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REPORT OF THE TASK FORCE ON TAX POLICY

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ECONOMIC STRATEGY FOR THE REAGAN ADMINISTRATION

A Report to President-Elect Ronald Reagan
from His Coordinating Committee on Economic Policy

Sharp change in present economic policy is an absolute necessity. The problems of inflation and slow growth, of falling standards of living and declining productivity, of high government spending but an inadequate flow of funds for defense, of an almost endless litany of economic ills, large and small, are severe. But they are not intractable. Having been produced by government policy, they can be redressed by a change in policy.

The Task Force reports that you commissioned during the campaign are now available. They contain an impressive array of concrete recommendations for action. More than that, the able people who served on the Task Forces are available to provide further detail and backup information to you or your designees. We all want to help and you can count on enthusiastic and conscientious effort.

Your Coordinating Committee has reviewed the Task Force reports. With due allowance for some differences in view about particulars and relative importance, we have found that they offer a substantial base for action by you and the team you assemble. We focus here on guiding principles, on priorities and linkages among policy areas, and on the problem of getting action.

You have identified in the campaign the key issues and lines of policy necessary to restore hope and confidence in a better economic future:

- o Reestablish stability in the purchasing power of the dollar.
- o Achieve a widely-shared prosperity through real growth in jobs, investment, and productivity.
- o Devote the resources needed for a strong defense...

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and accomplish the goal of releasing the creative forces of entrepreneurship, management, and labor by:

- o Restraining government spending.
- o Reducing the burden of taxation and regulation.
- o Conducting monetary policy in a steady manner, directed toward eliminating inflation.

This amounts to emphasis on fundamentals for the full four years, as the key to a flourishing economy.

Guiding Principles

The essence of good policy is good strategy. Some strategic principles can guide your new administration as it charts its course.

- o Timing and preparation are critical aspects of strategy.

The fertile moment may come suddenly and evaporate as quickly. The administration that is well prepared is ready to act when the time is ripe. The transition period and the early months of the new administration are a

particularly fertile period. The opportunity to set the tone for your Administration must be seized by putting the fundamental policies into place immediately and decisively.

- o The need for a long-term point of view is essential to allow for the time, the coherence, and the predictability so necessary for success. This long-term view is as important for day-to-day problem solving as for the making of large policy decisions. Most decisions in government are made in the process of responding to problems of the moment. The danger is that this daily fire fighting can lead the policy-maker farther and farther from his goals. A clear sense of guiding strategy makes it possible to move in the desired direction in the unending process of contending with issues of the day. Many failures of government can be traced to an attempt to solve problems piecemeal. The resulting patchwork of ad hoc solutions often makes such fundamental goals as military strength, price stability, and economic growth more difficult to achieve.

- o Central problems that your Administration must face are linked by their substance and their root causes. Measures adopted to deal with one problem will inevitably have effects on others. It is as important to recognize these interrelationships as it is to recognize the individual problems themselves.

- o Consistency in policy is critical to effectiveness.
Individuals and business enterprises plan on a long-range basis. They need to have an environment in which they can conduct their affairs with confidence.
- o Specific policies as well as long-term strategy should be announced publicly. The Administration should commit itself to their achievement, and should seek Congressional commitment to them as well. Then the public, as well as the government, knows what to expect.
- o The administration should be candid with the public.
It should not over-promise, especially with respect to the speed with which the policies adopted can achieve the desired results.

Seizing the Initiative

The fundamental areas of economic strategy concern the budget, taxation, regulation, and monetary policy. Prompt action in each of these areas is essential to establish both your resolve and your capacity to achieve your goals.

Budget

Your most immediate concern upon assuming the duties of the President will be to convince the financial markets and the public at large that your anti-inflation policy is more than rhetoric. The

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public, and especially the financial community, is skeptical and needs a startling demonstration of resolve. Many question whether you are serious about a sizeable cut in budget outlays. Credible FY 1981 and 1982 budgets which do that clearly and unambiguously, would evoke an extraordinary response in the financial markets, and set the stage for a successful assault on inflation and a decline in mortgage and other interest rates.

The FY 1981 Budget will be almost four months along by the time you take office and a FY 1982 Budget will have been submitted for consideration by the Congress. There are now estimates of alarming increases in these swollen budgets. Prompt and strong action is necessary if these budgets are to be brought under control, as they must be. The nation can no longer afford governmental business as usual.

The formal budget alone is far from the whole story, though it is visible and important. Off-budget financing and government guarantees mount and expand programs through the use of the government's borrowing capacity, draining the nation's resources without being adequately recorded in the formal spending totals. In addition, the mandating of private expenditures for government purposes has gained momentum as the spotlight has illuminated direct spending. These mandates are also a clear call by government on the nation's resources. Efforts to control spending should be comprehensive; otherwise, good work in one area will be negated in another. And these efforts should be part of the Administration's development of a long-term strategy

for the detailed shape of the budget, four or more years into the future.

The Weinberger Task Force has identified an extensive and promising array of areas for potential savings, but it will be up to your Administration and the Congress to do the job. It takes top-notch people to do it. We recommend that:

- o A Budget Director, permanent or pro tem, be chosen and set to work now.
- o A small team from OMB be assembled explicitly to work with the newly designated Director.
- o The Director's recommendations be a part of your discussion with Cabinet and sub-Cabinet appointees as these appointments are made.

Amendments calling for dramatic reductions in the FY 1981 Budget should be submitted to the Congress within the first week of your Administration. A thoroughly revised FY 1982 Budget provides even greater opportunities for large further reductions, and this budget should be submitted as soon as possible.

Finally, it has become all too evident in recent years that current budget procedures are biased in an expansionary direction. The Congressional budget process defined by the Budget Act of 1974 has failed to achieve its purpose of removing the "runaway" bias. We therefore recommend a presidential task force to develop new techniques which can help to rein in the growth of federal outlays. It should examine the presidential item veto, renewed presidential

power to refrain from spending appropriated funds, and other initiatives to hold down spending. This task force should report to you within two months.

Tax Policy

Tax policy is properly the province of your Secretary of the Treasury. The making of that appointment should have a high priority so that important work can go forward. The Walker Task Force provides the materials needed to pose the issues to you in concrete form and to translate your decisions into a proposal to the Congress. This proposal should be presented early in the new administration in tandem with other key elements of your economic program. It should embody the main thrust of tax policy for the whole of your first term, not simply for the year 1981. We consider that the key ingredients should be your proposals for the Kemp-Roth cut in personal income tax rates, simplification and liberalization of business depreciation, and a cut in effective taxes on capital gains (see Innovation Task Force). Consistent with your proposals earlier this year, the effective date for these reductions should be January 1, 1981.

Other key proposals are tax incentives for the establishment of enterprise zones in the inner cities and such other items as tuition tax credits, reductions in the windfall profits tax, inheritance taxes and the taxation of Americans living abroad, and the restoration of restricted stock options.

Regulation

The current regulatory overburden must be removed from the economy. Equally important, the flood of new and extremely burdensome regulations that the agencies are now issuing or planning to issue must be drastically curtailed. The Weidenbaum Task Force sets out the needed blueprint for personnel selection, immediate administrative action, and legislation. Again, the key to action is a knowledgeable and forceful individual to develop and coordinate strategy and to form a team to carry it out. Such an appointment should be made promptly, with the expectation that the effort would carry forward through the transition for at least a year into your Administration. Your appointee and his team should be located within the Executive Office of the President. Achieving regulatory reform will take informed, strong, and skillful work with the Congress, as well as with those in charge of departmental and agency regulatory efforts. The person heading up this effort will require your continued, wholehearted support.

Many of our economic problems today stem from the large and increasing proportion of economic decisions being made through the political process rather than the market process. An important step to demonstrate your determination to rely on markets would be the prompt end of wage and price guidelines and elimination of the Council on Wage and Price Stability.

To advance the entire regulatory effort--both to galvanize public support and to strengthen the positions of Administration

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appointees--we urge you to issue a message on regulatory reform in tandem with the budget and tax messages. The message should call upon state and local governments to launch similar regulatory reform efforts--as a few have already done.

Energy

The battle between government regulation and the private market is nowhere more apparent than in energy, where the market has a decisive comparative advantage. Governmental intrusion into energy production and use provides a glaring example of how regulation costs us all dearly. Alternatives to imported oil exist here in the United States. As the Halbouty Task Force emphasizes, market pricing and market incentives will accelerate the development of these alternatives, just as surely as present regulations and the politicization of this field inhibit them. Its recommendations and the issues it poses for careful review cover the energy field in a comprehensive manner and deserve immediate attention. M H

We recommend, also, that you promptly exercise the discretion granted to the President to remove the price controls on crude oil and petroleum products, rather than continue with the present calendar, which postpones complete decontrol until October, 1981. This decisive action will eliminate at once the regulatory apparatus administering the entitlements program, and discourage continued efforts by special interests to prevent or slow down decontrol and deregulation. Also,

the Natural Gas Policy Act of 1978 should be repealed so that all natural gas prices are decontrolled. These measures are particularly urgent because the uncertainty of our critical Middle East oil supplies, dramatized by the Iran-Iraq war, makes it all the more necessary to get the earliest possible incentive effect of free market pricing.

The Synthetic Fuels Corporation is incompatible with the free market pricing of energy and should be promptly eliminated.

The Department of Energy has become a large and unmanageable institution with a variety of programs ranging from essential to useless. The essential functions should be transferred and the Department eliminated. This should be the main task of your Secretary of Energy.

Monetary Policy

A steady and moderate rate of monetary growth is an essential requirement both to control inflation and to provide a healthy environment for economic growth. We have not had such a policy. The rate of monetary growth declined sharply in the early months of 1980, and rose rapidly in recent months. These wide fluctuations are adversely affecting economic conditions and may continue to do so into 1981.

The McCracken Task Force emphasizes that the attainment of a proper monetary policy deserves the very highest priority and that such a monetary policy can be achieved through effective use by the Fed

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of its existing powers. The Task Force also brings out the relationship of monetary policy to budgetary and other economic policies.

The Federal Reserve is an independent agency. However, independence should not mean lack of accountability for what it does. In practice, independence has not meant that the Federal Reserve is immune to Presidential and Congressional influence. The problem is how to assure accountability while preserving independence. We suggest that you:

- o Request the Fed to state targets for monetary growth year by year for the next five years that in its opinion will end inflation. Influential members of relevant committees of Congress have already urged the Fed to specify such long-term targets.
- o Assure the Fed that you will propose and fight for fiscal and other policies compatible with the elimination of inflation.
- o Improve the procedures for coordinating Federal Reserve monetary policy with the economic policies of the Administration and the Congress and support Congressional efforts to monitor the Fed's performance and to recommend changes in the procedures that could improve performance.

With these fundamentals in place, the American people will respond. As the conviction grows that the policies will be sustained in a consistent manner over an extended period, the response will quicken. And a healthy U. S. economy, as the Burns Task Force states, will restore the credibility of our dollar on world markets, contribute significantly to smoother operation of the international economy, and enhance America's strength in the world.

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Organizing for Action

The activities of a wide variety of departments, agencies, and other units of government within the Executive Branch impinge on economic policy. But the flow of economic events does not recognize organizational lines. The economy itself operates as a system in which constituent parts are linked, sometimes tightly. The combination of interwoven problems and disparate organizations means that, in the process of policy formulation and implementation, some people high in your administration must identify the central ideas and problems and devise a strategy and tactics for dealing with them. Your leadership is essential to this effort.

One arrangement that has worked well in the past is for the Secretary of Treasury to be the chief coordinator and spokesman on economic policy, domestic and international. To carry out this

mandate effectively, the Secretary should be one of your key staff members as well as a departmental head, with a White House title and office. Since economic developments are often closely related to security, the Secretary should be a member of the National Security Council. For this coordinating role, an Economic Policy Board, with comprehensive membership, should be established; it should meet regularly and be the avenue through which economic issues come to your Executive of the Cabinet and to your desk. The Council of Economic Advisers might suitably provide the secretariat for this group.

Maintaining a Steady Course

Our final point is our most important one. The success of your economic policy will be a direct reflection of your ability to maintain a steady course over your full first term. Rough times will come and crises of one kind or another, some small, some of great moment, will arise. Sustained effort through these testing times means that public understanding and support are essential. Of equal and related importance is the understanding and support of the Congress.

This last task--gaining understanding and support of the Congress--is of crucial importance. As a result of the voting on November 4, the 97th Congress, we are convinced, will be more cooperative on economic and financial issues. That cooperation will be fostered if, during the transition, the Secretary of

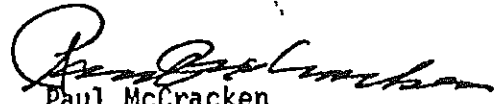
the Treasury (designate) consults intensively with key members of Congress on the design and implementation of your economic policies.

You have emphasized in your successful campaign precisely the strategy set forth in this document. In moving to implement it, you will be doing what the people voted for. Every effort must be made to maintain and broaden your base of support by improving public understanding and by close cooperation with the Congress. Cabinet officers and others in your administration can help in these tasks. Their ability to do so should be one important criterion in their selection.

At the end of the day, however, the burden of leadership falls on you: leadership to chart the course ahead; leadership to persuade that your course is the one to take; leadership to stay on course, whatever way political winds may blow. Through effective advocacy of the sharp changes so sorely needed, your leadership has brought us to this long-hoped-for opportunity at a critical moment for the nation. Your leadership can maintain this advocacy in the convincing manner necessary for a successful outcome.



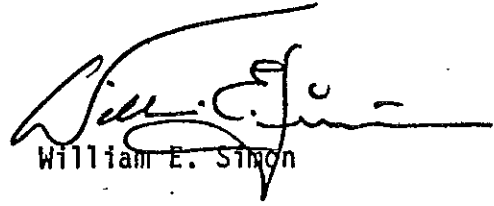
Arthur F. Burns



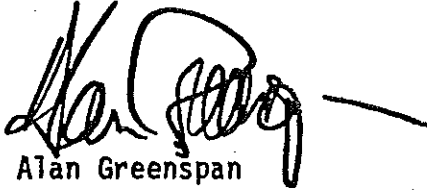
Paul McCracken



Milton Friedman




William E. Simon



Alan Greenspan



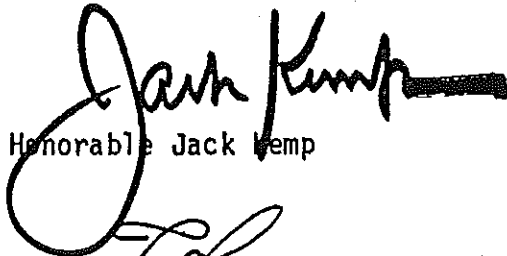
Charles E. Walker



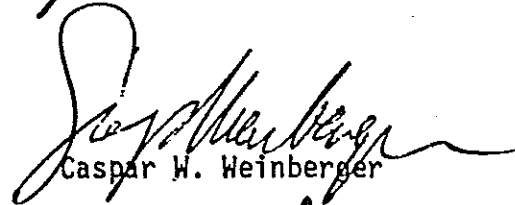
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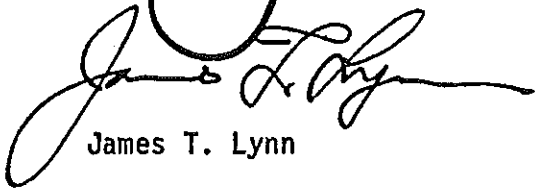
Murray L. Weidenbaum



The Honorable Jack Kemp



Caspar W. Weinberger



James T. Lynn



Walter B. Wriston



George P. Shultz,

Chairman

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