W

DRAFT
TESTIMONY

OF

WILLIAM S. WOODSIDE

CHAIRMAN OF THE BOARD
SKY CHEFS, INC.

and

VICE CHAIRMAN OF THE BOARD OF TRUSTEES
THE COMMITTEE FOR ECONOMIC DEVELOPMENT

ON

FEDERAL BUDGETARY VIEWS
Based upon CED's report
INVESTING IN AMERICA'S FUTURE

BEFORE

THE HOUSE WAYS AND MEANS COMMITTEE

Wednesday, February 8, 1989
2:00 p.m.
Longworth House Office Building
Room 1100
Washington, DC

SUBMIT STATEMENT FOR RECORD

MR. CHAIRMAN:

ANY COMPLAINTS ABOUT AIRLINE FOOD
I'LL PASS ON TO MY CUSTOMERS!

My name is William S. Woodside, and I am Vice Chariman of the Board of Trustees of the Committee for Economic Development. As you may know, the CED, founded in 1942, is now an organization of over 275 of the nation's top corporate executives and a number of presidents of universities who personally involve themselves in the development of CED's policy positions. WILL SUMMARIZE TO REFRESH YOUR MEMO, AND THEN TRY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

The CED's recent comprehensive policy statement entitled, Investing in America's Future, presents the trustees' perspective on what we believe are the most critical economic problems facing the nation and what should be done about them. We will leave copies here for you. Our message today is straightforward. It ~~contains five points~~.

WHAT IS DIFFERENT ABOUT OUR MESSAGE

Point one: We believe the most serious economic challenges facing the nation are the huge fiscal deficit, the equally large trade deficit, and our inadequate productivity growth in a highly competitive global economy.

Point two: The federal deficit has very frequently been understated by optimistic erroneous forecasts; its future burden has been understated by treating the temporary surplus in Social Security funds as if it was operating revenue, when we all know that these Social Security funds will be desperately needed to cover a demographic boom in retirees by the end of this century.

Point three: These twin deficits should and can be very much reduced through firm leadership, political candor, and bi-partisan cooperation.

TO MOVE THIS NATION FORWARD

Point four: We also believe that significant new investments are required in human resources, infrastructure, and research by both the public and private sectors. The education of today's youngsters is particularly inadequate and harmful to our future status as the world's leading economy. These new investments are necessary to avoid further erosion in our relative position, and to fully realize an ever-improving quality of life that should be attainable in our society.

Point five: To accomplish these important objectives, it will most likely be necessary to both decrease many current federal expenditures -- including entitlements -- and to also increase taxes. Any tax increases should be structured to discourage consumption, to encourage savings, and to encourage investments in more productivity capacity.

DEFICITS DO MATTER

Let me expand BRIEFLY on these points. Some are now saying that our huge twin deficits do not matter, and that some recent favorable changes in trends signal self-correction of our budget and trade deficits. We disagree on both counts. We believe the present forecasts are unsupportably optimistic, as ~~we~~ HAVE been most budget forecasts in the past 20 years. THESE OPTIMISTIC ASSUMPTIONS ARE KEY TO THE PRESENT BUDGE

Since 1980, 3/4 of our national gross savings -- over a trillion dollars -- has been "used up" or diverted by huge U.S. Treasury borrowings to cover the continued federal deficits.

Our debt per capita has recently grown from less than $4,000 to nearly $10,500, and is expected to further grow to $15,000 per capita by 1992. Had we invested much of these borrowed funds to better our future, instead of using them to finance government consumption, one might make an acceptable case for such federal borrowing. But we did not do so. Because we used these borrowed funds chiefly for consumption rather than for productive investment, we have not laid a sound enough basis for increasing our future standard of living and our future competitive position. This was a serious mistake. We must now reduce such consumption-oriented government borrowing.

The development of global financial markets during this period helped support and even encourage our profligacy. We were able to borrow heavily from abroad, at relatively low interest rates, to finance both our federal deficit and the increased consumed imports that have led to our trade deficit.

We now have built up net foreign debt of over $400 billion, which is growing by $130 billion per year. We have deteriorated from being the world's largest creditor nation to the world's largest debtor in just a few short years. Our ability to reverse the trade deficit is constrained by inadequate domestic investment in research and productivity.

Under a best case scenario, i.e., balancing our trade by 1993, we will still owe approximately $1 trillion abroad. Just servicing that debt would require us to run an annual export surplus of $60-100 billion. Servicing that debt, plus also reducing the annual trade deficit from its present high level, will obviously reduce the resources available for much needed investments in our future competitiveness and future quality of life.

NOT ONLY IS

In addition, our heavy dependence on foreign capital is dangerous and unreliable. A rapid recall of liquid debt by foreign creditors would have disastrous consequences. Such recall can be easily triggered by foreign political problems, economic pressures, currency fluctuations, or higher foreign interest rates.

Furthermore, the implications of such dependency go far beyond the economic consequences. History gives us no reason for confidence that a long-term debtor nation can also endure as a political, moral or military leader.

A CED PROPOSAL

In our report released last July, Investing in America, we urged Congress and the Administration to adopt a package of fair, credible, and enduring deficit cuts and revenue enhancements to bring the federal budget into balance by 1992.

To eliminate the budget deficit we recommended the following actions:

1. Aim for combined annual spending cuts and tax increases of about $40 billion, until these annual steps bring the budget deficit to near-zero.

2. Restrict federal spending across a broad base of line items, not excessively concentrated in a few areas.

Spending curtailment should extend to our major entitlement programs such as Social Security benefits for the non-poor.

3. Do not ~~further~~ cut means-tested federal spending that benefit the poor. We do not preclude savings from increased efficiencies in administering means-tested programs.

4. Further cut real defense spending, accompanied by an increased insistence on burden sharing by our allies, commensurate with our changing national security needs and Russia's changing situation. We believe that significant further cost-saving defense efficiencies can be attained, within the context of an effective and viable structure and stragegy.

5. Adopt some tax increases to help cut the deficit, if this is necessary. Such increases should be designed so that they do not deter research, growth, and productive investments.

The CED has not yet specified what kind of tax increases should be considered. The Committee is attempting to do so in a special tax subcommittee that is now underway.

RETURN TO ENTITLEMENTS

DEALING WITH ENTITLEMENTS

What I have just described is CED's broad program for a return to U.S. fiscal responsibility. Now, let me be more explicit about one controversial area in this package, where spending needs to be controlled.

I refer, of course, to entitlement outlays. They are such a large percentage of the budget, and are rising so fast, that they simply must be better controlled in any effective deficit reduction package. Difficulty does arise from the issue of fairness and the social contract.

Let me give you some examples of how we believe substantial and equitable savings can be achieved through Social Security changes:

BRING UP ~~RAISE~~ AN EASY, COMFORTABLE SUBJECT

1. Gradually raise the normal retirement age for Social Security from sixty-five to sixty-eight, and phasing this increase in more rapidly than current law provides. In addition, the early retirement age should be raised in stages to 65.

   This change would also ameliorate the demographic problem of a shrinking workforce that will confront us in the next century, as we have more people over 65 than under 18. Age 65 was selected as an appropriate retirement date in 1870, by Bismarck. Since then, medicine, nutrition, and environment have added well over ten healthy years to the average American, yet we mechanically cling to the age 65 yardstick.

2. Use the lesser of the annual increase in average wage or in the CPI, to calculate automatic inflation adjustments in Social Security benefits.

3. Eliminate the annual income threshold below which Social Security benefits are not taxed (currently these are $25,000 for a single return and $32,000 for a joint return), and continue to include 50% of Social Security benefits in taxable income. On this last recommendation I would personally favor taxing 85% of Social Security benefits because taxpayers receive much more in benefits than they now contribute.

These additional taxes would be paid by middle and higher-income individuals, but not by the poor who live primarily on their Social

Security checks, and whose taxable income in virtually all cases would fall below the bottom bracket of the present income tax structure. CBO has estimated that under the provisions of tax reform 46% of recipient households would not have to pay a tax even with these changes.

Number needed

If all these Social Security changes were made (including taxing 85% of Social Security benefits) they would reduce the federal deficit by APPROX ~~over~~ $20 billion per year.

HIGH-PRIORITY SPENDING NEEDS

While we recommend this rigorous program for overall budget deficit reduction, we also recognize that certain additional spending needs are so important to our future that they ought to be accommodated within the overall reduction targets cited above.

During the past several years, the CED has done major studies on education, labor policy, health care, retirement and other social programs, and within some of those areas we have found compelling needs for new resources coupled with both public and corporate policy changes. Even the limited role we recommended for the federal government in these cases will not be filled without more resources and reallocation.

Let me talk about three of those that are directly related to our economic performance. CED believes the most important unmet spending need is for investment in human BEINGS ~~capital~~. Our ability to remain competitive in the global economy depends heavily on the quality of the people who operate our plants and equipment, develop new technology and manage our nation's businesses. Six years of research by two CED subcommittees regarding the relationship of human capital to U.S. productivity resulted in the following conclusions:

- the nation's high schools are producing an alarming number of graduates who qualitatively fall far short of what business and the nation needs to remain competitive and to sustain our standard of living;

- an increasing proportion of students is not even making it through high school. In some urban school districts, 75% of black males do not finish high school;

- a great many of the nation's schools suffer from poor management and from a declining number of committed and competent teachers and administrators. Most of today's new teachers have below average scholastic achievement scores;

- students in many of today's schools, rather than developing good work habits and high standards of behaviour (such as self-discipline, reliability, honesty, and perseverance), find themselves in decaying buildings, where they are enticed by drugs, ridiculed by their peers for any success, while authority is disregarded.

In sum, we have a system of elementary and secondary education that produces too much school failure -- at huge social costs in crime and in foregone earnings by these poorly equipped students.

In our first study on education reform, Investing in our Children, we made 89 separate recommendations covering curriculum redesign, standard-setting, parental responsibility, school management and so on. We also devoted considerable attention to looking at where new investments in our schools were really needed. We determined that the following areas deserve priority attention: teacher compensation, educational research, upgrading the middle schools, and extension of the school year.

Finally, we advocated a strong pre-school program for disadvantaged children. We became convinced that by far the greatest return on society's investment would come from improving the education quality and opportunity in the beginning years. For example, twenty years of longitudinal research has shown that one year of high-quality pre-school programming at the age of 4 would return as much as $6 for every $1 invested.

If serious about education must start with prenatal c

In NYC 600,000 of 1,000,000

In our subsequent study, Children in Need, we discovered similar investments with like payoffs, including: good prenatal care, child immunization, prenatal food supplement programs and prenatal counseling. We also recommended that this investment be aimed primarily at the educationally and economically disadvantaged children in our nation, where 1 in 4 children under the age of 6 live in poverty. Without help, the majority of these children are virtually guaranteed to fail school.

Future is with enough even for [illegible]

In Wash day before inauguration to press this pt.

We estimate that a new program of such investments for each eligible child in poverty will cost over $11.5 billion annually. This is an investment we strongly believe needs to be made. We have recommended a combination of federal, state, and local funding for this purpose; mostly below the federal level. Specifically on the federal level, we have recommended full funding to upgrade the Head Start Program and Chapter I, which is now directed to meet the needs of poor children in elementary schools. We have urged that this investment be made despite the need for federal deficit reduction, an investment that inevitably will have to be funded by reallocating resources in the federal budget or through new taxes.

A second area in which CED believes additional resources are a high priority is in assistance and training for those who have been permanently laid off from their jobs. They desperately need help to obtain new employment opportunities. In our study, Work and Change: Labor Market Adjustment Policies in a Competitive World, we recommend~~ed~~ the establishment of a dislocated worker program, which has been enacted. Unfortunately, this well-designed program has been funded way below the level which both the Reagan Administration and the Congress had agreed to. And it is likely to continue to be underfunded as long as we face our current deficit crisis. Yet the expenditure of comparatively few more dollars spent in the right spots can yield invaluable dividends in regained worker productivity.

A third area deserving high-priority attention is our technological progress. Technological development begins with the creation of new knowledge and new ideas, often through basic research. Though private industry, foundations, universities and state governments have been and should be important sources of research funds, there is no realistic alternative to the federal government as one primary source of funds for basic research. Accordingly, we believe the federal government should adopt a major national objective of consistently supporting high level basic research, primarily in universities. This will maintain a strong foundation of knowledge to underpin our further economic growth and industrial innovation.

Finally, we believe greater attention needs to be made to upgrade primary portions of our nation's infrastructure -- highways, bridges, airports, harbors and the like. It is well recognized that much of our nation's infrastructure is in disrepair and needs considerable reinvestment. CED has not recommended specific budget figures nor outlined a specific federal role. We believe the federal government ought to begin by developing a well-researched assessment of national needs and capital investments. This assessment should carefully define priorities, and should specify the portion of new costs that should be financed by the federal, state and local governments and the private sector.

In closing, CED believes that our budget deficits must be eliminated. Within that austere context, we must also reallocate more resources to those investments which preserve our future economic strength. Consuming more than we produce has got to stop. It will never be cheaper to do so than it is now.

As a CED trustee, I expect that much of what I have said today has been cited piecemeal by others in previous forums. It would be hard to conjure up a comment that has not already been written about the size and consequences of our twin deficits. If so, I think there nonetheless are two special, supplemental values in our presentation today.

First, we have tried to present a comprehensive, integrated plan that is neither self-serving nor single issue in nature.

Second, the CED membership represents a very large, heterogeneous cross-section of corporate America. Our trustees are individually and severally among the most experienced, senior, and informed members of the private sector.

We hope that the CED's comments will be helpful to you.