control, and you have got to deal with defense to at least get it down to a 7-percent real increase.

We have also calculated that even if you do that you still need $60 billion in additional revenue. Now, if you can find a way to bring spending even further under control, reduce it further in order to obviate the need for that additional revenue, God bless you. But I guess we concluded that that is beyond the realm of the possible.

Senator BYRD. Well, I think that your emphasis on the need to get spending under control is really what needs to be dramatized to both the Congress and the public. Thank you.

The CHAIRMAN. I just have one question now, and that is, we are looking at some of these "loopholes" and we find that people who are affected are not as anxious to have those touched as it might seem to some others. But do you think there would be strong support from the business community, generally—we are going to hear from four outstanding business leaders on the next panel, final panel—do you find support for what you are suggesting in the business community?

Mr. BLUMENTHAL. It is my impression on the basis of those business leaders that I have talked to that the approach that we are suggesting has very wide support. And we hope to demonstrate that in the weeks to come in a very public way. It is equally clear that with regard to the old maxim that I always quote from Senator Long about people hiding behind a tree, when it comes to taxes, businessmen are no different from anybody else. And I would say, as a businessman, that I would hope the Congress is careful not to eliminate the incentives for investment and for increasing productivity that are so essential. But my impression is that in the context of a program that realistically brings this budget under control—if there are included some difficult things that are not very appealing to the business community—they will accept that if you are also dealing with entitlements and these other spending programs.

Mr. PETERSON. Senator, I might say on the business community that Bob Kilpatrick and others are better equipped than I to speak for the corporate sector. We are intending to broaden this group in a very important way nationally because we understand this is a long-term effort that is underway.

I would want to emphasize that in addition to the public officials that have quickly joined this effort—Cy Vance, George Ball, Harold Brown, all people you will have remembered, Felix Rohatyn, Henry Kaufman from Salomon Bros., Thornton Bradshaw of RCA—we hope to get a very representative group of outstanding business people. I think you will find a lot of Wall Street support at least for many of these proposals. We hope to demonstrate that by adding them to the list.

The CHAIRMAN. I noted one item you had there—it may be a loophole—safe harbor leasing. I assume you would have modification of that provision.

Mr. BLUMENTHAL. I speak personally now because we have not covered that. I personally think that that warrants looking at, yes, sir.

The CHAIRMAN. Either that or enlarge it so individuals could transfer their unused credits and exemptions, too. [Laughter.]

There are two ways you can approach it.

Mr. BLUMENTHAL. I think that certainly ought to be looked at. I think there is a question about the middlemen who have been doing rather well under it. I think there are some ways in which the program could be handled better.

Mr. PETERSON. Senator Dole, I might say, however largely, that while I would agree that we are going to have to have all sectors participate in the burden sharing of this effort, I do want to remind you that at least as we calculate the numbers, only about 20 to 25 percent of this tax cut was business oriented. And in previous years, my recollection, Mike, was the number was a third or more.

Mr. BLUMENTHAL. Yes.

Mr. PETERSON. I would hate to see things happen to this program in aggregate that already take a program not heavily slanted toward investment and cut it significantly further. So I would want the aggregate effect to be in the direction of investment.

The CHAIRMAN. I share that view. And I don't know what will finally emerge from this committee, but I do know that the part that we have been working on does very little on that. But there are some areas we have looked at, but not many. But we are trying to do just what you have indicated. Senator Long.

Senator LONG. First, let me ask Mr. Peterson about a matter that was not touched on in his testimony. To me, it is relevant. The best I can make out of it, if we are going to continue this trend we have in trade, that means we are going to produce less automobiles, a lot less steel, get out of shipbuilding, produce no textiles, no wearing apparel, get out of electronics, produce less aluminum.

When you were Secretary of Commerce, Mr. Peterson, you once suggested that a way to solve this trade problem was that every nation should be willing to settle for a balance of trade. Do you still hold that view, or do you feel differently about it?

Mr. PETERSON. I think, Senator, what I would like to suggest is that our current situation is heavily out of balance, and there is a very clear relationship that, frankly, is not publicly appreciated at the moment, that is, behind this budget crisis high interest rates and what is happening to America's trade position.

I recently returned from Japan. And you and I had some discussions 10 or 11 years ago about the Japanese and getting the exchange rates readjusted. You remember how remarkably unenthusiastic they were, to put it gently, about any adjustments in the yen, back in 1971. And you remember how they used to say to you and me: We are a humble little country, and, you know, we need these reserves, and so forth. And you remember that none of us were moved to great tears even then, remembering that we were in the presence of the head of the largest steel company in the world, about the largest electronic company, and so forth. Now, it has gone far different than that. The Japanese manufacturing trade balance, as you probably know, is now in the range of $100 billion, and there are about 35 to 50,000 jobs per billion.

Now, what is aggravating this situation now in a very significant way? This last visit, which I took in April, I was astonished to hear even the public officials, even the corporate executives, saying that the yen was undervalued by probably 20 full percentage points. Instead of 245 yen, I got estimates of 180 to 210. There are a lot of things they can do, Senator, to help on that, by opening up their markets and their capital markets. But I remain convinced that a single most important reason for that is our high interest rates. And I calculate—because the money is coming into the United States—that our overvalued dollar is costing us hundreds of thousands of jobs.

So what I am trying to suggest to you is yes, we are out of balance. One of the fastest ways of getting us into balance is get these interest rates down so that the dollar is valued properly, because it is costing us enormously now in terms of export jobs, just due to the overvalued dollar.

Senator LONG. Well, you are talking to a situation where I once thought you had the logical plan, that is, each nation ought to be willing to settle for a balance. Now, the Japanese are not going to voluntarily give up the enormous profit they are making at the expense of this country and its economy. Some time back, a Chinese delegation visited here. After they left, I said to a Japanese group that I had finally figured out how we could make some progress toward getting our trade accounts in balance. We have got to do business with the Chinese, because with our help they can sell us everything the Japanese are selling us, and meet the competition. And they will buy from us. So those Japanese people proceeded to say, oh, Senator, you wouldn't want to do that. You don't want to trade with a Communist country. And I said, well, ordinarily not. But I am going broke trading with you people. [Laughter.]

We ought to pursue the concepts you had: Look, if you want to sell into this market, you have got to take something home with you.

Have you abandoned that view? That is the view you once held as the Secretary of Commerce.

Mr. PETERSON. I have probably abandoned a lot of views or I have forgotten some that I was alleged to have. I don't know. I am not sure that I ever said that we needed balance with each particular country, Senator.

Senator LONG. You didn't say that. You said that each country ought to be willing to settle for a balance.

Mr. PETERSON. In its overall accounts, as over a period of years, yes, it should be much closer to balance than we are, much closer.

Senator LONG. Thank you.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. Thank you very much, Mr. Chairman. My figures show that there was a tax bill last time of 80 percent for the individual——

Mr. PETERSON Yes.

Senator BENTSEN [continuing]. And 20 percent for business.

Mr. PETERSON. Twenty percent, right.

Senator BENTSEN. If you add the alternative minimum pass, as has been proposed, you would end up 90 percent for the individual and 10 percent for business.

When you talk about putting these limitations on and the political problems then, we had a budget proposal by Senator Johnston that I voted for that called for a 7 percent on Defense over 3 years, and called for, in 1984 and 1985, a 4-percent cap on COLA's, and cut the deficit for 1983 to $103 billion, and brought about a balance budget in 1985 is what you are talking about.

Mr. PETERSON. Yes.

Senator BENTSEN. Now, I was interested to see, because I went back and spent 9 days on the fried chicken and green pea circuit back in my State, and I did five town hall meetings, and I wondered how much flack and heat I was going to catch for that vote. None, as long as they thought that it was done to all COLA's for everyone No one picked out and singled out, be it Social Security, Veterans, or what have you. They accepted it. And I think sometimes we put too much emphasis on their not understanding or not being willing to take it if they feel that it is equitably shared across the board.

Let me ask you one specific though on accelerated appreciation. We had proposed one in the fall of 1980 last year that did not have a negative result and effect. Yet, when we get into the accelerated depreciation for 1985 and 1986 and the acceleration up to 175 percent and 200, some point in there we get into a negative situation where a fellow in effect recovers back more than he has paid. Do you think we ought to reevaluate that part of it?

Mr. BLUMENTHAL. I certainly think you should; yes, sir.

Senator BENTSEN. And I say that with a great sympathy for the encouragement of investment and the need for it in trying to increase productivity. I think that we are going to have to look seriously at that third-year deferral because we try to nibble our way up to that $107 billion I think it is that we have to try to gain over 3 years. It is going to be exceedingly difficult to do it. Some place we have to be able to hit a long ball, and that may be the point where we have to do it, on the third year: defer all or at least part of it.

Mr. BLUMENTHAL. I agree with you, Senator Bentsen. I merely say that there are a lot of different steps that you can take. Each one of them is difficult, whether you are talking about a change in ACRS, or safe harbor leasing, or all of these other things. I know that there is a long list that was presented to you. Each one of the items on it is difficult. And I doubt whether it is feasible to get enough revenue generated out of all of these very difficult individual steps. I think you are going to have to look at what you called some long balls that you can hit, which is some major action some place.

Now, if you can do it without touching the third year, fine. But if you cannot do all the other things, you may have to look at that.

Senator BENTSEN. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Danforth, then Senator Durenberger and then Senator Bradley.

Senator DANFORTH. As I understand it, your position is that the best way to bring interest rates down is to have a responsible budget and close the deficits over the next 3 years. Are there other things we should be doing to get interest rates down? It would be possible, but not in place of closing the deficits, but supplementing the deficits closer, to come up with some more artificial means to bringing the interest rates down. Saving incentives, for example, some sort of interference with the Federal Reserve Board. The Looper bill is a way of artificially getting interest rates down. Should we be considering something in addition to closing it up?

Mr. BLUMENTHAL. Well, let me address myself to these points that you have made, Senator Danforth. I don't believe that it would be wise at all to seek to interfere with the functioning of the Federal Reserve. I would say that if we are talking about confidence and realism on the part of the investment and business community, an effort or a move by the Congress to seek to legislate loose money, or a looser monetary policy, might well have exactly the opposite effect from what you are seeking to achieve. Interest rates might go up rather than down because those who have the money to lend might be very concerned that such a move really is the beginning of an unkindling of a highly inflationary period ahead. I have always looked upon the Federal Reserve Act of 1914, I believe, or 1912, as being a very good act because it does provide the opportunity for the Federal Reserve to act independently and to follow a sound monetary policy. And I think it is a bulwark against some of the risks of going in another way under the political pressure of the moment.

Savings incentives in general terms sound good. But when you ask what kind of saving incentives are you talking about, it really becomes a matter of allocating resources. It costs money. Nothing is free. I don't think that such incentives would be free of any cost. And I just don't see how that is easily done. So I would say the key is the budget. And I don't believe that looking at monetary policy or legislating ways in which people are to allocate the capital available is going to solve our problems.

Senator DANFORTH. For example, the money markets are a new phenomena. The practice of savings is very high in interest paying. I am wondering if there could be an effort to control that way of saving money?

Mr. BLUMENTHAL. I think you have to ask yourself, where do the resources come from that have gone into money market instruments of various kinds. I think it has just been a shifting around. It reflects a recognition on the part of people that leaving your money in an insurance company when you can borrow on it at subsidized rates compared to market rates, or leaving funds in a savings account, which is why the thrifts are having all this difficulty, doesn't make much sense. So it is just shifting around. And I don't really believe that that is a way to solve this problem. You come back to the budget every time.

Mr. PETERSON. Senator Danforth, I think I would say that getting this budget under control is a necessary step, but probably long term not a sufficient step. And if I can just tell you an anecdote about Japan. You know, I wonder if we spend enough time in this country trying to understand why they are saving several times more than we are. We tend to explain it in terms of metaphysical, cultural, historic forces as though there aren't bottom line considerations. It seems to me the Japanese save more partly for cultural reasons, to be sure, but for two other reasons. First, they need to save more. And why do they need to save more? Well, frankly, some of their public pension programs are smaller than ours, so they need to save it. They have earlier retirement. But the other reason they save more is that it is enormously attractive in Japan to save. And I am sure this committee has done this, Mr. Chairman. But I think it is a very interesting exercise to look at how they treat investment income, how they treat capital gains, how they treat investments versus us. I had a Japanese official tell me on my last visit: He says, I look at your tax system, Mr. Peterson. You seem to be encouraging people to borrow, not to save. And there is a fundamental difference in the tax systems.

The second point I would make is if you look at the mix in the United States versus Japan on consumption oriented taxes versus investment taxes, there is a very significant difference. They are much more on the side of encouraging investment. We are much more on the side of encouraging consumption. And I happen to believe that in addition to getting the budget under control, that is really the next very important agenda item for this country.

The CHAIRMAN. Senator Durenberger.

Senator DURENBERGER. Thank you. As one who is up for reelection this year, let me step back to keep your opening comments about we are not politicians running for office so we can be honest and candid and truthful. It has been very difficult this year for some of us who are up for reelection to shed the image that we are just playing politics with this process. And I just want to say that by way of frustration.

Also with regard to social security reform, I think the heart of the issue and the problem here has not been with all of these statistics, and particularly having those of us who have been up for reelection over the last year and a half since the Budget Committee made this an issue last year, have been sensitive to the fact that nobody in my State under 35 believes there is going to be any social security. Not one single one. It isn't 69 percent, it is 100 percent. And among my parents in Minnesota and a lot of elderly people, the need to reform the system is immense, enormous. The only issue here is whether you do it in a budget resolution, or you do it right here in this committee. And we have been prevented from doing it in this committee by politics. And so it transfers over to the budget side and creates problems for it. Now, I have been looking for a value in deficits. Not that we continue to promote them, but some particular value in deficits. And it seems that the greatest value in having a deficit is that it forces you to find a better way to do things. And I guess I am pleased that you are looking at 1985 and you are talking about the need to reform the system because the idea that we can sit here and just push these numbers up and down to balance the budget, to me, is unrealistic. And you prove that with social security. You prove it with medicare, and on and on. But in the end, this whole issue of taxes, which is one of our major responsibilities, becomes a crucial issue.

We are all somewhat uncomfortable with the way we are dealing with the tax issue this year, because last year we felt good. We did a lot of good public policy. We started changing that impression that the Japanese have of us last year in tax policy. But this year we are listening, you know, to another voice that says, just raise money and narrow the deficit. And I think I heard Mr. Blumenthal say, if you can't find enough in loopholes, if you can't find enough in energy taxes, and you can't find enough in excise taxes, all of which, except maybe the loopholes, are basically regressive taxes and fall unevenly among our population, then we would permit you to go to the progressive income tax and find sources there either in the third year. And maybe that is one of the things that is bothering some of us. It isn't the issue whether we are for or against the President on a third year, or whether we believe in supply side economics. It is the sort of a choice of revenue weapons that we use. Should we try to pump everything out of cigarettes and alcohol and luxury taxes and all these things that usually you leave to State legislature, or should we look at the progressive income tax in this country with its current feeling as our long-term source of balancing the budget?

Mr. PETERSON. Senator, I know this is far from the unanimous view, but at the top of my list—and I would be saying this even if we didn't have this fiscal mess we have now—is the energy area. I would like to remind us of two or three things. In the first place, vis-a-vis Europe and Japan, our energy taxes are much lower than they are there, much lower. We have already seen what price can do to oil demand. Our imports are down significantly. Further reduction, to get to Senator Long's point, of imports would have an enormous effect on the dollar and keeping those resources in this country. But, to me, even if none of today's fiscal considerations were present, look at what is happening today in Lebanon. Look at the dependence this country has. And if you want to see an economy in a turmoil, you try to imagine what would happen to this country at the present time with an embargo at these current demand levels. And I don't know about Mike, but I would be advocating energy taxes and an enormous acceleration of the strategic storage reserve just as a national security issue and an economic security issue, even if we weren't in this current fiscal bind. And I know that isn't a vote winner either.

Senator DURENBERGER. We are trying to make it that. I don't know if we are going to make it.

The CHAIRMAN. Mike, do you want to follow up on that?

Mr. BLUMENTHAL. I fully agree with what Mr. Peterson said. I would just make the additional point that I have been impressed by the fact that the tax experts who work on these kinds of things, and the committee staffs, are really quite ingenious in taking almost any tax and making it relatively more or less progressive if they wish. You can deal with energy and make it a very regressive tax. Or you can make it more progressive. You can do that. I have seen some proposals for a single tax, for example, which remind me a little bit of my former boss, President Carter's, efforts at tax reform. And you can make that either regressive or progressive. So it is possible. What we are suggesting does not necessarily mean that we go to the regressive side as against a progressive one.

The CHAIRMAN. Bill.

Senator BRADLEY. Thank you, Mr. Chairman.

You each have recommended in your proposal that we raise taxes in 1985 by $60 billion. What does that mean in total revenue raised over a 3-year period? As I look at your menu of possible tax increases, and take tax increases that would equal $60 billion in 1985, and then add up what they mean in 1983 and 1984, I get to a

3-year tax increase of $150 billion. Is that consistent with your recommendation?

Mr. BLUMENTHAL. $130 billion, apparently, Senator.

Senator BRADLEY. $130 billion. All right. Well, I won't argue with that. The point is it is considerably higher than what the Senate Budget resolution has suggested in the way of tax increases.

Mr. PETERSON. Senator, on that point, and as a Republican I say it very painfully, I want to tell you. But, if you buy what we are saying about the 1985 projections, that there is $40 to $50 billion of water or hot air or any characterization you wish to use, it means you have got to get that money somewhere. So I would have been amazed if our program, since we don't accept those numbers, wouldn't have had more spending cuts and more on the revenue side.

Senator BRADLEY. All right. I just wanted to establish the size tax increase that we are really talking about over 3 years. Now, the issue that Senator Durenberger touched on, but that I think I would like to come at from a different angle, is we not only want to look at the total revenue we have to raise, but what is the optimal mix of sources of revenue from a macroeconomic prospective. In other words, is it best for employment, productivity, interest rates to slap on excise taxes, or to raise income taxes, or to put on an energy tax? From a macroeconomic standpoint, how would you advise the committee the relative merits of each of those approaches?

Mr. BLUMENTHAL. Well, I think what Mr. Peterson has said would summarize my view very nicely. First of all, I think energy taxes are an important first source for you to look at for reasons that go beyond merely the budget.

Senator BRADLEY. So you are saying that energy taxes, if I understand what Mr. Peterson said, energy taxes are good because we need a national security premium on imported oil essentially, and that we reduce demand and make ourselves more secure, and ultimately economically as well militarily.

Mr. BLUMENTHAL. But that will only give you, an important but clearly not major portion of that $130 billion over the 3 years that you need.

Senator BRADLEY. But my point is——

Mr. BLUMENTHAL. In response to your second question, or to your main question, what is the right mix, I would say, again following on the very pertinent illustrations that Mr. Peterson has given, my bias is toward a mix; that increases investment and savings in the society rather than spending.

Senator BRADLEY. But what would that mix be?

Mr. BLUMENTHAL. That would mean that you tax those areas that affect consumption more than you would those that either incentivize savings or provide incentives for investment.

Senator BRADLEY. So this would recommend essentially excise taxes and energy taxes, taxes on consumption, rather than personal income. Or would it mean rather than business tax increases?

Mr. BLUMENTHAL. There are some business taxes that you may wish to look at that are also not productive in providing incentives for investment, or perhaps for the wrong kinds of investments.

There you get into the kind of detail that obviously the committee has to look at item by item.

Senator BRADLEY. When we have suggested an energy tax up here from time to time, this administration, or independent analysts, as well, have said, well, look, the macroeconomic effect of an energy tax is going to be negative because you are going to increase the price of energy at a critical time in a recovery. You are going to increase inflation. You are going to zap any kind of momentum that might be developed after the tax cut comes in in July. So, how do you weigh those?

Mr. PETERSON. It is a little bit like what I said, Senator Bradley, about the entitlement programs. I would like to know when there will be a better time. Inflation at the present time is in better shape than it was, and that was always an important argument. In times past, oil prices were going up dramatically, and it was said that is the wrong time because it is going to increase oil prices. I can't predict where oil prices are. But, clearly, we are in a different environment now than we were then. The vulnerability point gets worse, not better, as time goes on.

So it is one of these things like entitlement programs. There is a certain logical inevitability to doing this something about this vulnerability. And while it is always painful, I can't—I don't understand why now is a, you know, not a better time than, you know, some other period. I think it is indeed a better time. And I remind you, on Senator Long's point, that a reduction of a couple of million barrels a day of imports would have a dramatic impact on the value of the dollar and the balance of trade, just a dramatic impact.

Senator BRADLEY. So that you are recommending tax increases of 130 plus over the next 3 years, and that your priority of tax increases would be essentially taxes that affect consumption, energy and excise taxes, first, income taxes, second, and, third, taxes that affect business investments. Is that correct?

Mr. BLUMENTHAL. Except those taxes that affect business which are not judged to be important to maintaining or increasing the kind of investment you want to see in the country. If I may just add one point, because, Mr. Chairman, you referred to this article I wrote entitled "What Ronald Reagan Can Learn from Jimmy Carter." The point—the illustration I used, if I recall correctly in that article dealt exactly with energy. There was never a right time I found during that administration, to deal with the energy situation quite as decisively as many of us felt, it ought to be dealt with. It was always a concern that OPEC was going to raise prices another $2 to $4 a barrel, and that this would mean 4 more cents at the pump. And there was always an election coming up and that wouldn't play too well out in the country. And when we took steps, we always took lots of little steps and we were always late.

It seems to me that in this period when energy prices have been somewhat softer, when the kind of budget situation we are facing is so serious, and when inflation is relatively lower, it is a good time to make a major step. If you don't do it now, you are not going to do it 1 year or 2 years from now.

Mr. PETERSON. Senator Bradley, somebody that is as sophisticated as you are in these economic matters probably doesn't need me to remind you of this, but the record might want to show that even those that are concerned about inflation should remember that interest rates are an important aspect of inflation. And if we did something here that sent out a credible signal that got interest rates down, increased the value of the dollar, which I think it would, significantly, there would be other effects that would reduce the inflation rate in other aspects of our society. And what we ought to be concerned about, I assume, is the net effect on inflation.

Senator BRADLEY. Thank you.

The CHAIRMAN. Senator Boren.

Senator BOREN. Thank you, Mr. Chairman. I apologize that I had to step out to another committee meeting in the midst of testimony. ny.

Senator LONG. Would the Senator excuse me for just 1 moment while we are on that point? Here we are right now with the prospect of having another Arab boycott put on us just any day now. We are in the prospect of getting in lines a mile long to buy a tank of gasoline. Yet we are still subsidizing energy consumption to the tune of $80 billion a year in America.

Mr. PETERSON. That's right.

Senator BOREN. I want to say amen to that. But what I did hear I certainly appreciate it very much. What Mr. Blumenthal just said a minute ago about our history doing too little too late, trying to nibble away at a problem instead of facing it head on with a dramatic enough action to really do something about and impact it, I certainly think is exactly a description of what we are in the process of doing now. And I find myself completely frustrated by what I see as institutional framework both at the White House and in the Congress for failure to face up to it.

It has been said, and I apologize if you have already gone into this, that what we must do now—the most urgent task facing the Congress—is to come up with a budget, any old budget. We just have to have one. If we just have one that that is going to have some magic impact on the country. And I gather what I hear both of you saying, or the thrust of what you said, is that we are going to have deficits of the magnitude of those that are actually in the Senate-passed budget resolution, when you get rid of all of these hokey, nonexistent management savings, and these fraudulent savings on interest payments. And we all know that we are talking about $500 billion and not $390 billion by the time you knock out all the hot air. And you look at the House alternative which appear to be even slightly worse than, that's possible, in what the Senate passed, you don't think that that is going to impress the market very much.

Do you feel that we have to tackle, before we really have an impact on the market sufficient for them to have confidence enough to take a little of the pad off the interest rates, as they look at it in the future at the delimiting deficits, you think we have to tackle entitlements and we have to tackle the revenue side, both to some degree if we are going to do that? Is that correct?

Mr. PETERSON. I might say, Senator Boren, that Wall Street is not exactly a folk hero in American life; we would agree, I think, with that characterization. And last year we heard a lot of complaints about how Wall Street was doing this and that, and they ought to bring interest rates down. Well, in the first place, Wall Street is the whole world, and it is at least characterized by one thing. They do put their money where their mouth is.

Now, you have got very sophisticated people throughout America who look at these budgets in detail. The idea that long-term interest rates—and that is what I am principally concerned about because it is the long-term interest rates that are killing us on investment—are going to come down if you don't get your long-term fiscal house in order is a contradiction in terms. And you are not goin^r to fool the markets.

No. 2, in preparation for this meeting, Mr. Chairman, I had our people question about a dozen very important bond market people across the country, and I said to them, what do you think it takes before the message that is sent out is credible? And by that I mean really bring down interest rates. And I think, without exception, they said, (a), make it credible. No more hokem-pokem, because we have had all too much of that in recent years. No. 3, it has got to be across the board. There can't be a lot of sacred cows. We can't do this and we can't do that. And, No. 4, without exception, the big entitlement programs are what we are looking at, including social security. And I know that is a tough message to deliver. But until those programs are moved on, I think you are going to find markets out there being very, very dubious about whether we have got our fiscal house in order, because they can look at those growth numbers just as well as I can. And why should anybody give you money long term if he has got that kind of a prospect he is facing? So I think that is the test that people are looking for.

Senator BOREN. I certainly agree with you. I don't think there is a conspiracy. I think that they can read hot air as anyone else can. And when they are talking about investing their own money, they are reacting to the facts.

So I gather that you would feel that if we passed—let's say we take the alternatives that are likely to emerge in the House and we take the Senate-passed budget and we split the difference down the middle between the two, you do not feel that there will be any very dramatic response in terms of the interest rates unless we take significant further action on the budget proposals before us. Is that correct?

Mr. BLUMENTHAL. I think that is correct. And I think there is plenty of opportunity for the Congress to do so. There is a reconciliation process. There are the various appropriation actions that have to be taken. There is a second budget resolution. And life does not end on the first or second Tuesday of November. You are going to have to take further action after that. So it is a process which is just beginning. Do the best you can now. And then you are just going to have to continue after that. Don't forget 1985.

Mr. PETERSON. I think, Senator, we have to say compared to what, don't we?

Senator BOREN. Yes.

Mr. PETERSON. I mean, obviously the markets would rather see a budget that has a deficit, a real deficit, of $140 billion, not as calculated——

Senator BOREN. Right.

Mr. PETERSON [continuing]. Than one of $250 billion.

Senator BOREN. Sure.

Mr. PETERSON. I mean, you know, by definition. But if you are asking what is it going to take before people—for long-term rates to come down "dramatically." And what do I mean, "dramatically"? I don't know about the rest of you, but housing, long-term investments. As long as you are sitting at 15 or 16 percent, what we call the hurdle rate in my business—it is so high—that people are unwilling to make long-term investments. I think those rates might have to come down, what, 3 or 4 percent, I would think.

Mr. BLUMENTHAL. To a level of close to 10 percent.

Mr. PETERSON. You know, before you are going to see a significant impact on investment.

Senator BOREN. Well, for example, in the thrift industry with the negative spread of 2¾ percent on portfolio, to solve that problem you have obviously got to have a minimum of 3 percent change right off the bat before you even stop the short-term bleeding.

Mr. Chairman, if I could just ask one brief followup question on this. How long do each of you feel—and I have heard some people argue that, well, we can adjust to interest rates at the level where we are now. We adjusted through all of our formulas and our CPI's to the kinds of intolerable inflation that we had for a certain period of time. And some people argue that we can adjust to interest rates at 15, 16, and 18 percent. We simply just build that into the system like we built inflation in. I don't happen to by any means agree with that assessment. And when you look at what it has done in terms of valuation of the currency, what is has done to the balance of trade, and what it has done to potentially snap critical sectors of the economy, I must admit to being one that is truly alarmed about what will happen if the interest rates don't significantly begin to fall. Let me ask you this. Am I right or wrong to be alarmed at the long-term interest rates sticking as high as they are? And how long do you think the economy—it has already had some significant damage—how long can the economy sustain these kinds of rates without suffering some very serious breaks in the economy along the way?

Mr. BLUMENTHAL. I think you are absolutely right in your concern. In the first place, initially, the increase in interest rates to these astronomical levels was a reflection of the high level of inflation in the country. The notion that we can accommodate ourselves to inflation by indexing everything is, I think, a very bad and a very dangerous notion. I always remember the Finance Minister of Brazil telling me one day that indexing was the single most important thing we ought to avoid doing, based on their experience in their country, where they index everything. And I would say that one of the worst things the Congress did, with all due respect, was to enact indexing in 1985 of the tax brackets. And I am speaking personally. I certainly hope that whatever you do, Mr. Chairman, you take a very close look at that.

Now, why are interest rates still high even though the rate of inflation has dropped so substantially? I think it is simply because of the point that Mr. Peterson and I have been making, namely, that the budget situation is not credible. People don't believe in the future. They are not willing to put their money out long term. And so the investment flows are not occurring. The savings rate is not there. People are not putting their money up. And you ask how long can this go on? Well, each day and each week it gets a little worse. And I think all of these indexes that we started out citing today—the rate of unemployment, the number of bankruptcies—all of those things are a reflection of that. It is going to get worse.

Senator BOREN. Can we sustain it 12 more months without sharply deteriorating from the current condition, in your opinion?

Mr. BLUMENTHAL. I think we are going to have a terrible situation on our hands if we would not be in a substantially different situation 12 months from now.

Mr. PETERSON. Senator Boren, if I can get in a commercial. I guess our firm does about as much as any in dealing in so-called troubled companies. We have euphemisms that are a little more pleasant than that one, but you know what I mean. I think, Mike, it has been a long time since we have been in a position we are now where this many household corporate names in America 6 months from now or 9 months from now, 1 year from now, might be in very serious trouble indeed.

The CHAIRMAN. Senator Grassley is next. I just want to make certain that you are not implying that because we don't have the right budget, that we shouldn't go ahead and try to do something in this committee?

Mr. BLUMENTHAL. Yes, absolutely.

Mr. PETERSON. Absolutely not.

The CHAIRMAN. Otherwise, I would cancel the meetings next week. [Laughter.]

Well, good. Senator Grassley.

Senator GRASSLEY. The first point, I would like to urge Mr. Peterson to get his social security chart show on television if you can, because the biggest problem we have is having people understand the seriousness of the situation. And our job would be a lot easier. So whatever you could do along that line I would urge you to do it.

Mr. PETERSON. I might say that it is at the risk of being on the hit list of the Gray Panthers, but I have decided to take that risk and proceed.

Senator GRASSLEY. It just seems to me like whatever is fact separated from fiction that anybody in this country ought to welcome that.

I want to take up right where Dr. Blumenthal left off when he said about the third year. You were not suggesting doing anything with the third year of the tax cut except as a last resort if we couldn't accomplish anything else. You suggest an emphasis upon consumption taxes as opposed to income taxes. And then you followed on with your statement you just made that indexing was a bad thing for us to have done. And I guess I would like to have you square those two positions you have taken on the income tax versus indexing because without indexing for every 10-percent increase a person has in income, his income tax is going to go up 16 percent. You have that ratchet effect of a multiplying factor of where people are rapidly put into higher tax brackets, and they pay more taxes and their take-home pay is less. And we have had ample demonstration that indexing is going to help middle-income and lower income people the most. And it seems to me like that is what we are trying to do through our general tax reductions of 1981, 1982, and 1983.

Mr. BLUMENTHAL. Senator, I object to the automaticity that is implicit in indexing in a situation in which we are looking at these very, very large deficits this year and in the outyears. If you can bring the budget under control, then, of course, we would be in a different situation. But the budget is out of control. And the prospect of automatic indexing in the outyears may make bringing the budget under control even more difficult. Moreover, it commits the Congress and the country to a course of action in the future when the conditions in the country at that point are really difficult to foresee. I would rather that action to reduce taxes for individuals—this is a personal viewpoint—be taken by the Congress in the light of then existing circumstances. This has been done regularly. For as long as I can remember the Congress has taken action to reduce taxes or adjust taxes more for low- and middle-income people than for upper, or whatever the Congress felt was sensible at the time. But to commit yourself to an indexing formula now, which is automatic, is just as dangerous, I think, as the indexing of social security payments that was enacted in 1972 and which is causing all of these problems now.

Mr. PETERSON. Senator Grassley, I have probably a little different emphasis. My point of view is that there is a kind of a Parkinson's law where if the revenues are going up 60 percent faster than the revenues, there is a temptation not only to spend that money but to spend more money. So why don't we start where I would like to end up? I want to see spending cut significantly and taxes cut.

My criticism, frankly, of what was done last year was not that you cut taxes so much, but that we didn't have whatever is required—and it is easy for a nonelected person to say this—to get the spending under control. So my priority is a little bit different. I want to see you get the long-term spending under control. And I don't want you to have the revenues that will encourage you to keep those spending programs going. And that program, it seems to me, puts the pressure on you to get the spending down, which is where I want to see you put your emphasis.

[The prepared statement of Peter G. Peterson follows:]

OUTLINE OF TESTIMONY AND CHARTS

BEFORE THE SENATE FINANCE COMMITTEE

ON JUNE 10, 1982 AT 9:30 A.M.

BY

PETER G. PETERSON*
CHAIRMAN OF THE BOARD
LEHMAN BROTHERS KUHN LOEB INCORPORATED

I. Introduction

A. Greetings from other members of bi-partisan coalition--including Bill Simon (in Africa) and John Connally (in Europe). Doug Dillon and Joe Fowler at a Board of Directors meeting they could not miss.

B. Welcome new support of our bi-partisan effort from such outstanding Americans as Cy Vance, Harold Brown, George Ball, Thornton Bradshaw, Henry Kaufman, Felix Rohatyn. We are confident many others across the country will join us.

II. We presumably find ourselves dealing with "irresistible" forces and "immovable" objects.

A. The principal "irresistible" forces are long-term, structural and massive fiscal forces largely fueled by the fully indexed entitlement programs--and in particular, Social Security--growing at a compounded rate of 15% and geared to demographic forces that can only accelerate the fiscal impact of these programs.

B. The principal "immovable" object is the body politic. We keep telling ourselves that reductions in growth of these entitlement programs are not only impolitic, but politically impossible.

C. Nonetheless, there can be no sensible, credible, long-term solution that accepts the premises of this formulation--i.e., the "irresistible" force vs. the "immovable" object.

Indeed, we must resist <u>and</u> reduce these forces, and we must move the body politic.

III. The magnitudes of the deficits are so large and so structural that a wide range of balanced actions must be taken--in which nothing is sacred and in which the goal of a deficit reduction in 1985 of $175-$200 billion is realistically achieved--and thereafter we are on a credible path toward balance.

A. Major spending reductions

1) The long-term, large, structural programs such as the indexed entitlement programs and particularly the non-need related programs

(a) which are many times larger than the need-related programs and

(b) which have up to now been reduced much less.

See statistical tables.

Our bi-partisan program goal--$60 billion in 1985.

2) Defense programs must also share in this effort.

Our bi-partisan program goal--$25 billion in 1985.

B. Significant tax increases--1985--$60 billion. (Again, nothing can be sacred, but we would put substantial emphasis on the energy consumption area, which we believe could be justified even if we were not in this very serious fiscal bind.)

IV. Credibility and realism are absolute musts if we are to achieve the desired, indeed indispensable result, of a substantial reduction in interest rates, including of course, long-term interest rates.

A. The markets have seen too much blue sky through rose-colored glasses (in theory) and mountains of red ink (in practice). To complete the color spectrum analogy, these deficit reduction efforts must meet the "green eyeshade" test to which they will inevitably be put by financial markets.

B. The current proposals from both sides of the aisle simply do not meet these credibility and realism tests.

Examples:

1) Phantom revenues such as $17 billion of 1985 "management saving" revenues of offshore oil lease sales--far more revenues than have ever been achieved in history, and in stronger oil markets than these.

2) Phantom savings--such as assuming an additional $25-$30 billion deficit reduction in 1985 by assuming 90-day T-bill rates of only 6.9% in 1985.

C. If these kinds of estimates turn out to be real--which we very much doubt--then the only effect will be that we will be that much closer to a balanced budget that much sooner--hardly a result to be deplored.

If, as seems far more likely, these budget deficit estimates look <u>and</u> are increasingly optimistic, we lose two ways:

1) the direct cost of having to finance these much larger deficits at higher interest costs, and

2) the indirect, but nonetheless, high costs of further loss of credibility to the financial markets which are growing ever more cynical by the prospect of even more 'blue sky", "rose-colored spectacle" forecasts.

V. Because we don't accept sacred cows and because Social Security is the largest sacred cow of them all, we can't visualize the necessary long-term, structural fiscal solutions (except draconian ones that are unacceptable to us and equally implausible) that do not include the big indexed entitlement programs in general and Social Security in particular. (Our surveys indicate that there is good reason to believe that the financial markets share this view, and they will not respond as decisively as they must to programs that avoid these big issues.)

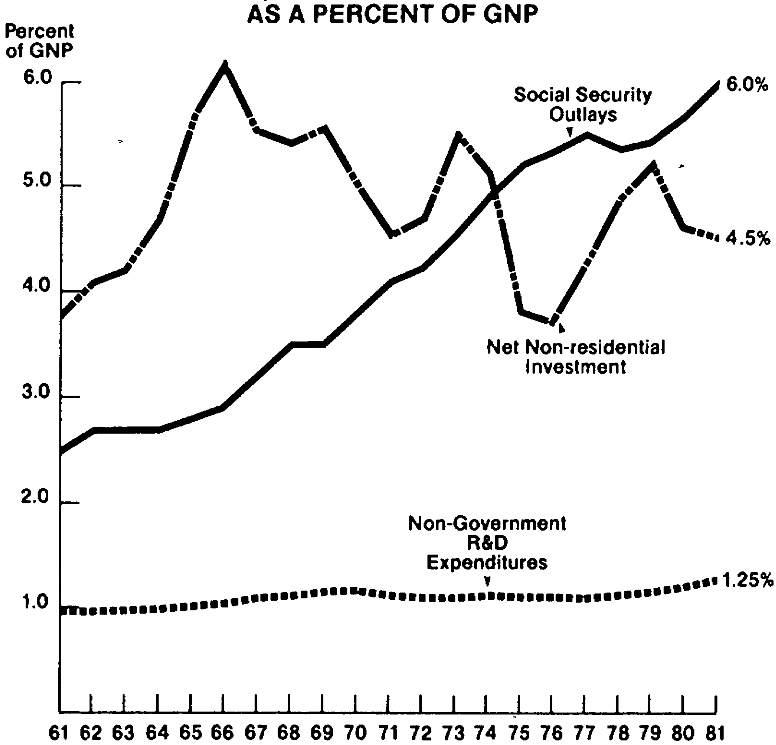
Therefore, I will focus on the politically very resistible and equally immovable Social Security area--not because it is pleasant, but because it is inevitable.

We believe the following charts illustrate ways in which it may be possible to do something about Social Security (both substantively and politically).

1

How Do Social Security Outlays Compare To Total Net Private Plant And Equipment And Research And Development?

COMPARISON OF SOCIAL SECURITY OUTLAYS, NET INVESTMENT, AND RESEARCH AND DEVELOPMENT AS A PERCENT OF GNP

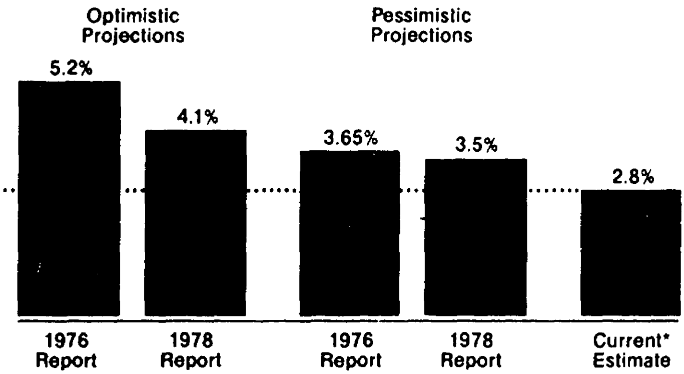


Sources: Social Security Trustees Reports
Department of Commerce
National Science Foundation

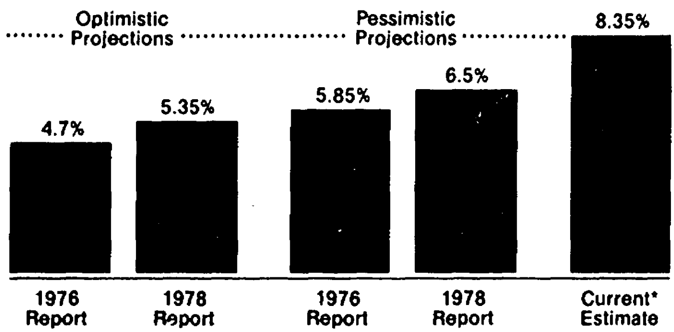
On The Basis Of Past Experience, Should We Consider That "Optimistic" Forecasts Have Turned Out To Be "Pessimistic"?

A COMPARISON OF PAST OPTIMISTIC AND PESSIMISTIC SOCIAL SECURITY FORECASTS

Real GNP Growth Rate Per Year, 1975-1985



CPI Growth Rate Per Year, 1975-1985

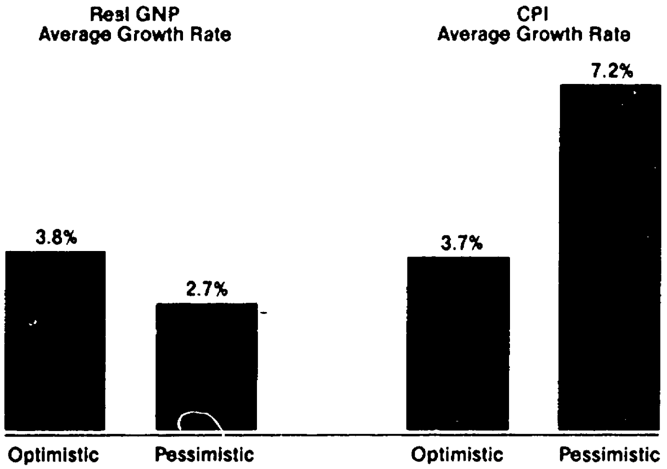


*For 1982-1985, CBO Economic Assumptions of January, 1982 were used.

Source: Social Security Trustee Reports, Congressional Budget Office

3

ALTERNATIVE ECONOMIC ASSUMPTIONS FOR SOCIAL SECURITY PROJECTIONS, 1985-1995

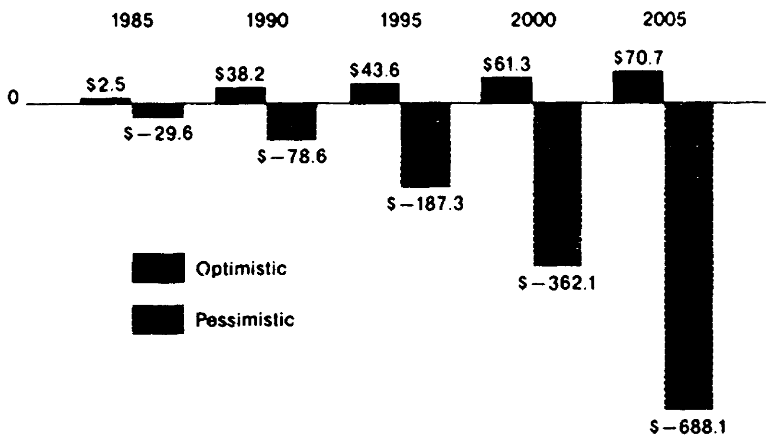


Source Social Security Trustees Report. April 1982

4

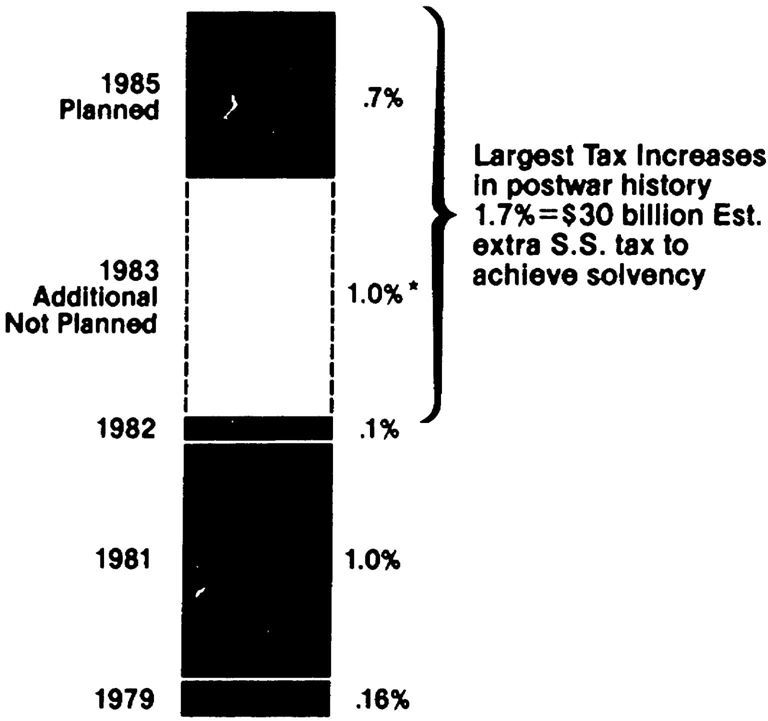
What Would Happen To The Social Security (OASDHI) Trust Fund Surplus/Deficit(–) Under Alternative Economic Assumptions?

SOCIAL SECURITY (OASDHI) TRUST FUND
SURPLUS/DEFICIT(–)
(billions of dollars)



Source Social Security Trustees Report April 1982

Tax Increases Needed If Social Security Solvency Is Achieved By Tax Rate Increases

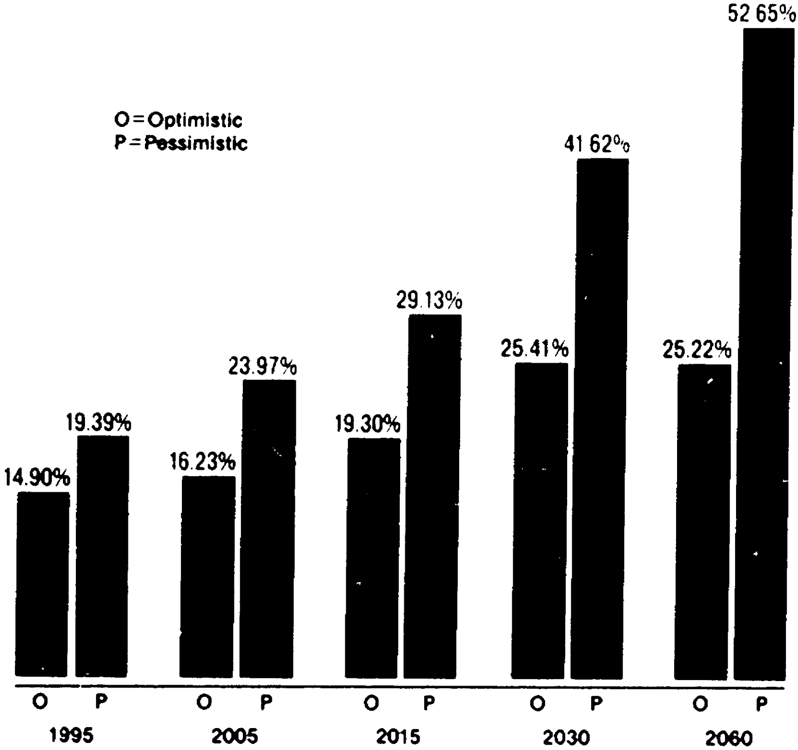


*Refers to increases in tax rates needed to raise $40 billion in revenues by 1985–$6 billion in 1983, $17 billion in 1984 and in 1985–figures originally reported by the Senate Budget Committee as the solvency requirement.

6

The Long Term Problem

Projected Social Security Tax Rates Needed To Retain Solvency If Benefits Not Reduced



Source Social Security Administration
Federal Reserve Bank of New York

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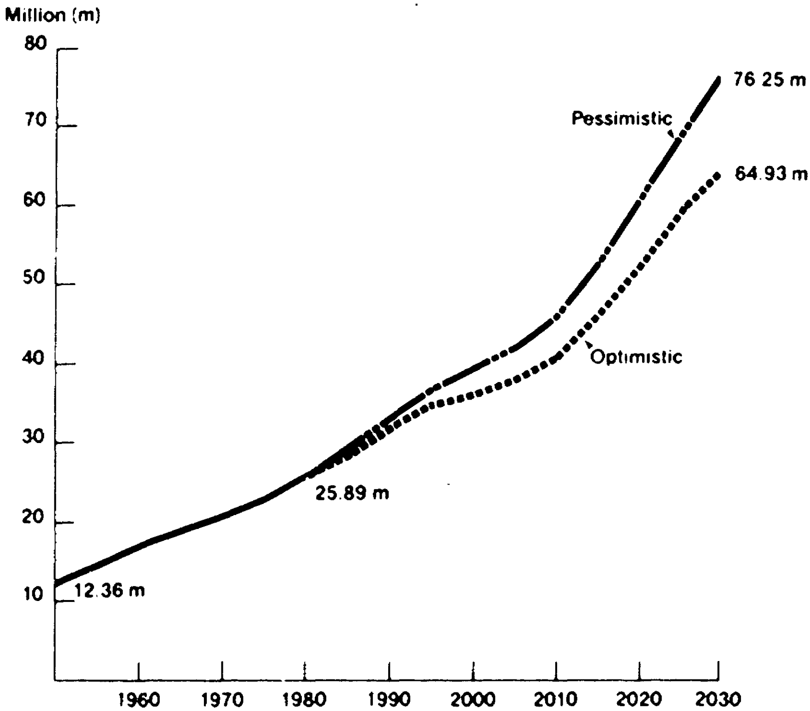
The Growth in Recipients: What Is Happening To The Size Of Our Elderly Population?

POPULATION AGE 65 AND OVER



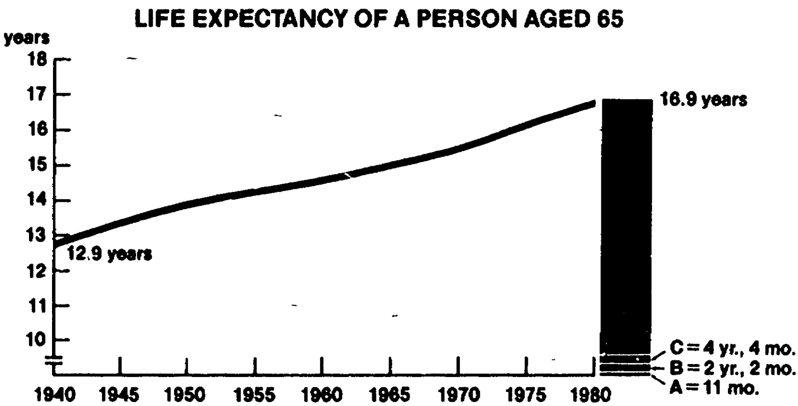
8

How Long Does It Take Social Security Retirees To Recover Their Original Contributions?

	To Recover Employee Contributions Only	To Recover Employee Contributions + Interest	To Recover Employee-Employer Contributions + Interest
Average wagearner (single or with working spouse)	1 yr., 5 mo.	3 yr., 3 mo.	6 yr., 5 mo.
Average wagearner (with nonworking spouse)	11 mo. A	2 yr., 2 mo. B	4 yr., 4 mo. C

Source. Social Security Administration.

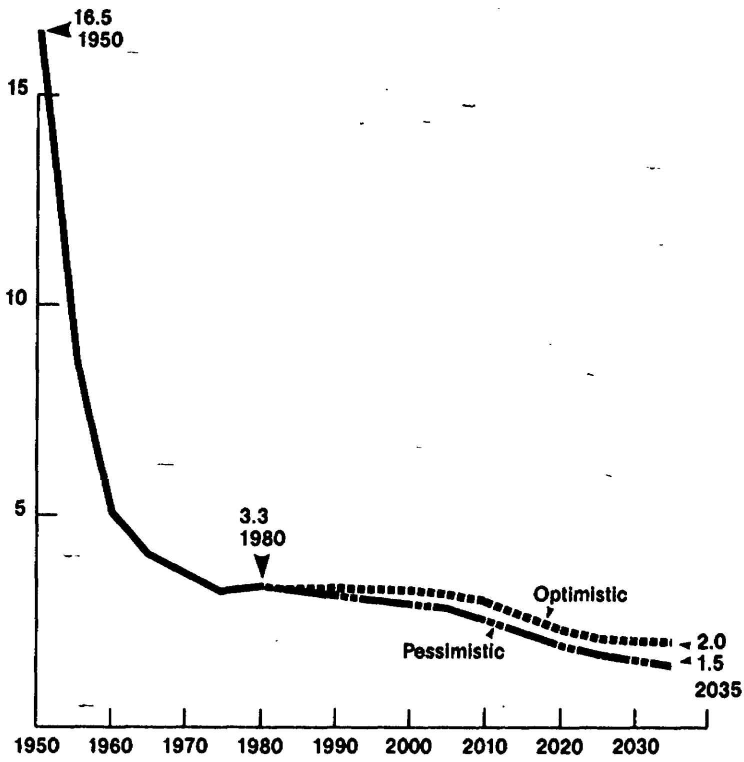
How Long Can The Average Retiree Expect To Receive Benefits?



Sources: U.S. National Center for Health Statistics
U.S. Bureau of the Census

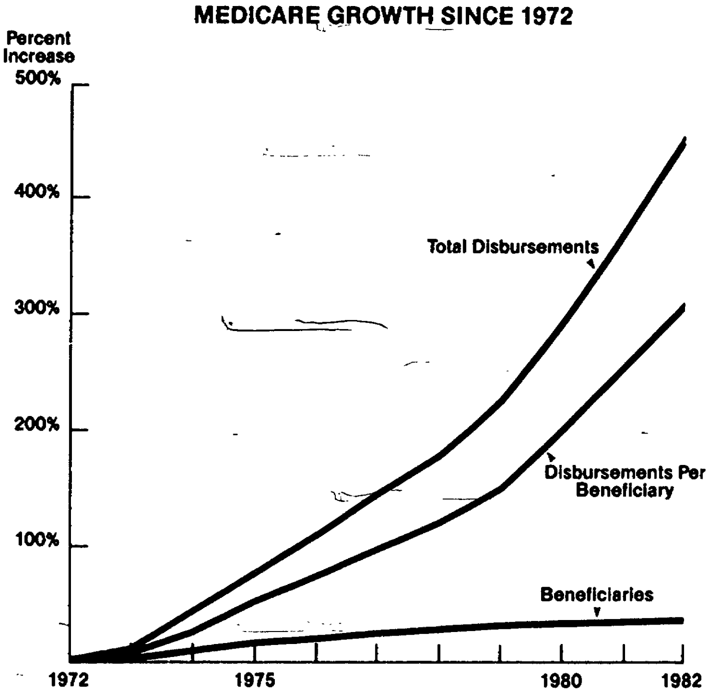
For Each Retiree, How Many Workers Are There To Fund His/Her Social Security Benefits?

WORKERS PER SOCIAL SECURITY BENEFICIARY



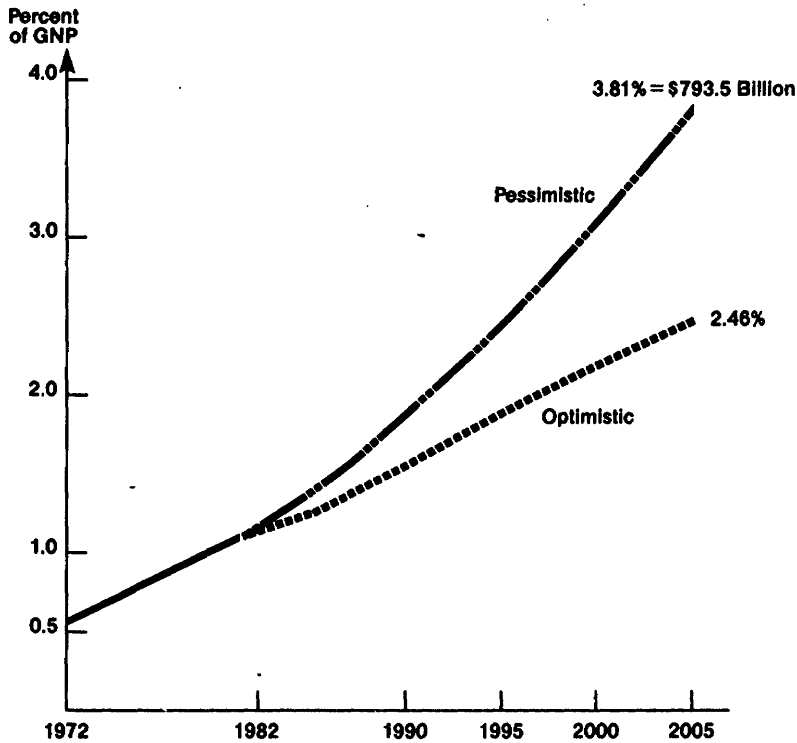
Source: 1982 Social Security Trustees Report

What Is Primarily Responsible For Medicare's Explosive Growth: The Increase In Beneficiaries Or The Increase In Disbursements Per Beneficiary?



Has The Explosion In Medicare (H.I.) Expenditures Come To An End, Or Is It Just Beginning?

MEDICARE (HOSPITAL INSURANCE) DISBURSEMENTS AS A PERCENT OF GNP

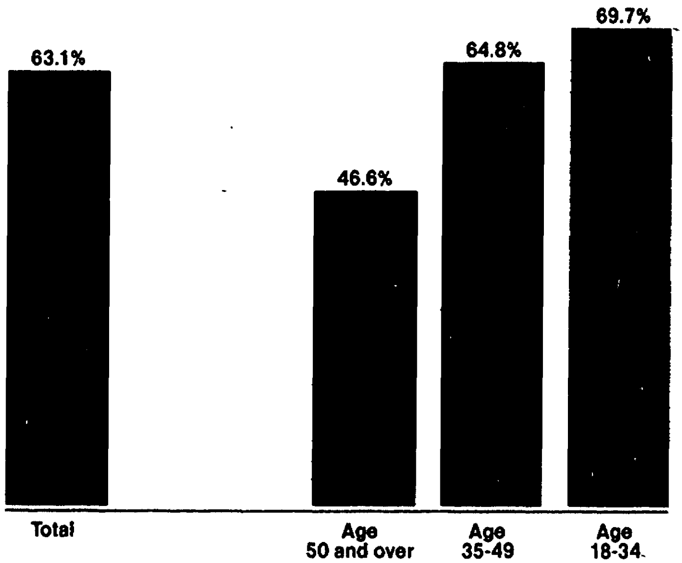


Source: 1982 Social Security Trustees Report

Confidence In Our Social Security System: Is It Really Unshakeable?

FEAR AMONG WORKERS THAT THEY WILL NOT RECEIVE SOCIAL SECURITY BENEFITS AT ALL

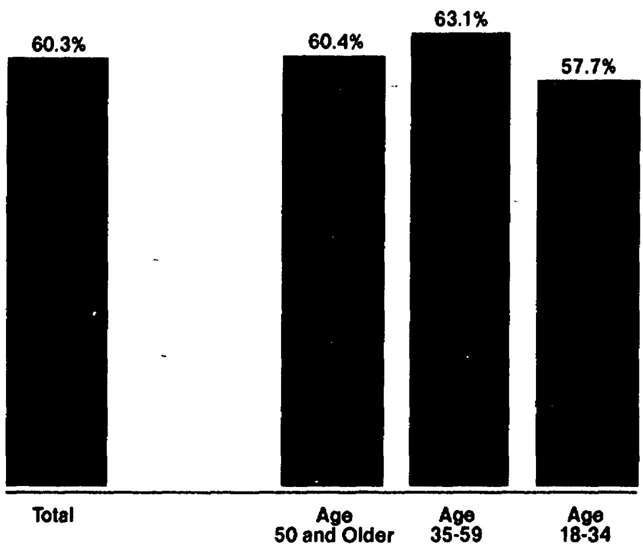
(Percent of Workers Who Expect They Might Receive NO Benefits Upon Retirement)



Source: Gallup Special Survey for U.S. Chamber of Commerce March. 1982

How Much Is Generally Known About Social Security Indexing?

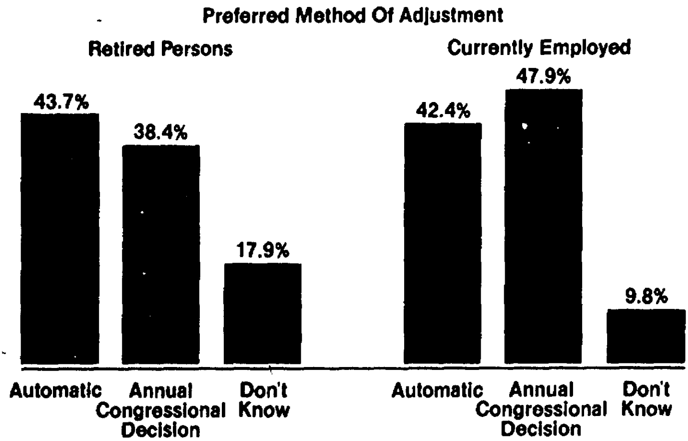
PERCENT OF WORKERS WHO THINK SOCIAL SECURITY BENEFITS HAVE GONE UP BY LESS THAN THE CPI IN THE LAST COUPLE OF YEARS

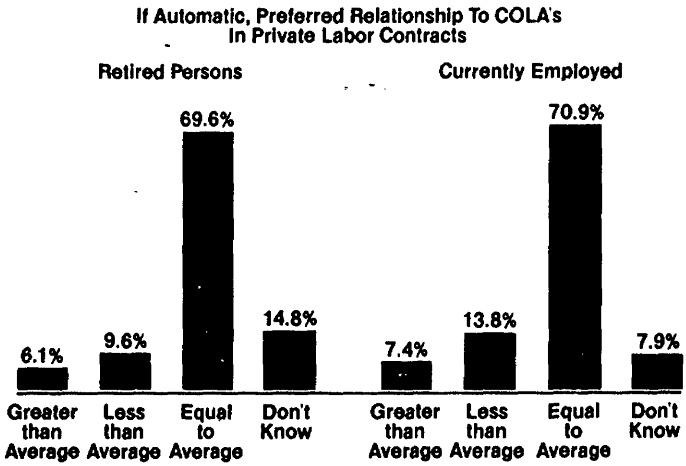


Source: Gallup Special Survey for U.S. Chamber of Commerce, March, 1982

What Sort Of Benefit Indexing Is Preferred By The Public?

VIEWS ON SOCIAL SECURITY COLA's

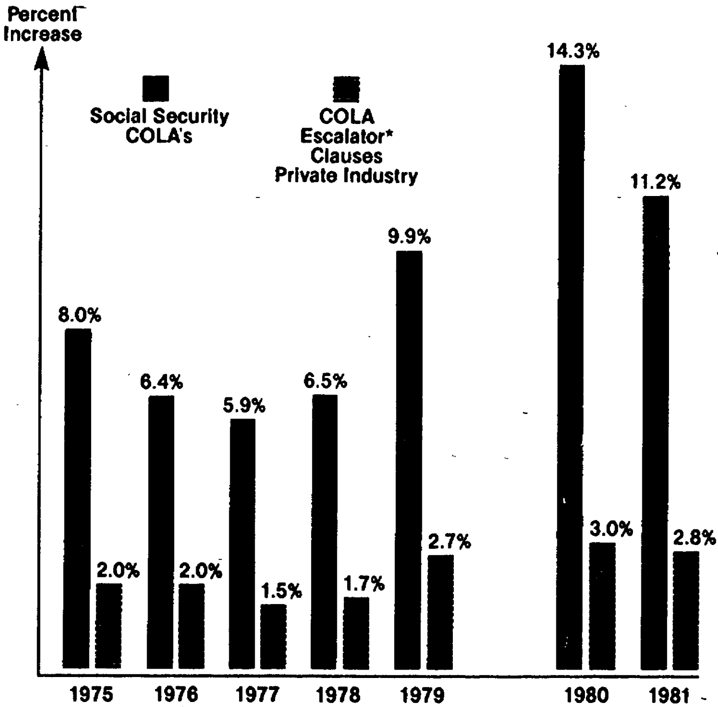




Source: Gallup Special Survey for U.S. Chamber of Commerce March, 1982

Since Preferred Indexing Relationship Is One Similar To COLA's In Private Labor Contracts, How Has Social Security Indexing Compared To These COLA's?

SOCIAL SECURITY AUTOMATIC INDEXING COMPARED TO PRIVATE INDUSTRY COLA's

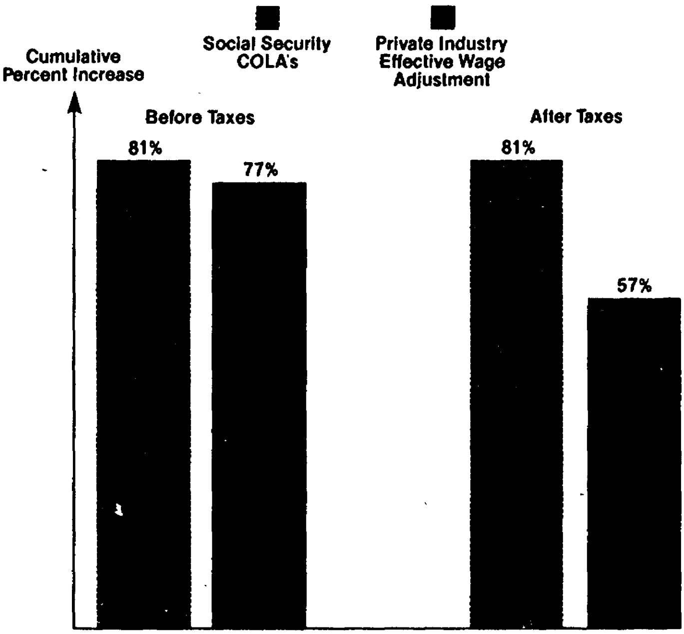


Source: Bureau of Labor Statistics

*Collective Bargaining Agreements Covering 1000 Or More Workers.

How Do Total Wage Increases Compare to Social Security Automatic Indexing*?

EFFECTIVE WAGE INCREASES (CUMULATIVE) 1974-1981
AND SOCIAL SECURITY AUTOMATIC INDEXING



Source: Bureau of Labor Statistics
Federal Reserve Bank of New York

*Compares wage increases from 1974-1981 to Social Security Cost of Living Adjustments.

Some Interesting Questions And Answers About Social Security

- Within what time period will current retirees, on average, receive social security benefits equal to their total contributions?
  Answer: Single person — 1.42 years. Average wage earner with a homemaker spouse — 11 months.*

- The life expectancy of a person age 65 in 1940 was 12.8 years. How many years can a person now age 65 expect to live? ***Answer: 16.9 years.***

- In 1930, 4 percent of the people were over 65. What is the percent today? ***Answer: 11 percent (about 25 million people).***
  What is the percent likely to be in the year 2030? ***Answer: 20 percent (about 65 million people).***

- In 1950, 16.5 workers supported each social security beneficiary. How many workers now support each beneficiary? ***Answer: 3.2 workers.***

- During the past three years, average wages increased by 30% (before taxes). During this period, by what percent did social security benefits increase? ***Answer: 40 percent (after taxes, of course).***

- Social security payments in fiscal year 1982 represent how much of the federal budget? ***Answer: 28 percent or over $200 billion.***

*(The maximum taxes that could have been paid by someone who participated in the program from the beginning in 1937 through 1981 would be $14,767 and his first year benefit, if he had a spouse, would be $14,206.)

Senator GRASSLEY. What is the difference whether the Federal Government takes money out of the economy through tax increases or through borrowing? Isn't the effect just about the same? In other words, shouldn't we be talking about the Federal budget as a percent of the GNP and whether or not it is a going impact or a portion as it has been?

Mr. BLUMENTHAL. I think the Federal Government takes it from different people, different parts of the economy, if it uses one as against the other method. If the Federal Government is in the market borrowing, and it preempts a significant and increasing portion of the resources available for investment in the markets in which Mr. Peterson works, that I think has a very specific impact and is a very unsettling thing which keeps interest rates as high as they are. I think that's different from general spending reductions. And I would certainly agree with Mr. Peterson that that has to be the first priority, followed by raising revenue in some fair and equitable way from both individuals and corporations to pay for what we want to spend. But borrowing and going into debt and preempting the available resources in the capital markets takes it from the wrong people and has the wrong impact on private investment.

Mr. PETERSON. Senator Grassley, again I have a slightly different view, or emphasis at least, not view. You have got to remember that I think what we are trying to do is get interest rates down. I mean, I assume that is the thing that unifies all of us. And the thing that is affecting the markets today is this absolutely extraordinary Government borrowing that affects the people who have the money to lend, plus something I think that all of us tend to underestimate. I don't want you to get too ecstatic about long-term rates coming down just because of what you do because the other huge borrower in the world is the private sector. Now, I am telling you I have never in my business experience seen balance sheets of the American corporations in the shape they are in now. There is an enormous demand for private credit that, in addition to the Government credit, there is going to be a tremendous demand for money. So the kind of taxes we are talking about, at least that I want to emphasize, are those that affect consumption, that release the money to be invested. The borrowing from the Government tends to affect investment directly, comes right out of the savings pool. So I don't really think they are analogous. And at this time you have something else going on, Mike, that is also psychological to some extent. The market believes that high deficits have a long-term effect on inflation and, therefore, affect interest rates. And as long as they believe it, whatever the theories of the economists are, you had better do something about the deficits—and that is much more important than anything else—because it affects interest rates directly. So, to me, it is both a logical and a psychological suggestion.

Mr. BLUMENTHAL. I agree with that.

The CHAIRMAN. Well, I want to thank both of the former Secretaries very much. And I want to urge the members—we have a vote—if we could run over and come back very quickly, maybe in the meantime Bob Kilpatrick could be getting ready to testify, followed by Mr. Dixon, Mr. Herr, and Mr. Snyder. Thank you very much. We appreciate it. And we will do the best we can in the next couple of weeks in this committee to try to start in the right direction.

[Whereupon, at 11:30 a.m., the hearing was recessed.]

AFTER RECESS

The CHAIRMAN. Senator Brady, come on up. I have invited Senator Brady who understands some of the concerns to come by. I wish he were a member of this committee.

Our next witness is Bob Kilpatrick, president and chief executive officer, CIGNA Corp., Hartford, Conn., on behalf of the Business Roundtable, and as chairman of the Committee on the Federal Budget. Bob, we are happy to welcome you to the committee this morning. I apologize for the long delay, but I think that maybe you found it interesting like many of the members to hear the former Secretaries, Peterson and Blumenthal.

STATEMENT OF ROBERT D. KILPATRICK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CIGNA CORP., HARTFORD, CONN., ON BEHALF OF THE BUSINESS ROUNDTABLE AS CHAIRMAN OF THE COMMITTEE ON THE FEDERAL BUDGET, WASHINGTON, D.C.

Mr. KILPATRICK. I did, Mr. Chairman. And I do thank you for inviting the Business Roundtable to be a part of the debate and discussions going on today. It did remind me, however, in putting me on after Mike Blumenthal and Pete Peterson, it is kind of like the divinity school graduate who went to his first church, and was all set to go until he found out that Billy Graham had been the guest speaker the week before. [Laughter.]

Mr. Chairman, I would like to present some short but perhaps not very sweet remarks on the state of the economy and the need for corrective action. I will number the points I will make for the purposes of clarity and emphasis and they number just seven.

Point 1, the Business Roundtable continues to support the basic thrust of President Reagan's economic program. His recipe for restoring the health of the American economy through a package of lower Government spending, reduced taxation, relief from regulatory burdens, and a stable monetary policy continue to be quite sound. In fact, it has produced a more rapid reduction in the rate of inflation than anyone in the business community had any reason to predict. That is a great accomplishment and must constantly be emphasized and preserved. We should resist at all costs any "fixes" right now, such as shifting to a significantly more expansionary monetary policy which would rekindle inflationary pressures, for example.

Point 2, the current and the prospective economic situation is serious and requires prompt congressional action. We are in a severe recession. Unemployment has reached a postwar high. Corporate profits are down substantially, and many companies, both large companies and small companies, are in trouble. Business and personal bankruptcies are increasing. Interest rates remain at unacceptably high levels, and record Federal deficits will keep them there in a way which will abort any sustained recovery. In short, gentlemen, the situation requires an immediate, we think, midcourse correction.

The economy cannot afford a stalemate or halfhearted action merely because this is an election year. While I know that this committee fully understands the situation, I have to say that some of the comment I hear gives the impression that the gravity of the country's economic predicament is not fully realized in Washington. Let me emphasize the most important domestic social program, the most important foreign policy initiative, the most important national security effort we can undertake is to get the American economy on a sound footing again.

Point 3, the deficit reduction targets the Congress is currently debating do not go far enough, none of them. The Senate adopted ceiling of $116 billion, $92 billion, and $65 billion in fiscal years 1983-85. These do not, frankly, give us much encouragement. The various House proposals are not much better. We are deeply troubled by the estimates of Federal borrowing recently released by the Office of Management and Budget which show that Washington will soak up more than half of the total available credit in fiscal years 1982 and 1983, up from an average of only 28 percent over the previous 5 years. I hope you will agree that this is not an acceptable Federal fiscal policy result. We must, simply must do better or all of the struggling over budgets and taxes will not produce the economic rebound we want. Any of the bills now being considered in the House and Senate is better than no budget at all. But the marketplace will simply yawn at all of these. It will not respond if this is the best that can be done. None of these proposals will impress anyone or cause any real change in economic fundamentals. What then does the Business Roundtable recommend that you do? The first point, and the highest priority: further reductions in Federal spending have to be your first priority. We fully recognize that the Congress and the administration teamed up last year to make many difficult and significant cuts. But Federal spending as a percentage of gross national product is still rising. We have not gone far enough. I would like to join the spokesmen for the bipartisan appeal, Secretaries Peterson and Blumenthal, who just testified in urging the Congress to be credible and realistic in these efforts. Dubious reductions through such things as overestimating management savings or overestimating tax receipts, or by shifting cost between sectors are not the answer. Tough program reductions on an across-the-board basis, with no area of the budget being held sacrosanct, are what is needed. This does include reduction in the rate of growth of defense spending and in key domestic programs as well.

Point 5, slowing the growth of entitlement programs, including modification of indexing, simply cannot be avoided. And, I repeat, cannot be avoided. This committee has a special opportunity and a special responsibility to play a leadership role in dealing with entitlements. These programs comprise 47 percent of Federal expenditures in 1983. They have been growing at a rate of about 15 percent a year. There is little the business community can suggest about how to make these reductions that you and your staffs have not already considered. My point is simply to urge you to make that commitment in a way that the financial markets will take seriously. If election year pressures mean that specific program reductions cannot be made until a post-November session, then I ask you to find some way to commit the Congress now to act at that time. You must act to restrain the growth in these programs or you cannot possibly hope to achieve a responsible budget either for the short term or the long term, nor can you sustain economic recovery unless these programs are restrained.

Point 6, we recognize that significant additional revenues will have to be raised to bring the deficits down. As an initial step, we believe that you should examine a variety of consumption taxes as least likely to undercut the advances made in the Economic Recovery Tax Act of 1981. Increases in excise taxes, user fees, accelerated deregulation of natural gas are options which raise revenues while avoiding disruption of incentives to work, to save and to invest.

Gentlemen, we do not favor modifying the 10-percent individual tax cuts scheduled for next month, July 1982. It is needed for economic stimulation and it is probably too late in any event. We would support a stretch out or delay of the July 1983 individual tax cut as a painful but probably necessary last resort in order to raise revenues.

We also believe that the business community must carry its share of tax increases. Now, I cannot tell you that the Business Roundtable has a consensus on specific business taxes that should be enacted. We do believe that you should avoid undercutting the incentives for investment that you created last year. We have indicated that some modification of the 1981 leasing legislation would be desirable to correct possible abuses and, speaking for my own industry of insurance, we have proposed a means to the Congress, a means of increasing our own Federal tax payments over the 1981 levels. Beyond this, we would seek the opportunity to work closely with you as you seek personal and business tax increases that are not self-defeating. I would like to put a caveat, an important caveat, on tax increases, however. They should not become a scheme for avoidance of spending reductions. In fact, I urge you to be inventive in tying the two together through some procedural device so that the American people, the financial markets, and the business community know that they are not being asked to pay more in taxes so that Government can spend more on programs.

If the Congress is going to seek tax increases now—and I believe that you have to—it must also commit itself now to spending reductions, even if some of those are not consummated until after November. This brings me, gentlemen, to my final point.

The congressional budget process, in our view, must be preserved. Whatever its shortcomings and whatever the problems it creates for authorizing and appropriating committees, that process is still our best means of packaging spending and tax commitments. Through it, I hope that you can fashion some kind of fiscal social contract with the voters and the many interest groups so that there can be a sense of sharing of the burdens necessary to achieve specific deficit and economic goals.

Mr. Chairman, this committee is one of the keys to the restoration of health to the American economy. The United States, in our view, is a very, very strong nation, including strong economically. Its people are resourceful, quite willing to work and quite willing to share burdens. Our present economic circumstances are not cause for doom and gloom. We are a very strong nation. But we must get our fiscal affairs under control, must get them under control. It cannot be avoided or we will be a very weak nation.

Now more than any time since the Second World War is the time for statement to provide leadership. That is both your opportunity and your responsibility. I would just like to pledge to you that the Business Roundtable looks forward to the opportunity to working with you and helping you pursue that path of statesmenlike leadership. Thank you.

Senator DURENBERGER. Thank you very much. The adjectives that I was struck by in the first 2 hours were the characterizations of the deficits as "large, rising and uncontrolled" and of the solutions "speedy, bipartisan, realistic, and a fair share of the sacrifice." And I take it you are going to agree with that characterization, both to the problem and the solution.

I just want to ask you one question that relates to the tax side of this as opposed to the spending side. The other thing we talked about in the first panel was, in addition to a $60 billion tax increase for fiscal year 1985, the tax policy. And you have referred I think to something we all agree with, and that is that we have too long lives with a tax policy that taxes investment and subsidizes consumption.

And we talked about 280 billion dollars' worth of subsidies to energy taxes and so forth.

My question of you is, as long as we are talking about everyone being statesmen, does the Business Roundtable have a position on various of the proposals that are before this committee that would continue the process of removing the subsidizations from consumption and/or the taxability of investments? For example, a fuel minerals tax, whether it is an import fee or a Btu tax or a per barrel fee, a gasoline tax; the removal of the casualty deduction; the removal of the medical deduction; subsidization for fully paid, no cost share of the employer's health care contribution; the consumer interest deduction; state and local tax deduction; mortgage interest deduction; and items like that. Has the roundtable taken a position on some of those recommendations?

Mr. KILPATRICK. Senator, we have not taken a position on all of those that you mentioned. It is perfectly fair to say that the Roundtable favors taxes that are consumption oriented, as opposed to taxing investments. It would be fair to say I believe that the roundtable, while it does not have that position now, would support a broad based energy tax. I am not referring to any one of the specific ones that you mentioned there, but a broad based energy tax on oil, coal, steam, whatever you want to do with it. I think that would ultimately be supported.

We have come out saying that we believe you should stretch out or delay the third year of the tax cut, which would be the fastest way to raise lots of revenue. I think, as you go along in the deliberations, you will find that we have also favored user taxes. We have favored deregulating natural gas, which, in our view, would create more revenue, would probably drive the cost ultimately of gas down. So I think we are in favor of most of these without being

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able to say that I can respond to each of the specifics that you mentioned there.

Senator DURENBERGER. Can I ask you with your two hats on, one your own corporate capacity and then the involvement with the roundtable, one of those charts that came up earlier in connection with social security was the medicare chart. And there is very few people in this country that seem to understand that we have now got ourselves into the box with interfund borrowing where we are cutting back on our medicare budget, shifting the cost of hospitalization over on to health insurance companies like yours and on private paying individuals so that we can put a little more money in the pot so that the folk~~s that are o~~ut there on social security retirement can get their 7.4-percent increase. And one of those charts showed us that it is the per beneficiary cost, not the number of beneficiaries, that is raising this. And ~~one~~ of the tax proposals, or a couple of the tax proposals, that are on our agenda right now deal with the medical deduction, deal with the cost-free nature of fully paid health care benefits. And some of us who would like to do something about the high cost of health care and the high cost of medicare and everything else would like to see some support for tax policy changes in that regard. What would your recommendation to us be?

Mr. KILPATRICK. On that $150 cap, Senator, I think that what you have here is a tax that is going to anger everybody—the unions, employers, the doctors, the hospitals, right down the whole spectrum—and it is going to produce very little revenue, to be quite frank about it.

Now, the roundtable has not even considered that specific one. I am speaking as a person employing a lot of people and also selling a lot of health insurance around the country. I think that tax is one that started out to be one that was under the guise of cost control. It is now a revenue measure. Frankly, Senator, it does neither very well. It is an attempt at tax reform without having thought it all the way through.

Senator DURENBERGER. Well, I just share with you the frustration of sitting here dealing with these costs, being accused of picking on the needy to help out the well-to-do elderly in this country, and not seeing a heck of a lot of help out there from people who are stake holders. Maybe there are better alternatives. This alternative is not on the platter just because it raises some revenue. It does raise some revenue. But if we wait for the business community and the employer community of America to decide which form of tax policy as it relates to health care, we will never get to it any more than you can come to a consensus on corporate tax changes. And, frankly, we need your help. We cannot do it without you.

Mr. KILPATRICK. Well, let me say this, Senator. And I mean it in a most sincere way. It is hard to find who speaks for the business community, if anyone. Let me say this. I think the business community generally is so alarmed by the current situation, so alarmed by the record deficits that we are developing, and so alarmed by the fact that if we are not in crisis economically now, we are headed for crisis. I believe ultimately the business community is going to support you, if you gentlemen and your colleagues throughout the Houses have heard all the arguments and decide in a forthright and a statesmanlike way that you are going to get control of fiscal affairs. Why, you will have people arguing over bits and pieces here and there, including my own industry, I think that you will find generally, though, the business community will be supportive. That is exactly why I am suggesting to you today that you ought to get after these entitlements programs, which is not popular. It is not popular for us either because we employ thousands of people. I also think that you ought to delay that third year tax cut. Furthermore, I think that there are other areas, including the tax that my own industry proposed, which raises our own taxes. I think you are finding the business community being fairly statesmenlike in that, even though I can't say that anyone does speak for them.

I do believe ultimately if you decide on a package that is credible in the marketplace, you are going to find a lot of people that won't like certain pieces of it, but I believe it will be supported, and I urge you to do it.

Senator DURENBERGER. Let me just say that your company has been very helpful, I mean, just as a company. And let me make sure I get that on the record in terms of changing health policy. And we appreciate that.

Mr. KILPATRICK. Thank you, Senator.

The CHAIRMAN. Senator Long.

Senator LONG. I agree with what you say here, Mr. Kilpatrick, but let me just submit to you part of the problem. I sat with that group of 17 down at the White House that tried to work out a budget, and I started out thinking that the project could succeed and that it ought to succeed. But we discovered in short order that the Democrats on the House side—not necessarily the Senate Democrats but the House Democrats—were not going to agree to cut anything from social security. And then I got my real shock: Over on the administration side where I thought that on the taxing end we could raise whatever amount of revenue might be necessary, the administration was not willing to support anything we could pass that made any real sense. For example, the easiest thing to pass would be what you suggested, just to defer the third year tax cut. A poll taken of American people indicated that the majority of people favored that—and they hadn't even had the argument explained to them—on the basis that we couldn't afford it. Now, the best I could make of it, Senator Roth and Mr. Kemp thought that, by all means, the Kemp-Roth tax cut should go forward no matter what. Well, that's par for the course. But in the White House I thought everybody had agreed with my view that this would be the easiest place to raise the money—except for a majority of one up there. One man, the President himself, agreed with Mr. Kemp and Mr. Roth that under no circumstances, that tax cut was the one thing that was sacred; you must not touch that. All right, so there is $37 billion a year that you can't touch.

Then you look at the next point. Here we are, subsidizing the consumption of energy. The Arabs are getting ready to put the boycott back to us. And here we are subsidizing energy consumption to the tune of $80 billion a year by Federal policy. My thought is, why don't we put a tax on energy. And I am tired of having the tax law single out oil. We produce a lot of oil in Louisiana, more than any

State in the Nation for the size of our State. Why don't we all pay something? Let everybody come up to this lick log. You are familiar with that old expression from Louisiana, Mr. Kilpatrick. Tell them all to come up to the lick log and put their licks in. You all have got to pay something. That way it would be uniform and no State would have an advantage over the other. Its not fair to say we can't tax gas, where they are getting subsidized $80 billion a year. Can't touch that. Can't touch coal, even though we are in the position to heat the whole wide world with coal. All we can tax is oil.

Well, now, if we can't raise money by doing anything but taxing production, we are in bad shape. Imagine, here we are, we agree that we ought to produce more and consume less. The logic of that would be that you ought to tax consumption rather than production. But, oh, no, we have got to raise money all by taxing production.

I think that your group has been very generous; they are willing to come up and pay another $1 billion in taxes. But, oh, no, that's not enough. You have got to pay $2 billion. In good grace, I think your people are wondering, why are we taxing other people? Why can't they pay something? But, no, now you are going to pick up some money by taxing industry. And who are you going to tax? The poorest fellow out there, the guy who's broke. He is the guy they are going after now by taking away leasing. If they succeed, 40 percent of the companies around here are not going to get the benefit of all that we voted. In other words, we go out here and tell people look what we did for you. But if you speak to a business audience and tell them all you did, you had better say, now look, I am only talking about you fellows that are doing very well indeed. The rest of you, we decided to leave you out. You know, the investment tax credit and the accelerated depreciation don't apply to them because they are not making a profit.

The only way we can raise the money, as I see it, is by taxing across the board, taxing somewhat uniformly. This idea of just taxing production doesn't make too much sense. But that is my logic. I am not being plagued at the moment by the theory of alimony for the rich. It looks like the Republicans are getting that put on them, but it doesn't bother most of us Democrats. So we can vote a tax across the board and tax rather uniformly and help balance the budget.

Let's look at the budget process. It has failed. It has never given us a balanced budget yet. In fact, half the time both Budget Committees have been asking for a bigger deficit than most people in Congress thought made any sense anyway. And they haven't succeeded in doing anything this round.

We have got a chance with this debt limit bill coming up to do what we didn't do with the budget process. We have got an opportunity to say that instead of giving the administration another $200 billion to go spend and then come back for more, we will just stretch it out. We will give you the debt limit increase bit by bit. But that should mean we increase the debt at the rate of maybe $5 or $6 billion a month rather than $10 billion a month, and next year maybe only go in additional debt at $4 billion a month, and it would phase on down so that over a period of time we would have a balanced budget. I think we have a chance to do something if we start out with those 21 Senators who voted for a balanced budget in 3 years. Did you know if that had happened in the Senate before we passed that debt limit, it would have put us in debt forever? Those 21 Senators, 12 Republicans and 9 Democrats, voted to balance the budget in 3 years.

It seems to me as though we have a chance to do something along that line. But I think you are leaning on a weak reed when you are leaning on the people who have never given us anything like a balanced budget yet.

Do you realize that since we initiated the congressional budget process, we have had the biggest deficits in history? The Budget Committees have yet to even recommend a balanced budget. The only time they came out with something was when an amendment was put on a debt limit bill requiring them to recommend a balanced budget for a future year, and on that occasion they did. I really think that this committee right here would be as good a prospect as any. We would have a try at that debt limit bill to see if we could bring spending under control, because the Budget Committee has had their chance.

Mr. KILPATRICK. Senator, talking about the budget process, my reason for mentioning that is that I fear that a constitutional amendment is picking up steam, and the people are going to look on that as some panacea as to how to force the Congress, if you will, to balance the budget. And at least the present version that I have seen has no possible way of accomplishing anything any better than the present process.

My point was that I think you have something that has been in being since 1974 that you need to continue to work with and try to refine it year after year. And I believe if you fall back on the versions of the constitutional amendment that we are talking about now, it is going to lull the Congress and the people, if you will, to sleep a little while until they finally found a solution. And it doesn't appear to be a solution.

Senator LONG. All they have got to do to conform to that version of a constitutional amendment is do what they are doing now; namely, just bring in a bunch of rosy assumptions, assume that they are going to collect more taxes than they are really going to collect, and assume that they are not going to have anything go contrary to the way they would like it to go and they can finance the Government with rosy assumptions and every year run the deficits just as big as they are running now. You are aware of that, I take it?

Mr. KILPATRICK. Oh, yes.

Senator LONG. So that is a very weak reed to lean on, and there is no real assurance that it would do anything that the budget process couldn't do.

Mr. KILPATRICK. Yes, sir.

Senator LONG. Thank you very much.

The CHAIRMAN. Let the record show that the Congress is not hard to lull. I mean, here we are, the year is half over, and we haven't done anything yet, except I guess the House did pass National Peach Month. [Laughter.]

And we are working on that. So we have had a great year so far. [Laughter.]

We have got to do something because there is another recess coming up. We would like to do something between recesses. And the House goes out again on June 24. So they are going to send us a 30-day extension on the debt or maybe a 60-day extension just in case another recess should occur before we got around to that. So we are experts in not doing very much very quickly. But I do think that Senator Long has touched on an area that we might use as a vehicle. And I appreciate the fact that the roundtable and others who will follow, even though it may be at some sacrifice or maybe a contribution is a better positive word for the economic recovery, understand how serious it is. And we don't want to raise anyone's taxes.

I found it a lot easier last year giving away money than collecting it this year. That's why we keep postponing our meetings. We have got to figure out how to get 11 votes. [Laughter.]

So, in any event, we are working on that. Senator Brady, do you have any comment or questions?

Senator BRADY. Just one question, Mr. Chairman.

Mr. Kilpatrick, would you make any differentiation between the size of this year's deficit of about $116 billion in the Senate thing, and the continuation in the second and third year? In other words, do you feel that it is the size of the deficit that's booked for 1983 or the fact that it continues at roughly the same level for 2 or 3 years?

Mr. KILPATRICK. Senator, I think it's the combination of the size which we believe is too large. None of the bills have stepped up to the entitlement programs. And then it is the believability of it. It is the fact that it is not credible. While we can start out in good faith and say it is a certain level, $116 billion, or whatever. The marketplace has been conditioned to believe that those figures will come out to be something substantially larger a little bit down the road. So it is a complex situation. A credible budget to us would be something that started out well under $100 billion and it showed——

Senator BRADY. Excuse me. But if you could start it out where it is now, not try to tackle this year's budget and slope it way down, then suppose it went down to 30 and zero in the second and third year, what would your opinion be of that kind of a plan?

Mr. KILPATRICK. I think we would regard that as credible, provided it had built into it restraints on the entitlements programs and a tax structure that we felt had some chance of being sustained over a period of years.

If you don't restrain the entitlements programs, there is no credibility at all to any budget.

The CHAIRMAN. Thank you very much, Mr. Kilpatrick. We appreciate your coming and your waiting.

Mr. KILPATRICK. Thank you, Mr. Chairman.

[The prepared statement of Robert D. Kilpatrick follows:]

REMARKS OF

ROBERT D. KILPATRICK

PRESIDENT & CHIEF EXECUTIVE OFFICER

CIGNA CORPORATION

AND

CHAIRMAN

THE BUSINESS ROUNDTABLE

COMMITTEE ON THE FEDERAL BUDGET

BEFORE

THE SENATE FINANCE COMMITTEE

WASHINGTON, D.C.

JUNE 10, 1982

Thank you for inviting The Business Roundtable to be part of this important discussion today. I am Bob Kilpatrick, President and CEO of CIGNA Corporation. I chair The Business Roundtable's Committee on the Federal Budget.

I would like to present some short but perhaps not very sweet remarks on the state of the economy and the need for corrective steps. Let me number the points I will make for purposes of clarity and emphasis. There are just seven.

1. We continue to support the basic thrust of President Reagan's economic program. His recipe for restoring the health of the American economy through a package of lower government spending, reduced taxation, relief from regulatory burdens, and a stable monetary policy is sound. In fact, it has produced a more rapid reduction in the rate of inflation than virtually any business person had dared to predict. That is a great accomplishment and must constantly be emphasized and preserved. We should resist at all costs any "fixes" right now which would rekindle inflationary pressures—such as shifting to a significantly more expansionary monetary policy.

2. The current and prospective economic situation is serious and requires prompt Congressional action. We are in a severe recession. Unemployment has reached a post-war high. Corporate profits are down substantially and many companies both large and small are in trouble. Business and personal bankruptcies are increasing. Interest rates remain at unacceptably high levels, and record Federal deficits will keep them there in a way which will abort any sustained recovery.

In short, the situation requires an immediate mid-course correction. The economy cannot afford a stalemate or half hearted action merely because this is an election year. While I know that this Committee fully understands the situation, I have to say that some of the comment I hear gives the impression that the gravity of our economic predicament is not fully realized in Washington. Let me emphasize—the most important domestic social program, the most important foreign policy initiative, the most important national security effort we can undertake is to get our economy back on the track again.

3. The deficit reduction targets the Congress is currently debating do not go far enough. The Senate adopted ceilings of $116 billion, $92 billion, and $65 billion in FY 1983-85 do not, frankly, give me much encouragement. The various House proposals are not much better. We are deeply troubled by the estimates of Federal borrowing recently released by the OMB which show Washington soaking up over half of total credit in FY 1982 and 1983--up from an average of 28 percent over the previous five years. I hope you will agree with me that this is not an acceptable Federal fiscal policy result. We must do better or all of the struggling over budgets and taxes will not produce the economic rebound we seek. What, then do we recommend that you do?

4. Further reductions in Federal spending have to be your first priority. We fully recognize that the Congress and the Administration teamed up last year to make many difficult cuts. But Federal spending as a percent of GNP is still rising. We simply have not gone far enough. And let me

join the spokesmen for the Bipartisan Appeal who just testified in urging the Congress to be credible and realistic in these efforts. Dubious reductions, through such things as overestimating management savings or tax receipts, or by shifting costs between sectors, are not the answer. Tough program reductions on an across-the-board basis, with no area of the budget being held sacrosanct, are what is needed. This includes reduction in the rate of growth of defense spending and in key domestic programs as well.

5. Slowing the growth of entitlement programs, including modification of indexing, simply cannot be avoided—I repeat, cannot be avoided. This Committee has a special opportunity and responsibility to play a leadership role in dealing with entitlements. These programs comprise 47 percent of Federal expenditures in 1983; they have been growing at a rate of 15 percent a year. There is little the business community can suggest about how to make these reductions that you and your staffs have not already considered. My point is simply to urge you to make that commitment in a way that the financial markets will take seriously. If election year pressures mean that specific program reductions cannot be made until a post-November session, then I ask you to find some way to commit the Congress now to act at this time. You must act to restrain the growth in these programs, or you cannot possibly hope to achieve a responsible budget or sustained economic recovery.

6. We recognize that significant additional revenues will have to be raised to bring the deficits down. As an initial step, we believe that you should examine a variety of consumption taxes as least likely to undercut the important advances made in the Economic Recovery Tax Act of 1981. Increases in excise taxes, user fees, and accelerated deregulation of natural gas are options which raise revenue while avoiding disruption of incentives to work, save and invest.

We do not favor modifying the 10 percent individual tax cut scheduled for July, 1982. It is needed for economic stimulation. We would support a stretchout of the July, 1983 individual tax cut as a painful but probably necessary last resort.

We also believe that business must carry its share of tax increases. I cannot tell you that The Business Roundtable has a consensus on specific business taxes that should be enacted. We do believe that you should avoid undercutting the incentives for investment that you created last year. We have indicated that some modification of the 1981 leasing legislation would be desirable to correct possible abuses and, speaking for my own industry of insurance, we have proposed a means of increasing our own Federal tax payments over 1981 levels.

Beyond this, we would seek the opportunity to work closely with you as you seek personal and business tax increases that are not self-defeating. I would like to put an important caveat on tax increases, however. They should not become a scheme for avoidance of spending reductions. In fact, I urge you to be inventive in tying the two together through some procedural device so that the American people and business community know that they are not being asked to pay more in taxes so that government can spend more on programs. If the Congress is going to seek tax increases now, it must also commit itself now to spending reductions -- even if some of those are not consummated until after November. This brings me to my final point.

7. The Congressional budget process must be preserved. Whatever its shortcomings and the problems it creates for authorizing and appropriating committees, that process is still our best means of packaging spending and tax commitments. Through it, I hope that you can fashion a kind of fiscal social contract with the voters and the many interest groups so that there can be a sense of sharing of burdens to achieve specific deficit and economic goals.

Mr. Chairman, this Committee is one of the keys to the restoration of health of the American economy. The Business Roundtable pledges its support to you as you pursue that goal.

The CHAIRMAN. Our next witness is Mr. Robert W. Dixon, chairman of Harvey Hubbell, Inc. Orange, Conn., on behalf of the American Business Conference; Mr. James Herr, president, Herr's Potato Chips, Nottingham, Pa., on behalf of the National Federation of Independent Business; and Mr. Harley W. Snyder, president-elect, National Association of Realtors.

I don't know whether you have a game plan or not, but we will proceed maybe in the way, the order, your names were called. Mr. Dixon?

Mr. DIXON. That's fine.

The CHAIRMAN. Senator Long is coming right back. He had to step out, but go ahead.

STATEMENT OF ROBERT W. DIXON, CHAIRMAN, HARVEY HUBBELL, INC., ORANGE, CONN., ON BEHALF OF THE AMERICAN BUSINESS CONFERENCE, WASHINGTON, D.C.

Mr. DIXON. Mr. Chairman, and members of the committee, it is a pleasure for me to have the opportunity to appear today before this distinguished committee. I am the chairman and chief executive officer of Harvey Hubbell, Inc., a manufacturer of electrical products for the commercial, industrial, utility, transportation, residential, and telecommunication markets. I am also a member of the board of directors of the American Business Conference.

The American Business Conference is a relatively new organization limited to the chief executive officers of 100 of America's most energetic and successful firms. These firms have annual revenues of between $25 million and $1 billion, and each has doubled in size over the last 5 years. They are located in all regions of the country and represent the full spectrum of American commerce.

Recently, the successful entrepreneurs who comprise the membership of the American Business Conference came to Washington to discuss their perspectives on the state of the economy. At the end of 2 days of meetings with key policymakers, the CEO's reaffirmed their support for the basic direction of the tax program that you enacted last year.

Mr. Chairman, that program signaled a dramatic turnaround in the design of our tax structure. Previously, the goal was to use the graduated income tax system to gradually equalize the after-tax income of all Americans. The income inequality produced by the play of the marketplace was to be rectified by the tax and spending actions of the Federal Government. The long-term result of this myopic and archaic economic philosophy was that the investment was discouraged, thrift was thwarted, and production was penalized.

Mr. Chairman, the members of the American Business Conference believe that it is imperative for the Congress to move forward and enact spending and revenue measures which will reduce the size of the impending Federal deficits over the next several years. The deficit for the fiscal year 1983 should be less than $100 billion, and the deficits in later years should trend even lower. We urge this Congress and this committee to enact a balanced program of spending reductions and appropriate tax increases which achieves that objective. Mr. Chairman, we urge this committee to act quickly. Otherwise, we fear that the positive steps taken last year will be swamped by the effects of a prolonged recession. At the present moment, there is little confidence on the part of the business community or consumers.

A significant reduction in the deficit is necessary to reduce interest rates. High interest rates are the fundamental problem with our economy. High interest rates force businesses to borrow even more in order to cover larger lending costs. The detrimental effects of high deficits and high interest rates extend to all facets of the economy. High interest rates raise the value of the dollar and weaken U.S. exports. Lower interest rates would be the best export promotion mechanism that this Congress could devise. Significant reductions in future deficits would be better than any export promotion scheme and would defuse any efforts toward greater protectionism.

The successful entrepreneurs who constitute the membership of the American Business Conference believe that the Congress should reduce the indexation of entitlement programs, including social security; push for more moderate increases in defense spending; and cut discretionary expenditures even further.

The American Business Conference believes that it is best not to defer or postpone the third year of the individual tax cut. No one can predict our economic circumstances a year from now, and I think we should send a signal of consistency rather than change to the financial markets. Marginal tax rate reductions for individuals are the key to reversing the erosion of the incentive structure of the American economy. Restoration of that incentive structure is the key to increasing the capacity of this economy to sustain a high rate of growth over the long term. The American Business Conference continues to believe that Federal deficits will not decline significantly without a strong economy, and a strong economy is predicated upon the absence of disincentives to economic revitalization.

In what I believe to be a dramatic and courageous step, the members of our group voted to urge the Congress to examine all corporate tax benefits in the search for additional sources of revenue. Specifically, we recommended that Congress repeal the inefficient and porous safe harbor leasing provisions enacted last year.

Mr. Chairman, when was the last time a business organization suggested that corporate tax relief is expendable, while individual tax reduction is not?

We at the American Business Conference are realistic. We know that the budget deficits are too large and that corporate tax increases will be one of the roads used to narrow the widening gap between revenue and expenditures. We hope that as you try to mold a program of measures to raise revenues, you will not compromise the essence of the tax revisions made last year—the restoration of incentives and stimulus to capital formation.

In the last few weeks there has been a lot of talk about imposing either a corporate minimum tax or a corporate surtax. I believe that the tax policies that you set this year should spread the pain of the tax increases around as evenly as possible. A minimum tax would fall unevenly across industry lines, and a surtax would force firms in high tax brackets to continue to shoulder more than their share of the burden of raising revenue.

I hope that you can devise a tax that is a hybrid of the minimum tax and surtax; a hybrid which is as broad based as possible and which does not place a disproportionately large share of the burden on any one industry or group of industries. Yet, I am well aware that the process of fashioning an equitable hybrid approach will not be easy. In fact, it will be quite a formidable task. The complexity and difficulty of the undertaking is the direct result of the condition and structure of our present Tax Code. The Tax Code is a nightmare of confusing and complicated regulations which are constantly being altered or reinterpreted. I think that we should start to give serious consideration to a move toward a flat rate system of taxation. Under this kind of system, all income—from individuals and from corporations—would be taxed. We would no longer be faced with a maze of deductions, special credits, loopholes, bracket creep, marriage penalties, success penalties, and the like.

A comprehensive, flat tax rate system would be easy to understand and administer and would be fair. Over a certain minimum, all income would be taxed at the same rate. The minimum would be set at a level which would provide adequate protection for lower income families.

More resources would be allocated according to basic supply and demand factors rather than according to tax considerations. Long-term investment commitments could be made without concern that the next Congress would again change tax guidelines. This would be of great value to our domestic economy and to our international competitive position. I think that it is time for the Congress to undertake a serious study of the feasibility of a comprehensive, flat rate tax approach such as that recently proposed by Senator Bradley.

In the meantime, while I do not relish the prospect of higher taxes any more than any of my colleagues on this panel, I think that the business community must have the courage to help narrow the deficit, and, furthermore, we must do it with good grace. Thank you very much.

The CHAIRMAN. Thank you, Mr. Dixon.

[The prepared statement of Robert W. Dixon follows:]

TESTIMONY OF ROBERT W. DIXON
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
of HARVEY HUBBELL, INC.
and
MEMBER OF THE BOARD OF DIRECTORS
of the
AMERICAN BUSINESS CONFERENCE

before the

SENATE FINANCE COMMITTEE

June 10, 1982

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

IT IS A PLEASURE FOR ME TO HAVE THE OPPORTUNITY TO APPEAR TODAY BEFORE THIS DISTINGUISHED COMMITTEE.

I AM THE CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF HARVEY HUBBELL, INC., A MANUFACTURER OF ELECTRICAL PRODUCTS FOR THE TRANSPORTATION, RESIDENTIAL, AND TELECOMMUNICATIONS MARKETS. I AM ALSO A MEMBER OF THE BOARD OF DIRECTORS OF THE AMERICAN BUSINESS CONFERENCE.

THE AMERICAN BUSINESS CONFERENCE IS A RELATIVELY NEW ORGANIZATION LIMITED TO THE CHIEF EXECUTIVE OFFICERS OF 100 OF AMERICA'S MOST ENERGETIC AND SUCCESSFUL FIRMS. THESE FIRMS HAVE ANNUAL REVENUES BETWEEN $25 MILLION AND $1 BILLION, AND EACH HAS DOUBLED IN SIZE OVER THE LAST FIVE YEARS. THEY ARE LOCATED IN ALL REGIONS OF THE COUNTRY AND REPRESENT THE FULL SPECTRUM OF AMERICAN COMMERCE.

RECENTLY, THE SUCCESSFUL ENTREPRENEURS WHO COMPRISE THE MEMBERSHIP OF THE AMERICAN BUSINESS CONFERENCE CAME TO WASHINGTON

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TO DISCUSS THEIR PERSPECTIVES ON THE STATE OF THE ECONOMY. AT THE END OF TWO DAYS OF MEETINGS WITH KEY POLICYMAKERS, THE CEO'S REAFFIRMED THEIR SUPPORT FOR THE BASIC DIRECTION OF THE TAX PROGRAM THAT YOU ENACTED LAST YEAR.

MR. CHAIRMAN, THAT ECONOMIC PROGRAM SIGNALLED A DRAMATIC TURNAROUND IN THE DESIGN OF OUR TAX STRUCTURE. PREVIOUSLY, THE GOAL WAS TO USE THE GRADUATED INCOME TAX SYSTEM TO GRADUALLY EQUALIZE THE AFTER-TAX INCOME OF ALL AMERICANS. THE INCOME INEQUALITY PRODUCED BY THE PLAY OF THE MARKETPLACE WAS TO BE RECTIFIED BY THE TAX AND SPENDING ACTIONS OF THE FEDERAL GOVERNMENT. THE LONG TERM RESULT OF THIS MYOPIC AND ARCHAIC ECONOMIC PHILOSOPHY WAS THAT INVESTMENT WAS DISCOURAGED, THRIFT WAS THWARTED, AND PRODUCTION WAS PENALIZED.

MR. CHAIRMAN, THE MEMBERS OF THE AMERICAN BUSINESS CONFERENCE BELIEVE THAT IT IS IMPERATIVE FOR THE CONGRESS TO MOVE FORWARD AND ENACT SPENDING AND REVENUE MEASURES WHICH WILL REDUCE THE SIZE OF THE IMPENDING FEDERAL DEFICITS OVER THE NEXT SEVERAL

YEARS. THE DEFICIT FOR FISCAL YEAR 1983 SHOULD BE LESS THAN $100 BILLION, AND THE DEFICITS IN LATER YEARS SHOULD TREND EVEN LOWER. WE URGE THIS CONGRESS AND THIS COMMITTEE TO ENACT A BALANCED PROGRAM OF SPENDING REDUCTIONS AND APPROPRIATE TAX INCREASES WHICH ACHIEVES THAT OBJECTIVE. MR. CHAIRMAN, WE URGE THIS COMMITTEE TO ACT QUICKLY. OTHERWISE, WE FEAR THAT THE POSITIVE STEPS TAKEN LAST YEAR WILL BE SWAMPED BY THE EFFECTS OF A PROLONGED RECESSION. AT THE PRESENT MOMENT, THERE IS LITTLE CONFIDENCE ON THE PART OF THE BUSINESS COMMUNITY OR CONSUMERS.

A SIGNIFICANT REDUCTION IN THE DEFICIT IS NECESSARY TO REDUCE INTEREST RATES. HIGH INTEREST RATES ARE THE FUNDAMENTAL PROBLEM WITH OUR ECONOMY. HIGH INTEREST RATES FORCE BUSINESSES TO BORROW EVEN MORE IN ORDER TO COVER LARGER LENDING COSTS. THE DETRIMENTAL EFFECTS OF HIGH DEFICITS AND HIGH INTEREST RATES EXTEND TO ALL FACETS OF THE ECONOMY. HIGH INTEREST RATES RAISE THE VALUE OF THE DOLLAR AND WEAKEN U.S. EXPORTS. LOWER INTEREST RATES WOULD BE THE BEST EXPORT PROMOTION MECHANISM THAT THIS

CONGRESS COULD DEVISE. SIGNIFICANT REDUCTIONS IN FUTURE DEFICITS WOULD BE BETTER THAN ANY EXPORT PROMOTION SCHEME AND WOULD DEFUSE ANY EFFORTS TOWARDS GREATER PROTECTIONISM.

THE SUCCESSFUL ENTREPRENEURS WHO CONSTITUTE THE MEMBERSHIP OF THE AMERICAN BUSINESS CONFERENCE BELIEVE THAT THE CONGRESS SHOULD:

* REDUCE THE INDEXATION OF ENTITLEMENT PROGRAMS, INCLUDING SOCIAL SECURITY,
* PUSH FOR MORE MODERATE INCREASES IN DEFENSE SPENDING, AND
* CUT DISCRETIONARY EXPENDITURES EVEN FURTHER.

THE AMERICAN BUSINESS CONFERENCE BELIEVES IT BEST NOT TO DEFER OR POSTPONE THE THIRD YEAR OF THE INDIVIDUAL TAX CUT. NO ONE CAN PREDICT OUR ECONOMIC CIRCUMSTANCES A YEAR FROM NOW, AND I THINK WE SHOULD SEND A SIGNAL OF CONSISTENCY RATHER THAN CHANGE

TO THE FINANCIAL MARKETS. MARGINAL TAX RATE REDUCTIONS FOR INDIVIDUALS ARE THE KEY TO REVERSING THE EROSION OF THE INCENTIVE STRUCTURE OF THE AMERICAN ECONOMY. RESTORATION OF THAT INCENTIVE STRUCTURE IS THE KEY TO INCREASING THE CAPACITY OF THIS ECONOMY TO SUSTAIN A HIGH RATE OF GROWTH OVER THE LONG TERM. THE AMERICAN BUSINESS CONFERENCE CONTINUES TO BELIEVE THAT FEDERAL DEFICITS WILL NOT DECLINE SIGNIFICANTLY WITHOUT A STRONG ECONOMY, AND A STRONG ECONOMY IS PREDICATED UPON THE ABSENCE OF DISINCENTIVES TO ECONOMIC REVITALIZATION.

IN WHAT I BELIEVE TO BE A DRAMATIC AND COURAGEOUS STEP, THE MEMBERS OF THE AMERICAN BUSINESS CONFERENCE VOTED TO URGE THE CONGRESS TO EXAMINE ALL CORPORATE TAX BENEFITS IN THE SEARCH FOR ADDITIONAL SOURCES OF REVENUE. SPECIFICALLY, WE RECOMMENDED THAT CONGRESS REPEAL THE INEFFICIENT ANC POROUS SAFE HARBOR LEASING PROVISIONS ENACTED LAST YEAR.

MR. CHAIRMAN, WHEN WAS THE LAST TIME A BUSINESS ORGANIZATION SUGGESTED THAT CORPORATE TAX RELIEF IS EXPENDABLE, WHILE INDIVIDUAL TAX REDUCTION IS NOT?

WE AT THE AMERICAN BUSINESS CONFERENCE ARE REALISTIC. WE KNOW THAT THE BUDGET DEFICITS ARE TOO LARGE AND THAT CORPORATE TAX INCREASES WILL BE ONE OF THE ROADS USED TO NARROW THE WIDENING GAP BETWEEN REVENUE AND EXPENDITURES. WE HOPE THAT AS YOU TRY TO MOLD A PROGRAM OF MEASURES TO RAISE REVENUES, YOU WILL NOT COMPROMISE THE ESSENCE OF THE TAX REVISIONS MADE LAST YEAR -- THE RESTORATION OF INCENTIVES AND STIMULUS TO CAPITAL FORMATION.

IN THE LAST FEW WEEKS THERE HAS BEEN A LOT OF TALK ABOUT IMPOSING EITHER A CORPORATE MINIMUM TAX OR A CORPORATE SURTAX. I BELIEVE THAT THE TAX POLICIES THAT YOU SET THIS YEAR SHOULD SPREAD THE PAIN OF THE TAX INCREASES AROUND AS EVENLY AS POSSIBLE. A MINIMUM TAX WOULD FALL UNEVENLY ACROSS INDUSTRY LINES, AND A SURTAX WOULD FORCE FIRMS IN HIGH TAX BRACKETS TO CONTINUE TO SHOULDER MORE THAN THEIR SHARE OF THE BURDEN OF RAISING REVENUE.

I HOPE THAT YOU CAN DEVISE A TAX THAT IS A HYBRID OF THE MINIMUM TAX AND THE SURTAX; A HYBRID WHICH IS AS BROAD BASED AS

POSSIBLE AND WHICH DOES NOT PLACE A DISPROPORTIONATELY LARGE SHARE OF THE BURDEN ON ANY ONE INDUSTRY OR GROUP OF INDUSTRIES.

YET, I AM WELL AWARE THAT THE PROCESS OF FASHIONING AN EQUITABLE HYBRID APPROACH WILL NOT BE EASY. IN FACT, IT WILL BE QUITE A FORMIDABLE TASK. THE COMPLEXITY AND DIFFICULTY OF THE UNDERTAKING IS THE DIRECT RESULT OF THE CONDITION AND STRUCTURE OF OUR TAX CODE.

TODAY, THE TAX CODE IS A NIGHTMARE OF CONFUSING AND COMPLICATED REGULATIONS WHICH ARE CONSTANTLY BEING ALTERED OR REINTERPRETED. I THINK THAT WE SHOULD START TO GIVE SERIOUS CONSIDERATION TO A MOVE TOWARDS A FLAT RATE SYSTEM OF TAXATION. UNDER THIS KIND OF SYSTEM, ALL INCOME -- FROM INDIVIDUALS AND FROM CORPORATIONS -- WOULD BE TAXED. WE WOULD NO LONGER BE FACED WITH A MAZE OF DEDUCTIONS, SPECIAL CREDITS, LOOPHOLES, BRACKET CREEP, MARRIAGE PENALTIES, SUCCESS PENALITIES, AND THE LIKE.

A COMPREHENSIVE, FLAT RATE TAX SYSTEM WOULD BE EASY TO UNDERSTAND AND ADMINISTER -- AND WOULD BE FAIR. OVER A CERTAIN MINIMUM, ALL INCOME WOULD BE TAXED AT THE SAME RATE. THE MINIMUM

WOULD BE SET AT A LEVEL WHICH WOULD PROVIDE ADEQUATE PROTECTION FOR LOWER INCOME FAMILIES.

MORE RESOURCES WOULD BE ALLOCATED ACCORDING TO BASIC SUPPLY AND DEMAND FACTORS RATHER THAN ACCORDING TO TAX CONSIDERATIONS. LONG-TERM INVESTMENT COMMITMENTS COULD BE MADE WITHOUT CONCERN THAT THE NEXT CONGRESS WOULD AGAIN CHANGE TAX GUIDELINES. THIS WOULD BE OF GREAT VALUE TO OUR DOMESTIC ECONOMY AND TO OUR INTERNATIONAL COMPETITIVE POSITION.

I THINK THAT IT IS TIME FOR THE CONGRESS TO UNDERTAKE A SERIOUS STUDY OF THE FEASIBILITY OF A COMPREHENSIVE, FLAT RATE TAX APPROACH SUCH AS THAT RECENTLY PROPOSED BY SENATOR BRADLEY.

IN THE MEANTIME, WHILE I DO NOT RELISH THE PROSPECT OF HIGHER TAXES ANY MORE THAN ANY OF MY COLLEAGUES ON THIS PANEL, I THINK THAT THE BUSINESS COMMUNITY MUST HAVE THE COURAGE TO HELP NARROW THE DEFICIT, AND, FURTHERMORE, THAT WE MUST DO IT WITH GOOD GRACE.

The CHAIRMAN. Mr. Herr.

STATEMENT OF JAMES HERR, PRESIDENT, HERR'S POTATO CHIPS, NOTTINGHAM, PA. ON BEHALF OF THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, D.C.

Mr. HERR. Thank you, Mr. Chairman.

The CHAIRMAN. I might say for the benefit of the witnesses that your entire statements will be made a part of the record. We are told there may be a vote in a few minutes, and if you would summarize it would be helpful.

Mr. HERR. All right. Mr. Chairman, I am James S. Herr, president of Herr's Potato Chips, Inc., Nottingham, Pa., and a director of the National Federation of Independent Business. On behalf of its over 530,000 small business members, I am pleased to be here today to discuss the current state of small business and the need for congressional action on the Federal budget crisis. And I intend to summarize the full statement and hope that the full statement can be included in the record.

[The prepared statement of James S. Herr follows:]

NFIB National Federation of Independent Business

STATEMENT OF

JAMES S. HERR

DIRECTOR

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

BEFORE: Senate Finance Committee

DATE: June 10, 1982

SUBJECT: The Need for Action on the Federal Budget Crisis

I am James S. Herr, President of Herr's Potato Chips, Inc. of Nottingham, Pennsylvania, and a Director of the National Federation of Independent Business (NFIB). On behalf of its over 530,000 small business members, I am pleased to be here today to discuss the current state of small business and the need for Congressional action on the federal budget crisis.

Every quarter NFIB surveys a sample of our membership to determine the current state of the small business economy. The <u>Quarterly Economic Report</u> (QER)* has been in existence since 1973, and through the years has proven to be a true and accurate barometer of the state of small business, both during good times and bad times. Members are surveyed about planned and actual inventory,

*The <u>Quarterly Economic Report</u> is published quarterly by the NFIB in cooperation with William Dunkelberg of Purdue University, Jonathan Scott of Southern Methodist University, and William Dennis, Director of Research, NFIB.

capital expenditures, employment, sales, prices, and changes in borrowing. The most recent QER dated April, 1982, surveyed economic conditions for the first quarter of 1982, the results of which have just been made available.

The small business economy could best be described as "adrift". During the first quarter it just seemed to float, and small entrepreneurs expected more of the same during the second quarter. While the survey provided no evidence of a further slump in the economy, it also produced virtually nothing over which to be optimistic about future economic conditions. In fact, the tenor of the survey results strongly resembled those of the late 1970's when a recession was just around the corner; recovery is the phenomonon now alleged to be ready to occur at any moment. Unfortunately, there is still no evidence of recovery, at least among small business.

Employment among operating small businesses fell in the first quarter, marking the tenth consecutive quarterly decline on a seasonally adjusted basis. The drop was .39 employees per firm. This was less than half of the disastrous .77 employees registered in the fourth quarter, 1981.

The unique phenomenon of the enormous drop in small business employment during the fourth quarter was that all three service sectors lost employees. By April, the situation had reversed itself and returned to what has been normal over the past two years. The number of job openings small business cannot fill were virtually identical to those reported in October, 1981, and January, 1982. Expected changes in the labor force were positive. Eighteen percent reported plans to increase employment and 8% reported plans to cut it.

The Index of Small Business Sales (seasonally adjusted) again fell during the first quarter and surpassed the previous low recorded in the first quarter of 1975. It was the fourth consecutive drop in the Index following the modest three quarter upturn in the second half of 1980 and the first quarter of 1981.

Expectations for second quarter sales rose on a seasonally adjusted basis, providing a modest improvement from January, 1982. The April, 1982, sales expectations figures were virtually identical to those recorded one year ago. Whether the improvement represents the early signals of stronger future sales or an attitude of desperation--"it can't get worse"--remains to be seen.

Clearly, sales are the critical element for small business. With few exceptions, strong sales can compensate for other problems, e.g. high interest rates, high inflation rates, etc. But if sales are weak and don't of themselves destroy a small firm, they exacerbate other problems that may exist. The tumble in small business sales appears to have begun in the third quarter of 1979 and, with various ebbs and flows, continues through the present. It is little wonder, therefore, that the cumulative effect of slow sales and accompanying problems such as high interest rates has resulted in the greatest number of business failures since the Great Depression.

The Index of Small Business Earnings jumped substantially in April. While the sharp rise would normally provide considerable optimism, the Index's absolute level was little higher than that registered for the third quarter of 1981. The increase did, however, break a three-quarter slide in the Index.

The April figures just underscore the degree of trouble in the fourth quarter of 1981. Facing even greater downward pressure on selling prices, no changes in carrying costs and even slower sales in the first quarter of 1982 than the prior quarter, the Index still rose. These data seem terribly inconsistent. However, there are several plausible explanations. The number of borrowers was down, thereby cutting fixed costs for a particular segment of the population. It is possible that the beneficial effects of lower inflation rates have begun to help some firms, but it should be clear that the absolute level from which the Index is measuring change is so low that any improvement will provide a sharp increase.

At the beginning of the fourth quarter of 1981, small business inventories were badly out of balance. Twice as many firms reported inventories too high as reported them too low. Three months later (January), the situation had improved, but no further improvement occurred in the first quarter despite significant price cutting.

Without a substantial increase in real sales, there can be no new inventory accumulation by small firms during the second quarter. Interest rates still being high, small firms must wait for a justification before rebuilding stocks. Clearly, no justification is seen.

Capital expenditures continued their gradual drift downward during the first quarter. Fifty-two percent made some type of capital expenditure, down one percentage point from the previous quarter. Over the last three years, the number of firms making a capital expenditure of $5,000 or more within a six-month period has fallen from 45% to 34% (or about one-quarter) of the population.

Small business expects virtually no change in capital expenditures over the next six months from the previous six months. April figures were virtually identical to January, which in turn were virtually identical to October, 1981, figures. It is as if everything were on hold.

For the first quarter, a whopping 19% reported lower prices than in the previous quarter, in contrast to only 27% reporting higher prices. Both figures were survey records. With prices softening throughout the economy, the number of small businesses planning price increases in the second quarter dropped one-third from the January level. Only 20% of respondents planned to raise prices in the second quarter, matching a survey record low. Significantly all three service industries reported less frequent planned increases than the small ~~business average.~~ Retail stood at 23%.

While the softening of prices is good news for consumers, certain observations must be made regarding the fall in the rate of small business price increases. First, lower prices which in large part result from slow sales put a severe strain on earnings. Second, a large portion of the price fall still rests on the construction and allied industries, e.g. real estate. That phenomenon can only continue so long before the entire industry collapses or other sectors slow as well.

Credit Conditions

Interest rates continued to plague small business during the first quarter. Small firms paid an average of 17.8% on short-term loans, 1/10 of one percent (10 basis points) less than the prior quarter. Nearly four out of five paid between 16.0% and 18.9%. Given the current inflation rate and reasonable expectations for changes in the rate over the next twelve months (maximum duration of a short-term loan), it is clear that small business is paying a real interest rate of well into double-digit figures.

Table 1 provides the distribution of interest rates charged small firms on short-term loans, the average rate, and the average prime rate at the end of the quarter. Note that as prime has risen, the average interest rate charged small firms lagged. The same was true as the prime began to fall. In other words, the trend in prime preceeded the trend in small business interest rates. The second point to note on Table 1 is the coalescence of rates paid. For example, during the fourth quarter of 1980 (just over one year ago), the distribution of interest rates paid on short-term loans was enormously diverse. Twenty-two percent reported paying between 13.0% and 15.9%. Yet another 22% reported paying 21% or more. By the first quarter of 1982, 79% reported short-term loans at between 16.0% and 18.9%.

TABLE 1

Interest Rates Paid on Short-term Loans

Interest Rate Paid	79:4	80:1	80:4	81:1	81:2	81:3	81:4	82:1
			Percentage Reporting					
Under 10%	2%	2%	1%	1%	1%	*	*	*
10 to 12.9%	22	8	5	2	1	1	1	1
13 to 15.9%	45	25	22	14	8	4	9	5
16 to 18.9%	23	35	33	54	35	33	63	79
19 to 20.9%	6	22	17	20	29	33	18	11
21 or more	2	8	22	9	25	29	9	4
Average Rate	14.6	16.4	18.0	17.7	19.0	19.3	17.9	17.8
Prime Rate at end of quarter	15.3	19.8	20.2	17.2	20.4	18.5	15.8	16.5

Interest Rates-Financing continues as the most important problem faced by small business. In April of 1982, 37% of respondents cited Interest Rates-Financing as their single most important problem. Of the small firms directly impacted because they borrowed in the last quarter, 56% cited Interest Rates-Financing as their single most important problem.

It is becoming increasingly clear that non-borrowers enjoy an advantage over borrowers, as revealed in net earnings. Since mid-1979, non-borrowers have reported a consistently higher net earnings change than borrowers. This deteriorating earnings position is due to: 1) borrowers not generating sufficient sales increases to cover increased borrowing costs; and 2) the inability of borrowers to pass all of the higher interest cost on in the form of higher prices.

The cumulative impact of high interest rates on borrowing small businesses' earnings has caused them to reduce capital expenditures relative to non-borrowers. The difference between the net percent reporting capital expenditures for borrowers and non-borrowers has fallen from an average of 18% in late 1979 to an average of 7% from 1980 to the present. Higher interest rates have also caused borrowing small businesses to reduce their hiring relative to non-borrowing small businesses.

It is clear that an economic expansion led by small business will not happen unless interest rates fall. During the mid-1970's, small business accounted for almost 80% of all new jobs. The continued high level of interest rates has brought small business employment gains to a halt and has substantially reduced the capital expenditures necessary to expand businesses.

Deficits continue to be the culprit which prevents any real improvement in the interest rate picture from occurring. In 1982, over 90% of all individual savings* will be borrowed by the federal treasury to finance a burgeoning federal deficit, and

*Sources: Federal Reserve Board; Treasury Department; Manufacturers Hanover Trust Company

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long-range budget projections offer little hope of a balanced budget until 1986 or beyond. Meanwhile the debt service on the national debt will increase to well in excess of $100 billion because the Federal Treasury is borrowing constantly at higher rates, driving up the average cost of maintaining the public debt.

Claims are made that no empirical evidence exists to show high deficits as being a cause of high interest rates. However, the actions of the financial community speak for themselves. The constant pressure on money markets due to government borrowing needs--both on and off budget as well as current and estimated--signals the money managers to hedge their bets and to maintain high rates as protection against future credit squeezes.

In 1981 total Federal borrowing--the sum of direct Treasury borrowing, Federally guaranteed loans, and borrowings by federally sponsored enterprises--accounted for almost 74% of total national savings. In 1982 OMB's projected federal borrowing activity is projected to exceed 90% of national savings. While these figures may be disproportionately high because private sector borrowing would replace much of the off-budget lending, a dangerous trend can be seen. The point to be made is that excessive federal borrowing will limit future economic growth by absorbing too high a percentage of our national savings pool. If any upturn in the economy does materialize, the pressure from competition with Treasury borrowing will most likely force interest rate increases, thereby stalling any potential recovery before it even gets rolling.

How the deficit is reduced is as important as reduction itself. Reducing the deficit through revenue raising measures is clearly an inappropriate way to reduce the deficit problem. Spending reductions, which include adjustments in all federal programs including defense and social security, are imperative. Automatic cost of living adjustments (COLA) must be reduced as well. Balancing the budget by raising taxes during a recession has several undesirable side effects. First, increased taxes will severely weaken the strength of any recovery. Second, the lack of future spending reductions reinforces the impression that Congress is unable to tackle tough decisions and thereby transmits the wrong signal to the financial community. Future increases in spending demands will result in greater revenue needs by the federal government which must be met with further revenue increases or greater deficits. Reduction of spending levels commensurate with automatic spending adjustments will demonstrate the fiscal responsibility that the banking and financial community are looking for.

Through deficit spending we have been mortgaging our future. As everyone eventually discovers, you run out of future to mortgage. We are at such a critical juncture that we must reorganize and restructure our spending patterns or we will find ourselves with all of our assets mortgaged and unable to handle current operating costs.

Obviously, the cuts in spending programs must be made by Congress. Just as obviously, the serious delays by Congress in moving towards tough political decisions, but necessary economic ones, is exacerbating the current economic crisis. Money markets do not see that Congress is serious about fiscal responsibility. Their response is to keep interest rates high because the markets will still be strained in the future. Comparisons between long-term rates and short-term rates reveal a major symptom of our economic malaise. Long-term rates historically have exceeded short-term rates by 30-40%. Current differences are within a few percentage points. This factor alone points to a deep concern over our economy in the short run by those who risk their capital by lending to others. Currently, a historically high risk premium of almost 6% is being asked by lenders, another indication of a tremendous lack of long-term confidence.

Congress needs to exercise its responsibility on fiscal policy, and it must do so before too much more time passes. Just a short year ago we all complained about inflation's hidden tax. Now we can complain about the tax we pay to support runaway federal deficits. This tax is reflected in current interest rates and, as any punitive tax does, is draining off capital and savings from useful investment.

We must reiterate, Congress must go forward with a budget and must do so in a fiscally responsible manner.

NFIB members in recent polls through our Mandate have stated emphatically that:

1. Budget deficits are of prime importance and must be reduced, and

2. Raising revenues through tax increases is unacceptable.

Eliminating budget deficits by a combination of spending reductions and revenue increases was also rejected by the membership.

While we would have preferred no increased revenues in the Senate budget, we are cognizant of your responsibilities and duties as elected representatives the following is a list of guideposts which can be used in deciding whether a particular proposal is favorable or unfavorable for small business. To repeat, we would prefer to see no tax revenue increases but the following guidelines illustrate areas where small business taxes can be increased in a fair manner.

A. <u>Do not undo the Economic Recovery Tax Act of 1981 (ERTA)</u>
The 1981 tax bill included many incentives for capital formation and retention. These incentives are still necessary to encourage investment in small business and to help reverse the overtaxation of our capital base. Many of the incentives helped small business and large business, though in different degrees and in different ways. Certainly ACRS is a major part of the incentive package. But the individual tax cuts are a major small business incentive as well.

Over 60% of small firms pay taxes as individuals. Rate reductions for these smaller labor intensive firms provide the only effective way to provide a capital formation incentive, for a small business owner will take a tax reduction and characteristically plow it right back into the business for expansion.

Another major aspect of last year's tax bill was the method by which incentives for capital formation could be used and understood. Complexity in the tax law penalizes small business, particularly because small firms do not have the funds to hire tax expertise familiar with all the loopholes in the tax system. Many use neither an attorney or accountant for tax advice. Simplification in depreciation rules and inventory rules were a major concern for small business last year, and these goals to varying degrees were attained. In the haste with which you must come up with revenue increases, please keep this concept in mind. New complex formulas will result in a major burden for small firms.

Tax Increases NFIB Supports

Several specific tax changes have been proposed by Congress which NFIB members have been polled on and support. Specifically the tax increases which NFIB members do concur with are elimination of safe-harbor leasing and a change in ACRS accounting procedures to an open-ended accounting system.

Safe harbor leasing provides an inefficient method for transferring tax benefits as a condition of a sale of certain capital assets. It has proven to be a loan to large firms who have taken advantage of one of the most popular loopholes ever devised.

Changing to an open-ended accounting system for ACRS would be a simplification in accounting procedures under ACRS, but one which also raises revenues.

Structural Tax Changes Which Could be Supported

The alternative minimum tax proposal and the Administration's proposal for legislative changes to the completed contract mehtod of accounting pose difficult problems for small business. Both proposals would introduce vast new complexities in tax compliance while not raising much in revenues from small business. The alternative minimum tax alters the effect of investment tax credits and net operating losses for small firms in such a fashion that taxes are raised out of proportion to the firm's tax liability.

The completed contract proposal forces wholesale changes in accounting procedures which complicate matters for small contractors who defer tax liabilities for one year instead of ten or fifteen. This proposal as well as the minimum tax proposal need to be reworked structurally to be supportable by NFIB.

The Following Items are Strongly Opposed by NFIB

1. Altering the 3rd year of the individual tax cut scheduled for 1983.
2. Elimination of indexing.
3. A corporate or individual surtax.
4. Increases in employment taxes (e.g. FICA or FUTA).
5. Reduction in the investment tax credit.

Conclusion

The 1981 tax bill concentrated its benefits on capital intensive industries, of which small business comprises approximately 25% of the population. While we recognize that the Senate is now mandated to raise taxes, it would be unfair to now tax evenly capital intensive with labor and inventory intensive firms who received less in the way of tax benefits last year. Labor and inventory intensive firms pay a higher effective tax rate than almost every other industry, making specific types of proposals even more burdensome for these firms.

We would hope that in your deliberations you take this perspective into account in determining which industries have to give something up.

It is our sincerest desire that Congress take action which would reduce the Federal deficit and bring down interest rates. We are convinced, as is almost every economist, business owner, and money manager, that further Congressional inaction can only result in a longer recession.

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Mr. HERR. And I am sure that you are all acquainted with the fact that NFIB has a survey. We survey our membership. This is called the Quarterly Economic Report, which has been in existence since 1973, and through the years has proven to be a true and accurate barometer of the state of small business, both during good times and bad times. Members are surveyed about planned and actual inventory, capital expenditures, employment, sales, prices, and changes in borrowing. The most recent QER, dated April 1982, surveyed economic conditions for the first quarter of 1982, the results of which have just been made available. The small business economy could best be described as adrift. During the first quarter, it seemed to float, and small entrepreneurs expected more of the same during the second quarter. While the survey provided no evidence of a further slump in the economy, it also produced virtually nothing over which to be optimistic about future economic conditions.

In fact, the tenor of the survey results strongly resemble those of the late 1970's when a recession was just around the corner; recovery is the phenomenon now alleged to be ready to occur at any moment. Unfortunately, there is still no evidence of recovery, at least among small business.

Employment among operating small businesses fell in the first quarter, marking the 10th consecutive quarterly decline on a seasonally adjusted basis.

Clearly, sales are the critical element for small business. With few exceptions, strong sales can compensate for other problems, such as high interest rates, high inflation rates, et cetera. But if sales are weak and don't of themselves destroy a small business firm, they tend to exacerbate other problems that may exist.

The tumble in small business sales appears to have begun in the third quarter of 1979 with various ebbs and flows and continues through the present. It is little wonder, therefore, that the cumulative effect of slow sales and accompanying problems such as high interest rates has resulted in the greatest number of business failures since the Great Depression. Without a substantial increase in real sales, there can be no new inventory accumulation by small firms during the second quarter. Interest rates still being high, small firms must wait for a justification before rebuilding stocks. Clearly, no justification is seen. Capital expenditures continued their gradual drift downward during the first quarter, and small business expects virtually no change over the next 6 months from the previous 6 months. It is as if everything were on a hold. For the first quarter, a whopping 19 percent reported lower prices than in the previous quarter, in contrast to only 27 percent reporting higher prices.

While the softening of prices is good news for the consumer, certain observations must be made regarding the fall in the rate of small business price increases. First, lower prices which in large part result from slower sales put a severe strain on earnings. Second, a large portion of the price fall still rests on the construction and allied industries, such as real estate. That phenomena can only continue so long before the entire industry collapses or other sectors slow as well.

Interest rates continue to plague small business during the first quarter. Small firms paid an average of 17.8 percent on short-term loans, one-tenth of 1 percent—10 basis points less than the prior quarter. Nearly 4 out of 5 paid between 16 percent and 18.9 percent. Given the current inflation rate and reasonable expectations for changes in the rate over the next 12 months, it is clear that small business is paying a real interest rate of well into double-digit figures.

Obviously, interest rates financing continues as the most important problem faced by small business. In April 1982, 37 percent of respondents cited interest rates financing as their single most important problem. Of the small firms directly impacted because they borrowed in the last quarter, 56 percent cited interest rate financing as their single most important problem.

Therefore, NGIB believes that the immediate action is needed to reduce the Federal deficit in order to allow the economy to recover and expand. Uncertainty by the business community about what Congress will do, and delay in its doing anything are, in themselves, hurting small businesses.

While NFIB members strongly believe that the current budget crisis should be solved by further cuts in spending and not wide range tax increases, we urge this committee and the Congress to quickly be about its business of setting in place a budget, even if it means some tax increases. The urgency of the situation can hardly be overemphasized. Many small businesses are not going to be around to see the recovery if we don't act soon.

NFIB wants you to act quickly, but, please, responsibly and in ways that don't make the situation worse than it already is. And some of the ways we think it should be done is not undo the capital formation and retention goals of the Economic Recovery Tax Act of 1981; not disproportionately increase taxes on labor intensive business, which received less benefit under ERTA than capital intensive businesses; not repeal the third year individual tax cut; and not repeal indexing; not increase labor taxes; not impose a surtax of any kind; and not increase the complexity of the Tax Code. But, in addition, they do urge you to repeal the Safe Harbor Leasing Act; consider an open-ended accounting system for ACRS; and restructure the proposed minimum corporate tax so as not to introduce vast new complexities.

In short, Mr. Chairman, small business people do not like the idea of tax increases, but since they must be raised in this budget fight, we urge that you do it quickly and to do it in a way that gives the greatest hope for economic recovery. Thank you.

The CHAIRMAN. Thank you.

Mr. Snyder.

STATEMENT OF HARLEY W. SNYDER, PRESIDENT-ELECT, NATIONAL ASSOCIATION OF REALTORS, VALPARAISO, IND.

Mr. SNYDER. Thank you, Mr. Chairman. My name is Harley W. Snyder. I am president-elect of the National Association of Realtors, and I am appearing here before you today on behalf of the over 640,000 members of our national association. We greatly appreciate the opportunity to present our testimony.

We have submitted for the record our written statement, along with many attachments. However, I would like to summarize that statement if I might, just touch on briefly some of the more salient points there.

[The prepared statement of Harley W. Snyder follows:]

STATEMENT
on behalf of the
NATIONAL ASSOCIATION OF REALTORS®
regarding
THE NEED TO REDUCE FEDERAL DEFICITS
to the
SENATE COMMITTEE ON FINANCE
by
HARLEY W. SNYDER
June 10, 1982

I am Harley W. Snyder, President-elect of the NATIONAL ASSOCIATION OF REALTORS®. I am accompanied by Albert E. Abrahams, Senior Vice President for Government Affairs of the Association.

On behalf of the over 640,000 members of the National Association, we greatly appreciate the opportunity to present our views on the need to reduce the federal deficit.

The overall economy declined at an annualized rate of 4.6 percent during the fourth quarter of 1981 and declined nearly 4.0 percent during the first quarter of 1982. Also, unemployment has topped 9.5 percent according to the latest Bureau of Labor Statistics reports. Moreover, the economy has been sick for nearly 3 years. The hardest hit sector has been shelter which accounts for over one-third of the Gross National Product.

Housing activity has declined for 42 months and this decline has accelerated during the last 12 months. We are in the worst housing depression since the 1930s. Existing and new home sales and starts have fallen by more than 50 percent from peak to trough in dramatic and stark contrast to the overall national economy. More Americans have lost the opportunity to satisfy their homeownership need than at any other time in the United States' history (Attachment 1). Over the last three years about 5 million households have been denied the opportunity to buy adequate housing of their own, of which nearly 3-1/2 million would have been purchases of existing homes.

The Federal government is the primary cause of the current economic recession and housing depression and has impacted the economy primarily through:

(1) Record deficits and record borrowing by the Federal government to fund deficits (Attachment 2).

(2) Record taking away of savings from use by housing and industry (Attachment 2).

<u>These events</u>:

(3) Have resulted in record real interest rates, double and triple normal levels which have increased from the normal 3 percent level during the post-war period to an average of 7.8 percent during 1981; 11.9 percent so far in 1982; and 8.5 percent in our forecast for 1983 (Attachment 3).

(4) Have, in turn, resulted in real long-term interest rates that are far higher than other industrial nations whose central government deficits take smaller shares of savings (Attachment 4).

(5) Will completely offset the stimulating effects of last year's tax incentives to invest (Attachment 5).

(6) Will limit the next economic recovery to about one-half the

normal rate (Attachment 6).

(7) Will continue to cripple the interest-sensitive sectors including real estate, automobile, farm, and small business (Attachment 7).

(8) Will lead to greater economic concentration and conglomerate tying arrangements which will likely cause higher housing costs and less homeowner choice in financing and products and other services.

We and others have urged that deficit reductions in FY 1983, 1984, and 1985 be achieved preferably and primarily by slowing the growth of spending. Revenue increases should be adopted in addition to spending reductions only as necessary to significantly reduce the deficit. We believe that the actions to date on adoption of the FY 1983 budget make clear that the urgent need to reduce the FY 1983 and subsequent deficits now requires action to increase revenue.

RECOMMENDATIONS

The NATIONAL ASSOCIATION OF REALTORS® has strongly recommended:

(1) That Congress adopt a total federal deficit of much less than $100 billion for 1983 and a balanced budget by 1985 or 1986. Spending this fiscal year has overrun the commitments of the President and Congress by double the rate compared to past Presidents and Congress' during the last 10 years (Attachment 9).

(2) Federal spending growth must be slowed down in all parts of the federal budget. Congressional action on the budget this year has shown a degree of willingness to slow the growth on domestic discretionary programs, but Congress and the President must be willing to reduce the growth in entitlement and defense spending which together account for close to 72 percent of the total federal budget. Reduction must be made now in defense budget authority to have significant effect in later years. Additionally, to control future budgets requires curtailing the runaway growth of entitlements through changes in the cost of living adjustments.

(3) Tax relief planned for July 1983 and indexing scheduled for 1985 should be deferred. As an alternative, the imposition of a surtax on individuals should also be considered on a short-term emergency basis. REALTORS® 1981 recommendations on size of tax relief are provided in Attachment 10.

(4) Other tax increases to discourage consumption, but not savings and investment, should be adopted to the extent spending changes are insufficient to meet the deficit goal. Such increases could take the form of an oil import fee or raising excise taxes on cigarettes, liquor, and so on.

(5) Administrative and legislative changes should be made to remove barriers to the efficient use of the existing state and municipal housing bond program which is provided for in the existing budget for FY 1982 and in the President's FY 1983 budget. This would provide as much as another

$10 billion for more mortgages, equivalent to helping 300,000 to 400,000 families. These amendments could be implemented in the House-Senate Conference on H.R. 4717, the Miscellaneous Revenue Act of 1981. We strongly believe this is the most immediate way to provide some relief for housing. If these barriers to efficient use are removed, it would:

a. Not add to deficit estimates.
b. Be temporary by being sunsetted in 1983.
c. Be limited to first-time homeowners (90 percent of whom cannot now qualify for the medium-priced home).
d. Include new and existing homes. Existing home sales stimulate as many jobs for Americans as are created by new homes.

(6) The National Association supports the enactment of a reasonable alternative minimum tax rather than an add-on minimum tax. A reasonable alternative minimum tax should be developed. We would welcome the opportunity to work with this Committee in the development of suggested tax preference items for an alternative minimum tax.

(7) The use of industrial development bonds should be restricted to eliminate abuses. Specifically, IDB financing should be prohibited if 25% or more of the proceeds were used to provide a facility the primary purpose of which is motor vehicle sales or service, the retail sale of food or beverages, or the provision of recreation or entertainment.

(8) The capital cost recovery provisions contained in last year's tax bill should be retained and given time to work. When interest rates decline, we are confident that these provisions will induce investment and economic growth intended by Congress.

(9) The safe harbor leasing rules contained in the Economic Recovery Tax Act should be modified. These rules have generated many well-publicized abuses and have simply not provided the tax equality envisioned when this provision was enacted.

(10) Because everyone should pay his or her fair share of tax, we support increased tax compliance and penalty provisions directed at the so-called underground economy such as those contained in the Dole-Grassley Taxpayer Compliance bill, S. 2198.

(11) We support the improved information reporting requirements on payments to independent contractors and the safe harbor classification standards for these individuals contained in S. 2369, introduced by Chairman Dole.

(12) The tax treatment of pension plans set up by private individuals should be reformed to eliminate the abuses that have arisen, and to provide a level playing field between self-employed individuals and those who choose to incorporate themselves. The mere fact that an individual chooses to incorporate himself, such as many doctors and lawyers have done, should not allow the individual to defer taxation on amounts ranging to $100,000 per year when others are limited

to KEOGH contributions of $15,000 per year.

(13) The All Savers program should be repealed. This program has not provided the stimulus intended for housing when it was enacted nor has it provided any continuing assistance to the savings and loan industry. Why retain a program that has not helped anyone?

In summary, it is essential that the budget deficits be reduced to permit interest rates to come down. It is clear that Congressional actions to slow spending growth will be inadequate to bring the 1983 deficit below $100 billion and that some of the revenue increases we have discussed should be enacted.

ATTACHMENTS

1. Periods of Decline in Existing Home Sales
2. Record Deficits
3. Record Real Interest Rates
4. Central Government Deficits and Real Interest Rates in Major Industrial Countries
5. Tax Incentives to Invest Offset by Interest Rates
6. Recovery Limited
7. May 1, 1982 Forecast Tables
8. Housing as Share of Loanable Funds
9. Spending Overruns Beyond President's Budgets
10. REALTORS® 1981 Recommendations on Size of Tax Relief
11. June 8, 1982 REALTORS® Advertisement

ATTACHMENT 1

PERIODS OF DECLINE IN EXISTING HOME SALES

Housing Recession	Duration of Sales Cycle (Peak to Recovery)	Percent Decline in Existing Home Sales (Peak to Trough)	Unit Volume of Sales Lost	Dollar Volume of Sales Lost (in Billions of Dollars)
Dec. 1968 to Mar. 1970	21 months	-19.9 percent	236,000	$ 5.7
Feb. 1973 to Jan. 1975	32 months	-18.4 percent	489,000	$ 17.4
Nov. 1978 to Apr. 1982 (So Far)	42 months (So Far)	-53.7 percent	3,714,000	$267.4

Source: NATIONAL ASSOCIATION OF REALTORS®

ATTACHMENT 2

THE FEDERAL TOTAL DEFICIT AND SAVINGS
($ Billions)

Fiscal Year	Surplus or Deficit(-) Amount	Percent of GNP	Percent of Personal Savings	Percent of Private Savings
1948	12.0	4.9	173.3	35.9
1949	0.6	0.2	5.5	1.4
1950	-3.1	1.2	29.5	7.6
1951	6.1	2.0	51.8	13.9
1952	-1.5	0.4	8.7	2.7
1953	-6.5	1.8	35.9	11.5
1954	-1.2	0.3	6.5	2.1
1955	-3.0	0.8	19.0	4.9
1956	4.1	1.0	21.8	6.1
1957	3.2	0.7	14.2	4.4
1958	-3.0	0.7	13.5	4.1
1959	-12.9	2.7	54.0	16.0
1960	0.3	0.1	1.5	0.4
1961	-3.4	0.7	16.8	4.3
1962	-7.1	1.3	28.8	8.0
1963	-4.8	0.8	22.2	5.3
1964	-6.0	1.0	23.8	6.0
1965	-1.6	0.2	5.2	1.4
1966	-3.8	0.5	10.7	3.0
1967	-8.8	1.1	21.9	6.6
1968	-25.2	3.0	55.2	17.6
1969	3.2	0.4	8.6	2.3
1970	-2.8	0.3	5.8	1.9
1971	-23.0	2.2	37.5	13.5
1972	-23.4	2.1	43.4	12.8
1973	-14.9	1.2	23.3	7.2
1974	-6.1	0.4	7.1	2.6
1975	-53.2	3.6	58.6	21.0
1976	-73.7	4.5	82.0	24.9
1977	-53.6	2.9	74.0	17.3
1978	-59.2	2.8	76.1	17.0
1979	-40.2	1.7	47.6	10.2
1980	-73.8	2.9	76.0	17.4
1981	-78.9	2.8	78.9	17.1
1982 e	-118.3 (131.3) [145.5]	3.8 (4.3) [4.7]	90.3 (100.2) [111.0]	22.9 (25.4) [28.1]
1983 e	-107.2 (137.1) [164.0]	3.1 (4.0) [4.8]	65.4 (83.6) [100.0]	17.5 (22.3) [26.7]
1984 e	-97.2 (144.1) [162.7]	2.6 (3.8) [4.3]	48.5 (71.8) [81.1]	13.6 (20.2) [22.8]

Footnote 1: Figures in parenthesis are based on CBO budget estimates.
Footnote 2: Figures in [ ] are based on REALTORS® budget estimates.

SOURCE: Budget of the United States Government, 1983, Congressional Budget Office, An Analysis of the President's Budgetary Proposals For Fiscal Year 1983 Savings data from the national income accounts and estimates by the NATIONAL ASSOCIATION OF REALTORS®.

ATTACHMENT 3

REAL INTEREST RATES IN THE UNITED STATES

Period	Real Long-Term Interest Rates 1/
1950 - 1959 Average	2.0
1960 - 1969 Average	3.4
1970 - 1979 Average	2.2
1980	4.2
1981	7.8
1982 (Forecast)	9.7
1983 (Forecast)	8.5
1984 (Forecast)	9.0

1/ Real long-term interest rates are defined as mortgage rates minus the rate of inflation as measured by the percent change in the GNP deflator.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®

ATTACHMENT 4

CENTRAL GOVERNMENT DEFICITS AND REAL INTEREST RATES IN MAJOR INDUSTRIAL COUNTRIES

Country	FY 1982 Deficit 1/		Real Long-term Interest Rates
	$ U.S. billions	% of Personal Savings in 1982 2/	
United States	118.3 (145.5) 3/	100.2 (111.0)	7-8
United Kingdom	15.6	62.5	5.0
West Germany	23.2	37.8	3.0
France	11.6	19.0	3.0
Japan	31.8	18.3	2-3

1/ Federal deficit for U.S., general government current account deficits for calendar 1982 for all other countries.

2/ 1982 personal savings figures for all countries other than the U.S. supplied by Wharton Economic Forecasting Associates.

3/ Figures in parenthesis are REALTOR® estimates.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®

ATTACHMENT 5.1

THE COMPARATIVE IMPACT OF THE ECONOMIC RECOVERY TAX ACT AND HIGH INTEREST RATES

In 1981, Congress passed the Economic Recovery Tax Act (ERTA) in an effort to stimulate savings and investment. A major feature of the new tax package directed at boosting investment, was the Accelerated Cost Recovery System under which tax lives for investment in equipment, commercial and industrial buildings and rental housing were reduced and certain tax credits enlarged or enhanced. ERTA also contained many other provisions having stimulative effects on savings and investment, including expansion of IRA and Keogh Plan provisions, reduced maximum tax rates on non-service income, and the All Savers Certificate program.

However, by far the largest component of ERTA in terms of revenue cost was the phased across-the-board reduction in individual income tax rates. While these individual rate reductions provide some modest incentive for savings and investment, most of the impact of these tax rate reductions is reflected in higher consumer spending. In all, almost 75 percent of the ERTA tax cuts are directed primarily at increased consumption and only 25 percent at directly stimulating savings and investment, one of the smallest proportions in the post war period.

Exploding Federal deficits and excessively tight credit growth policies have forced both long- and short-term interest rates to record levels, even after adjusting for inflation. Unfortunately, this has and will continue to offset the impact of ERTA in stimulating investment. As a result the share of both non-residential and housing investment in Gross National Product continues to fall, the very opposite of the intent of ERTA (see Table below).

Share of Investment and Consumption in GNP
(Percent)

	Actual			Forecast		
	Average 1970-79	1980	1981	1982	1983	1984
Private Consumption	62.4	63.2	63.5	65.0	65.0	64.7
Non-Residential Investment	10.4	10.7	10.7	10.5	10.5	10.8
Investment in Housing	4.2	3.2	3.0	2.0	3.3	3.6

ATTACHMENT 5.2

The reasons why high interest rates have more than offset the impact of ERTA on investment are demonstrated. The Accelerated Cost Recovery System, the main investment stimulus in the overall package, increased the rate of return (the incentive to invest) in new non-residential structures by about one percentage point--about the same effect as a one percent drop in long-term borrowing costs (see Table below). For rental housing, the increases in return were slightly larger--around 1.8 percentage points--although this still provided very little incentive for new construction because of the uneconomic return prevailing in the industry before ERTA was passed.

Impact of ERTA on Returns[1/] to New Investment

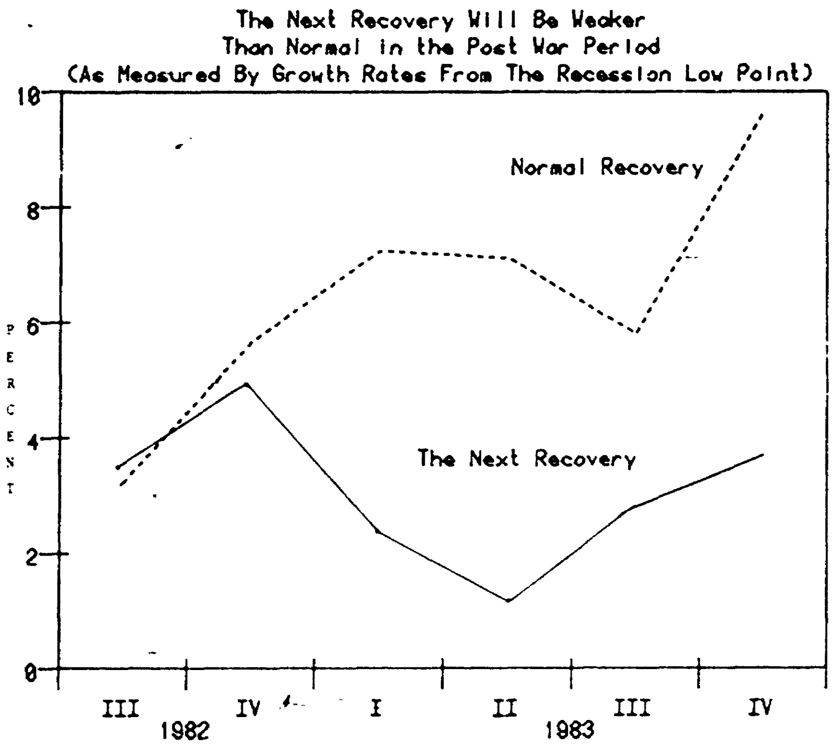
	Holding Period Years			
	5	10	15	20
Non-Residential Construction	+1.0	+0.8	+1.3	+2.5
Rental Housing	+1.9	+1.8	+1.6	+1.3

1/ The effect of a one percentage point increase on after tax returns to investment is approximately equivalent to a one percentage point decrease in interest rates.

Against this, nominal interest rates have risen by almost five percentage points since 1979 and even after adjusting for inflation, are currently more than five percent above normal levels.

This does not imply that the investment incentives in ERTA were inappropriate; on the contrary, they were necessary to stimulate capital formation. However, Congress has the opportunity to enhance the impact of these incentives even more by significantly lowering the Federal deficit, which would allow the Federal Reserve Board to ease its excessively tight credit policies and bring about a sizeable reduction in interest rates.

ATTACHMENT 6



SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

ATTACHMENT 7.1

Table 1

U.S. ECONOMIC OUTLOOK

MAY 1982

	QUARTERS							YEARS					
	Actual		Forecast					Actual			Forecast		
	81:4	82:1	82:2	82:3	82:4	83:1	83:2	1979	1980	1981	1982	1983	1984
AGGREGATE ECONOMY													
Gross National Product ($ billions)	2,998	2,995	[illegible]	[illegible]	[illegible]	3,255	3,320	[illegible]	2,626	2,926	3,060	[illegible]	[illegible]
Percent Change	4.6	-3.8	2.5	9.9	[illegible]	9.9	8.2	[illegible]	8.8	[illegible]	4.9	9.8	[illegible]
Percent Change without inflation	-4.5	-3.9	-2.6	[illegible]	4.4	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	2.8	3.8
Consumption	-2.2	6.0	[illegible]	4.2	[illegible]	3.3	[illegible]	2.9	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Durables	[illegible]	4.5	[illegible]	[illegible]	13.8	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	5.5
Nondurables	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	2.2	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	2.3
Services	[illegible]	3.4	[illegible]	2.4	2.5	2.2	[illegible]	[illegible]	[illegible]	[illegible]	2.2	[illegible]	3.2
Residential Investment	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Nonresidential Investment	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Structures	[illegible]	5.3	[illegible]	[illegible]	-4.9	-3.5	[illegible]	[illegible]	[illegible]	[illegible]	4.3	[illegible]	[illegible]
Equipment	[illegible]	[illegible]	[illegible]	4.5	[illegible]	[illegible]	[illegible]	5.5	4.2	[illegible]	[illegible]	[illegible]	[illegible]
Exports	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	5.5
Imports	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	5.8	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	4.4	5.5
Government Purchases	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Consumption (% of GNP)	[illegible]	55.2	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Residential Investment (% of GNP)	2.6	2.6	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Nonresidential Investment (% of GNP)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Inventory Change ($ billions)	[illegible]	[illegible]	[illegible]	[illegible]	2.5	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Capacity Utilization Rate (%)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Auto Sales (millions of units)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Manufacturing Industrial Production (% change)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	4.5	[illegible]	[illegible]	[illegible]	[illegible]
Common Market	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Japan	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Unemployment Rate (%)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Disposable Income per Household ($)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent Change	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total Taxes per Household ($)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent Change	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Percent of Disposable Income	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Consumer Price Inflation (%)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Producers Price Inflation (%)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Compensation per Manhour (% change)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Productivity (% change)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Unit Labor Cost (% change)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

[illegible]

[illegible]

ATTACHMENT 7.2

Table 2

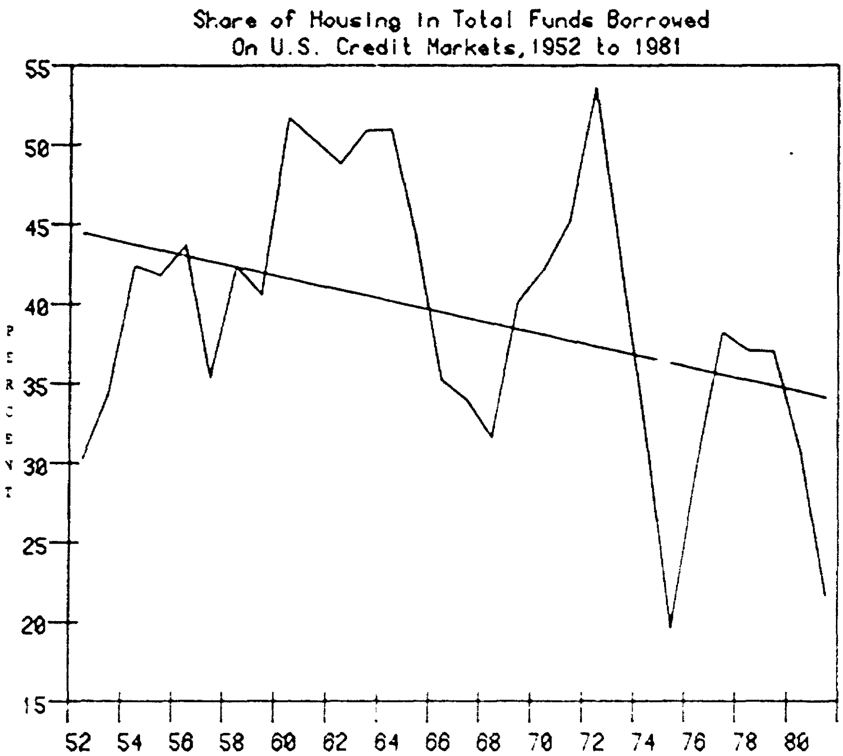
REAL ESTATE AND FINANCIAL MARKETS

MAY 1982

	QUARTERS							YEARS					
	Actual		Forecast					Actual			Forecast		
	81:4	82:1	82:2	82:3	82:4	83:1	83:2	1979	1980	1981	1982	1983	1984
REAL ESTATE MARKETS													
Existing Single-Family Home Sales (thousands)	1,923	1,933	2,130	2,457	2,776	2,945	3,069	3,701	2,881	2,351	2,326	3,164	3,664
Percent Change - Year Ago	-34.6	-25.6	-19.0	7.9	44.3	52.3	44.0	-6.2	-22.2	-18.4	-1.2	35.3	16.5
Dollar Volume (billions)	149.2	153.3	172.7	204.4	226.6	243.8	260.4	237.6	209.7	184.1	189.3	269.8	340.9
Existing Home Prices - Median ($1000's)	66.2	66.8	69.0	71.3	70.4	71.7	73.8	55.7	62.2	66.4	69.4	74.4	81.4
Percent Change - Year Ago	4.5	3.9	3.8	5.6	6.0	7.3	6.9	14.1	11.7	6.6	4.9	7.2	9.5
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	795	782	745	747	745	770	788	433	588	742	755	797	883
Percent of Household Income	30	29	27	27	26	27	27	20	25	29	27	27	27
New Single-Family Home Sales (thousands)	402	365	403	457	472	462	480	704	545	437	424	500	518
Percent Change - Year Ago	-27.4	-30.2	-11.5	23.7	17.5	26.5	19.0	-13.7	-22.5	-19.8	-3.0	18.0	3.4
New Home Prices - Median ($1000's)	69.4	64.8	67.9	69.1	70.4	71.6	72.6	62.7	64.7	68.8	68.6	73.2	78.1
Percent Change - Year Ago	4.9	-0.1	-1.8	-0.9	1.4	6.7	6.9	12.5	3.1	6.4	-0.3	6.7	6.8
New Home Prices--Mean ($1000's, Quality Adjusted)	87.3	90.0	92.2	93.0	93.9	97.7	100.0	71.4	78.5	85.5	92.3	100.1	108.7
Percent Change - Year Ago	8.7	8.8	8.1	8.1	7.6	8.6	8.5	8.8	10.1	8.8	8.0	8.5	8.5
New Mortgage Commitments ($ billions)	45.3	52.9	57.2	73.8	99.3	70.8	52.6	129.3	87.1	60.7	58.4	56.2	93.9
Percent Change - Year Ago	-52.6	-32.3	-17.5	54.2	97.3	34.3	-4.1	-8.8	-32.5	-30.4	-3.8	-17.9	67.2
Mortgage Debt Outstanding ($ billions)	1,544	1,582	1,617	1,654	1,690	1,726	1,755	1,268	1,400	1,508	1,636	1,771	1,922
Homeowners Equity ($ billions)	2,296	2,290	2,272	2,260	2,268	2,314	2,361	2,313	2,115	2,229	2,273	2,384	2,581
Housing Inventory (millions)	84.7	84.8	84.9	85.0	85.1	85.3	85.5	82.0	83.8	84.5	84.9	85.6	86.4
Private Housing Starts (thousands)	865	919	993	1,168	1,265	1,298	1,303	1,745	1,292	1,085	1,111	1,225	1,538
Single-Family	537	586	650	799	862	890	899	1,194	852	706	749	806	1,092
Multi-Family	328	333	343	369	403	409	403	551	440	379	362	419	446
Subsidized	157	147	143	136	133	75	57	175	173	115	135	52	18
Mobile Home Shipments (thousands)	207	237	245	251	265	270	268	276	221	240	249	267	262
Rental Vacancy Rate (%)	5.0	5.3	5.3	5.3	5.3	5.3	[illegible]	5.4	5.4	5.3	5.3	5.3	5.1
Unsold New Homes (% of sales)	76.7	78.1	78.6	74.2	69.1	65.8	67.1	59.6	58.4	75.6	74.5	66.5	68.8
Office Vacancy Rate (%)(1)	4.8	5.4	5.5	5.6	5.4	5.2	5.3	4.4	3.7	4.3	5.5	5.3	4.6
Industrial Vacancy Rate (%)(1)	3.8	3.8	4.0	4.2	4.2	4.4	4.5	3.3	3.5	3.7	4.1	4.4	4.1
New Commercial Building Construction ($ Ch Value)	9.8	30.6	-27.8	-7.5	2.2	7.5	14.3	33.8	21.7	11.7	2.7	4.1	14.3
New Industrial Building Construction ($ Ch Value)	6.2	-20.1	-25.3	-8.7	[illegible]	8.3	2.1	37.2	-6.7	20.1	-8.3	2.6	20.6
FINANCIAL MARKETS													
Personal Savings Rate (%)	6.1	5.3	6.0	6.7	6.7	5.9	5.8	5.2	5.8	5.3	6.2	6.4	6.9
Money Supply (M1) (% change)	5.9	3.6	3.1	3.2	5.4	4.5	1.5	7.7	6.3	7.2	5.6	4.3	4.7
Money Supply (M2) (% change)	9.2	10.3	9.1	7.6	8.1	7.2	6.9	8.5	9.3	9.8	9.2	7.8	9.3
Total Time and Savings Deposits (% change)	8.2	7.5	8.6	3.6	8.4	6.7	5.5	8.6	7.5	8.7	7.6	7.3	7.2
Selected Interest Rates (Percent)													
New Home Mortgage Commitment Rate	17.95	17.45	16.27	15.56	15.72	15.87	15.89	11.27	14.00	16.71	16.20	15.93	16.15
New Mortgage Rate	18.44	17.85	16.95	14.65	14.39	14.75	14.79	11.21	14.24	[illegible]34	15.56	14.79	14.27
Assumption Rate	13.54	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	NA	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Seller Take Back Mortgage Rate	12.80	12.50	[illegible]	[illegible]	12.50	[illegible]	[illegible]	NA	[illegible]	[illegible]	[illegible]	12.54	[illegible]
Blended Rate	15.00	[illegible]	[illegible]	13.64	13.90	[illegible]	14.00	[illegible]	[illegible]	[illegible]	14.02	[illegible]	14.28
Corporate Bond Rate (AAA)	14.62	[illegible]	14.00	[illegible]	12.78	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	13.78	12.98	13.27
Government Bond Rate	14.11	14.45	12.86	[illegible]	[illegible]	[illegible]	13.48	9.52	[illegible]	[illegible]	13.02	[illegible]	12.69
Real Long-term Government Bond Rate	4.61	2.54	[illegible]	5.27	4.98	[illegible]	5.69	[illegible]	[illegible]	5.67	[illegible]	5.99	3.81
Federal Funds Rate	13.33	13.93	13.28	12.78	12.44	11.89	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	13.94
3-Month Treasury Bills	11.75	12.81	12.15	[illegible]	12.45	[illegible]	13.38	[illegible]	[illegible]	14.03	[illegible]	13.91	12.62
1-Year Treasury Bills	13.55	14.32	13.28	12.44	12.92	13.66	14.12	10.67	12.25	14.78	13.24	13.88	12.85
Commercial Paper Rate	13.24	13.81	[illegible]	[illegible]	13.90	14.62	15.56	10.97	12.66	15.33	13.64	[illegible]	13.58
Rate on Money Market Fund Shares	13.1	14.36	14.02	13.39	14.32	14.96	15.84	[illegible]	12.89	15.68	13.87	15.38	13.84
Prime Rate	17.01	16.27	15.92	15.02	15.48	16.55	16.55	12.67	15.27	18.87	15.87	16.67	15.15
(1) Historical data courtesy of Coldwell Banker													

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS and Data Resources, Inc. Assumptions and simulations by Dr. Jack Carlson, Hugh Graham, [illegible]

ATTACHMENT 8



SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

ATTACHMENT 9

OVERRUN IN FEDERAL SPENDING CONTRASTED
TO PRESIDENTS' ORIGINAL COMMITMENTS
(Dollars in Billions)

Fiscal Year	Initial (January) Budget Estimate	Actual Budget Spending		Spending Overrun	
				Percentage	Amount
1972	$229.2		$232.0	1.2	$2.8
1973	246.3		247.1	0.3	0.8
1974	268.7		269.6	0.3	0.9
1975	304.4		326.2	7.1	21.8
1976	349.4		366.4	4.9	17.0
1977	394.2		402.7	2.2	8.5
1978	440.0		450.8	2.4	10.8
1979	500.2		493.6	-1.3	-6.6
1980	531.6		579.6	9.0	48.0
1981	615.8		660.5	7.3	44.7
1982	695.3 (3/10/81)	May 15			
		-Congress	695.5e	0.0e	0.2e
		July 15			
		-President	704.8e	1.4e	9.5e
		Sept. 10			
		-CBO	723.0e	4.0e	27.7e
		Sept. 24			
		-President	709.3e	2.0e	14.0e
		Feb. 8			
		-President	729.2ef	4.9e	33.9e
		-REALTORS®	742.7ef	6.8e	47.4e
		June 3			
		-CBO	743.9ef	7.0e	48.6e
72-82 Average				3.7e	17.8e
1983	762.1f	Feb. 25			
		-CBO	785.1ef	1.7e	13.0e
		April 9			
		-President	771.4ef	1.2e	9.3e
		May 5			
		-CBO	790.4ef	3.7e	28.3e

e = estimate
f = adjusted for comparability by increasing $4.4 billion in 1983 and $3.9 billion in 1982 for SMI and VSI Insurance premiums excluded from spending figures starting in 1983 budget.

SOURCE: Budgets of the U.S. Government, First Concurrent Budget Resolution 1982, Congressional Budget Office Reports, and public statement of the President.

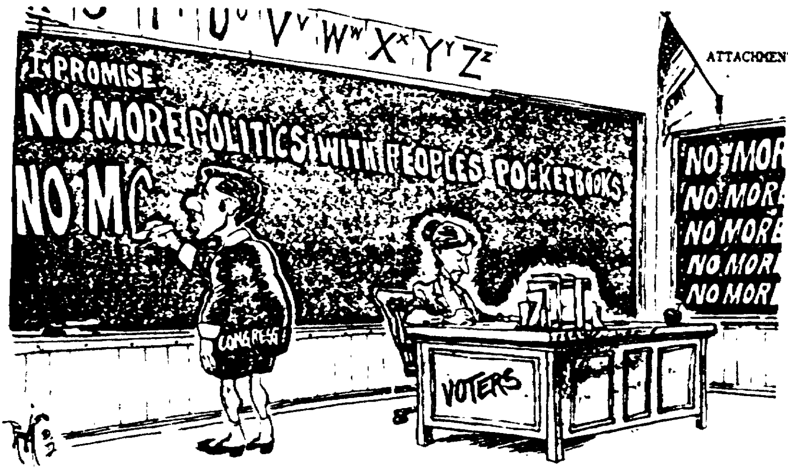
ATTACHMENT 10

EXCERPT FROM STATEMENT OF
THE NATIONAL ASSOCIATION OF REALTORS®
TO SENATE BUDGET COMMITTEE

April 6, 1981

Because of the need for keeping spending reductions and tax relief linked and the need to stimulate savings, we recommend limiting across-the-board personal income tax relief to 5 percent annually over the next 3 years, starting no sooner than July 1981.

ATTACHMENT 11



IF YOU DON'T LEARN YOUR LESSON NOW, CONGRESS, THE VOTERS WILL EXPEL YOU IN NOVEMBER.

NATIONAL ASSOCIATION OF REALTORS®

Working for America's property owners®

Mr. SNYDER. I think, as you are keenly aware, the overall economy has declined at an annualized rate of 4.6 percent during the first quarter of 1981 and nearly 4 percent during the first quarter of 1982. And as has been said earlier here today, unemployment has topped the 9½-percent level. And while we are here today testifying on behalf of the National Association of Realtors and all of its members, I think we are here to suggest to you and the other members of this committee that we are more keenly aware about the total economy, because we feel that if we have a healthy economy, then indeed we will have a healthy real estate industry.

And I would like to just make a couple of comments that I have experienced and talked to individuals about in the past several weeks, during the time which the National Association of Realtors has been trying to encourage other groups, as well as the citizens of this country, about the gravity of the problem. I come from, in addition to an industrial area, also an agricultural area. In our area, farmers who borrowed money in 1981 to plant their crops, which they typically do, and as they do all across this country, experienced in most areas of the country in 1981 a poor crop year because of bad weather under the conditions. Those same farmers find themselves now in a position where they must borrow money in 1982 to not only put their crops in this year and hopefully have a better crop year than they had in 1981, but they are also finding themselves in a position where they have to borrow money to service the debt that they incurred last year, because of high interest rates and all of the other problems that have gone with the illness of the economy that we are experiencing today.

I happened to have the privilege of sitting on a board of directors with the general superintendent of one of the major steel companies in our area, and he tells me that their order book is only 60 to 75 days out. And this in a time when, clearly, the program was supposed to be for industry to expand and encourage jobs, and, in fact, encourage a more healthy economy. And I think we all recognize the fact that industry cannot exist on 60 to 75 days out. We have experienced in our area unemployment far higher than the 9.5 percent across the country. And business, in general, certainly has been hurt severely. So what we are concerned about is not just the real estate economy, but, more importantly, the total economy of this country. Record deficits and record borrowing by the Federal Government to fund the deficits are what has created the economic recession, and what we feel almost trending toward depressionary conditions that we are in today. Of course, this has brought about record taking away of savings from use by housing and industry. And that has resulted in record real interest rates which have increased from the normal 3-percent level to an average of 7.8 percent during 1981, an 11.9 so far in 1982, and as near as we can see, about 8½ percent projected in our forecast for 1983. And in addition to that, they have resulted in long-term interest rates that are far higher than other industrial nations, and they will completely offset, in our opinion, the stimulating effect of last year's tax incentives to invest.

And I might just say there that while 1982, in some few short weeks we are going to see the 1982 tax credit coming forth to the people of this country. And as we see it, this may encourage some modest increase in the economic conditions, but unless there is something done dramatically to reduce the deficits that are projected in the 1983 budget and the out years, we see that the fall of this year will merely bring us back to the same condition that we are in right now, and that we have been in for the last 3 years. We are deeply concerned about the problems that are continuing with these long-term debts that we are having with the Federal Government.

We and others have urged that the deficit reductions in fiscal years 1983, 1984, and 1985 should be achieved preferably and primarily by slowing the growth of spending. Revenue increases should be adopted in addition to spending reductions only as necessary to significantly reduce the deficit. We believe that the actions taken to date on adoption of the fiscal year 1983 budget make clear that the urgent need to reduce the fiscal year 1983 and subsequent deficits now requires action to increase revenue.

I know my time is up, Mr. Chairman. I would like to just comment on a statement made by the Business Roundtable which I think is somewhat of an overstatement, that only by the entitlement cuts will Wall Street take it seriously. And certainly we, the National Association of Realtors, have encouraged entitlement cuts, but we cannot live with the $182 billion deficit that is projected if we don't get a budget out of this Congress. And we think that the Senate budget only call for modest entitlement cuts, and certainly under the latter alternative that is before the House, there are only modest entitlement cuts.

And, in closing, let me say, Mr. Chairman, that we are here today, as I said, not only to appear before this Senate Finance Committee but also because, as you are well aware, the House has a vote. And I would like to submit for the record a letter that the National Association of Realtors has sent to all the Members of the House of Representatives today encouraging their support on the latter alternative that will be voted on today. So I would like to submit that for the record also.

[The letter follows:]

REALTOR®

NATIONAL ASSOCIATION OF REALTORS

Julio S. Laguarta, President
Jack Carlson, Executive Vice President

Albert E. Abrahams, Senior Vice President, Government Affairs
Gil Thurm, Vice President & Legislative Counsel, Government Affairs
Joe Winkelmann, Vice President, Legislative Liaison

777 14th Street, N.W., Washington, D.C. 20005
Telephone 202 383 1000

June 9, 1982

Dear Representative:

The NATIONAL ASSOCIATION OF REALTORS® urges your vote tomorrow for the budget resolution to be offered by Rep. Latta because it reduces the FY 1983 deficit below $100 billion and it contains a binding reconciliation date which will force the process toward a balanced budget in future years.

We believe that passage of a federal budget reducing the deficit below $100 billion in 1983 is a necessary step toward the real goal of interest rates declining to normal levels. Without this action, government spending will continue to increase faster than people's income and federal deficit borrowing will consume virtually the entire savings pool of the American people.

Congress must write a budget that will regain control over the deficit and provide the impetus necessary to restore the health of the many interest-sensitive segments of the nation which have been devastated by unaffordable interest rates. We are hopeful that this action will result in a decline in interest rates sufficient to generate economic recovery.

We are not happy with the high deficits in the "out" years forecast by the Latta Resolution. In recent months, we have urged on the Congress a deferral of the personal tax cuts which, regrettably, is not included in this package. But we have opted for the Latta Substitute Resolution because its direction remains the best alternative for future years. The President's original proposal of February 8 is the worst of the three choices, since it has the highest deficit. The Jones Alternative that the country and the Congress is being offered appears to move away from the budget decisions of last year.

The real test of will and judgment is now before you.

Sincerely,

Julio S. Laguarta
President

Harley W. Snyder
President-Elect

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

Mr. SNYDER. Mr. Chairman, I thank you very much for the opportunity. I would like to just say that we feel it is essential that the budget deficits be reduced to permit interest rates to come down. And it is clear that congressional action to slow spending growth will be inadequate to bring the 1983 deficit below $100 billion, and that some of the revenue increases that I suggested should be certainly considered or discussed. Thank you very much, sir.

The CHAIRMAN. Thank you very much. And I want to thank each member, not only for your statement, but for giving up your time to be here this morning. I think the message, as I understand it, is we have to do something. You may not like everything we do, but we must do something and we must do it very quickly. Would that be a fair summary?

Mr. DIXON. You have to establish confidence in the whole population and not just one particular group. And it is that confidence that only a declining budget deficit can create on a realistic basis.

Mr. SNYDER. We couldn't agree more with that. I think that what we would strongly like to see is a 1983 fiscal year budget with a deficit no more than $100 billion and, hopefully, significantly less than that; 1984, something in the range of probably $70 billion; trending down to in the range of $40 billion in 1985, with a prospect, and the target, for a balanced budget in 1986.

Mr. HERR. I think it has been a very good sign when we see inflation come down to the rates and the levels it is. It makes you think of the good old days. But now the interest rates, there is so much difference between the inflation rate and the interest rates, and this is the thing that is really hurting us. And I think we all know that. I wouldn't want to be naive to just quickly say that I know what the answer is, but I think that you gentlemen—we have confidence in you that you can get some kind of a solution to bring those interest rates down. And I think that really is going to put confidence back into the people out where we live, anyhow. It seems to me that that is what will get the thing going again because if you can get down to 11 or 12 percent, which I am predicting, by October, I think that we can live with that. And that is my own personal opinion, by the way. That is not NFIB.

The CHAIRMAN. Senator Durenberger supports that. [Laughter.]

Well, what we intend to do is to excerpt from each of the statements and other witnesses this morning and have those statement summaries available next, either Monday or Tuesday when we start trying to mark up a proposal here which will have spending reduction provision—I think that is where the emphasis must come first—and the revenues necessary. No one wants to increase revenues. Certainly we don't enjoy doing that. The alternatives that you have outlined are not very promising. We have got to lower the deficit. It is our primary responsibility in this committee. And even though 10 of the 20 members of this committee happen to be running for reelection, I am an optimist. I hope they are optimistic. One is retiring, so it leaves about nine of us on active duty. But we have a number of options. We have options A, B, and C that we are looking at on the revenue side, but we are not ignoring the spending reduction side. Medicare, for example. So I am hopeful that we will have a budget resolution adopted in the House although I understand that is sort of touch and go. We don't want to keep you any longer. If you could go over and contact a few wavering souls it would be helpful. But without it, we will just have to proceed on the debt ceiling.

I think there are some "special interest groups" that figure if there is no budget then they won't be affected. Well, that may be true but I don't think so. We have got other ways to address the problem other than the budget resolution.

Mr. DIXON. Well, the battle is half won with the inflation rate being down so significantly. And rather than look at the horrendous situation we are in and throw up our hands, if we can take this additional step, what a wonderful, strong, solid economy we are going to have for a number of years.

The CHAIRMAN. We are on the threshold. If we just do the right thing, whatever it is.

Mr. DIXON. It can be done.

Mr. HERR. I think that you folks put too much emphasis on what do the people think about us touching these entitlement programs. And actually there are a lot of us that are saying, look, whatever you have to do, the interest rates must come down. If you can get that accomplished and get confidence in the people, they want the right thing done, even people that are on some of these programs. And I think that you need to come out and make it clear to us what you are doing. Too many people get the idea with the news media blowing up the taking away of these benefits, and so on. And I think when it actually comes down to it, you are not doing that much taking away. It is just a matter of holding the line. And all of us out there are holding the line on our businesses. And actually some of us are taking less increases in wages, and some taking cuts. And I think if they can see that all across the board, that there is not going to be the reaction that I think the people who are being up for reelection think there would be.

The CHAIRMAN. Well, we appreciate your testimony. And your entire statements will be made a part of the record. And the hearing record will remain open for a period of 5 days in the event you would like to add anything to your testimony.

Mr. DIXON. Thank you for the opportunity.

Mr. HERR. Thank you.

[Whereupon, at 12:48 p.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

Written Statement of

Dr. Robert W. Stump, DPA

Arlington, VA

on

The Need for Action on the Federal Budget Crisis

Committee on Finance
United States Senate

June 15, 1982

Mr. Chairman, I am Robert W. Stump of Arlington, Va. I am an independent consultant in the field of training and human resource development. I have a Doctorate of Public Administration from the University of Southern California with a concentration in Public Finance. Prior to starting my consulting practice in 1980, I worked for over seven years with the National Institute of Education, the research and development arm of the U.S. Department of Education. My major responsibilities dealt with the impact of and returns to individual and public expenditures for education and training.

Given my experience and professional background, I would like to focus my remarks on one of the major elements in the Federal budget crisis -- the high rate of unemployment. Its costs are to the economy in lost productivity and to the Federal budget in lost tax revenues and increased expenditures for unemployment compensation, welfare, and other social programs to aid those we call "disadvantaged." As many have noted, a one percent increase in unemployment rate means tens of billions of dollars lost to the Federal Treasury.

The Federal budget crisis and the potential costs to society will be reduced by efforts to get individuals back to work -- in the private sector -- with the least cost to the public. The Congress' task is to pass a budget that ensures every dollar will be spent on the most efficient means to alleviate the several causes of the crisis.

Traditional approaches to getting the disadvantaged into private sector employment have relied on subsidies to pre-employment training. While this approach is often the only viable one and may for some individuals continue to be the best, I have often wished there were a mechanism to have this expenditure paid off more quickly. Under the training approach, there is no payoff until the training is finished, a job is found and the individual's cumulative income grows. The chances of ever recouping this training investment depend on many factors, including its cost, the chances of employment after the training, the future demand for certain skills, and a host of other factors which could not be controlled and possibly not predicted at the time the training investment is made.

In 1978, Congress enacted the Targeted Jobs Tax Credit (TJTC) program. It represented a reasoned refinement of other attempts to use the tax credit mechanism to ease unemployment and focused the effort on disadvantaged individuals. The program was extended in 1982, with some changes, and is proposed for extension with the current bill, S.2455, sponsored by Senator Heinz, Senator Domenici, and fourteen fellow Senators.

I support this extension on the grounds that TJTC will be an economically efficient way to make some headway in alleviating one cause of the budget crisis and of aiding the disadvantaged. It will be efficient because of its relatively low cost and the short amount of time before returns on the public investment are realized.

My support is based on analysis I did for one of my clients, the Vrain Corporation of Martinsville, VA, whose principal officers have almost three decades experience in training unskilled and low skilled workers for private sector employment. In the past several years, Vrain has assisted employers to find and hire workers who are TJTC eligible. Currently these employers have over 1,300 employees and the numbers are growing, in contrast to the national figures cited below. Nearly half these individuals are in their second year with the employer, and the second year net impact on the Federal budget is significantly more positive.

This fact was noted in testimony presented last year by Mr. Fred Schuermann, Vice President and Chief Financial Officer, American Furniture Company (Hearings, Subcommittee on Economic Growth, Employment and Revenue Sharing, Committee on Finance, United States Senate, April 3, 1981, pp. 296-302). Mr. Schuermann noted that over two years, his corporation might take a $2,565 credit on an individual employee. However, since the credit is offset by taxes paid by the employee and the company totaling $3,916, the net effect is an increase in Federal income of $1,351. In the first year of employment, this increase would be $248; in the second year $1,103. Unfortunately, the information is not available on the TJTC program nationally to examine the total impact of employees who are in their second year of employment under the program.

My analysis of the TJTC program nationally is not thoroughly rigorous because, as one observer put it, the TJTC program is "data poor." Because of problems in administration and implementation which last year's changes did a great deal to eliminate, the information available is not the best nor as complete as one would like. As a taxpayer and someone with a professional interest, I urge the Senate to request the Administration to conduct a study to assess adequately and thoroughly the program's impact on taxes, expenditures, revenues and employment.

The most recent estimate of TJTC's cost comes from the Joint Committee on Taxation's annual report on tax expenditures. In March 1981, the TJTC tax expenditures were estimated before the program's extension last August. At that time, the FY 82 and later costs were estimated to be $170 million. In March 1982, the Committee's figures for FY 82 and later are based on the one year extension. These additional costs, $250 million, is the Committee's tax expenditure estimate for the one year extension, although the tax expenditures are spread out over several fiscal years.[1]

My major concern with the Committee report, however, is that it gives an incomplete picture of the cost of the program. Because the credit is granted only when someone is employed, there are substantial offsetting Federal revenues which occur automatically and immediately. For each dollar of wages, both the employer and the individual employee make contributions to Social Security -- a total of 13.4 percent in 1982. In addition, those participants earning sufficient income, and some do, pay personal income taxes.

Under the assumption that these individuals would not otherwise be employed, these two offsetting revenues would amount to approximately $157 million. Thus, the net cost to the Federal Treasury is less than $95 million. (See attached table of estimates.) If the

[1]In any one fiscal year, the tax expenditures consist of credits for new hires, credits on the second year of an employee's wages, and credits that corporations carry over from one tax year to another. Part of the "data poor" nature of this program is not having more than estimates of the amounts involved in each of these during the current and future fiscal years. See summary table at the end of this text.

certification figures in this table were for fiscal year 1982, the revenues of $157 million would offset the Committee's estimated tax expenditure of $235 million, for a net expenditure of only $78 million.

Earlier studies of the TJTC implementation have raised questions about whether the individuals would have been hired without the credit. If it could be shown that only half were in this category and only half the $157 million revenue is generated by the credit, the cost of TJTC would have been only two thirds of the Committee's estimate.

I made the point earlier that TJTC is one of the more economical ways to deal with unemployment. If the net cost is between $80 and $100 million to serve about 300,000 disadvantaged youth and young adults, this amounts to between $250 and $300 per person -- an amount far less than traditional approaches whose graduates may pay taxes in the future, if they get jobs.

This Committee ought to consider other current year savings that may result from the employment generated by the TJTC. For each week that a teenager or young adult does not draw unemployment compensation, these current year monies are saved. With the national average compensation running about $108. a week, if only one third of the non-cooperative education participants did not draw a week of compensation, this would save between $55 and $60 million dollars.

Introducing testimony before the Committee last year (April 3, 1981), Senator Heinz noted a number of other ways in which TJTC might have a beneficial impact on the Federal budget. A portion of the impact is by having employed persons no longer dependent on other Federal programs for survival. Examples from one manufacturer in the footwear industry shows that these effects do occur, although we cannot estimate what they amount to in the aggregate.

- o A sixteen year old male no longer uses welfare and medicare to support his wife and child. His job is the base family income and the company insurance helps with the medical bills.

- o A seventeen year old mother -- abandoned by her husband -- no longer subsists on food stamps and AFDC. Her TJTC eligible employment helps her pay expenses, is allowing her to buy the trailer she lives in and enables her to use private health insurance for the child and her own arthritis.

- o A young male raised in subsidized foster homes and publicly supported residential schools is now living with foster parents. He contributes to the family income and has the prospect of becoming independent in the near future.

We are not in a position to assert that TJTC is a money maker, but, if these kinds of savings occur on any scale, the potential certainly exists.

The Congress' task of cutting Federal deficits will not be easy, and it may not be popular with members of this Committee to suggest continued spending even of this relatively modest proportion. Nevertheless, when a program has this potential impact on present and future employment, it should be continued. I recommend that you approve S.2455 to continue the Targeted Jobs Tax Credit program. It is not free. But it is a wise expenditure of Federal dollars -- fewer than many estimates; it is more economical than other remedies; and it will have its impact on unemployment and the Federal budget immediately and for some time to come.

Estimated Tax Expenditures

TJTC Extension from Dec. 1981 to Dec. 1982

Committee Reports [1]	Tax Expenditures for Targeted Jobs Credit (Millions of Dollars)					
	FY 82	FY 83	FY 84	FY 85	FY 86	FY 87
March 8, 1982	235	75	60	35	10	5
March 16, 1981	150	20	-	-	-	-
Difference	85	55	60	35	10	5

[1] Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 1982-87," March 8, 1982, p.15; and "Estimates of Federal Tax Expenditures 1981-86," March 16, 1981, p.12.

Targeted Jobs Tax Credit

Estimate[1] of Net Tax Expenditures

		Disadvantaged Youth	Disadvantaged Cooperative Education	Other Target Groups[2]	Total
Wage Rate per hour		$3.35	$3.35	$5.00	
Hours per week	x	25	15	30	
Weeks per year	x	45	36	45	
Estimated Annual Wages		$3,768	$1,809	$6,750	
Tax Credit @ 46 Percent Corporate Tax Rate		$1,017	$ 489	$1,620	
Estimated Number of Certifications in FY 82 (Thousands)		129.5	102.9	42.5	
Total Amount of Tax Credit (Millions of Dollars)		$131.7	$50.3	$68.9	$250.9
Social Security Taxes					
Employer Contribution		$254	$121	$452	
Employee Contribution		254	121	452	
Federal Income Tax (Single individual)		56	-	408	
Total Federal Revenues per person		564	242	1,386	
Total Federal Revenues (Millions)		$73.0	$24.9	$58.9	$156.8
Net Tax Expenditure (Millions)		$58.7	$25.4	$9.9	$94.1

[1] See Notes Attached

[2] Other target groups include Vietnam Veterans, Ex-convicts, Handicapped, and recipients of SSI and General Welfare payments

Targeted Jobs Tax Credit

Estimate of Net Tax Expenditures

Notes

Wages. Average initial wage rates for non cooperative education certifications through the first three quarters of FY 1981 was $3.84 per hour. Almost three out of four were earning below $4.00. No initial wage rates have been reported for cooperative education students and they have been assumed to start at the minimum wage. Hours and weeks worked are estimated from reported experience and national averages.

Number of Certifications. Preliminary figures for the first quarter of FY 82 show a decline from the first quarter of FY 81. The decline could be attributed to a combination of (1) recession, (2) elimination of non-disadvantaged cooperative education students, and (3) elimination of retroactive certifications. For this estimate, the participation has been set at 68 percent of the FY 81 under the assumption that in the short term these conditions will lead to further reductions.

Social Security Taxes. 6.7 percent of the wages contributed by employee and employer alike.

Federal Income Tax. Based on a single individual tax rate for 1982, with standard deduction and personal exemption of $1,000.

Disadvantaged Cooperative Education. The TJTC extension approved last year allows eligibility only for cooperative education students who are also economically disadvantaged according to the law's definition. Estimates are that the disadvantaged students are 60 percent of the total who were in the program prior to the 1981 amendment.

National Governors' Association

Richard A. Snelling
Governor of Vermont
Chairman

Stephen B. Farber
Executive Director

TESTIMONY OF

GOVERNOR RICHARD A. SNELLING

BEFORE THE

FINANCE COMMITTEE

U.S. SENATE

MARCH 11, 1982

HALL OF THE STATES • 444 North Capitol Street • Washington, D.C. 20001 • (202) 624-5300

Senator Dole and Members of the Committee:

My name is Richard A. Snelling, and I am the Governor of Vermont. I am currently serving as Chairman of the National Governors' Association and am here as a representative of NGA today. Accompanying me is Governor Scott Matheson of Utah, who will succeed me as Chairman of NGA. It is our plan that I will concentrate on the President's federalism initiative, and with a number of discretionary grant programs under the purview of your Committee. Governor Matheson will concentrate on the effect of the FY 1983 budget on entitlement programs which are the joint responsibility of the states and the federal government. The two are interrelated, however, and our testimony will, I hope, make that point.

Before proceeding with that general division of labor, I would like to make a few comments designed to place the statements we are delivering to you today in a common framework.

The importance of the decisions which this Congress will be making in the weeks ahead may very well be unparalleled in the modern history of this nation. Seldom before has a sense of perspective been so essential to the likelihood of a satisfactory outcome. President Ronald Reagan has correctly identified three separate but related tasks which the nation must promptly address. These are:

1. to restore the nation's economic health;

2. to rebuild our defenses; and

3. to recapture that fundamental sense, upon which all other strengths depend, that our government is "of the people".

Each of the three urgent national agendas is separately an essential goal, but they are also interrelated.

A strong defense cannot be obtained by the purchase of arms at a rate that endangers the economy. It is the economy which must support the capacity for defense.

Neither a strong economy nor a strong defense can be achieved unless the the public has confidence in the competence and fairness of the government.

Since President Reagan's election, it is his proposals which has been determining the shape and substance of the national debate. We have, quite properly, put aside debate on how fast taxes can increase and instead we are debating how fast they can decrease. We are no longer allowing defense spending to become a dwindling portion of the budget; we are considering how fast it should increase to afford the requisite security. And, for the first time in a half century, the nation is discussing how to return greater responsibility to state and local governments.

It is the duty of the nation to pick up the President's charge and phrase a response in harmony with a national sense of what will be worthy to endure. Mr. Chairman, you have a critical role in this endeavor, and I want you to know that the Governors are prepared to work with you in any way you would find helpful.

FEDERALISM REFORM

Let me turn now to the federalism reform opportunity before us. While I realize that this Committee is most immediately concerned with recommendations on the FY 1983 Budget, the President's federalism initiative provides an important new framework for those decisions.

Before turning to the specific action taken by the Governors at our winter meeting last month, Mr. Chairman, I believe it would be helpful to discuss for a moment why we feel that progress on intergovernmental reform is urgently needed. Although the grant-in-aid system has certainly done much to alleviate poverty in this country, to strengthen the nation's capital infrastructure, and to advance social goals, all the evidence now points to the need to re-examine the intergovernmental partnership. An eleven volume study recently published by the Advisory Commission on Intergovernmental Relations concluded that the federal system is overburdened. Indeed, we all know that it is. With our hands tied by 500 separate categorical programs and their attendant regulations, over 1000 separate mandates on state and local government, and a paperwork burden estimated to cost $5 billion in 1977, we are not surprised that many Americans simultaneously believe that government is not meeting their needs and that it costs too much.

Governor George Busbee described the confusion of roles and responsibilities in the current intergovernmental system as follows: It is "difficult to imagine an issue too local or parochial to avoid the attention of Washington policymakers. Pot-hole repair, fire fighting, garbage disposal, building codes, have all been the subject of solemn deliberations on the Potomac...to a point where the Congressional Record sometimes bears an uncanny resemblance to the minutes of a county commission meeting."

In view of the urgency with which the Governors view the intergovernmental situation, we welcome the priority that the President has placed on the issue by speaking about it so extensively in his State of the Union address. By his action, the President has elevated federalism reform to a topic of national debate. The action taken by your Committee will have a major impact on the structure of the Congressional response.

NGA policy sets forth many federalism principles and guidelines that are compatible with the President's federalism initiative. We are in full accord with his proposal for federal assumption of Medicaid. We also welcome his far reaching suggestion that a range of categorical programs be transferred to state responsibility. And we believe, as does the President, that a mechanism for financial transition is essential.

The President's federalism proposals contain some elements that are not consistent with existing policy positions of the National Governors' Association, such as assigning responsibilities for food stamps and AFDC to the states. However, we feel these differences can either be reconciled by negotiation or temporarily set aside as we build a program based on existing areas of mutual agreement. To this end, NGA and the White House have begun negotiations on the federalism legislation to be submitted to Congress.

In preparation for these negotiations, the Governors worked at the winter meeting to identify areas of consensus and to develop a federalism initiative premised on the areas of agreement. Governor Matheson had a lead role in crafting this compromise. Our proposal is as follows:

1. The federal government would assume full responsibility for Medicaid. The exact savings to the states would depend upon the fiscal year 1983 appropriations levels and the services actually assumed by the federal government.

2. The AFDC-food stamp portion of the original proposal would be deferred for further negotiations. The states will continue discussions on the details of a later proposal for AFDC and food stamps.

3. The states would take over some negotiated set of federal categorical programs (excluding transportation programs). Decisions on programs returned to the states will be made in a spirit of partnership and cooperation with local governments.

4. During the first year, states would be required to fund all programs at the previous year's level. Over the next three years, states would have full discretion over the use of the funds.

5. The transportation programs and the highway trust fund would be dealt with separately, to recognize the unique relationship that has existed between user fees (e.g. the motor fuels tax) and transportation initiatives and the desirability of separating human capital and physical capital programs.

6. Because of the cost to the states of the returned programs is in excess of the federal government's estimated cost to assume Medicaid programs, a trust fund would be created at the level of swap difference. The trust fund would not increase in size, and would be funded from any federal revenue sources.

7. During fiscal year 1984, distribution of the trust fund would be based on historical expenditure levels to hold states harmless. In fiscal year 1985, 20% of the fund could be distributed according to the fiscal capacity of the states; in fiscal year 1986, 40% in fiscal year 1987, 60%; in fiscal year 1988, 80%; and in fiscal year 1989, 100% could be distributed based upon fiscal capacity.

8. In fiscal year 1989, the President and Congress would re-evaluate the total amount required for the trust fund and determine the most efficient manner to allow the states to retain the appropriate revenue base for returned services.

Mr. Chairman, this last point is an important one. We shouldn't start down the program turnback and trust fund phaseout road without considering where it ends. We are not a nation of separate, sovereign, self-sufficient states. I con't believe the founding fathers saw it that way and certainly no thoughtful person would see our nation that way today. We are enormously impacted as states by national policy, our own historical development, interstate migration, and the luck of the draw as to where natural resources in current demand are located.

Mr. Chairman, it is not conceivable to me that the end of this federalism road is the turnback of responsibility for the domestic affairs of this nation with the resources to pay for them left to the 50 states to work out for themselves.

Just as the President, with his Medicaid proposal, has moved in our direction, we have moved in his:

First, we have agreed to take over a substantial portion of the grant-in-aid system without guarantees of permanent funding. The President proposed a $30 billion swap. We have accepted his proposal.

Second, we have accepted the concept of a trust fund that does not increase in size. This position would have been unthinkable before this year.

Third, we have agreed to discuss an issue which arises in Congress whenever reauthorization of major programs is debated on the floor. I refer here, of course, to the formulas through which federal funds are distributed to the states. As you know, this is a divisive issue. However, many students of federalism agree that restructuring of the system cannot take place without review of the current distribution of funds. Our proposal addresses this issue.

Finally, we have agreed to defer for further negotiations the AFDC-food stamps portion of the original proposal. There is a strong consensus on the historic NGA policy position that income security is a federal responsibility. This policy was reaffirmed by the Governor last month. State assumption of food stamps--now a fully federally-funded initiative--and AFDC is antithetical to this policy. But we have agreed to continue discussions on AFDC and food stamps.

DISCRETIONARY PROGRAMS

Now I would like to turn briefly to the discretionary grant programs which are under the jurisdiction of the Finance Committee.

If the President's projections are accepted by Congress, aid to states and local governments will drop from 15.9% of the federal budget in 1980 to 9.6% in 1985. Spending on education, training, employment, and social services will drop 20%. The block grant programs, which support such important activities as maternal and child health, rehabilitation, alcohol and drug abuse, and child welfare, will be cut 15.7% on top of 13.2% cut last year.

Three programs deserve special mention. First, the FY 1983 Budget again proposes to reduce funding for the low income energy assistance program by over $500 million and to count the remaining funds in determining eligibility and benefits in the AFDC and food stamp programs. As you know, Mr. Chairman, this program was designed to offset the increase in energy costs that resulted from decontrol. While we have seen some stabilization of oil prices, we have also seen rapid increases in the cost of natural gas. There has not been sufficient time for basic aid programs to adjust to these increases and continued assistance is needed. Equally important, these payments for special needs should not be used to reduce payments for the basic needs provided by food stamps and welfare.

Second, the FY 1983 Budget recommends that the Social Service Block Grant be reduced by some $426 million and funded at a level of $1.974 billion. This cut would leave social service funding some 34 percent below its FY 1981 level. These reductions, when combined with other proposed reductions in WIN funding and employment and training programs, will seriously hamper state efforts to assist welfare recipients in becoming self-sufficient. In addition, other vital services such as those which help to reduce the need for institutional care will also be reduced. Such changes will work real hardship on individuals in need of service and may, in the longer term, actually increase governmental expenditures on the more costly entitlement programs.

Finally, the FY 1983 Budget proposes a new child welfare block grant to be funded at $380 million. We are concerned that this funding level, a cut of over 27 percent from FY 1981, will be inadequate to assure the availability of the needed array of preventive and foster care services for abused, neglected or homeless children. This proposed funding reduction is particularly distressing in light of Congressional action over the past several years to develop a more comprehensive program designed to help children find permanent homes.

Mr. Chairman, citizens are complaining that government does not deliver for them now. In the judgment of the Governors, the cuts proposed by the Administration in these and other grant programs go deeper than the fat in the grants system. It is for this reason that we have called for level funding of discretionary grant programs in FY 1983.

Mr. Chairman, we agree that the economy is the major domestic issue with that Congress must tackle this session. But as I have pointed out, the important problems addressed by intergovernmental grants cannot be neglected. These problems will not be met by withered federal programs...programs starved for funds and flexibility...programs burdened by regulations designed for an era of growing appropriations and unsophisticated state and local governments. That is why we believe that the President's federalism initiative deserves immediate and serious consideration by Congress and that such an initiative must be based on funding levels no less than those provided in the current fiscal year.

Mr. Chairman, this Committee is in a unique position to reflect, through its discussion of functional spending levels for FY 1984, the commitment of Congress to address the current imbalance in the federal system. We hope your work will reflect support for enactment of federalism legislation that will permit Congress to focus on truly national concerns, that will untie the hands of state and local officials to deliver services they are best equipped to handle, and that will restore citizens' faith in their government.

STATEMENT BY THE NGA EXECUTIVE COMMITTEE

May 5, 1982

This nation is in trouble. The federal budget is in shambles, and each day the economy continues to suffer.

With high unemployment, high interest rates, trade imbalance and a declining economy the prospects for improvement are dim.

With a breakdown in negotiations for a bipartisan budget the nation faces a deficit of approximately $600 billion over the next three years. $200 billion dollars is almost $50 billion more than all the states spend annually. That adds $9,950 to each family's share of the national debt. It is on top of the existing trillion dollar national debt, which is $16,500 per family.

Such deficits would further aggravate our economic chaos.

Unfortunately during an election year, the President and some of the Democratic and Republican leadership in the Congress have declared certain items in the budget and tax laws to be untouchable.

For the last seven months the Governors have consistently suggested – and we continue to believe – that defense, indexed entitlements, taxes, and tax expenditures should all be considered as part of a FY 1983 budget compromise.

NGA feels that conditions of our economy demand that the automatic growth of entitlements and cost of living adjustments must be examined.

While we strongly support defense, we feel that the defense budget is touchable, that waste exists, and that some defense items are of higher priority than others.

A responsible budget should close tax loopholes and may require new revenues.

Before the discussions ended, budget negotiators from the Administration and Congress had agreed on many elements of the approach we have advocated. The Governors believe that the President and the Congressional leadership have an obligation to return to the negotiating table immediately and reach a bipartisan budget agreement at the earliest possible date. It is past time for federal officials in Washington to understand the severe damage to the people which their failure to come to agreement is causing. We pledge our full bipartisan support to this renewed effort. The national interest demands nothing less.

Whatever political discontent that would result is dwarfed by the benefits that economic recovery would bring to every American.

COMMITTEE FOR EMPLOYMENT OPPORTUNITIES
1101 CONNECTICUT AVENUE, N.W. • FIFTH FLOOR
WASHINGTON, D. C. 20036

Written Statement of the

Committee for Employment Opportunities

on

<u>The Need for Action on the Federal Budget Crisis</u>

Committee on Finance
United States Senate
June 15, 1982

The Committee on Employment Opportunities, 1101 Connecticut Avenue, N.W., Suite 500, Washington, D.C. 20036, submits this written testimony concerning its thoughts on the immediate need to bring the federal budget under control. The Committee believes this can be done by increasing employment, thereby bringing more federal taxes and social security taxes into the government from employees and employers and also lowering the federal outlays to those receiving them prior to employment. A major cause of the current federal deficit is the extraordinarily high and unacceptable rate of unemployment. The federal deficit can be substantially reduced by placing persons currently receiving welfare or other government payments in private sector jobs.

CEO believes an extremely effective stimulus to increase employment and thereby lower the federal deficit is the Targeted Jobs Tax Credit, which unfortunately is due to expire at the end of this year. The CEO strongly supports S. 2455 introduced by Senators Heinz and Domenici and sponsored by a bi-partisan majority of the Finance Committee.

The Targeted Jobs Tax Credit was originally enacted in 1978. In 1981 the program was extended for one year to allow the Department of Labor to develop statistics concerning the program. On January 24, 1982 the United States Employment Service Office of Program Review released statistics indicating the Targeted Jobs Tax Credit is working to put these targeted individuals into productive, private sector jobs. For fiscal year 1981, 411,581 certifications were issued under the program. As the Secretary of Labor has recently indicated, after an uncertain start, the program is working and should be extended.

The Targeted Jobs Tax Credit offers a way out of poverty and joblessness for those targeted individuals who are looking for productive private sector employment opportunities. It has been referred to as the human cost recovery act. Much like the capital cost recovery act, the Targeted Jobs Tax Credit is concerned with making an investment now for a better future.

The credit is available for hiring individuals in one of the nine targeted groups. These groups are targeted because they need this special incentive for employers to hire them. The Targeted Jobs Tax Credit lowers the barrier to a productive life for these targeted individuals.

The Targeted Jobs Tax Credit certainly must be extended. S. 2455 extends the credit for five years. It also makes two small changes to the law that should make the program even more effective. One change relates to the cooperative education category. Originally, the credit extended to all cooperative education/work study/vocational education students. In 1981, the Senate bill included all cooperative education students at a somewhat lower wage base. However, the Conference on the Economic Recovery Tax Act of 1981 concluded that only economically disadvantaged vocational education students should be eligible for the credit. That policy is unsound and S. 2455 correctly allows the credit for all cooperative education students. This change is particularly important to vocational educators. These educators have found the "labelling" of parts of a peer group has caused serious morale problems among the students. It is similar to a situation, since wisely corrected, that stigmatized certain persons in lunch programs as disadvantaged. The experience there was that persons would go hungry rather than admit to being disadvantaged. Cooperative education students, the majority of whom are educationally or economically disadvantaged, are likewise highly reluctant to being stigmatized. This inclusion of only disadvantaged cooperative education students in the credit has built up barriers the credit was intended to lower. In addition, this group currently needs to be double certified, once as a cooperative student and once as disadvantaged. This obviously causes administrative problems for both the school and the potential employer. Finally, all vocational education students need the employment incentive to acquire needed skills and thereby assimilate into a workplace environment as productive citizens.

In order to further restrict abuse situations, but clarify the current rules, the credit should not be allowed on persons who have worked for the employer within the last 180 days. In addition, S. 2455 makes crystal clear that a targeted person cannot be "churned" by providing a maximum credit availability directly in the legislation. However, this technical provision should simplify employment procedures in small, rural communities.

In summary, CEO has a relatively simple solution to lower the federal deficit -- put people to work that are currently receiving federal government social safety net payments. This would allow more to be paid in and less to be paid out -- a double whammy on the deficit. S. 2455 does exactly that and must be enacted.

SUBMISSION OF THE

DISTILLED SPIRITS COUNCIL OF

THE UNITED STATES

TO THE

SENATE FINANCE COMMITTEE

ON

THE FEDERAL EXCISE TAX

JUNE 10, 1982

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DISTILLED SPIRITS COUNCIL OF THE UNITED STATES, INC.

1300 PENNSYLVANIA BUILDING
WASHINGTON D C 20004
202-628-3544

June 8, 1982

The Honorable Robert Dole
United States Senate
Washington, D.C. 20510

Dear Senator Dole:

As you debate budget and tax issues in the next days or weeks, we in the distilled spirits industry urge you not to consider an increase in the Federal Excise Tax (FET) on our product. As President of the Distilled Spirits Council of the U.S., Inc. (DISCUS), I want to bring to your attention several important facts about our industry and the FET which are more fully explained and supported in the accompanying material.

The distilled spirits industry already is hit harder and more inequitably by the Federal excise tax than any other U.S. industry. In total, 47 percent of the typical retail price of our product is Federal, state and local tax. Fully 26 percent of the retail price of a typical bottle of spirits is accounted for solely by the FET. This is double the tax share on cigarettes, eight times the tax share on gasoline, four times the tax share on beer and fifteen times the tax share on wine.

State governments rely increasingly on beverage alcohol taxes for revenue to meet heightened pressures to raise more money to offset inflation and provide basic services. In the last thirty years, state and local revenues from spirits have nearly quintupled. State revenues/gallon rose over 120 percent in the same period. In the first four months of 1982 alone, forty-four states proposed tax/markup increases on distilled spirits. Any increase in the FET will lead to substantial excise revenue losses in the states from reduced sales. Further, lost jobs and profits in the industry mean reduced state income taxes and other revenue costs. Most important, an FET increase will preempt this key state revenue source at the same time that states are asked to handle a larger financial burden under the New Federalism.

Lost jobs and threatened businesses will mean further economic distress for the states. Nationally, the beverage alcohol industry employs 826,000 workers in 398,000 businesses -- predominately small taverns, retail package stores, restaurants and other retailers. There are an estimated 250,000 workers in supplier industries -- grain processing, cans, bottles, shipping. Please note especially the attached fact sheet on your state of Kansas which shows that the beverage alcohol industry yielded $28 million to the Kansas Treasury in 1979, 42 percent from spirits alone, and provides nearly 5,000 jobs and $109 million in payroll and profit income.

A 100 percent FET increase will mean at least a 20 - 25 percent spirits industry sales reduction. Even a 5 - 20 percent employment loss would mean 40,000 - 80,000 jobs lost nationally. In a time of economic recession, with an unemployment rate of roughly 9 percent, punitive taxation of our industry will add further to the economic problems of the states.

Other sound economic points concerning the FET and distilled spirits:

- The FET is an regressive tax, compounded by state excise and sales taxes (also regressive taxes), which hits hardest at low- and middle-income consumers.

- The FET is an inefficient tax, devastating an industry and its workers for the sake of perhaps $2 billion (your Committee's estimate) which will be eaten away in lost industry Federal income taxes, lost taxes from supplier industries and other costs.

- The FET is an unreliable tax due to already anemic market conditions which will be further exacerbated by dramatic price increases -- FET revenues from spirits in 1981 were 2.3 percent below 1979 levels from poor market conditions.

- The FET is a harmful tax, providing incentives for production of untaxed, dangerous illegal spirits.

Finally, President Reagan carefully considered excise tax increases earlier in the year. In recognition of the importance of this revenue source to the states, he proposed phasing out the FET in his New Federalism plans, not increasing it at the expense of the states. Further, a proposal to increase the FET was rejected by the National Governors' Association as less desirable than leaving the revenue sources to the states.

We urge you to be aware of the facts presented about our industry and the FET and not increase an already excessive and inequitable FET on distilled spirits.

Please contact me if you have any questions or desire further information. Our industry leaders, of course, would be pleased to discuss this issue with you at any time.

Sincerely,

Fred Meister

F.A. Meister
President

FAM:sk
Attachments

EXECUTIVE SUMMARY ON FEDERAL EXCISE TAX

1. The FET is a regressive tax, hitting hardest at the low and middle income people. Its regressivity is compounded by state excise and sales taxes -- also regressive taxes.

2. Current taxes take 47 percent of typical retail bottle price of distilled spirits -- higher than on any other product.

- The Federal Government takes 26 percent
- State and local governments take 21 percent.

3. The federal excise tax share of the retail bottle price of distilled spirits is the highest excise tax of all.

- Double the tax share on cigarettes
- 5 times the airline ticket tax share
- 4 times the beer tax share
- 15 times the wine tax share
- 8 times the gas tax share

4. States increasingly are relying on beverage alcohol taxes. An FET increase will preempt a key state revenue source. President Reagan, in recognition of that fact, as well as wishing to return power to the states, has proposed phasing out the federal excise tax.

- Distilled spirits is the second most highly taxed product at the state level.
- States will lose their excise revenues from reduced sales if the FET is increased.
- In 1981, state and local governments collected $2.9 billion in taxes on distilled spirits. State and local revenues nearly have quintupled in the last 30 years.

5. While the federal excise tax has not been raised since 1951, license states have increased distilled spirits excise taxes by 76 percent since that time.

6. Federal beverage alcohol revenues are already jeopardized by poor market conditions for spirits.

- FET revenues fell in 1979 and 1980. By 1981, FET revenues were below 1973 levels.
- Per capita consumption has shown virtually no growth in the past seven years.
- Doubling the federal excise tax could increase liquor prices by as much as 50 percent, and decrease consumption by 20 to 25 percent, with a devastating effect on the 826,000 people in 398,000 businesses, many of them small retailers, in the beverage alcohol industry.

7. In other countries, an increase in FET has caused the following problems:

- Australia increased tax in 1978 by 82 percent, prices rose 40 percent and spirits sales declined 26 percent.
- In the UK, following tax increases for 1980 and 1981, Treasury forecasts of a 10 percent increase were wrong. The increase was only .6 percent, 1/17 of the projection.
- Danish 1977 tax increases of 37.5 percent caused a 12 percent drop in tax revenues. Revenues have not yet recovered pre-tax levels.

8. Major excise tax increases could provide incentives for the production of untaxed, dangerous, illegal alcohol - a probability enhanced by the roughly 11,000 licenses now outstanding for the production of fuel alcohol, which could easily be switched to beverage production.

9. Doubling excise taxes exacerbates the already major differences in taxes among spirits, wine, and beer (the FET share of retail prices on spirits is 26 percent, while on beer it is only 7 percent, and on wine it is an insignificant 1.7 percent).

- Distilled spirits seeks no special tax break. It only wants to keep a bad situation from getting worse.

10. Doubling the federal excise tax provides about $2 billion for budget deficit purposes at a catastrophic cost to the industry while more than $100 billion is needed to balance the budget.

- It is debatable whether, after reduction of the spirits volume taxbase, Federal and state income losses on reduced industry payroll and profits, costs of unemployment compensation, reduced state excise tax revenues and replacement of legal spirits with untaxed illegal spirits, that a dramatic increase in the FET will result in <u>any</u> net revenue increase.

WHITE PAPER

PROBLEMS WITH INCREASING

THE

EXCISE TAX ON BEVERAGE ALCOHOL

Prepared by

Distilled Spirits Council

of the United States, Inc.

EXECUTIVE SUMMARY

Some members of Congress continue to propose an increase in the federal excise tax (FET) on distilled spirits of as much as 100 percent despite:

- The President's refusal to recommend excise tax increases, after considerable and extensive debate, in his State of the Union and budget messages;
- A recent, explicit rejection of excise tax increases solely to balance the budget by Democrats of the Joint Economic Committee;
- The evidence that spirits already bears an excessive tax burden and any further tax increases will burden consumers, threaten the industry and create problems for many state governments.

Currently, the beverage alcohol industry pays:

- Over $1 million an hour to all levels of government;
- At least $2.1 billion in regular personal and corporate taxes;
- At least $11.1 billion in excise taxes and other taxes and fees.

Current taxes take 47 percent of the retail price of distilled spirits:

- Federal government takes 26 percent;
- State and local governments take 21 percent.

Current FET share of retail price on distilled spirits is:

- Double what it is on cigarettes;
- Five times what it is on airline tickets;
- Nearly four times what it is on beer;
- Five to six times what it is on tires;
- Eight times what it is on gasoline;
- Thirteen times what it is on teletypewriters;
- More than fifteen times what it is on wine.

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States increasingly rely on the beverage alcohol tax:

- State and local governments have quintupled their revenues from beverage alcohol sources in the last 25 years;
- State and local governments collected $5.3 billion in revenues in 1979;
- $5.3 billion is about equal to what the 50 states spend for health programs and over twice their expenditures for police protection;
- State and local governments, on the average, received almost $24.00 per capita from taxes and fees on beverage alcohol.

The argument that there have been no new federal excise taxes on beverage alcohol since 1951 fails to recognize that:

- State and local governments have increased their distilled spirits excise tax rates by 76 percent in the last 30 years;
- Federal policy has been to create a broad-based, comprehensive neutral tax system;
- Republican and Democratic administrations, since 1965, have sought to reduce and eliminate excises;
- Federal government has dropped excises on such items as furs, jewelry, luggage and toiletries;
- Tax code should not be used to dictate morality or personal tastes.

Federal beverage alcohol revenues already are jeopardized by poor spirits market conditions:

- The bulk (roughly 70%) of Federal revenues from beverage alcohol comes from distilled spirits;
- Per capita consumption of spirits has shown virtually no growth in the past seven years;
- Because of poor market conditions, the growth in Federal tax revenue has dropped dramatically. There was an actual decline in Federal revenues in 1979 and 1980. Any increase in the FET could accelerate a decline in industry sales and thus Federal and state revenue growth.

Advocates of an increase in the FET should be aware of other countries' experiences:

- Australia increased excises and duties by 82 percent in 1978 and saw sales of spirits decline by 26 percent. Australia's revenues were less than anticipated;

- In the U.K., following tax increases in 1980 and 1981, Treasury 1980/1981 forecasts of a 10 percent increase in spirits revenues later reduced to a marginal 0.6 percent increase, one-seventeenth of projected additional revenues;

- In Denmark, following a 1977 tax increase of 37.5%, tax revenues from spirits fell 12 percent the next year and have yet to reach 1977 revenue levels.

A major increase in the FET could affect:

- The 100 million consumers who use alcohol in moderation by an unprecedented "shock" effect of significant price increases;

- The lower and middle income classes, by having them pay a proportionately higher tax than the upper income class because excise taxes are very regressive;

- The ability of the states to provide the services that the "new federalism" requires;

- The industry, by reducing consumption of distilled spirits significantly and thus causing workers to be laid off;

- The industry, by affecting its productivity and attractiveness to investors;

- The industry, by requiring them to pay significantly more interest on new borrowing because they must pay the excise tax before they receive income from their sales;

- Tax revenues and health by increased illegal production, particularly because of roughly 11,000 Federal licenses granted in all states for fuel-alcohol stills which can produce illegal, untaxed beverage alcohol;

- The federal deficit only marginally while wreaking havoc on the industry and its consumers by an unprecedented discriminatory tax scheme.

Opposing an increase in the FET:

- Is not an appeal for special tax break, only fairness;

- Seeks to keep a bad tax situation from becoming worse by preventing a few industries from having to assume unreasonable burdens;

- Continues the effort to achieve a fair, equitable and neutral federal tax system.

Letter of December 29, 1981, to President Reagan from F.A. Meister, President of Distilled Spirits Council of the United States, Inc., and letter of January 12, 1982, to President Reagan from Governor Richard A. Snelling, Chairman of National Governors' Association.

THE PROBLEM -- STILL MORE TAXES ADVOCATED

While the President, in his State of the Union message, did not propose excise tax increases after careful consideration of the issue and, more recently, Democrats of the Joint Economic Committee explicitly opposed regressive increases in Federal excise taxes solely to balance the budget, debate still continues on possible revenue enhancers, including excise tax increases. Some members of Congress specifically have proposed raising the excise tax on distilled spirits, by as much as 100 percent, in spite of the President's policy. This paper explains in detail why any increase in the federal excise tax (FET) on distilled spirits is unwarranted and discriminatory taxation. It could create financial difficulties for many state governments and place new and additional burdens on over 100 million consumers, while doing little to reduce projected federal deficits.

A HIGHLY TAXED INDUSTRY

In 1980 the beverage alcohol industry -- distilled spirits, beer, and wine -- paid over one million dollars an hour in taxes to all levels of government.

LIKE other businesses, the beverage alcohol industry pays corporate taxes and the owners and employees pay personal income taxes ($2.1 billion in 1979).

UNLIKE many other businesses, the distilled spirits industry has excise taxes and other fees on its products -- the highest tax burden of any industry on which such taxes are placed ($6.9 billion in 1979).

ALMOST 50 PERCENT OF THE COST IS TAXES

Forty-seven percent of the average purchase price of a bottle of distilled spirits is taxes. The federal excise tax amounts to 26 percent of the retail price. State and local government taxes and fees amount to another 21 percent of the retail price. Each day distilled spirits taxes provide $18 million to the treasuries of federal, state and local governments. All levels of American government benefit from the taxes and fees imposed on the beverage alcohol industry.

HIGHEST EXCISE TAX ALREADY

The FET share of the retail price on spirits is more than that imposed on any other product. The FET share of retail price on spirits is 26 percent.

- Almost double the share on cigarettes (10 percent to 14 percent);
- Five times the share on airline tickets (5 percent);
- Nearly four times the share on beer (7 percent);
- Five to six times the share on tires (3-6 percent);
- Eight times the share on gasoline (3 percent);
- More than fifteen times the share on wine (1.7 percent).

The present federal excise tax on alcohol already is levied inequitably on the three major classes of beverage alcohol products. An ounce of pure alcohol contained in a distilled spirits product bears a federal tax of 16.4¢, the same amount of alcohol in a bottle of beer is taxed at 4.93¢ and in a bottle of table wine the alcohol is taxed at 1.06¢ per ounce. Any increases in current taxes would compound this inequitable taxation. Stated differently, the FET share of retail prices on spirits is 26 percent, while on beer it is only 7 percent and on wine is an insignificant 1.7 percent.

STATES INCREASINGLY RELY ON BEVERAGE ALCOHOL TAXES

State governments have increased their reliance on taxes generated from beverage alcohol. In 1980, 21 percent of the price of a bottle of distilled spirits went to state and local governments. In contrast, in 1955 only 12 percent of the price went to state and local governments. In the 25 years, 1955 to 1980, the federal revenues on distilled spirits doubled while state and local revenues have nearly quintupled.

In 1979, the most recent year for which information is available, revenues collected by state and local governments from the sale of beverage alcohol totaled $5.3 billion, with liquor accounting for almost 53 percent of the total. On the average, state and local governments received almost $24.00 per capita during 1979 for taxes and fees on beverage alcohol. The sums the states receive from this source are significant. For example, California received $477 million and Texas collected $340 million in 1979 from taxes on the sale of beverage alcohol.

Distilled spirits produce $2.8 billion in revenues for state and local governments. This sum would pay the state police budgets in every state and the state share of housing and urban renewal expenses. The beverage alcohol industry (spirits, beer and wine) generates $5.3 billion for state and local governments. This revenue is about equal to what the 50 states spend for health programs, or twice what they spend for police protection.

States rely heavily on income raised from beverage alcohol sales. A major concern of states is that this revenue is dropping because of unstable economic conditions. State and local revenue growth from beverage alcohol, in spite of tax increases, has slowed. This is due predominately to slow growth in spirits consumption (per capita consumption has been stable for the past seven years) and spirits revenues. The growth in spirits revenues has dropped by more than half -- from a 57 percent increase between 1964 and 1969 to a 24 percent increase between 1974 and 1979. State and local revenues from spirits barely increased in 1979 -- by 2 percent. A Staff analysis of the National Governor's Association states "the alcohol tax, with its heavy emphasis on distilled spirits . . . may show little growth and might even have declining yields if a trend away from distilled spirits continues." Further tax increases, particularly a major increase with its unprecedented "shock" impact, could lead to serious revenue declines and eliminate alcohol taxes as a stable current and future source of income. For example, nearly half the states already are experiencing declining sales of spirits.

WHAT'S THE RATIONALE?

In the next three years the federal deficit has been projected to be at least $100 billion a year. Such deficits will create problems for the government and the American economy, but sound public policy is not served by singling out the beverage alcohol industry for punitive taxation which compounds present inequities.

A major argument cited for an FET increase is that there has not been an increase since 1951. It might be interesting to ask why the "temporary" excise tax increase levied in 1951 to raise revenues for the Korean War is still with us? In any case, this argument fails to recognize historic and economic developments which have taken place since 1951.

While the federal government has not imposed any new excise tax on beverage alcohol, consumers have paid increased state and local taxes on the product. State governments have increased their excise tax rates on distilled spirits by 76 percent in the last 30 years. According to the Federation of Tax Administrators, more states raised excise or sales taxes on cigarettes and beverage alcohol in 1981 than in any year in the past decade.

Tax experts and economists have found excise taxes to be an inequitable way to raise revenue. Democrats of the Joint Economic Committee recently opposed excise tax increases. "Increases in Federal excise taxes are a superficially attractive way of raising new Federal revenues. This temptation should be avoided." A report of the Institute for Research on the Economics of Taxation concluded that:

> "Selective excises should not be employed merely to raise revenues. These taxes are distortionary and, given the current emphasis on broad-based, comprehensive neutral tax systems, the use of excises purely for revenue purposes would be a giant step backwards."

The study also stated that "excises should be methods of last resort, given all the uncertainty surrounding their use."

Increasing the federal excise tax is contrary to the efforts of previous administrations, both Republican and Democratic, to reduce and eliminate excise taxes. In 1965, Congress passed the Excise Tax Reduction Act which eliminated many of the wartime excises. Further reductions were made in the nation's excise taxes in 1971 and 1977. A tax on sugar manufactured in the United States was allowed to expire in 1975 and excises on toll telephone service and teletypewriter service are to expire in 1983.

Photographic equipment, furs, jewelry, luggage and toiletries have been dropped from the list of items taxed. These items are no longer subject to the excise tax, but beverage alcohol is being considered for an FET increase of as much as 100 percent. The inequity of the situation is obvious and it is easy to understand why economists and tax experts find excise taxes of little value and difficult to defend.

Some anti-alcohol groups have sought to defend taxing the beverage alcohol industry in terms of making "sin" expensive. It is not sound public policy to use the tax code in this manner. The Institute for Research on the Economics of Taxation study makes this point by noting ". . . the tax code is hardly a place to dictate morality or personal tastes to the American populace." An estimated one hundred million Americans use beverage alcohol responsibly and they should not be penalized for the enjoyment they derive from drinking their favorite beverage.

After reviewing the arguments set forth for increasing the excise tax on beverage alcohol it is difficult to perceive a sound and rational basis for a tax increase. The detrimental effects of such a policy decision would weigh especially heavy against distilled spirits since any FET increase would perpetuate and distort even more greatly the unfair FET burden on spirits compared to wine and beer.

BAD FEDERAL POLICY

Reliance on the FET is bad federal public policy. Increasing the excise tax on beverage alcohol could cause a drop in federal excise tax revenue, due to a drop in alcohol production and consumption. Already, a marked reversal in spirits consumprion growth in recent years has led to virtually stagnant growth in Federal beverage alcohol revenues. Spirits revenues account for the bulk (roughly 70 percent) of Federal beverage alcohol revenues. Per capita consumption of spirits has shown virtually no growth in the past seven years. Consequently, Federal revenues from spirits basically have stagnated and actually declined in 1979 and, based on preliminary estimates, declined again in 1980. Further tax increases could worsen this already poor revenue picture. There is a limit to how high taxation on a product may rise before it is counterproductive.

Recent experience in Britain, Australia and other countries has demonstrated that punitive levels of taxation can lead to serious decreases in consumption, thus affecting public revenues, which depend on steady or increasing consumption.

In Augusc 1978, Australia increased the excise tax and duty tax on spirits by 82 percent. The next year showed an overall decline in spirits' sales by 26 percent. Recently, the Australian government has rolled back some of the tax. The actual revenues the new tax generated were below estimates. The spirits industry's normal growth has been retarded. The result of this effort was not what the government anticipated, but it was what the industry feared would happen. In the United Kingdom, following tax increases in 1980 and 1981, Treasury forecasts for 1980/81 of a 10 percent increase in revenues from spirits were reduced to a marginal 0.6% increase, one-seventeenth of expected additional revenues. In Denmark, following a 37.5% tax increase in 1977, tax revenues from spirits actually declined by 12 percent the following year; revenues have not yet reached pre-tax increase levels. Further increases in the FET could produce these types of unanticipated results in the United States.

Raising the FET flies in the face of the Administration's commitment and efforts to reduce taxes and create a fair tax structure. In its first year in office, the Administration championed tax reductions for businesses and individuals. A major increase in the FET will nullify the 1981 tax reduction for this industry.

The industry will face layoffs and mergers from business failures as it seeks to meet the problem such an unreasonable action will create. It is not simply a "consumption tax" as some public officials have mentioned. The manufacturer initially pays the tax. Since sales will drop, the productivity of the industry will decline, and investing in the industry will be less attractive. Additionally, firms in the industry will have to pay significantly more in interest on new borrowing because they must pay the excise tax before they receive income from their sales.

STATES FACE MOUNTING PROBLEMS

Large and drastic changes in the federal excise tax could affect the ability of the states to provide essential services to their citizens. State officials, such as Governor Richard A. Snelling of Vermont, who is chairman of the National Governor's Association, have opposed any increase in the Federal excise tax on spirits. ". . . these taxes have long been regarded as state revenue sources and should remain so."

Currently, state revenues from beverage alcohol are used to fund important programs. In 1979, Florida received $377 million from beverage alcohol sources which would pay for 70 percent of state expenditures for health and hospitals or 49 percent of the highway budget. California received $412 million which accounts for 32 percent of its health and hospital spending or 35 percent of its highway budget.

It is unsound public policy to create more uncertainty for state and local government officials when they already are unsure whether the resources are available to perform their necessary tasks. Increasing the FET could reduce state revenues and undermine their fiscal position.

Numerous leading legislators such as Ways and Means Chairman Dan Rostenkowski, House Budget Committee Chairman Jim Jones, and Senator Wendell Ford have noted the regressive, unfair nature of any increase in the excise tax. Democrats of the Joint Economic Committee recently opposed an excise tax increase because of its inflationary and regressive nature. Economist Walter Heller recently stated that "recognizing that the poor suffered severely in the 1981 fiscal give and take . . . this is hardly the time to hit them again, harder, with regressive excise or sales taxes." The people who will suffer financially from increasing the FET are the nation's middle and low income families. Since the tax is a constant rate for all income levels, middle income and poor Americans who enjoy beverage alcohol products in moderation would pay a higher proportion of their income for such pleasure than high income Americans.

This situation is especially troublesome since the distilled spirits industry traditionally has kept its price increases substantially below the increase measured by the Consumer Price Index (CPI). Between 1974 and 1979, prices for spirits have risen 14.8 percent which is in sharp contrast to the 47.2 percent increase for consumer products during the same five-year period.

ILLEGAL PRODUCTION

Some may think that the problem of illegal spirits production, with consequent health hazards and lost tax revenues, is a relic of the past or a minor problem associated with "backwoods moonshiners." Excessive spirits taxation, however, could lead to a potentially serious problem of illegal production, particularly because the Federal government has granted roughly 11,000 licenses for fuel-alcohol stills capable of producing illegal beverage alcohol.

These fuel-alcohol still licenses have been granted in every state in the country. Over 100 licenses have been granted in each of thirty-one states. Over 1,000 licenses have been granted in California; over 500 licenses in Michigan and Texas; over 400 licenses in Alabama, Florida, North Carolina, Ohio and Washington; over 300 licenses in Iowa, Illinois, Indiana, and Oregon.

With sufficient economic incentives due to further tax increases, these fuel-alcohol stills, which are not closely supervised by the Federal government and whose owner's usually are not bonded, are capable of producing illegal and untaxed beverage alcohol. This is especially the case because there currently is low demand for gasohol. Recently, an alcohol-fuel permit owner pleaded guilty to selling illegal beverage alcohol and was sentenced to five years in prison. Additionally, excessive spirits taxation will provide incentives for production by other means of potentially lethal, home-distilled spirits.

Illegal production means lost tax revenue. Each of these "small" stills has an annual capacity of 10,000 proof gallons. If running at capacity, each still deprives Federal, state and local governments of over $180,000 in lost tax revenues. In 1952, after several wartime excise tax increases, consumption of illegal, tax-free spirits was estimated to account for 18 percent of total U.S. consumption. In 1954, it is estimated that Federal and state governments lost over $900 million due to illegal production. If only 10 percent of current spirits consumption shifted to illegally produced spirits with a doubling of the FET, Federal and state governments would lose over $1 billion in tax revenues.

The health consequences of illegal production can be severe. Illegal spirits can contain poisons, frequently lethal lead salts. Deadly methanol spirits may be sold instead of ethanol-based beverage alcohol. In the Soviet Union, where there is high taxation and other severe restrictions on beverage alcohol availability, it is estimated that one-third of total spirits consumed are home-distilled. The Soviet Union has the world's highest death rate from acute alcohol poisoning.

HEALTH CONSEQUENCES

While some would argue that a major increase in the FET will reduce consumption and thus ameliorate alcohol abuse problems, there is no valid, supportable evidence for this position. One leading expert in the alcohol abuse field, Dr. David Pittman, has stated, "The values and attitudes of any population group toward beverage alcohol are deeply embedded in the structure of society . . . cosmetic devices such as taxation increases are doomed to failure . . ."

Dr. Morris E. Chafetz, leading expert and formerly director of the National Institute on Alcohol Abuse and Alcoholism, notes that increasing the excise tax on beverage alcohol will reduce consumption among people "who can take alcohol or leave it. Using taxes as a deterrent to consumption can reduce healthy drinking, leaving unhealthy drinking as the chief role model for the young."

Nor should anyone delude himself that increasing the excise tax will cure the alcoholic. The problem drinker will have to find additional money to pay the increased cost of the product. Increasing the price of beverage alcohol adds to the alcoholic's problems without doing anything about the illness.

ADVERSE EFFECTS ON THE BEVERAGE ALCOHOL INDUSTRY

Our industry estimates that doubling the federal excise tax, as some have proposed, could increase liquor prices by as much as 50 percent ($2-3 on an average $6 bottle of spirits) and reduce consumption by as much as 20 to 25 percent. Such a drop in sales would have a devastating effect on the industry and the estimated 826,000 people employed in the manufacturing, wholesaling and retailing levels of the beverage alcohol industry in the United States.

The beverage alcohol industry contributes $15.3 billion in payroll and profits and $51 billion in retail sales to the American economy. A major increase in the FET would cause employee layoffs and some small firms might be forced to close their doors. Small retailers and tavern owners would face difficult times as reduced sales would cut into their profit margins and payrolls.

It is estimated that for every ten persons employed in beverage alcohol manufacturing there are 37 persons employed indirectly in suppliers sectors, such as farmers, grain processors, bottle and can manufacturers, paper and printing, railroads and trucking. These groups also would suffer.

SUMMARY AND CONCLUSION

Proposals to raise excise taxes already have received extensive and considerable public debate. After careful consideration, the President decided not to propose excise tax increases as part of his State of the Union and budget messages. Recently, Democrats of the Joint Economic Committee explicitly opposed any increases in excise taxes because of their inflationary and regressive nature. Despite this, some members of Congress continue to propose excise tax increases of as much as 100 percent.

There have been few, if any, times that an industry has faced continued proposals for a tax increase of such a large magnitude and so punitive an impact. The potential shock effect of a federal excise tax increase of the magnitudes being considered hardly can be overestimated. The beverage alcohol industry will lose sales. The distilled spirits industry, in particular, which already faces flat sales, will be especially hard hit. Any increase in the FET with the current tax system will unfairly penalize spirits compared to beer and wine.

State governments, who depend heavily upon income from beverage alcohol sales, will find this revenue source threatened and in many cases diminished.

The beverage alcohol industry is not asking for a special favor or a tax break. We are asking for a fair, equitable treatment. The distilled spirits industry already finds itself in a situation where an astounding 47 percent of the retail price of our product is taxes.

Surely, this is a great enough burden for any product or industry to bear. The 100 million consumers who use our product in moderation also will be discriminated against and penalized by an FET increase. Prices could go up significantly and hit low and middle income families in a most regressive fashion.

Our industry, our employees and our stockholders contribute at least their fair share to government revenues.

Finally, while a federal excise tax increase would cause these severe problems, the revenue raised, at best a few billion dollars from a doubling of the FET, will be insignificant when compared to budget deficits of over 100 billion dollars in each of the forthcoming years. Sound public policy requires that all segments of society share equitably in the solution to national problems.

U.S. FACT SHEET

- Taxes on distilled spirits account for roughly 47 percent of average spirits retail price. Federal taxes alone account for 26 percent of retail price, almost double the excise tax component of any other product.

- The U.S. beverage alcohol industry generates $11.1 billion in Federal, state and local revenues.

- While distilled spirits accounts for only one-third of the pure beverage alcohol sold in the U.S., due to its higher tax rate compared to beer and wine, it accounts for nearly two-thirds ($6.9 billion) of public revenues from beverage alcohol.

- The beverage alcohol industry contributes over $5.5 billion to the Federal treasury, $3.8 billion (nearly 70 percent) from distilled spirits. Beverage alcohol taxes are the third largest tax source after income, gift and estate taxes.

- The beverage alcohol industry contributes $5.3 billion to state and local governments, about equal to all state expenditures on health, twice state expenditures on police protection.

- There are close to 400,000 beverage alcohol manufacturers, wholesalers and retailers in the U.S. employing 826,000 people directly (full-time equivalent). Additionally, for every ten persons employed in beverage alcohol manufacturing, there are 37 persons employed indirectly in supplier sectors.

- The beverage alcohol industry contributes $15.3 billion in payroll and profits and $51 billion in retail sales to the U.S. economy.

- The Federal government has licensed construction of 10,515 small fuel-alcohol plants in the U.S., each capable of producing up to 10,000 proof gallons annually of illegal, non-taxed spirits.

Contribution to Public Revenues

Year	Federal Tax Collections ($millions)		State & Local (Excise and Other Tax) Collections ($millions)		Total Tax Collections ($millions)	
	Spirits	Beverage Alcohol	Spirits	Beverage Alcohol	Spirits	Beverage Alcohol
1977	$3,392	$5,487	$2,551	$4,603	$6,443	$10,089
1978	4,221	5,926	2,726	4,967	6,947	10,992
1979	3,979	5,677	2,792	5,255	6,853	11,091
1980	3,824	5,588	N/A	N/A	N/A	N/A

Contributions to the National Economy

Year	Establishments*	Employment**	Payroll** & Profits ($mil)	Retail Sales ($mil)
1967	365,348	746,632	$ 5,992	$12,025
1972	361,804	793,009	8,474	22,303
1977	389,360	814,840	11,441	39,233
1978E	399,771	821,458	12,438	42,521
1979E	397,771	832,000	13,871	47,270
1980E	397,771	826,150	15,297	50,802

* Includes manufacturing, wholesale and retail.
** Includes full-time equivalent employees and payroll at retail.
E - Estimated. N/A - Not Available.
Sources: Estimated from data of Bureau of Census; Alcohol, Tobacco and Firearms; Labor Statistics; Economic Analysis; also Internal Revenue Service, Distilled Spirits Council of the U.S., Wine Institute and U.S. Brewers Association, and tax authorities of the several states and District of Columbia.

Distilled Spirits Council of the U.S. - March 12, 1982

FACT SHEET

FEDERAL EXCISE TAX INCREASE ON DISTILLED SPIRITS

ISSUE

An increase in the Federal excise tax (FET) on distilled spirits is unwarranted and inequitable.

FACTS

1. Excise tax increases already have been rejected as a sensible policy prescription, after considerable public debate, by the Administration and others.

- The President, after extensive public debate and careful consideration, did not propose excise tax increases in his State of the Union or budget messages.

- The National Governors' Association in a letter to the President, expressed strong concern about the potentially deleterious impact on state revenues of an FET increase.

- Democrats of the Joint Economic Committee recently rejected excise tax increases solely to balance the budget as regressive and inflationary.

2. The distilled spirits industry already bears an excessive and inequitable tax burden.

- Nearly half (47 percent) of the average retail price of spirits is Federal, state and local tax. The Federal excise tax accounts for 26 percent of the average retail spirits price, state and local taxes account for another 21 percent.

- The beverage alcohol industry already pays more than its fair share in taxes.

  -- Like every other industry, it pays personal and corporate income taxes -- $2.1 billion in 1979.

  -- Unlike most industries, the beverage alcohol industry pays excise taxes and other taxes and fees -- $11.1 billion in 1979, nearly two-thirds ($6.9 billion) from spirits alone.

-- The beverage alcohol industry contributes over $1 million dollars per hour to all levels of government. The spirits industry contribution alone is enough to cover all Federal spending for health, highways, and police.

- The Federal excise tax on spirits is disproportionately higher than on any other industry paying excise taxes.

  -- The FET share of retail prices (26 percent) is double the share on cigarettes, five times the FET share on airline tickets, five to six times the FET share on tires, eight times the FET share of gasoline prices.

- Within the beverage alcohol industry, the FET on spirits is discriminatory.

  -- An ounce of pure alcohol contained in a distilled spirits product bears a Federal tax of 16¢ while the same amount of alcohol in a bottle of beer is taxed 5¢ and in table wine is taxed only 1¢.

  -- The FET on beer only accounts for 7 percent of average retail price and a mere 1.7 percent of table wine prices, compared to 26 percent of spirits prices.

3. <u>The fact that the FET has not been increased since 1951 -- the purported rationale for the tax increase -- is basically irrelevant.</u>

- The 26 percent Federal tax share already is a disproportionate burden on the spirits industry.

- While the FET has not increased, state tax rates have increased significantly, by 76 percent in the past 30 years.

- Tax experts have criticized excise taxes as a form of revenue raising.

  -- A recent study by the Institute for Research on the Economics of Taxation concluded that:

  "Selective excises <u>should not</u> be employed merely to raise revenues These taxes are distortionary and, given the current emphasis on broad-based, comprehensive neutral tax systems, the use of excises purely for revenue purposes would be a giant step backwards".

- Increasing the FET is contrary to efforts of previous Administrations, both Republican and Democratic, to reduce excise taxes.

  -- In 1965, Congress passed the Excise Tax Reduction Act which eliminated many of the wartime excises. Further reductions were made in 1971 and 1977. A tax on sugar expired in 1975 and excises on toll telephone service and teletypewriter service will expire in 1983.

  -- It is a fundamental public policy inequity to punitively raise the FET on beverage alcohol when excises on many other "luxury" items - furs, jewelry, luggage, toiletries, photographic equipment - have been eliminated.

- It is not sound public policy to punish an industry with a punitive tax increase on the basis of some organizations' perceived moral view of the FET as a "sin" tax.

  -- The Institute for Research on the Economics of Taxation states this forcefully. ". . .The tax code is hardly the place to dictate morality or personal tastes to the American populace."

  -- An estimated 100 million consumers use beverage alcohol responsibly. It is a fundamental inequity to penalize them for the excesses of a few or to use the tax code to supercede the criminal code.

4. <u>Any increase in the FET is unsound Federal tax policy.</u>

- Singling out a few industries for a discriminatory and punitive tax increase will not begin to solve the massive Federal budget deficit problem. The few billion dollars collected from the spirits industry is insignificant in the face of a deficit exceeding $100 billion.

- Federal revenue growth from beverage alcohol already is jeopardized by slow-growth in spirits. Any increase in the FET could accelerate a decline in industry sales and thus Federal and state revenue growth.

  -- The bulk (roughly 70%) of Federal revenues from beverage alcohol comes from distilled spirits.

  -- Per capita consumption of spirits has shown virtually no growth in the past seven years.

  -- Because of poor market conditions, the growth in Federal tax revenues has dropped dramatically. There was an actual decline in Federal revenues in 1979 and 1980.

-- Recent experience in other countries demonstrates the threat to revenues from excessive taxation. In Australia, an 82 percent spirits tax increase led to a consumption drop of 26 percent and less-than-expected revenues. In the U.K., following tax increases in 1980 and 1981, Treasury 1980/81 forecasts of a 10 percent growth in spirits revenues were reduced to a marginal 0.6 percent increase. In Denmark, following a 1977 tax increase of 37.5 percent, spirits revenues actually fell 12 percent the next year and have not yet recovered.

- A punitive tax increase on an industry with the nation's highest tax burden violates this Administration's commitment to reduce the tax burden on industry, stimulate investment, and create a fair tax structure.

  -- A major increase will nullify the 1981 tax reduction for the spirits industry. It would be an added barrier to investment and employment, not a stimulus.

  -- Raising the FET punishes an industry with a good productivity and anti-inflation record. Price increases for spirits have risen at roughly one-third the rate of overall price increases and the industry has one of the nation's higher productivity rates.

5. Raising the FET could jeopardize the revenue base of the states.

- States increasingly rely on beverage alcohol taxes.

  -- The state share of spirits retail price has risen from 12 percent in 1955 to 21 percent in 1980.

  -- State and local revenues from distilled spirits have nearly quintupled since 1955 while Federal revenues collected from distilled spirits have doubled.

  -- State revenue collections from beverage alcohol are significant - a total of $5.3 billion dollars in 1979, or $24 per capita. This is about equal to what states spend for health programs and twice their expenditures on police protection.

  -- Drastic changes in the FET could affect the states' ability to use excise taxes on beverage alcohol to meet their revenue needs at a time when the Administration's proposed "New Federalism" will place greater financial burdens on states.

-- Many states will lose revenues from consumption drops if the FET is increased and all states may find it increasingly difficult to raise beverage alcohol excise taxes on top of a major FET increase without threatening their revenue base.

6. An FET increase is a regressive and potentially harmful tax on consumers.

- Since the FET is the same for all income levels, middle- and low-income Americans who enjoy beverage alcohol in moderation unfairly will be penalized more severely. Democrats of the Joint Economic Committee explicitly have opposed excise tax increases as regressive.

- Further taxation of spirits could lead to a serious problem of illegal production, especially since the Federal government has granted licenses for roughly 11,000 fuel-alcohol stills. These stills are capable of producing illegal spirits, depriving government of tax revenues and posing a potential health hazard.

- Dr. Morris E. Chafetz, former director of the National Institute on Alcohol Abuse & Alcoholism, has stated that increasing excise taxes on beverage alcohol could reduce consumption among people "who can take alcohol or leave it. Using taxes as a deterrent to consumption can reduce healthy drinking, leaving unhealthy drinking as the chief role model for the young."

7. Raising the FET will have an adverse impact on an important American industry.

- The beverage alcohol industry is a major American industry. It contributes $15.3 billion in payroll and profits and $51 billion in retail sales to the American economy.

- A major increase in the FET will raise spirits prices significantly and dramatically worsen already poor spirits market conditions. For example, a 100 percent increase in the FET could increase spirits prices by as much as 50 percent and reduce consumption by 20-25 percent.

- A drop in consumption could have a severe impact on the 826,000 people employed in the manufacturing, wholesaling and retailing of beverage alcohol.

- A major tax increase could cause employee layoffs and some small firms might be forced to close their doors.

-- The many suppliers to the spirits industry - bottlers, truckers, farmers and others - would face reduced sales.

-- Small retailers and tavern owners would face difficult economic times as reduced sales could cut into their profit margins and payrolls.

CONCLUSION

The distilled spirits industry is not asking Congress for a special tax break. It only requests that Congress not worsen an already excessive and inequitable tax burden by legislating a punitive and unwarranted FET increase.

Fact Sheet

IMPACT ON STATES OF INCREASING THE FEDERAL EXCISE TAX ON SPIRITS

ISSUE

Threatened increases of Federal excise taxes on distilled spirits will jeopardize current and future state income from spirits.

KEY POINTS

1. Taxes on alcohol beverages, especially distilled spirits, contribute significantly to state and local revenues.

- Collections of such taxes totaled \$5.3 billion in 1979, about equal to state expenditures on health and double state expenditures on police protection.

- Revenues from distilled spirits alone amounted to \$2.8 billion, 53 percent of all alcohol beverage revenues collected by state and local governments. Most of the states rely on distilled spirits as the major source of revenue from beverage alcohol. (Table 1)

  -- State and local governments, on average, earned \$6.24* per gallon of spirits sold in 1979 compared to 37¢ per gallon of beer and \$1.19 per gallon of wine.

- Taxes from distilled spirits and other alcohol beverages have been an increasing source of funds for state and local jurisdictions. Average excise revenues per wine gallon of spirits in license states increased 76 percent from \$1.54 in 1951 to \$2.71 in 1980. Total state and local revenues from spirits nearly quintupled from \$620 million in 1955 to \$2.8 billion in 1979. State and local revenues from all alcohol beverages increased from \$1.0 billion to \$5.3 billion in this period.

* Includes excise taxes, sales taxes, state monopoly profits, license fees, and other sources of revenue.

- Revenues collected from beverage alcohol are significant for many states. In New Hampshire, state revenues from alcohol beverages were 11.0 percent of total revenues, and in Florida 8.8 percent with varying percentages in other states (Table 2). In New England, such taxes contributed $278 million or 4 percent to total state revenues, in the South Atlantic Region, $1.02 billion or 5.4 percent, and in the West South Central Region, $455 million or 4.4 percent.

2. <u>Beverage Alcohol Revenues Finance Major State Needs.</u>

   - The $377 million of state beverage alcohol taxes collected in Florida in 1979 would cover 69 percent of expenditures for health and hospitals in the state or 49 percent of the highway budget.

   - In Washington State, 70 percent of state expenditures for health and hospitals would be covered by state beverage alcohol revenues or 28 percent of highway expenditures.

   - In Nevada 64 percent or 22 percent respectively, of health and hospital or highway expenditures would be covered, in California 32 percent or 35 percent, and in Maine 62 percent or 24 percent. Examples for all states are given in Table 3.

3. <u>The burden of taxes on distilled spirits is excessive and inequitable.</u>

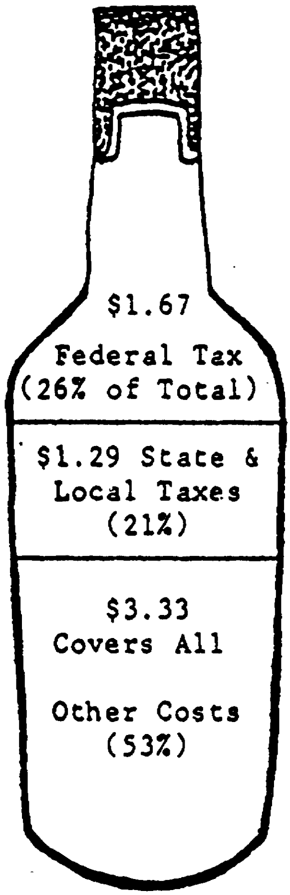
   - Nearly half (47 percent) of the average retail price of spirits is Federal, state and local taxes. Federal taxes ($1.67 per 750 ml bottle) are 26 percent of the price. State and local taxes ($1.29 per bottle) are 21 percent of the retail price. (Figure 1)

   - The FET share of retail spirits price (26 percent) is discriminatorily high compared to cigarettes (10-14%), beer (7%), airline tickets (5%), gasoline (3%) and wine (1.7%).

   - Combined Federal, state and local taxes increased the retail cost of a typical bottle of spirits 89 percent over production and marketing costs in 1980.

   - State and local taxes increased from 12 percent of the average retail price of a typical bottle in 1955 to 21 percent in 1980.

Figure 1



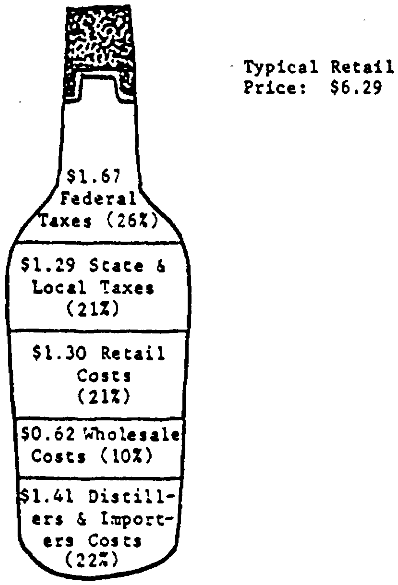
Typical Retail
Price: $6.29

Typical Proof
80°

- State and local taxes roughly equal the entire cost of retailing including retail profits, ($1.29). These taxes are more than double wholesale costs and profits of $0.26. (Figure 2)

- State and local taxes, ($1.28), were 91 percent of distiller's and importer's costs and profits ($1.41).

Figure 2
1980



Typical Proof
80°

4. <u>The States have a relatively larger stake in alcohol beverage revenues than the Federal Government.</u>

- State revenues from beverage alcohol (excluding local) were 4 percent of total state revenues compared with 1 percent of total Federal Government revenues obtained from beverage alcohol.

- Distilled spirits' revenues (excluding local) were $2.6 billion or 2 percent of revenues raised in the states compared with $3.9 billion or 0.7 percent of total Federal revenues.

5. <u>The increasingly large stake of state and local governments in distilled spirits revenues will be jeopardized by excessive taxation at the Federal level.</u>

- Nationally, spirits already is a slow-growth market. Spirits consumption increased by 6.3 percent between 1975 and 1980, compared to 31 percent growth in wine consumption and 20 percent growth in beer consumption.

- A major increase in the FET could cause a significant drop in spirits consumption. The unprecedented "shock" impact of a large tax increase could lead to serious revenue declines and eliminate spirits taxes as a stable current and future source of state income.

- Because spirits is the predominate source of beverage alcohol revenues, nearly half the states already face threats to their excise tax revenue base from declining spirits consumption. (Table 4) Doubling the FET could worsen greatly poor market conditions for spirits, depressing sales and state revenues even further.

  -- State and local revenues decline by $6.24* for every one gallon drop in spirits consumption. It requires sales of 17 gallons of beer or 5 gallons of wine, on average, to make up for this lost spirits revenue.

  -- A staff analysis from the National Governors' Association states that "the alcohol tax, with its heavy emphasis on distilled spirits . . . may show little growth and might even have declining yields if a trend away from distilled spirits continues."

- The legitimate concern of states over Federal excise tax increases was expressed by Governor Richard Snelling, Chairman of the National Governors' Association, in a letter to President Reagan:

  "First, these revenue sources are important to the states and already account for about one-eighth of state revenues. Last year 15 states increased alcoholic beverage taxes, 6 states increased tobacco products taxes, and 26 states increased motor fuel taxes.

* Includes excise taxes, sales taxes, state monopoly profits, license fees and other sources of revenue.

Second, these taxes have long been regarded as state revenue sources and should remain so. The Governors share your desire to return revenue sources to the states, not to remove them. It is hard to see what federalism objectives are to be served by federal increases in taxes which any state can, if it wishes, increase to meet its own needs. Even a plan to collect and then return the increased federal revenues to the states is less desirable, in terms of federalism, than leaving the revenue sources to the states."

TABLE 1

RELIANCE OF STATE AND LOCAL GOVERNMENTS ON REVENUES FROM DISTILLED SPIRITS, 1979

	Revenues from Distilled Spirits as % of Total State and Local Revenues from Beverage Alcohol
Alabama	53.4%
Alaska	59.1%
Arizona	45.2%
Arkansas	44.2%
California	50.7%
Colorado	47.8%
Connecticut	53.9%
Delaware	69.8%
District of Columbia	62.8%
Florida	43.0%
Georgia	43.9%
Hawaii	39.1%
Idaho	49.2%
Illinois	51.3%
Indiana	46.8%
Iowa	63.5%
Kansas	41.9%
Kentucky	56.0%
Louisiana	38.2%
Maine	64.1%
Maryland	50.0%
Massachusetts	62.9%
Michigan	56.2%
Minnesota	59.3%
Mississippi	49.2%
Missouri	46.7%

	Revenues from Distilled Spirits as % of Total State and Local Revenues from Beverage Alcohol
Montana	61.1%
Nebraska	42.7%
Nevada	60.4%
New Hampshire	70.5%
New Jersey	57.9%
New Mexico	36.8%
New York	61.6%
North Carolina	45.1%
North Dakota	48.5%
Ohio	61.9%
Oklahoma	53.2%
Oregon	84.3%
Pennsylvania	55.8%
Rhode Island	46.5%
South Carolina	44.5%
South Dakota	50.0%
Tennessee	42.1%
Texas	45.4%
Utah	61.8%
Vermont	65.7%
Washington	71.9%
West Virginia	58.8%
Wisconsin	51.8%
Wyoming	62.8%
Avg.	52.8%

TABLE 2

PERCENTAGE STATE ALCOHOL BEVERAGE TAX REVENUES ARE OF TOTAL STATE TAX REVENUES, 1979[1/]

License States	Percent of Total Revenues from Alcohol Beverages	Percent of Total Revenues from Distilled Spirits	Control States	Percent of Total Revenues from Alcohol Beverages	Percent of Total Revenues from Distilled Spirits
Alaska	1.0	0.6	Alabama	6.6	3.7
Arizona	2.9	1.4	Idaho	4.4	2.1
Arkansas	2.8	1.3	Iowa	4.4	2.8
California	2.5	1.3	Maine	5.7	3.7
Colorado	3.4	1.7	Michigan	4.0	2.2
Connecticut	4.4	2.4	Mississippi	5.5	2.7
Delaware	1.0	0.7	Montana	5.4	3.5
District of Columbia	2.6	1.6	New Hampshire	11.0	7.7
Florida	8.8	3.8	North Carolina	5.1	2.4
Georgia	4.8	2.1	Ohio	5.2	3.2
Hawaii	2.7	1.0	Oregon	4.7	3.9
Illinois	2.8	1.4	Pennsylvania	3.9	2.2
Indiana	2.9	1.4	Utah	3.4	2.2
Kansas	2.4	1.0	Vermont	6.0	4.0
Kentucky	1.8	1.0	Virginia	5.1	2.5
Louisiana	3.4	1.4	Washington	5.9	4.2
Maryland	2.7	1.4	West Virginia	3.1	1.9
Massachusetts	2.8	1.8	Wyoming	2.6	1.7
Minnesota	2.8	1.7			
Missouri	2.7	1.3			
Nebraska	2.9	1.3			
Nevada	5.4	3.4			
New Jersey	3.2	1.9			
New Mexico	2.1	0.8			
New York	2.7	1.8			
North Dakota	3.3	1.6			
Oklahoma	2.7	1.4			
Rhode Island	3.8	1.8			
South Carolina	6.9	3.1			
[illegible]th Dakota	5.2	2.6			
Tennessee	3.9	2.3			
Texas	5.4	2.5			
Wisconsin	2.6	1.3			

1/Excluding local revenues.

TABLE 3

State Alcohol Beverage Revenues[1/] Related to
State Expenditures for Highways, Health and Hospitals, 1979

License States	Revenues from Alcohol Beverages $ Million	Alcohol Beverage Revenue as Percent of Expenditures for Highways	Health & Hospitals
Alaska	$ 8	6%	18%
Arizona	45	15	32
Arkansas	28	9	23
California	412	35	32
Colorado	48	18	27
Connecticut	76	36	32
Delaware	5	8	11
District of Columbia	22	34	13
Florida	377	45	69
Georgia	120	21	32
Hawaii	24	26	20
Illinois	176	17	30
Indiana	77	14	27
Kansas	28	10	15
Kentucky	38	5	21
Louisiana	76	16	21
Maryland	72	14	18
Massachusetts	102	28	20
Minnesota	89	19	33
Missouri	54	11	18
Nebraska	21	9	20
Nevada	25	22	64
New Jersey	119	30	25
New Mexico	18	8	17
New York	315	30	18
North Dakota	11	9	25
Oklahoma	42	13	27
Rhode Island	20	47	18
South Carolina	105	42	38
South Dakota	13	13	34
Tennessee	72	14	31
Texas	309	25	41
Wisconsin	84	21	27
Control States			
Alabama	116	28	40
Idaho	21	16	46
Iowa	71	15	36
Maine	32	24	62
Michigan	239	28	31
Mississippi	67	23	42
Montana	22	17	43
New Hampshire	32	28	55
North Carolina	149	25	33
Ohio	244	27	32
Oregon	67	21	37
Pennsylvania	264	34	30
Utah	24	15	23
Vermont	16	26	42
Virginia	133	16	27
Washington	159	25	70
West Virginia	37	8	34
Wyoming	9	7	35

TABLE 4

STATES WITH DECLINING SPIRITS CONSUMPTION
(wine gallons)

State	Apparent Consumption 12 Mos. Ending Sept. 30, 1981	12 Mos. Ending Sept. 30, 1980	Percent Change
LICENSE			
California	56,499,959	57,601,740	-1.9%
Connecticut	7,321,239	7,419,158	-1.3%
District of Columbia	3,804,982	3,832,595	-0.7%
Georgia	10,975,874	11,195,835	-2.0%
Illinois	24,776,660	25,044,214	-1.1%
Maryland	11,007,069	11,185,652	-1.6%
Missouri	6,842,134	7,087,690	-3.5%
Nevada	4,477,881	4,592,507	-2.5%
New York	39,389,854	40,147,484	-1.9%
Oklahoma	4,355,526	4,503,413	-3.3%
Rhode Island	1,985,186	2,158,341	-8.0%
South Carolina	6,258,167	6,400,350	-2.2%
CONTROL			
Alabama	5,316,803	5,710,047	-6.9%
Iowa	3,912,102	3,976,042	-1.6%
Michigan	17,827,712	18,249,584	-2.3%
Mississippi	3,958,154	3,979,745	-0.5%
New Hampshire	4,431,450	4,460,072	-0.6%
Ohio	14,282,788	14,962,709	-4.5%
Oregon	4,755,942	4,771,369	-0.3%
Pennsylvania	16,830,727	16,937,354	-0.6%
Vermont	1,343,230	1,377,594	-2.5%
West Virginia	2,497,174	2,718,906	-8.2%

Fact Sheet

Excessive Taxation of Distilled Spirits Jeopardizes

Future Revenue Growth

ISSUE

A major increase in the Federal Excise Tax (FET) on distilled spirits will jeopardize future revenue growth potential from distilled spirits.

KEY POINTS

1. Major increases in beverage alcohol taxation will impact especially hard on spirits consumption.

- Increases in beverage alcohol taxation will have a more severe impact on spirits than on other beverage alcohol products.

  -- The FET on a typical gallon of 80 proof spirits is \$8.40 while on a gallon of beer it is 29¢ and on a gallon of table wine it is 17¢. Therefore, any FET increase raises the spirits tax by a far higher dollar amount per gallon.

- Spirits prices will increase much more sharply than beer and wine prices.

  -- For example it is estimated that if the FET were doubled, spirits prices could rise by as much as 50 percent, while beer and wine prices would increase by an estimated 11 percent and 8 percent, respectively.

- Spirits consumption would be more severely impacted.

  -- Because price increases would be more dramatic for spirits, it is likely that spirits consumption would decrease most sharply. Beer and wine consumption might decrease slightly or even increase as consumers substitute beer or wine for spirits.

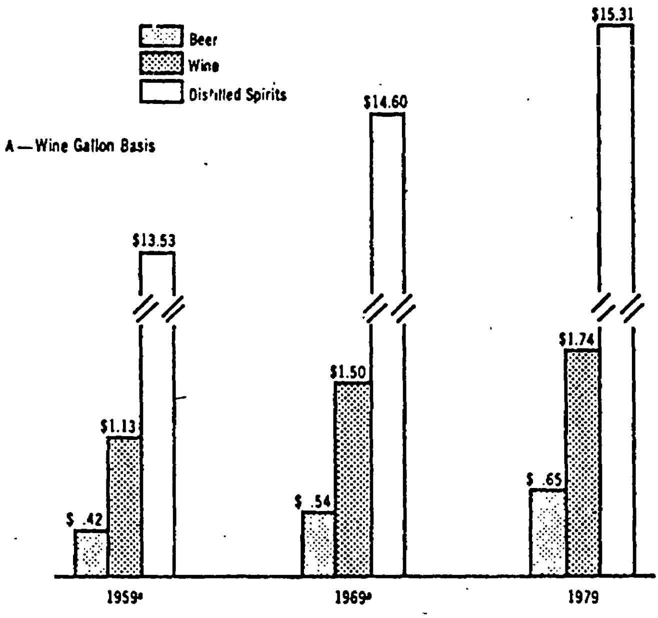
2. Distilled spirits is the major revenue source for Federal and state beverage alcohol taxes.

- Distilled spirits provide substantially more revenues for each gallon sold.

  -- For every gallon of spirits sold, Federal, state and local governments receive $15.31, while for wine and beer they receive only $1.74 and $.65, respectively.

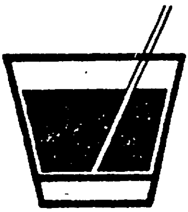
Figure 3

Total Revenues per Gallon of Beverage by Beverage Type for Selected Years



-- The Federal government alone in 1979 received an average $9.08 per gallon of spirits, compared to 29¢ per gallon of beer and 56¢ per gallon of wine.

-- For standard servings containing the same amount of pure alcohol, the Federal government receives far more from spirits than beer or table wine.

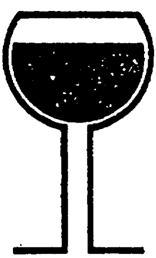


1 cocktail
(1.5 oz. spirits)

= 10¢ Federal tax

12 oz. beer

= 2.7¢ Federal Tax



5 oz. wine

= 2/3 of a penny Federal tax

- Distilled spirits provides the bulk of beverage alcohol taxes.

  — Spirits contributes roughly 70 percent of all Federal beverage alcohol taxes.

Sources of Federal Beverage Alcohol Tax Revenues, 1979

  -- Spirits provides 53 percent of all state and local beverage alcohol taxes. States and local governments in 1979 received on average, $12.46 per capita from spirits, $8.81 from beer and $2.32 from wine sales.

  -- The majority of states rely most heavily on spirits taxes for their beverage alcohol revenue. (Attachment I)

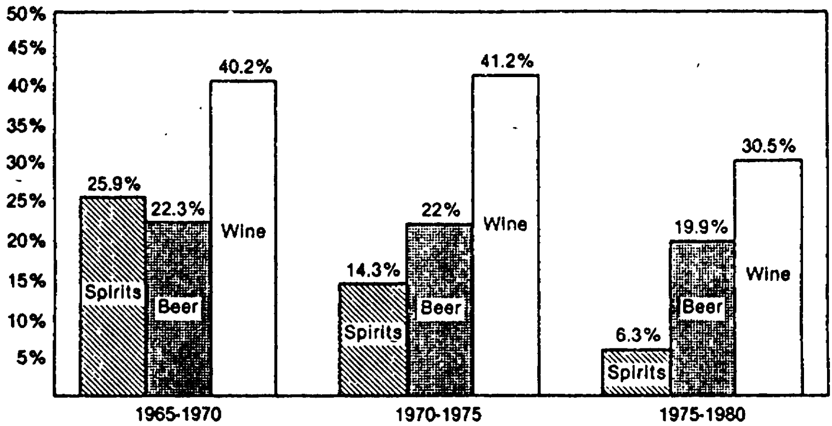
3. <u>There already is a dramatic slowdown in the growth of the (highly taxed) spirits market, in favor of (lower-taxed) beer and wine.</u>

- Per capita consumption of spirits rose only 1.0 percent between 1975 and 1980, while per capita beer and wine consumption rose 14 percent and 24 percent, respectively.

  -- Total spirits consumption rose only 6.3 percent between 1975 and 1980, while beer and wine consumption rose 19.9 percent and 30.5 percent, respectively.

- Slow-growth in spirits consumption is a marked reversal of higher growth rates in previous years, while lower-taxed beer and wine consumption have continued to show substantial increases.

Percent Increase in Consumption of Spirits, Beer and Wine

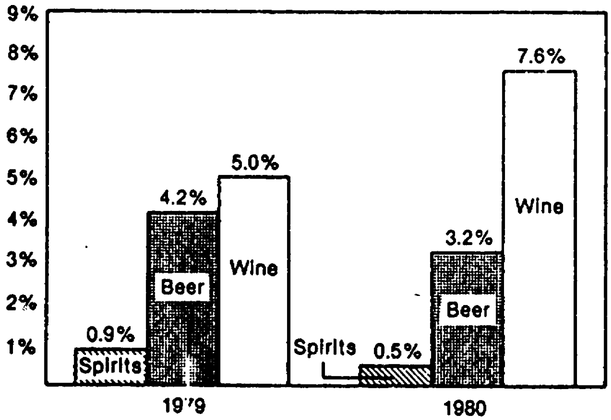


-- While wine consumption grew 1.6 times faster than spirits consumption between 1965 and 1970, it increased three times faster between 1970 and 1975, and five times faster between 1975 and 1980.

-- Beer consumption between 1965 and 1970 grew at roughly the same rate as spirits but between 1975 and 1980 increased more than three times faster.

- In the most recent years for which data is available, 1979 and 1980, spirits consumption barely increased, while beer and wine consumption grew far more rapidly.

Percent Increase in Consumption of Spirits, Beer and Wine



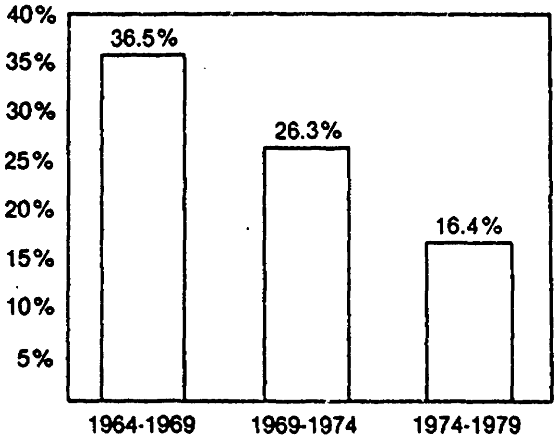
-- In 1980, U.S. consumption of wine at 472 million gallons exceeded spirits consumption (450 million gallons) for the first time.

- Spirits consumption has been falling in nearly half the states (Attachment II), jeopardizing their tax revenue base.

4. Beverage alcohol revenue growth is slowing because of the trend in consumption away from high-tax spirits.

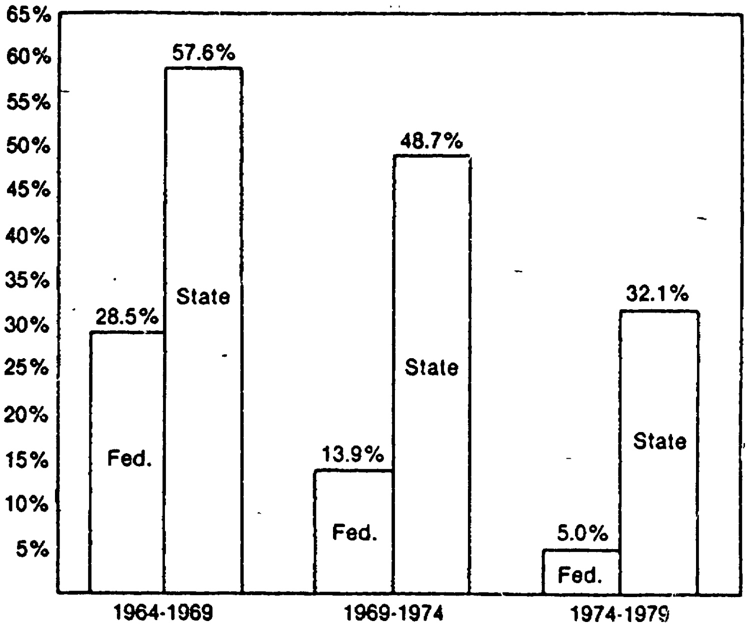
- Percentage increases in beverage alcohol revenues have slowed from a growth of 36.5% between 1964 and 1969 to a growth of 16.4% between 1974 and 1979.

Percent Increase in
Total Beverage Alcohol Revenues



- The slowing of beverage alcohol revenue growth has occurred at both Federal and state levels -- most severely at the Federal level.

Percent Increase in Beverage Alcohol Revenues

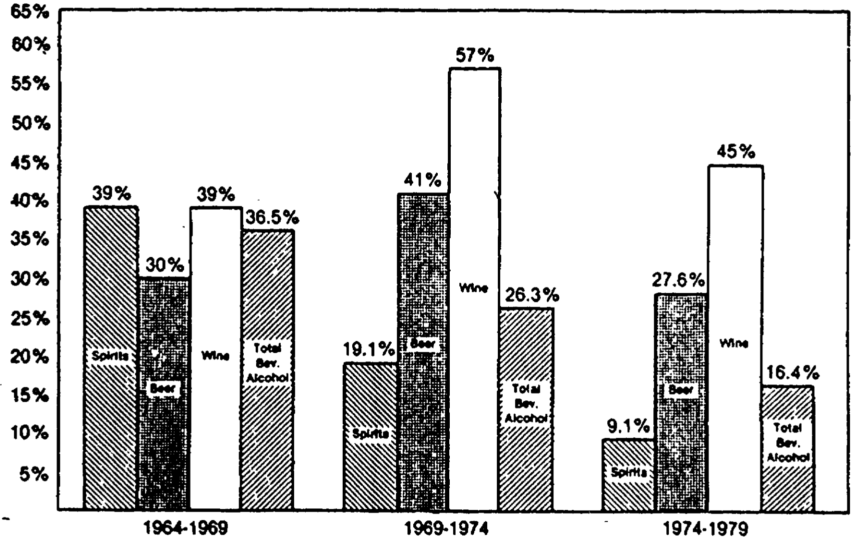


-- Federal revenue growth has slowed from 28.5% in 1964-1969 to 5% in 1974-1979. There was an actual decrease in Federal revenues of 2 percent in 1979. Preliminary estimates indicate another drop in 1980.

-- State and local revenue growth, in spite of tax increases, has slowed from a 57.6% increase between 1964 and 1969 to a 32% increase between 1974 and 1979.

- The predominate cause of slowing revenue growth is the slow growth in the spirits market and consequently in spirits revenue.

Percent Growth In Revenues From Spirits, Beer and Wine

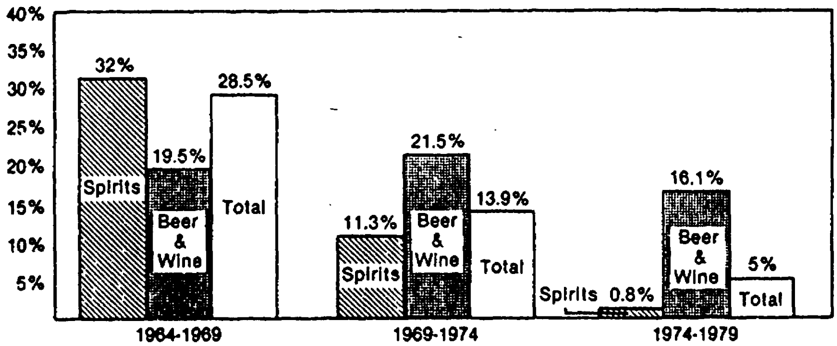


-- Between 1969 and 1974, total revenue growth slowed from the 1964-1969 period (from 37% growth to 26% growth) in spite of acceleration in beer and wine revenue growth because revenue growth in spirits dropped sharply (from 39% growth to 19% growth).

-- Between 1974 and 1979, total revenue growth again dropped below the 1964-1969 period (from 37% growth to 16% growth), even though beer revenue growth was not substantially reduced and wine revenue growth was higher, because of another drop in spirits revenue growth (from 39% growth to 9% growth).

• The slowing of Federal revenue growth from beverage alcohol has been due basically to the slow growth of highly taxed spirits.

Percent Increase In Federal Revenues From Spirits, Beer and Wine



-- Even though the growth in Federal beer and wine revenues accelerated slightly in 1969-1974 over the 1964-1969 period (from 20% growth to 22% growth), total revenue growth dropped sharply with a dramatic slowdown in spirits revenue growth (from 32% growth to 11% growth).

-- Between 1974 and 1979, the growth in Federal beer and wine revenues decreased slightly compared to the previous five years (from 22% growth to 16% growth). However, total revenue growth in 1974-1979 dropped dramatically (from 14% to 5%) with virtually no growth in spirits revenues.

5. <u>A tax increase inducing further substitution away from higher-tax spirits toward lower-tax beer and wine will reduce future revenue growth potential.</u>

- To replace revenues from a 1 percent volume drop in spirits consumption requires a 2.4 percent growth in volume of beer consumption or a 17.2 percent growth in volume of wine consumption at current average tax rates.

- It requires the sale of 30 cases of beer or 49 cases of table wine to generate the Federal tax revenues of a single case of spirits.

- It requires sales of 5 gallons of wine or 17 gallons of beer to generate the state and local tax revenues of a single gallon of spirits.

- The staff analysis from the National Governor's Association states that "The alcohol tax, with its heavy emphasis on distilled spirits . . . may show little growth and might even have declining yields if a trend away from distilled spirits continues."

- A major FET increase also would create a more favorable economic climate for illegal spirits production, which would reduce further the spirits tax base.

6. <u>The impact of excessive taxation of spirits on revenue growth is dramatically illustrated in other countries.</u>

- In Australia, an 82% tax increase in 1978 led to a 26% drop in spirits consumption, and a slight decline in beer consumption. At the same time, consumption of wine, which has no excise tax, increased. Revenue growth, however, was below expectations with the decline in spirits and beer consumption.

- In the U.K., following tax increases in 1980 and 1981, it has been estimated that 1980/1981 Treasury forecasts of revenues from beverage alcohol were vastly overestimated. Estimates for 1981 of a 10% increase in spirits revenues were reduced to a marginal 0.6% improvement in revenues, an overestimate of 110 million. The actual spirits revenue increase was only one-seventeenth of what was forecasted originally.

97-039 0 - 82 - 18

-- The same report estimates that combined taxation receipts from alcohol and tobacco in 1980/1981 will not be less than 270 million below the official budget forecasts, and revenue forecasts for the following year (1981/1982) will be close to 600 million below official forecasts, only half of the additional revenue forecasted.

- Denmark, after the tax was increased 37.5% in 1977, the tax revenue from spirits actually declined 12 percent the following year. Revenues have not reached pre-tax increase levels since the 1977 tax increase.

Attachment I

RELIANCE OF STATE AND LOCAL GOVERNMENTS ON REVENUES

FROM DISTILLED SPIRITS, 1979

	Revenues from Distilled Spirits as % of Total State and Local Revenues from Beverage Alcohol
Alabama	55.4%
Alaska	59.1%
Arizona	45.2%
Arkansas	44.2%
California	50.7%
Colorado	47.8%
Connecticut	53.9%
Delaware	69.8%
District of Columbia	62.8%
Florida	43.0%
Georgia	43.9%
Hawaii	39.1%
Idaho	49.2%
Illinois	51.3%
Indiana	46.8%
Iowa	63.5%

	Revenues from Distilled Spirits as % of Total State and Local Revenues from Beverage Alcohol
Kansas	41.9%
Kentucky	56.0%
Louisiana	38.2%
Maine	64.1%
Maryland	50.0%
Massachusetts	62.9%
Michigan	56.2%
Minnesota	59.3%
Mississippi	49.2%
Missouri	46.7%
Montana	61.1%
Nebraska	42.7%
Nevada	60.4%
New Hampshire	70.5%
New Jersey	57.9%
New Mexico	36.8%
New York	61.6%
North Carolina	45.1%
North Dakota	48.5%
Ohio	61.9%

	Revenues from Distilled Spirits as % of Total State and Local Revenues from Beverage Alcohol
Oklahoma	53.2%
Oregon	84.3%
Pennsylvania	55.8%
Rhode Island	46.5%
South Carolina	44.5%
South Dakota	50.0%
Tennessee	42.1%
Texas	45.4%
Utah	61.8%
Vermont	65.7%
Virginia	47.0%
Washington	71.9%
West Virginia	58.8%
Wisconsin	51.8%
Wyoming	62.8%
Avg.	52.8%

ATTACHMENT II

STATES WITH DECLINING SPIRITS CONSUMPTION
(wine gallons)

State	Apparent Consumption 12 Mos. Ending Sept. 30, 1981	12 Mos. Ending Sept. 30, 1980	Percent Change
LICENSE			
California	56,499,959	57,601,740	-1.9%
Connecticut	7,321,329	7,419,158	-1.3%
Dist. of Columbia	3,804,982	3,832,595	-0.7%
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Oklahoma	4,355,526	4,503,413	-3.3%
Rhode Island	1,985,186	2,158,341	-8.0%
South Carolina	6,258,167	6,400,350	-2.2%
CONTROL			
Alabama	5,316,803	5,710,047	-6.9%
Iowa	3,912,102	3,976,042	-1.6%
Michigan	17,827,712	18,249,584	-2.3%

CONTROL

Mississippi	3,958,154	3,979,745	-0.5%
New Hampshire	4,431,450	4,460,072	-0.6%
Ohio	14,282,788	14,962,709	-4.5%
Oregon	4,755,942	4,771,369	-0.3%
Pennsylvania	16,830,727	16,937,354	-0.6%
Vermont	1,343,230	1,377,594	-2.5%
West Virginia	2,497,174	2,718,906	-8.2%

Fact Sheet

FET INCREASE IMPACT ON ILLEGAL PRODUCTION OF LIQUOR

ISSUE

An increase in the FET on distilled spirits will encourage production and consumption of illegal, untaxed and potentially dangerous substitutes for commercially-produced liquor.

KEY POINTS

1. A ma.,r increase in the FET on distilled spirits will add strong economic incentives for the production of illegal liquor.

- There is no serious problem now in the U.S. with production and sale of illegal spirits.
  - -- In the past twenty years, legal distillers have eroded steadily the profit on illegal liquor by raising productivity (one of the highest and fastest growing in the U.S.) and keeping price increases low.
  - -- At the same time, Federal and state seizures of illegal stills have fallen to a minimal level from much higher levels in the previous three decades.
  - -- Illegal producers have been further discouraged by the high price of sugar, a key ingredient, in recent years.
- A major increase in the FET could generate strong incentives for illegal production.
  - -- An increase in the FET could raise spirits prices significantly. For example. a 100 percent increase in the FET could raise spirits prices by as much as 50 percent, making illegal production far more economically profitable.
- The roughly 11,000 "small" fuel-alcohol still licenses granted in the last few years by the Federal government could become an important source of illegal, untaxed liquor. These government licenses for small stills have been granted in every state in the country. In California, over 1,000 licenses have been granted, in Michigan and Texas over 500 licenses; in Alabama, Florida, North Carolina, Ohio, and Washington over 400 licenses; in Iowa, Illinois, Indiana, and Oregon over 300 licenses. In thirty-one states over 100 licenses for "small" stills have been granted. (Attachment I)

-- These "small" stills (up to 10,000 proof gallon capacity) are not closely supervised by the Federal government, nor are the owners usually bonded. (Medium and large fuel-alcohol stills are inspected at licensing and their owners bonded).

-- The "small" fuel-alcohol stills are capable of producing beverage alcohol as well as fuel-alcohol. There currently is an oversupply of fuel-alcohol, making it uneconomic to produce and making production of beverage alcohol a more attractive alternative.

- A further economic incentive is the low price of sugar, down substantially from higher levels in prior years.

- According to the Wall Street Journal (1973): "The number of moonshiners is decreasing, but their stills are getting bigger all the time. In North Carolina, for example, the capacity of the average still 15 years ago was 400 gallons, Federal men estimated. Today it is 1,800 gallons."

- In the U.S. on September 29, 1981, lawmen in Henry County, Virginia destroyed a 10-pot whiskey still with an annual production capacity of 52,000 gallons.

- Recently an alcohol-fuel permit holder pleaded guilty to selling illegal, non-taxed beverage alcohol and was sentenced to five years in prison.

3. <u>Historically, prohibitive taxation and strict regulation have led to increased illegal production of liquor in the U.S.</u>

- During Prohibition, "bathtub gin", tax-free liquor from Canada and backwoods "moonshine" flowed freely in the U.S.

- By 1952, when the FET on distilled spirits had increased 425 percent over the 1934 post-Repeal level, U.S. consumption of tax-free liquor exceeded 60 million gallons, or 18 percent of total consumption.

- The average annual number of stills seized by Federal agents increased 33 percent after the 16 percent FET increase of 1951. The average rose from 8,109 stills in 1947-50 to 10,852 stills in 1951-54.

4. <u>The experience of other countries which have prohibitive liquor taxation or strict regulation indicates the serious potential for illegal production.</u>

- The National Institute for Alcohol Research in Norway estimated that 20 percent of the liquor consumed is produced illegally and sold outside the restrictive national liquor monopoly.

- In the Soviet Union, with strict limitations on the availability of alcohol and high taxation of liquor that accounts for 10 percent of its budget, an estimated one-third of total spirits consumed is home-distilled and it has the world's highest death rates from acute alcohol poisoning (160 per million persons).

5. <u>Tax-free production of liquor can cost Federal and state governments over a billion dollars in lost tax revenues.</u>

- In 1954, three years after a 16 percent FET increase, Federal and state governments lost over $900 million on an estimated output of 72 million gallons of moonshine.

- In 1983, if only 10 percent of total consumption shifted to illegal liquor following a massive FET increase, state and local governments could lose about $300 million and the Federal government could lose roughly $750 million.

6. <u>Illegal liquor production will raise enforcement costs for the states.</u>

- The Federal government is considering dismantling the Bureau of Alcohol, Tobacco and Firearms, which may shift more enforcement to the states.

- Any reduction in Federal enforcement coupled with a major FET increase could be added incentive to illegal producers, combining prospects of higher profits with lower risks.

7. <u>Illegal production and consumption of liquor poses a serious health hazard.</u>

- Legal distillers are subject to strict quality-control standards by law to ensure the purity of the product.

- Illegal producers often sell a product that is dangerous and even fatal.

-- Illegal producers often use car radiators to distill liquor, poisoning the product with lethal lead salts. This poison was found in 90 percent of seized stills in 1973.

-- Illegal producers may sell deadly methanol-spirits (wood alcohol) instead of ethanol-spirits to unwary consumers. In 1955, eight New Yorkers died from illegal spirits containing wood alcohol.

-- In February, 1981, Georgia agents searched for an illegal still responsible for at least six deaths because traces of rubbing alcohol were contained in the illegal liquor.

-- In January, 1981, 29 people died and 80 others were hospitalized in Malaysia from alcohol poisoning.

-- In July, 1981, 311 people died in India from a single batch of illegal spirits made with methanol.

State	Licenses
Tennessee	244
Texas	545
Utah	120
Vermont	30
Virginia	154
Washington	497
West Virginia	59
Wisconsin	245
Wyoming	33
TOTAL	10,515

N.B. Small Alcohol Fuel Plants are capable of producing up to 10,000 proof gallons annually.

Source: Bureau of Alcohol, Tobacco and Firearms

ATTACHMENT I

Small Alcohol Fuel Plant Licenses

as of September 30, 1981

State	Licenses
Alabama	441
Alaska	13
Arizona	159
Arkansas	261
California	1,037
Colorado	164
Connecticut	26
Delaware	20
District of Columbia	5
Florida	417
Georgia	241
Hawaii	15
Idaho	190
Illinois	305
Indiana	330
Iowa	320
Kansas	261
Kentucky	226
Louisiana	88

State	Licenses
Maine	38
Maryland	132
Massachusetts	61
Michigan	523
Minnesota	292
Mississippi	81
Missouri	239
Montana	94
Nebraska	191
Nevada	41
New Hampshire	24
New Jersey	60
New Mexico	73
New York	216
North Carolina	416
North Dakota	45
Ohio	449
Oklahoma	124
Oregon	378
Pennsylvania	266
Rhode Island	16
South Carolina	245
South Dakota	65