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INFLATION & TAXATION

## Introduction--- Inflation

The year just past has seen the highest inflation rate since the Second World War. While all the figures are not in, the final rate should be around 13%.

To my mind, inflation must remain our overriding concern throughout the 1980's. I say the 1980's because it appears that inflation will be with us for some time, absent some remarkable event which lowers the rate dramatically. Projections are that inflation will drop to 9 or 10% next year, still an intolerable rate.

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Inflation has many causes, but to emphasize the seriousness of this economic "fact of life," it is important to see what inflation produces.

To my mind inflation weakens our national defense, because economic instability in the United States unsettles our allies and strengthens our enemies. Bringing inflation within control may do more to enhance our national security than any new weapons system or manpower increase. An economically strong America is a confident America, and that means a politically strong America around the world.

Inflation causes a weakening in our national spirit. To see hard earned dollars depreciate in value before they can be spent; to find that prices rise not annually, but

daily; and, to find a personal home beyond one's reach is to feel economic uncertainty and to lose the spirit of America.

Inflation causes a new mentality, which must be resisted; it is the mentality of spending. Some people are beginning to adapt to this new "fact of life" by spending and borrowing to buy at an unprecedented rate. Consumer borrowing has reached its highest level in history--some \$369.3 billion in the 3rd quarter of 1979 alone. Soon these loans will come due and I am concerned about that time.

Personally, I feel an obligation to fight inflation, which may be simply defined as too many dollars chasing around too few goods, because of the fear I have for an America running rampant with inflation.

The Latin American countries are the best lesson we can have. With inflation rates running as high as 300% at times and at sustained rates of 100% or more for years, they are weakened nations, where political turmoil is as much a "fact of life" as inflation.

I have fought indexing of taxes for this very reason. If we index taxes-- automatically adjust them for inflation-- we are surrendering and admitting that inflation cannot be beaten, but must be endured. Indexing would take care of accounting for inflation, but it would also perpetuate it to my mind. As Arthur Okun, the Brookings Institution economist noted, indexing "...is not a cure but a disease which institutionalizes inflation."

As you can see, inflation is serious and I have no reservations about calling it our first priority for the new year. We must challenge it head on; we must channel our national unity on crises such as Iran to the very real and pressing crisis of inflation.

The United States has never sustained such a period of inflation, not during the time of the Articles of Confederation, nor during the post Civil War or post Second World War periods. We must not allow this to continue. We have survived, but it is not an environment most of us enjoy.

We seem to have an attitude in this country that we should either be at the beginning or at the end of a crisis and never in the middle. By that I mean, that

we are in a crisis now, it is not a one-day event, it is an ongoing battle which began several years ago and which must continue until we lick this inflation. Rather than complaining about the inability of the government to produce a cure for inflation, we must concentrate on each individual's efforts to lick the problem.

I do want to tell you what the President and the Congress are doing as their part in this effort.

#### 1979--SOME POSITIVE THOUGHTS

Without juggling too many figures, it is clear that we did make some headway against inflation in 1979.

Consider that energy, food and housing costs went up some 21% on the average.

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Now, dropping these three items from calculations, inflation was running at an annual rate of 7.4%.

Still one does have to heat a home, eat and have a place to live. In those areas of voluntary price controls, however, outside the three categories I have listed, the inflation rate has stayed remarkably close to the President's 7% standard, which demonstrates a high degree of compliance.

What this means is that the American public has not given up on the battle with inflation. We have not accepted it as a way of life, but are still willing to tighten our belts to achieve a victory.

No one could predict and no one could control the dramatic price increase in fuel

prices. A 100% jump in many cases had to be dealt with by an American economy already overburdened with high energy costs. Yet, we have begun to learn our lesson. This Thanksgiving, for example, despite adequate supplies of gasoline, consumption was down--a product of high prices and, to my mind, an understanding that the time for conservation has arrived. Overall, gasoline consumption was down 4.7% in 1979.

We really have even the price of energy within our control if we will act. As Time magazine reported this past week, the OPEC cartel is in a bit of a disarray at this moment over prices; supplies are expected to go up next year. Any drop in demand now might just trigger price cuts which would severely weaken the monopoly power of the cartel. So even in the energy



area, Americans do have some control over their destiny.

There are two signs that demonstrate the underlying strength of the American economy. First, the unemployment picture was better than was expected last year. The rate remained at 5.8%. Whether we can hold this through 1980 is uncertain, but I am convinced that the Congress will do its best to keep the government out of the way of business growth and employment opportunities.

Next, one can see that in contrast with other parts of the world, we are not fairing badly. You have all heard the fact that a cup of coffee costs \$3 or more in Japan. A trip I took there last year for the Intelligence Committee brought this

home to me. Prices for gasoline are over \$2.50 a gallon in most of Europe and nearly \$3 in Portugal. We have been able to maintain our lifestyles for the most part in a time of high inflation and economic downturn. We can be grateful in the Southeast and in North Carolina in particular that we have fared so well. I am convinced that North Carolina's balanced budget and highly productive labor force are the foundation for our strong economic showing.

#### TAXATION

The passage of the windfall profits tax to my mind represents an important determination by the Congress that inflation can be brought under check.

Let me explain.

Last year, the President took the unpopular step, approved by the Congress, of removing price controls on certain forms of oil. This would allow the oil companies incentives to drill for oil in this country and to reduce imports.

Naturally, this means raising the price of oil and therefore gasoline and home heating oil. This is coming and we know it is coming, and there is no way to avoid it. What we can do is to soften the blow, especially for those who can least afford it.

First, we can conserve. Let me make it clear conservation does not always lower the price; what it does is to preserve the supply. But as many businessmen know, a price hike is less severe than a supply

interruption.

Next we could and we have insured that oil companies do not take advantage of the rise in the price of their product to the injury of the nation. Thus in the transition period, we have created a windfall profits tax to tax that part of gains made by oil companies related to the sudden rise in prices. It is a moderate tax aimed at limiting a benefit in this time of national distress, without inhibiting oil exploration and the development of new energy sources.

A footnote to this windfall profits tax was the repeal of the carryover basis tax provision. This law, enacted in 1976 would have required the payment of capital gains on inherited property from the time the property was purchased by the decedent.

This would have created a bookkeeping, accounting, and legal nightmare. The people who would have benefitted from it--the lawyers, the accountants and the bankers--were all opposed. Additionally, with inflation, the taxable gain would have meant that many people would have had to sell their family businesses and farms. The carryover basis would have injured the fundamental concept of personal property as we know it for it would have threatened the ability to pass property from one generation to another.

No one wanted a revenue measure which would have raised an additional \$1 billion, but would have cost so much in terms of our society. The final enactment of the windfall profits tax bill will retroactively repeal this provision.

Finally, we are looking in the Congress at tax readjustment in 1980. In 1979, the Congress undertook the task of making technical corrections to the provisions of the Revenue Act of 1978. We eased the burden on taxpayers in attempting to comply with the law by reducing the technicality and the paperwork.

In 1980, there may be tax cuts. My personal view is that any tax cut should be kept to the bare minimum. Inflation is key, and a large tax cut with a resulting deficit over the President's goal of \$15 billion will only fuel inflation. Some people are talking about no tax cut at all. A final decision will have to be made in light of first and second quarter economic performance.

Most members of Congress are looking to tax cuts aimed at business investment. I have mentioned the problems we have with productivity and the Congress is aware that encouraging research and development and capital investment are the best ways to improve productivity in the least inflationary manner. Any foreseeable tax cut would most likely be aimed at accelerating depreciation, reducing small business taxation and encouraging research and innovation.

I believe that the people of America are sophisticated enough to see that tax cuts which encourage consumer spending only fuel inflation and provide only short term happiness. Having a job, in a strong company with low inflation is more desirable to most Americans. The Congress will have this in mind in undertaking any tax cuts in

1980.

## SOLUTIONS

There are no short term cures. Plain and simple, we got into an inflationary spiral over the years by overregulation, by housing shortages, by speculation in certain commodities and by a drop in our balance of payments.

First and foremost, we must retain the view that every individual has a stake in fighting inflation. The government has an obligation and a responsibility to tighten its belt and to do what it can. But each of us retains a stake in combatting the problem. Frankly, I do not need to preach this doctrine in North Carolina-- a state of strong work ethic and dedication to good quality of life.



Second, we must increase productivity. This can be done by workers through harder work and by business through innovation and invention. Small business in particular plays the key role in innovation, and I am working to insure adequate capital, reduced regulation and strong government assistance to allow small businessmen to do the work that they are capable of. Our rate of productivity in the first quarter of 1979 was declining at an annual rate of nearly 4.5%, brought about by strikes and other economic disruptions of last winter. Now, we have the lowest productivity in the free world. Inflation would not be nearly so bad if productivity were up; it isn't and we are paying the price.

Next we must encourage savings. Our

rate of savings is the lowest in the free world. Savings is **a**nti-inflationary.

Our savings rate has declined from 7.4% in 1970 to under 4.3% in 1979, a modern low. The figure may be even lower.

Savings insure individuals against that rainy day that can come with frightening speed and it provides money for new homes and new plants and equipment which allows for productivity gains. One reason that the U.S. has only invested 10% of its national income in new plants, mines and equipment and research, while Japan and West Germany have invested over 15% is an absence of savings.

A personal savings plan by every

American would go a long way toward assisting the big picture. The popular statement now is that you are losing money when you put money into savings. This has been true, but we are trying to return the incentive. As part of the windfall profits tax we have removed the tax on the first \$250 of interest earned from savings. More can be done and will be done, but the personal resolve of every American is vital.

After all these numbers and problems, let me end by stating that I am optimistic about our economic future and about the relationship of the government to the economy. This is the strongest nation on earth, we have weathered every form of economic distress

and have managed to remain the banker for the world. We have learned that government actions interfere with a strong American economy. The 1970's have been years of education for all of us.

I am optimistic that we have learned about the world and about ourselves and that our knowledge will stand us in good stead as we seize the opportunities and build a stronger America in the years to come.