The Economic Club of New York

307th Meeting
78th Year

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Dan Rostenkowski
Chairman, Ways and Means Committee
and
Robert Packwood
Chairman, Senate Finance Committee

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February 25, 1985

New York Hilton
New York, New York

Questioners: Dr. Henry Kaufman
Executive Director, Solomon Brothers

John Weinberg
Chairman, Goldman Sachs.

Introduction

F. Ross Johnson, Chairman

Welcome ladies and gentlemen to the 307th meeting of the Economic Club of New York in its 78th year. I have a particularly pleasant duty to perform this evening. From 1981 until 1983 the Chairman of the Economic Club and my predecessor was Pete Peterson. Now I want it clearly understood that when I assumed the Chairmanship of the Economic Club of New York, I did not go to Pete and insist that I have the job. (Laughter) It was graciously presented to me by Pete and the Board of Trustees, however, with publicity, Peter I did do some research from some objective people at Lehman Brothers such as Steve Schwartzman and Andy Sage and they indicated to me that not at all were you cold or imperious. And I always thought that it was necessary in order to hand out the exorbitant outrageous fees that I have paid from Peter over the years. (Laughter) Nevertheless, historically upon retirement, the Chairman is presented a token of appreciation which is this time, a Swan. Now you may rightfully ask, what took so long and why a Swan. As to timing, we gave upon live swans with Pete's concurrence. Delivery was a problem. And as to selection, this is a Steuben Swan. It is the kind that goes on looking wonderful forever and ever. Which is what we expect Pete Peterson to do. Pete for two wonderful years and from a grateful membership, your Swan. (Applause)

Peter Peterson: I guess Ross put three items on the agenda that I will respond to briefly. (Laughter) As far as these outrageous fees are concerned, with Ira Harris here and Johnny

Weinberg I don't know why the hell I should be defending their fees. But I do recall that a friend of mine once said, when I asked him what an outrageous profit was, he said it was one slightly more than you can actually get. (Laughter) Now since it takes two to make markets and since you are the guy that has been paying them, I guess one should ask the question is, why you pay such outrageous fees. (Applause) And as far as this business of being cold and imperious, I have an even better source than Andy Sage and Steve Schwartzman, my wife. Now I went to her the day that story appeared and I said, darling do you find me cold and imperious, and she said, "Of course not, Mr. Peterson". (laughter and applause) Now, you are absolutely right, it was two years ago in August as I recall of '83 that I told you that you were the last Chairman I was going to name that year, that was for sure. (Laughter and applause) And I hope it isn't too unkind to say that I think I was a little luckier with this one than I was with the last one. (Laughter) But more seriously, my only complaint about you Ross is you are making me look pretty bad. I think Ross has done a superb job and I think everybody knows it. So it is my privilege really to have been your predecessor, thank you very much Ross, I deeply appreciate this. (Applause)

F. Ross Johnson, Chairman: Thank you Pete. One other piece of business before we get on to tonight's agenda. Our next dinner meeting will be on Monday April 1st, and will feature the Honorable James Baker, recently appointed Secretary of the Treasury. So circle your calendars, April 1st, the Honorable James Baker.

A special welcome to our guest this evening, Senator Bob Packwood and Congressman Dan

Rostenkowski. Their topic, a program on taxation. It was more than 300 years ago that Jean Baptiste Colbert, the Controller General of France under Louis XIV found himself unable to balance the national budget because of increased military spending. He decided new taxes were needed and then he issued what is probably the most cogent statement ever made on the subject of taxation. The art of taxation he said, consists in so plucking the goose as to obtain the largest amount of feathers with the least amount of hissing. (Laughter) Now none of us know how many feathers are going to be plucked in Washington this year or how much hissing will ensue. But whatever the outcome, each of the two speakers in our program this evening, will have had a great deal to do with it. One of them is the Chairman of the Senate Finance Committee which handles the taxes for that chamber. Our other speaker is the Chairman of the Tax Unit in the House of Representatives, The Ways and Means Committee. Now that name may seem strange to you because it is rarely stated that way. The customary expression is the All Powerful Ways and Means Committee. Speaking first this evening will be the Senate Finance Committee Chairman Bob Packwood. It would appear that he faces a situation similar in many ways to that of Jean Baptiste Colbert. Like Monsieur Colbert Senator Packwood favors a balanced budget at a time of stepped up military spending. Mr. Packwood’s emphasis on pro-investment tax policies, said the *New York Times*, makes him a strong opponent of the Treasury Department’s current proposal, to eliminate preferential treatment of capital gains and to stretch out the current accelerated depreciation schedule. On taxes he once said, I am as predictable as the sun rising. On most anything we can do to use the tax system to encourage capital investment in savings is good. And on a different occasion he was heard to remark that and I happily quote, “it is not the business of government to prevent capitalistic acts between consulting adults.” It seems that wherever he goes he attracts journalists determined to pin labels on him. One of the most recent, just a couple of months ago, also comes from the *New York Times,* which called him “A blunt spoken, no nonsense legislator”. I have not idea whether he is going to speak bluntly this evening, but I am certain what he does say will be entirely devoid of nonsense. Ladies and gentlemen, it gives me great pleasure to introduce to you the new Chairman of the United States Finance Committee, Oregon Senator Bob Packwood. (Applause)

Robert Packwood

Chairman, United States Finance Committee

From time to time there appears throughout the Sherlock Holmes stories, the bumbling inspector who has caught the wrong man, but confident, of course, that he has caught the right man and cannot resist lauding it over Mr. Holmes. And so it is in the story of Silver Blaze, the great race horse that is stolen and the trainer has been killed and the inspector has caught again what turns out to be the wrong man. But midway through the story, as he is walking down the trail with Sherlock Holmes he says, “And is there anything else Mr. Holmes to which you would like to call my attention?” Holmes says, “Yes, the strange conduct of the dog in the night”. The inspector says, “Why, the dog did nothing in the night”. Holmes said, “Yes, that was the strange conduct”. Holmes reasoning deductively, as he does in all of his stories, reasons backwards from conclusions and as he says to poor old Watson all the time, “Watson, when you have eliminated all of the possibilities as to how it couldn't have happened, what remains is the answer." That is a perfectly legitimate way of thinking. It is much more oriental than occidental in terms of philosophy. But you recall that Holmes was at least interested in the occult and certainly was knowledgeable about oriental philosophy. I thought it was more succinctly stated in one article in the New York Times on May 7th of last year. It was a 30th anniversary of the final defeat of the French at the Battle of Dien Bien Phu. And the New York Times had interviewed both of the generals who were still alive. General de Castries for the French, General Giap for the Vietnamese. And each of them explained how they looked at the battle. General De Castries had 14,000 French troops encamped on the valley floor. And as he said, he had no fear of artillery on the hillsides because there were no roads, let alone any trails which would permit moving artillery to the hillside. That is inductive reasoning. General Giap looked at it exactly the opposite. When he saw that the French intended to remain on the valley floor, he thought how can I get artillery to the hillside. And having decided that he wanted artillery on the hillside, then reasoned backwards, deductively, the thousands or perhaps hundreds of thousands of peasants lugging disassembled artillery, bolt by bolt and piece by piece up mountainsides that had no trails, until they reached the hillsides and then they were reassembled. And the French were bombarded into submission, without too many significant hand-to-hand infantry battles. I think we make too many mistakes in this country, in fact, in the West, by not reasoning deductively rather than inductively. We want to raise more money, get rid of the Accelerated Cost Recovery System. Get rid of the investment tax credit. Now there may be merit or lack of merit in getting rid of ACRS or the investment tax credit, but unless your sole goal is raising money, regardless of the consequences, damn the torpedoes. There might be some other considerations that you should look at before you reach those conclusions.

So let's reason deductively at some of the policies this country might want to pursue and I throw them out not necessarily as my policies but simply policies to consider. Do we want an indigenous military and commercial ship building and repair capacity in this country? Do we want education that is financially within the reach of all who are able to benefit from it? Do we want energy independence? Do we want to encourage people to contribute to charity? Do we want adequate healthcare? Do we want pensions and life insurance? Now if the answer to any of those questions is no, we are not concerned about ship building in this country, we are not concerned about adequate health coverage, we are not concerned about education that can be obtained by all, then you don't need to worry. And you need no government policy. But if you answer yes to any of those questions, and the myriad of other questions, that are policy choices, then you have to ask the next question, will those goals be achieved by letting the marketplace and the marketplace alone both domestic and international operate without any action by our government. And if the answer to that question is yes, those goals will be achieved, without any action by our government to in any way favor or discriminate for or against the marketplace, fine. We again, need no policy. But if the answer is no, those goals will not be achieved by letting the marketplace operate alone. Then you have to come down to another question, the government must adopt a policy which tilts toward the achievement of those goals. And government policies can take many forms. They are not all tax policies. Build American. We require that all military ships be constructed in this country, although not commercial. And it has resulted, at least in some shipyards in this country having some capacity to build ships because they build military ships. We don't have the same policy for commercial ships and my guess would be, if we didn't have the same policy for military ships almost all of our ships would be built overseas.

Education, we have student loans both guarantees and direct, underwritten by the Federal Government because we think it is good that our children be able to be educated better than we were. Energy, we vacillate but by and large I think we would like to be energy independent and one of the arguments made by ___ Ford is the deduction of intangible drilling costs. Charitable contributions I run across very few people who say that is bad. And we continue to allow it by the deduction of charitable contributions from your income tax.

Healthcare, we encourage employers to provide it by not taxing the value of the premiums paid as income to the employees. As far as pensions, life insurance are concerned, we have IRAs and 401K pension plans and the non-taxability insurance inside buildups, all in the name of achieving goals that most of us share. Now there are a variety of ways to achieve the goals that we want.

Social Security is an example of the Federal Government collecting money and parceling it out according to the laws that we pass. On balance, however, I much prefer using the tax code for incentives to achieve the goals rather than government run programs to attempt to achieve the same goals. Good example, health insurance, healthcare.

I had the Joint Tax Committee, which is the professional committee that advised both Chairman Rostenkowski's committee and mine, as to the technicalities and details of the tax law, do a study for me on what it would cost the Federal Government to provide the same level of health coverage that most of you provide for your employees. Now just assume we wipe out employer provided plans and we substitute government paid-for health coverage. And I had them run that study because we are forever being beat over the head with the argument that, because we do not tax the value of health insurance premiums, as income to the employers, the Federal Government is losing $30 billion a year in revenue. About $22 billion in income tax and about $8 billion in Social Security tax. The Joint Committee's Study concluded that for the Federal Government, however, to provide the same level of health insurance that you now provide, it would cost the Federal Government about $100 billion a year. So by foregoing $30 billion in income, what we get is a population that has never asked for national health insurance in this country. I can go to any one of your factories, mills, my litmus test of course would be lumber mills, coffee shacks in Oregon. I get questions about property taxes and gun registration and abortion and women's rights, I get no questions about health insurance. I certainly get no questions about national health insurance. I get that question at the Harvard School of Medicine. Understandably, they have their priorities in the right order. If we pass it they get to run it. So they perfectly understand what they want to achieve. I was intrigued with a poll that Mr. Roper took recently asking, and it was a broad, broad cross-section, the following question; if your employer did not provide you with health insurance, how difficult would it be for you to afford to buy health insurance on your own? Very difficult, 61%, somewhat difficult 26%. Another question. If your employer did not provide you with a pension plan and increased your pay instead, would you save the same amount for retirement. Yes, would save the same amount, 26%, no, would not 68%. And what does that mean? It means that if you were not encouraged to do it, by tax incentives, and your employees did not do it, we would have in this country today, not just Social Security three times over, but National Health Insurance, and to the extent we encourage a variety of other social programs to be provided by employers, we have prevented from the Federal Government offering it at significantly increased costs, infinitely less responsibly. So when I ask about our goals and ask, do we want people to retire decently? Do we want them to have adequate health coverage. The answer from everyone is yes. My answer is, if that is the answer, then let's use the tax code and encourage employers and others to provide it rather than the Federal Government doing so. Now if you are not going to use the tax code period, just period. Boy that solves Dan and I a lot of problems. We can get rid of ACRS and the investment tax credit and capital gains preference and charitable contributions and the whole mortgage interest deduction, we can just get rid of the whole thing, go to a straight neutral code, period. And I bet you Dan and I both chuckle about those people who say, neither he or I want to do it because we like the power it gives us, and once we have to decide upon these questions and all the power it gives us, we like to that, take it away and we would become powerless committees. I bet you we would both trade all of the headaches we have, passing upon every one of those, for the slight loss in power that would come because we no longer passed on it. If we don't have employer provided health insurance and use the tax code as an incentive, if we don't have a variety of other tax incentive programs, then be prepared for a host of government spending programs like Amtrak, boy there is an example of well-spent money. And I don't mean necessarily between Boston and New York, or Los Angeles and San Diego, those are closer to mass transit programs than they are Amtrak programs. But you mean, can you get people to ride the train from Los Angeles to Chicago, other than to take their grandchild once to see the Rockies from a dome car, no you cannot. The Federal Government does not do anything other than one thing well. We collect money very well. We are adept at it, we have been doing it for a long time and it is hard to avoid us. We spend it very badly. And I have often wondered how our government run armies win wars. Until I realized that they are fighting against other government run armies. (Applause) You know the decision should not be, do we want accelerated cost recovery. The decision ought to be this, do we want a steel industry in this country? Yes or no. Maybe we don't want one. Maybe we do. But if we decided we want one then the next step ought to be, do we need quotas, do they need incentives to invest and recapitalize and in my mind that is deductive thinking. Do we want ship building; do we want health policies that cover most of our people? Other countries place their goals in priority. You know, for all of us who have been to China, or for those of you who have been to Russia, you are well aware that China and Russia have priorities. They downplay commercial office buildings and air travel, as far as passengers are concerned, and private autos. And they emphasize steel mills and passenger rail travel. They have their priorities. Anybody who has been to the Beijing airport is stunned by the fact that it is not much bigger than Kansas City. Because they just figure it is not worth their capital investment to provide an air travel infrastructure so that all of their citizens can travel about conveniently at relatively cheap rates from place to place on the plane. Maybe in 50 or 100 years they will change that philosophy as they advance.

All I am suggesting is that we too should have priorities. And this country cannot do everything for all of you and reduce the deficit. So maybe we need to decide questions like these. Do we have too many office buildings in New York City and Houston, should we change the rules involving real estate investment to slightly discourage investment in those areas and tilt it elsewhere? That is a legitimate policy question. But let’s not start down the road of syndicated partnerships in 35 members without understanding where it is we are coming out when we finish. Let’s ask the ultimate question first of what we want.

Now, in terms of the tax bill that is going to come before us, let me make it very clear. If the President wants a tax reform bill, he will get a tax reform bill. I sense that Chairman Rostenkowski and I may have some input into that, but there will be a tax reform bill if he wants it. He will have to sell it, but I will not underestimate the capacity of Ronald Reagan to sell what he wants to this country, and having sat in the leadership meetings with him, he wants a tax reform bill. He wants very much, and I share his philosophy, to cut the individual tax rates. If I had my preference I would cut the individual tax rates significantly further than he cuts them. But I would have a difference. Rather than making up the taxes, by increasing the taxes on capital and income, my preference would be to increase them on consumption in a tax neutral bill. I want it to be very clearly understood that I am not advocating tax increases. He wants a revenue neutral bill, I think the Chairman wants a revenue neutral bill, I want a revenue neutral bill, but if we are going to cut taxes some place they have to be raised someplace else and the taxes on capital and income are high enough in this country and we ought to be moving towards an additional tax base to reach a revenue neutral bill.

Now what is your job in all of this? In one form or another I could swear, if there are 1,000 of you here, I think I have met you all three times on one occasion or another, in my offices or in small meetings. I understand that your particular industry, whatever it may be, is the lynchpin of America. (Laughter) And without it, this country is gone. And all of you and all of your lobbyists ought to come to us and tell us how critical it is that you continue in business no matter what. Dan and I will then discount that by 90%, take the remaining 10% and try to put it in some kind of rational order for what we think are the goals that America should reach. The only thing that distinguishes Dan and I from the rest of you is that we have been elected to a position of political leadership and the minimum you have the right to expect is political leadership. Will you agree with us all the time? I hope not. Are Dan and I trying to do what we think is best for America, I know this man well, I can speak for him and I hope for me, the answer is yes. Will we make mistakes? You bet we will. But if we focus first on what the goals of America are, and separate the critical goals from the goals that would be nice to have if we could afford them, but they are not critical, and then we reason backwards from that as to what is needed to obtain those goals, then I think we will have success. And I think America will continue, I don't say regain, because we have never really lost that preeminence. We will continue the preeminence that we have. When I meet with the leaders of other countries or when you really meet with the military leaders of some of our major antagonists, and you ask either their political leaders deep down, or their military leaders, would they trade places with us, in terms of our power, our capacity, our innovation, our leadership, the real answer is you bet they would trade places with us. We have a system they can't match. All we have to do is understand that to continue that system we keep our head down and our eye on the ball and we will succeed beyond anything this world can touch. Thank you very much. (Applause)

F. Ross Johnson, Chairman: Thank you Chairman Packwood. And now from the other side of the aisle, on the other side of the Capitol Building, our other speaker this evening. Although Chairman Packwood and Rostenkowski belong to different parties, and occupy different chambers in Congress, they share a commitment to sound economics. Each in his own way is determined to trim the Federal deficit. There is still another similarity, Chairman Rostenkowski too, is a lifelong politician, having been elected to the Illinois General Assembly in 1952 at the age of 24, two years later he won a seat to the Illinois Senate. And since 1961 has represented the Chicago based eighth district of Illinois continuously in the U.S. House of Representatives. What this means is that he has been reelected 12 times, which indicates something about how his constituents regard him. Apparently he enjoys the same kind of popularity in Congress itself. He has served twice as Chairman of the Democratic caucus there and twice as Chief Deputy

Majority Whip, all of which would seem to bear out the *Newsweek* description of him as the Congressman's Congressman. One reason for this esteem, which he has held by Republicans as well as Democrats, according to one Reagan aide, Dan Rostenkowski is a key Congressman who has the President's respect and friendship. *Business Week* also took note of the Congressman's willingness to compromise, to give in on minor matters when bigger issues are at stake. However, there is one place that he refuses to compromise and that is on the golf course where he insists on pars, birdies and eagles. It was this policy of his that resulted a few weeks ago in his being on the winning team on the Pro-Am part of the Bob Hope Classic in Palm Springs and on behalf of all of us, Chairman Rostenkowski, congratulations. (Applause) For those of you who had trouble recognizing him out there, he was the one in the mask.

Before he speaks to us this evening, I would like to pose a question for him as one of America's top tax experts; it was first asked a few years back, by humorous Peg Bracken. What she wanted to know was, why does a slight tax increase cost you $200 and a substantial tax cut saves you $.30. Here possibly with the answer and then possibly not, is the Chairman of the All Powerful Ways and Means Committee, Chairman Dan Rostenkowski. (Applause)

Dan Rostenkowski

Chairman, Ways and Means Committee

Thank you Ross, Senator Packwood, members of the Economic Club, ladies and gentlemen, I might confess that, that Palm Springs where I exhibited my athletic prowess, I didn't have the courage to go up and get the trophy, however. Bob Hope remarked on television in my absence, well I guess he is in the confessional.

Tax reform is a noble cause. Like any genocide treaties and Flag Day proclamations, everybody is for tax reform. But choosing the individual parts of a sweeping reform is no easier than grabbing quick silver. The question that I put to you tonight is not so much whether we need tax reform, or want tax reform, but whether we can enact tax reform. The cause for tax reform has been stated many times, many ways, to some, it means spreading the burden more evenly, to others it means saving a trip to H & R Block. Some link tax reform with lower rates, some fear it will end up costing them money, others dread the fiscal uncertainty. To most, perfect tax reform is to have someone else's shelter torn down to pay for their tax cut. Building a national consensus around tax reform or more bluntly twisting enough arms on the floor of the House and Senate is a considerable challenge. Not just for Ronald Reagan, or my colleague Bob Packwood or Dan Rostenkowski, but for all of us who worry that the inequities and the inadequacies and excesses in the tax code will slow and perhaps halt the progress of recovery. Similar to a car with a soft tire. Tax reform ought to be done, tax reform can be done. All it takes is a lot of education, a lot of pushing, and a lot of negotiation, but all of it against the clock. As President Reagan put it, if not us, who? If not now, when? So far most tax reform proposals have been written in quiet chambers beyond the clamor of politics. Most are expansive, and provocative. Though at times they seem to complicate, rather than simplify. Parts of each plan truly defy administration, others beg fights that shouldn't be fought or can't be won. But then scholars and technicians tend to be far more courageous than politicians. But taken together, they contain most of the concepts that in my opinion will guide us. When Secretary Jim Baker sits down before the committee in two days, the Committee on Ways and Means, the campaign for massive reform will enter a new and more combative phase. From that moment on, tax reform moves from the cloisters into the coliseum. Without question, stakes are high; the Treasury plan would pick up an estimated $80 billion by 1990 and move it to other columns. Some groups and industries would be forced to give up a substantial number of tax breaks; others would gain enormously through rate cuts. But for most, the gain is a freer and simpler tax system. In a more perfect world, we could all agree with a series of guiding principles and then move quickly toward a balance that assures all parties long-term gains but this is a freewheeling democracy and not a perfect world. So instead of gathering for a common cause, corporations, trade groups, and unions, have already begun to mass under separate battle flags. Extend the research and development credit, save investment tax credit, head off the assault on capital gains treatment. Stop all taxes on fringe benefits. Powerful coalitions are a reality in Washington, where campaign contributions, direct mail fields and grassroots pressure have dramatically altered the deliberative process.

As the intramural competition for tax benefits intensifies, the code naturally becomes more convoluted as politicians seem to accommodate often contradictory interests. To most, the word tax reform suggests a benign campaign for fairness and simplicity. But to a relative few tax reform is a call to arms to protect lucrative tax breaks, no matter how unproductive, obsolete or excessive.

The last decade has provided ample evidence of a small number of people with a large amount at risk outflanking a larger number of people each with a small amount to gain. The making of tax policy is always done with good intentions. Stepping up capital formation, encouraging more public housing, promoting research and development. Often tax policy is borne of crisis. Energy credits to cushion another embargo. Safe harbor leasing to preserve basic industry. The all saver certificate for teetering S & L's. The tax code reads like an American History book. Chronicling our new uneven economic and social demands. Most were worthy in their time. Many are now outdated and unproductive. Sluicing cash from one sector to another with little concern for the ultimate economic consequence. To those who are preparing to stand against change I have a warning. Don't underestimate the public demands for reform. Not just in think tanks and among liberal tax lawyers, but in the great belt of middle income earners whose taxes are automatically withhold and sent off to Washington. Poll after poll reveals that far more than half the nation's taxpayers feel they are paying more than their fair share. That they are footing the bill left behind by those wealthy and facile enough to front the front-loading deductions. To defer income and turn ordinary income into capital gains. In essence a few get to play the pinball game, the rest put up the quarters.

This growing bitterness hasn't escaped President Ronald Reagan. He has bent it to his own political advantage for years and now he is riding a new spirit of populism that suddenly puts him on the side of the poor and middle income taxpayer, at the expense of big business and big personal wealth, particularly those who pay an extremely low rate of tax. After all, it is not to big business or the wealthy that this president owes his wide margin of victory, but to America's middle who so readily answered the call to protect traditional values like fairness. Those who are gathering to derail tax reform should recall the President's knack for dividing complex issues into simple parts. Good and bad. Fair and unfair. Givers and takers, and asking which side are you on. It is not beyond the President to ask television viewers across the nation why the most powerful special interests should...(CHANGED AUDIO SIDES)...that could unleash a potent backlash. Taken one at a time, proposals to limit tax expenditures would all be defeated. The only chance for tax reform is the promise for simplicity and rate reduction. If we give up that tension, that trade-off, we are lost. Our success in what's (48:54) to come will in my opinion depend on four factors.

First, we need a visible and vocal presidential commitment. It isn't enough to recite tax reforms litany in the State of the Union Address. He has got to bang the drum loudly. Keeping pressure on interest groups and Congress alike.

Second, we can't make side deals that remove certain tax breaks from play. I understand the anxieties of labor, governors, churches, business and others who stand to lose benefits under the current reform proposals. But we can't rule out any change in the beginning. Even the most popular and least rational. We have to start negotiations with everything on the table.

Third, we have got to begin the process where we are going to end. And that is in Congress. No ad-hoc group, no matter how august or powerful can replace the often rough and tumble legislative forum.

And fourth, if we are ever to reach a balanced reform plan we have to hue to a set of principles as we embark. We ought to agree to revenue neutrality. If we raise a dollar in reform, then we owe that dollar back in rate reduction. Whether for individuals or corporations. If budget cutting falters and the deficit becomes a national dread, then revenue may have to be raised in the future. But that is the President's call, not ours. We must not make the system less progressive or more progressive, that means maintaining the proportional share that each income class in our society pays. There is no time to shift the burden upward or downward. We have to pay for income tax cuts with income tax increases. This must be a zero sum gain. To pay for income tax cuts with the proceeds of another form of tax discounts the dollar for dollar trade-off between tax reform and tax cuts.

The paradox presented by tax reform is that free enterprise has a substantial price, especially for business. Getting government off your back in the last analysis means doing it yourself. Whether it is selling of airplanes abroad, salvaging a steel mill, or developing an advanced microchip, that is the simple truth that some find painful, even those who cry loudest for freedom of choice. The alternative is continued government intervention and more layers of social exceptions, exemptions, transitional rules, credits and deductions that erratically guide economic decisions. We can't have it both ways. We can't ask government to get off our backs and still extend a helping hand whenever time gets a bit difficult. Nor can we expect tax rate cuts without paying the price of reform. The price of reform, however, must be affordable. No one sector should be crippled by the elimination of present breaks. No person should be penalized tomorrow for doing something that is perfectly permissible today. The transition from the old code to the new code must be without abrupt and arbitrary changes. Transition rules will be a major concern in drafting such a proposal. The price of tax reform should also include a reprieve from massive annual shifts in taxation. Business has good reason to gripe about continued uncertainty. As Chairman, I hate to lead the committee back into a section of the code that we just finished rebuilding the last time around. Tax reform can't be a game of endless overtimes. If we successfully conclude a major tax over haul in this Congress, I would be the first to oppose any significant restructuring for the foreseeable future. Tax reform must be a bipartisan mission. We can't have one side promising tax cuts, and the other side left to raise the money to pay for them.

In the end, the measure of success will not be the weight of reform, but the balance of votes. While tax reform will be one of the central focuses of the Ways and Means Committee in the coming weeks and months, we cannot lose sight of the urgent need to reduce the budget deficit and eliminate the most serious threats to our median and long-term economic health. By the end of 1984 the Federal debt was equal to nearly 40% of our Gross National Product. And that figure could climb to 50% by the end of the decade if we don't take steps immediately to reduce the budget deficit.

Already we see that the cost of servicing our burgeoning debt is the fastest growing component of the budget. As the Federal government takes on an increasing share of the private savings generated here at home, we must import capital from abroad to satisfy the growing credit demands of business and government. Last year the capital sent here by foreigners was enough to finance about half of the federal budget deficit. Clearly, we need that capital to avoid even higher interest rates and a damper on economic growth. But this situation cannot continue indefinitely. And it already is harming some important sectors of our economy, primarily those that must export to compete with imports.

The enormous inflow of foreign capital to the United States are keeping the dollar at astronomical levels. While the budget deficit is not the only reason for a strong dollar, the strong U.S. economy and this countries political stability also are important factors. The budget deficit is the one fact that we can’t alter. Our trade deficit has doubled in size for each of the past three years. Last year, it reached an unprecedented $125 billion. Most analysts, including the Reagan Administration, blame the strong dollar for most of this drain. In essence economic recovery is bypassing our trade sector with serious implications for the future.

If we fail to reduce the budget deficit and thereby help bring the dollar to more reasonable levels, we will be ensuring the steady erosion of our manufacturing base as firms realize they must build plants overseas to escape the disastrous effects of a strong dollar on their international competitiveness. In short, the Federal Government can't go on running up its current spending on our exporters tab.

Gathered in this room tonight is the force for change. To most of us deficit reductions and tax reform are just causes. It makes sense to simplify the code and lower tax rates. Despite public testimony from business groups, few decisions in your world hang on any one provision of the tax code. For all the promise of the 1981 investment incentives, their impact is not clear. Clearly certain industries, like real estate development benefitted greatly, just measure the overhang of unused office space in Houston. But given the cost, the complexity, and bias, is more, better than less, or should we all begin the long task of rethinking and re-balancing federal tax incentives. If you agree with me that everyone must pay a certain price for reform, then you must also accept my invitation to work with us in Congress, not against us. Too often, I talk to heads of business who declare their support for reform, only to be attacked by their Washington lobby pursing the firms special interest with a vengeance. Too often the falconer never talks to his falcon. The result confusion, ill will and delay.

We only get a chance at profound reform every decade or so. Our Republican president seems prepared to back the struggle, if not lead the charge. Secretary Baker seems to be ready to ride. Congressional leaders, while rarely enthusiastic about projects which demand such painful choices, appear ready for or resigned to the long march. Tax payers are slowly but surely warming up to the rewards of reform. And we owe and woe to the politician that disappoints the tax payers. But without you leaders in the business world, the prospect for success is very tentative. If you can see beyond the battle flags of your own special interests, if you can reason beyond the hysteria of the moment, I am convinced that tax reform and tax freedom is within our grasp. It may be the last chance we all have for a long time into the future. Thank you very much. (Applause)

QUESTION AND ANSWER PERIOD

F. ROSS JOHNSON: Thank you Chairman Rostenkowski. We now come to that period in the tradition of the club where we have anointed two interlocutors who are trustees of the club to ask questions to both chairmen. On my right, we have Dr. Henry Kaufman, the Executive Director of Solomon Brothers and on my left, John Weinberg, Chairman of Goldman Sachs. We will start with Dr. Kaufman.

HENRY KAUFMAN: Chairman Packwood, you spoke very eloquently this evening, concerning priorities and objectives, whether our tax money should go to incentivize the giving money for charity, for energy independence, healthcare. You are the Chairman of the powerful Finance Committee in the Senate. How do you arrange your priorities? What do you believe the priorities ought to be? And what is most important and what is least important in the setting of these priorities according to your scheme of things?

ROBERT PACKWOOD: Henry, I have thought out the priorities in my mind, but I will tell you this, as gingerly as I can. I have discovered that the more I announce in public early, the less I have to trade later. So all I can say in terms of things that I have already given away anyway, so it doesn't matter, is that I do not understand how a nation can be great if it does not have what I would call a hard goods infrastructure and I don't care if you call that ship building or steel making, we are not going to be a major factor in this world if we say, well we can't compete in everything, so let's give cars to Korea, and steel to Brazil and textiles to Singapore and we will be good at something. The one thing we can be very, very good at is farming. I don't care how good Japan is at cameras or Germany is at cars, they cannot farm as well as we have and there is nothing wrong with that. But beyond that I am not prepared to say what my exact order of priorities are with this one exception. I feel so strongly that the government is so inept at the provision of social services that any bill that comes with serious taxation of broad-based employed benefits, I am talking about health, pensions, daycare, education. Not quirky fringe benefits that are limited to a few. Any bill that comes with a broad taxation on those benefits, I would find unacceptable, period, no matter what else was in it.

JOHN WEINBERG: Chairman Rostenkowski, in your judgement can tax reform and simplification as well as the necessary deficit reduction be accomplished at the same time?

DAN ROSTENKOWSKI: I have had varied signals as to just what is going to be proposed in this administration. I have also had some mixed signals from my brothers in the Senate as to when they were going to work on entitlement programs. I have made the statement publically and sometime shave been misinterpreted by one of the publications in Washington, that we will go through what I interpret a movement toward tax reform or simplification, keeping our eye for a period of time on revenue neutrality. But that once the budget of both the House and Senate is either agreed to or not agreed to, that the business community would be looking for some attack on deficit reduction. And that we can continue to move this locomotive on two tracks. But ultimately maybe not this year, but ultimately the deficit we will recognize is our largest problem and the possibility of revenues will be reviewed as necessary. I want to conclude my observation with the fact that I am hoping that the President will recognize this and that the Congress in my opinion will not move on anything without the leadership, the direction, and the solicitation of the White House. I honestly see no enthusiasm in at least the House of Representatives to do anything unless the President will march with us.

HENRY KAUFMAN: Chairman Rostenkowski, if I don't ask you a question and just alternate asking Chairman Packwood, I will never get to you. I would like to keep you on one track. The deficit reduction, for a minute. What is a reasonable legislative time table for deficit reduction measures? Another words could you describe to us people here in the business and financial community the procedure and the timing that will suggest to us that the process is on schedule or running off track?

DAN ROSTENKOWSKI: I am afraid that you are seeing the legislature confused and the symbol of uncertainty because he doesn't know whether or not there is going to be the joint effort. I feel about deficit reduction very strongly. I do, however, see no massive enthusiasm by my colleagues. What I am afraid happens, Henry, is that we have continually legislated in crises. I don't know that, that is the optimum, but until such time as there is the crisis that there is the recognition that interest rates will rise and that the bottom line is that because of the deficit I can't give you a time table. But I am afraid that the Congress has, by its recent history only moved when a crises was in existence and when truly those constituents of ours recognized that there is a need for the movement. I made in my formal remarks the need for education. I would join forces with anyone whether it is popular or not as a public official, to make, or to educate the constituency of these United States because I just don't see people accepting what is that glacier out there waiting to melt. And when that glacier starts melting, the streams in Illinois and Indiana and throughout this country are going to be overrun. That is what is going to happen, in my opinion, if we don't very seriously address deficit reduction. But as far as a time table, Henry, I am sorry, I can't give you that.

JOHN WEINBERG: Chairman Packwood, the modified flat personal tax rate proposal appears to have broad political support. What are its chances in your judgment of enactment in 1985 or 1986 and how is its revenue loss likely to be financed?

ROBERT PACKWOOD: The latter is irrelevant because the answer to the first part of your question is zero. (Laughter and Applause)

JOHN WEINBERG: Well I bombed on that one. Let me try another one.

ROBERT PACKWOOD: That isn't fair. You know whenever anybody asks me about the flat tax or tax reform and I bet you Dan you do the same thing. I ask the questioner what do you mean by the flat tax or tax reform because as I understand they don't mean the same thing I mean. A real flat tax is no deductions and a flat rate. I don't know if a modified flat tax means 10% , 20%, 30% or it means a flat rate but some deductions. So whoever asks, ask them what they mean. But this argument about simplicity I thought was best put in perspective by Henry Block of H & R Block. He polls a lot; obviously, he has some interest in what people think about taxation. And he was polling on simplicity. Now bear in mind, two-thirds of the people in this country file a 1040 or a 1040E or a 1040E with six or fewer deductions. They don't have a complicated tax. He was asking the question on simplicity and he got back about 75% who were in favor of it. He could not understand, until he grasped the fact that he was asking simplicity and they were answering fairness. That is what they heard when they heard simplicity. So he separated the question and asked them, are they interested in simplicity, qua simplicity from their standpoint, less than 5% gave a damn about simplicity from that standpoint. What they know, they absolutely know in their hearts, is that there are so many rich in this country who pay no taxes, that if you all paid just your fair share, their taxes would be lowered. I get letters every day from people that make $15,000 a year and a $150,000 a year, both wanting a flat tax because it is going to lower their taxes. It cannot work that way. Both ends of the teeter totter can't be up at the same time. Again, I had the Joint Committee do a wonderful study for me, how much money can we raise if we confiscate all of the income in this country above $100,000, and I mean, confiscate, gross income, I don't mean taxable income. We are going to take it all, $76 billion once, because nobody will ever make over $100,000 a year again. That is the end of that goose. And then I don't know where we go. So flat tax, understand that when people say simplicity they mean fairness. When they understand that a real flat tax means, I assume the taxation of the employer paid a portion of Social Security when they collect it, when they are 65, like all other pensions, when they discover that it means the taxation of all employee benefits, life insurance, health insurance, daycare, whatever else you got, my hunch is, they are going to say, that isn't fair. But until they come to the fairness concept, I understand the desire for a flat tax, but I do not think that you are going to see a flat tax in this Congress nor any modified, closely modified version of it, if by that you mean a real flat tax.

HENRY KAUFMAN: Chairman Rostenkowski, in view of the outcome of last year's national election, is there now a strong consensus view among the legislatures of your party as to how the budget deficit should be reduced?

DAN ROSTENKOWSKI: (Laughter) I was on the podium in a city by the ocean when my colleague said I am going to raise your taxes, he won't tell you, I just did. That was the first step in the wrong direction. (Laughter). Dr. Kaufman, there is in my opinion, no way, that we can avoid if we are going to be serious about deficit reduction, avoid raising revenues to do it. I don't see Democrats doing it. I don't see Republicans doing it. Unless there can be a bipartisan initiative, I don't see the Congress doing it. The problem is that elections don't conclude on the second Tuesday after the first Monday in November. And that in itself is the saddest element in this democracy. I would love to use, if President Reagan felt so, to use the initiative of the administration to insist that leadership on both sides of aisle in both chambers join forces and try to pound out a program that we can march through in a bipartisan manner. We as Democrats have a big problem. In some respects I don't think that the messenger was the problem in our election last November. I think it was the message that was the problem. And so, with I would say a strong committed bipartisan effort you could see something happening now. The charm and the shine of an administration, and I have been in Washington as Ross has pointed out, for longer than I want to admit, but the shine and the strength diminishes as you move away from inauguration day. I honestly believe that it is sad that we will move in the arena that I described a few minutes ago, that we will wait for the crisis. And I just think that we will do it, but it will only be after there is an evident crisis.

JOHN WEINBERG: Chairman Packwood, I will try again. Is it politically feasible in your judgment to expect this Congress to freeze the overall level of federal expenditures in the budget for fiscal year 1986 and two or three following years without a reduction in the projected levels for defense spending and reduction or postponement of the cost of living adjustments in Social Security, military and civil service pensions, and Medicare costs.

ROBERT PACKWOOD: No. That one really doesn't need any elaboration. If I take your premise of no freeze in the COLAs and no freeze on the military even in budget authority, are we going to reach the totals that anyone is talking about, the answer is no, not without including both defense and military retirement, civilian retirement, Social Security, Medicaid, Medicare, no, we cannot get there, I don't think, no, I know we can't get there. We don't have the votes period. And we don't have the votes among the Republicans in the Senate, let alone the Democrats in the House or anyplace else. We just will never get to first base.

JOHN WEINBERG: Are you implying that the administration will have to blink first?

ROBERT PACKWOOD: Well, now again, I want to characterize this carefully. I go to the leadership meetings; I think the President has already publically winked on the COLA's on Social Security and others. He hasn't said yes, but he hasn't said no. I mean, if we drag him kicking and screaming, he will go along. On the military budget, I don't sense that wink. I don't know what the President will do if this is the alternative. Let's say we are trying to cut $50 billion for starters next year, $50 billion real cuts. And the Congress and the President are only about $10 billion apart on the defense cuts, but let's say that we cannot get, and I think this is an accurate assessment, we cannot get the votes for the $40 billion in non-defense cuts without the additional $10 billion in the defense cuts. And Dan is absolutely right, if the President just says no, he is going to win. But what it means is, he is going to have $230 or $240 billion deficits instead of $180 billion next year for the first year because the votes are not there for the cuts in Amtrak and for the limitations in student loans for colleges and all those other domestic cuts unless the military bears what appears to be a fair share. And the decision is going to be his, much more than ours. And if he says I think the defense of this country is so critical, that we are better off with $230 or $240 billion deficits, but an adequate figure in my mind for defense, I think he will get it. If he says no, the deficit is a greater problem, and I will accept $10 billion more in defense cuts for the sake of getting $40 billion more in domestic cuts, you will get that, but it has to be his leadership and his call.

HENRY KAUFMAN: Chairman Packwood, while you are on your feet, a Wall Street publication reported this morning that your committee is considering the imposition of a flat minimum tax on interest earned on municipal bonds. Could you give us some further details on this, and how such a tax bill will fit into the tax reform?

ROBERT PACKWOOD: Henry do you have any personal interest in that? (Laughter and applause) One of the frustrations I have with the press is not that they misquote me, but that they quote me accurately on things I wish I hadn’t said. (Laughter) I don’t know where... are you talking about the bond buyer or whatever that publication is.

HENRY KAUFMAN: It is the Wall Street Letter, to be specific.

ROBERT PACKWOOD: Well alright, then it comes from some publication I have never heard of. In a meeting before the independent sector, which is the broad based umbrella group of all of the charities, I made a statement, I said, listen, you know my views on charitable contributions and I think they are good and I like what you are trying to achieve and by and large I have supported you in the past, but I am now in a position of Chairman and I can't look at just the two or three things I was interested in, I am now a Chairman and I have to look at the whole bill. But be that as it may, the one thing that we must have in this country is that everyone who earns some income must pay some tax and I don't care what their preferences are, charitable contributions, appreciated property or anything else. And someone in the audience said, well do you mean taxes on municipal bonds also, and I said, yes. Next day I see this headline in this publication I have never heard of, Packwood Attacks Municipal Interest. I suppose ultimately, Henry, the answer to that question is yes, because the reason my coffee shack workers and the lumber mill think the system is unfair is because of the stories they read about the people who pay no tax because they are taking advantage of legitimate preferences. We have reached the place where no matter how legitimate the preferences, they must pay some tax individual and corporate, so that we end those stories about people paying no tax and if we end those stories, 80% of the fervor to undo this system, which by and large has not worked badly, will disappear. So I guess the answer is yes. (Applause)

JOHN WEINBERG: Chairman Rostenkowski, the treasuries tax reform proposal reduces personal tax receipts and increases the taxation of business on balance. Wouldn't that reduce the investment in the economy and lower our long-term economic growth rate as well as impact our countries competitive stance worldwide?

DAN ROSTENKOWSKI: There are those that have that view, but I just like to bow to what my colleague Senator Packwood has suggested. We have a proposal that has been issued by the Treasury Department. I have not endorsed it, I don't know that Jim Baker has endorsed it. But until such time as we have Mr. Baker who will appear before our committee on Wednesday, I don't know what we will be doing in the business area. I do agree that there is going to be the debate takes place in the committee as well if this emanates from the committee to the floor about whether or not investment and business incentives will curtail opportunity. But I do think that, that is a legitimate issue to be debated, but we have given through some of our colleagues in both the Senate and the House, the impression to the general public that rates would be lowered. And this is contagious. We also have had a constant criticism that government should get off of our back. I hasten to suggest that it just isn't federal government that has aggravated our society, it is government generally. And so I have made a commitment to my governor who has a surplus in his treasury that we will do everything we can in the Federal Government to see to it that Illinois will shoulder the burdens that are necessary in one particular area like enterprise zones. And I think that this is the smoke and blue mirrors. We have a situation where our President suggests that enterprise zones would be the answer to a decaying core of the city. I don't know that, that is the solution. But I do know it costs money. I don't know that tuition tax credits won't help 70% of my community, but I do know it costs money. And so in an area that I find a great faith in and they certainly trust me, I think that my people are willing to make that sacrifice. What we have to establish in investment, in trying to balance the budget is the realism that you can't talk about reductions in services and saunter off before 10,000 Catholic nuns and talk about tuition tax credits. That is just unfair. I think government has, for too long a time, created an atmosphere of solving all of the problems. I would like to see Illinois and New York and Connecticut and California and Washington and Oregon solve some of their own problems. And I hope that before I terminate my service in Washington, that the states will stand up and be counted and relieve us on the federal level from the obligation of the constant revenue sharing that they all expect so much.

HENRY KAUFMAN: Chairman Rostenkowski, is a tax on oil imports an attractive alternative to raising federal revenues particularly if per chance the price of oil would decline further?

DAN ROSTENKOWSKI: I have...I am one of the rare individuals that about seven or eight years ago, not only voted for, but initiated an increase in taxes on energy. I think that is definitely going to be discussed. There is a movement in Washington, a very serious movement in Washington about a tax on imports in the energy area and I should imagine that, that will become more and more visible as we continue through the debate in Washington. But I should suggest that with the price that we are now paying for gas, it certainly is an area that I think we should recognize there is a possibility that they too are going to be considered and I should imagine, not sleep too comfortably.

F. ROSS JOHNSON: That was the last question. We would like to thank Chairman's Packwood and Rostenkowski, in the tradition of the Club and thank our interlocutors and what we do for the gentlemen from Portland and from Chicago is present a remembrance of the Big Apple here and how much you contributed to this evening. Let's hear it for them. (Applause)
The meeting is now adjourned. The next meeting is April 1st.

End of Meeting