Tax Reform

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From: Mayor Bret Schundler

A BLUEPRINT FOR ECONOMIC JUSTICE

by Mayor Bret Schundler

For the remainder of this year, President Clinton and the new Republican majority in Congress will probably wrestle with the key issues of welfare and tax reform. This is a good thing. America's current welfare and tax policies are inefficient and expensive, and unintentionally function to encourage the break-up of families, trap the poor in dependency, and destroy the human spirit.

There are some Americans who cannot work because of true physical disability, and improved governmental polices are needed to help them. But the far greater problem confronting our nation today is the number of Americans who could work, but do not, either for a lack of job opportunities, or because of the perverse incentives of a governmental system which penalizes them for leaving welfare.

This paper is intended to address this latter problem, and outline an economically just combination of welfare and tax policies which could be used to materially and spiritually help every American adult who can work, by ensuring: 1) that every person who is willing to work is also able to find a job; 2) that every person who takes a job is able to earn a decent living; and 3) that every person who works hard to increase family income is benefitted for doing so and not penalized.

I will begin this discussion by expanding on some of the problems with our current welfare and tax policies.

The Problems With Today's Welfare and Tax Policies

One problem with our current welfare system is that it is inefficient. A significant percentage of the dollars spent on social programs never actually make it to the poor. Instead they go to pay salaries for the federal, state and local government employees who administer today's government programs. And there are also other ways in which our current welfare spending is inefficient. After all, the dollars which do reach welfare recipients do help to reduce their material deprivation, but they do so through, in essence, paying welfare recipients not to work. Relative to our diverse goals for government, it would be far more efficient and productive to pay welfare recipients in exchange for made safe and our citizens need not fear going out at night; and to clean our streets of litter and graffiti, so that when our children go outside they internalize beauty and order from their external environment, instead of the visual chaos that confronts their senses today.

There is no shortage of public work needing to be done in our inner cities, but right now, most cities do not have the money to pay for more public services. The reason cities don't have the money is because most cities, like Jersey City, get most of their revenue from property taxes. Property taxes may be sufficient to fund government in suburban and rural communities, where the defining characteristic of such communities is that they have a lot of property to tax, yet not a lot of people to serve. But property taxes do not work well as a way of funding city governments, where their defining characteristic is that they do have a lot of people to serve, but not a lot of property to tax.

The result of the property tax revenue system is that cities need state financial assistance in order to remain financially solvent, but few states have extra money available to subsidize supplementary public services in their cities, because most states, as is also the case with the federal government, are already tapped out funding welfare and other entitlements.

In Jersey City, we have 17,000 families on welfare, at a financial cost to the state and federal government of several hundred million dollars. This is an absolutely huge number of people for a city of 230,000 people, and a huge sum of money. To give you a sense of proportion, my entire civilian workforce in Jersey City is only approximately 1,000 workers, and my entire civilian payroll costs less than $25 million!

Imagine the quality of life changes which could be affected -- especially in our most distressed neighborhoods -- if we in Jersey City could put this enormous reservoir of labor to work, using the welfare dollars that these individuals are already receiving from the state and federal government.

As a Mayor who believes in the dynamic advantages of competition, I would not have the City of Jersey City manage many workfare jobs directly. Instead, I would competitively contract with private management companies to provide diverse supplementary public services in Jersey City. The city would pay these private vendors their management fees, leaving every cent of federal and state money that had been used to fund welfare checks to go to the workfare employee, only now in the form of a paycheck which has been earned.

I have already mentioned that the advocates of our current welfare system sometimes criticize workfare programs on the basis of expense. But in point of fact, this approach that I am advocating should allow for a reduction in government spending for social welfare, both at the federal and state level of government, and at the local level of government.

Federal and state governments should save money because workfare is less likely to breed dependence than welfare, allowing substantial governmental savings during times of general economic expansion when private sector job opportunities are readily available.

Local governments should save money as some currently provided public services, which do not require a high degree of special training, could easily be provided using workfare workers paid for with federal and state funds instead of from local revenues.

Municipal unions are certain to resist the attrition of local civil service positions, and the provision of any historically provided government services by workfare employees. But it makes absolutely no sense to raise federal and state taxes to pay welfare dollars to one group of citizens not to work, and then to raise additional local taxes to pay another group of citizens to do the tasks which the first group could quite easily be doing. Ultimately, elected officials must have sufficient political courage to exercise some common sense.

Under this workfare system, cities which failed to demand true work in exchange for workfare paychecks would find themselves magnets for the slothful, but cities which did enforce a requirement of work in exchange for economic assistance would be able to provide improved public services without increasing local property taxes.

Again, this would most certainly improve the quality of life in our inner cities, which are where the vast majority of America's poor live. Even more importantly, this workfare program would elevate the spirit of the otherwise unemployed by giving them the opportunity to earn their living, and to receive a paycheck for which they worked, instead of a welfare check for which they did not.

The three important essentials of a successful workfare program are not difficult to understand. First, workfare jobs must pay less than the prevailing private sector minimum wage, so that workfare jobs serve to transition the unemployed to other, permanent jobs, but do not become an employment destination in and of themselves. Second, workfare income must be sufficiently supplemented to allow someone working at a workfare job to live decently for the time that they are in that workfare position. And third, any supplementary benefits provided to a workfare recipient must not be eliminated when the recipient finds a higher paying, permanent job. This is essential to encourage the workfare employee not to stay on that first workfare rung of the economic ladder, but instead to climb to the second rung, and to the third, and up out of economic marginality. To accomplish the second and third elements of this plan, significant tax law changes will have to be implemented.

Tax Code Changes

In particular, I propose that Congress abandon the current unfair, complicated, and anti-work tax code, and replace it with a flat tax plan that would include, among other features: a) a large standard deduction; b) a non-means tested, refundable income tax credit targeted specifically for health insurance or Medical Savings Account expenses;

c) a non-means tested, refundable, Earned Income Tax Credit to help pay for life's other essentials (such as housing, food, and day care); d) the indexation of capital gains and a decrease in the capital gains tax rate; e) a limited, non-refundable tax credit for charitable contributions targeted to helping the poor. (I would also include a small $50 non-refundable tax credit for political contributions, and various business tax changes, like the immediate expensing of capital investment. But this paper is intended to discuss just a basic outline of a more just tax code, not each and every recommended element of one.)

As mentioned above, our current tax system is tremendously regressive towards the working poor. The very highest marginal tax rates in the code are the effective tax rates on those who want to leave welfare and take an entry level job. They rapidly lose most of their governmental benefits and instead are taxed.

A flat tax plan, like that proposed by Dick Armey and Malcolm S. Forbes, would close most of the loopholes in our current tax system and, because it couples a flat marginal rate with a very high standard deduction, would also result in significant progressivity relative to effective tax rates. These are very positive elements of the plan, and it is unfortunate that the latter point, concerning progressivity, is often glossed over by the plan's political opponents.

On the other hand, there are also negatives to the Armey/Forbes plan: for instance, its non-taxation of consumed investment income, and, secondly, the fact that very low-income, working Americans will not be able to take full advantage of the high standard deduction which the plan contemplates.

On the first point, if educated that the base level of capital investment in an economy ultimately helps to increase the base level of wages, Americans may be willing to defer the taxation of re-invested investment income. They may also be willing to encourage greater equity financing of business expansion, and end the double taxation of dividends, through making dividends deductible against the income tax of dividend paying corporations. But Americans will never be willing to accept the notion that consumed investment income, whether interest, dividend, or capital gain derived, should be fully tax free, while consumed wage income is fully taxed. This will offend their sense of equity and justice.

Relative to the second point cited above, the large standard deduction envisioned by the Armey/Forbes plan will improve the progressivity of the tax code relative to today's law, but will nevertheless result in a greater tax benefit being enjoyed by middle and upper income Americans than by low-income Americans who lack the tax liability to be fully able to use the deduction. Replacing the plan's very high standard deduction with a more modest -- though still greater than current -- standard deduction, coupled with refundable tax credits, would effectively remedy this inequity.

A refundable tax credit is one which refunds cash to its targeted beneficiaries when they do not have a high enough tax liability to fully benefit from a regular tax credit. For example, someone with a $150 tax liability, and a $250 refundable tax credit, would pay absolutely no taxes, and would instead receive a check from the government for $100. Incorporating refundable tax credits into the Armey/Forbes proposal would provide a guarantee that the deduction-like benefits enjoyed by Americans of greater means would also be enjoyed by the working poor.

Some "soak the rich" politicians will find it objectionable that my proposal does not means-test its benefits, and instead provides the rich with the very same tax expenditures that it provides the poor. But such criticism ignores the fact that refundable tax credits simply allow the rich to keep more of their own money, while in effect redistributing someone else's income to the poor. These critics will blindly fight to preserve the means-tested system we have today, which penalizes the poor when they try to climb out of poverty by removing their governmental benefits once they get a job. This is absurd. In my opinion, it should not be a goal of governmental policy to penalize middle income and wealthy Americans for working hard, and it should not be a goal of government policy to keep the poor in poverty. Making governmental benefits non-means-tested will enable the poor to climb up the ladder of economic opportunity without penalty, while at the same time decreasing class antagonism in America and making all of us truly equal before the law. Both of these results would be positive.

I would also like to point out that my proposal would work to ensure that every citizen is both enabled and incentivized to obtain health insurance for his or her family. It would do this by targeting a portion of the contemplated refundable tax credits to covering health insurance or Medical Savings Account deposits.

The plan also includes a general, Earned Income Tax Credit, that would be added on top of today's Earned Income Tax Credit (which merely refunds payroll tax payments), in order to further increase the reward of work and to satisfy the government's interest in helping our citizens obtain the other necessities of life.

Taken together, these tax code changes would allow for the elimination of most other tax benefit and income assistance programs. For instance, deductions for mortgage interest payments and employer health care contributions could be eliminated, as could most of today's inefficient, bureaucratically administered, federal food, housing and health care assistance programs.

This too would advance fairness. The current mortgage interest expense deduction provides a bigger tax benefit for the wealthy individual, who is able to afford a big house, than it does for the working person who lives in a relatively humble abode. My proposal addresses this unfairness by giving both the same refundable, Earned Income Tax Credit that can be used to offset the cost of housing.

It is also not fair that those who work for corporations often get health coverage that is paid with pre-tax dollars, while the self-employed and small businesspersons often must buy their health insurance using after-tax dollars. My proposal addresses this unfairness by giving both the same refundable tax credit that can be used to reimburse health insurance costs.

Finally, as already mentioned earlier, it is highly inefficient to provide economic assistance to low-income Americans through erecting massive government bureaucracies which directly distribute food, housing, and health care. My plan addresses this inefficiency through allowing the replacement of bureaucratically provided economic assistance with a much more efficient system of Earned Income Tax Credit-provided health care and housing assistance, which, as far as the latter is concerned at least, requires as a condition of its receipt that the beneficiary work.

The attached charts provide examples of how this plan would help to incentivize not just work, but also family formation. To cite just one example here, a workfare employee, working 40 hours per week at $4.00 per hour, would earn $8,000 a year, but because of the refundable tax credits envisioned in the plan, would be "netted up" to a total income of $11,000. Hence, instead of the tax code reducing the reward for work, this plan would increase a low wage employee's reward for working.

The plan would allow Americans' household income to be easily doubled simply by having two adults form a family. A woman who worked 30 hours a week at a workfare job, and a husband or sister who worked 40 hours a week at a $4.25 minimum wage job, would together enjoy a $20,365 household income, net of tax credits. They would not be rich, but they would be able to live decently. And if the woman later found a higher paying private sector job, and the husband or sister later found a higher paying job, their household income would grow, and yet they would neither lose benefits nor become taxed at a higher marginal rate.

Combined with business tax changes that would best be discussed in another paper, these tax law changes would invigorate the economy by providing not just greater returns for savings and investment, but greater rewards for economically marginal Americans to marry and work. Current supply-side economic thinking tends often to focus narrowly upon capital formation as the key to productivity growth. But in fact, properly incentivizing labor and marriage is equally important. When the one-sixth of Americans, usually single adults, who are currently trapped in welfare dependence are instead encouraged to become economically productive and form households, the American economy will grow and our many of our social problems will subside. The change will be especially evident in our cities, where most of our poor live, but where the quality of life will dramatically rise even as poverty and local property taxes fall.

Imagine the impact on the spirits of working Americans, when they realize that by working harder they will actually be able to <u>increase</u> their household income, instead of being <u>penalized</u>. This will allow many who are lost in despair to once again turn to work as a source of meaning and hope for the future. What a novel idea: the thought that work should pay, and that Americans who work hard should be able to dream of a brighter future for themselves and for their children!

The non-refundable tax credit this plan envisions for charitable contributions targeted to helping the poor is specifically intended to create an explosion of state, local, and private initiatives which could build upon this foundation of economic justice and spiritual rebirth. The most effective social programs are those where control is exercised close to the individual in need. Energizing neighbor to neighbor assistance is critically important if we want to help those with the greatest individual needs.

Many will criticize this "Blueprint for Economic Justice" by saying that providing tax credits to the middle class and wealthy, as well as to the poor, will increase government spending. But it seems a stretch to suggest that expanding government tax credits, and allowing people to keep more of what they earn, represents an increase in government (as opposed to individual) spending.

There are others who will argue that providing tax credits to the middle class and wealthy, as well as to the poor, will reduce government revenue. But I wonder, why should anyone want unnecessarily to give a lot of money to government when we can keep more of it in our own hands, and better accomplish the goals of our social policy, through this combination of workfare and tax code changes.

Earned Income Tax Credits are currently under attack from some quarters because of fraud. The reason a degree of fraud exists in today's Earned Income Tax Credit program is that refundable tax credits incentivize Americans to report income, but today's welfare and tax policies disincentivize Americans on welfare from taking paying jobs. As a result, some non-income earning welfare recipients fraudulently report earned income in order to obtain the earned income refund. But the solution to this problem is not to eliminate the Earned Income Tax Credit program, it is to eliminate the disincentives which discourage those on welfare from actually taking a paying job!

Another probable criticism of this plan is that it does not provide extra benefits to families with extra children. This is intentional. In my opinion, federal policy should incentivize working, but should not incentivize having children. The reward for having children should be the joy of parenthood, not increased federal assistance.

Economic Opportunity Is The Goal

The focus of the national debate surrounding welfare and tax reform should be more than just eliminating welfare fraud and tax evasion, or spurring capital formation and economic growth. An equally important goal should be to provide a social safety net which catches Americans when they stumble economically, but instead of trapping them in dependence, both enables and incentivize them to work their way out of poverty, dependency, and despair, and up the ladder of economic opportunity. That is specifically what these recommended workfare and tax law changes are intended to accomplish.

If this proposal were implemented, there would be other gains as well. In particular, this plan would allow for a significant reduction in inefficient government bureaucracy and spending -- and hence a significant reduction in taxes -- at the same time that it devolves considerable power to states, local governments, and individuals.

State and local governments, as well as the private sector, have an important role to play in expanding economic opportunity for each and every American, and they would easily be able to build upon this federal foundation of economic justice. For instance, the states could (and, in my opinion, should) experiment with improving education through school choice initiatives, including the use of public and private school vouchers. Local governments, with state financial assistance, should also initiate creative public-private partnerships in job training and job placement, such as the America Works program in New York. But the success of all such efforts will ultimately be dependent upon a rock solid federal foundation of economic justice. That is why these federal welfare and tax code changes are so important.

There are certainly other options which we could pursue. We could leave today's welfare and tax policies in place, and just ignore their grotesque inefficiency and administrative costs, as well as the damage they do to family stability, the dependency they breed, and their spiritual destructiveness. Or we could go in the exact opposite direction. We could scrap the entire welfare system, flatten tax rates, and leave no federally provided social safety net or funding in place, while hoping that most people will be able to find a private sector job in a newly re-invigorated economy, and that the states or private charity will be able to take care of those individuals who do not land on their feet. As a third option, we could take a hybrid approach, and leave today's insane welfare and tax policies in place, even as we limit the receipt of welfare benefits to two years, so that we first encourage a state of dependent stupor, and once such is achieved, then cut benefits off. But I do not believe that any of these alternatives will ever be morally acceptable to the American people.

Other solutions still need to be crafted to meet the needs of those who cannot work. But the reforms which I have proposed here would at least ensure: 1) that every American who is willing and able to work, would also be able to find a job; 2) that every American who took a job would also be able to earn enough to live decently; and 3) that every American who worked hard to increase his or her family income, would also be benefitted for doing so and not penalized. And this proposal would accomplish all of this while permitting a significant reduction in the size and intrusive power of government.

This is the direction in which we should be moving. The time has come to empower every citizen with economic opportunity, and to once again make America a land of liberty and justice for all!

CHART: "Net Income Examples"

* $8,000 standard deduction per adult

* 27% flat tax, paid quarterly

* $1,000 in refundable earned income tax credits per adult, refunded or credited quarterly, for general necessities (Note: to receive refunds, returns must be filed quarterly showing earned income of at least $1,000 per quarter)

* $2,000 in refundable tax credits for health care per adult (Note: to receive refunds or tax credits, proof of insurance payments or MSA contributions required)

* workfare jobs would be limited to a sub-minimum wage of $4.00 per hour

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	Single Adult Works 40 Hrs / 50 Weeks / Yr	Family Income If Spouse Earns Same
Income from Workfare Job @ $4.00 / hr	**$8,000**	**$16,000**
Tax Liability 27% Marginal Tax Rate w/ $8,000 Standard Deduction	0	0
General Purpose Refund or Credit	$1,000	$2,000
Health Care Refund or Credit	$2,000	$4,000
Total Income Net of Refunds and Taxes	**$11,000**	**$22,000**
Effective Tax Rate	**(38%)**	**(38%)**

Income from Private Job @ $8.00 / hr	**$16,000**	**$32,000**
Tax Liability 27% Marginal Tax Rate w/ $8,000 Standard Deduction	**($2,160)**	**($4,320)**
General Purpose Refund or Credit	**$1,000**	**$2,000**
Health Care Refund or Credit	**$2,000**	**$4,000**
Total Income Net of Refunds and Taxes	**$16,840**	**$33,680**
Effective Tax Rate	**(5%)**	**(5%)**

Income from Private Job	**$30,000**	**$60,000**
Tax Liability 27% Marginal Tax Rate w/ $8,000 Standard Deduction	**($5,940)**	**($11,880)**
General Purpose Refund or Credit	**$1,000**	**$2,000**
Health Care Refund or Credit	**$2,000**	**$4,000**
Total Income Net of Refunds and Taxes	**$27,060**	**$54,120**
Effective Tax Rate	**10%**	**10%**

Income from Private Job	**$60,000**	**$120,000**
Tax Liability 27% Marginal Tax Rate w/ $8,000 Standard Deduction	($14,040)	(28,080)
General Purpose Refund or Credit	$1,000	$2,000
Health Care Refund or Credit	$2,000	$4,000
Total Income Net of Refunds and Taxes	**$48,960**	**$97,920**
Effective Tax Rate	**18%**	**18%**

Income from Private Job	**$100,000**	**$200,000**
Tax Liability 27% Marginal Tax Rate w/. $8,000 Standard Deduction	($24,840)	($49,680)
General Purpose Refund or Credit	$1,000	$2,000
Health Care Refund or Credit	$2,000	$4,000
Total Income Net of Refunds and Taxes	**$78,160**	**$156,320**
Effective Tax Rate	**22%**	**22%**

Income from Private Job	**$1,000,000**	**$2,000,000**
Tax Liability 27% Marginal Tax Rate w/ $8,000 Standard Deduction	($267,840)	($535,680)
General Purpose Refund or Credit	$1,000	$2,000
Health Care Refund or Credit	$2,000	$4,000
Total Income Net of Refunds and Taxes	**$735,160**	**$1,470,320**
Effective Tax Rate	**26%**	**26%**

CHART: "Sample Scenarios"

1) A single adult, without children, earning $100,000 per year, would net $78,160, representing an effective tax rate of 22%. The taxpayer would not be penalized for working hard to earn a relatively high income, and would be able to take advantage of the full $8,000 standard deduction, the non-means tested $1,000 general purpose tax credit, and the non-means tested $2,000 tax credit for health care, which the taxpayer could claim after submitting proof of payment of health insurance or medical savings account expenses.

2) A married couple, with children, with one spouse earning $80,000, and one spouse earning $40,000, would net $97,920, representing an effective tax rate of 18% on their combined income. The couple would take advantage of two standard deductions, two general purpose tax credits, and two health care tax credits. The couple would not receive any tax breaks for choosing to have children, but neither would the couple be penalized for choosing to marry and form a single household. Their combined tax liability would be precisely the same as it would have been had the two adults filed separately. In fact, the couple would receive some economic benefits for forming a family, since by sharing a single rent and family health insurance policy they would be able to stretch their spending.

3) A married couple, without children, one earning $110,000 per year, and one reporting $10,000 in income paid by the other spouse for homemaking services, would officially net the same $97,920 as the couple above, representing the same 18% effective tax rate as the couple above, on a combined nominal income of $120,000. The couple's actual external income would only be $110,000, of course. But the artifice of having the homemaker bill the externally working spouse for $10,000 in services would be accepted as a legitimate means by which the couple could take advantage of two standard deductions and two sets of Earned Income Tax Credits. This would have the tax code recognize for the first time that homemaking is valuable work, and would provide a distinct economic benefit for having formed a family.

4) A single adult, with children, earning $16,000 per year, would net $16,840, representing an effective tax rate of -5%. Making ends meet on $16,000 a year is hard enough, without having the government take out taxes. The "netting up" effect of the "refundable" tax credits would actually add to the reward for work which this adult receives from his or her employer.

5) Co-habitating adults, without children, one earning $11,000 at a minimum wage job, and the other earning $6,000 at a 30 hour per week workfare job, would net $22,730, for an effective tax rate of -34%. Since this couple was not married, they would not be able to file a joint return. But since marriage and household formation is neither penalized

nor preferenced under this system, the couple's filing separate returns would have no economic consequence. They would simply receive the same economic benefit which all households receive from sharing a rent and medical policy between two or more income earners. This "householding benefit," combined with the netting up of their two very modest incomes, would allow them to live decently even though they were working at very low paying jobs.

6) A single adult, with children, earning $6,000 at a 30 hour per week workfare job, would net $9,000, representing an effective tax rate of -50%. This adult would find it difficult making ends meet. This would give him or her an incentive to form a household and share a rent and other expenses with at least one other adult. It would also encourage the adult to take advantage of job training opportunities and search for a higher paying job. If the adult landed a 40 hour a week, $8.00 an hour job, his or her income, with the benefit of the refundable tax credits, would quickly rise to $16,840.

7) A single adult, without children, fraudulently reporting $6,000 per year of income from a workfare job, would net $3,000, representing an infinitely negative effective tax rate, until such time as the fraud was detected. Of the $3,000 in benefits received, $2,000 would represent a refund for health insurance premiums or MSA contributions. This would be cheaper than today's per person cost for providing medicaid coverage. Another $1,000 of the received benefits would come back in the form of cash. This would hardly be enough to live, creating a significant incentive for the adult to seek real employment and legitimize his or her fraudulent claim for the Earned Income Tax Credit.

CHART: "Sample Scena[illegible]

1) A single adult, without children, earning $100,0[illegible] [illegible] year, would net $78,160, **representing an effective tax** rate of 22%. The taxpayer would not be penalized **for working hard to earn a relatively** high income, and would be able to take advantage **of the full $8,000 standard deduction**, the non-means tested [illegible]000 general purpose **tax credit, and the non-means** tested $2,000 tax credit for health care, which the **taxpayer could claim after submitting** proof of payment of health [illegible]ance or medical **savings account expenses.**

2) A married couple, with children, with one spouse earning $80,000, and one spouse **earning $40,000, would net $97,920**, representing an effective tax rate of 18 % **on their combined income. The couple** would take advantage of two standard deductions, two **general purpose tax credits,** and two health care tax credits. The couple would **not receive any tax breaks for** choosing to have children, but neither would the **couple be penalized for choosing to marry** and form a single household. Their combined **tax liability would be precisely** the same as it would have been had the two adults filed **separately. In fact, the couple** would receive some economic benefits **for forming a family, since by sharing a single rent** and family health insurance policy they would be able **to stretch their spending.**

3) A married couple, without children, one earning $11[illegible] per year and one reporting **$10,000 in income paid by the** other spouse for homemaking services, would [illegible] net **the same $97,920 as the couple** above, representing the same 18 effective tax rate [illegible] the **couple above, on a combined** nominal income of $120,000. [illegible] couple's actual [illegible] **income would only be $110,000**, of course. But the artifice of having the home[illegible] bill **the externally working spouse** for $10,000 in services would be accepted as a [illegible] **means by which the couple** could take advantage of two standard deductions and [illegible] sets **of Earned Income Tax Credits.** This would have the tax code recognize for the first time **that homemaking is valuable** work, and would provide a [illegible] economic benefit **for having formed a family.**

4) A single adult, with children, earning $16,000 per year, would net $1[illegible],940, representing **an effective tax rate of -5%.** Making ends meet on $16,000 a year is hard [illegible], **without having the government** take out taxes. [illegible] **"refundable" tax credits would** actually add to the [illegible] which [illegible] adult **receives from his or her** employer.

5) Co-habitating adults, without children, one earning $[illegible] at a minimum [illegible] job, **and the other earning $6,000 at** a 30 hour per week work[illegible], would net $2[illegible], for **an effective tax rate of -34%.** Since this couple was not married, they would not be able **to file a joint return. But since** marriage and household [illegible] is neither penalized

nor preferenced under this system, the couple's filing separate returns would have **no economic consequence. They** would simply receive the same economic benefit which **all households receive from sharing** a rent and medical policy between two or more income **earners. This "householding** benefit," combined with the netting up of the [illegible] very **modest incomes, would allow** them to live decently even though they were working at very **low paying jobs.**

6) A single adult, with children, earning $6,000 at a [illegible] per week [illegible] **job, would net $9,000, representing** an effective tax rate of [illegible] This adult would find **it difficult making ends meet.** This would give him or her [illegible] incentive to form [illegible] **hold and share a rent and other** expenses with at least one other adult. It [illegible] **also encourage the adult to take** advantage of job training opportunities and [illegible] **a higher paying job. If the** adult landed a 40 hour a week, $8.00 an hour job [illegible] **her income, with the benefit of** the refundable tax credits, would quickly rise to [illegible]

7) A single adult, without children, fraudulently reporting $6,000 per year of [illegible] **from a workfare job, would net** $3,000, representing an infinitely negative effective [illegible] **rate, until such time as the fraud** was detected. Of the $[illegible] benefits rec[illegible] **000 would represent a refund for** health insurance premiums or MSA contribu[illegible] **This would be cheaper than today's** per person cost for providing Medicaid coverag[illegible] **her $1,000 of the received benefits** would come back in the form of cash. This w[illegible] **dily be enough to live, creating** a significant incentive for the adult to seek real e[illegible] **ent and legitimize his or her** fraudulent claim for the Earned Income Tax Credi[illegible]

Bruce: FYI

Tax Reform

Scrambling to Pay the Bills: Building Allies for America's Working Families

**A Set of Comprehensive, Specific
Democratic Proposals to
Address Wage and Income Stagnation --
to Produce Long-Term, Higher Rates of Economic Growth,
Shared with Working Families,
in the United States**

**Presented by Senator Jeff Bingaman (D-NM)
to the Senate Democratic Leader,
Senator Tom Daschle (D-SD)**

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Full Report

INTRODUCTION

An important debate has now broken out of the editorial pages and into the public arena -- about the real health of the U.S. economy. Some economists such as Robert Samuelson have argued that many American's anxieties about side-stepping pink slips and managing economic survival are really false concerns. He argues that rates of joblessness and job-hopping are roughly similar to or only slightly higher today than twenty years ago. Furthermore, Samuelson argues that the economy is performing as it should, rewarding those best prepared to adjust to transitions through which the American economy must inevitably go.

Others on the other end of the debate are alarmed that the economy is leaving the working middle class behind; that the combination of hard work and dependable performance no longer assure adequate health care and retirement savings, educational opportunities for children, and the promise of an improved standard of living over time. For the first time in the nation's history, productivity is surging upward and average real wages are failing to respond. In the first quarter of 1995, for example, productivity surged 2.7%, but wages have continued to decline, in fact registering their largest decline in eight years. Productivity has now outstripped wage growth for two straight years. As Samuelson argues, those who are on the upper end, with advanced training and education, are rewarded in an economy that needs their services. But these unskilled workers, who represent 70% of working Ameriea and historically had opportunities for relatively high-paying jobs, are increasingly abandoned by an economy that needs their services less and less.

In his 1996 State of the Union address, President Clinton declared that the "American economy is strong." Home ownership is at its highest rate in 15 years; 7.8 million new jobs have been created in the last three years; and the administration's 1993 economic plan has cut the deficit nearly in half and significantly reduced the burden of taxpayers. Furthermore, to say that corporate profitability, stock market averages, and manufacturing volume productivity are at historic highs fails to capture just how continuous and eruptive these advances have been. But clearly, America's working families are not hitting these same historic highs -- and an updated version of President Clinton's 1992 campaign slogan, "It's still the economy, stupid" continues to reflect the anxiety that most working families feel about their current and future economic circumstances.

Not since the American Civil War has there been a 20-year period in which average real wages fell -- except from the 1973 to the present. The American standard of living has been even further undermined when Americans tried to make up the difference by working harder -- more jobs, and both spouses working. The average full-time male employee now works a week and a half longer a year than in 1973. The number of two-worker families rose by more than 20% in the 1980s, and seven million workers hold at least two jobs, the highest proportion in 50 years. And the largest increase in the proportion of working spouses was among families earning the least money.

To add to the financial tension of working families, the cost of education at public universities has risen 50 percent higher than inflation since 1984, and even the cost of sending a son or daughter to a community college has doubled in real dollars since 1970. The cost of health care has skyrocketed and participation in pension plans has dropped.

As if lower wages, longer hours, and higher prices for education and health care were not enough, job insecurity has grown and grown. The American working family has confronted unrelenting lay-offs, downsizings, relocations, and business reorganizations. With the mean time to financial failure (the time after the loss of sources of income by which all family financial assets would be used up) for almost half of all working families at somewhere between two minutes and two and a half weeks, average working families' anxiety about their economic futures has reached new highs. The "American Dream," the belief that the next generation should be and will be better off than the previous generation, has simply shattered.

How could this have happened? One reason is that since 1973, our economy has not sustained rates of economic growth close to those of previous decades. From 1870 to 1973, the American economy sustained average annual growth rates of 3.4%, but since then, the nation has averaged only 2.3% annual economic growth. Had the American economy grown at an average of 1% more per year than it did since 1973 (which would still put the growth rate a little lower than the U.S. historical average), annual income for the typical family would have been about $5,500 a year higher in 1993, and possibly more. From 1973-1993, the typical family would have earned an additional $50,000 in income, which it could have used to pay for college, for health care, for a down payment on a home, or to allow one parent to stay home with the kids a little longer.

And the second reason that the American dream has stalled is that the fruits of what growth there was have not been shared with average working families. During the period 1950-1978, economic growth was shared by all income groups. But from 1979 through the present, any increase in profits seemed to only increase the inequality of wealth in America. For example, from 1950 to 1978, the bottom 60% of American families (by income) experienced an average growth in real income of 114%, while the top 40% averaged only a 105% growth in real income. But from 1978 to 1993, the bottom 60% saw real family income growth go negative, an average <u>drop</u> of 8%, while the top 40% experienced an <u>increase</u> of 8%.

Many of those who have thought about the wage and jobs problem in America have come out swinging against "Corporate America." Even the front contenders in the Republican presidential primaries, having stubbed their toes upon the problem of stagnant incomes, have toyed with rhetoric about corporate "captains of greed" and the urgent need for corporate responsibility. And to an extent, some corporate executives have played into their hands by pairing surging executive compensation packages with proliferating pink slips and job out-placement counseling for "down-sized" employees. But in truth the villain is not corporate America. Rather, America's economic system which has been increasingly challenged by international trade competition and Wall Street's increasing insistence on short-term profits has produced a dysfunctional relationship between working families, on the one hand, and corporations, labor, securities markets, and the government, on the other.

The "system" has failed to provide adequate incentives for business investments in the United States that will produce new products, new processes, higher profit margins, and higher wages in the long run -- that will produce global market power in high-value-added products and services: research, development, plant, equipment, process technologies, new distribution channels, new marketing strategies and worker training.

Moreover, businesses are faced with tough choices given the incentives that foreign governments often provide in tax abatement packages, financial grants, lower labor costs, and less stringent environmental protection regimes. Countries such as China are known to squelch market access unless a firm agrees to technology transfer concessions or to building a manufacturing operation in that country. China then compels that manufacturer to export up to 70% of what is produced, often to the United States, thus displacing jobs in this country that should be directed towards fulfilling America's own domestic demand. And our securities markets exert enormous pressure on businesses to slough off workers and scale back R&D programs to pump up quarterly financial results. The results of these systemic pressures include lower and lower wage strategies, leading to restructuring, downsizing and outsourcing all contribute to the uncertainty and anxiety that working families feel about their futures.

According to pollster Stanley Greenberg, Americans feel that they are "scrambling" just to hold things together, just to manage the bills that come in month to month. But still, people feel that they can chart a course through this uncertainty -- as long as they can make it to retirement and get access to Medicare and their social security savings. But lately Medicare and Social Security, part of the personal survival strategies of many Americans, have been threatened. In addition, according to Greenberg, most Americans believe that economic advancement can come through education and training -- but the costs of education are increasingly out of reach for those who would most benefit and who are least able to pay. The story is the same in health care -- costs are going up and workers are having to personally carry more and more of that burden. Retirement security is the same. We are shoving the responsibilities and risks of this economy onto average workers who, by themselves, cannot cope. It is time to build powerful allies for working families for their personal economic strategies.

America should not minimize, and Democrats should be proud of, the important steps that have been taken in the past to support working families. The institutionalization of a minimum wage, the 40 hour work week, COBRA, work place safety rules, family and medical leave, college loans and the right to organize labor unions, as well as Social Security, Medicare and Medicaid, have all been important in securing a certain degree of safety net for hardworking Americans. But the new global marketplace in which we all work requires new ideas and new ways in which to make businesses, the financial market, and the governments allies of working families for the struggles ahead.

It is high time to demand that the American economy put itself on a "high-wage road" back up to our historic economic growth rates. The key players must finally assume their roles to help us get there: American businesses, Wall Street and the financial community, and the federal government must all become allies of working families, self-employed workers, and small businesses. Our report consists of a comprehensive strategy to ally these forces. It proposes to align federal tax policies, spending priorities, and regulatory policies along a single trajectory toward higher economic growth:

- ❑ ***By producing long-term investments*** by business, Wall Street, and government in: research, development, plant, equipment, process technologies, new distribution channels, new marketing strategies, and worker training.

- ❑ ***That is shared by America's working families.*** A trajectory for economic growth that will value and invest in the nation's workers -- equipping them with the skills they need to be the best workers in the world, giving them tools they need to embrace, and not fear, economic change, and rewarding them for world-class performance.

- ❑ ***In the United States.*** A trajectory for economic growth that uses both carrots and sticks to force open lucrative, growing foreign markets for American-made products and services and which prevents the undermining of the finest parts of our economic system by intolerably lax labor, environmental, and property standards elsewhere.

There are those who will say that building alliances for this enormous task between working families on the one hand, and businesses, Wall Street, and the government, on the other, is futile. They will say that higher economic growth is not possible, and we must simply leave the "invisible hand" alone to do what it will do. In other words, none of us has responsibility for working on this problem. None of us can do it, so none of us should be asked to try.

We reject that view categorically. We look at America's strengths:

> "We are still the most productive and richest nation per capita in the world, with unmatched reserves of financial resources and productive capacity. We remain leaders in dozens of key industries, from chemicals to electric turbines, personal computers and software, semiconductors and biotechnology. We are the best retailers and distributors in the world. We are an entrepreneurial people and a mobile one, a sprawling nation with plenty of room for new beginnings. Unlike the world's former economic leaders, Holland and England, we are still a gigantic marketplace where the world's best companies continue to build plants and distribution facilities. We are aging far less quickly than our advanced competitors, for whom the financial pressure of Social Security and pension obligations will be even greater than ours. Our high levels of immigration, if periodically overwhelming, are a source of young, ambitious people, whose predecessors throughout our history have been highly successful here, no matter how they have been insulted for genetic incapacities by the 'experts' of the day. We are still one of the best educated

peoples of the world." (Jeffrey Madrick, *The End of Affluence*, pp. 159-160.)

We are determined to take these strengths, rebuild the standard of living for America's working families, and restore the "American Dream." And we challenge all who are willing, among America's businesses, financial community, and the federal government, to join a new alliance and take on their share of that solemn responsibility.

ESTABLISHING THE "A-Corp":
HELPING BUSINESSES BECOME ALLIES OF AMERICA'S WORKING FAMILIES

America's businesses are facing enormous pressures from international competition and from Wall Street to produce higher and higher short-term earnings. They are confronted with tough choices in the global market place. For example, should they make their next investment in the United States, or in a particular foreign country that touts lower wage costs, lower labor standards, and lower environmental requirements while at the same time promises to deny access to its market unless the company invests within its own borders? And how does the company daily satisfy its Wall Street investment analysts that it is taking every step imaginable to pump up quarterly earnings at least for the short-term? Too often, without countervailing pressures, America's businesses are compelled to pursue short-term, low-investment, low-wage, cost-cutting strategies. The result? Down-sizing, restructuring, and out-sourcing.

These words -- down-sizing, out-sourcing and the like -- are frightening words for most of America's working families, because so many key components of each family's economic strategy are dependent on provisions made for them by their employers. After all, decisions about pension plans, worker training, health care, and their wage rates are in the hands of their employers. As workers must be partners with their employers in producing world-class goods and services, businesses should necessarily be allies of their employees in helping them execute successful personal economic strategies. We therefore propose a powerful set of incentives to help businesses fulfill this role.

We propose permitting businesses which operate in the United States to self-qualify for status as a "Business Allied with America's Working Families." The attorneys and accountants for such businesses (which might be called "A-Corps") would provide opinions that the business qualifies, according to certain criteria. For every year it qualifies for status as an A-Corp, the business would get the benefit of extremely favorable tax, regulatory, and government contract treatment, as described below.

How would a business self-qualify as an A-Corp? The business (which shall be defined as all of its businesses, subsidiaries, and joint ventures under common control) would have to meet certain tests, about which its attorneys and accountants could give an annual opinion. For example, the business would have to:

- ❑ Contribute an amount equal to at least three percent (3%) of payroll to, and offer to its U.S. employees, a multi-employer or multiple employer pension plan (defined contribution or defined benefit, with significant portability), or sponsor a collectively-bargained, single-employer plan.

- ❑ Devote an amount equal to at least two percent (2%) of payroll for U.S. employee training or education which training or education was certified to meet standards set by certain industry groups.

  Note that the National Skills Standards Board, created under the Goals 2000 legislation passed in 1994, is tasked with developing a system of voluntary skills standards. The system will establish a common set of skills needed for a cluster of occupations that workers will need.

- ❑ Offer to all U.S. employees (permanent and temporary employees working for more than 3 months), and pay at least half of the cost of, a health care plan conforming to a basic model health care benefits plan drafted by the National Association of Insurance Commissioners.

- ❑ If a for-profit entity, operate for its U.S. workers either an employee profit-sharing plan, or an employee gain-sharing plan (bonuses tied to employees meeting certain measurable productivity, quality, safety or other objectives), or an employee stock option plan, or an employee stock ownership plan:

  - ✓ in which 50% or more employees participate, where no individual employee owning more than 5% of the stock or receiving over 5% of the benefits is counted toward this requirement;

  - ✓ which is managed by an employee-elected trustee; and

  - ✓ in which all stock is full voting stock.

- ❑ Maintain a compensation plan such that:

  - ✓ the compensation (excluding stock options and purchases meeting the restrictions below) of the highest-paid employee is no greater than 50 times the compensation of the lowest-paid full-time employee; and

  - ✓ such plans shall require gradual, 5-year vesting of options and underlying shares acquired by management executives under all stock option and stock purchase plans; and

  - ✓ a substantial proportion of the compensation received by members of the company's board of directors shall be in the form of stock options which shall require the same vesting requirements as for management executives.

- ❑ Show that in the preceding three-year period:

- ✓ at least 50% of the total of all net new investment in research & development was made in the United States; and

- ✓ at least 90% of the total of all net new investment in plant, equipment, and employment used for the production and delivery of products and services consumed in the United States, occurred in the United States. This would likely be calculated by requiring that these investments equal 90% of the proportion that net new sales in the U.S. represent of the business's total net new sales in the world during that three-year period.

- ❑ Maintain above-average or continuously improving occupational safety and environmental compliance records.

- ❑ After December 31, 1998, belong to and pay significant dues to an industry association which shall be certified by the Department of Commerce as:

  - ✓ actively participating in the United States in the setting of education, training, and apprenticeship standards for workers in its industry; and requiring its members to support local school-to-work systems through consultation with local school officials, supporting school to work curricula, or providing work opportunities for students participating in school to work programs;

  - ✓ offering to all of its U.S.-members the opportunity to participate in a managed, multi-employer or multiple employer, portable pension plan similar to those operated by TIAA-CREF, the National Automobile Dealers Association and the Rural Electric Cooperatives, for example;

  - ✓ providing significant assistance to its members with respect to the export of the industry's goods and services from the United States.

A-Corp Tax Benefits and Tax Benefits for all Corporations

We believe that stagnant wages are traceable partly to inadequate long-term investment.[1] This view holds that long run wage *increases can only be based on improvements in labor productivity,* which in turn depends on both the degree and direction of America's investment/capital allocation activity.

Recent statistics indicate increases in workforce productivity, but the longer productivity trend over the last 20 years is weak and any recent gains have been in *volume* (number of units of standard product produced per worker) not *value* (units of output per unit of labor and relative prices) productivity. Increased volume productivity will not lead to higher wages if the price of a company's products falls relative to the price of its inputs. In fact, since 1981, value productivity growth has been much slower than volume productivity growth.

This trend has direct impact on America's competitive position and American living standards. If the U.S. continues down the road of stifled innovation and low-value productivity gains, foreign competitors will make greater inroads since they more easily can match efficiency improvements on standard products or compete successfully with American firms based on lower wages. In other words, American wage growth will not expand until the U.S. expands production of higher-value items. Furthermore, new products and new markets are needed to create new jobs and offset employment reduction that often accompanies productivity growth in established products and services.

The existing Federal regulatory framework (most corporate governance rules, tax laws, and accounting conventions) exacerbates the problems of capital allocation and wage stagnation since much of it was developed before WWII. Since the 1950s and 1960s, revolutionary changes have swept the business world, including dramatic growth in information and communications technology, extensive globalization of production and investment, a shift in importance from large and diversified companies to smaller and more flexible organizations, and a pronounced concentration of private equity ownership in institutional agents. We believe that the Federal government must update its investment, corporate governance, and tax policies to reflect these fundamental changes, to link productivity growth to wage growth, and to encourage proliferation of responsible business practices.

In our view, composition of investment matters. If the U.S. takes beneficial measures to reduce deficits and increase savings without efforts to channel these benefits into productive capacities, then it will have done little to address the root causes of income stagnation. In other words, it will matter if the newly expanded savings pool is spent on worker skill upgrades and new technology or on nicer houses and more office buildings.

Overall growth in the nation's net capital stock has fallen considerably over the past twenty years. A decline in fixed investment means that growth of the capital-to-labor ratio in US industry -- which is crucial to growth in value productivity and wages -- is slow by historic and international standards. Three particular investment trends have contributed to this pattern and are of concern to us:

1. *Net investment* in fixed corporate assets in the United States has fallen substantially, by both historic and international standards. American companies now invest at lower rates in intangible assets (R&D, workforce training, new products and new markets, supplier relationships, establishment of brand names and distribution channels) than their foreign competitors.

2. *New equity issues* have been outpaced in recent years by equity retirements (e.g. from acquisitions and stock repurchases). This matters to the issue of high-wage

jobs because most intangible investments (R&D and new market development) are funded by new equity, not tax-favored debt or internally-generated cash flow. Most corporate investment now has to look solely to internally-generated cash as a source of funds, and not a much larger pool including new, outside capital.

3. *Increased dividend payouts by firms reflect capital market pressure for current income as well as shortage of investment opportunities that meet perceived hurdle rates.* High hurdle rates (required return) in the U.S. relative to foreign competitors result in comparatively high profits and lower investment in the U.S. than elsewhere. If there is a short supply of capital and immediate returns are demanded and if certain types of investment (R&D, worker training, market share development) are less conducive to precise future cash flow projections, high hurdle rates will inefficiently skew capital away from longer-term to shorter-term or more tangible projects. As a consequence, American companies spend billions buying back own stock rather than investing in new assets.

Reform of capital allocation patterns must begin with tax policy, since the tax code affects the choice between saving and consumption, the form investments take, and the vehicles government chooses to pursue specific public goods. Problems in the current U.S. tax code mean that:

1. *Debt is favored over equity* so capital is steered toward older, established firms with assets that lenders can collateralize, and away from younger high tech-firms with a greater proportion of intangible assets. Business traditionally finances riskier, long-term, value-added activity such as R&D and worker skill training through equity instruments, not debt financing. But the current tax system, which makes interest payments fully and immediately deductible business expenses while double-taxing dividends on equity and providing no deduction, or only a partial deduction or extended depreciation for the use of retained earnings for longer-term investments, incentivizes debt while discouraging equity.

2. *The incurring of research & development expenses in the United States is still discouraged.* First, the r & d tax credit is still temporary and limited. And second, the percentage of r & d expense that is deductible depends on the percent of a business's income that is foreign sales income. For example, if 50% of the firm's income is foreign income, only 50% of the firm's r & d expense is deductible against U.S. corporate income taxes, even if <u>all</u> of the research & development is done in the U.S.

3. *The licensing of U.S.-invented technology to foreign companies is explicitly encouraged.* In a perverse structure, firms license their technology in foreign countries so that they can increase their foreign income on which they must pay foreign taxes, which in turn increases the foreign income tax credit available to

them to offset against total corporate income for U.S. tax purposes.

4. *There are big differences in the corporate income taxes paid by different types of firms in the U.S.* The enormous complexity of the current corporate income tax structure leads to remarkable unfairness over types of firms. That in turn leads to demands for reduction in the unfairness which means *a reduction in, or a ratcheting down of, the percent of all U.S. taxes paid by corporations.*

5. Finally, there is *an entire industry which costs the economy in excess of $300 billion annually, to find ways through the complexity of the current corporate tax code to reduce business taxes.* In a classic misallocation of resources, some of the best, brightest, and well-trained minds in the country -- lawyers and accountants, generally -- are highly compensated to achieve no net value to the domestic economy.

For all of these reasons, we propose elimination of the corporate income tax and the adoption of the Boren-Danforth Business Activities Tax as described in "The Comprehensive Tax Restructuring and Simplification Act of 1994" (hereafter "B-D"), with three major changes. The B-D business tax , which is fully border-adjustable (it taxes imports, not exports), applies a fixed tax rate to a tax base resulting from taking all business receipts and subtracting payment to other businesses for goods and services (including the purchase of new equipment, construction of plants, etc.). Neither employee compensation payments nor payments of interest or dividends are included in the subtraction. Two of the changes we propose would:

- ❑ Provide that money spent on the provision of training or education to employees of the workplace, which training or education was certified to meet standards set by certain industry groups in coordination with the National Skills Standards Board, shall not be part of employee compensation and shall be fully subtracted from B-D tax base, just as an investment in a new machine would be; and

- ❑ Provide that research & development expenses incurred in the United States (as defined under the current tax regulations governing the existing temporary r & d credit) shall be fully subtracted from the B-D tax base, just as an investment in a new machine would be.

Adoption of the Boren-Danforth business activities tax with the above two changes accomplishes a number of objectives which will aid <u>all</u> American businesses in improving their performance:

- ✓ In the business tax setting, *it eliminates any preference for debt over equity.* Neither interest payments to lenders nor payments of dividends to shareholders are subtracted from the B-D tax base. This is important because business traditionally finances riskier, long-term, value-added activity (investment in intangible assets such as R&D, workforce training, new products and new markets, supplier relationships, establishment of brand names, and distribution channels) through equity instruments, not debt financing.

- ✓ *It incentivizes investment in the United States* in new plant and equipment, research & development, and worker training. Under our modified B-D business tax, all company expenditures for new plant and equipment (built, used, or consumed in the U.S.), and research & development and worker training (conducted in the U.S.) are subtracted from the tax base. And it eliminates the incentives in the current code to invest in, or to license U.S. technology to, foreign countries.

- ✓ *The tax is fully border-adjustable, taxing imports but not exports.* The revenue received from the sale of exported goods and services is not included in the B-D tax base, and the amounts paid for all imported goods are taxed at the applicable rate as they cross the border into the United States.

- ✓ Our business activities tax is *much more fair across types of firms*. It does not vary with the type of business generally, and makes only one big distinction -- between "businesses allied with America's working families" (those that qualify for A-Corp status), and those that choose not to be.

- ✓ *It is simple, not complex, and will eliminate the multi-billion industry of lawyers and accountants* whose entire livelihood depends on playing all the angles in the current complex corporate code.

- ✓ Finally, the revenues generated by uniformity of the tax *allows us to roughly cut in half the cost of the OASDI payroll tax paid by business* -- a reduction of 3.1%, from 6.2% to 3.1%. This change would cut the cost of doing business generally and specifically the marginal cost of adding new employees. Note that the OASDI trust funds would be replenished by receipts from the business tax in the same amounts as would have been paid in under the old payroll tax rates.

But our third modification of B-D would provide an enormous incentive for business to become allied with America's working families. This third change would provide two rates, not one rate, applied to the tax base for the business. Of the two, the significantly higher rate (for example, 18%) would apply to the tax base of all businesses which had not qualified for A-Corp status. Businesses which, in the opinions of their attorneys and accountants, qualify as A-Corps, would pay a significantly lower rate (for example, 11%) on their tax base.

This rate differential finally provides to American businesses an incentive of the scope other countries routinely provide to businesses for corporate decisions they want to encourage. How many times have we seen even American businesses decide to locate their next plant in another country, partly because of the special tax treatment they will be afforded? Under our proposal, American business will finally have a significant incentive to build that next plant right here in the United States, to provide their American workers health care coverage, and to invest in their American workers' training and retirements.

Note also, the B-D business tax would not apply to small businesses with annual gross receipts of less than $100,000. Exempting these small businesses from the tax would entirely eliminate over 60% or 15 million businesses from the business tax rolls. And financial services companies require a slightly modified regime as provided in the draft legislation for the B-D. Finally, there are significant transition issues which would need resolving when the plan is implemented.

A-Corp Regulatory Benefits

As a qualified A-Corp, a business would be required to comply with all applicable federal laws and regulations, but also would be entitled to (1) speedier federal agency review and decision making, (2) participation in voluntary compliance programs, and (3) take advantage of safe-harbor provisions designed for A-Corps from applications of certain regulatory requirements.

A-Corp Government Contract Benefits

Qualified A-Corps shall be entitled to a strong preference (10% cost advantage, set-asides, goal provisions, and the like) in competitions of U.S. government procurement contracts, awards, and other programs in which businesses are allowed to participate.

HELPING BUSINESSES BECOME ALLIES OF ... AMERICA'S WORKING FAMILIES ... BY SUPPORTING THEM IN THE GLOBAL MARKETPLACE

We must also respond to the needs of the American corporation which is faced with an easy choice: go where labor is cheaper, labor and environmental laws are weak, and markets are held hostage to investment and technology transfer. For the United States to continue to grow, the welfare of the American corporation must be preserved, but the corporation must be encouraged to invest in itself, its workers, and its research and development, to grow over the long-term. Building the American economy in a healthy manner requires that government, labor, and business come to terms with the economic dimensions of national interest; and that Americans learn to conceptualize, prioritize, and pursue these economic interests both at home and abroad. Certainly today, America's long-term economic vitality must rank as the nation's top national security concern.

The consequences of globalization are not well understood. Certainly, an open global economy offers opportunities to the United States to export items that may create good jobs and to import those products that it would not otherwise produce. But the fact is that much of the global market is not open; barriers to trade can be identified the world over, and a majority of global trade flows not freely but is managed by informal and formal arrangements protecting respective producers in other countries, particularly in Asia which accounts for an overwhelming majority of the U.S. global trade deficit.

In contrast to the closed and limited-access markets for goods and services abroad, labor markets abroad are wide open. Manufacturing investment from the United States to other nations flows freely, drawn by cheaper labor costs and lower labor and environmental standards as well as lax code enforcement. The global economy offers the clear danger that U.S. wages will decline to the least common denominator set by countries determined in their own industrial development to maximize job creation within their own borders, at the expense of the finest parts of the American economy.

Free trade may be the ideal agenda in an ideal world, but to be blind to the absence of free trade beyond our shores will only lead to the slow death of American industry and to the ultimate impoverishment of the American worker. The U.S. has economic interests it needs to pursue both domestically and internationally so that the benefits of trade are truly mutual and do not flow just one direction.

HELPING BUSINESSES BECOME ALLIES OF AMERICA'S WORKING FAMILIES... BY CONFRONTING THE ASIA-PACIFIC TRADE & INVESTMENT PROBLEM

Probably no higher priority exists on America's trade agenda than restoring equity to its trading relationships with nations in the Asia-Pacific region. America's global trade deficit with the Asian region displaces more than 2 million American workers from good, high paying jobs. China requires firms desiring access to the Chinese market to invest in its country with considerable technology transfer concessions and agreements to export up to 70% of the product produced in China to the international market. This is clearly a job displacement strategy. Similarly, Japan's long-term ability to restrict market access has muted American economic development, thus lowering our own ability to save and invest and compete in the international system. Only Asia stands out in having endemic, large scale merchandise surpluses with the United States, and any recipe designed to improve the lot of American workers and American corporations must deal squarely with the Asia-Pacific trade problem.

While the move of low-tech industry abroad is part of the natural evolution of the U.S. economy, a significant part of American high-tech industry and manufacturing capacity has moved abroad as well -- especially to Asia. This shift has not occurred entirely through market dynamics and comparative cost factors. Much of the high technology sector, particularly in the components industries for automotive and aerospace industries, has understandably been targeted in the industrial policy plans of East Asian developing nations. But the governments of these nations then negotiate directly with the multinational corporations and specifically condition access to their commercial markets and to their government contract markets upon those companies' transferring technology and committing to higher-end manufacturing within their borders.

Action Plan

- *Establish Presidential Commission on U.S.-Asia Pacific Trade and Investment Policy.* We support the establishment of a commission of non-governmental experts on Asian investment and trade policy to address America's chronic and unyielding merchandise trade imbalances with the Asian region. Over the last five years, this imbalance in trade between the U.S. and Asian nations has accounted for 96% of America's total global trade deficit. The commission will draw together expertise from the business, academic, and labor communities and address America's trade and investment problem by suggesting possible prescriptions. These may include strengthening monitoring and enforcement mechanisms of standing trade agreements, as well as withdrawing market access to goods produced in nations that do not provide truly reciprocal access to U.S. firms.

- *Take action to prevent arrangements whereby technology is transferred in exchange for granting market access in foreign nations.* We urge the Administration to enforce 1992 Market Access Memorandum and the technology transfer provisions of the 1995 Intellectual Property Rights Agreement with China which disallow the practice of withholding market access for technology transfer concessions from U.S. firms. Moreover, the Administration should, as part of their support for the Commission on U.S.-Asia Pacific Trade and Investment Policy, study the practice of foreign nations' trading market access for technology and report to Congress on an action plan that responds to this growing problem. The administration should explain if there is any reason that this practice is not defined as anti-competitive as specified in Section 301 of U.S. Trade Law and thus actionable under U.S. Trade Law.

HELPING BUSINESSES BECOME ALLIES OF AMERICA'S WORKING FAMILIES ...
BY UPGRADING LABOR AND ENVIRONMENTAL STANDARDS

In the present day international trading system, American corporations are challenged by other multinational firms attempting to secure massive economies of scale while at the same time slashing labor, land and materials costs. High environmental and labor standards that insure the welfare of American citizens and the nation are under pressure from nations that have relatively weaker labor and environmental codes, or which have weak enforcement policies. Our response must not be to dilute American codes or enforcement; rather, we must use international trade organizations and diplomatic resolve to ratchet up the labor and environmental codes of other countries.

Some efforts have been made by the Department of Commerce in cooperation with the U.S. Chamber of Commerce and overseas-based American chambers to develop a voluntary "Code of Conduct for U.S. Firms Doing Business Abroad." The basic tenet of the code is for U.S. firms to abide by the same labor, environmental and general business practices abroad that they follow at home.

Action Plan

- ❑ *The Administration should report to Congress on the results of a complete review of American compliance and the compliance of all of our significant trading partners with respect to the provisions of: International Labor Organization conventions, protocols of the Caribbean Basin Initiative, and the General Preferences and Standards.* In its report to Congress, the Administration should identify all remedies available to respond to any non-compliance by foreign nations that export goods to the United States, including any anti-competitive trade practices that may be actionable under Section 301 of U.S. Trade Law.

- ❑ *Maintain U.S. membership in and increase activity of U.S. in the International Labor Organization.* The Administration should submit an action plan for increased participation and leadership in the International Labor Organization.

- ❑ *Strengthen International Codes of Conduct.* The Administration should organize a conference involving representatives of U.S., Chamber of Commerce, the Association of Asian American Chambers of Commerce, the U.S.-Japan Business Council, U.S.-China Business Council, the U.S.-Russia Business Council and the U.S.-Korea Business Council, as well as business councils that focus on American trade with and investment in Malaysia, Indonesia, India, Thailand, Taiwan, Hong Kong, Philippines, Brunei, Vietnam, and Singapore. Other business organizations may be included for the following nations-members of the CIS, and Poland, Hungary, Slovakia, Czech Republic, and Romania. The purpose of the conference would be to seek further development of the U.S., Chamber of Commerce report, "Code of Conduct for U.S. Firms Doing Business Abroad," and higher levels of adoption and adherence to the Code.

Following the conference, the Administration should disseminate a report on the conference and its support of this "Code of Conduct" to foreign business associations operating in the United States as well as to Keidanren in Japan, etc.). The International Trade Administration and the Department of Labor will have responsibility for identifying both foreign business associations operating in the U.S., and business federations that would be appropriate for report dissemination in other nations with and in which the U.S. trades and invests.

HELPING BUSINESSES BECOME ALLIES OF AMERICA'S WORKING FAMILIES ... BY FOSTERING U.S.-BASED JOINT VENTURES IN CRITICAL TECHNOLOGIES

There are certain technologies and certain technology products which are critical to the national security of the United States. The Defense Department Report of Critical Technologies, first released in 1990, catalogues these technologies, and explains why they are central to a strong national defense. There have been occasions in our recent history where the health of U.S. based industry producing such technology products was in serious question and when the Defense Department acted aggressively to restore that health.

The clearest example is the semiconductor industry, and the establishment of Sematech. In that instance, the Defense Department supported an industry consortium in a critical technology, committing approximately $800 million over a 9-year period on a cost-shared basis. The results, combined with the success of the Japan-U.S. Semiconductor Agreement, were spectacular. U.S. companies returned to world dominance in their industry, and the availability of U.S.-made semiconductor products for American defense systems was secure.

We believe that there may be other critical technologies and critical technology products which deserve the same, or more intense treatment as the U.S. semiconductor industry required. Flat-panel displays may be precisely one such case. At this time, there is no volume manufacturer of such displays, and 90% of the world market in such displays is controlled by Japanese companies. The United States, through the Advanced Research Projects Agency and other agencies, needs to be able to secure within U.S. borders the ability to manufacture and produce such identified technologies and products.

Action Plan

- ❑ *The Administration should conclude an updated review of critical technologies and should assess the capacity of the American manufacturing base to manufacture these key technologies and components.*

- ❑ *On the basis of this review, the U.S. should sponsor a Joint Venture Initiative,* to support through economic and political incentives, the establishment of foreign firm joint ventures with American firms for the manufacture and production of critical technologies and components in the United States. If foreign companies with such technology leadership are unwilling to enter into such joint venture initiatives in these critical technologies, the Administration should propose seed funding, pre-competitive research support, and other strategies with U.S.-government-industry partnerships to redress the situation.

HELPING BUSINESSES BECOME ALLIES OF AMERICA'S WORKING FAMILIES ... BY ENCOURAGING GREATER AMERICAN EXPORTS

Export workers earn on average 15% more than the average manufacturing worker. They receive 33% more in employee benefits. Export workers are 30-50% more productive than workers at non-exporting plants. And they enjoy greater job stability in an industry in which employment is growing significantly faster than the rest of the economy and in which failure rates are 30% less. The United States needs to partner with small and medium-sized business to give them a seat at the table of the international trading system. When one billion dollars of trade deficit roughly equates to 20,000 lost jobs in the United States, this effort will, in part, help remedy our trade shortfall ($130 billion in 1994) in which our economy has subcontracted out nearly 3.6 million jobs to foreign workers.

Supporting the Bureau of Export Administration, International Trade Administration and its Foreign Commercial Service, OPIC, the Ex-Im Bank is only the beginning of what the U.S. should be doing to increase exports of American-made products and services.

Action Plan

- ❑ *Double resources by the year 2000 for domestic centers of the International Trade Administration and Foreign & Commercial Service.*

- ❑ *Establish a matching resources program, further extending export assistance centers* into states that commit staffing and other overhead support for these centers. The Administration should report on an action plan to broaden the deployment of domestic export centers and better extend export assistance services to small and medium-sized businesses throughout the United States, especially through matching-funded state-federal partnerships. The administration should coordinate this efforts with state and local economic development agencies and Chambers of Commerce.

- ❑ *Extend the average term of Foreign Service and Commercial Services Officers in certain priority nations.* Because of the cultural literacy and language expertise required and because of the emphasis on relationship building and relationship maintenance in Asian nations, it is critical that the U.S. better leverage its scarce human resources in helping to support American commercial interests in Asia. The Administration should focus on priority nations that have high potential for American exports: China, Japan, South Korea, and India.

- ❑ *Establish A-Corp Industry Association Export Assistance Requirement.* To qualify for A-Corp status, a company would have to be an active member of an industry association which provides significant assistance to its members with respect to the export of the industry's goods and services.

HELPING BUSINESSES BECOME ALLIES OF AMERICA'S WORKING FAMILIES ...
BY RESTRUCTURING GOVERNMENT TO ACT STRATEGICALLY

If national security can be defined today as national economic security, then our government is badly organized to support that cause and function. We need to focus on how the institutions that deal with our domestic and international economic interests are organized and how they interact. An "Economic Security Initiative" that would highlight the government agencies and departments involved, suggesting new patterns for interaction and more defined national objectives, might be one approach. Another might be to create a Department of Economic Development, subsuming the appropriate departments and agencies under it.

Other governments are failing to think and act strategically too. State vs. state competition for domestic and foreign investment is resulting in negative gains to the taxpayer rather than yielding growth and net positive returns to the nation, states, and localities. States are straining against one another to trade concessions for inward bound investment, even when the net return to taxpayers is meaningless or even negative. Some even try to pirate firms from one state to their own and offer increasingly robust cash grants, tax abatements, and other financial and infrastructure concessions to attract both U.S. firms from other states and foreign firms. It is entirely appropriate for states to compete with foreign nations; but it only harms the national interest when they attempt to outbid each other for firms that reside in fellow states and for firms investing in this nation from abroad. It is important to impede the granting of direct cash subsidies and tax holidays that do little more than rob the taxpayers of the funds needed to build infrastructure and other public goods. At the same time, we must do nothing to discourage support of general infrastructure development -- roads, bridges, other transportation and communication systems, educational institutions, and training centers -- the kinds of investments that serve businesses and a broader cross-section of individuals and communities. Some reasonable but firm federal action is required to help curtail this unhealthy competition.

<u>Action Plan</u>

- ❑ *Strengthen and Enhance the Department of Commerce.* We propose that the Department of Commerce be strengthened and enhanced by supplementing the functions of some of its agencies, including the Bureau of Export Administration, International Trade Administration, National Institute for Standards and Technology, Economic Development Administration, Minority Business Development Agency, and National Telecommunications and Information Administration; with the inclusion in the Department the following agencies: International Trade Commission, Export-Import Bank, Overseas Private Investment Corporation, Patent and Trademark Office, the U.S. Trade

Representative, all international functions of the Department of Labor, all international exchange programs and activities of the Department of Education, all technology and economics programs in the Department of State. To signal its significantly enhanced role, the Department might be renamed "The United States Department of Economic Development."

- *Establish Academic Centers for the Study of Industry.* Based upon the pioneering work of the Sloan Foundation, the Department of Commerce (renamed or not) or the National Science Foundation should provide grants to competing university-based consortia (universities in association with business and industry associations) for the study of key high-wage industries: world-wide markets; the position of American-made products and services in those markets; future trends in technology, production, distribution, finance; likely future success scenarios in those industries, etc.

- The Department of Commerce should *report to the President and Congress with a set of policy recommendations with respect to state vs. state competition for domestic and foreign investment.* Without in any way limiting the scope of any other recommendations, the report should discuss whether and to what extent it recommends policies which would:

  require states to file a cost-benefit analysis statement prepared by firms investing in production facilities in any state that involve state concessions on infrastructure development, tax abatement, or subsidies; and/or

  result in financial liabilities on firms making the investment, whether American or foreign, equal to the sum of direct cash subsidies and grants as well as the amount uncollected initially in tax abatement and tax holiday programs.

- We support legislation, similar to HR463/S192, that would *restrict federal monies in the form of community development block grants to states or localities from being used in any way to solicit or to provide transfer assistance to a firm based in another state or locality.* Presently, federal funds granted to states through the Economic Development Agency, the Food and Drug Administration, and the Job Training Partnership Act cannot be used to pirate firms from other states or localities into the grantee state or locality.

ESTABLISHING THE "A-Fund":

HELPING FINANCIAL MARKETS BECOME ALLIES OF AMERICA'S BUSINESSES AND AMERICA'S WORKING FAMILIES

We have concluded, along with many experts, that our current financial markets exert enormous short-term pressures on America's businesses. That pressure to produce short-term profits inevitably makes it harder for businesses to make the long-term investment in their employees that a true alliance with America's working families requires. We believe that this counter-productive phenomenon must be confronted head-on; at a minimum, we need to create a "speed-bump" against this short-termism. We believe that we must take steps to help "Wall Street become allies with Main Street."

Our bottom line? We propose creating a disincentive to the churning of securities in the form of a less-than-one-half-of-one-percent and declining tax on the sales of securities that occur within two years of purchase, and using the proceeds to pay for a huge education and training tax cut for America's working families.

The transaction tax on short-term speculation on all securities, is described in greater detail below. The proceeds from this tax would be segregated in a "Financial Markets Allied with America's Businesses and Working Families Fund" (the "A-Fund"). And the primary uses of the "A-Fund" would be to pay for tax deductions for post-secondary education and training purchased by American workers, and for tax credits to help cover the expense of raising and educating children of pre-school, elementary, and secondary school age. In other words, we propose a tiny tax on short-term trading to fund a big tax cut for long-term investment.

A-Fund Sources

The tax is imposed on the short-term churning of securities. It is paid in diminishing amounts over the holding period of the security, and <u>is not paid at all</u> if the security is held just two years or more. Remember that one of the purposes of the fund is to encourage well-informed investments in corporate securities followed by sustained support of the securities over some reasonable investment time period.

Our proposal would impose a small and diminishing securities transfer excise tax (STET) on broad-based security sales made less than two years after purchase. The tax would extend to transactions by individuals, corporations, and tax-exempt pension funds and other entities and would apply to stocks, bonds, options, futures, and swaps of currency, interest rates, and other assets. This would include trades on behalf of Americans and American assets on American and foreign exchanges, whether done directly or through any intermediary investment fund. It is important to apply the STET to all securities, to avoid prejudicing investment in one securities vehicle over another. The tax would be paid by the seller (the person on whose behalf the sale was made) at the time of the transaction and would not apply to new issues.

The following chart outlines the STET rates contemplated. Note that all the rates below work out to be *less than one half of one percent of the value* of the security at the time of the sale. (Consider, in contrast, the 10 to 15 times that amount each of us pays in sales tax for every item at the grocery store.) Moreover, no tax is paid if the security is held for just two years.

TAX RATES BASED ON HOLDING PERIOD OF SECURITY					
	< 6 MOS.	**6 - 12 MOS.**	**12 - 18 MOS.**	**18 - 24 MOS.**	**>2 YRS.**
STOCKS	0.0048 x value	0.0036 x value	0.0024 x value	0.0012 x value	No Tax
Priv BONDS	0.0001 x val per remaining year of term	0.000075 x val "	0.00005 x val "	0.000025 x val "	No Tax
TREAS Bills	0.0001 x val per remaining year of term	0.000075 x val "	0.00005 x val "	0.000025 x val "	No Tax
TREAS Bonds	0.0001 x val per remaining year of term	0.000075 x val "	0.00005 x val "	0.000025 x val "	No Tax
Futures	0.0002 x val of underlying commodity per year of term	0.00015 x val "	0.0001 x val of "	0.00005 x val "	No Tax
OPTIONS	0.0002 x val of underlying commodity per year of term	0.00015 x val "	0.0001 x val of "	0.00005 x val "	No Tax
SWAPS of Currency, Int Rates, or Assets	0.0002 x val of underlying commodity per year of term	0.00015 x val "	0.0001 x val of "	0.00005 x val "	No Tax

To minimize any evasion of the tax in global financial markets, the U.S. should take the lead in the G-7 to coordinate a policy preventing STET evasion. At least eight European Economic Community nations (including the UK and France) and four Pacific Rim countries (including Japan, Korea, and Taiwan) have some form of securities transactions tax.

Some Wall Street traders and investors will modify their behavior in response to the tax. But others, unfortunately, will not. So the proceeds from this tax will likely be substantial. Precise estimates of the revenue available for the "A-Fund" are difficult to make, as they depend on guesses as to the extent to which Wall Street will modify its selling behavior. But using 1994 trading numbers, revenue available to the A-Fund would total $27 billion annually if Wall Street experienced a large reduction in short-term trading volume; $43 billion annually, if Wall Street had a medium reduction in short-term trading volume; and $62 billion annually, if Wall Street experienced a small reduction in short-term trading volume:

Assuming...	**REVENUES for the "A-FUND"**
Large Drop in Short-term Trading Volume	$27 billion per year
Medium Drop in Short-term Trading Volume	$43 billion per year
Small Drop in Short-term Trading Volume	$62 billion per year

A-Fund Investments

The primary investments of the A-Fund would be:

- *To Fund Tax Deductions for Higher Education and Work Skill Training.* The President has proposed a deduction for education and training of up to $10,000 for tuition and associated fees paid to institutions and programs eligible for federal assistance. The maximum allowable deduction would be phased-out for taxpayers filing a joint return with adjusted gross incomes (AGIs) between $100.000 and $120,000. (The deduction would phase out for single filers at AGIs between $70,000 and $90,000.) When fully implemented, this deduction would result in a loss of revenue of approximately $7.5 billion a year.

- *To Fund Tax Credits for Dependent Children.* We propose, like the President, a $500 tax credit for each dependent child under 18 years old, which would help working families pay for the education costs of pre-school, elementary, and secondary school children. The credit would be phased out for taxpayers with AGI of between $60,000 and $75,000, but the credit amount and the phase-out would be fully indexed for inflation. When fully implemented, this deduction would result in a loss of revenue of approximately $15.4 billion a year.

The bulk of the remaining dollars in the "A-Fund" investments would go to support federal, state, and local efforts to reform and improve education and training:

- ✓ *Workforce Training.* The National Skills Standards Board, created under the Goals 2000 legislation passed last year, is tasked with developing a system of voluntary skills standards. The system will establish a common set of skills needed for a cluster of occupations that workers will need. The National Skills Standards Board, which had its first meeting in April of 1995, is currently identifying occupation clusters. The A-Fund would provide federal support for workforce training programs operated by states or government-business partnerships which met the voluntary skills standards.

- ✓ *School to Work.* The 103rd Congress passed the School to Work Opportunities Act, which provides for *the establishment of apprenticeship systems enabling the three quarters of high school students not proceeding to a four-year college degrees to enter high skill-high wage careers.* The act provides grants to localities and states to set up appropriate systems, with the base requirement that such systems shall include both work-based and school-based learning, and involve local business, labor and education leaders. Both planning and implementation grants have already been made to state and local governments. The A-Fund would provide continuing federal support for this effort.

- ✓ *National Education Goals and Standards.* The 103rd Congress also passed the Goals 2000: Educate America Act, which calls for the setting of voluntary national content and performance standards in core academic subjects such as math, history, and geography. It also provides funding for school reform efforts and programs to improve student achievement through educational technology. The A-Fund would provide continuing federal support for this effort.

Finally, a smaller, residual amount of "A-Fund" investments would be allocated to support industry-driven, government-industry partnerships in technology research & development and industrial extension and to export promotion:

- ✓ *Technology Research & Development.* Funds from the A-Fund would be used to fund successful programs like Sematech, the Technology Reinvestment Project, the Advanced Technology Program, and other long-term technology research & development programs which are industry-driven, cost-matching, government-industry partnerships.

- ✓ *Industrial Extension.* Funds from the A-Fund would be used to fund successful programs like the Manufacturing Extension Program (MEP) in the Department of Commerce and small business development centers (SBDCs). These programs typically focus on small and medium-sized enterprises trying to upgrade their technical and management processes to compete world-wide.

✓ *Export Promotion.* Funds from the A-Fund would also be used to fund successful programs now in the Department of Commerce and the Office of USTR to expand the export of American-made products and services, including those run by the Export-Import Bank, OPIC, the U.S. Foreign Commercial Service, and others. Funds from the A-Fund would also be used to support new Academic Centers for the Study of Industry.

HELPING FINANCIAL MARKETS BECOME ALLIES WITH AMERICAN BUSINESSES AND WORKING FAMILIES ...
THROUGH SECURITIES REGULATION REFORM

And finally, *we need to significantly reform our securities regulatory structure to promote long-term human resource investment over short-term earnings decisions.*

We believe that changes in securities and corporate governance rules must accompany changes in the tax code to achieve the maximum benefits of long-term, stakeholder business practices. Effective oversight and communication between investors and corporate decision-makers leads to better investor understanding of corporate strategies. But when those who bear the risk of corporate decision-making (owners) are not those who make the decisions (money managers/corporate managers) there is potential for unproductive conflicts of interest and agency problems. Managers are therefore under tremendous pressure to produce results and may lack the informed consent or directive to innovate, take constructive risks and make crucial long-term investments. These pressures and misunderstandings are exacerbated the more that ownership becomes detached from corporate decision-making.

In recent decades, equity ownership has concentrated in institutional investors (i.e. pension and mutual funds), creating an additional agent between shareholders and corporate managers. These institutional funds are mostly managed by professional investment advisors who are evaluated by their one-to-three year performances. This leads to shorter institutional time horizons relative to individual investors who tend to have longer-term investment goals such as savings for retirement or college tuition. Shorter horizons and more frequent trading reduce capital allocation efficiency by raising corporate investment hurdle rates for investments with long-term payouts and by generating increased transaction costs.

Most investors want greater access and disclosure of leading business performance indicators such as customer satisfaction, investment in workforce training and participation, R&D, etc. But separation of ownership from control affects the availability and flow of this information.

Information, including short-term or long-term business prospects, is often readily available to corporate managers but inaccessible to owners/investors. This limited availability and lack of agreement on how to interpret available data is an information gap between owners/investors and corporate managers. When equity owners (individuals or institutions) hold only small, passive stakes, this gap between owners and companies becomes even worse. Furthermore, by increasing investor uncertainty, information gaps also can raise investment hurdle rates.

We therefore endorse changes in securities regulations that better align the interests and activities of owners/investors, corporate managers and investment managers. Since educated investors better understand corporate decision-making, the goal of these regulatory reforms should be an investment and management climate where information flows more freely, corporate oversight is enhanced, risks are better understood, and short-term pressures are mitigated. These changes should free all those involved in corporate decisions to choose long-term, productive investments that are crucial to the growth of high wage jobs, without jeopardizing the current efficiency of America's financial markets.

Reducing Barriers to Collective Shareholder Monitoring

Action Plan

- ❑ *Reducing the Risk of Litigation.* We believe that the costs of frivolous securities litigation can be reduced without jeopardizing the rights of individuals seeking relief from fraud. Reforms should reduce potential sources of liability and compliance costs for groups of institutional investors and other shareholders wishing to engage in collective monitoring of companies in their portfolios by having the SEC expand exemptions and adopt streamlined requirements.

- ❑ *Improving Access to the Proxy Statement.* We endorse changes to reduce the expense of collective shareholder monitoring efforts, including amending the Securities Exchange Act of 1934 to provide groups of investors holding a specified percent of shares (e.g., 10%) access to proxy statements to nominate one independent director to boards of directors and to present other non-related proposals to shareholders.

- ❑ *Improving Disclosure about Board Independence.* We would improve investor confidence that boards of directors adequately represent investor interests by amending the 1934 Securities Exchange Act to require greater disclosure regarding independence of nominating and audit committees of boards of directors.

Reducing Regulatory Impediments to Larger Holdings in Companies by Individual Institutional Investors

Larger, institutional investors possess the potential leverage to engage in effective oversight of corporate decision-making. But current law, designed to discourage concentrations of institutional stock ownership and encourage diversification, keeps institutional investors from exercising that leverage. We endorse the following changes that will reduce barriers to larger holdings in, and greater monitoring of, companies by institutional investors.

Action Plan

- ❑ *Private Investment Company Exception.* Give greater regulatory flexibility to institutional investors who wish to experiment with private investment pools that take significant and stable stakes and engage in heightened monitoring of companies in their portfolios (so-called "relational investing"). (For a good example of "relational investing," the Report of the Twentieth Century Fund Task Force on Market Speculation and Corporate Governance cites Berkshire Hathaway, which holds a few firms as a part of its portfolio and is attentive to long-term relationships with those firms, including Coca-Cola, GEICO, the Washington Post, Salomon Bros. and Wells Fargo). The Investment Company Act of 1940 should be amended to expand the private investment company exception to exclude from the 100-investor limit all "qualified institutional buyers" as defined by the Securities Exchange Act of 1933. This expansion should apply only to private investment companies that invest predominantly in equities and have a minimum average holding period of two years.

- *Greater Flexibility to Investors Who Engage in Heightened Monitoring.* Give greater regulatory flexibility to investors who wish to experiment with publicly-traded investment pools that take significant and stable stakes and engage in heightened monitoring of the companies in their portfolios. SEC should issue regulatory exemptions from certain sections of Investment Company Act of 1940, and Subchapter M of IRS Code should be amended to permit the creation of closed-end funds (restricted funds with a limited number of shares) for this special purpose. Funds should be "undiversified" for purposes of this Act but would qualify for pass-through tax status. At least one half of a fund's investments would have to be in significant, minority stakes with no single position representing more than a specified maximum of fund assets. Average portfolio holding period should be a minimum of two years.

- *Financial Incentives for Greater Corporate Governance Monitoring.* Current law severely restricts compensation for investment advisers for large institutional clients and therefore prevents institutions from providing incentives to qualified investment advisers who intensively monitor corporate governance. The Investment Advisers Act should be amended to give sophisticated investors, i.e. "qualified institutional buyers," greater flexibility to structure compensation arrangements with their investment managers, and particularly create greater financial incentives to perform long-term corporate governance monitoring.

- *ERISA's Prudence Requirement / Encourage Larger Individual Holdings.* Allay unfounded fiduciary concerns regarding prudence of investing in sizable stakes. Direct the Department of Labor to clarify through administrative guidance that: (1) ERISA diversification standards don't require investment in hundreds or thousands of stocks, rather, prudence depends on facts and circumstances of portfolio construction; and (2) prudence is to be evaluated on portfolio-wide rather than individual investment basis.

- *Guidance on Proxy Voting for Investment and Insurance Companies and Banks.* Underscore the importance of shareholder monitoring by all types of institutional investors. Have the SEC and state regulators adopt statements of obligations regarding proxy voting similar to the Department of Labor's statement of obligations for pension funds.

Encouraging Long-Term Management and Investment Behavior

The goal of corporate managers should be responsible management geared towards growth and profit. For firms to grow properly, they must invest in their workers and in their technology and manufacturing bases. For firms to remain profitable, while returning fair value to shareholders over the long run, managers must be willing to pursue strategies that tilt towards long term performance rather than the short term.

But during the 1980s, the increased volume of trading, the volatility on our financial markets, and the churning of stocks on our financial markets partially contributed to a perception of increasing Wall Street demand for short-term profits. Purchasers of company stocks tended to look more like overnight traders and less like investors who intended to hold those stocks for the long term. And finally, as some firms began to try to organize themselves for the long run, to put cash aside to ride through economic downturns and cyclical consumption slumps, particularly in the automobile sector, they made themselves vulnerable to takeovers by corporate raiders.

Action Plan

- ❑ *Reduce Short-Term, Speculative Investment Behavior.* Impose a diminishing securities transfer excise tax (STET) as described above for the "A-Fund."

- ❑ *Promote Full Voting Rights for Employee Owners.* Amend ERISA to establish standards and principles to ensure employees are provided with full, balanced information, that they aren't subject to coercion, and that they are afforded other appropriate protections.

  Also, with respect to employee stock ownership plans (ESOPs), current law requires that stock that has been purchased by a company for its employees but not yet allocated to those employees cannot be voted according to employee instructions. Instead, it is voted by the ESOP trustee who may not weigh employee concerns when presented with a tender offer. Trustees are forbidden to take into account such non-financial factors essential to the rational decisions of employees, including potential job loss, dislocation, etc., when considering potentially hostile tender offers that are above market value. We recommend that ERISA be amended so that trustees are required to vote and tender unallocated shares in the same proportion as employees vote and tender allocated shares. Employees should be provided with full, balanced information, should not be subject to coercion, and should be afforded other appropriate protections.

- ❑ We support the enactment of some form of *The Long Term Investment, Pension Protection and Corporate Takeover Reform Act*, first offered by Senator Terry Sanford in the 102d Congress. The bill would restrict the use of pension funds and pension fund surpluses from being considered in financing arrangements for corporate takeovers. The individuals or institutions engaged in such a takeover will have to demonstrate that both long-term and short-term interests of those participants in the corporate pension plan or covered by

ERISA were duly considered in corporate governance matters, for at least two years after the takeover, and for all time when it concerns any funds tied to a pension program. Furthermore, tender offers would be required to include disclosure to stockholders and the SEC of all sources of financing, and all sources of financing will not be permitted to finance on the basis of cash or other highly cash-liquid assets held by the targeted firm as part of the actual purchase package.

Improving Available Information on Firm's Prospects

We endorse the following regulatory changes to improve the flow and supply of information about corporate performance.

Action Plan

- ❑ SEC and FASB (Financial & Accounting Standards Board) should *develop principles for measuring certain salient categories of nonfinancial information, including human resource investment, and assessing their materiality.* The goal should be to develop generally accepted standards for voluntary disclosure of such information, which would facilitate comparisons by its consumers -- shareholders, analysts, directors, and managers.

PREPARING THE "A-Check": MAKING THE UNITED STATES GOVERNMENT AN ALLY OF AMERICA'S WORKING FAMILIES

We propose above several concrete steps to encourage businesses to become allies with America's working families by helping them with health care, their pensions, education and training, and by investing more in the United States. We offer a dramatic proposal to use our financial markets to foster long-term investment instead of short-term profits that specifically funds working families' investments in their own education and training. These proposals go a long way in restructuring the incentives in our economy to improve the incomes, benefits, and economic security of America's working families over the longer run.

But the next question is what the United States can do, right now and very directly, to help America's working families execute successfully their strategies for a secure work life and retirement for themselves and a brighter future for their children.

The whole purpose of the comprehensive strategy outlined in our proposal is to increase the incomes of the average working families of the country. The whole point is to put more money into working families' budgets to pay for day-in, day-out expenses and to save for education, training, family emergencies, or retirement -- to "make the bills" each month and still provide for a decent retirement for themselves and a better future for their kids. While consolidating gains in that regard will take time, any improvement on this score should be welcomed as soon as possible.

We propose that the government become an ally of working families by making more money available to them (the "A-Check") to deposit in their checking and savings accounts for their personal economic strategies:

- We propose to *cut in half each employee's OASDI payroll tax (from 6.2% to 3.1%).*

  For example, our proposal would cut taxes for a family with total pay checks of $33,000 per year by over $1,000. Our proposal to replace the current corporate income tax, described above, makes such a tax cut possible. Some portion of revenues derived from that proposal would be transferred to the old-age and survivors insurance and disability insurance trust funds to compensate for the reduction in trust fund revenues caused by the reduction in the payroll tax rates.

- *We propose to cut individual income taxes by tripling the standard deduction for taxpayers who do not itemize deductions.*

The extra standard deduction would be $8,650 for married individuals filing joint returns, $7,600 for heads of household, $5,200 for single individuals, and $4,325 for married individuals filing separate returns. This extra standard deduction would be allowed in addition to the basic standard deduction and the additional standard deduction for the aged and the blind. For a taxpayer claiming both the basic standard deduction and the extra standard deduction, the total standard deduction at 1994 levels would be $15,000 for married individuals filing joint returns, $13,200 for heads of household, $9,000 for single individuals, and $7,500 for married individuals filing separate returns.

The extra standard deduction would be phased out ratably for taxpayers with adjusted gross income (AGI) in the following ranges: $45,000 - $88,250 for married individuals filing joint returns, $37,000 - $75,000 for heads of household, $27,000 - $53,000 for single individuals, and $22,500 - $44,125 for married individuals filing separate returns. The amount of the extra standard deduction and the phaseout ranges are expressed in 1994 dollars and would be indexed for inflation.

This change will entirely remove from the tax rolls approximately 20 million taxpayers. Again, our proposal to replace the current corporate income tax, described above, makes such a tax cut possible.

- We propose providing *income tax deductions up to $10,000 for individuals' investments in their personal post-secondary education and training.*

  The President has proposed a deduction for education and training of up to $10,000 for tuition and associated fees paid to institutions and programs eligible for federal assistance. The maximum allowable deduction would be phased-out for taxpayers filing a joint return with adjusted gross incomes (AGIs) between $100.000 and $120,000. (The deduction would phase out for single filers at AGIs between $70,000 and $90,000.) The tax expenditures for these deductions will be funded from the "A-Fund," described above.

- We propose providing *income tax credits of $500 for each dependent child under 18 years old, to help working families pay for the education costs of pre-school, elementary, and secondary school children.*

  The credit would be phased out for taxpayers with AGI of between $60,000 and $75,000, but the credit amount and the phase-out would be fully indexed for inflation. The tax expenditures for these deductions will be funded from the "A-Fund," described above.

- We support *continuing the Earned Income Tax Credit program as it was expanded by the Omnibus Budget Reconciliation Act of 1993.*

- *We propose to cut income taxes further by providing for refundable tax credit amounts additional to the current Earned Income Tax Credit.*

  Our proposal would cut taxes for lower-middle-income and poor taxpayers up to a maximum of an additional $1,378 for married people filing jointly, for example. The maximum amount of AGI eligible for the credit would be $9,500 for married individuals filing joint returns, $7,900 for heads of household, $5,700 for single individuals, and $4,750 for married individuals filing separate returns. The maximum credit would be $1,378 for married individuals filing joint returns, $1,146 for heads of household, $827 for single individuals, and $689 for married individuals filing separate returns.

  The credit would be phased out at a 20 percent rate for taxpayers with "modified AGI" in the following ranges: $15,000 - $21,888 for married individuals filing joint returns, $13,200 - $18,928 for heads of household, $9,000 - $13,133 for single individuals, and $7,500 - $10,944 for married individuals filing separate returns. Modified AGI would be defined as AGI determined (1) without regard to deductions for individual retirement arrangements (IRAs), simplified employee pension plans (SEPS) or Keogh plans, or to exclusions for foreign income, income from the possessions and educational savings bonds, and (2) by adding in tax-exempt interest and the portion of Social Security benefits not otherwise included in AGI. The AGI limits and the beginnings of the phaseout ranges are expressed in 1994 dollars and would be indexed for inflation. Again, our proposal to replace the current corporate income tax, described above, makes such a tax cut possible.

  An individual would be eligible to receive this increase on an advanced basis similar to that available for the current earned income tax credit. It would be available to all individuals who provide an eligibility certificate to his or her employer that (1) certifies he or she is eligible for the credit on the basis of AGI, (2) certifies that he or she does not have an eligibility certificate in effect for that year with another employer, (3) states whether the individuals spouse has an eligibility certificate in effect, (4) estimates the individual's AGI and modified AGI.

- We support efforts to *raise the minimum wage 90 cents over two years* to restore some of the erosion in buying power in the minimum wage.

MAKING THE UNITED STATES GOVERNMENT AN ALLY OF AMERICA'S WORKING FAMILIES ... THROUGH COLLECTIVE BARGAINING

In the past, labor-management relationships were often governed by bargaining agreements, and operated in the realm of a national economy. The percentage of employees represented by unions has decreased from roughly one in three in the 1950s to roughly one in six now. The figure for private sector employees is roughly one in ten. In addition to representation, the Dunlop Commission noted an increase in the acrimony associated with the collective bargaining process, and made specific recommendations to reduce that acrimony.

The Dunlop Commission, among many others, noted that the current election system for union certification has resulted in protracted periods of antagonism and illegal discrimination against employees favoring union representation. This antagonism is extremely detrimental to the development of constructive labor-management relations. The most significant cause of delays appears to be the number of issues requiring hearings raised prior to elections.

Action Plan

- ❑ We concur in the Dunlop Commission recommendation for *streamlining election procedures* through the postponement of legal hearings before the National Labor Relations Board until after a representation election is held. Any disputed ballots would remain sealed until hearings were held.

- ❑ Furthermore, we are is concerned that current prohibitions on discriminatory actions against employees involved in collective bargaining activities may not be adequate to prevent such practices. To provide further incentive to obey current law, we recommend *establishment of a fine for violating the National Labor Relations Act by wrongfully dismissing employees involved in the organization of a workplace*. Such fine shall be equal to triple the amount of wages an employee would have received if that employee had retained employment. Such a fine is anticipated to have a deterrent effect, thus reducing the number of workers facing discrimination while attempting to organize a workplace.

MAKING THE UNITED STATES GOVERNMENT AN ALLY OF AMERICA'S WORKING FAMILIES ...
BY SUPPORTING LABOR-MANAGEMENT PARTNERSHIPS

The Dunlop Commission on the Future of Worker-Management Relations, established by President Clinton to recommend changes that would promote better labor-management relations, issued a report in December of 1994. One issue that the Commission addressed was Section 8(a)(2) of the National Labor Relations Act. That section is intended to prohibit company unions. In recent years, however, some have interpreted this section to as prohibiting many forms of employee involvement, such as quality circles, whose purposes are not to prevent the establishment of independent unions.

Action Plan

- ❑ The Dunlop Commission recommended that there should be *clarification of the application of Section 8(a)(2) of the NRLA, thereby continuing to prohibit company unions, and allowing the sort of employee involvement process that can help employees and employees meet the competitive pressures of the global economy. We concur.*

- ❑ We also believe that to ensure such organizations are not used to prevent the development of legitimate collective bargaining units, *such organizations should not be allowed for a period of two years after an employer is found to be in violation of the National Labor Relations Act.*

- ❑ In recent years, the use of permanent replacements for striking workers has also eroded labor-management relations. The National Labor Relations Act prohibits the firing of workers engaged in a legal strike. In 1935, however, the Supreme Court Mackay Radio decision made significant inroads into this protection from dismissal by allowing the hiring of permanent replacements for striking workers. In the last 15 years, the threat of using permanent replacement and the actual use of permanent replacement has increased. Rather than addressing differences with legitimately elected bargaining representatives, thus developing partnerships, employers too often simply threaten to replace these workers. *For that reason, we support legislation to ban the use of permanent replacements in legal strikes.*

- ❑ Common sense would indicate, and experience has shown, that workers are able to make better transitions to new jobs when they have adequate notice before being laid off. For that reason, Congress passed the Worker Adjustment and Retraining Notification (WARN) Act in 1988. Since that time, however, the GAO and others have found that the Act could be improved. Pursuant to GAO's specific recommendations, we believe that *the WARN Act should be amended to provide better enforcement and coverage to ensure that the maximum number of workers have adequate notice of downsizing and plant closings.*

MAKING THE UNITED STATES GOVERNMENT AN ALLY OF AMERICA'S WORKING FAMILIES ...
BY REFORMING AND IMPROVING EDUCATION and WORKFORCE TRAINING

American prosperity and standard of living depend on the nation's global competitiveness. Competitiveness in turn depends upon workers who have achieved higher levels of literacy and problem solving than were needed in the past. The American public, educators and the federal government have roles to play in securing the conditions in which students can acquire the skills and knowledge they will need. Local communities are well positioned to devise the programs that will help students attain this knowledge, while other aspects of education infrastructure require cooperation among various levels of government.

The federal government needs to support the development of 4 essential elements of infrastructure of the education system: (1) academic and skill standards for students; (2) professional standards for teachers; (3) new configurations of time for student learning and achievement; and (4) appropriate access and use of education technology.

Academic and Skill Standards for Students

Two related activities are underway that merit national support and encouragement.

First is the development of academic-standards for what all students should know and be able to do in core subjects of the curriculum if they are to be prepared to continue in higher education, to get and hold and perform well at their jobs, and to function as responsible citizens. States, local schools, and professional organizations are all working to develop and refine such academic standards for students.

Second is the identification by businesses of the skill standards they are using to decide who they will hire, retain and promote in the workplace. Building upon the prior work of the SCANS Commission, individual companies and collective business efforts, the National Skills Standards Board leads efforts to articulate and communicate the skills standards to which graduates will be held in the real world of employers.

<u>Action Plan</u>

- ❑ The federal government has a stake in continuing support for both efforts, coordinating the results and encouraging their use in local schools. *Funding should therefore be maintained for the Nationol Skills Standards Board, the National Education Goals Panel, and Goals 2000.*

Professional Standards for Teachers

Good teaching is recognized as key to helping students reach higher standards, and efforts to professionalize teaching merit national support. Currently, efforts to define professional teaching standards and certify whether interested teachers meet them are underway at the National Board of Professional Teaching Standards. Such standards can inform pre-service and in-service professional development activities undertaken by school systems and colleges and universities.

Action Plan

- ❑ *Federal funding should therefore be maintained for the National Board of Professional Teaching Standards and associated professional development activities.*

- ❑ Congress should enact legislation providing that *teachers certified as meeting national professional standards shall be deemed qualified for teaching in all states* (except that states may require evidence of competence in local or regional history or culture for teachers with responsibility in these fields).

- ❑ States and local school districts should provide *additional compensation to teachers who become nationally certified*, as an incentive for teachers to upgrade their knowledge and skills.

- ❑ States should provide *help to teachers willing to apply for certification as meeting national standards.*

New Configurations of Time for Student Learning and Achievement

As Americans clarify the academic standards schools need to reach, schools need to arrange how they use time in whatever ways best enable them to do the job. Schedules have been governed by conventions. Tradition has shaped the length of the school day and year and the division of a day into periods and a period into minutes. Instructional time has been held constant and student learning has varied. Now schools need support in seeking and using extended and flexible methods to bring students to higher levels of performance.

Action Plan

- ❑ Federal funds should therefore be provided for the US Department of Education and its Office of Educational Research and Improvement to *support research projects and publications that explore more effective and efficient ways to organize learning time* to help schools reach their academic standards.

- Congress should disseminate research and comparative information about, and state and local districts should enact, *models of an "academic school day" for instruction in basic skills and mastery of the important and enduring knowledge and skills* in state academic standards. These models should describe the relation of the academic day to the additional, valued, non-academic activities offered by schools.

- Congress should provide funds for interested school systems to develop and implement *new schedules that entail longer school days and longer school years* as well as programs that make more efficient and effective use of currently available time.

- States should identify a manageable but focused set of important academic standards for students and ask local school districts to identify a variety of *options for arranging how instructional time, technology, and time for teachers' professional development* be used to insure that students achieve them.

Appropriate Access to and Use of Education Technology

Emerging technologies have transformed many aspects of American life and need to be harnessed to help students and schools reach the emerging standards of performance required of them Efforts are underway to apply new technologies to the management of schools and the instructional process. Familiarity with these technologies was recognized in A Nation at Risk in 1983 as part of the "new basics" schools should teach and workers will need. The government needs to ensure broad access to the technology, support for teacher training in its use, and the development and use of sound instructional material that give students access to the network of information the technology makes possible.

<u>Action Plan</u>

- Federal funding should therefore be maintained for *the Technology for Education Act of 1994 (Title III of the Improving America's Schools Act), Star Schools, and other federal programs expanding the use of education technology*, and the coordination of these efforts.

- Implementation of *the Telecommunications Competition and Deregulations Act of 1995* should be actively pursued to assure schools and libraries universal and affordable access to information services.

- States and local communities should provide resources and *training for teachers' professional development in the use of technology* and their continual refinement of their use of technology in their instructional program and efforts to meet academic standards.

School-to-Work Transitions

In addition to ensuring that each student has access to adequate education, we believe that federal government has a responsibility to ensure that each graduating student has opportunities for a smooth transition into the world of work. Many other nations have developed apprenticeship structures enabling non-college bound students to develop skills enabling them to enter the workforce as skilled employees. In the United States, however, the majority of students not entering four-year universities are not given any skills training. Indeed, most drift through low-paying jobs until their mid-twenties before receiving any specific skills training. The National Center on Education and the Economy, for example, has documented the average age of entering apprentices in the U.S. to be 29 years.

The challenge for American education systems is developing paths for non-college bound students to enter skilled occupations directly after finishing high school without precluding any future academic options. Specifically, each American high school graduate not entering college should have both a high school diploma qualifying the student for a university education and certified skills enabling her to enter the workforce at a living wage. For students to have these qualifications, schools and employers, and others involved in employment systems must work together to define the skills needed in the workforce, develop training curricula to teach those skills, and develop opportunities for students to gain meaningful work experiences to use those skills.

The School to Work Opportunity Act, enacted in the 103rd Congress, is designed to foster the development of programs that will accomplish each of these important tasks. The Act enables the federal government to fund the planning and development of such systems in each State, and complements the development of National Skills Standards enabling employers and employees to measure the skills employees bring to the workplace.

__Action Plan__

- ☐ We support the *continued development of School-to-Work systems at the State and local level providing students with academic and skills training, as well as work experience. The development of successful School to Work systems requires education officials, employers, labor unions, and others interested in employment issues to work together in identifying skill needs, developing meaningful curricula, and providing work experiences for students.*

- ☐ We *also support a continued federal role in transmitting "best practices"* in the development of such systems to others working to create school to work systems throughout the nation.

- ☐ We *encourage employers to participate in the development and deployment of school to work systems in their communities by working with schools and others interested and* *involved in employment issues. We support this involvement through A-Corp provisions encouraging membership in industry associations which require such participation in local school to work programs.*

Workforce Training

Continuing job training throughout the years of employment is crucial to ensure that workers have the qualifications to be employed in high-wage occupations. Numerous studies, including America's Choice: High Skills or Low Wages, have documented that the U.S. is facing a skills shortage. The shortage is a result of both a failure of employers to invest in their workers and a lack of efficient government investment in general skills training and infrastructure.

It is anticipated that consolidation of job training programs into block grant funding will be completed in the 104th Congress. We support these efforts in principle, but believes that the federal government should commit adequate resources to these block grants. Indeed, we anticipate the need to significantly increase the resources available for this function.

Action Plan

- We support *the use of A-Funds for these purposes*.

- Furthermore, we believe that some aspects of job training, including *the Job Corps program and some demonstration programs should be funded outside of the block grant process*. In the case of Job Corps, the ability of students to choose among a variety of national centers offering different skills, and in some cases, opportunities to begin a new start in a new environment, can only be preserved in a national program. A national demonstration program will ensure that leading-edge training strategies can be developed for implementation throughout the United States.

- We believe that each State should make a commitment to several key components in allocating job training resources. The first is that *the retraining of displaced workers must be a high priority*. To the extent possible, such retraining should take advantage of available private sector training opportunities *through the use of training vouchers*.

- Training opportunities should also be done in the context of good labor market information. We therefore *support Administration efforts to ensure that the best labor market information is easily accessible to workers receiving training*.

PREPARING THE "A-Check," Part II:
MAKING THE UNITED STATES GOVERNMENT AN ALLY OF AMERICA'S SELF-EMPLOYED WORKERS and SMALL BUSINESSES

Working families are scrambling to assemble personal economic strategies to "make the bills" each month and provide for a solid retirement for themselves and brighter future for their kids. But several components of that strategy are not found in regular jobs with big or even medium-sized employers. Many workers rely on themselves for a sizeable chunk of family income, as self-employed real estate professionals, for example. Still more are employed by small businesses.

We propose that the government become an ally of these self-employed workers and these small business owners by making more money available to them (the "A-Check," Part II) to deposit in their checking and savings accounts for their personal economic strategies:

- ❑ *We propose to cut in half the self-employed worker's OASDI tax, from 12.4% to 6.2%.*

  For example, a self-employed worker making just $33,000 would pay over $2,000 less in taxes each year than she now does. As with an employee's payroll tax, some portion of revenues from our proposed replacement of the current corporate income tax would be transferred to the old-age and survivors insurance and disability insurance trust funds to compensate for the reduction in trust fund revenues caused by the reduction in the payroll tax rates. Our proposal to replace the current corporate income tax, described above, makes such a tax cut possible.

- ❑ *All small businesses with less than $100,000 in annual receipts would be exempt from federal business taxes.*

  Small businesses, especially those conducted by self-employed individuals would be, at their option, completely exempt from the provisions of our proposed modified Boren-Danforth business tax. Exempting these small businesses from the tax would entirely eliminate over 60% or 15 million businesses from corporate tax rolls.

- ❑ *We would maintain and make permanent the provisions of OBRA of 1993 which provided for a 50% capital gains tax cut* for securities held for more than five years *and a 100% capital gains tax cut* for securities held more than 10 years, in a qualified small business.

- ☐ In fashioning individual income tax reform, consideration should be given to an *increase in the amount of losses on small company stock that individuals are permitted to offset against ordinary income* (from \$50,000 to \$100,000), and perhaps increase the size of companies considered "small" for this purpose (from \$1 million paid in capital to \$5 million paid-in capital).

MAKING THE UNITED STATES GOVERNMENT AN ALLY OF AMERICA'S SELF-EMPLOYED WORKERS and SMALL BUSINESSES... BY SUPPORTING THE DEVELOPMENT OF SMALL, HIGH-GROWTH BUSINESSES

Small business has been the biggest engine of U.S. job creation in recent years. Smaller businesses have combined the advantages of size (lean and efficient organizational structures) with dynamic, entrepreneurial attitudes to become prime producers of high wage jobs. But certain market and regulatory barriers have hindered the potential of these growth engines.

Small businesses traditionally face even higher capital costs and hurdle rates than larger businesses because of smaller economies of scale. This is mainly due to the higher fixed-cost to investors of gathering information on smaller firms.

Bank loans are the main source of small business capital. Banks usually have closer relationships and better information on small business. However, current federal law (the Glass-Steagall Act in particular) prevents banks from also underwriting securities, which are the main source of capital for new innovations and intangible investments. Therefore, those with the best information and strongest relationships with small business are prevented from offering the kind of help these businesses need most. The result: the market presents smaller firms with disproportionately high transaction costs for securities issues.

Since much of business innovation and growth that drives productivity and wage growth occurs in smaller and start-up firms, access problems and high transaction costs are increasingly important issues. We endorse the following regulatory changes that will improve small business access to equity markets and reduce transaction costs:

Underwriting of Small Business Issues by Banks

<u>**Action Plan**</u>

- ❑ *Revise Glass-Steagall to broaden powers of both commercial banks and securities firms.* At minimum, expand access by small firms to equity markets and reduce their underwriting costs by exempting commercial bank underwriting of small business debt and equity offerings through holding companies, with certain conditions.

Reducing Equity Issuance Transaction Costs

Action Plan

- Amend Securities Act of 1933 to provide SEC with authority to *raise the ceiling on size of small business equity offerings* that qualify for exemption from federal regulation from $5 million to $10 million.

- Encourage *greater coordination among state securities regulators, as well as between state and federal securities regulators,* to lower compliance costs and streamline regulatory process for securities offerings.

- Direct the SEC to facilitate market access and lower transaction costs by *expanding "test-the-waters" procedure* under which issuers may test market interest for an issue before coming to market, in order to encompass registered offerings.

Facilitating the Operation of Matching Facilities

Action Plan

- Expand the pool of financing for entrepreneurial and start-up ventures by directing the SEC to *undertake rulemaking regarding Matching Facilities* and other informal networks that specialize in mobilizing capital supplied by high net worth individuals to such firms. Aim to facilitate process by which prospective issuers could make such info available to persons participating as investors in such matching facilities.

Facilitating Loan Securitization

Action Plan

- Direct Office of Comptroller of Currency and/or Federal Reserve to facilitate development of a market for small business loan securities by *launching pilot program to develop a uniform loan rating benchmark* that would assist investors to assess the quality of loans in a loan pool.

- Direct federal bank regulators to encourage securitization by facilitating creation of market conditions that would *permit credit rating agencies to assess the loss experience of loan pools.*

Improving the Efficiency of Small Business Administration Programs

<u>**Action Plan**</u>

- ❑ Direct the SBA to maximize capacity to catalyze additional bank lending to smaller firms by *instituting a "tranche-based" pricing system for Section 7(a) small business loan guarantees to commercial bankers.* Borrowers would be assessed up-front loan origination fees that increase with proportion of loan guaranteed.

- ❑ Direct the SBA to *undertake study of its major loan and investment programs* to better inform public policy choices.

APPENDICES

TRADE DEFICIT NUMBERS AND HIGH-WAGE JOBS[2]

Despite the U.S. merchandise trade deficit reaching $166 billion in 1994 and on target to hit $185-190 billion in 1995, conventional wisdom at least in some economic quarters argues that trade deficits are nothing to worry about, that they are in fact a sign of strength as the growing U.S. economy sucks in imports from more sluggish economies abroad. American consumers benefit, they argue, as they meet in the marketplace an array of inexpensive, high quality goods which force domestic producers to become more competitive.

Many also argue that American trade deficits are a function of low savings; that if the government and American citizens simply saved more, the trade deficit would disappear. Alternatively, it is argued that the exchange rate value of the dollar could continue its slide which will, at some point, correct the trade deficit. Or better yet, if we are patient, America's highly successful services trade will eventually offset the deficit in goods anyway.

Despite the conventional wisdom, it is important to recognize that the bulk of America's merchandise trade deficit is structural rather than the result of disparate growth rates. Recent American growth rates have not been stunning by historical standards and can hardly be used to explain all time high merchandise trade deficits. When Japan's economy was sharply outperforming American growth, Japan still continued to amass sizeable surpluses with the United States. Furthermore, China has been averaging double-digit growth since 1988, yet its surplus with the U.S. has ballooned from $3 billion to nearly $30 billion. In 1995, China's surplus with the U.S. may hit $50 billion.

Quite remarkably, the bulk of America's trade deficit can be accounted for by just one region of the world, Asia. Over the last five years, Asia accounted for 96% of America's global merchandise deficit. The "Don't Worry" crowd needs to explain why so much of the U.S. global merchandise deficit remains fixed to the Asia Pacific region.

In 1994, service trade surpluses offset only about a third of the merchandise deficit. And despite the unquestioned competitiveness of U.S. airlines, telecommunications providers and other service industries, our services surplus is growing slowly at best. And to be realistic about the net return to the American productive machine, one must understand that most of America's services surplus is in tourism and royalties -- hardly a source of encouragement.

Since the Plaza Accord in 1985, exchange rate shifts have helped bring U.S.-European trade into rough balance. But although the yen has risen in value from 278 in 1985 to a range between 80-100, our deficit with Japan continues to hit record highs. And of course, a weaker dollar has the undesirable side effect of making the U.S. a poorer country.

And on the savings front, it is true that our international deficit must match our imbalance between savings and investment. But if a nation's imports are pushed artificially high and its exports kept low because of barriers abroad, then savings too must be driven lower, resulting in lower economic growth and incomes. The conventional wisdom has failed to understand that this equation of savings, investment, and trade balances can go both ways. Trade barriers abroad matter and yield muted economic activity in America, not economic benefits as some argue.

While conventional wisdom argues that trade deficits are a manifestation of a strong and growing American economy, the fact is that such deficits represent real job leakage from the economy. Nations abroad which can restrict imports and still export freely into the American economy are displacing American workers. In fact, if the U.S. does reach a merchandise trade deficit of $180 billion in 1995, roughly 3.6 million jobs are lost in the American economy to foreign producers. The advent of large, regular U.S. trade deficits since the early 1980s have been accompanied by a sizable slowdown in average economic growth. In fact, average economic growth since that time has been over a full percentage point <u>lower</u> that it was in the 1950s and 1960s when we regularly had trade surpluses.

Other consequences of a large structural trade imbalance include the declining trend of the U.S. dollar, both recently and over the long term: The weak dollar not only has had little impact in correcting the trade imbalance because of its structural nature, but it has created additional adverse effects on the economy over and above the direct impact of the import displacement and constrained exports that make up our trade deficit. These include an upward bias on inflation and interest rates, and a squeeze on living standards. In addition, the weaker dollar has made our assets cheaper to foreigners, which has resulted in some foreign takeovers of U.S. businesses (thus causing the profit to flow offshore), and has made it even more expensive for U.S. companies to invest overseas. The latter create an even bigger structural deficit in the long term, because foreign investment by U.S.-based corporations generally results in increased U.S. exports. Furthermore, this may cause other countries to move away from dollar-based trade and commodity pricing, which could have additional consequences for the U.S. economy.

Reducing the structural trade deficit can come only from market opening in Japan, China and other Asian countries. It is thus imperative that the administration continue its policies aimed at bringing about more open markets in these countries. It should in fact be made clear to all that the underlying principle for U.S. trade policy in the future will be free trade with equal access or reciprocity -- we will no longer continue to permit one-way, unilateral free trade of the type that has severely hurt many U.S. industries in the past, and has contributed to our large structural trade imbalance.

It has, in fact, become clear over the fifteen years that one way free trade can be as destructive to the U.S. economy as a policy of widespread protectionism. The constituency for real free trade is evaporating in this country because more and more Americans now realize that it is not in our national interest to keep our markets open when other countries do not, and when some of the foreign penetration of our markets is a result of predatory trade practices.