

BOARD REPORT

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U.S. CHAMBER OF COMMERCE
BOARD OF DIRECTORS MEETING

WEDNESDAY, NOVEMBER 12, 1986

SLIDE 1: CHAMBER LOGO

NOW THAT TAX REFORM HAS BEEN RESOLVED, THOUGH NOT QUITE AS WE WANTED, OUR ATTENTION SHOULD FOCUS ON THE REAL BURDEN OF GOVERNMENT ON THE ECONOMY--THE HIGH LEVEL OF FEDERAL SPENDING. RISING FEDERAL EXPENDITURES AND THEIR IMPACT ON THE ECONOMY SHOULD BECOME THE MAJOR FOCUS OF ECONOMIC POLICY FOR THE REMAINDER OF THE 1980S.

SLIDE 2: FEDERAL SPENDING VS. RECEIPTS

THE SHEER SIZE OF THE FEDERAL BUDGET, NOW OVER A TRILLION DOLLARS, HAS CAPTURED THE PUBLIC'S EYE. NOT SURPRISINGLY, THE GROWTH IN THE FEDERAL BUDGET DEFICIT COINCIDES WITH THE GROWTH IN SPENDING. SOME PEOPLE ARGUE THAT THE DEFICIT IS A RESULT OF A SHORTFALL IN REVENUES AND BLAME THE TAX CUTS OF 1981 FOR THIS FISCAL IMBALANCE. BUT THE TRUTH IS THAT REVENUES HAVE REMAINED RELATIVELY CONSTANT AS A PERCENT OF GNP. IT IS SPENDING THAT HAS CAREENED OUT OF CONTROL.

SLIDE 3: FEDERAL SPENDING AS A PERCENT OF GNP

FEDERAL SPENDING AS A PERCENT OF GNP REMAINS FAR ABOVE

HISTORICAL LEVELS, NOW AVERAGING CLOSE TO 24 PERCENT OF GNP COMPARED TO THE 20 PERCENT AVERAGE FROM 1964 TO 1979, AND THAT WAS WHEN THE FEDERAL GOVERNMENT WAS PAYING FOR THE "GREAT SOCIETY" AND A WAR. THIS FOUR PERCENTAGE POINT INCREASE ALMOST EXACTLY MATCHES THE GROWTH IN THE DEFICIT.

SLIDE 4: GRAMM-RUDMAN-HOLLINGS DEFICIT TARGETS

THE ENACTMENT OF THE GRAMM-RUDMAN-HOLLINGS BALANCED BUDGET ACT WAS A STEP IN THE RIGHT DIRECTION TOWARDS CONTROLLING EXCESSIVE SPENDING. MORE IMPORTANTLY, IT REFLECTS THE CONSENSUS IN THIS COUNTRY THAT THE SIZE OF THE FEDERAL GOVERNMENT MUST BE REDUCED AND SPENDING CUT BACK. THE GRAMM-RUDMAN TARGETS REQUIRE A BALANCED BUDGET BY 1991. BUT THE FEDERAL DEFICIT WAS \$220 BILLION IN FISCAL YEAR 1986, \$48 BILLION ABOVE ITS GRAMM-RUDMAN TARGET FOR THAT YEAR. THIS MEANS THAT NEXT YEAR OUR ELECTED OFFICIALS WILL BE UNDER SEVERE PRESSURE TO MEET THE MANDATED \$108 BILLION DEFICIT TARGET. MANY WILL CLAIM THAT THE JOB CANNOT BE DONE WITHOUT--YOU GUESSED IT--AN INCREASE IN TAX RATES.

SLIDE 5: ANNUAL SPENDING GROWTH

THE GRAMM-RUDMAN-HOLLINGS ACT HAS ALREADY HAD A POSITIVE INFLUENCE IN IMPOSING SOME BUDGET RESTRAINT. ANNUAL FEDERAL SPENDING GROWTH SLOWED IN 1986. WHILE THIS PROGRESS IS ENCOURAGING, THE WAR AGAINST EXCESSIVE SPENDING IS FAR FROM OVER. IT IS CLEARLY

A WAR IN WHICH THE WEAPONS ARE NOT EQUAL. IT IS A WAR OF CANNONS VERSUS SPEARS. THIS IS BECAUSE THE ANTI-SPENDING FORCES DO NOT HAVE THE ARMS THEY NEED, SUCH AS THE LINE-ITEM VETO OR THE CONSTITUTIONAL BALANCED BUDGET AMENDMENT.

SLIDE 6: SPENDING AND ECONOMIC GROWTH CHART

FURTHER REDUCTIONS IN FEDERAL SPENDING AS A PERCENT OF GNP ARE CRUCIAL RIGHT NOW IF WE ARE TO ACHIEVE RAPID ECONOMIC GROWTH. ONE THING IS CLEAR: FAILURE TO CONTROL THE GROWTH OF PUBLIC SPENDING IS ASSOCIATED WITH ECONOMIC STAGNATION, AS ILLUSTRATED BY THIS CHART.

AS THE DIAGRAM ILLUSTRATES, AT VERY LOW LEVELS, GOVERNMENT SPENDING WILL INCREASE ECONOMIC GROWTH BECAUSE PUBLIC SERVICES THAT ARE ESSENTIAL FOR MARKETS TO OPERATE (SUCH AS A JUDICIAL SYSTEM AND NATIONAL DEFENSE) ARE PROVIDED. HOWEVER, AS GOVERNMENT SPENDING AS A PROPORTION OF GNP CONTINUES TO INCREASE, THE PUBLIC GOODS AND SERVICES BEGIN TO CROWD OUT PRIVATELY PRODUCED GOODS AND SERVICES. ADDITIONAL GOVERNMENT PROGRAMS BECOME LESS AND LESS EFFICIENT IN PROVIDING NET BENEFITS OF REAL VALUE AS COMPARED TO THE PRIVATE SECTOR. SOCIETY'S RESOURCES BECOME LESS EFFICIENTLY UTILIZED--OUTPUT GAINS BECOME SMALLER--AND CITIZENS ARE INCREASINGLY REWARDED FOR NONPRODUCTIVE BEHAVIOR. WE NEED ONLY LOOK TO EUROPE TO SEE THE EVIDENCE OF THE RELATIONSHIP BETWEEN GOVERNMENT SPENDING AND ECONOMIC GROWTH. THE NEXT CHART ILLUSTRATES THIS RELATIONSHIP FOR ALL MAJOR INDUSTRIAL COUNTRIES.

SLIDE 7: ECONOMIC GROWTH AND SPENDING IN MAJOR COUNTRIES 1974-84

BETWEEN 1974 AND 1984, IN THE OECD COUNTRIES, THE HIGHER THE LEVEL OF GOVERNMENT SPENDING AS A PERCENT OF GDP, THE LOWER ECONOMIC GROWTH. IN OTHER WORDS, THE COUNTRIES WITH LOWER GOVERNMENT SPENDING BURDENS ENJOYED HIGHER ECONOMIC GROWTH.

THIS DOES NOT APPLY ONLY TO THE LARGER INDUSTRIAL ECONOMIES. THE 15 SMALLER OECD EUROPEAN COUNTRIES ALSO FACE THE SAME PROBLEM. IN THOSE COUNTRIES WITH A SMALLER PUBLIC SECTOR, REAL ECONOMIC GROWTH AVERAGED 4.9 PERCENT BETWEEN 1965 AND 1969. BUT WHEN COUNTRIES HAD A BURGEONING PUBLIC SECTOR, THE AVERAGE REAL ECONOMIC GROWTH RATE FELL TO 1.6 PERCENT FOR THE PERIOD 1980 AND 1984.

SLIDE 8: MAJOR INDUSTRIALIZED NATIONS' PUBLIC SPENDING AS A % OF GDP

OUR EUROPEAN NEIGHBORS HAVE CLEARLY TRAVELLED MUCH FURTHER DOWN THE PATH OF PUBLIC SPENDING THAN WE HAVE. WHILE TOTAL PUBLIC SPENDING IN EUROPE IN THE 1960S AVERAGED 33 PERCENT OF GNP, SIMILAR TO JAPAN AND THE U.S. TODAY--IT IS NOW OVER 50 PERCENT OF GNP.

SLIDE 9: AVERAGE REAL GDP GROWTH FOR OECD EUROPE

WELL, THE EUROPEANS COULD BRAG ABOUT THEIR BRISK ECONOMIC GROWTH IN THE 1960S AND EARLY 1970S, YET THEIR ECONOMIES NOW BREED STAGNATION. REAL ECONOMIC GROWTH PLUMMETED TO LESS THAN 1 PERCENT

BETWEEN 1980 AND 1984. WHILE OTHER FACTORS, SUCH AS INCREASED ENERGY PRICES IN THE 1970S AND THE WORLD RECESSION IN THE EARLY 1980S, HAVE CERTAINLY AFFECTED EUROPEAN ECONOMIES, THE CONTINUED ECONOMIC DETERIORATION IN EUROPE LONG AFTER VIGOROUS RECOVERIES IN THE LESS HEAVILY TAXED U.S. AND EAST ASIAN COUNTRIES SUGGESTS THAT GOVERNMENT ABSORPTION OF RESOURCES AND HIGH MARGINAL TAX RATES ARE INDEED THE PRIMARY PROBLEM.

SLIDE 10: SPENDING AND UNEMPLOYMENT RATE 1974-84

PERHAPS THE CLEAREST DIFFERENCE IN NATIONAL PERFORMANCE, AT LEAST IN HUMAN TERMS, IS THE NUMBER OF PEOPLE EMPLOYED IN THESE INDUSTRIAL COUNTRIES. BETWEEN 1974 AND 1984, THE U.S. EXPERIENCED THE SMALLEST INCREASE IN BOTH TOTAL GOVERNMENT SPENDING AS A PERCENTAGE OF GNP, AND ALSO EXPERIENCED THE SMALLEST INCREASE IN THE UNEMPLOYMENT RATE. IN CONTRAST, THE MAJOR WESTERN ECONOMIES EXPERIENCED DRAMATIC INCREASES IN PUBLIC SPENDING AND UNEMPLOYMENT RATES.

I THINK IT IS A GOOD BET THAT MEASURING THE PRECISE ECONOMIC IMPACT OF AGGREGATE GOVERNMENT SPENDING--AND OF SPECIFIC GOVERNMENT PROGRAMS--ON JOB CREATION, STANDARD OF LIVING, AND ECONOMIC GROWTH WILL BE THE MAJOR FOCUS OF ECONOMIC POLICY IN THE COMING YEARS.

SLIDE 11: CURRENT TAX LAW VS. NEW LAW TOP TAX RATES

SPENDING REDUCTION IS OF COURSE IMPORTANT, BUT TO INSURE

ECONOMIC VITALITY, IT MUST GO HAND IN HAND WITH LOW LEVELS OF TAXATION.

THE NEW TAX LAW HAS CAUSED SOME CONCERN WITHIN THE BUSINESS COMMUNITY BECAUSE OF THE UNCERTAINTY ASSOCIATED WITH THE NEAR TERM ECONOMIC IMPACT OF THE BILL. THE TAX REFORM ACT OF 1986 SCALES BACK AND REPEALS MANY TAX CREDITS AND DEDUCTIONS THAT WERE INTRODUCED INTO THE TAX CODE OVER THE PAST FEW DECADES, IN EXCHANGE, AS YOU KNOW, IT REDUCES MARGINAL TAX RATES ON PERSONAL AND CORPORATE INCOME.

SLIDE 12: IMPROVE CAPITAL COST RECOVERY

RESTORE CAPITAL GAINS DIFFERENTIALS

REINSTATE FULL FOREIGN TAX CREDIT

CONGRESS STILL HAS THE OPPORTUNITY TO GUARANTEE A LONG RUN POSITIVE ECONOMIC OUTCOME TO THE TAX REFORM ACT IF IT IMPROVES CAPITAL COST RECOVERY, RESTORES CAPITAL GAINS DIFFERENTIALS, AND FULLY REINSTATES THE FOREIGN TAX CREDIT.

SLIDE 13: TRADE WEIGHTED VALUE OF THE U.S. DOLLAR

MOVING AWAY FROM FISCAL POLICY ISSUES, LET ME SHIFT YOUR ATTENTION TO THE NEAR TERM OUTLOOK FOR THE DOMESTIC ECONOMY. THE CONVERGENCE OF TWO EVENTS, THE CONTINUED SLIDE IN THE VALUE OF THE U.S. DOLLAR AND THE COLLAPSE OF OIL PRICES, HAS SIGNIFICANTLY IMPROVED THE OUTLOOK.

SLIDE 14: PERCENT CHANGE IN DOLLAR EXCHANGE RATES

THE TRADE WEIGHTED MEASURE OF THE DOLLAR MASKS SIGNIFICANT DIFFERENCES IN ITS VALUE VIS-A-VIS PARTICULAR TRADING PARTNERS. FOR INSTANCE, THE DOLLAR HAS DEPRECIATED SHARPLY AGAINST THE GERMAN MARK AND JAPANESE YEN. AT THE SAME TIME, IT HAS NOT DECLINED IN VALUE WITH RESPECT TO MANY CURRENCIES SUCH AS THE CANADIAN DOLLAR, TAIWAN DOLLAR AND SEVERAL LATIN AMERICAN CURRENCIES, FROM WHICH A LARGE SHARE OF OUR IMPORTS COME. WE MIGHT, THEREFORE, EXPECT TO SEE A NARROWING OF THE TRADE GAP WITH THOSE COUNTRIES WHOSE CURRENCIES HAVE APPRECIATED AGAINST THE DOLLAR AND NO IMPROVEMENT IN THE TRADE DEFICIT WITH THOSE WHOSE CURRENCIES HAVE NOT CHANGED.

SLIDE 15: MERCHANDISE TRADE DEFICIT (MONTHLY)

NEVERTHELESS, A SLOW BUT SURE TURNAROUND IN OUR MERCHANDISE TRADE DEFICIT IS NOW EVIDENT. THE DROP IN THE AUGUST AND SEPTEMBER U.S. TRADE DEFICIT HAS REKINDLED HOPES THAT A TRADE TURNAROUND IS OCCURRING AND WILL SPEED ECONOMIC GROWTH NEXT YEAR. INDEED, THE RAPID GROWTH IN IMPORTS IS NOW TAILING OFF AND EXPORTS ARE EXPECTED TO PICK UP IN 1987. MANY TRADE ANALYSTS NOW PROJECT A \$30 BILLION REDUCTION IN OUR TRADE DEFICIT NEXT YEAR.

SLIDE 16: REAL GNP PROJECTIONS (ANNUAL)

TO SUM UP: MOST OF THE UNCERTAINTY IN THE ECONOMY HAS TO DO WITH HOW INDIVIDUALS AND BUSINESSES WILL RESPOND TO TAX REFORM. WE EXPECT REAL GNP TO RISE BY 2.6 PERCENT THIS YEAR AS THE BENEFICIAL EFFECTS OF LOWER OIL PRICES ARE OFFSET SOMEWHAT BY REDUCED INVESTMENT SPENDING DUE TO TAX REFORM CONSIDERATIONS. GROWTH SHOULD BE STRONGER IN 1987 AS THE TRANSITION TO LOWER TAX RATES IS COMPLETED.

SLIDE 17: MARKED DECELERATION IN INFLATION

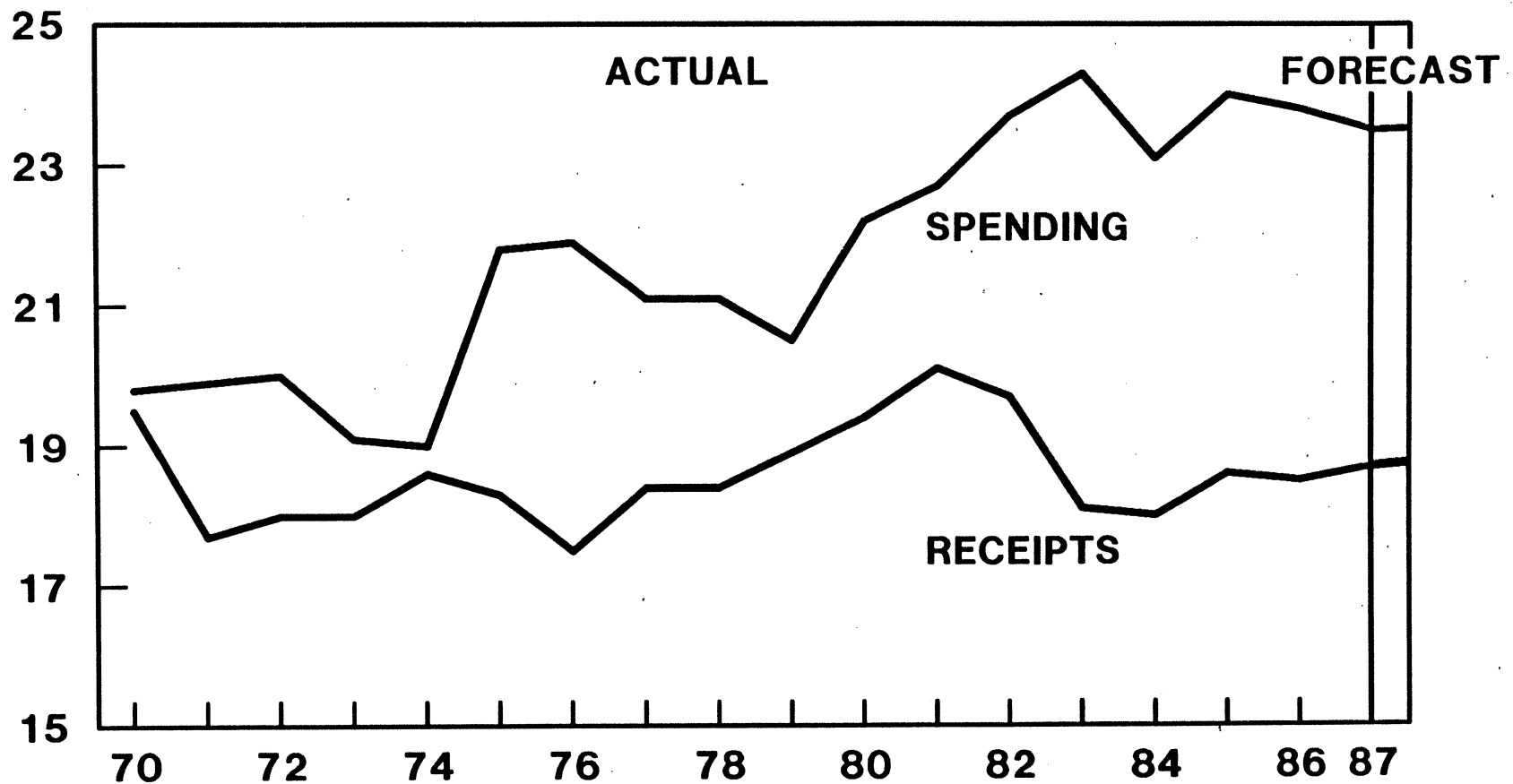
SEVERAL FACTORS, INCLUDING LOW MONETARY VELOCITY, MODERATE WAGE INCREASES, LOW LEVELS OF CAPACITY UTILIZATION AND THE DROP IN OIL PRICES WILL HOLD THE LINE ON CONSUMER PRICE INCREASES, KEEPING INFLATION IN THE 2 TO 3 PERCENT RANGE THIS YEAR AND NEXT.

ON THE TABLE AT THE BACK OF THE ROOM YOU WILL FIND COPIES OF THIS PRESENTATION AND THE ECONOMIC OUTLOOK.

THANK YOU.

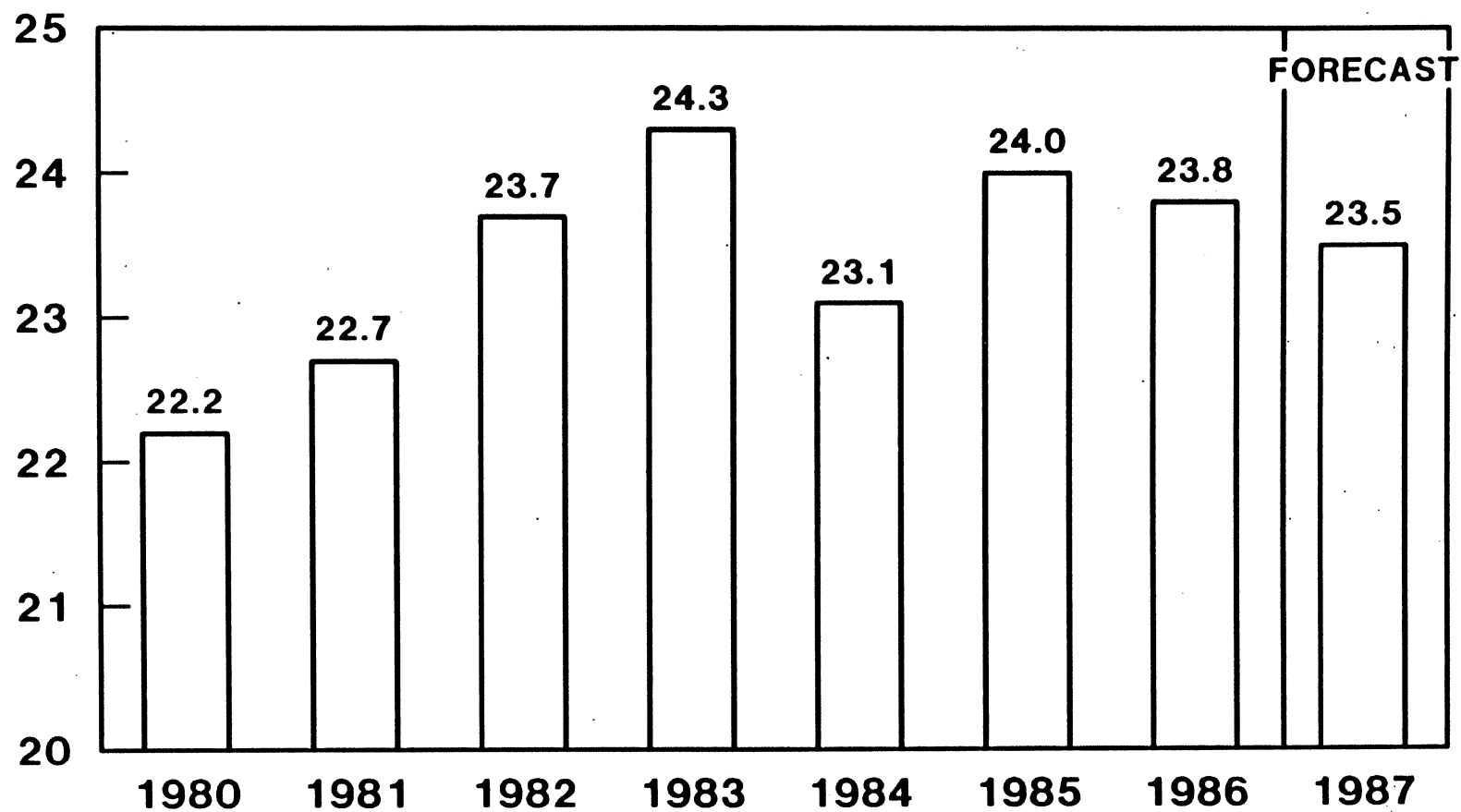
FEDERAL SPENDING AND RECEIPTS AS A PERCENT OF GNP

PERCENT



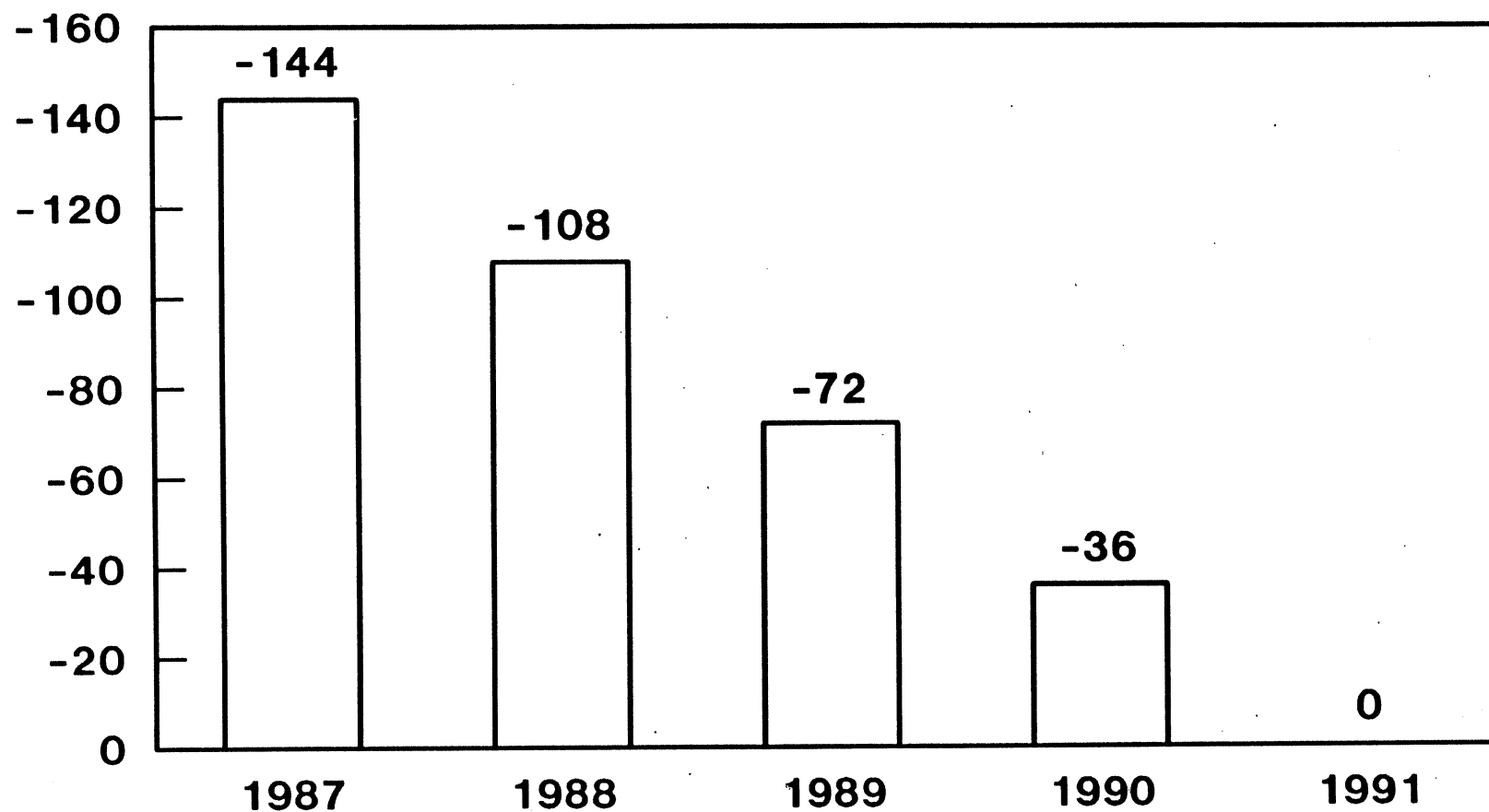
FEDERAL SPENDING AS A PERCENT OF GNP

PERCENT



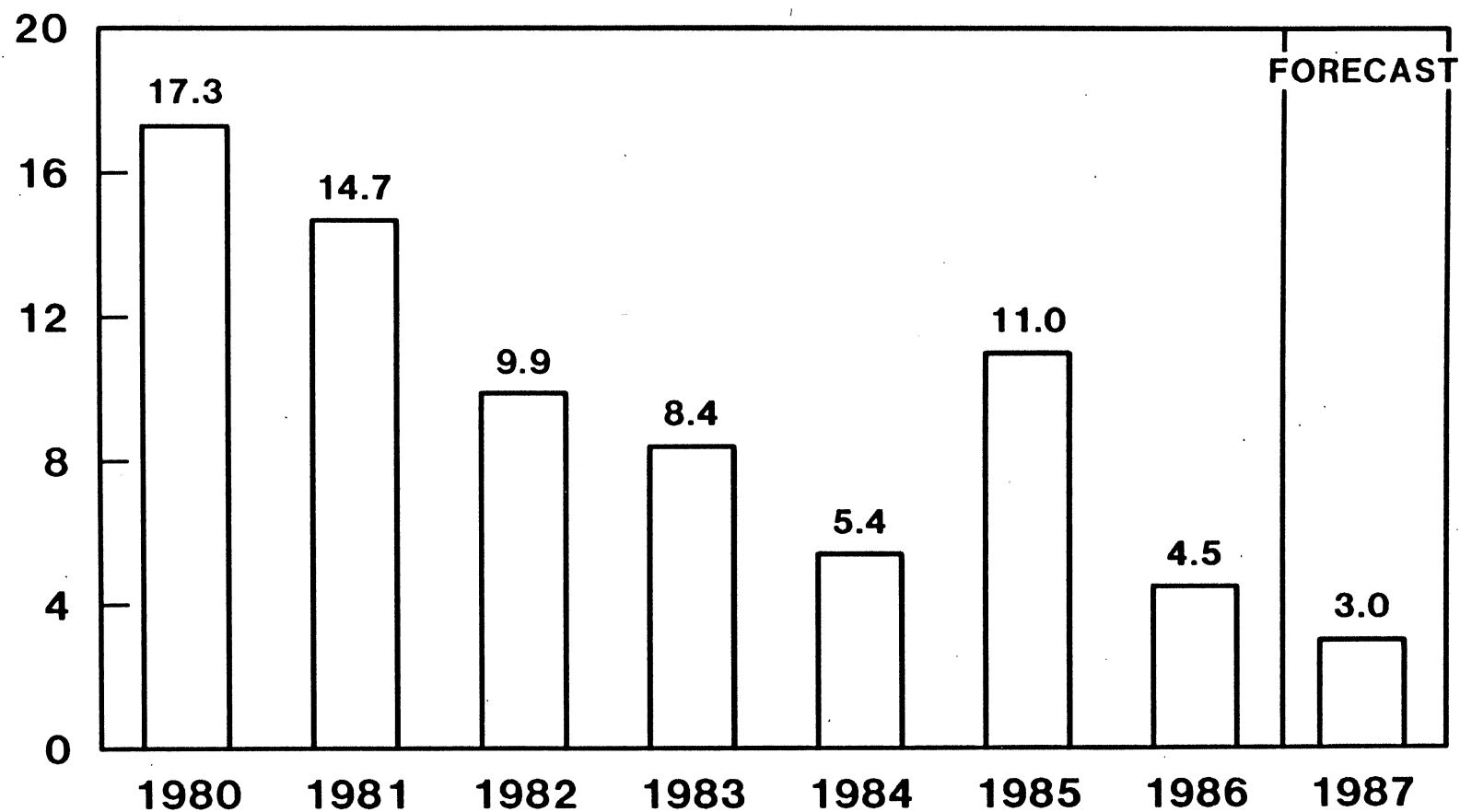
DEFICIT TARGETS UNDER GRAMM-RUDMAN-HOLLINGS ACT

BILLIONS OF DOLLARS



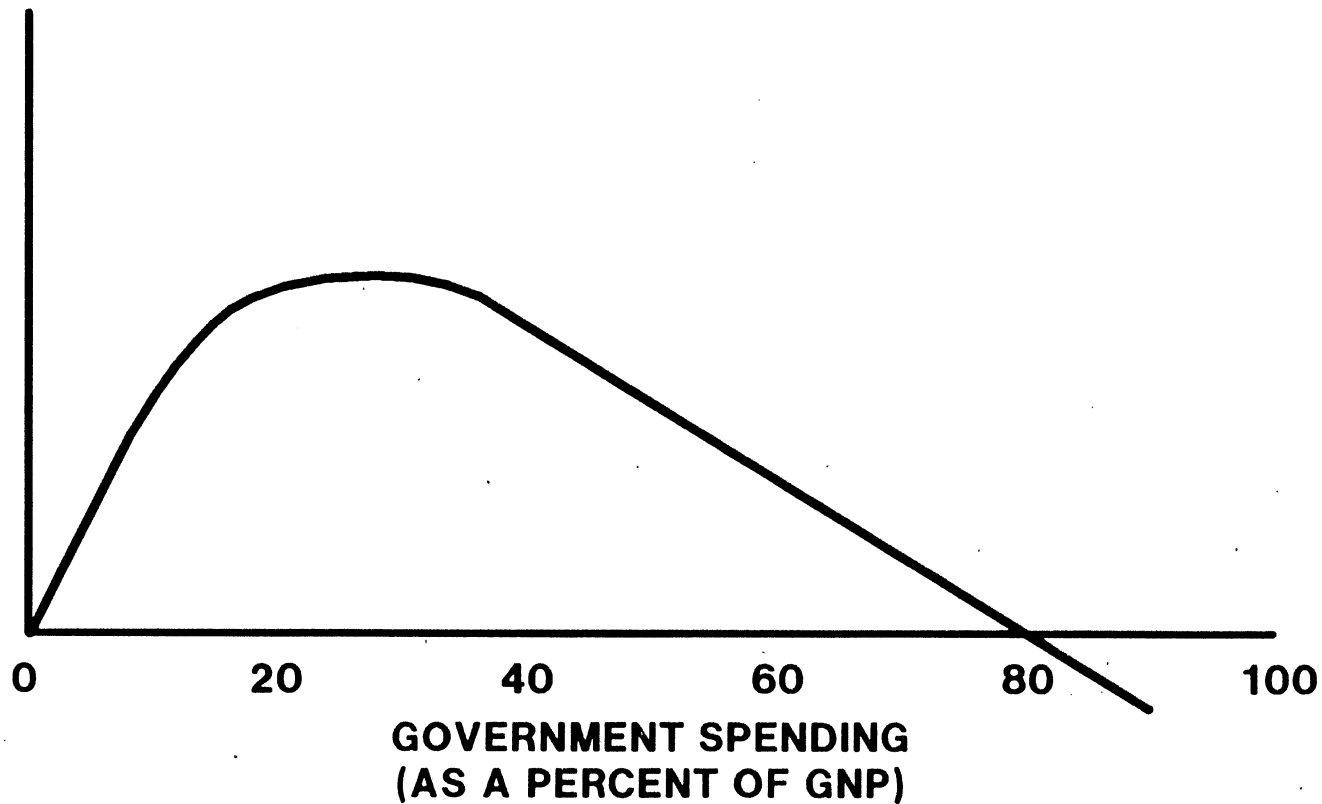
ANNUAL SPENDING GROWTH

PERCENT CHANGE

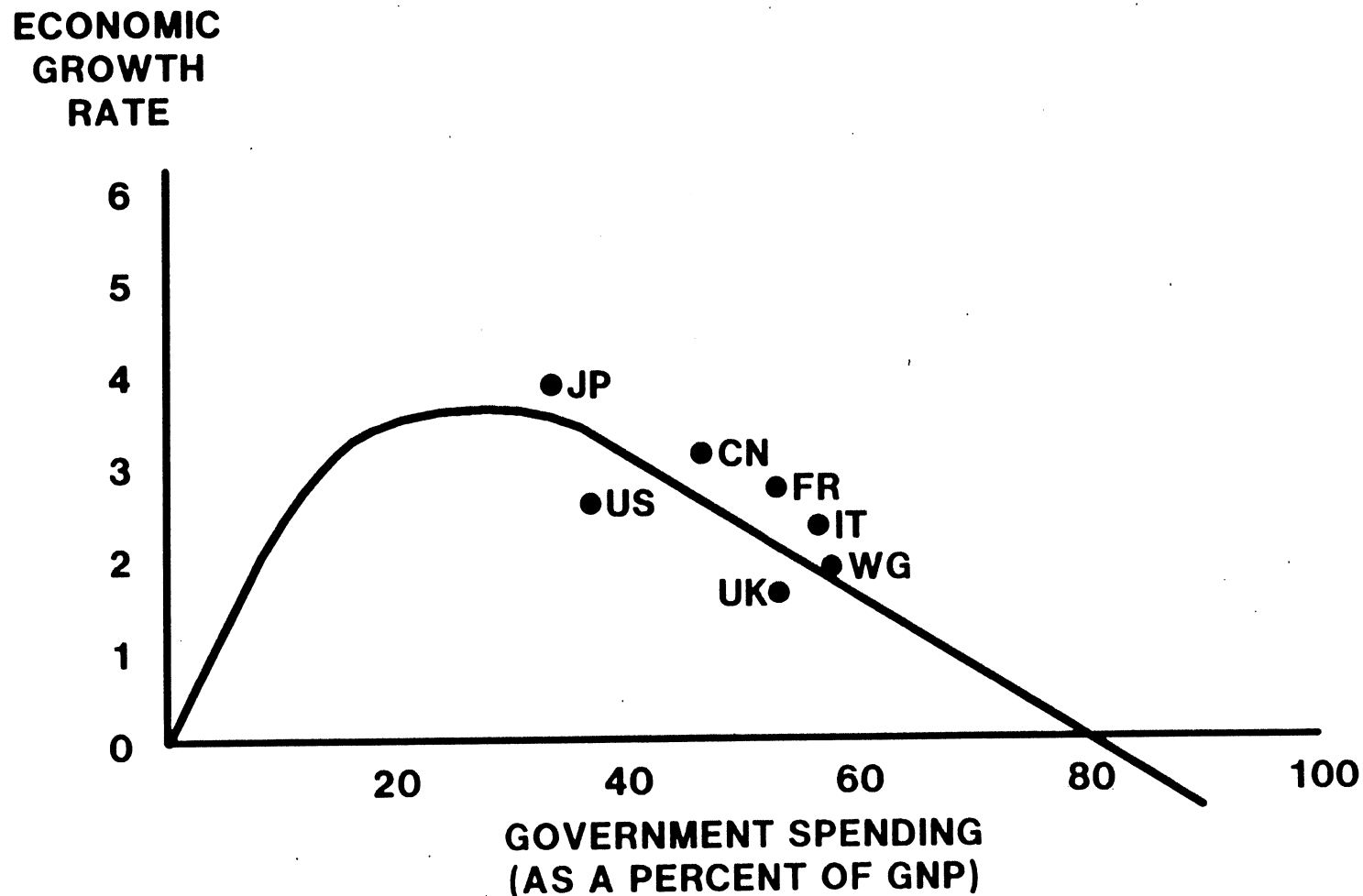


GOVERNMENT SPENDING AND ECONOMIC GROWTH

ECONOMIC
GROWTH
RATE

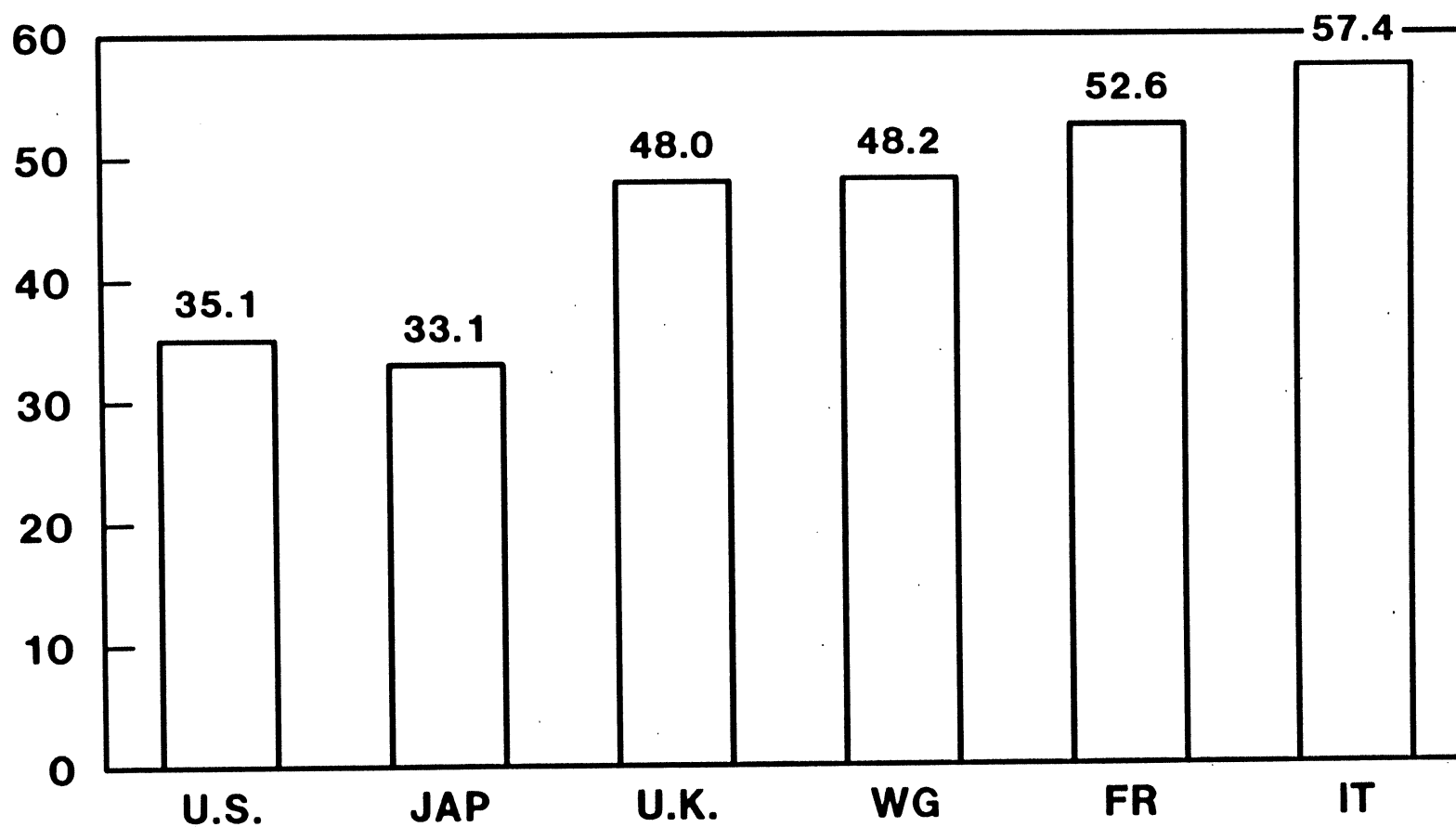


GOVERNMENT SPENDING AND ECONOMIC GROWTH IN MAJOR COUNTRIES 1974-1984



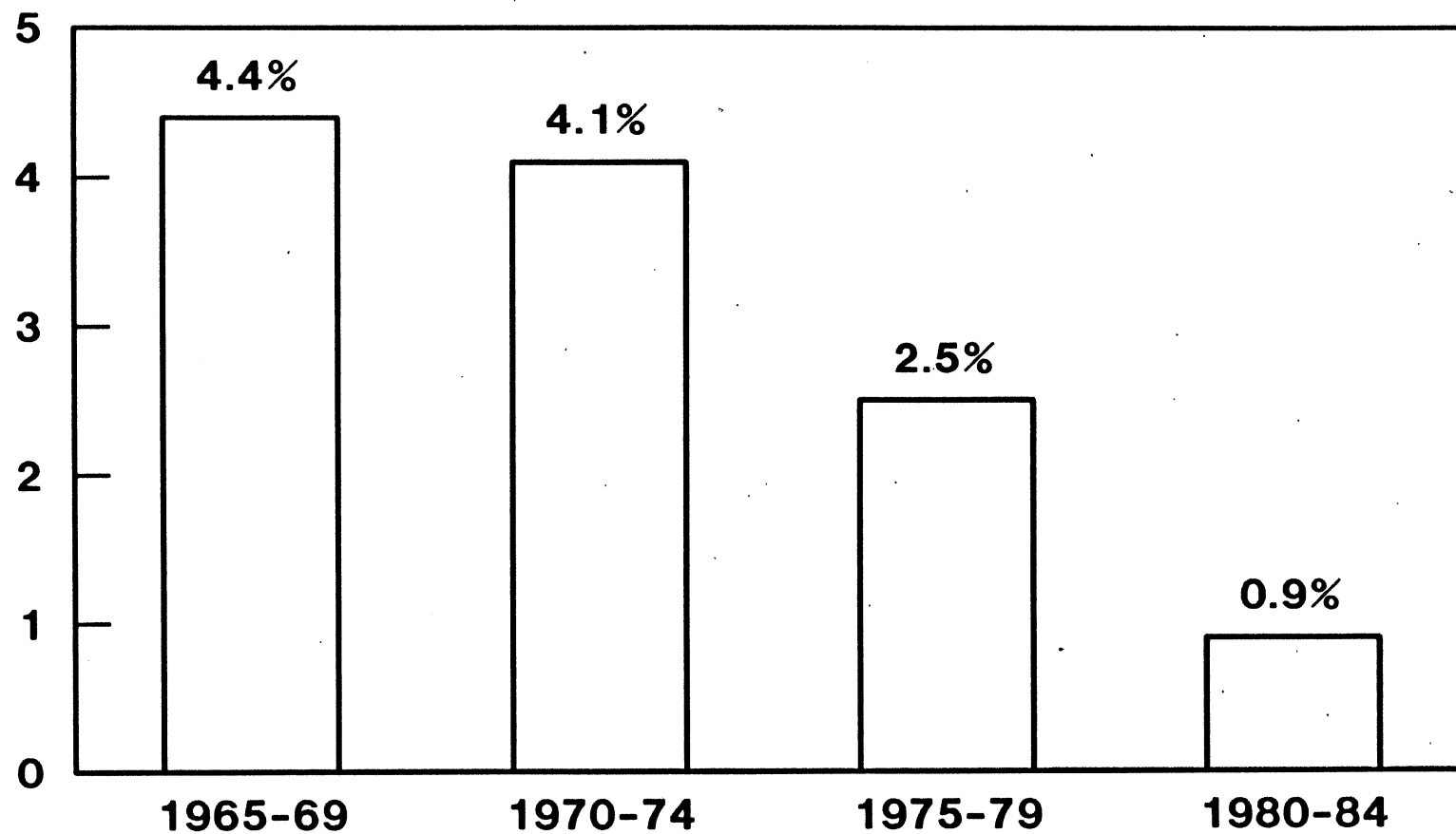
TOTAL GOVERNMENT SPENDING AS A PERCENT OF GNP 1984

PERCENT



AVERAGE REAL GDP GROWTH FOR OECD EUROPE

PERCENT



PUBLIC SPENDING AND CIVILIAN UNEMPLOYMENT

1974-1984

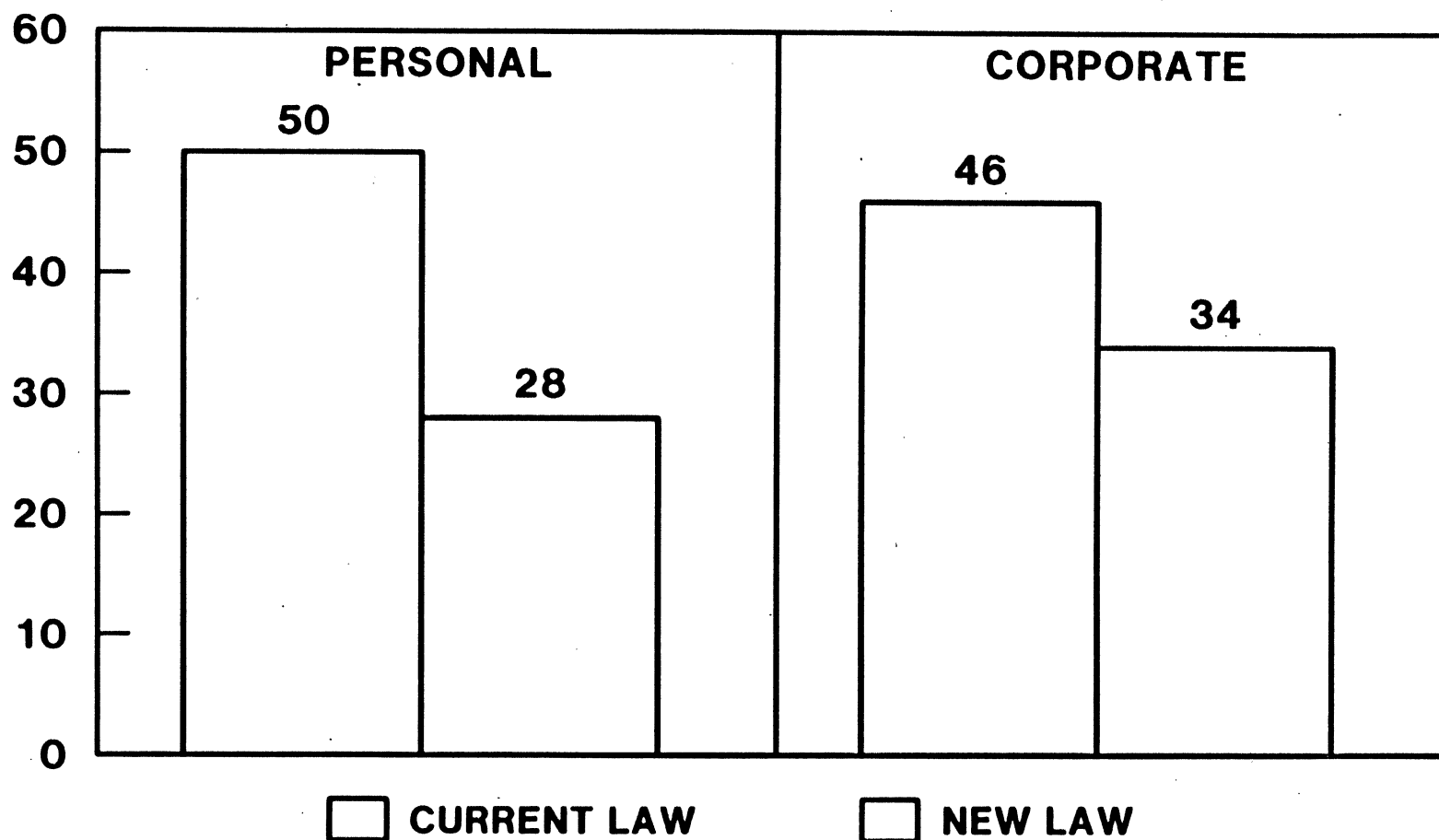
GROWTH IN PUBLIC SPENDING AS A PERCENT OF GNP

GROWTH IN CIVILIAN UNEMPLOYMENT RATE

U.S.A.	6.3%	34.5%
JAPAN	35.1	92.8
ITALY	66.8	92.4
FRANCE	46.5	246.0
U.K.	24.0	319.0
GERMANY	24.2	431.0

PERSONAL AND CORPORATE TAX RATES

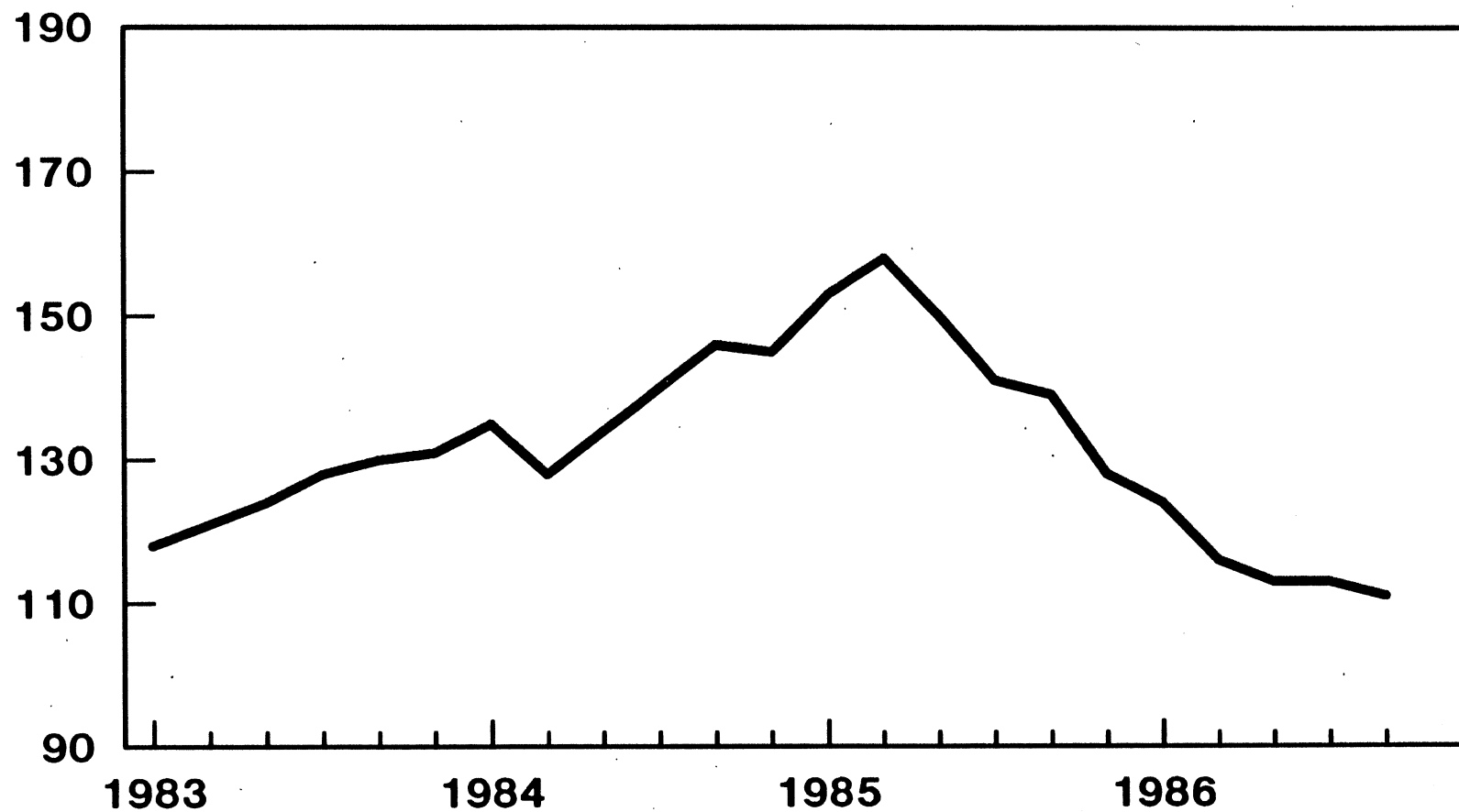
PERCENT



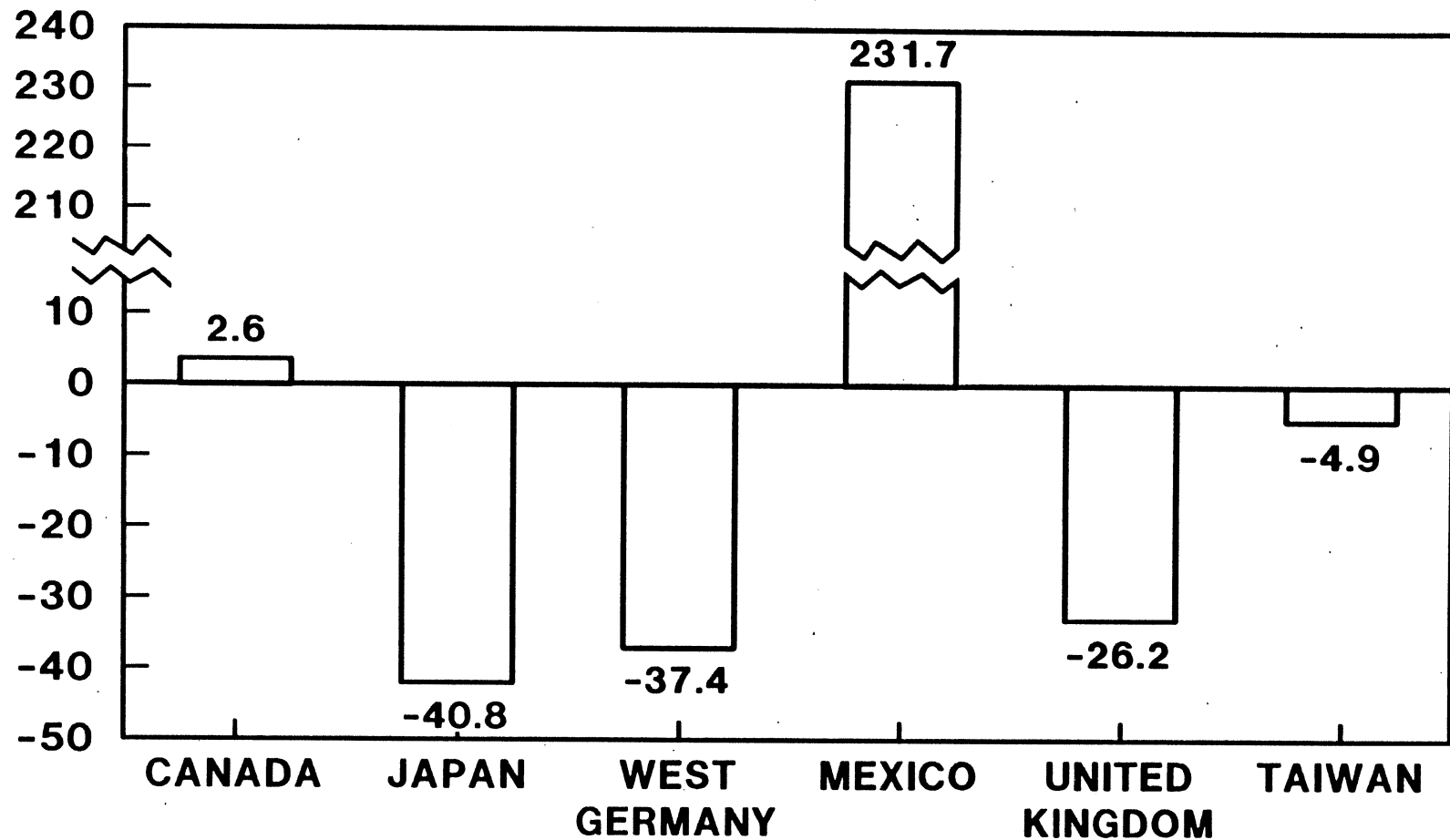
- **IMPROVE CAPITAL COST RECOVERY**
- **RESTORE CAPITAL GAINS DIFFERENTIALS**
- **REINSTATE FULL FOREIGN TAX CREDIT**

TRADE WEIGHTED EXCHANGE VALUE OF THE U.S. DOLLAR

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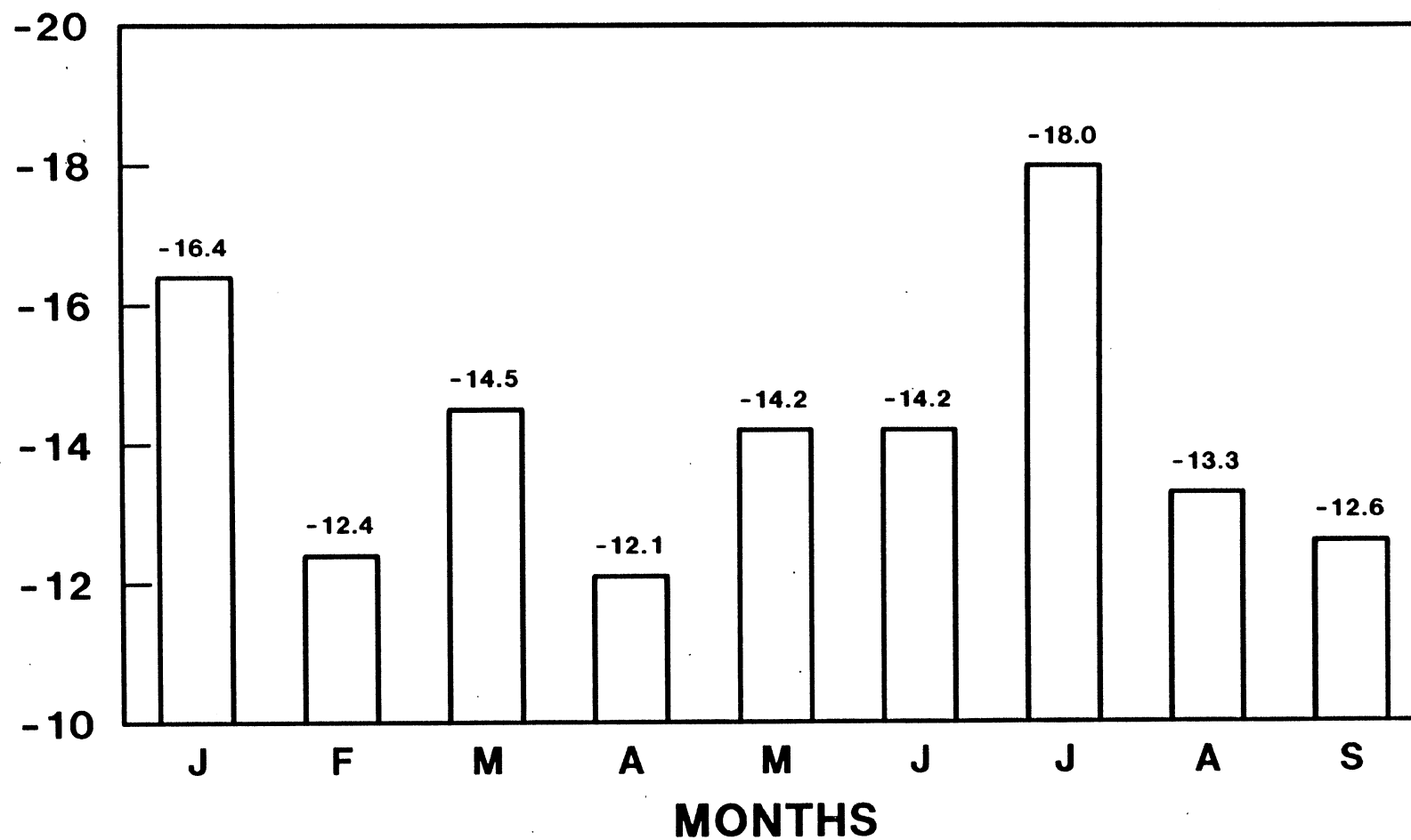
PERCENT CHANGE IN DOLLAR EXCHANGE RATES FEBRUARY 1985 TO AUGUST 1986



MERCHANDISE TRADE DEFICIT

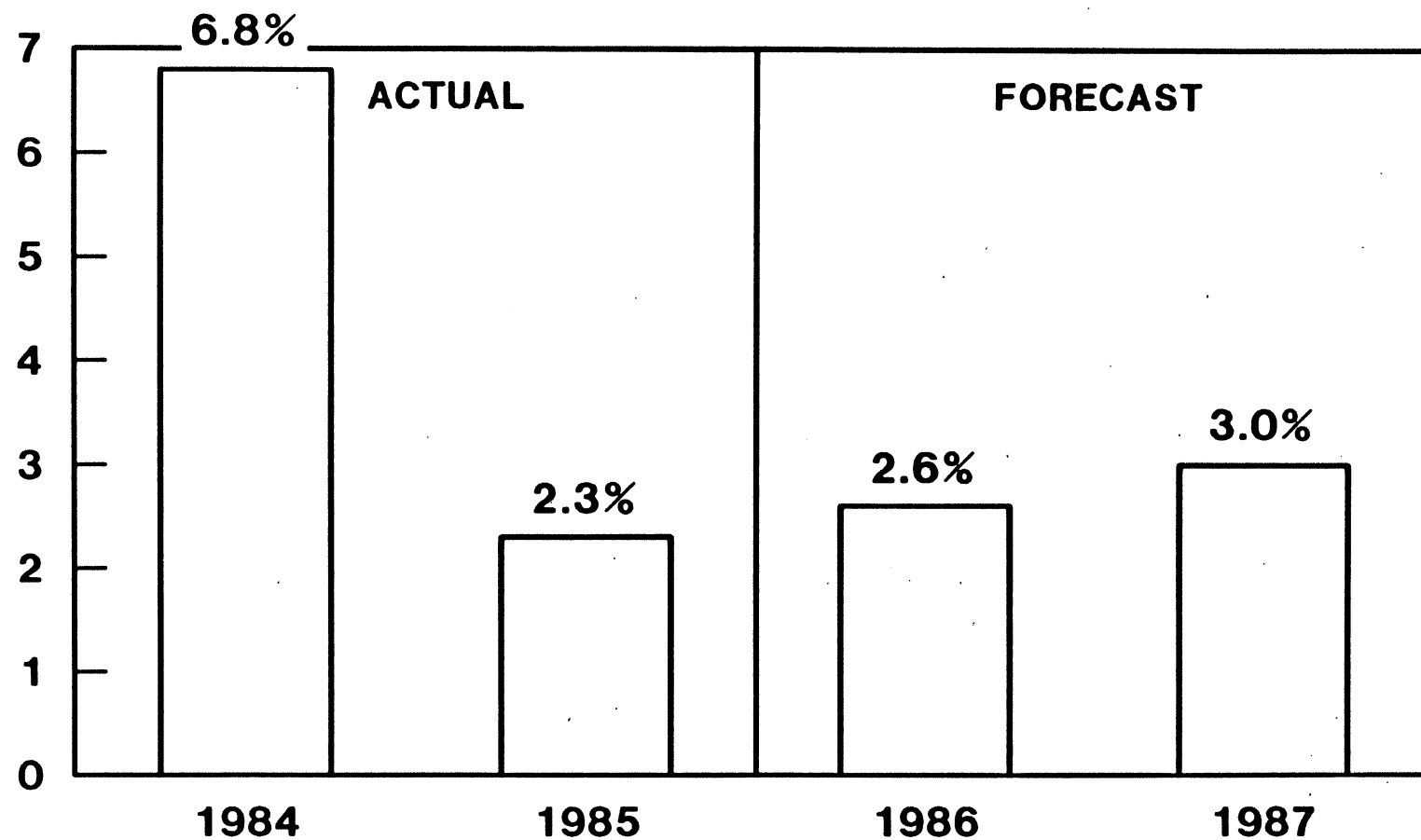
1986

\$ BILLIONS



REAL GNP GROWTH

PERCENT CHANGE



MARKED DECLINE IN INFLATION 1980-1987

PERCENT CHANGE

