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CABINET ECONOMIC POLICY GROUP

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 22, 1980

MEMORANDUM FOR THE PRESIDENT

FROM: G. WILLIAM MILLER
CHAIRMAN, ECONOMIC POLICY GROUP

Bill

SUBJECT: Economic Program for the 1980s

Attached are the following documents:

1. Summary of decisions we will be seeking from you. (Tab I) Attached to the summary are tables showing revenue and budget effects. Most of the elements of the program are agreed to. Those items on which areas of disagreement have been identified are marked with an asterisk.

2. Memorandum from the EPG Steering Committee with background on the components of the program. (Tab II)

3. Draft statement of the program. (Tab III) The statement, which would be revised to reflect your decisions, is intended to be released publicly concurrently with the announcement of the program. It attempts to put the different program elements in perspective.

In addition to discussing each of the components of the program with you, we would like to discuss the timing of the announcement of the program in light of the actions taken by the Senate Finance Committee this week.

Lane
Refund ITC(-)
Ind Revit Corp ++
Use JEC language

Take pol. heat.
Veto any tax bill
Long range program. c̄ immediate benefits
JFK - 100% Bus.
Infl 12.5 → 7.5 not incl mtge int

I

TABLE A

The Revenue Impact of the Proposed Tax Cut Package

($ billions)

	1981	1982	1983	1984	1985
			Calendar Years		
Provision:					
Constant rate depreciation -- 40 percent (January 1, 1981)	-6.3	-12.4	-16.5	-20.6	-24.2
Refundable investment tax credit at 30 percent	-2.4	-2.6	-2.5	-2.5	-2.3
Section 911/913 hardship relief	-0.2	-0.3	-0.3	-0.3	-0.4
8 percent social security credit 1/	-12.8	-14.5	-16.2	-18.0	-21.0
Targeted investment tax credit	-0.2	-1.0	-1.0	-1.0	-1.0
Marriage penalty relief (10 percent exclusion up to $30,000)	-4.7	-5.6	-6.6	-7.7	-8.9
Earned income tax credit 2/	-0.9	-0.8	-0.8	-0.7	-0.6
Total	-27.5	-37.2	-44.0	-50.9	-58.3
			Fiscal Years		
Constant rate depreciation -- 40 percent (January 1, 1981)	-2.8	-9.0	-14.3	-18.4	-22.2
Refundable investment tax credit at 30 percent	-0.2	-2.4	-2.6	-2.5	-2.5
Section 911/913 hardship relief	-0.1	-0.3	-0.3	-0.3	-0.3
8 percent social security credit 1/	-3.8	-19.3	-15.7	-17.5	-20.1
Targeted investment tax credit		-0.7	-1.0	-1.0	-1.0
Marriage penalty relief (10 percent exclusion up to $30,000)	-0.3	-5.2	-6.0	-7.1	-8.0
Earned income tax credit 2/	*	-0.9	-0.8	-0.8	-0.7
Total	-7.3	-37.9	-40.7	-47.6	-54.8

Office of the Secretary of the Treasury
Office of Tax Analysis

August 21, 1980

1/ The social security credit expires at the end of 1982, replaced by other proposals with tax reductions equal to the 8 percent credit.
2/ Includes outlay portion of earned income credit.
*Less than $50 million.
Note: Details may not add to totals due to rounding.

Addenda: Percent of tax liability reduction allocable to:	1981	1982	1983	1984	1985
Business	56%	63%	64%	65%	65%
Productivity/Investment	33%	44%	46%	48%	48%

TABLE B

'81 '82

Summary of Spending Initiative Possibilities

'79 EDA Guarant[ees]
grants.
+ int. subs. = $1 1/2 B.
already on hill $3 B.
$4 B. → $5 B
Jim

	1981 BA	1981 BO	1981 PROG	1982 BA	1982 BO	1982 PROG
($ millions)						
EDA Expansion*	198-1000	31	1000	373-2000	180	2000
Science and Technology (General Language)	295	165	295	305	335	305
Federal-Aid Highways	----	80	500	----	260	----
Energy Conservation						
Solar Bank	100	75	100	----	25	----
Pub. Hous. Weatherization	----	----	200	----	----	200
Fed. Bldgs. Weatherization	175	33	175	----	70	----
Schools and Hospitals Weatherization	100	50	100	140	120	140
Low-Income Weatherization	100	100	100	100	100	100
Human Resources						
Pos. Adjust. Demo.	10	5	10	50	30	50
Vo-Tech. Demo.	10	5	10	25	20	25
Supplemental Benefits* Unemp Comp	744	744	744	617	617	617
CETA Title II-B/C*	300	300	300	300	300	300
Private Sector Initiatives*	75	75	75	----	----	----
Youth Programs* add-on	200	200	200	----	----	----
Countercyclical Revenue Sharing	1000	1000	1000	----	----	----

*These items in disagreement.

Youth. #2 (for 81 + 82) 1.2 0.8
Reopen c Congress?

no forgiveness of trust fund debt

Recently decreased in unspent funds estimates =

II B - Training
II C - " no income test (6% of II B)

II

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CABINET ECONOMIC POLICY GROUP

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 22, 1980

MEMORANDUM FOR THE PRESIDENT

FROM: EPG STEERING COMMITTEE

SUBJECT: Economic Program for the 1980s

I. Economic Background

A. Major Economic Developments and Objectives

-- The economic recovery in 1981, as seen by virtually all forecasts including our own, will be quite sluggish. In the absence of new policy measures, the unemployment rate will languish in the neighborhood of 8-1/2% throughout 1981.

-- Inflation, while likely to improve temporarily in the next few months, will probably rise into the 9% to 10% range in 1981.

-- The share of GNP devoted to investment must grow over the years ahead to meet our energy needs, to modernize industry, and to improve productivity. The bulk of the added investment should be private, but some government or governmentally assisted investment will be needed.

These developments carry some direct implications for the design of an economic renewal program:

-- Taxes. To help promote an otherwise lackluster economic recovery, we need a tax cut in 1981:

  - for individuals, to offset some of the large rise in effective personal tax rates, and

  - for business, to help stimulate an expansion in private investment.

  Given our investment requirements, a much larger than usual share of the 1981 tax cut should be directed toward stimulating private investment.

-- Budgetary prudence. Because inflation will remain a major problem, we must be sure that the tax and expenditure program enacted in 1981 does not lock us into large budget deficits in later years when unemployment has been pulled down.

-- Incomes policies. To make further inroads on inflation, while simultaneously reducing unemployment, we will need to moderate wage and price increases. The current pay and price standards have played a significant role in holding down inflation. At this juncture, however, they have outlived their usefulness. We should, therefore, continue to explore possible approaches to incomes policy in conjunction with our economic renewal program.

B. Economic Effects of the Proposed Economic Renewal Program

The effects of the proposed economic program--which is assumed to include tax and spending initiatives which total about $29 billion for the calendar year 1981--can be seen most easily by contrasting the likely course of the economy in the absence of the program with the path based on enactment of the program. CEA's analysis of the two paths suggests that although modest in size, the program should nevertheless have a visible and beneficial impact on our economic performance.

More specifically, the program is likely to achieve the following:

-- Employment gains resulting from the program should be in the neighborhood of 450,000 in the fourth quarter of 1981 and rise to 900,000 by the end of 1982. These gains are on top of those additional jobs created in the normal course of events by the recovery from the recession, as well as those jobs stimulated by new programs already in the budget.

-- The unemployment rate should be pulled down by 0.4 percentage points in the fourth quarter of 1981, and by 0.8 percentage points in the fourth quarter of 1982. This would put the level of the unemployment rate in the neighborhood of 8% at the end of 1981, and 7% at the end of 1982.

-- Growth in real GNP from the fourth quarter of 1980 to the fourth quarter of 1981 should be boosted by 1-1/4 percentage points, while for the year ending with the fourth quarter of 1982, the program should boost real GNP growth by 3/4 of a percentage point.

Reflecting both the economic program and the economic growth which is likely to occur in the absence of the program, the overall advance in real GNP during 1981 and 1982 should proceed at an annual rate of from 4% to 5%. Growth during 1981 is likely to be at the bottom end of this range but should pick up somewhat in 1982.

-- Real business fixed investment will receive particular attention in the program via the liberalization of depreciation and the expansion of the investment tax credit. We estimate this will boost real investment--above what it would be in the absence of the program--by 4% in the fourth quarter of 1981, and a significant 11% by the fourth quarter of 1982. These are precisely the sorts of gains we need to begin to meet our investment requirements for the 1980s.

-- Since part of the program involves a reduction in business costs (via credit for Social Security taxes paid), inflation in 1981 could well be moderated a few tenths of a percentage point as a result of the program. This effect is likely to disappear by 1982. What this suggests is that the proposed package should provide a forward looking stimulus to economic activity without adding to inflationary pressures. Indeed, over the longer run the stimulus to investment should be to help improve both our productivity and inflation performance.

II. Possible Elements of a Tax Program

Table A summarizes the estimated revenue costs of the various elements of the tax program. If all items were included, the package would result in a calendar year 1981 reduction in liabilities of $27.5 billion, and a fiscal year 1981 reduction in receipts of $7.3 billion. These estimates are based on the assumption that the program is enacted by Congress during the spring of 1981, that the liberalized depreciation proposal is made effective with respect to qualifying investments made on or after January 1, 1981, and that the individual income tax cuts are made effective as of January 1, 1981.

Assuming all elements of the tax program are adopted, 56% of the tax liability reduction in calendar year 1981 would be allocable to business (liberalized depreciation, refundable investment tax credit, targeted investment tax credit, and half of the 8% social security credit). The tax progrqm could be modified by providing for refundability of 50% of the investment credit rather than the 30% assumed in Table A. To hold down the revenue cost during the first year, this modification would be combined with a phase-in of the reduction in the marriage penalty. Under this modification, the total size of the package in 1981 would decrease by $0.7 billion and would increase by 1985 by $1.5 billion. The percentage of the first year tax reduction allocable to business would be 63%.

The Senate Finance Committee is expected to report a tax bill at the end of this week that will provide for an aggregate tax reduction in 1981 of more than $39 billion, of which approximately 55% will be allocable to individuals and the remainder to business. The tax reduction per family will be much larger than the tax reduction per family under the Administration's proposal.

A. Constant Rate Depreciation System

In order to encourage a substantial increase in private capital investment to meet the backlog of national needs, EPG recommends that the Administration propose, for enactment by Congress in January, a new system of liberalized depreciation. Treasury's proposal for a constant rate depreciation system ("CRD") has the following features:

-- Fewer Classes. The number of asset classes would be reduced to about 25 to 30 from the 130 provided for under current law. There would be three asset classes (for common assets and buildings) and roughly 27 classes for various activities such as agriculture, construction and different categories of manufacturing.

-- Single Depreciation Rate for Each Class. A single depreciation rate would replace the choices of "life" and "method" for depreciation. In most cases, this rate would be equivalent to the double-declining balance method applied to the shortest allowable present-law lives in each class, plus a speed-up of 40%.

-- Immediate Effectiveness. CRD would be made effective immediately upon the specified effective date thus avoiding 10-5-3's complicated phase-in rules and the possible adverse investment incentive effects.

-- Accessibility to Small Business. The substantial simplification from present law would make accelerated depreciation more readily available to all firms--large and small.

-- Boost to Investment. Acceleration of depreciation would increase the rate of return on new investments and would substantially increase cash flow for those firms investing in new plant and equipment.

-- <u>Minimal Distortion</u>. The benefits of the accelerated depreciation would be distributed nearly equally to all assets and industries thus minimizing the distortions inherent in other approaches to depreciation reform.

<u>Revenue Cost</u>

	($ billions)				
	1981	1982	1983	1984	1985
CY Liabilities	6.3	12.4	16.5	20.6	24.2
FY Receipts	2.8	9.0	14.3	18.4	22.2

B. Refundable Investment Tax Credit

Under current law the 10% investment credit is allowed only to the extent of tax liability (100% of the first $25,000 plus 90% of the remainder--80% in 1981). Unused credits can be carried back three years and forward seven years.

Treasury estimates that about $1.6 billion of investment credits expire unused per year. However, a larger amount of investment credit is not utilized in the year of investment but must be carried over. In 1979, it is estimated that $12.6 billion of credits from 1979 and prior years were carried over to 1980.

Allowing 30% or 50% of the investment credit to be refundable without regard to tax liability would mean that a significant portion of credits for new investment after the effective date would be utilized currently. (The portion of the investment credit which is not made refundable would be available for use under the provisions of current law. EPG considered making 100% of the investment credit refundable, but the revenue loss-- $5.6 billion in calendar year 1981-- was considered excessive.)

The question of making the investment tax credit refundable has arisen repeatedly since the investment credit was adopted in 1962. Senators Long and Kennedy have long favored refundability, while Treasury has previously opposed it.

Revenue Cost (30% Refundability)

	($ billions)				
	1981	1982	1983	1984	1985
CY Liabilities	2.4	2.6	2.5	2.5	2.3
FY Receipts	0.2	2.4	2.6	2.5	2.5

Revenue Cost (50% Refundability)

	($ billions)				
	1981	1982	1983	1984	1985
CY Liabilities	4.0	4.3	4.2	4.2	3.8
FY Receipts	0.2	4.0	4.3	4.2	4.2

Advantages

-- Making a portion of the investment credit refundable would boost incentive for investment in new equipment by reducing uncertainty about utilization of the credit.

-- If the purpose of the investment credit is to reduce the cost of capital goods, a refundable investment credit is conceptually correct. The current limitation on utilization of the credit based on a person's Federal income tax liability is not consistent with this purpose.

-- Immediate tax relief would be provided to those industries unable to use the investment credits they will generate in 1981. Rapidly growing firms, firms experiencing cyclical downturns, and newly organized firms with start-up losses typically are not able to use all their credits. In 1976, the latest year for which Treasury has a complete file of tax returns, the major beneficiaries of refundability would have been petroleum refining, primary metal manufacturers (steel), electric utilities, and railroad transportation. The steel and auto industries would be major beneficiaries in 1981.

Disadvantages

-- Refundability of the investment credit makes it more difficult to resist refundability of other credits and to resist extending the credit to tax exempt organizations such as universities.

-- Some would view refundability as subsidizing losers that can never earn a profit.

-- Per dollar of current year revenue loss, refundability is relatively ineffective since about two-thirds of the immediate revenue loss represents an acceleration of credits that would otherwise have been allowed on future years.

C. Targeted Investment Tax Credit

An additional 10% investment credit could be allowed for qualifying investments certified by the Commerce Department, which would be authorized to issue certificates of necessity for up to $1 billion of additional investment credit. In certifying investments entitled to the bonus credit, the Commerce Department will be required to consider the extent to which investment will provide job opportunities in and contribute to the economic base of the distressed area. Thirty percent (or fifty percent) of the targeted investment credit would be refundable (assuming an affirmative decision were made on refundability for the regular investment tax credit). The tax basis of the certified equipment for purposes of computing depreciation would be reduced by the additional investment credit. Certificates of necessity would expire if after five years from the date of issue the plant or equipment has not been placed in service. Areas would be designated for the additional investment credit only for a period of five years.

At the present time the criteria for designation of distressed areas have not been developed. One possibility would be to define distressed areas as states with unemployment above some specified percent. Another possibility would be to develop criteria along the lines of the Administration's 1978 proposal. Those criteria involved a rather complex formula based on the State unemployment rate, percent change in per capita income, percent change in population, and percent change in employment.

Revenue Cost

Assuming enactment in the middle of 1981 and authorization of $1 billion a year beginning in FY 1982, the revenue impact would be:

	($ billions)				
	1981	1982	1983	1984	1985
CY Liabilities	0.2	1.0	1.0	1.0	1.0
FY Receipts	*	0.7	1.0	1.0	1.0

Advantages

-- A targeted investment credit would be responsive to the desire to do something for areas hard hit by unemployment.

Disadvantages

-- Targeted incentives for distressed areas could channel capital into less efficient uses, delay needed economic adjustments, and reduce productivity increases.

-- An employment subsidy would be more effective than a targetted investment credit to deal with high unemployment.

-- If the regular investment credit is made refundable, it may be responsive to the desire to help declining industries and regions.

D. Credit for Social Security Taxes Paid

A credit of 8.0% of Social Security taxes paid would slightly more than offset the scheduled rate increases from 6.13% to 6.65% for employees and employers (and offset 60% of the increase from 8.10% to 9.30% for the self employed). The credit would be nonrefundable to individuals, although it is proposed that the earned income tax credit be liberalized to compensate the lower income parents covered by Social Security. Before legislation is drafted, Treasury would consider possible technical modifications to deal with low income, childless couples and single persons who pay Social Security taxes but who are not eligible for the earned income tax credit.

The credit would be refundable to employers, some of which are state and local governments and nonprofit institutions. Businesses would be required to reduce the deduction for Social Security taxes by the amount of the credit. Businesses would take the credit into account in making estimated income tax payments and would be permitted to claim a refund if estimated taxes are in fact negative.

The credit for Social Security taxes paid would be in effect for two years during which time the broader problems of Social Security financing could be addressed. The revenue estimates are based on the assumption that tax reductions in 1983 and beyond would replace the credit.*

Revenue Cost

	($ billions)				
	1981	1982	1983	1984	1985
CY Liabilities	12.8	14.5	16.2*	18.0*	21.0*
FY Receipts	3.8	19.3	15.7*	17.5*	20.1*

Advantages

-- The employer portion of the Social Security credit will reduce labor costs and this should have a modest anti-inflationary effect. (CEA estimates a reduction in the rate of inflation of roughly .2 by the fourth quarter of 1981.)

-- This tax reduction is more progressive than most individual tax reductions.

Disadvantages

-- Those not subject to Social Security--the retired, many government workers, and some non-profit employees--would complain that they do not receive any benefit from the income tax credit.

-- The recent report of the Social Security trustees indicated that the whole issue of Social Security financing will have to be addressed again, and this may not be the appropriate time to open up Social Security issues.

E. Liberalization of Earned Income Tax Credit

Under present law, taxpayers with dependent children may claim an earned income credit equal to 10% of the first $5,000 of earnings. As income increases between $6,000 and $10,000, the credit is phased out at a 12.5% rate. The earned income credit is refundable.

Expanding the earned income tax credit would complement the proposal to provide for a tax credit for Social Security taxes paid. An increase of two percentage points in the rate of credit to 12%, and phasing out the credit from $7,000 to $11,000, would more than compensate most parents who could not be compensated through a nonrefundable credit for the increase in Social Security Taxes paid. A somewhat smaller increase in the earned income credit was part or your welfare reform bill.

Revenue Cost

	($ billions)				
	1981	1982	1983	1984	1985
CY Liabilities	0.9	0.8	0.8	0.7	0.6
FY Receipts	*	0.9	0.8	0.8	0.7

Advantages

-- A generous increase in the earned income credit is one way to ensure that a significant portion of any tax reduction is provided to low income families.

-- The suggested increase in the earned income credit more than compensates for the Social Security tax increase for low income taxpayers with dependent children.

-- Would achieve passage of an important component of your welfare reform bill.

Disadvantages

-- The earned income credit does not reach low income workers without dependent children.

-- The earned income credit may reduce work incentives for a number of workers. Under current law 54% of the taxpayers who benefit from the earned income credit have income above $6,000 and thus are subject to a 12.5 percentage point increase in their marginal tax rate. The proposed change increases this marginal tax rate in the phase-out range to 15%.

F. Reduction of Marriage Penalty

Rapidly increasing money wages are pushing more households into the steeper portions of the rate schedule that was enacted in 1978. The higher rates that apply to any additions to family income are felt especially by families with two wage earners, who constitute an increasing percentage of married couples. The labor force participation rate of wives in 1978 was 47.6%.

Treasury has developed a proposal which would partially correct for the penalty. Married couples filing jointly would be permitted a special tax deduction up to 10% of the lesser earning spouse's income up to a maximum deduction of $3,000.

Revenue Cost

	($ billions)				
	1981	1982	1983	1984	1985
CY Liabilities	4.7	5.6	6.6	7.7	8.9
FY Receipts	0.3	5.2	6.0	7.1	8.0

If the option to propose 50% refundability of the investment credit is adopted in lieu of refundability of 30% of the investment credit, it will be necessary to reduce the size of the overall tax package to keep it within reasonable bounds. It is suggested that this be accomplished by phasing in the reduction of the marriage penalty by providing for a deduction of 5% of the lesser earning spouse's earned income up to $30,000 in 1981 and 10% thereafter.

Revenue Cost (5% in 1981)

	($ billions)				
	1981	1982	1983	1984	1985
CY Liabilities	2.4	5.6	6.6	7.7	8.9
FY Receipts	0.2	3.1	6.0	7.1	8.0

Advantages

-- The suggested approach is far simpler and less costly than the more popular alternative: optional separate returns. (Treasury estimates optional separate returns would cost roughly $10 billion in 1981.)

Disadvantages

-- Single individuals and one earner married couples would complain that they would not benefit from the two earner credit. (In 1979, 40 million single returns, 6.3 million unmarried, head of household returns, and 23 million joint returns showing one earner were filed.)

G. Hardship Exclusion for Americans Working Abroad

The taxation of Americans working abroad has been identified by the President's Export Council as having a significant effect on U.S. competitiveness in some areas, especially for U.S. firms for which labor costs are a major part of total costs. Secretary Klutznick and Ambassador Askew, in their memorandum to you on export promotion and disincentives, have recommended that you indicate a willingness to give early and favorable consideration to appropriate measures to deal with this.

EPG has reviewed a Treasury proposal under which Americans employed in hardship areas would be permitted to exempt from tax the first $25,000 of foreign earned income plus 60% of the next $60,000 (a total exemption of $61,000 for persons earning $85,000 or more).

The exemption would be allowed in locations where the State Department authorizes a post differential to the U.S. government employees to compensate for unhealthy or otherwise adverse living conditions. It could be tied, like the hardship deduction now in section 913 of the Internal Revenue Code, to locations eligible for a 15% or higher differential; or it could be broadened to include those for which a 10% differential is allowed (10% is the lowest). In either case, it would include all the Middle East and would exclude all OECD countries, Bermuda, the Bahamas, Rio, Hong Kong, Singapore, and South Africa.

Revenue Cost

	($ billions)				
	1981	1982	1983	1984	1985
CY Liabilities	0.2	0.3	0.3	0.3	0.4
FY Receipts	0.1	0.3	0.3	0.3	0.3

Advantages

-- The export community has identified taxation of overseas Americans as one of the major barriers to U.S. competitiveness. The proposal would respond to these concerns.

-- The incentive would go to places where a financial incentive is needed to get Americans to work, typically places where the level of public services is low.

Disadvantages

-- The proposal would be more favorable to low cost than high cost hardship areas.

-- The proposal would favor those with outside income by putting them into lower brackets.

-- The proposal would not fully remove the competitive disadvantages the American export community has expressed concern for and it would not help those in Europe. On the other hand for Europe we would retain the 1978 relief provisions for extraordinary costs of living abroad, e.g., cost of living differential, excess housing cost deduction, education allowance.

III. Possible Spending Initiatives

It is important to put the spending proposals into context. A substantial spending increase is occurring automatically in response to economic conditions brought on by the recession. In FY 1980 and FY 1981, spending for unemployment compensation in the regular unemployment insurance program and the trade adjustment assistance program, other income security programs, and programs designed to support the savings and loan and housing industries, has been revised upward by $18 billion since March in response to changing conditions in the economy. We have in place programs for unemployment compensation that will spend nearly $20 billion in FY 1981. In addition, we have programs that will spend more than $11 billion on public service employment and training. Our $2 billion Youth Initiative has yet to be finally acted upon by Congress.

The central theme of the economic program for the 1980s is job creation through rebuilding of the industrial base of the economy and promoting the energy security of the country. This theme and its important elements are not new to this Administration. It is well to recall that we have already made major proposals along these same lines. For example:

-- The initiative now pending before Congress for expanding the Economic Development Administration more than two-fold responds to widely held opinions of the need for a new "industrial policy." The new proposal in this package builds upon that initiative to further expand the activities of EDA.

-- This Administration has a strong record of promoting basic research. The proposals made here will sustain the growth of real basic research that would have been eroded by higher inflation.

-- Considerable progress toward implementing sound energy policies has already been made. Both the Energy Security Corporation and the Solar Bank will yield major results later in the decade. The steps we are now proposing would accelerate the activities of the Solar Bank and provide immediate reductions in energy usage. We propose to weatherize and install energy conservation devices in public sector buildings and in the homes of low income individuals who are unlikely to be able to respond to the incentives for conservation provided by higher energy prices.

For the most part, the spending proposals differ substantially--both in character and funding level--from the package of countercyclical spending programs that people usually expect during a recession. For this reason there will be some who will criticize the program as an inadequate response to the recession, and to your commitments to the platform. They will criticize the fact that it creates relatively few public jobs, and is small in comparison to the tax package. Nonetheless, there are compelling arguments to support the proposed approach. The spending proposals, for the most part, involve programs that can be accurately characterized as necessary investments in future economic and industrial growth, and as aids to productivity that will help reduce inflation, rather than as "stimulus" that might reignite it.

A. Investment in Economic Base

The Administration has already increased basic research, export assistance and economic development significantly. In addition, we propose additional 1981 and 1982 funding above current budget estimates in the three areas described below.

1. Industrial Adjustment and Revitalization

To expand and make more effective the Federal Government's efforts to promote capital formation and create employment in regions experiencing difficulties adjusting to industrial change, the Administration has proposed new EDA development financing legislation and funding that would totally restructure and redirect EDA in a manner that makes it an even more effective vehicle for stimulating industrial adjustment. If the Administration's proposals are enacted, EDA's overall program level would grow from $0.6 billion in 1980 to $1.5 billion in 1981. Building on this proposal, we propose further expansion of EDA based on the following key elements:

-- Quick enactment of the Administration's proposed EDA development financing initiative. This initiative provides all the additional financing tools necessary (development grants, loans, interest subsidies and guarantees) for the government to react flexibly and effectively in dealing with economic adjustment problems. The initiative is tied up in the conference on the EDA reauthorization legislation, but a strong push--starting with our economic policy speech--could jar it loose. Such a renewed effort in support of this legislation, and tied to our industrial initiative, should serve both to give us overdue credit for that proposal, and to indicate that the Administration is not only proposing but enacting its industrial policy program. The EDA bill signing ceremony will provide a good opportunity to emphasize our concern and progress.

-- Expanded funding for EDA, centering on the newly enacted development authorities. Program levels would be increased by $1 billion in 1981 and $2 billion in 1982. The bulk of the increases, $800 million in 1981 and $1.65 billion in 1982, would be for expanded loan guarantees to channel private sector capital to development financing projects. Other increases would be distributed among development grants, direct loans and interest rate subsidies.

We recommend that announcement of an affirmative decision on expanded funding for EDA be combined with the establishment of the Industrial Revitalization Board (described below at page 36). Among other things, the Board would provide advice on the organization of the Federal Government's present programs for economic development.

	1981		1982	
	BA	O	BA	O
	($M)		($M)	
Industrial Adjustment and Revitalization	198 to 1,000	31	373 to 2,000	180

NOTE: The BA amount will depend upon the percentage share of the loan guarantees supported by actual appropriations. If the guarantees are fully appropriated, the BA required would be the full $1 billion in 1981 and $2 billion in 1982.

2. Scientific Research and Technological Development

Technological advance has accounted for an estimated 30-50% of the Nation's economic growth in the period 1950-70. The Federal Government can play an important role in fostering technical innovation. Last year in your Innovation Message you affirmed your intention that it will do so.

-- Tax Initiatives. The tax package we are recommending fulfills, at least in part, your promise to examine new tax incentives for research and development. Accelerated depreciation and the refundable tax credit will spur some increase in the rate of technical progress through the introduction of new processes in new plants.

-- Basic Research Spending. In the Innovation Message you also committed to real growth in Federal R&D spending. This commitment has been eroded by high inflation and congressional budget reductions and is now estimated at less than 3% over the entire 1979-81 period. The amended 1981 budget ($4.9 billion for basic research) provides less than real growth over FY 1980.

All your advisers agree that the FY 1981 basic research budget should grow by at least the 3% originally planned in the 1981 budget (an addition of $225 million). With this additional support there are a number of specific programs which can be enhanced to stimulate research and to improve its equality. Examples are: (1) the NSF's program to enhance collaboration between universities and industry to make university work more relevant to our economic need; and (2) initiatives--modeled after the Cooperative Automotive Research and the Ocean Margin Drilling Programs--to finance sectorally oriented research jointly between the Federal government and key industrial sectors.

In addition to 3% real growth, your advisers believe that $50 million should be provided in FY 1981 to initiate a program to upgrade university research facilities. For 1982, up to $275 million may need to be added to the amounts now provided for in our planning ceilings to assure 3% real growth and continued support for science and engineering facilities at universities.

-- Innovation and Small High-Technology Firms. Your innovation study also recommended programs to support small technology firms. Examples of improvements through increased funding are: expansion of the small business innovation research grant program to provide seed money for research on concepts not yet ready to compete for venture capital; and an experimental program of two Regional or State Corporations to provide equity financing and related assistance to small high-technology firms.

All of your advisers agree that U.S. policy should now move more toward increased support of this class of firms, as have the policies of West Germany, France and other nations. OMB and OSTP believe that $50 million spread over FY 1981 and FY 1982 can help accomplish these goals.

We recommend that you announce you are committing a total of $600 million in new budget authority for FY 1981 and FY 1982. We will announce the programmatic details after the FY 1982 budget process is complete. In the interim the Administration will seek advice from universities and others as well as refine current internal thinking on which programs merit further support. (NOTE: DPS believes that without a much larger, targeted tax incentive for research, it will not be possible to make an argument that this program is large enough to warrant a claim that we are unleashing American technology or supporting it at levels similar to those provided by the Germans or the Japanese.)

-- Related Programs. The Vice President also recommends that the Scientific Research and Technological Development component of the recovery program be broadened to challenge the higher education community to help overcome obstacles to innovation, regional growth, and the competitive strength of our economy that cannot be solved by science and technology alone. Illustrations of such obstacles include non-technological barriers to higher productivity, disputes over allocation of resources within regions (e.g., water which is impeding development of important energy resources in the West), the need for better methods to promote positive adjustments of our workforce, and the need for business students to receive better language and area studies training necessary to compete more successfully with European and Japanese businessmen, and the need for more fellowships and assistantships in critical areas.

He suggests a competitive program to permit creation of 6-12 Regional Industrial Innovation Institutes--these would be multi-disciplinary research and management service centers. The Vice President recommends that these initiatives be included in the $600 million limit for R&D and other graduate programs.

	1981 BA ($M)	1981 O ($M)	1982 BA ($M)	1982 O ($M)
Science and Technology	295	165	305	335

3. Increase Federal Highway Obligation Level

Evidence is mounting that our aging national highway system--a critical component of the distribution network of the economy--will require increased investment in repairs and rehabilitation if it is to continue to provide adequate support. We believe we can now justify selected relaxation of earlier highway constraints imposed last March because of overriding fiscal objectives. The proposed $500 million increase in FY 1981 highway obligation from $8.4 billion to $8.9 billion would help address what is emerging as the 1980's major highway concern--adequate preservation of our national highway system. No new budget authority would be required.

	1981 BA ($M)	1981 O ($M)	1982 BA ($M)	1982 O ($M)
Increase Federal highway obligation level	--	80	--	260
(Program level increase)	(500)		(--)	

B. Energy Conservation

In order to accelerate the attainment of energy conservation benefits, we are recommending an increase of $1.1 billion over FY 1981-82 for these programs.

-- Solar Energy and Conservation Bank. The Bank, which was just signed into law, will provide significant subsidies to moderate and low income homeowners and renters, and to commercial firms. The $100 million in additional funding proposed will permit the Bank to assist without delay those who seek its help in making energy saving investments. More specifically, it will allow the Bank to support additional conservation and renewable energy investments for 83,000 households at the maximum conservation subsidy level.

	1981		1982	
	BA	O	BA	O
	($M)		($M)	
Solar Energy and Conservation Bank (HUD)	100	75	--	25

-- Public Housing Weatherization. The Federal government, through the Department of Housing and Urban Development, owns some 1.2 million public housing units. Conservation investments in this area will provide immediate benefits to those who live there as well as reduce the long-term costs to the Federal Government of maintaining these units. With the proposed increase of $200 million per year, HUD will undertake weatherization commitments for an additional 192,000 dwelling units over the next two years. The additional amounts will be earmarked in each year from the overall public housing appropriation. No new budget authority is required; outlays spend out slowly because the rehabilitation work, which takes place immediately, is financed through long-term bonds.

	1981		1982	
	BA	O	BA	O
	($M)		($M)	
Public Housing Weatherization (HUD)	(200)	(10)	(200)	(20)

-- <u>Federal Building Weatherization and Coal Conversion</u>. The Federal Government owns and operates large numbers of buildings and power plants. We propose to increase investments in these facilities by $175 million in 1981, thereby helping to ensure that Federal buildings meet high standards of energy efficiency and that selected power plants owned by the Federal Government cease using oil and gas and convert to coal.

	1981 BA	1981 O	1982 BA	1982 O
	($M)		($M)	
Federal Buildings Weatherization and Coal Conversion (DOE)	175	33	--	70

-- <u>Schools and Hospitals Weatherization</u>. We propose to increase Federal support for the weatherization of schools and hospitals by $240 million over the next two years. U.S. schools and hospitals are now facing sharply rising energy costs, which translates into higher medical and education bills. By making these facilities more energy efficient, we can increase energy efficiency and reduce inflation. The additional funding will allow grants for an additional 4,800 energy conservation projects in school and hospital buildings.

	1981 BA	1981 O	1982 BA	1982 O
	($M)		($M)	
Schools and Hospitals Weatherization (DOE)	100	50	140	120

-- <u>Low-Income Weatherization</u>. The final recommendation is to further expand DOE's low-income weatherization program, which with additional funding to $100 million per year can provide for weatherization of 200,000 more homes over the next two years.

	1981 BA	1981 O	1982 BA	1982 O
	($M)		($M)	
Low-Income Weatherization (DOE)	100	100	100	100

C. Human Resources

A recession is a good time to invest in building a better labor force for the future. During the next decade, we will experience important changes in the demography of the population as well as in the structure of labor demand. Training skilled workers requires access to expensive capital equipment and experienced instructors. A period of slack demand can make both available, and a cooperative effort among government, labor and industry can provide the opportunity to retrain workers whose skills have become obsolete and to open up good paying jobs to thousands of workers who will otherwise be consigned to work well below their productive potential.

More than 8 million jobs have been created during this Administration. Direct Federal resources have been targeted upon the most disadvantaged, providing training and work experience. Federally-supported private industry councils have become partners of CETA prime sponsors in building fruitful work experiences and developing private sector jobs. The President has proposed a $2 billion Youth Initiative, combining programs of the Department of Labor and the Department of Education, to assist disadvantaged youth to break free from the unemployment and hopelessness that too many experience.

Following are six possible additional initiatives:

1. Positive Adjustment

All of your advisers support a proposal focused on devising sound incentives for retraining or relocation of workers making the transition to growing industrial sectors. The Department of Labor is now preparing a preliminary plan for a dozen or so pilot projects which would test a variety of incentives. It has requested proposals for a more definitive plan. The pilot projects would begin in 1981 and continue through 1982, providing information we do not now have about how to design effective programs to help experienced workers make the necessary transition to jobs in different industries or locations.

	1981		1982	
	BA	O	BA	O
	($M)		($M)	
Positive Adjustment Assistance Demonstration (DOL)	10	5	50	30

no

In addition to the above, DPS recommends that you commit to a major 1982 positive adjustment assistance program. DPS argues that such a promise is necessary to show that the Administration is as seriously committed to investment in human resources as it is to investment in physical capital.

If successful, then commit

OMB has serious reservations about making such a commitment at this time, and argues that we do not know how the adjustment process works today, what the problems in that process are, or what the Federal Government ought to do to assist adjustment. Until we know more, the Administration should not commit itself to a major adjustment assistance program. This is the reason for the above-described positive assistance demonstration program.

2. Industry/Government Cooperation

All of your advisers support a proposal focused on improving the responsiveness of the Nation's vocational and technical training efforts to the needs of growing high technology industries. The Department of Education would use the funds to support cooperation between the government and high technology industries to develop vocational and technical training programs to prepare students for work in high technology fields. Improving cooperation between government and industry will also be addressed in the development of the Administration's proposals for reauthorization of Federal vocational education assistance programs to be presented to Congress next year.

	1981		1982	
	BA	O	BA	O
	($M)		($M)	
Demonstration of industry/government cooperation in vocational and technology training (ED, NSF)	10	5	25	20

3. Federal Supplemental Benefits (FSB)

By the end of August, the Administration will face substantial pressure to enact an emergency extension of the Unemployment Insurance system (UI) similar to the Federal Supplemental Benefit (FSB) program of the 1974-75 recession. This pressure is likely to stem from higher unemployment rates and sharply increasing exhaustions from the regular UI programs, and the triggering on of the Extended Benefits programs.

DPS and DOL recommend that a new FSB program be proposed which would include a State trigger, a "weeks of work" requirement, and a pension offset requirement. The specific features would be:

-- State trigger set at an insured unemployment rate (IUR) of 6.0% and with EB recipients not included in the trigger rate. Moreover, no FSB benefits would be paid until the national IUR exceeded a threshold of 5.0% in order to limit FSB benefits to a national recession.

-- Weeks of work requirement set at 32 weeks, so that only workers with 32 or more weeks in the base period would be allowed to receive FSB benefits.

-- Duration limited to an additional 13 weeks beyond Extended Benefits in order to reduce the work disincentive effects.

-- A dollar-for-dollar pension offset in order to limit the provision of FSB benefits to retirees.

-- A work test similar to the work test contained in the 1977 amendments, requiring that FSB recipients take any available job.

-- Financing by general revenues, because the trust fund balances are not adequate to fund even a modest FSB program. In fact, advances from general revenues will be required to fund the EB program.

The outlay costs of the recommended program would be about $744 million in FY 1981 and $617 million in FY 1982. As shown in the following calculation the next costs, after allowing for savings in the Trade Adjustment Assistance program, would be about $526 million and $435 million in FY 1981 and 1982, respectively.

	($ million) FY 1981	FY 1982
State Trigger of 6.0% exclude EB from IUR	1,094	913
Minus Weeks of Work Requirement (22%)	- 241	- 205
Minus Pension Requirement (10%)	- 109	- 91
Minus TAA Offset (20%)	- 218	- 182
Net Program Costs	$ 526	$ 435

OMB opposes FSB for three reasons. First, it provides general revenue financing for benefits without any requirement that recipients be needy; general taxpayers should not be required to provide incomes to families who cannot demonstrate they need it. Second, it provides a maximum of 52 weeks of benefits even though the proportion of recipients who exhausted 52 weeks of benefits during the last FSB program was actually <u>less</u> than the proportion who exhaust 26 weeks of benefits in normal times. Third, the proposal does not include corrections of the deficiencies in the present 39 week <u>extended benefit</u> program, including a national trigger that requires extended benefits in states with low unemployment.

	1981 BA ($M)	1981 O	1982 BA ($M)	1982 O
Federal Supplemental Benefits	744	744	617	617
Net	(526)	(526)	(435)	(435)

4. Training (CETA Title II-B/C)

DOL and DPS recommend that funding of training opportunities under CETA Title II-B/C be increased by about $300 million in FY 1981 and the increased program levels would be sustained in FY 1982. Title II-B produces a broad range of employability development and skill training services to economically disadvantaged, unemployed workers. This would provide for an additional 54,000 service years of training over current levels, an increase felt to be readily sustainable by program operators. Expanded training and employability development activities would focus on persistent skill shortages and anticipated areas of long term job expansion. Maximum emphasis would be placed on the use of on-the-job training in expanding industries.

Program operators would also be encouraged to make maximum use of the Title II-C authority which allows up to 6% of II-B funds to be used for re-training or upgrading dislocated skill workers. We should retain the flexibility to channel a portion of these funds through Title III, if that would lead to more effective targeting on areas of greatest need and most effective tripartite cooperation.

OMB opposes any increase in the funding base for Title II-B/C because there is no satisfactory evidence that the training actually helps the recipients. OMB believes such evidence is essential before an increase, particularly of the magnitude proposed, is considered.

	1981		1982	
	BA	O	BA	O
	($M)		($M)	
Increased CETA Training	300	300	300	300

5. Private Sector Initiatives (CETA Title VII)

The FY 1981 budget for the private sector initiative program calls for $150 million in BA and outlays of $360 million in anticipation of a $210 million carryover from FY 1980. This will allow for an aggregate expansion inthe program over the anticipated FY 1980 outlay level of $115 million. However, prime sponsors who initiated their PSI program aggressively in FY 1980 and expended their full share of the authorized FY 1980 level of $325 million may now face a substantial program reduction. DOL and DPS propose an additional $75 million in BA in FY 1981.

OMB opposes any increase in the 1981 Private Sector Initiative because it believes the additional money could not be used. The 1980 outlay estimate for the program has been reduced since the Mid-Session Review from $164 million to $115 million because funds are not being spent at the rate projected. OMB is convinced that the $309 million in outlays now projected for 1981 will not be achieved. History shows that private sector jobs programs cannot be dramatically increased when unemployment rates are high. An estimate of $150 million is more realistic. If there is a maldistribution of available resources, the Secretary has the authority to transfer money from the non-users to the users.

	1981		1982	
	BA	O	BA	O
	($M)		($M)	
Private Sector Initiative	75	75	--	--

6. <u>Youth Programs (CETA Title IV)</u>

The currently planned FY 1981 budget provides a $300 million increase in budget authority and an estimated $100 million in outlays for special youth programs under CETA Title IV. DOL and DPS propose increasing funding in FY 1981 by an additional $200 million. One hundred million dollars in outlays in FY 1981 would continue to be reserved for planning and phase-in of the Administration's new Youth Initiative planned for full implementation in FY 1982. The additional $200 million would be outlayed in FY 1981 under the existing youth programs. Prime sponsors would be encouraged to focus additional resources on out-of-school youth who will be most affected by the economic downturn.

OMB opposes any increase in the current youth training and employment program. The President's Youth Initiative is a carefully designed program intended to combine the government's efforts in education, training and employment toward increasing the skills of those youth who suffer the most as a result of unemployment. Requiring prime sponsors to build up current youth programs will distract them from the complex task of putting the new program in place and jeopardize its chances of success.

	1981		1982	
	BA	O	BA	O
	($M)		($M)	
Youth Programs	200	200	--	--

Finally, DPS recommends inclusion of our proposed Vocational Education Policy Review in the announcement, stating that we will look at vocational education broadly in light of our need in the coming decade for a more highly trained workforce, and the needs of minority and poor people for access to the mainstream. This would also ensure that industry and labor play a greatly expanded role in employment and training efforts as major partners of government at all levels.

D. Countercyclical Revenue Sharing

There is growing pressure from some members of Congress and from various interest groups for funding of a $1 billion countercyclical revenue sharing program in 1981. The Administration's budget currently includes $0.5 billion for Transitional Assistance Payments, which the Congress has rejected. Thus, the countercyclical proposal would represent a net addition of $0.5 billion to our current request.

This proposal would appeal to organized labor and local government groups. In addition, the General Revenue Sharing reauthorization legislation reported by the House Government Operations Committee includes a $1 billion countercyclical authorization. This authorization was supported by the Administration as the price of having the Committee reconsider and remove from its bill out-year authorizations which (if appropriated) would have continued the $2.3 billion state share of GRS.

Notwithstanding its political appeal to some, a countercyclical revenue sharing proposal does not fit well in an overall package aimed primarily at eliminating or reducing long-term structural problems. As its name indicates, its purpose is to address a cyclical economic problem. Furthermore, we are stating publicly that recovery from the recession is now under way and countercyclical stimulus is inappropriate. Its inclusion would, therefore, impair somewhat the overall credibility of our claim to be proposing a long-term package, and attract criticism to the whole program that might otherwise be directed to the countercyclical proposal alone.

We believe you have three choices:

1. Propose funding at a $500 million level. This would not require an addition to our current budget proposal, nor inclusion in our economic package. It would, however, be taken as a reneging on legislative commitments or platform commitments, or both.

2. Propose funding at the $1 billion level and include the proposal in this package. This would please the interest groups, but detract somewhat from the credibility of and perhaps attract additional criticism to the overall package.

3. Propose funding at $1 billion, but announce the proposal as being separate from this package aimed primarily at long-term structural problems. This would be a little awkward, but would satisfy the interest groups and would tend to protect the credibility of this spending package.

		1981		1982	
		BA	O	BA	O
		($M)		($M)	
Countercyclical Revenue Sharing	(1)	500	500	--	--
	(2) & (3)	1,000	1,000	--	--

IV. Industrial Revitalization Board

The government confronts complex issues relating to industrial policy. To assure that it reaches the most appropriate conclusions regarding these issues and to reinforce the cooperative nature which must characterize the relationship between the government and the private sector, it is proposed that an Industrial Revitalization Board be established as a Presidential advisory committee. It would be subject to the Federal Advisory Committee Act. The Board would be comprised of 12 to 20 leaders of American labor, industry and the public.

The Board would be charged with making recommendations on how the government can improve its efforts in a number of both general and specific matters of economic and industrial policy. For example, it would:

-- Advise on the organizing of the Federal Government's present programs for economic development so they can most effectively promote investment to rebuild distressed areas of the country.

-- Recommend ways to mobilize public and private capital to achieve these results.

-- Advise on the need, if any, for new public facilities and infrastructure for economic expansion.

-- Recommend methods of dealing with large scale adjustments in communities and industries, particularly in regard to severe dislocations.

-- Provide guidance on renewing the skills of the American workforce.

There is some disagreement among your advisers about the range of issues which the Board would be asked to make recommendations on.

III

ECONOMIC GROWTH FOR THE 1980's

All Americans share a common commitment to achieve our Nation's economic goals of full employment, price stability and balanced growth.

Progress in achieving theses goals has been impaired over the last decade by inflation, the energy crisis, and declining American competitiveness.

These economic difficulties did not develop overnight. The roots of the problem go back a long time.

ECONOMIC BACKGROUND

The Post War Era, 1945-1965

For twenty years after World War II, the United States economy was engaged in supplying the pent-up demands deferred from the war and in helping to reconstruct the war-torn economies of other nations.

There was adequate American industrial capacity, a relatively slow growth of the work force, steady increases in capital investment per worker, increasing productivity, low inflation rates, and surplus in international accounts.

Although the economy experienced four recessions during this twenty-year period, the overall growth was healthy and real incomes improved.

Transition Period, 1966-1976

By the mid-60's, post-war reconstruction had been completed and the world economy entered a new period. Other industrial nations emerged as economic powers and began to play a greater role in world commerce.

In the United States, there was a faster growth of the work force, lower rates of increase in capital investment per worker, lower productivity growth, and higher inflation rates. International surpluses disappeared and the dollar was devalued. The international monetary system moved to a regime of floating rates.

The adverse trends were exacerbated by the Viet Nam War and by the explosion of world oil prices.

ADMINISTRATION ECONOMIC POLICIES

New Directions, 1977-1980

When the Carter Administration came to office, America faced an agenda of unsolved economic problems. The Administration began to chart new directions for the economy to address the basic causes of our difficulties and to provide the base for a resurgence of economic vitality.

A consensus was built to support the hard decisions to deal with the fundamental issues which formed a barrier to achieving our national goals.

Overall Economic Policy

One of the first objectives was to provide employment for a growing work force. A policy of economic growth opened up new opportunities. In three and a half years, over eight million jobs were created, more than in any similar period of time in our history. And a higher percentage of adult Americans were able to participate in work than ever before.

But the underlying inflation continued to be a clear and present danger. By Inauguration Day 1977, inflation had been building up for more than a decade. It was already deeply imbedded in our economic structure. There were many causes, aggravated by huge increases in world energy prices.

Inflation threatens our ability to achieve full employment; it reduces real incomes and values; it dries up job-creating investments; it impedes productivity; it breeds recession; and it falls most heavily on those least able to bear the burden.

President Carter has, therefore, assigned top priority to waging war against inflation. A comprehensive campaign has been directed at the fundamental causes, not just the symptoms. A broad array of policies has been brought to bear on all fronts on a continuing basis.

First, fiscal policy: For many years, federal spending had been growing at a faster rate than the overall gross national product. The Federal Government was becoming a larger and larger part of our economy. Cumulative deficits over many years added to inflationary pressures.

Neither a nation nor a family can live beyond its means for long without paying a heavy price.

The Carter Administration undertook to restore fiscal responsibility by restraining government spending while maintaining our historic human and social values.

There has been substantial progress, particularly if the Congress adopts the proposed Fiscal Year 1981 budget, now pending. Including the 1981 budget, real federal expenditures for President Carter's term will have grown at an average rate of less than 2% a year, compared with 4% for 1965-76 and 3.4% for 1947-65.

Second, monetary policy has been directed toward restraining the rate of growth of money and credit in order to reduce inflation over time. The coordinated efforts of the Administration and the Federal Reserve last March helped dampen inflationary expectations and curb speculation. Since then, interest rates have declined sharply while monetary aggregates have continued to expand within target ranges.

Third, wage and price policy: An important aspect of any anti-inflation effort is responsible behavior with respect to wages and prices. Fiscal and monetary policies are powerful weapons to attack the fundamental causes of inflation, but they take effect with some lag. So the Administration established a voluntary program to moderate pay and price increases.

The program has received widespread cooperation from both business and labor. As a consequence, inflation has been 1 to 1-1/2 percent lower than it would have been without such a program. However, any such program comes under strain over time, so we must continue to pursue sound fiscal and monetary policies.

Fourth, international policy: A sound and stable dollar is essential to achieving price stability in our domestic economy. A declining dollar increases the prices we pay for necessary imports and otherwise contributes to higher prices here at home.

The value of the dollar is adversely affected by deficits in our balance of payments. Large deficits developed because of the enormous increase in our nation's oil import bill.

The Carter Administration has pursued policies to bring our international accounts into balance. Compared with 1976, exports this year are up 91%. Agricultural exports have increased by 66% and nonagricultural exports by 97%. Large balance of payments deficits in earlier years were brought into equilibrium in 1979 and the outlook continues favorable.

The Administration also dealt forcefully with unwarranted exchange markets pressures on the dollar. Strong measures were introduced on November 1, 1978 and have been maintained since that time.

The value of the dollar in relation to other international currencies has been strengthened. On a trade weighted basis, the dollar is now 6% higher than it was two years ago.

Fifth, energy policy: In the last analysis, the war against inflation will not be won unless we deal with the energy issue. The more than ten-fold increase in world oil prices over the decade of the 70's has been a principal contributor to inflation. Dependence on a thin, fragile line of supply from abroad undermines our national security. As noted below, President Carter has made great strides in guiding the nation on to a course toward greater energy self-sufficiency.

Sixth, structural improvement to reduce regulatory burdens and enhance competition. The Administration has worked to eliminate unnecessary government regulations and to make cost effective those which are necessary. Passage of the Regulatory Reform Act by Congress would strengthen these efforts.

We have also sought to let the private enterprise system be free to compete as much as possible. Legislation was passed to deregulate airlines and to reduce regulation of trucking and banking. Additional deregulation will continue to be pursued in other areas, including the railroad and telecommunications industries.

National Energy Policy

During its first hundred years, the United States built its economy using renewable sources of energy: wood and water and wind. During the second century there was a shift to fossil fuels, and increasingly to the use of oil.

Abundant and inexpensive sources of domestic oil and gas and coal made it possible for America to build the world's greatest economy and the world's highest standard of living. Inexpensive energy was often employed instead of additional capital or labor.

By the 1970's, however, the limitations of domestic supply at low prices and rising world energy demands set up conditions for a dramatic increase in energy prices.

The more than ten-fold increase in world oil prices since 1970 has come in two major waves: The first in 1973-74 following the oil embargo, and the second in 1979-80 following the upheaval in Iran. The oil price shocks have had a serious adverse impact on the world's economy, greatly accelerating inflation, reducing output and increasing unemployment.

U.S. demand for oil grew over the years while domestic supplies receded. Artificial control over domestic oil and gas prices discouraged production, encouraged consumption, and resulted in increased imports at higher and higher costs. In 1970, the United States paid $3 billion for imported oil. By 1979, the Nation's oil import bill had sky-rocketed to $60 billion. This year we will pay $85 billion for less oil.

One of the greatest challenges President Carter faced in assuming office was to forge a national energy policy. It was exceptionally difficult to do so because of the divergent views and interests within the United States. Some regions are producers, others consumers. Some areas can be supplied with domestic energy, while others depend upon imports.

Working with the Congress and the public, the President was able to develop for the first time a comprehensive national energy policy to deal with the threat to our society from excessive dependence on foreign oil.

The main objective of our national energy policy is to reduce that dependence upon imported oil. And to reduce our dependence upon oil itself by shifting to alternate energy sources.

It was first necessary to accept the reality that inexpensive energy is no longer available. Moving toward the pricing of energy at its replacement value has helped establish conditions for both greater conservation and greater domestic production.

The priorities for our national energy policy are clear.

First, conservation: This is the surest, cheapest, cleanest way to reduce our dependence on imported oil.

Second, increasing the development and use of conventional domestic sources of energy, including oil and gas and coal and nuclear power.

Third, to assure longer term supplies, the expe~~n~~dited development of unconventional domestic energy sources, such as synthetic fuels from coal and shale and unconventional natural gas.

Fourth, increasing the use of renewable energy sources, such as solar, alcohol, biomass, wind and wood.

The United States has also exercised leadership among major oil importing industrial countries in order to coordinate policies for energy conservation, development of alternate sources, and the fair sharing of limited supplies. Important commitments were made at the recent Summit Meeting in Venice to accomplish these purposes.

Already substantial progress has been realized. Oil imports in 1980 are running almost 20% below their peak in 1977. U.S. production of oil has now increased, reversing the long-term trend of declining output. The energy required for economic growth has been substantially reduced, so that we can now plan for future growth with lower energy requirements.

To complete the framework of energy policy, the Congress should promptly enact pending legislation authorizing the Energy Mobilization Board and providing programs for shifting electric power generation from oil to coal or other energy sources.

While the accomplishments in a short three years are encouraging, the task now is to implement the national energy policy during the 80's.

RECENT DEVELOPMENTS

Until the current recession, there was excellent progress in terms of jobs and output. Inflation remained too high, but there were signs of progress in reducing the rate of inflation while maintaining a healthy pace of economic activity.

Then, the revolution in Iran interrupted oil supplies from that country. The world experienced a new oil price shock of enormous magnitude. Oil prices more than doubled in 1979 and price increases continued into 1980.

The oil price shock had both an inflationary and a recessionary impact on the U.S economy. U.S. inflation rates soared and the anti-inflation program suffered a major setback. The drain caused by higher oil prices reduced purchasing power available for other activities and created the conditions for economic downturn.

In early 1980, there was a surge in inflation and inflationary expectations, aggravated by the uncertainty over the future level of defense spending resulting from the Soviet invasion of Afghanistan. There was a wave of anticipatory borrowing and spending which upset financial markets and drove U.S interest rates to historic highs. Speculation was excessive. There was a threat of serious economic damage.

To deal with this situation, on March 14 President Carter announced intensified anti-inflation measures. Based on extensive consultations with Congressional leadership, the Fiscal Year 1981 budget was revised to reduce government spending further. A program of selective credit restraints was introduced for a temporary period.

The President's firm actions met the challenge. There was a cooling of inflationary expectations. Interest rates fell steeply and inflation rates dropped. However, there was no way to avoid some period of recession. Output is now lower and unemployment higher than can be accepted.

The recession is the seventh since World War II. It has resulted in automatic increases in federal expenditures to compensate for unemployment, and in lower federal tax revenues because of lower incomes. This has helped cushion the downturn. The economy now shows signs of stabilizing and there are prospects for an upturn within the next several months. Automobile sales and housing starts have begun to recover, lower interest rates and lower inflation rates are helping form a base for recovery. Without further policy measures, however, recovery is likely to be too slow and unemployment will remain too high. Moreover, a number of longer term problems still need to be addressed.

AN ECONOMIC PROGRAM FOR THE 1980's

During its first years, the Carter Administration has addressed the fundamental economic issues, even though it has not yet been possible to solve every problem. By facing the real problems -- by making hard choices and implementing difficult decisions -- the Administration has built a solid base for long-term economic progress.

The foundation has been established for revitalizing the American economy. We have the opportunity -- if we are determined and resolute -- to build a better America.

The Carter Administration intends to seize that opportunity to achieve our national goals of full employment, price stability and balanced growth.

This is the time to set forth a basic program to revitalize our economy for strong growth in jobs and create jobs, improve productivity, reduce inflation, enhance technology and contribute to long-term growth.

- To continue a vigorous war against inflation, including maintaining a policy of budgetary restraint and monetary discipline, and to prevent the erosion of the value of the wages our workers earn.
- To implement our national energy program to reduce dependence on imported oil and develop alternate domestic energy sources.
- To maintain a sound and stable dollar to help contribute to world economic and financial stability and growth.

The Administration's new economic program will concentrate initially on three areas: First, industrial revitalization; second, increasing public investment; and, third, reducing tax burdens.

inflation

I. INDUSTRIAL REVITALIZATION

Revitalizing American industry to provide even stronger growth in jobs and national income in the

1980's will require a new spirit of cooperation and increased coordination among business, labor and government.

A great strength of the American economy is its primary reliance on the private enterprise system. The cumulative effect of millions of decisions by individuals and businesses within a competitive marketplace is by far the most effective and efficient way to produce for our nation's needs and wants. However, private industry and its workers in America face the challenge of unprecedented changes which threaten their vitality.

The economic world of the 1980's is vastly more complex than that of the 1950's and the 1960's. We have become more heavily involved in international trade, and forces influencing the international competitiveness of our industries have taken on increased importance. The pace of technological change has accelerated, creating opportunities but necessitating adjustment. The character of American industry and the work skills it needs are changing. The actions of the governments at the Federal, State and local levels are even more critical to industry.

The role of the Federal government in seeking to revitalize American industry is primarily to create a climate which encourages private innovation and investment and creates jobs.

In present circumstances, when many industries are undergoing structural change, government must go further. It should help smooth the adjustment process of regions and workers to avoid undue distress and hardship.

To reinforce cooperation between government and the private sector, in dealing with the complex issues of industrial policy, the President will establish a new, high-level Industrial Revitalization Board (IRB), compromised of representatives of American labor, industry and the public. The purpose of the Board will be to advise the government on the broad range of issues involved in the on-going process of revitalization.

The Board's initial agenda will include:

- Advising on the organization of the Federal Government's present programs for economic development.
- Recommending ways to combine public and private capital to achieve economic development in distressed areas.

- Recommending how to deal with large-scale adjustments in communities and industries experiencing severe dislocations.
- Providing guidance on improving the skills of the American workers to meet the needs of the coming decades.
- Recommending ways to reduce regulatory burden.

This extensive mandate to work with government on major policy issues on a sustained basis represents a bold step in the recognition of the intricate and interdependent relationship among government, labor and business.

Encouraging Private Capital Investment

Substantial gains in our standard of living depend on strong and continuous growth in productivity -- the output of each worker. Our productivity growth, however, has slowed seriously over the last decade. Insufficient capital investment is an important cause of this disappointing trend.

To improve productivity, as well as to provide for the energy resources necessary for our economic and national security, will require that an increased share of our national output be devoted to investment.

To accomplish this, the Administration will propose tax changes to encourage investment.

A new system of depreciation allowance -- the charges a business may deduct from its income to recapture the capital investment costs -- will be proposed for enactment next January. The liberalized depreciation allowances will encourage business to expand investment to modernize productive capacity and provide new jobs. The depreciation program will be designed:

- To provide for a constant annual rate of depreciation for each asset class of equipment and structures.
- To reduce the number of asset and industry classes to between 25 and 30 from the present 130. Few taxpayers would use more than 2 or 3 classes.
- To simplify the procedures for using accelerated depreciation, which permits business to recapture investment costs more rapidly. Accelerated depreciation will be available to all firms -- large and small.
- To increase the allowable depreciation rate approximately 40 percent.
- To allow roughly equal liberalization of depreciation for all assets, and thus

minimize the distortions inherent in other approaches to depreciation reform.

- To take effect immediately upon the specified effective date, thus avoiding complicated transition rules that could actually delay some investments.

The first year effect of the proposed Constant Rate Depreciation system would be to reduce tax revenues by an estimated $______billion, increasing to $_______ billion in the fifth year.

Reducing Employer Payroll Taxes

The change in depreciation allowances will help reduce the cost of capital and encourage investment. We are also proposing measures to reduce labor costs and thus encourage employment. The Social Security tax increase for employers scheduled to take effect in 1981 is essential to maintain the System's financial integrity, but it adds to costs and thus to inflation. This increase will be particularly burdensome on those businesses which rely more heavily on labor than on machinery.

To help offset this increase, we will propose a Social Security tax credit for employers. This would apply to all employers who pay Social Security taxes and would be a refundable credit against Federal income taxes equal to _____ percent of Social Security taxes paid. The first year cost is estimated to be $___ billion and the fifth year cost $_____ billion.

Dealing with Economic Dislocations

The industrial changes now taking place around the world will result in special problems for many workers in industries and areas. The Federal Government must play a part in helping to ease the burden of adjustment for those affected adversely.

Refundable Investment Tax Credits

To help industry obtain capital for investment in new plants and productive equipment, the tax code permits 10% investment tax credit.

The investment tax credit offers no current benefit to industries without a tax liability. Thus, it is of limited usefulness to firms suffering temporary losses or limited profits. It is also effectively denied, at least in part, to new firms just starting out which have not yet produced taxable earnings. These enterprises are often an important source of technological progress and innovation.

The Administration will, therefore, propose that the investment tax credit be simplified and made refundable effective in 1981.

%?

It is estimated that the first year cost would be $____ billion, and the fifth year cost $_____ billion.

Targeted Investment Tax Credit

As a supplement to ongoing programs designed to foster growth in distressed areas, the Administration will also propose a special targeted investment tax credit of 10 percent for eligible investment projects in areas of high unemployment threatened by economic decline. One billion dollars would be authorized for this incentive each year. The incentive will be apportioned by the Economic Development Administration to eligible projects through "certificates of necessity."

Economic and Industrial Development Assistance

The Carter Administration has substantially increased government support for economic development. In FY 1980, about $7.4 billion has been authorized for economic development programs, fifty percent more than the level when the Administration came into office. Assistance programs for small business have grown by $800 million, and a $675 million Urban Development Action Grant program has been instituted to stimulate private investment in distressed areas. The Congress now has before it a proposal to build on these efforts by adding an additional $2.5 billion for development financial assistance.

Economic Development Administration

More must be done to deal with current problems. To meet the expanded development needs, the President will propose to expand and enhance the programs of the Economic Development Administration. Additional budget authority of $1 billion for FY '81 and $2 billion for FY '82 will be requested. This authority is beyond the $_____ billion already proposed for the Economic Development Administration and pending in Congress. EDA will use direct loans, loan guarantees and interest subsidies -- in partnership with private investment and State and local funds -- to create productive job opportunities in industries and regions hard-hit by industrial change.

Countercyclical Revenue Sharing

EDA and the targeted investment tax credit are primarily oriented to stimulate private sector economic development. In addition, increased fiscal assistance will be provided to communities undergoing economic transitions to help enable them to maintain the services needed to promote economic development.

Increased countercyclical revenue sharing will help assure that harmful temporary reduction in service levels do not take place. Budget authority of $500 million for FY '81 is now pending, and the Administration is prepared to support an increase of $500 million to a total of $1 billion.

Human Resources

The more than 8 million jobs created during the Carter Administration -- the largest growth in employment over any similar period in our history -- are the product of both private and public initiative. The Administration expanded Federal funding for employment and training from about $7.3 billion when it took office to about $9.6 billion in FY 1980. Federal support for basic and vocational education expended from $____ billion in 1976 to $8 billion in FY 1980.

The Administration has established two public services employment programs under CETA which now provide 400,000 jobs. In addition, welfare reform demonstration projects are now operational in 14 sites around the country, enrolling welfare recipients in CETA training, job search, and employment activities.

The Administration also recognizes the importance of cooperating with the private sector in providing job training and employment. The Private Sector Initiative program,, funded at $400 million during FY 1980, directly involves business and industry in the planning of training activities. Private Industry Councils, composed of members of the local business community, have been organized with virtually every CETA prime sponsor throughout the country.

The Targeted Job Tax Credit also provides incentives for employers to hire economically disadvantaged persons. The goal this year is 300,000 job placements.

Youth represent one of our most vital natural resources. Expenditures on youth training and employment have expanded from less than $2.5 billion in 1977 to over $4 billion today.

To assure further that young people develop basic job skills, the President has proposed a $2 billion youth initiative, now pending before the Congress. The initiative draws together programs in the Departments of Labor and Education to assist disadvantaged youth in breaking free from idleness and poverty.

As American rises to the economic challenges of the 1980's major industrial change will create vast new opportunities for jobs, but will also impose inevitable strains of adjustment in the skills of some working people.

Government cannot ignore the large adjustments sometime imposed on working people by the intersecting forces of energy transition, technological advance, and shifting patterns of world trade. The Trade Adjustment Assistance program provides benefits, job training, and relocation to workers who have beeen adversely affected by imports. Currently, 310,000 auto workers are eligible for benefits in addition to 134,000 workers in other aadversely affected industries. FY 1980 benefit outlays to date amount to about $1 billion.

Our unemployment compensation system is an essential form of assistancae to workers who have lost their jobs. The Administration will propose changing the unemployment compensation system so that workers suffering long-term unemployment will be eligible for benefit payments over a more extended period.

The Administration is also devising better means of retraining and relocating workers displaced by industrial changes. We will launch a series of special demonstration projects, under the Department of Labor, to assess the merits of different methods for retraining displaced workers. One such project in Michigan is already underway.

Regulatory Reform

Regulation plays an essential role in protecting consumers and in safeguarding health and safety. However, in many cases regulation has not been effective and has imposed unnecessary costs on our economy.

Regulatory reform is an important element in policies to promote healthy economic growth without inflationary strains and to improve productivity.

There are two parts to regulatory reform. The first is reducing or eliminating unneeded economic regulations that serve only to restrict competition or to mandate arbitrary and productivity-lowering practices. The second is making necessary regulations more efficient and cost-effective. Over the past three years, the Carter Administration has taken major steps in both areas:

- No Administration has done more to remove unneeded and counterproductive economic regulations. Far-reaching deregulation is underway for airlines, trucking, financial institutions, and energy. Trucking and airline reform alone is estimated to save $10 billion or more per year.

- The President by Executive Order has set up new mechanisms to improve regulatory efficiency. Costs and benefits of major rules are now analyzed to assure that the most cost-effective route to the regulatory goal is selected. Outmoded rules are phased out and rules must be written in plain English.
- The President also established a Regulatory Council, composed of all the regulatory agencies, to provide advance notice and a comprehensive calendar of upcoming important regulations and to minimize overlap, duplication, and inconsistencies.

To continue this progress, the President has directed that the Office of Management and Budget explore the feasibility of a Regulatory Budget and a Regulatory Cost Accounting System. Basic regulatory statutes will be reviewed for possible amendments to improve cost-effectiveness.

II. INCREASED PUBLIC INVESTMENT

The steps proposed to revitalize our economy will assure that our industries, workers, and communities are able to meet economic challenges of the 80's. The Administration will support these efforts by proposing increased levels of public investment in critical areas.

Investment in Energy Security

Continued progress in the energy area will be an essential part of our economic program. Enormous investments in conservation and domestic energy production will be required over the next decade to accomplish the reduction in oil imports so essential to our national and economic security. These investments will create hundreds of thousands of jobs domestically and will help protect the jobs of all Americans from future oil price shocks.

Through decontrol and the other measures already undertaken, we have reduced our oil imports by about 20% from their previous peak levels. Most importantly, this reduction has been the result of increased conservation and use of domestic energy resources, and not lower economic activity. We have reduced the amount of energy required to produce a unit of national output by about 10%.

The Administration has provided for greatly increased funding for energy conservation and production since taking office. In addition to appropriations for the Energy Security Corporation, the 1980 budget provides about $5 billion for energy production and conservation, more than twice the level when the Administration took office.

In the last four years, Congress has approved $4 billion in tax credits to stimulate energy production and conservation. In addition, $20 billion (out of an ultimate $88 billion) in budgetary authority has been authorized for the Synthetic Fuels Corporation to stimulate a major new synthetic fuels industry. By 1992, synthetic fuels will supply about 2 million barrels of oil per day.

The 1981 budget provides for even greater funding for energy conservation and production.

- The Administration has proposed -- and the Congress now has before it -- a $10 billion program to help finance electric utility conversion from oil to coal or other fuels. This program will save an additional 500,000 barrels of oil per day by 1995.

- The Congress also has before it our proposal to create an Energy Mobilization Board to help expedite the administrative process in establishing energy production facilities.

In addition, the Administration will propose an additional $1 billion in funding for energy conservation, including increased funding for the Solar and Energy Conservation Bank, conservation investments in Federally-owned public housing units, improvements in the efficiency of Federally-owned power plants and weatherization of schools and hospitals throughout the United States.

The impact of all of these measures will be to reduce the amount of imported oil by about one half by the end of this decade.

Investment in Research and Development

Long-term productivity growth depends on the quality as well as the quantity of capital formation. Research and development will enhance the quality of investment.

The Administration has significantly increased Federal support for research and development. Between 1965 and 1976, Federal support for basic research declined by more than 2 percent per year in real terms; since 1977 it has increased by ____ per year in real terms.

stronger

The Administration will propose increasing Government support for research and development by $_____ million over the next two years.

Investment in Infrastructure

Highways: The ability to transport people and goods efficiently is essential to our economic, energy and national security objectives. This Administration has made substantial investments in transportation. For example, $2.5 billion in improvements to the northeast rail corridor are underway; $950 million will be obligated in 1981 to construct and rehabilitate bridges. The 1981 budget contains $8.4 billion to complete and repair the Federal highway system.

Our national highway system is an integral part of our transportation system and has been constructed over many years at great expense. Evidence is mounting, however, that more investment is needed to maintain this vital national asset. The Administration proposes a $500 million increase in fiscal 1981 highway obligations.

This will help address what is emerging as the 1980's major highway concern -- adequate preservation of our national highway system.

Coal: The United States has enormous deposits of coal, and there is a great opportunity to expand the use of this energy resource both at home and abroad. Coal can and will be an important new export product for the United States. Bottlenecks in our coal transportation system, particularly at seaports, are a serious impediment to using this abundant natural resource.

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Port facilities for coal exports need modernizaton and enlargement. While much of the investment will come from private sources, the Federal government will play a role in deepening ship channels to accommodate larger and more efficient coal carrying vessels. The President has asked the Corps of Engineers to expedite its review of current dredging proposals.

Export Promotion

At the beginning of the 70's, only about 5 percent of the U.S. economy was involved in international trade; now it is closer to 10 percent. Foreign markets have become increasingly important for American firms. When President Carter took office, exports accounted for about 6.7 percent of GNP; this year they will account for about 9 percent. This increase in exports has been an essential source of jobs and of foreign exchange needed to pay for imported oil.

This Administration will continue to stress the growth of U.S. exports. To do this we have already increased support of the Export-Import Bank, and we have reorganized and combined the Government programs which support international trade.

In addition, the Administration will:

- Support Export Trading Company legislation now pending in Congress that will encourage small business participation in export markets.
- Propose measures to assure reliable long-term funding for the Export-Import Bank.
- Propose specific amendment to the Internal Revenue Code to provide for an exclusion for income earned abroad in certain hardship areas. This will increase the ability of U.S. exporters to compete in foreign markets.

III. REDUCING TAX BURDENS

Inflation has reduced the real disposable income by American workers both by diminishing their purchasing power and increasing their tax burdens. But general tax cuts that merely result in a greatly expanded Federal deficit and reignite inflation would not be of lasting benefit to Americans.

The Social Security tax increase scheduled to take effect in 1981 will increase tax burdens on individuals and keep the recovery of consumer purchases unnecessarily depressed. While the revenues from that Social Security tax increase are necessary to assure the financial soundness of the Social Security System, the increased tax burden on workers should be offset by carefully targeted reductions in income taxes. The Administration plans to accomplish this objective through the following 1981 tax proposals to be presented in January:

- A Social Security income tax credit for individuals. This would be available to all individual taxpayers, and would consist of a nonrefundable credit against Federal income taxes equal to 8 percent of the Social Security taxes paid. The first year revenue cost is estimated to be $____billion, increasing in the fifth year to $______billion.
- Liberalization of the present earned income credit in order also to provide

tax relief for nontaxable individuals and families with dependent children. Under current law, taxpayers with dependent children may claim a refundable earned income tax credit equal to 10 percent of the first $5,000 of earnings. The credit phases out as income increases from $6,000 to $10,000. The Administration will propose increasing the credit from 10 percent to 12 percent, with phase out as income increases from $7,000 to $11,000. The first year cost is estimated to be $_____.

The marriage penalty is another tax burden that needs to be addressed. Families with two wage earners may owe higher income taxes than would be the case if the spouses were unmarried individuals. The Administration plans to propose a tax deduction equal to 10 percent of the lower-earning spouse's earnings up to a limit of $30,000.

CONCLUSIONS

The Administration's economic program for the 1980's is both responsible and dynamic. It builds on previous gains and addresses current problems. It provides the basis for long-term growth that will provide permanent jobs and reduce inflation.

Yet, the benefits will begin to be realized in a relatively short time. The proposed initiatives will create about 450,000 jobs during 1981 and 900,000 jobs in 1982, in addition to those generated through normal economic recovery. And over the decade, millions of jobs will be available to carry out the task of building our nation's industrial might. inflation?

The Administration is dedicated to assuring that its leadership and its efforts will be directed toward building for the future and assuring lasting vitality for our economic system. That is the only way to assure the greatest good for the most people.

The task ahead is to build a better America. As we do so, all Americans will be able to enjoy the greater bounty of our national labors.