The Economic Club of New York

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Introduction

Chairman, Peter G. Peterson

Ladies and gentlemen, our first speaker this evening is David Stockman. You can applaud, now, that will fine. (Applause) It is said in Washington that you don't really need a computer if you have David Stockman's telephone number. In truth, there is no computer that can store so much data and retrieve it so quickly, as I am sure you are going to discover this evening. In fact, David, at IBM I understand that you are the personal model and inspiration of a new super computer, that is so advanced that it has even impressed the Japanese (laughter). As I contemplate the grotesque out-year deficits which I know trouble David Stockman, you can see where this group is coming from David, which I know trouble David as much as the rest of us. He may have another capacity and skill that may be even more important, I am referring to the less known fact that Dave is a product of the Divinity School. So if things don't work out on the supply side, (laughter) we have a good candidate here for robotic dial a prayer. (Laughter)

Many of you have forgotten that it was in June of 1981 that I was scheduled to be a co-speaker with David Stockman. Another budget crisis intervened on that occasion, and he was unable to come. Dave, I want you to know that I was enormously relieved and told the audience that being paired with you in front of the Economic Club made me feel like Alexander Haig at a convention of English teachers. (Laughter)

President Reagan apparently shares both my admiration and my apprehension. Let me finish here. Dave made his first impression on the President when he stood in for both Jimmy Carter and John Anderson (that is an assignment) in rehearsals for the Presidential Candidate Debates in the fall of 1980. President Regan has said that the only debates he ever lost were to David Stockman. But there is much more to David than his forensic rhetorical skills. We are seeing today in the budget, or perhaps I should say, non-budget, discussions that rhetorical spending restraint comes much more easily and painlessly than genuine spending restraint. Our speaker tonight, I can tell you from personal experience, is for real restraint. He is also a genuine wonder kindred. At 36 years of age, he has already served four years in the Congress, and has been the youngest member of the Cabinet in this century, for the last two. So David if I can mix my political metaphors, we all sleep better knowing that you are in that job. Mr. David Stockman. (Applause)

David Alan Stockman
Director, United States Office
of Management and Budget

Thank you very much ladies and gentlemen, and Pete, let me say first, that I understand when I missed last time, you gave most of my speech on that evening. And I am a little apprehensive. However it is obvious that you didn't use any of my jokes. So I will proceed along that line. (Applause and laughter)

Let me begin by announcing that Chairman Dole and I tonight will follow the usual division of labor that he and I engage in when we jointly address occasions of this sort. He will supply the jokes and the taxes and then I will address the problems and the spending in my remarks. Then, afterwards in the next round, I will take any questions that any of you may have on politics or any aspect of policy, and then he will take any tips that any of you may have on what bank stocks are going to go up after they repeal withholding. (Laughter)

Of course, if you don't like what either of us have to say, I just want to note that we are prepared to depart on a moments notice off the roof from a helicopter, supplied through....a Coast Guard helicopter supplied by the Chairman's wife, and the catch, Bob is, she only put enough gas in it to get us to Newark. So maybe we will stay here and hold our ground instead.

Now I understand that the time is very limited, so let me launch my basic proposition tonight, and that simply is that the budget and the massive prospective deficits that we are all worried about has become, in my mind, the hapless victim of twin forces of truly historic proportion. The first of these is the monumental unprecedented process of rapid disinflation and a $3 trillion economy that we have gone through for two years and that is still underway.

And the second is the now obvious political legislative gridlock over the proper mix of spending and revenue measures required to cope with the enormous and unexpected budgetary consequences of disinflation that is underway. To be sure comprehension of these forces will not make them go away. But it can help pierce through the confusion and the partisan finger pointing that now impedes a solution, and hopefully help you and all of us to get some better grasp on why we are fixed in this situation that we face today.

As for the first proposition on the enormous and adverse affects on the budget of this disinflation that we have gone through, I think a simple comparison of two budget plans, now barely 30 months old, suffice to illustrate the case I am making here tonight. Had the path of the economy played out as envisioned by the Carter administration's lame duck budget planners in January of 1981 and had their policy combination of 5% real defense growth, modest tax cuts, and status quo domestic spending levels actually been implemented over the succeeding time, the FY-84 budget would have shown a $32 billion surplus as they then envisioned it. But under that very same fiscal plan as proposed by the outgoing Carter administration, and under the actual economy which has unfolded in the last two years, that $32 billion surplus would have collapsed into $189 billion deficit in 1984 reflecting the massive shift in the path of the economy that has already occurred during the last two years and that is forecast for the two years ahead.

Likewise had the four year budget plan been implemented as proposed by this administration, by the Reagan administration, barely two months later in March 1981, including the full 30% tax rate cut in ACRS. Real defense growth rates about twice the Carter level and drastic curtailments of domestic spending commitments, the 1984 deficit would have been $193 billion, almost the same number, compared to the $189 with the economic path that actually emerged in the period since then, and that we see ahead of us, as opposed to the $1 billion surplus in 1984 that we envisioned when we laid out original fiscal plan.

Now the point of this comparison is that both would have ended up somewhere in the $190 billion range in 1984. Is that neither the fiscal policy mix of this administration, deep spending cuts, enormous rollback in the domestic spending commitments and a substantial buildup in defense, nor the radically different balance of fiscal priorities embodied in the outgoing Carter budget, neither of these are the original culprits as to the magnitude of the underlying structural deficit that we are coping with in 1983, 1984, and the years beyond. The culprit in my judgment, the culprit in the first instance, is an economic path that has unfolded radically unlike any forecaster envisioned, even in his wildest imagination only 30 months ago.

Again, I think a single statistic dramatizes that reality. The Carter economists projected a 1985 level of GNP and of course that is what determines the revenues, at 4.5 trillion. We originally projected 1985 GNP at 4.4 trillion. But the current consensus of CBO or the administration or any number of outside forecasting firms is for a 1985 GNP of only 3.8 trillion, a figure 500 to 600 billion smaller, despite an assumed strong recovery in the months ahead. And at bottom it is this half trillion dollar shortfall in the GNP in 1985 and the years beyond, that is the story of the unexpected precipitous collapse of inflation that has already occurred and the six quarters of severe recession which accompanied it.

To be precise the Carter economists over predicted the 1985 real GNP by 5% and the cumulative inflation over that 5 year period by 85%. We over-predicted the 1985 real GNP by 8% and the cumulative inflation over that 5 year period by 46%. My point tonight is that the adverse budgetary consequences of this have been profound because the type of sudden, pervasive disinflation we have experienced has proven to have radically asymmetrical, radically asymmetrical affects on the revenue and outlay sides of the budget. On the outlay sides, the loss from lower output and higher unemployment are roughly offset by the gains from lower inflation and COLA or Cost of Living Adjustments. For instance, compared to our original budget plan of March 1981, COLA costs, as we now project them over the '83, '86 budget period, four years, will be $63 billion lower and unemployment costs will be $59 billion higher, almost a wash.

But on the receipt side of the equation lower output and lower inflation occurring at the same time work in the same direction. Autos not produced, or inflationary incomes not taxed, because they didn't occur, both yield lower revenues and immediately without the long lags built into the spending side of the budget.

Thus, the recovering but dis-inflated economy that we now forecast for 1985 would produce $163 billion less in revenue in that year than the tax policy as we forecast it with the economy we saw in March 1981. Likewise, that same economy that we now see for 1985 would produce $226 billion less in revenue in that year, than the wholly different 1985 tax policy proposed by the Carter administration in January 1981 with a much different view of the economy as well.

Moreover these dis-inflationary revenue shortfalls are cumulative, and if uncorrected, they build up permanent debt service charges at startling rates. And that is one of the forces driving budget disequilibrium we are facing at the present time.

The cumulative revenue shortfall over ‘83 to ‘86, four years, due to this shift in the path of the economy would be $622 billion for the Reagan administration tax policy and GNP forecast of March 1981, and $821 billion for the Carter tax policy and GNP forecast of January 1981. In turn the annual added debt service charges associated with these cumulative revenue shortfalls, would be $52 billion, and $67 billion respectively, by 1986, as a result of what I have described. And this is a permanent annual outlay cost that will not go away until an era of budget surpluses emerges out of the misty and distant future.

So in my mind, it is clear, as to where the problem came from. By early 1981, the federal budget was living on borrowed time, on unsustainable rates of inflation, and in erroneous notions as to the swiftness, the depth and the output loss associated with the disinflation that had to come. And just as debtors everywhere have been stranded high and dry by the subsequent dis-inflationary plunge of the economy, so has the federal budget. And our problems, like theirs, have been essentially one of choosing between raising prices, which is to say taxes or cutting costs, which is to say spending, to bring cash flow back into line.

And it is this fundamental fiscal choice that is the source of the second historic force at work that

I mentioned at the outset, the gridlock that now literally grips federal fiscal policy. Moreover the sequence of fiscal events, over the last 22 months indicate that this gridlock has been steadily intensifying in response to each new round of efforts to contain and reverse the disinflation generated growth of estimated deficits.

I have kept a mental score sheet on the 1985 current services deficit projections from July 1981 forward, that we have used internally, that tracks the unfolding of the economies dis-inflationary path that few could understand or divine at the time. In round numbers the 1985 annual deficit projection, was $80 billion in September 1981. The ‘85 projection was $150 billion by December, $200 billion by April 1982 and the current services projection was up to $250 billion by December of 1982. And at each benchmark the administration proposed a major policy response to contain these escalating projections and at each point the legislative outcome foretells the emergence of the present paralysis that we must find some way to break. The first response was the so called September Offensive, a 12 % across the board cut in non-defense discretionary spending. But when that was proposed, by the fall of 1981, the spending cut ardor was beginning to wane on Capitol Hill and the result was a vetoed continuing resolution, a temporary shutdown of government that many of you recall, and an eventual compromise at half the proposed savings. The second round came with the FY-1983 budget in February 1982. The administration then proposed deep extensive reductions in both entitlement and discretionary spending that totalled $190 billion over the three years of 1983 to 1985, four times more than the modest revenue raisers contained in that same February of 1982 budget.

Our FY-83 budget strategy thus came down preponderantly on the cost cutting side to cope with the spiraling deficit. In response, the Congress dug in its collective heals, rejecting cuts of this magnitude with an outpouring of indignant rhetoric. But as the spring season passed last year, a process of negotiations went forward behind the scenes, even while the public current services deficit projections continued to rise and cross the $200 billion mark by late May.

In June, the compromise of 1982 was eventually reached with the Congress. For the three year period, 1983 to 1985 the compromised budget resolution and fiscal plan worked out with the Congress called for a fiscal mix, substantially different than what we had originally proposed in February. It included $46 billion in three year defense savings, compared to none that we had proposed. It included $100 billion in three year tax increases, double what we had proposed. It included $80 billion in non-defense savings, less than half of what we had originally proposed. And of course, other savings for debt service and expected lower interest rates. Thus, as things appeared in the summer of 1982, the dis-inflationary deficit problem was being contained because a temporary political accommodation on the mix of measures to cope with it had been reached. By the time of my fourth benchmark, however, in December 1982, two things were clear. One the current services deficit for 1985 was even larger than we had previously projected in the $250 billion range, because the recovery had not yet commenced at that time, and because inflation continued to plunge.

Secondly, Congress was seriously welching on the 1982 compromise as it became apparent that less than one-third of the three year non-defense savings would actually be achieved. Nevertheless after much internal debate and soul searching, the President approved in January an FY-84 budget plan that called for five year deficit reductions built along the lines of the compromise that we had reached with Congress the previous summer.

In summary, for the five years, the budget that we proposed in January contained $235 billion in revenue increases through the contingency tax, the Social Security reform package, and other minor measures. It contained $47 billion in defense reductions compared to our previous plan and $180 billion in five year domestic savings relative to the current services baseline. So I would note that 60% of the President's January deficit reduction package, consisted of defense savings and revenue increases in the very areas where Congress was insisting on greater flexibility.

I would also note that of the $180 billion in five year domestic savings, only $14 billion or 8% was attributable to means tested entitlements like AFDC, Food Stamps and Medicaid. By contrast $95 billion or more than half was due to a pay freeze, the COLA delay and Medicare reforms, all savings from non-means tested or middle class entitlement programs. The balance was attributable to a freeze on discretionary spending.

Now in return for an opening fiscal plan that tilted heavily towards the expressed congressional sentiment, when we proposed it in January of this year, the President asked two things in return.

Number one, that the domestic spending savings that he had proposed, a modest 6% of what is built in for next year and future years, that these be achieved as a quid pro quo for the out year tax increases that he was willing to support.

And secondly, that Congress forebear from an attack on the essence of his tax reform achievement, the third year rate cut, and indexing. For a brief few weeks as the jobs bill compromise and the bipartisan Social Security plan were enacted, it appeared that the accommodating spirit of 1982 might translate into a fiscal agreement with Congress for 1984 and the out years.

But such hopes were fatally dashed in mid-March when the House Democratic majority railroaded through a budget plan that was in essence a frontal assault on nearly everything that had been accomplished over the previous two years, and on the compromised spirit and approach embodied in the new round of FY-84 presidential budget proposals. The House plan in short provided for zero non-defense savings, next year, or any year in the future. And by failing to target even one dime of savings from a five year baseline that will automatically spend out at $3 trillion if nothing is done, I have to conclude that an outrageous dereliction of fiscal responsibility was embedded in the House plan.

Likewise, the House plan proposed front-loaded tax increases of $30 and $40 billion in ‘84 and ‘85 rather than in the out years as the President had proposed, and these are dollar magnitudes, which as a practical matter, can be achieved only by gutting the third year and indexing the areas he asked them to leave alone.

Unfortunately, this frontal assault on the President's compromised budget of January, has gradually poisoned the entire legislative well in the weeks since. The Senate majority split down the middle on the question of taxes, in response to the House's partisan assault and by default adopted a few days ago, a budget that embodies the worst of both worlds.

On the one hand the Senate budget resolution provides higher taxes in the near years, '84 and '85 in the present proposed, and on the other, it contains almost no spending cuts in any year next year or any of the four thereafter. In fact the Senate resolution contains barely $20 billion in five year non-defense savings beyond those already enacted in the Social Security bill. This amounts to a microscopic spending policy cut, equal to 1.7% of that $3 trillion five year baseline already built in.

So today as the budget conference prepares to meet between the House and the Senate, the collected irresponsibility of Congress imperils any progress on fiscal policy. After resisting spending cuts in the fall of 1981, after welching on the promise cuts in last year's compromise, the Congress has apparently now concluded that 99% of this $3 trillion and built in domestic spending over the next five years, is untouchable and sacrosanct and can't be reduced.

After receiving a compromised presidential budget plan in January that tilted 60% to 40% in Congress's direction, it is past resolutions that solved 100% of this dis-inflationary deficit problem on the defense and tax side, and which envisioned tampering with indexing in the third year, for absolutely nothing in return.

Now this congressional posture will surely lead to a protracted battle of vetoes over appropriations bills, anti-recession bailout bills, and any tax bills that may be coming down the pike this summer and fall. And while the prospect is not encouraging, it is probably now unavoidable. Yet, even then, the scenario is not entirely bleak. Nearly $100 billion in five year savings have already been enacted by virtue of the Social Security bill and its provisions for delaying the COLA's including upper income benefits in the tax system, the payroll tax accelerations and the prospective payment system and the savings it will produce for Medicare.

Secondly, the struggle over defense and non-defense appropriated spending will likely produce lower aggregate spending than either side desires.

And third by provoking a major battle over spending now, some verdict will surely be rendered by the American people as to the appropriate balance of spending cuts and revenue increases that will ultimately be required to treat with these mega deficits, fiscal aberrations generated by the unprecedented dis-inflationary wring out of the national economy that has dominated the early 1980's.

Obviously this course, as I have described it tonight and the prospect that we face down the road, obviously this course is fraught with economic risks, but in the final analysis the budget deficit numbers cannot come down until the central political issue, spending versus taxing, is finally resolved. The resolution of that issue is now the business at hand. Thank you. (Applause)

Chairman, Peter G. Peterson: Thank you David very much. Now to Bob Dole. I should say that I have the kind of affinity for Bob Dole that can only come, Bob, when we have been joint comrades in battle. In 1971 and 1972 he and I were in a contest to see who could be the most popular figure with the White House staff, which meant Mister's Haldeman, Ehrlichman and Colson. The contest ended up in a tie, for last place that is. We each got a similar prize. He was fired as Chairman of the Republican National Committee within days after the party's greatest victory, and at least some of you know what happened to me.

Bob asked me to announce this evening that he is particularly pleased that there are so many commercial bankers here. He feels he knows them so well, (laughter), and very intimately, somewhat in the way that the pavement knows the steamroller. (Laughter)

Bob Dole has been in far more serious and important battles than even withholding. He was a combat platoon leader in World War II. He won the Bronze Star and the Purple Heart in the rank of Captain at the cost of a severely wounded shoulder, cracked vertebrae, permanent loss of his right arm, and a medical prognosis, obviously given by people that didn't know Bob Dole, that he would never walk again. He has brought to his current critical assignment, a rather rare and trenchant wit, that for many us, Bob, makes the melancholy fiscal situation at least slightly more tolerable.

Recently, for example, he referred to three previous presidents as, see no evil, hear no evil, and evil. (Laughter and applause) I won't elaborate on which presidents. Like David Stockman he also has great intelligence and rhetorical skill, and like David he also has been a guest preacher.

In Bob Dole's case it has recently been widely reported that he has earned larger honorarium fees than anyone in the Senate. Since I devoutly believe in the market system, I can only assume that he is the best Senator rhetorically there is. It is my great pleasure to introduce my good friend and very able Chairman of the Senate Finance Committee, Bob Dole of Kansas. (Applause)

Robert J. Dole

Chairman, Senate Finance Committee

Well, Pete I appreciate that introduction. That is the first time, as I sat in this same room about a week ago, that I haven't been introduced simply as a husband of Elizabeth Dole. It is nice to be introduced on my own merit. I am very proud of Elizabeth, and as I have said, when she was nominated to be in the Cabinet, there was a big flurry of excitement. A lot of people came to take pictures, a lot of stories were written. I was never identified in the pictures, except it would say;

the man on the left is the husband. And of course, my mother recognized me, and all of the bankers of course picked me out, but otherwise, not too many people knew who I was.

And about that same time, *People Magazine* came to town, and they took about 300 pictures. I Remember, it was very cold that day, and they ended up using three. And one of the three showed us making the bed, which brought a hot letter from a guy named Bate, I think D. K. Bate from California, whose wife had read the article and he was now helping make the bed. (Laughter) And he said, Senator I don't mind your wife getting the job, she is well qualified, I know she will do a great service to the President and the administration of the country, but I want to give you a little advice, please stop messing around the house, let her do those things, and you are going to cause men trouble all across this country. And I wrote back, and I said, buster, you don't know the half of it. (Laughter) The only reason she was helping was because they were taking pictures. (Laughter and applause) That may be the only true story you will hear tonight. (Laughter)

At about that same time, you know there are a lot of political experts, as Dave Stockman and everybody else knows in this audience in Washington, whether you get in a cab or an elevator or run into a member of Congress or run over a member of Congress, they all know what is going to happen. And this very sharp fellow, called me and he asked a lot of questions and he finally said, now, Bob let's assume Ronald Reagan will not run in 1984, he said, what would you think about a Bush/Dole ticket. And I said, well I haven't thought much about it, but I just don't think I would have any interest. He said, well it is probably a good thing, because we didn't have you in mind. So I understand how you go up and down in this business. (Laughter) And I want to state that I wouldn't say I am unpopular with bankers, even though my banker came by last week and picked up his toaster and set of dishes. So I don't want to quarrel with bankers. I don't even want to quarrel with Dave Stockman. I have heard the White House excuse, now I want to tell you about the Congress and why we haven't been able to put it all together.

I want to thank Pete Peterson, we are good friends. I think we went to Camp David about the same time, back in '72 to get our marching orders. I remember I flew up in a helicopter with Richard Kleindienst, so I knew I was in trouble before we arrived. (Laughter)

But I was Chairman of the party, during those days, I hasten to add, that was my night off, as I look back on it. I was on a job in Chicago, but we had better people. (Laughter) But I remember calling the White House a lot during those years and I kept thinking I ought to meet the President; I was the Party Chairman, it doesn't seem like it was asking too much. I had only been Chairman, and I traveled a lot and said how close we were. And I kept trying to get through and I used to get a guy named Curly a lot. I don't know what happened to him. He was a nice fellow. And one night I went all the way to the top, I got Haldeman. And he said, I understand you have been trying to see the President and you would really like to see the President. Yes Sir, I certainly would. He said, well; turn on Channel 7 at 9:00. So I never got too close to that group.

Well I want to take a look at this whole problem from the side of Congress. I don't quarrel with much of what Dave Stockman has said. We have watched it grow and we have seen what has happened, we know we have big problems and I want to try to take three or four minutes to sort of outline, as I see it, as the Chairman of the Senate Finance Meeting, who will have some role to play in what we may or may not do this year or the next year. I can't speak beyond '84 because there is an election in '84 and the margin in the Senate is very close and who knows what will happen in November of 1984.

But economic advice is always blamed when things go badly, but the dismal science rarely gets its due when things go well. Because you know, public officials can't resist taking credit for what is right about the economy, but they like to have someone take the fall when things get out of control. And I don't say that with reference to the congress or the administration, but that is just the way it has worked. It has always worked that way.

So economists are well advised to be cautious in giving advice, since all of their risks are on the downside. Even so we see them pay more attention than ever to economics and economic projections. And there is no doubt about it, that Dave Stockman has done a magnificent job in his position has a Budget Director. Without him, we would have been lost in the Congress and I think the administration would have been lost time after time after time.

And that is true not only for basic decisions as to fiscal monetary and trade policy, but considerations such as the economic consequences, specific spending programs, the incentives or disincentives associated with a taxation and welfare policy, and many, many other areas.

The emphasis on economic analysis is helpful, but it gets confusing when you can generate a plausible economic argument complete with charts and statistics for almost any policy position. And I don't think many economists would quarrel with what. So valuable as it is, economic analysis seldom makes it any easier to forge a consensus on policy goals. It is remarkable then to see economic opinion converge on the issue of the federal budget deficit. It seems even more remarkable that notwithstanding this unusual consensus, Congress seems determined to ignore the advice that we are being given. Why this is so makes for a rather interesting story and I will spend just a few minutes on that.

First, I think we ought to understand as Dave Stockman has said, and I would guess nearly everyone in this room, maybe not everyone, but nearly everyone in this room, would agree that there is a strong need to reduce the deficit. The general view is that as the recovery proceeds, the size of these deficits currently projected at around 6% of GNP will either force us to monetize the debt, rekindling inflation, or we will divert so much of our savings to financing the government that private investment will be choked off, and Pete Peterson just gave me an example here, of what is going to happen as he sees it, in the next few years. And even now as the recovery appears to be on track, obviously the deficits are causing problems. And future risk cause present uncertainties and that influences the behavior of financial markets, business planners and the investment community, and many of you are right here.

And having spent more than two years establishing an anti-inflation pro-growth policy, it would be tragic and again, as Dave Stockman has said, if all of our gains went down the drain, because we can't put together the right group or the right program to make certain that we are going to have an impact on these deficits and we have, Dave calls it a gridlock, I call it a deadlock. There is no doubt about it, that the root causes of the deficits are well known. Members differ very sharply. And I can name Republicans, and I can name Democrats, who are probably as conservative economically as many in this audience, or more than many in this audience. But no one can agree on how we ought to do it. And as I saw the budget resolution develop last week, I learned very quickly, or didn't learn very quickly, I could see which way it was going. No spending reduction, just give it all to the Senate Finance Committee and let them raise taxes. Well we did that last year. And I hear the President said how he was talked into raising taxes. Well I believe we did the right thing. And I am still prepared, and the Senate Finance Committee is still prepared, if necessary, to take a look at the revenue side. But very honestly, I believe before we take more of a look at the revenue side, or another look at the revenue side, we ought to make certain we are getting something on the spending side. And I think that is where we are locked right now in not knowing what we could do. (Applause) And why can't we do better in the Congress? You know people write to me and say, why do you put up with all of this in the Congress. Well the facts are, and this is not a partisan statement, the facts are, Tip O'Neill has 101 vote margin in the House. The facts are, we have a slender 8 vote margin in the Senate

Republicans. So Democrats have a lock in the House, and we have a margin in the Senate, we have a Republican in the White House. So there is no doubt about it that politics is a problem.

You know, we took a shot at reducing government spending in '81 primarily. And we have never gotten over it. We did it once, and thought well that ought to be it. We have solved our problems. We have all made these very tough votes, and look at what has happened. The deficit has gotten bigger. So politics, I think, is the first reason that we haven't been able to proceed and I don't necessarily mean partisan politics. But even with the recession, revenues are projected at just under 19% of GNP. And that is in line with recent history. So I don't think taxes are too low.

And finally, there is a strong consensus for boosting defense outlays, even though, I must say Congress doesn't have the same fixation as the administration. We don't believe they are going to lock up the Pentagon if they only get 6% or 5.5%, 6.5%. I happen to share the President's view that we have a lot of catching up to do. We are willing to go the extra mile on defense. But we are trying to sell as a practical matter, cuts in Medicare, and either means tested or non-mean tested, entitlement programs, it is fairly difficult to put together a majority of Republicans and Democrats and say, well first of all, defense is off limits. We will have to take a look at means tested or non-means tested and get it all out of there. Or some of the other discretionary programs. But we are willing to do that. And the President has come a long way on the defense side as Dave has indicated. So it just seems to me, that first of all, we have to take a look at the politics.

I think secondly, you have to realistic. You know, we all, most members of Congress like it there. They want to stay there. We don't want to make anybody mad. I have already got everybody mad at me, in 2.5 years, not everybody, but everybody that has money. (Laughter) So we see this recovery, we hear about the recovery. Henry tells us about the recovery and Dave tells us about the recovery, the President talks about it all the time. We figure if it is going to work for him, maybe it will work for us. We are all going to run at the same time. So we have adopted sort of a wait and see attitude. Don't do anything that might disrupt anybody in the constituency, even though price supports are going out of sight and the AAG program and a lot of other areas that ought to be addressed. We are very hopeful that the recovery is going to overcome all of our weaknesses in the Congress and save us all on Election Day in November 1984. So that is another problem, politics, sort of the wait and see attitude. We are in a recovery period. Don't rock the boat.

And I think, finally, we are asking the budget process to carry too much of the load. I have the highest regard for Senator Pete Domenici, the Chairman of that committee and for Lott and Chiles, a ranking member on the Democratic side on the Budget Committee. They did the very best they could. They didn't put much together, but they did the best they could. Because they didn't have the votes. In my committee there are 11 Republicans and 9 Democrats and if it is a straight policy vote and I lose one Republican, it is all over. It is a tie. And we don't have sudden death playoffs in the Finance Committee. It just ends that way. It doesn't pass. And you have to go back and try some other way. And so that is another problem. We have loaded up the budget process to the extent we expect so much in the budget process, and frankly, all it is, is sort of a numbers game. You have heard all of the talk about the third year the tax cut is going to be postponed. Don't believe it for a moment. Never was in serious difficulty. But if you listen to the stories and read all of the newspaper articles or watch television or radio, you would think the Budget Committee was deciding the fate of the third year of the tax cut. That happens to be in the Senate Finance Committee jurisdiction. We are not a subcommittee of the Budget Committee, as we keep reminding Pete Dominici and others. They deal in numbers, and I don't quarrel with the process, there must be some way to focus on all of the federal spending, and I believe the budget process does that. It is a little like the United Nations, it is a place for everybody to get together and talk about all of these things, and then, break up and hope the rest of us can work it out. And we believe we have been able to do that. Because we have had pretty good budget resolutions.

Now I don't know what I would suggest to strengthen it. Maybe in the long-term we ought to have a Constitutional Amendment to give the President a line item veto. To me that would make a lot of sense. The President says he is poised to veto all of the bills we send him over the appropriations and I believe he should. We also have a budget every year. And maybe we ought to have a two year cycle. And I honestly believe we ought to include, if we have a budget process at all, it ought to include members of the Finance Committees in the Congress and the Ways and Means Committee on the House and the Appropriations Committees in the House and the Senate. Because essentially when it is all over, as I have indicated in the past two weeks, but all they have debated was how much the revenue was going to be, and whether there was going to be the third year indexing or whatever it might be, and they don't have any jurisdiction on that in any event. And I am willing to bet right here the vote was 50 to 49 for the budget resolution, and I am willing to bet that 10% or 20% of those 50 who voted for the budget resolution wouldn't vote to raise $1 in revenues, even on the budget resolution they voted for, they are going to raise $75 billion. Now that doesn't mean it has changed since politics 10, 20, 30 years ago. It doesn't suggest I am critical, it suggests that is the real world. So when somebody votes for a lot of numbers in a budget resolution, and passes it on to our committee or some other committee, and says, go to it, and raise the revenue and we do that, then I want to see that same 50, line up and say, well we voted for the budget resolution, you have these revenue numbers, and we are going to support the Chairman of the Senate Finance Committee or the Chairman of the House Ways and Means Committee. I just suggest that, that is probably the third reason.

So if our budget process is inadequate, what is to be done? If we pass budget resolutions that can't be implemented, we offer no real hope to the business or investment community, or to our allies and trading partners. As always, the problem is the failure of Congress to contend with the pleadings of special interests. And I just suggest, that hasn't changed. I would like to think, if we have to raise revenue, if we don't take away the third year of the tax cut, we don't necessarily have to touch indexing, we were told if you read the cover story in *U.S. News* about two months ago by Roscoe Edgar, there is still about $100 billion due in taxes that aren't being collected. We have $296 billion in so called tax expenditures. We ought to take a look at those. Some of those are incentives, some may be classified as loopholes, depending whether they affect you or somebody you know, (laughter) but at least we ought to take a look at that $296 billion figure in tax expenditures. And I think if they would permit us to do that, or if the Budget Committee would suggest that, that is how we raise the revenue, then we would feel a lot better about it, and I believe, the President of the United States would sign off on such a program that didn't tamper with the workers, tax cuts, and indexing, in the next two or three years.

So, let me conclude by saying this. Yes I think we ought to improve the budget process. Yes I believe in the budget process. But it is pretty much like the volunteer fire department in my home town. My father was on that fire department for years, they used to come back after the fire and say, well we had a hell of a fire. (Audio ends and begins again, no overlap) the building was gone, but the lot was still there. (Laughter) And that is how I view this year's budget resolution. All we have left is the process. What we passed doesn't amount to anything but it is still standing. The structure is gone, but the lot is still there. And we have a lot to do; I guess that is the second part of that statement.

And whether somebody is going to rise up at the White House and say it is time to get into this game, you know, we think about that from time to time, and the President says, oh this is not my business, this is a congressional discipline. It is called the budget process. But he is called the President. And those deficits are going to impact on what we do or do not do in the next three or four years. And I just happen to believe that the President has enough strength and enough moral leadership, particularly as he gets stronger and stronger in the polls as the recovery gets stronger and stronger, that he is going to be able to forge a budget resolution. Or forge a budget process that will bring down these horrendous deficits in the next two to three years.

So we have made the budget process work in the past, largely because of the President's efforts, and Dave Stockman's efforts and some Democrats and Republicans who were dedicated to making it work, and we ought to preserve the process. And I don't know how we are going to get people to agree and there are some as I said, Republicans and Democrats, there are some who don't want to raise taxes one nickel And there are others, just as many, who don't want to reduce spending one nickel. Now how do you reach that consensus? The Majority Leader, Howard Baker who has done an outstanding job, said there is no way to do it. So we just fought it out on the floor and after 11 votes we adopted a resolution supported by 21 Republicans and 29 Democrats, that doesn't cut spending, and raises $75 billion in taxes over the next three years. Now whether it is $3 billion or $9 billion in revenue in '84, to me is immaterial. Or whether it is $6 billion or $12 billion in '85. I guess it is that third year we really look to, to see whether or not we can really have an impact on the deficit. Now the President has agreed on a $50 billion revenue number, and this so called moderate compromise is about $51 billion or $53 billion. But the one difference is, the President demanded properly so that we accompany that with some spending reduction.

So I just suggest to this audience that it is not hopeless. But I am not certain where we go from here. There has been so much talk about the budget process, so they are going to have a conference come Wednesday and they are going to try to put it together. What can they put together? I don't think very much, because Dave has already explained the House budget resolution is way up here in revenues and ours is about here, and the President is down here.

So I just suggest that we have to make it work. There has to be enough Republicans and Democrats in the Congress with strong urging from the White House to put together a responsible budget resolution that would make a difference to this audience. And I don't blame those that are in the business of renting money for not lowering the long-term rates, when you are looking at those staggering deficits. Whether it is $500 billion or $600 billion, over a three year period, it may not make that much difference. So I say then, Senators, are always saying in conclusion and then never stop, but I would say finally, the federal budget is just one part of the economic picture. And it is probably not the most important part. But there are very good reasons why the nation and the world are paying such close attention to our budget decisions and the effectiveness of our budget procedures. What is at stake is a credibility of our commitment to return to a non-inflationary growth in the decades ahead. The same fear that trouble domestic investors, that we will reflate the economy or that we will choke off a promising expansion, just as it gets underway, also disturbs foreign investors. Because the world looks to us for recovery. And they are concerned about our deficits. Or they are concerned about the strong dollar. That doesn't concern me as much as the deficits. If we took care of that, I think the other would take care of itself.

We are going to do our best; we are going to do our best to keep fair trade. We don't buy all of the protectionist rhetoric we are hearing in the Congress these days. The administration doesn't buy it. I doubt that many in this audience buys it, but it is going to be very difficult. Because many of my colleagues look to trade as a way to create jobs and get more people back to work and sell more of their products to the farm states and the industrial states throughout America.

So I guess I would conclude as Dave did that we haven't maybe done the best job in Congress. I won't be as hard on Congress as someone in the administration would be, but I do believe if in fact the economy starts to sputter, and starts to peter out, no doubt in my mind that the number one culprit I guess would be the Congress of the United States. And again, I don't think it is so much because we have Democrats and Republicans, who can't agree. Just as I said, you look at the politics, you look at the recovery, and you look at the process itself, we just can't get it together this year.

In 1981 when Ronald Reagan said we ought to do this, we did it. Some of us never looked back and some never even looked forward. But that has changed. And it just seems to me that our obligation is there. We need the urging of everyone in this audience, to make it work. But I am confident in the final analysis it will work. But I don't see much hope in the budget resolution we adopted last week. (Applause)

QUESTION AND ANSWER SESSION

CHAIRMAN PETER G. PETERSON: Now we go to our tradition of questioners. On my left is Bill May the Dean of the Graduate School of the New York University. On my right, Dwayne Andreas, Chairman and Chief Executive of Archer Daniels Midland. And as you know we rotate, gentlemen. And Dwayne, why don't you take the first question of whomever you would like to ask.

DWAYNE ANDREAS: Alright, I will address this question to Senator Dole. Most of us have read and heard a lot lately about the condition of the third world countries and the enormous bank that they have to the private banks. Bill Safire said today that about the only thing that has happened in Congress in paying attention to this impending problem, is silent prayer. We all know that we like, it is customary to sweep that kind of a problem under the rug. But I just wonder if there are any plans in your committee, since you, as Chairman of the Finance Committee would probably make the most important decisions in case of large scale defaults of these loans. Do you think that you would be inclined to just let market forces take their toll with all that, that implies, or would you be inclined to see the government protect the depositors in the private banks or do you think the government might go so far as to endeavor to even protect the shareholders?

SENATOR ROBERT DOLE: I am glad that is not my committee, Dwayne, but, I want to protect the banks all I can, but (laughter) we have been working on some items that they haven't....(laughter) Well I am not certain, in our committee, I will say very honestly that we don't have jurisdiction of that problem. But we are aware of the problem. And we are aware that some banks have lent more than 100% of their capital to developing nations, which appear to be at some risk of default. But we are told again, in our committee by the so called experts, that the international debt picture has brightened considerably. I am not certain what the administration, be it an administration call, where they are going to try to protect the shareholders and depositors and others, but interest rates have come down and there has been a little better handle on that particular problem. I do believe we have to face up very quickly in the Congress of the International Monetary Fund and what we are going to do in this area. And in my view, it is not whether we are so anxious to pump in $8.4 billion into the IMF, as our share of the new quota. And I guess there will be as we look at that particular problem, maybe some restriction, some restraint, some way to maybe better police and have a little better discipline on some of the loans. But as I look at it, if we don't do it, the consequences are unthinkable. As you look at Mexico and some of the other countries who are having difficulty now and I don't think there will be a default, but if they couldn't reschedule or rollover, whatever they do with their debt, and they became more of an economic problem, there is going to be a lot of movement in those countries, and a lot of it is going to come through Texas and other places. And so I just suggest in that area, though it doesn't specifically address that question, I think we have to address the International Monetary Fund. I think we have to allow the administration to have the extra $8.4

billion, along with some restraint, maybe we ought to leave it up to the Fed rather than the Congress because when we start to manage anything, we have real problems. (Applause)

BILL MAY: In fairness, let me direct this question to David Stockman. If unemployment comes down as slowly as is generally predicted, won't any measure reductions, and I am talking about substantial reductions now to eliminate these tremendous deficits, won't those reductions in the transfer payments become difficult to impossible from a practical, if not a political standpoint?

DAVID ALAN STOCKMAN: I would try to answer that question this way. That view, probably would have been true 20 years ago because a very heavy share of federal transfer payments 20 years ago were unemployment payments that are directly triggered or linked to the unemployment rate, and things like AFDC and even Food Stamps just starting. But if you look at the structure of federal entitlement spending today, it is almost entirely medical and pension transfer payments to the elderly, who are not linked to the business cycle or the state of the unemployment rate, and the problem that you have to face there is a structural one as to the benefit growth rate or appreciation rate over time. So I think there is still enormous requirement to take a look at that entire set of non-means tested pension and medical programs that go primarily to the non-working age, and that is really the heart of our budget problem at 70 or 80% of the total entitlements. On the other hand, unemployment payments will be coming down automatically. Unlike in the past where we had the extra weeks of unemployment geared to the national unemployment rate, they are now geared on a state by state basis and as the economy picks up, and the employment level picks up this summer and next year, many of those states will trigger out of extended unemployment benefits and we expect $10 billion or so in lower outlays next year than we are facing this year. In one area the means tested entitlements AFDC, Medicaid and so forth. I admit that we have made some very large changes in the last two years and there is not really very much room left to make changes that wouldn't have harmful effects or that wouldn't be highly contentious in terms of their overall social policy impact. So to sum up, there is a lot of automatic spending, but it is in the area of farm price supports and it is in the area of pension and medical benefits, for the non-working age population, and that is where we hope that we can get Congress to focus. (Applause)

DWAYNE ANDREAS: Senator Dole, to change the subject, some of us have wondered in recent months, whether the Jackson-Vanik bill is in fact succeeding having any of the effects for which it was intended. Do you believe that it is, or do you believe that it should be repealed?

SENATOR ROBERT DOLE: Let me say, the Jackson-Vanik amendment, I think it does express an important American value and that is that one should be free to immigrate. I voted for the Jackson-Vanik amendment. I think it served its purpose, but I think like anything else, and we have jurisdiction of this in our committee, it is a trade related matter, whether you are going to draft that particular country a most favored nation status, it seems to me that we have an obligation to constantly review the programs that were maybe put in place 10 years ago, 12 years ago, to make certain it still serves the same useful purpose and obviously the Jackson-Vanik amendment served a very useful purpose. The demonstration just in New York over the weekend, about Soviet Jewry, underscored the importance of focus in this area. But as I looked over the figures and this is a matter we have been working on, and if one is concerned about immigration, you must ask whether Jackson-Vanik accomplishes its twin goals, of increasing immigration and trade. The record suggests that Jackson-Vanik does not affect Soviet attitudes regarding either immigration or trade. At worst, it could be counterproductive. In recent years Jewish immigration has widely fluctuated. Thirty-two thousand left in '72, 13,000 in '75 and 2600 last year. And less than 200 so far this year. And U.S. exports to the Soviet Union has similarly fluctuated 542 million in '72, went up to 3.6 billion in '70, 2.5 billion in '82, and whether or not we have anything this year depends maybe on the long...or how much we had depends on the long-term grain agreement. So it would just seem to me that we ought to take a look, an objective look at the Jackson-Vanik amendment, without any prejudgments or without any pre-conviction about where we go. Maybe we decided, it ought to be left in place. And we have had a better record as far as Hungary and Romania is concerned when we granted most favored nation status, so I have suggested publically earlier this year we ought to take a look at it. It doesn't mean we are going to retreat from it; he is going to look at it, and determine whether or not changes should be made. (Applause)

BILL MAY: To vary my shots I am going to direct this one to Senator Dole. Assuming additional taxes are indicated in the out years, should these taxes be shifted toward consumption, rather than savings and investment, in order to stimulate investment and perhaps assure collection being more certain?

SENATOR ROBERT DOLE: Well I could answer that yes. I mean, if you could do it, if you had the votes to do it, obviously that is the way you would go. We took a look at some of these consumption type taxes last year and the so called tax reform proposal. But we didn't, we weren't able to put together a package. But the answer is yes. I think coupled with that, as I said it earlier, we ought to take a look at compliance, and we ought to take a look at tax expenditure, generally to see whether or not some of those have been in effect for 10 to 20 to 30 years ought to be updated. But if it is a strong yes, and there is strong support for that, I might say, I think fairly broad bipartisan support for that effort.

DWAYNE ANDREAS: Mr. Stockman, I would like to ask you, in this framework, about the P.I.K. program, just announced for agriculture, the thrust of which I understand came to a certain extent from the Bureau of the Budget. Agribusiness in the United States is by far the largest single industry in the world. It totals 23 million employees, 22% of the labor force of this county, 20% of the GNP, over $400 billion. Now because of our diminished exports, you found it necessary to spend something like $10 to $12 billion to idle 83 million acres, which will reduce world production of food by some $25 billion in terms of bread and meat. Senator Danforth said the other day that he had a study from the Department of Agriculture which indicated that since wheat is only $.03 or $.04 worth of product in a loaf of bread, and other values accordingly, that we could do the job far more effectively and cheaper, much cheaper by growing it and giving it away, than by paying farmers to idle the soil and idle themselves. Has your group considered alternatives of that kind to this massive program to idle the soil?

DAVID ALAN STOCKMAN: Well the question was, why did the Bureau of the budget come up with the P.I.K. Program, and the answer is the Bureau of the Budget was abolished 14 years ago and if we had done the same for the farm price support programs, we wouldn't have had P.I.K., (applause) but unfortunately, and this is an illustration to give a serious answer here of the larger point that I was making earlier about the unexpected and radical affects of disinflation on the budget. We passed a farm bill in December of 1981 that I was extremely reluctant about, Senator Dole was as well, that turned out to have built in escalators for price supports and target prices that carried the support price far above the level of cost increases that were actually being generated in the farm economy in '82 and '83 as this disinflation got underway. And what we ended up with was a situation in which the support level automatically escalating upwards, became so generous that no matter how low prices had temporarily gotten, there was a guaranteed way to derive revenue and at least cover operating costs if people planted, ditched the dish hedge row to hedge row. And so they did, and as a result we ended up, by the end of last crop year with such massive carry-overs, such huge ending stocks that the cost of paying those deficiency payments and of paying those price supports that were built into the 1981 law, escalated in a matter of 18 months from two to three billion a year to 21 billion a year. And the problems was, there was no way to correct this problem without something as drastic and disagreeable as P.I.K. because since the price supports were built into the law for a couple of more years, and since they essentially offered on the part of government to buy any crop produced, at least at a breakeven rate, and probably in many cases, even at a profitable rate, the only prospect in sight was more massive full capacity production, worsening levels of inventory, and even greater current costs for outlays and for deficiency payments in the year ahead and the year after. So some way we had to find a mechanism to break the cycle. And what we came up with was very imperfect but we essentially said we paid for all of this crop under loan once, if we continue to hold onto it we are eventually going to end up owning it, after the three year loan period is elapsed in which we pay the interest and the storage costs and it is going to be worthless to us unless we do something with it now. So the essence of the P.I.K. program is to stop spending any more new budget cash on farm price supports by canceling in effect all of these loans that have been created over the last two years, from the excessive price support level in return for a one time, one year scale back of production designed to bring stocks and supply and demand back into balance. But I'll tell you two things. We should never do it again and more importantly we should never adopt a farm price support program that gears the support level to some artificial index as we did in 1981. (Applause) Because as the market changed, this program proved to be totally inflexible, and we had the federal government simply working, totally at odds with what the marketplace was trying to tell us to do. So I hope as a result of the one year P.I.K. we can equilibrate the market and we can learn a big lesson. And that is, to get these price supports down and to abolish the deficiency payments which are nothing more than welfare payments to farmers and allow U.S. agriculture to compete in the world market where it can compete and efficiently if the government isn't destabilizing and artificially distorting the market. (Applause)

BILL MAY: This is to David Stockman also. Recently a group of economists came to the opinion that cyclical deficits could be inflationary but structural deficits probably were not. Would you comment on that?

DAVID ALAN STOCKMAN: Well I think that is essentially right. The idea of a structural deficit is a permanent imbalance in the revenue structure and the spending commitments that persist over time, that requires permanent large financing, that by definition, taps the longer term private savings flow in the economy and it seems to me that all amounts to less investment, less growth, less productivity, less real expansion of the economy over time. So what we have is a structural deficit. It resulted not from policy decisions per say, but from a disinflation process that wasn't anticipated and still is only ill understood, but nevertheless it is there, it won't go away, we are stuck in a stalemate on how to solve it at the present time, but despite some of the pessimistic and perhaps bleak implications that could be derived from some of the things that I have said tonight, I believe that when push comes to shove after the test of all of this posturing in politics has finally occurred and we have gone through it, I believe sooner or later we will see the political process gel, we will get some strong message from the financial markets and from the American people, and we will get something done before it is too late. Thank you. (Applause)

DWAYNE ANDREAS: Senator Dole, we have heard a lot of very tough trade talk recently by several presidential candidates on the Democratic ticket. I wonder if you would care to comment on the attitude of these presidential contenders toward trade.

SENATOR ROBERT DOLE: Well I wouldn't want to comment on all of them, as it is already 9:30. So I will just take the frontrunners and I am not certain who they are, so I will just pick Mondale because we are good friends and I wanted to mention his name. I mean, he is our choice. (Laughter) Now I served on the Senate Finance Committee with Fritz Mondale and we did a lot of things together, never voted together, but did a lot of other things; had lunch, and things of that kind. And I am a little surprised to hear Fritz Mondale become the big protectionist in the presidential debate. And I know that I was one of the first states. I know that because I went out there in '80. Nobody knew it, except me, and the guy that used to check my bag, and I know that if you are going to convince the American farmer or the auto worker that you are going to have a local content law or somehow restrict throw up some trade barriers, it may be short-term good politics and I don't say this in criticism of former Vice President Mondale, and there is a lot of feeling in the Congress, but it just seems to me, if we step back and take a look at the long-term, then we better make certain that we don't get into some protectionist, straight jacket we can't get out of, whether Republicans or Democrats, and I have been very proud of President Reagan for stating time after time after time, we were not going to go that route. And I know the temptations are great, but there are a lot of jobs at stake and in addition a lot of other things that I think we ought to be alert to. Now we have jurisdiction of trade in the Finance Committee. There have been some talk that maybe we can improve our trade by creation of a new Department of Trade. That is an idea that I think ought to be focused on, but I don't really feel that it may move all the way in Congress this year. I think we also get some indication from the administration that they mean if we are going to be competitive when you have the so called Egyptian sale where you have a value added. We sold flour instead of wheat to the Egyptians, created jobs in this country. Now that signal of course raised the hackles of some in the European Community and others, who were saying, oh no, you took the entire share of the Egyptian flour market. But I really believe what the President was trying to signal in that sale, was the fact that we are going to be competitive. We are not going to be buried with export subsidies and other non-tariff barriers; we are going to demand access to markets. And we ought to do that. And we passed in the Senate Finance Committee about a month ago, or six weeks ago, what we call a reciprocity bill which it says in effect, if you give us access, you will access to our markets. So a lot of things we can do to make certain the people understand, the countries understand, and I hope to bring it up in Williamsburg next week, that we are going to be competitive. We are not going to be protectionists, and I would hope that as the Democratic candidates look into this, and as the recovery picks up, that they may back away from some of their earlier statements. We don’t need local content legislation. It is not good long-term policy. We don’t need protectionist barriers, non-tariff or tariff barriers to keep out certain products. What we need it access and what we need is to make certain, the European Community and Japan and all of the other countries understand that we are going to be competitive. And in the meantime, in my view we ought to be doing the best we can with a long-term agreement of some kind with the Soviet Union; grains agreement. And that is in the works. And that has been given the green light by the President, just ten days ago. (Applause)

BILL MAY: This question is addressed to Senator Dole. Do you think that the present budget process which is now almost a decade old is working and should be retained, and are there any modifications or improvements which you would like to see to it?

SENATOR ROBERT DOLE: Well, I mentioned a couple in my statement. One, maybe a two year budget cycle. You know, here it is, June 1st and we have spent all this year, literally, all this year on the budget process, that didn't give the rest, even if they reach an agreement, which is doubtful, in a House and Senate conference sometime in June, that would give us the month of July, the authorizing committee, to the tax writing committees, we take a break in August for five or six weeks, so here we have gone into a half year into the budget process, and it just seems to me that we spent too much time. We ought to impose some deadlines. This year the target in the Senate for the budget resolution was April 15th. And it happened last week. Now it just seems to me that we have to put some kind of muscle in the budget process. We ought to try to preserve it. There have been a lot of good people who spent a lot of time on it. Senator Bellman, former Senator Muskie, Congressman Gimo(?). It has been a bipartisan effort to bring some discipline to the Congress. We need it, believe me. And the alterative is going back to the old way of everybody running up with amendments and we run out of money, which you never do, we just add it to the debt, then you stop. Now we have to raise the debt ceiling this week before we adjourn on Friday or we can't pay our bills next week; the government can't. So we have to go to about $1.4 trillion and we are going to try to also handle enterprise zones in the Caribbean Basin, and withholding and a couple of other things this week. But I would say, yes, the budget process will probably survive. It is not on its last legs, but very honestly, there are a number of us who feel that these ought to be tightened up, or maybe we ought to put it on hold for a year or two. And very honestly, I think if you checked in the cloak rooms on the Republican side and the Democratic side on the budget process, the odds are 50/50 that we won't do anything until after the 1984 election, as far as addressing the deficits. (Applause)

DWAYNE ANDREAS: Mr. Stockman, if the administration is so enthusiastic as they seem to be about the maintenance of the tax indexing, which on the revenue side, which flattens revenues, why wouldn't the conservative government take an equally strong position on capping the COLAs on the other side of the equation. At the present time, all we have talked about, as I understand it, is a six month freeze between now and 1988 which is about $25 billion, out of a total of something like $2 trillion of entitlements. Isn't there a possibility that sometime soon we are going to go after the COLA indexing which nearly everyone seems to agree must be capped sooner or later?

DAVID ALAN STOCKMAN: Well I think you have raised the heart of the issue, but let me just suggest a couple of things by way of perspective. First, when you talk about indexed entitlements, you are talking front, center and primarily about Social Security. Seventy-eight percent of the entire cost of indexed entitlements and therefore the cost of COLA outlays is Social Security. And there is a very clear rule of thumb, politically, legislatively, in policy that is developed which says, you do no more or less to the others, veterans, and retired federal civil servants, and railroad retirees and so forth, the other 20%, you do no more, no less, than you have done on Social Security. Now unfortunately, the very best arrangement that we could get in this last go around, was a six month delay which is equivalent to a one or two percent real benefit cut at the inflation rates that we now have underway. Obviously, we wanted more. Obviously there were many in the Congress who were willing to support more. The problem is, we were faced with a drop dead date of July 1, 1983 in which Social Security would have been bankrupt and it was in that time pressure with all of the demagoguery and all of the polarization and politicization of this issue that it occurred during 1982 by the other side that shaped the context in which that bipartisan agreement was finally reached. And so out of that we now have hostaged a system that, you are right, will cost more than $1.5 trillion over the next five years to Social Security which is the heart of which, for which the best we could get under the circumstances that prevailed last winter and spring was a six month delay. Now one of the real tragedies of this, and I don’t know how history can be undone, and it is part of the fiscal reality that we deal with, is that after three years of everyone in the process, sort of ponying up to the COLA issue, inching up to it, but then backing off, we finally discovered a mechanism that could get political consensus. And that mechanism was not CPI minus 3, or 75% of the CPI or anything else, it was a COLA delay because for some reason members of Congress were willing to interpret that as technical and not a cut as the word CPI minus 3 or something else implied. Now the tragedy is that if we could have gotten this done in 1980 when the inflation adjustment was 14% we would have saved $14 billion a year. If we could have gotten this done in 1981 when the COLA adjustment was 11.5%, we would have saved $10 or $12 billion a year. But we didn't get it done until the 11th hour this winter, when these high inflation rates had already collapsed and we were facing a 3.5% COLA for next year that has now been delayed for six months. Now the unfortunate thing is that all of those 100% high inflation COLAs of 1980, 1981, and 1982 are built into the system. There are checks in the mail. They are part of the basic entitlement, and there is no Congress I know of now, where it can envision any time in this world or the next, that will ever take those checks back, now that they have been granted. And as a result, we are left in a rather unfortunate circumstance where politically we have found the mechanism but it was only after inflation came down so much that its yield in terms of savings, is quite limited. Now that means that there is going to have to be some other way to do this, but I don't think this Social Security agreement as a pure hard political matter can be reopened any time in the next couple of years. And if that leads to a pessimistic conclusion about saving on the indexed benefit side, that is part of the dilemma that we are struggling with in the budget as a result of the history that has gone by. Thank you. (Applause)

CHAIRMAN PETER G. PETERSON: Could we have one more question please, from each and then we will adjourn. Bill.

BILL MAY: Alright, this is to Senator Dole. According to the press and the Congressional Record, you have recommended from time to time that the holding period on capital gains be reduced from 12 months to six months. What is the chance of such a change being passed?

SENATOR ROBERT DOLE: Well I might say, we passed that three times in the Senate. So we will pass it again. It is just a question of when we bring it up. We had thought about keeping withholding on dividends in exchange for that little program, but we haven't quite worked that out yet. But there are probably a lot of corporate people here, and if you would like to make a trade like that we would like to visit with you. (Laughter) Because we would pick up a substantial amount of withholding on dividends and there is less compliance on that side than there is on interest. And I would just say a word about that issue, because I know it is my last question. First I want to thank everyone, those who are awake and those who may wake up. That has been a very difficult issue and I want to make it perfectly clear as we used to say, that a lot of the bankers didn't send in any coupons. And for those, we are very grateful. And a lot didn't distribute them in their bank. I mean a lot of banks, we went into three New York banks trying to find coupons to mail in, one of my visits up here, and they didn't have them. So we took their names and they are in better shape than some of the other banks who did. (Laughter) But withholding has been a frustration. It seems to me it may have set back tax reform a while, because all we are trying to do is collect taxes that are due. And we know of all of the emotion that issue and we are not going to debate it here tonight. We may debate this next week in the Senate one more time. But I think the air has pretty well gone out of that for the time being. We are trying to compromise where we could still save about half of the revenue. Again, it seems to me, I look at all of these people who voted for the budget resolution. If we are going to stand up later this week and vote to repeal withholding on interest and dividend income, and give up about $20 billion in revenue over the next four years. It doesn't make sense. But it indicates, and you send us enough mail, it doesn't have to make sense. We are going to cave in if we get lots of mail. But I think it is a mistake. We have only answered about 82,000 letters; I have even answered people who haven't written. I am getting a lot of people who say, Bob I didn't write. Well, I assume some resourceful banker sent in cards for all his depositors, so I am going to write them all. I have the best mailing list in America. The trouble is, I can't ask for anything because they don't like me. The holding period question, last passed a Senate by a vote of 77 to 17. We believe it was a step to make, the administration supports this action. We would hope that sometime this year or next, we can fulfill a promise we made to carry out that provision. (Applause)

DWAYNE ANDREAS: Mr. Stockman I believe that most everyone in this room regards you as certainly one of the most knowledgeable and talented people, one of the four or five most knowledgeable in the world. Based on your recent experiences in fiscal trade and budget policy, I wonder if you would do us the favor of telling us with the benefit of all of the hindsight that you have, if you had it to do over again, and you could call the shots for an administration, what would you do differently?

DAVID ALAN STOCKMAN: Well I think it is 9:30 and the gong goes off. I don't know whether I could express in any one proposition what I would do over again. But I certainly do now have a much better sense of the kind of embedded politics and I don't mean that in a negative sense, I mean that in a descriptive sense that drives our system. Because whatever we may think of the waste of farm subsidies, the $22 billion that we are going to spend more in welfare for farmers, than for poor people, it is hard to convince people out there in North Dakota or South Dakota or Oklahoma where they are growing wheat and they probably shouldn't be, that we ought to just abolish them cold turkey. And you can go down the line through every category of the budget and you will find that same dilemma. The rational solution simply cannot be imposed by fiat because there is strongly embedded political feeling, the economic interest, regional interest, parochial claims in our system, that cannot be waived away with a wand. And I don't think that is ever going to go away. But I think if we allow those horses alone to dictate national policy, and to totally dominate the agenda, then we are going to have fiscal irresponsibility run rampant forever. We are going to have protectionism in one form or another of worsening degree, we are going to have not a national policy that makes sense for the collective good of this country over a longer period of time, but a cacophony of very narrow, conflicting, confusing, and unproductive policy. So if I had to do anything over, I would factor in with heavier weight those forces that I have just described, not because that they necessarily need to be encouraged or reinforced but they need to reckon with. I think anybody who makes sweeping criticisms about how easy it would be to maintain the line on a free trade policy or to balance the budget by having the guts to step up the line and cut somebody's Social Security benefit or farm subsidy needs to keep that in mind. That is part of our system. We are an economic system and we know what is right for it, but we are a democracy, we are a political system, where those things that cause problems and go wrong along the way or in the several parts of our society can be resolved. And as we try to do the right thing in terms of keeping taxes down and keeping the government out of markets, and keeping the international economy free, I think we also have to have some very practical strategies as to how we reckon with the political interest that pervades the system and that ultimately is an important part of it. Thank you. (Applause)

CHAIRMAN PETER G. PETERSON: Thank you David for that very eloquent closing statement. Gentlemen we are not in a position to give honoraria here, but we are in a position to express our warmest gratitude through a symbol of New York, the Big Apple, of course, from Steuben and each of you will get one of those with our warmest thanks. So I am sure you would like me to thank them once again for a great job. (Applause)