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LARRY LINDSAY'S BOOKS

Harvard discovers the supply side

Rep. Dan Rostenkowski has succeeded in ever so slightly moving President Bush's lips, or so we are led to believe. The chairman of the House Ways and Means Committee proposes a plan to end the deficit by 1994, three or four years sooner than would otherwise be the case. This would be accomplished by increasing the tax on gasoline, cigarettes and alcohol, and by raising the 28 percent top tax rate to 33 percent.

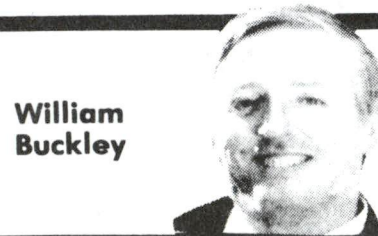
The Bush administration is evidently tempted. Mr. Bush's freeze on the question of higher taxes made sense for a while, as it was wise to consolidate the 1986 reforms until we could get a little perspective on them. We have this now, and have most pointedly to be grateful to economist Lawrence Lindsey, on leave from Harvard and now associate director for domestic economic policy at the White House. One hopes he has the presidential ear. (It pays to remind oneself that to have a White House address doesn't necessarily mean that you ever get to see the president, let alone talk to him.)

Professor Lindsey begins his book, "The Growth Experiment," with a charming and unusual confession. He began his scholarly inquiries by doubting that supply-side economics was more than merely a superstition, as

so many of his brother economists had described it. Moreover, he accepted the convention that Paul Volcker's sharp reduction in the money supply, done several months before the inauguration of Ronald Reagan, was the critical factor in bringing down inflation.

He has discovered that it was otherwise: What reduced inflation and spurred the great growth of the '80s were the two tax reforms, in 1981 and 1986. Moreover, although these reforms did cost revenue, they were responsible for a 2 percent to 3 percent growth in economic output, thereby hugely outdistancing in production what they cost in revenue. Professor Lindsey's point now is that we have learned enough to coach us on where to go. He proposes a tax package that is revenue-neutral, but one which will increase productivity by stimulating sensible economic behavior and by significantly easing the burden on the little taxpayer. Are you ready?

— Eliminate all federal taxes for single persons earning less than \$6,000 and couples earning less than \$12,000. Increase to \$5,000 the exemption for each dependent under age 3, \$3,000 for each dependent over 3. Extend to the lower- and middle-income classes a deductibility on rent, even



William Buckley

On the right

as upper-income earners enjoy a deductibility on mortgage.

— Restore the IRA deductions, eliminated by the 1986 tax, but jack them up to \$5,000 per year: tax-free savings.

— And: lower the tax rate to a single figure: 19 percent, including capital gains.

So much for the good news. How would the loss in revenue be made up?

— Tax business on cash flow, rather than on "profits," which are difficult to calculate and can approach near-inscrutability.

— Limit the deductibility of home mortgages to \$10,000 (now \$1 million). It is Mr. Lindsey's point here that home ownership should be encouraged, but not the building of

mansions.

— Tax the whole of a wage-earner's income (above the \$12,000). This includes health services. (It is an old saw but true that General Motors pays more for health services for its employees than it does for steel for its cars.)

— Limit the deductibility of state taxes to burdens that exceed 6 percent of the taxpayer's income. Mr. Lindsey's point is that such state taxes as provide enjoyable amenities, e.g. good schools, nice beaches, city golf courses, heated swimming pools, are properly taxable.

"If you are like most taxpayers," writes Mr. Lindsey in Forbes magazine, "you want to know what this means for you. Do not count on any big tax cut. What you gain from lower marginal rates you will probably lose through lost mortgage interest and local tax deductions. This tax system raises just as much revenue as the current code. Except for low- and moderate-income families with children, just about everyone will have to pay just about as much tax as now in absolute terms ..."

• William F. Buckley Jr. is a columnist with Universal Press Syndicate.

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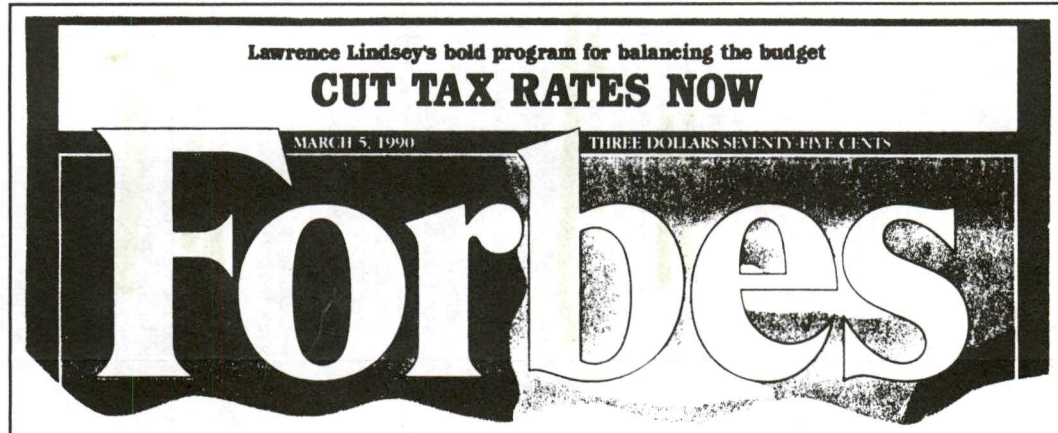
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April 15, 1990
Number 28

Eight Questions Examined - and Answered - in Lawrence Lindsey's **The Growth Experiment***

- (1) Under Reagan, did the rich get richer and the poor get poorer?
- (2) Did tax-rate reduction create more revenue than it lost?
- (3) What lessons have we learned about the relation between tax policy and jobs?
- (4) To balance the budget we must increase taxes and reduce spending: True or False?
- (5) In what specific ways can tax policy help those in poverty?
- (6) Have working women borne an unfair share of the tax burden?
- (7) The consumer debt burden: When will the bubble burst?
- (8) Did supply-side tax policies create the boom of the 1980s?

* *The Growth Experiment: How the New Tax Policy is Transforming the U.S. Economy*, by Lawrence B. Lindsey, Basic Books, April, 1990.



A blueprint for economic policy

We rarely publish book excerpts, but when galleys of Lawrence Lindsey's about-to-be-published *The Growth Experiment* hit our desks, we felt at once it was a work that would greatly influence economic thinking in the 1990s. A Harvard economist now working in the White House, Lindsey is not your doctrinaire supply-sider. He became one only after his doctoral studies persuaded him that the tamer inflation and steadier economic growth of the 1980s were largely a consequence of Ronald Reagan's tax cuts. "It's time for another cut in tax rates," starts on page 82. Read it. It's a logical blueprint for Washington's economics in this decade and on into the 21st century. Following the excerpt is an interview with Lindsey by Washington Bureau Manager Howard Banks.

*James W. Michaels, Editor
Forbes, March 5, 1990*

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS

*Chairs
and
speechwriters*

November 8, 1989

Don

To: Dave Demarest
From: Mike Boskin
Re: Administration Economic
Achievements

Let me know if we can amplify on
any of the attached points.

ECON

Michael J. Boskin
Chairman

KEEPING THE ECONOMY STRONG

SUMMARY

- o Record expansion: During the current economic expansion--in its 83rd month as of October--over 20 million jobs have been created and the unemployment rate has fallen to levels not seen in 15 years. Income levels have risen sharply and growth in industrial output is nearly double that of Western Europe. Consumer price inflation has remained under 5 percent for the past 7 years.
- o Savings and loans: In August the President signed the Financial Institution Reform, Recovery and Enforcement Act of 1989 to begin resolving the savings and loan situation. The President's plan calls for tough standards to help ensure such a crisis never happens again.
- o Third world debt: The Administration has taken the lead in finding a way to reduce the debt burden and encourage economic growth in developing countries. At the Administration's urging, the IMF and World Bank have set aside funds to support debt reduction programs for developing countries. Three countries have successfully negotiated debt agreements under the Administration's debt plan.
- o International trade: The Bush Administration successfully broke a stalemate in the Uruguay Round of multilateral trade negotiations and advanced its proposal to correct and prevent trade distortions in agriculture. It is engaged in bilateral trade talks with important trading partners to discuss structural impediments to expanding trade and encourage them to open their markets to our exports.
- o Budget policy: This spring, the Administration successfully negotiated a budget agreement with the Congress. However, Congress did not legislate the agreement, leaving the projected budget deficit for FY 1990 above the Gramm-Rudman target. Consequently, funds are being sequestered, enforcing a reduction in the Federal budget deficit.
- o Minimum wage: The Administration achieved agreement with the Congress on the President's goal of increasing the basic minimum wage to \$4.25 per hour. The plan will be particularly useful to the working poor, while providing business the ability to employ younger and less experienced workers at a reasonable training wage.

KEEPING THE ECONOMY STRONG

Maintaining the current expansion with low inflation is the key to improving standards of living, increasing job opportunities for all Americans, and increasing investment in productive capacity. Economic performance during this expansion has been exceptionally good with extraordinary job growth. The policies of the Bush Administration are designed to preserve this strong record.

- o Record peacetime expansion: The current expansion reached 83 months in October. This is the second longest economic expansion in U.S. history and the longest peacetime expansion.
- o Job creation: Over 20 million new jobs have been created during this expansion, and this year the unemployment rate has reached levels not seen in 15 years. The benefits of robust economic growth have been shared by a wide variety of demographic groups, with unemployment rates for both men and women as well as minorities at relatively low levels. During this decade, America has created more new jobs than Japan and the nations of Western Europe combined.
- o Record income: Real per capita disposable personal income--personal income after taxes and inflation--has risen 19 percent during this expansion.
- o Higher national saving and investment: Partly due to the discipline of the Gramm-Rudman-Hollings process, the Federal deficit has declined from 6.3 percent of GNP in fiscal year 1983 to 3.0 percent this fiscal year. The personal saving rate averaged 5.4 percent over the first three quarters of 1989, well above its recent low of 3.2 percent in 1987.
- o Inflation under control: Consumer price inflation has remained under 5 percent in each of the seven years from 1982 to 1988, and the recent slowing in economic growth to a sustainable rate will lessen price pressures in the near future. In the last twelve months, the CPI has increased only 4.3 percent and, in the last three months, the index has risen only 2.4 percent at an annual rate, reflecting lower energy prices.

ACTION BY THE ADMINISTRATION:

- o Implementing fiscal restraint: In view of the failure of the Congress to legislate the budget agreement reached last spring, the Administration has implemented a sequester of funds under the Gramm-Rudman-Hollings law. The sequester will effectively restrain federal spending while it is in force,

and will help reach the President's goal of hitting the Gramm-Rudman targets with no new taxes.

- o **Addressing the international debt problem:** The Administration has taken the lead in encouraging commercial banks to reduce the debt and debt service burdens of developing countries. Recently, three countries--Mexico, the Philippines, and Costa Rica--have reached agreements with commercial banks under the Administration's debt plan. The differences in these agreements appropriately reflect differing circumstances in the three countries and illustrate the flexibility of the Administration's approach.
- o **Minimum wage agreement:** The Administration and Congressional leaders have reached agreement on a plan to raise the minimum wage to \$4.25 per hour and to permit businesses to pay a training wage to young, entry-level workers. The higher minimum wage will help the working poor and the training wage will allow businesses to hire inexperienced workers and give them the start they need in a working career.
- o **Disaster assistance:** The Administration and the Congress are working together to provide adequate funding to assist victims of Hurricane Hugo and the California earthquake. This funding will help provide the homeless with temporary shelter, will assist uninsured, needy families rebuild their homes, and will help the state as well as counties and municipalities to rebuild highways and other public facilities.
- o **Savings and Loan reform:** The President signed the Financial Institution Reform, Recovery and Enforcement Act of 1989 on August 9. This legislation comes to grips with the problems facing our savings and loan industry, and will safeguard and stabilize America's financial system. The Act assures that the long developing problems in our savings industry will never happen again. It significantly reforms the regulation of the thrift industry and separates the chartering of the institutions from the insurance of deposits. It establishes strict new guidelines to assure the solvency of thrift institutions in the future, including new capital requirements, and sets stiff penalties for wrongdoing by the officers of insured institutions. Further, the act establishes new agencies to remedy existing problems in the thrift industry and authorizes funds to finance the restructuring of insolvent institutions.
- o **International Trade:** The Administration is forcefully promoting the opening of world markets through bilateral negotiations and the Uruguay Round of the General Agreement on Tariffs and Trade. It successfully broke a stalemate in the Uruguay Round's mid-term review and put in place a framework, agreed to by the 96 member nations, to correct and prevent

trade distortions in agriculture. It is engaged in bilateral trade talks with Japan to identify and eliminate structural patterns that may impede efficient patterns of world trade. The approaches being pursued in these discussions will provide long-term benefits for both countries. The Administration also has created a high level interagency group to assure that U.S. trade and investment interests are addressed as the European Community works to create a single market in 1992.

- o **Steel imports:** The President initiated a two-and-a-half year Steel Trade Liberalization Program designed to phase out, in a responsible and orderly manner, the Voluntary Restraint Arrangements (VRAs) that currently limit steel imports into the U.S. and to negotiate an international consensus to address trade-distorting practices.
- o **Agricultural initiatives:** The Administration has announced its comprehensive agricultural proposals for the General Agreement on Tariffs and Trade. These proposals would harmonize domestic agricultural programs and reduce trade distortions to minimize their distorting effects on international production and trade. In addition, the Administration has formed a task force to develop a farm bill for 1990.
- o **National Energy Plan:** The President directed the Secretary of Energy to develop a comprehensive national energy strategy for the nation. The strategy will help the nation meet our energy security and environmental responsibilities and, at the same time, allow a sensible mix of energy sources to protect America's economic competitiveness.

78TH STORY of Level 1 printed in FULL format.

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March 5, 1990, Monday

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HEADLINE: Gallup Finds 34% May Use Savings Plan

BYLINE: By YVETTE D. KANTROW

DATELINE: NEW YORK

BODY:

One-third of consumers who would be eligible to contribute to President Bush's proposed Family Savings Account would be likely to do so, a consumer survey found.

The survey, conducted by the Gallup Organization and commissioned by Fidelity Investments, lends credence to the belief that Mr. Bush's tax free savings plan would bolster the consumer saving rate - and provide a windfall for the nation's banks.

"If I were a banker, the fact that 34% would use a family savings plan would make me develop programs quickly," said James D. McLaughlin, director of agency relations for the American Bankers Association. Bankers Could Start Planning

While the Family Savings Account is only a proposal, Mr. McLaughlin said, bankers should start planning to take advantage of it.

Under the Bush initiative, families with incomes of up to \$120,000 would be able to escape taxes on the earnings of money saved or invested for at least seven years. The money could be spent for any purpose - not just retirement.

In interviews with 720 consumers nationwide from Jan. 25 to Feb. 3, Gallup sought reactions to savings proposals.

Besides finding that 34% of eligible investors would contribute to a Family Savings Account, the survey provided equally encouraging insights into types of individual retirement accounts that are most likely to succeed.

"Back-end IRAs" - tax-free withdrawals at retirement - were preferred by 53% of respondents. But 36% would prefer a 50% tax deductibility for contributions. Both types of IRAs are in bills before Congress. Surprise on Back-End IRAs

The preference for back-end accounts is surprising, considering that it was the tax deductibility of contributions that popularized IRAs in the first place. Before the Tax Reform Act of 1986, all IRA contributions were tax-deductible, but many taxpayers are no longer eligible for those advantages.

The survey "shows that people are planning ahead, and that's very significant for banks," said Joe Belew, president of the Consumer Bankers Association. He said the finding reflects the population's aging.

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Robert Pozen, general counsel for Boston-based Fidelity Investments, said that, given the public's receptivity to back-end IRAs, they would be an excellent bank product.

Linda Lindrick, an investment services officer at National City Bank, Cleveland, said she is unconvinced that consumers truly favor a back-end IRA.

"I don't think the issue of tax deductibility is one that the public is well-educated on," Ms. Lindrick said. Her bank has no plan now to take advantage of the President's savings proposal, she said.



OFFICE OF THE VICE PRESIDENT
WASHINGTON

FACT SHEET ON PRODUCT LIABILITY REFORM

"Product liability reform...it's time to act together."

President George Bush
State of the Union Address
January 31, 1990

"A legislative priority for our Administration will be the reform of our costly product liability laws. The burden of our present product liability system is excessive and adversely affects our ability to compete abroad. In fifteen years, product liability suits have increased over 1,000 percent -- representing unnecessary litigation and extreme costs to American business and consumers alike. This is unacceptable, and our Council on Competitiveness, chaired by Vice President Quayle, has made product liability reform a top competitiveness priority."

President George Bush
February 6, 1990

"Our current product liability system of 50 different State laws generates excessive litigation, inflates insurance costs, and creates uncertainties for American businesses. This is a self-imposed burden on our ability to compete. It also has a chilling effect on innovation and the development of new products. Ultimately, the costs of our inefficient product liability system are borne by American workers and consumers."

Vice President Dan Quayle
November 30, 1989

An Administration Priority.

Product liability reform is a top legislative priority for the Administration. It is essential to business innovation, U.S. international competitiveness, and consumer safety and welfare.

- o In his State of the Union address President Bush called upon Congress to enact essential product liability reform legislation.

- o On November 30, 1989 Vice President Quayle announced the Administration's product liability reform initiative developed by the Council on Competitiveness. The Administration strongly supports S.1400 -- a bipartisan reform bill co-sponsored by Senators Danforth, Inouye, Kasten and Rockefeller and similar legislation in the House of Representatives, and it will seek additional reform provisions to strengthen the bill.
- o The Senate Commerce Sub-committee on the Consumer will hold hearings on S. 1400 on February 22, 1990.

Restore Basic Principles of Fairness.

The Administration's reform initiative will restore basic principles of fairness to America's product liability system:

- o First, protection of an innocent person's legal right to fair compensation for medical expenses, lost wages, property damage and other actual losses.
- o Second, payment for losses based on actual responsibility for the harm -- fault based liability -- not ability to pay -- "deep pocket" liability.
- o Third, cooperation and the prompt and fair settlement of differences should be encouraged through alternatives to costly and time consuming litigation, which only reduces the compensation available to the injured party.

Strengthen U.S. Competitiveness.

Our product liability system --with its excessive litigation costs -- is a self-inflicted burden on America's ability to compete. U.S. product liability laws are more onerous than those of other major industrial countries, such as Japan and European nations.

- o The estimated cost of product liability suits in the U.S. -- \$80 billion per year -- equals the combined profits of the nation's 200 largest corporations.
- o Total U.S. liability insurance costs are estimated to be 15 times higher than Japan's and on average 20 times higher than the European nations'. These costs are reflected in higher prices for U.S. goods and hamper our ability to compete with foreign manufacturers.

Enhance Product Innovation.

Equally devastating is the chilling effect of the liability system on product innovation. The fear of potential law suits deters businesses, especially small and start-up businesses, from introducing new and safer products.

- o Many products are no longer being produced for American consumers -- single-engine aircraft, vaccines against deadly Japanese encephalitis, and gymnastic equipment are a few examples.
- o Many companies decide against introducing new products. For example, Monsanto will not market an inexpensive, safe asbestos substitute and Genentech declined to go forward with a new hepatitis vaccine developed through biotechnology because of liability risks.
- o 36% of American businessmen in a recent survey stated that they stopped some manufacturing as a result of product liability risks. 15% laid off workers and 8% closed plants.

Reform Advances Consumer Welfare and Safety.

Safety and health considerations, the principle rationale for continuing the current system, are undermined by the current product liability regime. Consumers are not always offered new, safer products (like vaccines and the Monsanto asbestos substitute). Also, the costs of excessive liability risks are reflected in higher prices for goods and services.

- o A 1989 Rand Corporation study reveals that on average only 46% of total expenditures from tort law suits went to compensate injured parties. Legal fees and expenses consume on average of 37% of the amount spent -- in some product liability cases this figure reaches 70% of the total amount.
- o The cost of DPT vaccines rose from \$2.80 per dose to \$11.40 per dose to cover liability insurance costs.
- o In a February, 1990 Consumer News article, Bonnie Guiton, Special Advisor to the President for Consumer Affairs states "These are among the ways in which America's current product liability system works against consumers....Done properly, however, product liability reform can benefit consumers..."

The Administration will work with the bi-partisan sponsors of S.1400 and with groups from all sectors of the American public to support U.S. product liability reform that achieves improved U.S. international competitiveness for businesses and restoration of basic principles of fairness for consumers.

For more information contact:
David McIntosh 456-2816

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Suggested Speech Inserts on Product Liability Reform

Reform of our costly product liability laws is a top legislative priority for our Administration. The burden of our present product liability system is excessive and adversely affects our ability to compete abroad. In 15 years, product liability suits have increased over 1,000 percent -- representing unnecessary litigation and extreme costs to American business and consumers alike. This is unacceptable, and our Council on Competitiveness, chaired by Vice President Quayle, has made product liability reform a top competitiveness priority. —

We must restore basic fairness to our product liability system. A person who is injured by a product should be compensated for his or her actual losses. Liability should be based upon whether a person or company is at fault. Individuals and organizations with "deep pockets" must not be made to pay for losses that are not their fault.

You don't need a law degree to know that something is very wrong with a system in which over 50% of the money spent never gets to the injured person. Rather, it is used up in lawyers' fees, court costs, and other legal expenses. That's why I support product liability reform to encourage settlement out of court through arbitration and alternative dispute resolution.

Ultimately, the American consumer pays for the excessive cost of our inefficient litigation system. Companies abandon or severely limit the development and manufacture of important consumer products because of fear of protracted lawsuits and unfair judgments. Product liability reform is needed to preserve the health of Americans who will be worse off when they cannot obtain -- or cannot afford -- vaccines against hepatitis and other deadly diseases. Our kids will miss out on sports, if no one is willing to sell equipment like football helmets and masks. Mothers will not be able to buy car safety seats for their children, if all the manufacturers are forced out of business by skyrocketing insurance premiums. Our office buildings and schools will not be able to replace asbestos with safer products, if the fear of lawsuits prevents their introduction into our economy.

We must act together now. I call for Congress to act immediately to pass needed, bi-partisan product liability reform legislation. We must work together to restore justice, preserve our competitive edge, and promote consumer safety and welfare.



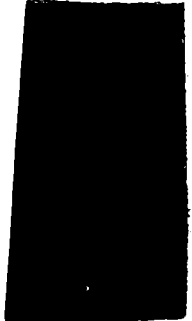
CAMP DAVID

Roger

read with interest
be sure speechwriters get the
facts in here and the
anecdotal stuff.

gb

1-15-90



THE PRESIDENT HAS SEEN

**ADDRESS BY ROGER B. PORTER
BEFORE THE
UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS
New York, N.Y.
December 5, 1989**

I. Introduction

I am honored to join with you in celebrating excellence. It was Plato who observed many centuries ago that what is honored in a country will be cultivated there. John Akers, throughout his career, has shown a commitment to excellence, a capacity for leadership, and a broader vision than merely short-term profitability. He has evidenced a vision for the long-term success of the enterprise he heads. At the same time, he has shown a willingness to attend to issues that are at the top of the nation's agenda.

The President has asked me to convey to John his special greetings and appreciation for John's service on the President's Education Policy Advisory Committee and on the Business Roundtable's task force on education.

II. Where We Have Been and What We Have Learned

The meeting of the U.S. and Soviet leaders in Malta this past weekend presents a fitting occasion to assess what we have learned and where we have been. The pace of change in recent

months has been truly dramatic. It reminds one of the refrain of the Angel Gabriel in the play, Green Pastures: "Everything nailed down seems to be coming loose."

I am also reminded of the scene from the movie, "Three Days of the Condor," in which a CIA analyst discovers a plot within the agency. He takes his discovery to an old OSS hand bound to a desk job in Langley and, after revealing the details, asks the old man, "You saw some action once, too, didn't you? Do you miss the action?" Slowly, the old man replies, emphasizing every word, "It is not the action I miss. It is the clarity." I suspect that the events of the last few weeks have caused some to long for a return to similar clarity. But the clock cannot be rewound. The changes we are witnessing are truly reshaping the face of a continent.

Even in this time of change, and perhaps because of it, certain lessons seem a bit clearer.

- We have learned that the yearning for freedom and for democratic institutions is strong, even among peoples who have been denied them for many decades.

- We have learned that efforts to centrally manage economies ultimately fail by misallocating resources.

- We have learned that markets and market-oriented institutions do efficiently allocate resources and produce economic growth and prosperity.

- The verdict of this century in country after country confirms the wisdom of both democratic political institutions and market-oriented economic arrangements.

In many respects, the post-World War II period has been one of the most remarkable in the history of the world. We have experienced no major world war for forty-five years, compared with two during the previous forty-five years. There have been regional conflicts to be sure, but since 1945 we have maintained a time of relative peace.

The post-World War II period has also been a time of unprecedented economic growth and of shared prosperity. When World War II ended, the worldwide average for life expectancy was just 46 years. Today, it is 62 years. Worldwide, infant mortality has been cut by more than half, from 155 per thousand births to 71 today. In the United States, only 53 percent of 25-29 year olds had completed high school in 1950, compared with 86 percent today. In short, in many measurable ways we are much better off than we were 45 years ago.

What accounts for this unprecedented growth and prosperity? Two have pulled us down the path of peace and prosperity. The first is the diffusion of technology and ideas associated with the transportation, communications, and technological revolutions. Consider what has happened in the U.S. during the decade of the 1980's alone:

- The percentage of households with cable television went from 19 percent to 51 percent.
- The percentage of households with VCRs went from 1 percent to 58 percent.
- The number of personal computers in use went from 2 million to 38 million.
- The percentage of elementary and secondary schools with microcomputers rose from 18 percent to 96 percent.
- If you are not persuaded by these statistics, ask yourself how we survived only a few years ago without FAX machines.

The second engine has been an open and increasingly integrated international economy. World trade has expanded by

6.2 percent annually since 1950, compared with 4.1 percent for the world economy as a whole. During the 1980's, trade has been even bigger contributor to growth. Between 1981 and 1989, world trade expanded at a rate of 4.5 percent annually, compared with world output growth of 2.8 percent per year.

Despite these victories and this progress, there is deep and appropriate concern on the part of many Americans about our competitive position in the world. Our budget and trade deficits are troubling, both in their magnitude and in their persistence. To some it appears that U.S. firms and U.S. real estate are all being sold to foreigners.

Therefore, it is appropriate to turn our attention to the question of what will be the major challenges for us as a nation in the 1990's and what we must do.

III. Investing in the Future: A Longer-Term Vision

The first characteristic of a mature people and a mature society is the care it takes for its future. We have learned through much experience that productivity is tied to investment. We all instinctively know that no successful farmer consumes his seed corn. Current consumption is no substitute for carefully planned investments. This is true for individuals and

families, it is true for business organizations, and it is true for societies.

In practical terms this is reflected in our policies, practices, and patterns with respect to investments in three critical areas -- physical capital, research and development, and human capital.

Physical Capital. Central to securing adequate capital investment is a pattern of private saving and public borrowing that is conducive to lowering the cost of capital. We have known for a long time that our current levels of private saving are inadequate, particularly when combined with the levels of public borrowing that characterized the 1980's. This is a battle that we must wage on both the public borrowing and the private saving fronts.

It is a challenge that will require great patience and persistence. On the public borrowing front, we are making considerable progress in reducing the relative size of the budget deficit. Between 1985 and 1988, for example, the Federal deficit declined in relation to GNP from 4.9 percent to 3.0 percent. Indeed, if one considers the entire public sector, including state and local governments, the decline is even more dramatic - from 3.3 percent to 2.0 percent between 1985 and 1988.

And we are not doing poorly when compared with other industrial countries. For the public sector as a whole, our 1988 deficit in relation to GNP is comparable to that of Germany (2.0 percent), Canada (2.6 percent), and France (1.4 percent); and far better than in Italy (10.6 percent). GNP.

The 1989 budget battle provides reason for encouragement. It was a landmark in the fight to reduce the budget deficit:

- First, the President began the year by proposing a realistic budget that was not declared "dead on arrival." It served as the basis for successful budget agreement negotiations with the Congress.

- Second, as the budget battle played out over the year, the political system shifted away from the discipline that had characterized it during its early period. In the end, there was the genuine threat and actual imposition of sequestration. I consider it significant that it was the willingness of the President to remain in and manage sequestration for an entire year if necessary that brought the political system (in this instance the Congress) back to the table and produced a Reconciliation Bill that included genuine spending reductions.

-- Third, among other things, the budget battles of 1989 demonstrated that we could put our fiscal house in order without resorting to higher taxes. The Gramm-Rudman target was met without increased taxes.

Research and Development. The second critical area in considering a longer-term vision for the future is research and development. A strong R&D effort is central to the success of an economy. This is why the administration has proposed making the R&D tax credit permanent. The other essential element of tax policy as far as R&D is concerned is stability. Stability with respect to federal tax policy permits private sector organizations to plan with greater confidence. Indeed, one of the most important things that government can do is provide a stable environment in which entrepreneurship can flourish.

✓ The numbers indicate that, while the United States has improved its R&D effort over the last decade, we still have work to do. According to the National Science Foundation, our R&D effort increased as a share of GNP from 2.1 percent in 1977 to 2.6 percent in 1987. But other countries also increased their efforts. This left us only slightly behind both Japan (2.9 percent) and Germany (2.8 percent). If defense R&D is excluded, however, the gap widens: In 1987, the U.S. effort was 1.8 percent of GNP, compared with 2.8 percent for Japan and 2.6 percent for Germany.

There has been much discussion about what will happen to defense R&D in this new era of defense cut-backs. It is simply too early to forecast what will be in the administration's FY 1991 proposals. But it is highly unlikely that we will see increases in defense R&D spending. This will mean that we will need even greater R&D spending in other parts of the system.

While the government has an important role to play in basic research and development spending, it is crucial that U.S. businesses consider carefully their R&D spending patterns with respect to their implications for investments in the future. Often the trade-off is higher dividends today or greater R&D spending for tomorrow.

Human Capital. Investments in human capital are also important, and with the tightness of our labor force this will become even more important in the future. Throughout the decade of the eighties, our labor force has grown at an average annual rate of 1.7 percent, a substantial drop over the 2.5 percent average rate of the 1970's. Recent projections indicate that the growth rate will decline toward 1 percent a year during the 1990's. This, of course, is heavily dependent on what happens with respect to immigration, which has accounted for about one-fourth of all the population growth in the United States during this century. The point is that with the labor force growing

more modestly, it will be even more important that businesses effectively train their employees.

At the President's Education Summit Conference with Governors in Charlottesville, one governor related a conversation he had with the chairman of Toyota. During the course of their discussion the governor asked this business executive what percentage of his workers were illiterate. He replied, "By American standards none. By Japanese standards, fifteen percent." ||

~
Puzzled by this response the governor asked what he meant. The chairman replied, "All my workers can read and write, but fifteen percent of them are not yet fully able to program a computer."

This is the kind of world in which we must compete during the decade of the 1990's and beyond. It will require investments in our future, investments in physical capital, research and development, and human capital.

IV. Balancing Security and Dynamism

A second basic challenge for the United States as a nation in the 1990's will be striking a balance between security and dynamism. There is an underlying tension in the life of every

individual, every organization, and every society between the desire for security and stability and a recognition of the need for dynamism, adjustment, and change.

The more affluent a society becomes the more it has the luxury of satisfying the desires of its people for security. We have seen much of this in Western societies during this century with the wide array of measures designed to provide protection against the vicissitudes of life and to provide for health, welfare, employment security, and retirement. Many of these measures have become a part of our thinking about what a proper society should have. Is there anyone who wants to dispense with having an unemployment compensation system? The list of mandated benefits that some would add to the current array is a long one indeed. And there are legitimate arguments that one can make for each of these.

What I am arguing is that one must take care to look at the aggregate effect of these measures designed to achieve greater security. The reason for this is very simple. Much of America's success over the last two hundred years, I am convinced, comes from our capacity to innovate, to adapt, to reallocate resources, to change. We are by far the most mobile society in the world.

America has had a remarkable record of job creation during the 1980's, while employment in Europe has been relatively

stagnant. Between 1982 and 1988, total employment in America rose 15 percent. In France, the number of people employed actually fell by 150,000. German employment rose a modest 1.6 percent. Margaret Thatcher's economic miracle in England produced the best record in Europe -- 6.9 percent job growth over this period.

During the late 1980's, the duration of unemployment in the United States has fallen significantly below that of Europe. The pain of long-term unemployment is far less common here than in Europe. In 1987 in the United States, only 14 percent of the unemployed had been out of work more than 6 months, while only 8 percent had been out of work more than a year. By contrast, more than 60 percent of the United Kingdom's unemployed had not worked in 6 months and more than 40 percent had been out a full year. The situation in France was even worse, with nearly two-thirds of the unemployed out of work for more than 6 months and nearly half out of work for a year or longer.

The Europeans are aware of these comparisons, and they have much to do with Europe's commitment to complete its single internal market by 1992.

One of our greatest strengths is the flexibility with which we deploy our resources, human, financial, and otherwise. We

must preserve this adaptability and mobility if we are to have a truly dynamic economy.

Contrast the relative flexibility that exists in our labor market arrangements with the inflexibility that characterizes much of our education system.

Over time, America's education system has gravitated toward security and stability. We need a major restructuring to achieve greater dynamism through increased innovation, accountability, competition, and choice. As an active participant in the President's Education Summit last September in Charlottesville, I see some reason for encouragement on this front. There is a commitment to reform among governors all across the nation that can help produce the educational renaissance that is so desperately needed.

As one who has spent many hours in the classroom, I am convinced that the educational renaissance that is needed can happen. Four years ago, I had the privilege of visiting the largest private high school in Osaka, Japan. My morning began with an address to its 4,000 students. I spent the day sitting in classes and talking with the exchange students from the United States, Great Britain, Canada, and Australia. This is truly an impressive school. It was founded in 1945 in the ashes of the Second World War. In the past forty-five years it has produced

seven Olympic gold medal winners. They regularly win the all-Japanese gymnastic and tennis championships.

But it is not just their athletic prowess that impressed me. Fully 98 percent of their students graduate and go on to attend universities and colleges. Their academic accomplishments parallel their athletic achievements. At the end of the day, I met with the Headmaster and the Vice Headmaster and made many inquiries about where they recruited their students and teachers, what kind of entrance requirements did they have, and similar sorts of questions. But the great lesson for me came in response to my question to the Headmaster: "What is the key to your success?"

Without pausing or reflecting, he looked at me and said: "The key to our success is very simple. It can be summarized in a single word, expectations. At Seifu Gakuen we have a tradition of expectations. When students come here they know that they are expected to attend class every day. They are expected to have their homework completed. They are expected to master the material, however long it takes. Anything less is simply not acceptable.

The students were full of enthusiasm and commitment. They felt they were engaged in something that was important. They cared and so did their teachers and parents. It is that kind of

commitment and that kind of dynamism that can transform our schools.

V. **Summary**

As we prepare to respond to the challenges of the next decade, I believe that we would do well to recall the advice of Thomas Huxley, who visited America in 1876. He observed:

I cannot say that I am in the slightest degree impressed by your bigness, or your material resources, as such. Size is not grandeur, and territory does not make a nation. The great issue, about which hangs true sublimity, and the terror of overhanging fate, is what are you going to do with all these things?

Perhaps never before in the history of the world has a nation seemed to have achieved so much. During this century we have championed democratic political institutions. We have also championed market-oriented approaches to managing economic activities.

Indeed, we have been the great torchbearers for democracy and free enterprise. Everywhere we turn the direction is towards these two goals. We do not face the prospect of a 1930's type of depression or of the double-digit inflation of the 1970's. We do not face hostile regimes abroad like Hitler's Germany or Stalin's Russia. We have peace and remarkable prosperity.

- We are now in our 85th month of the longest peacetime expansion in our history.
- Nearly 20.5 million new jobs have been created during the current economic expansion.
- Unemployment levels have been sustained at levels not seen since the Vietnam war.
- We are in the eighth straight year of keeping inflation under 5 percent.

But the challenge for us will be not to pause and not to rest on these successes. For during the coming decade we will discover how mature we are as a people. If we are to achieve productivity growth rates that will provide for our aspirations as a nation, we will need two things.

- First, we will need to make reasoned investments in the future which will require both wisdom and a willingness to defer some current gratification.
- Second, we will have to embrace dynamism and a willingness to adjust, to adapt, and to innovate. This will mean eschewing measures which hold forth the

promise of protection from foreign competition and the security of mandated benefits.

These are great challenges for a great people. How we rise to meet them will test our maturity as a nation. I am confident we have the leadership and will summon the commitment to successfully meet these challenges. Our children and those who will follow them deserve no less.

Letter received

Smaller audience - and one
which will look for something

more warlike than the standard average
speech.

~~And that must be so~~

goal

There is

No other way to push

~~if we're serious about~~

help the homeless, live in dignity,
helping the homeless?

break the grip of

life on the streets



OFFICE OF THE VICE PRESIDENT
WASHINGTON

February 8, 1990

NOTE TO: DAVE DEMAREST ✓
ROGER PORTER
ANDY CARD
JIM CICCONI

FROM: BILL KRISTOL WK

Here's a fact sheet on product liability reform that we're distributing, as well as some draft paragraphs on the subject. Both provide material that could be included in various Presidential speeches on the legislative agenda, on competitiveness, to business audiences, etc.

I think this issue is a good one for us, and we've been working effectively with the Hill and the business community. The first hearing in the Senate Commerce committee is February 22, so it would be useful for the President to mention product liability reform once or twice before then.

cc: Chriss Winston

Speechwriter
XW



OFFICE OF THE VICE PRESIDENT
WASHINGTON

FACT SHEET ON PRODUCT LIABILITY REFORM

"Product liability reform...it's time to act together."

President George Bush
State of the Union Address
January 31, 1990

"A legislative priority for our Administration will be the reform of our costly product liability laws. The burden of our present product liability system is excessive and adversely affects our ability to compete abroad. In fifteen years, product liability suits have increased over 1,000 percent -- representing unnecessary litigation and extreme costs to American business and consumers alike. This is unacceptable, and our Council on Competitiveness, chaired by Vice President Quayle, has made product liability reform a top competitiveness priority."

President George Bush
February 6, 1990

"Our current product liability system of 50 different State laws generates excessive litigation, inflates insurance costs, and creates uncertainties for American businesses. This is a self-imposed burden on our ability to compete. It also has a chilling effect on innovation and the development of new products. Ultimately, the costs of our inefficient product liability system are borne by American workers and consumers."

Vice President Dan Quayle
November 30, 1989

An Administration Priority.

Product liability reform is a top legislative priority for the Administration. It is essential to business innovation, U.S. international competitiveness, and consumer safety and welfare.

- o In his State of the Union address President Bush called upon Congress to enact essential product liability reform legislation.

- o On November 30, 1989 Vice President Quayle announced the Administration's product liability reform initiative developed by the Council on Competitiveness. The Administration strongly supports S.1400 -- a bipartisan reform bill co-sponsored by Senators Danforth, Inouye, Kasten and Rockefeller and similar legislation in the House of Representatives, and it will seek additional reform provisions to strengthen the bill.
- o The Senate Commerce Sub-committee on the Consumer will hold hearings on S. 1400 on February 22, 1990.

Restore Basic Principles of Fairness.

The Administration's reform initiative will restore basic principles of fairness to America's product liability system:

- o First, protection of an innocent person's legal right to fair compensation for medical expenses, lost wages, property damage and other actual losses.
- o Second, payment for losses based on actual responsibility for the harm -- fault based liability -- not ability to pay -- "deep pocket" liability.
- o Third, cooperation and the prompt and fair settlement of differences should be encouraged through alternatives to costly and time consuming litigation, which only reduces the compensation available to the injured party.

Strengthen U.S. Competitiveness.

Our product liability system --with its excessive litigation costs -- is a self-inflicted burden on America's ability to compete. U.S. product liability laws are more onerous than those of other major industrial countries, such as Japan and European nations.

- o The estimated cost of product liability suits in the U.S. -- \$80 billion per year -- equals the combined profits of the nation's 200 largest corporations.
- o Total U.S. liability insurance costs are estimated to be 15 times higher than Japan's and on average 20 times higher than the European nations'. These costs are reflected in higher prices for U.S. goods and hamper our ability to compete with foreign manufacturers.

Enhance Product Innovation.

Equally devastating is the chilling effect of the liability system on product innovation. The fear of potential law suits deters businesses, especially small and start-up businesses, from introducing new and safer products.

- o Many products are no longer being produced for American consumers -- single-engine aircraft, vaccines against deadly Japanese encephalitis, and gymnastic equipment are a few examples.
- o Many companies decide against introducing new products. For example, Monsanto will not market an inexpensive, safe asbestos substitute and Genentech declined to go forward with a new hepatitis vaccine developed through biotechnology because of liability risks.
- o 36% of American businessmen in a recent survey stated that they stopped some manufacturing as a result of product liability risks. 15% laid off workers and 8% closed plants.

Reform Advances Consumer Welfare and Safety.

Safety and health considerations, the principle rationale for continuing the current system, are undermined by the current product liability regime. Consumers are not always offered new, safer products (like vaccines and the Monsanto asbestos substitute). Also, the costs of excessive liability risks are reflected in higher prices for goods and services.

- o A 1989 Rand Corporation study reveals that on average only 46% of total expenditures from tort law suits went to compensate injured parties. Legal fees and expenses consume on average of 37% of the amount spent -- in some product liability cases this figure reaches 70% of the total amount.
- o The cost of DPT vaccines rose from \$2.80 per dose to \$11.40 per dose to cover liability insurance costs.
- o In a February, 1990 Consumer News article, Bonnie Guiton, Special Advisor to the President for Consumer Affairs states "These are among the ways in which America's current product liability system works against consumers....Done properly, however, product liability reform can benefit consumers..."

The Administration will work with the bi-partisan sponsors of S.1400 and with groups from all sectors of the American public to support U.S. product liability reform that achieves improved U.S. international competitiveness for businesses and restoration of basic principles of fairness for consumers.

For more information contact:
David McIntosh 456-2816

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2/8/90

Suggested Speech Inserts on Product Liability Reform

Reform of our costly product liability laws is a top legislative priority for our Administration. The burden of our present product liability system is excessive and adversely affects our ability to compete abroad. In 15 years, product liability suits have increased over 1,000 percent -- representing unnecessary litigation and extreme costs to American business and consumers alike. This is unacceptable, and our Council on Competitiveness, chaired by Vice President Quayle, has made product liability reform a top competitiveness priority. —

We must restore basic fairness to our product liability system. A person who is injured by a product should be compensated for his or her actual losses. Liability should be based upon whether a person or company is at fault. Individuals and organizations with "deep pockets" must not be made to pay for losses that are not their fault.

You don't need a law degree to know that something is very wrong with a system in which over 50% of the money spent never gets to the injured person. Rather, it is used up in lawyers' fees, court costs, and other legal expenses. That's why I support product liability reform to encourage settlement out of court through arbitration and alternative dispute resolution.

Ultimately, the American consumer pays for the excessive cost of our inefficient litigation system. Companies abandon or severely limit the development and manufacture of important consumer products because of fear of protracted lawsuits and unfair judgments. Product liability reform is needed to preserve the health of Americans who will be worse off when they cannot obtain -- or cannot afford -- vaccines against hepatitis and other deadly diseases. Our kids will miss out on sports, if no one is willing to sell equipment like football helmets and masks. Mothers will not be able to buy car safety seats for their children, if all the manufacturers are forced out of business by skyrocketing insurance premiums. Our office buildings and schools will not be able to replace asbestos with safer products, if the fear of lawsuits prevents their introduction into our economy.

We must act together now. I call for Congress to act immediately to pass needed, bi-partisan product liability reform legislation. We must work together to restore justice, preserve our competitive edge, and promote consumer safety and welfare.

- o Raising \$239 million through Federal Aviation Administration fees for commercial airline landing rights.

Unfortunately, there is no guarantee that Congress will actually apply the new revenue to deficit reduction instead of additional spending. The sequester's spending restraints are necessary to force some discipline on government spending. Eight straight years of deficits exceeding \$150 billion, fueling a national debt topping \$3 trillion, clearly indicate that the budget process has broken down.

Contrary to popular argument, the sequester does not represent "deep and arbitrary cuts" in spending. Congress insured itself against "arbitrary" cuts when it passed GRH by deliberately exempting 64 percent of outlays from sequestration because it deemed that portion untouchable. Items such as Social Security, state unemployment benefits, programs for the poor and many others will be left intact.

The remaining 36 percent of outlays that Congress selected for reductions are evenly divided between defense and domestic programs. Defense experts have long maintained that we can get more defense with less money if serious reforms are implemented. Reforms cannot spring up overnight, but the pressure of a sequestered budget could finally spur these needed reforms.

The sequester does not really involve deep "spending cuts," since it only reduces spending growth. Those who speak of "spending cuts" are usually counting reductions in the already built-in spending increases as "cuts." Even with the full \$16.1 billion sequester reductions, the Office of Management and Budget estimates that total spending in 1990 will increase by \$20 billion.

Americans are tired of promised budget restraints that never materialize. Each year when the smoke clears on the budget agreement, America finds less and less genuine deficit reduction. The current automatic restraints under GRH could change this trend.

The Gramm-Rudman-Hollings law already sets the 1990 deficit target at \$100 billion. Without sequestration, current proposals will lead to a \$5 billion-plus tax increase, permitting Congress to meet the deficit target at a higher level of spending. Furthermore, a \$10 billion "margin of error" spending bonus creates a non-sequester deficit target of \$110 billion -- not the intended \$100 billion.

Without sequestration's real spending restraints this year, it will be even more difficult to reach next year's deficit target of \$64 billion. The current sequester provides a reasonable way to subdue spending growth and reduce the deficit without tax increases.

Paul G. Merski
Director of Tax and Budget Policy



CAPITOL COMMENT

No. 51

November 3, 1989

A TIMELY PERSPECTIVE ON CURRENT PUBLIC POLICY.

TAX INCREASE OR SEQUESTRATION ... AN EASY CHOICE!

The sequester that went into effect Monday, October 16 at midnight is the best budget prescription to avoid more than \$5 billion worth of tax increases. It would help guarantee that necessary deficit reductions are made to comply with the \$100 billion 1990 Gramm-Rudman-Hollings (GRH) deficit target. Few budget analysts would view a sequester as the best form of budget management, but many would agree that it is better than a tax increase and would yield more deficit reduction than the budget reconciliation bill drafted by Congress.

Chairman of the House Ways and Means Committee Dan Rostenkowski (D-IL) likes the idea of letting the ax fall: "It can result in more real deficit reduction than we will ever achieve from the budget reconciliation bill," he said. Past budget agreements relied heavily on accounting tricks, one-time savings, smoke and mirrors, and broken promises to exercise more fiscal restraint in the future. The 1990 reconciliation legislation currently in the pipeline is no exception.

For example, both the House and Senate versions propose to remove the U.S. Postal Service's operating budget from the federal budget and count that as almost \$2 billion in savings. The sequester prevents such deception by imposing real reductions in the growth rate of federal spending. Sequestration will certainly make it easier to reach the 1991 deficit target of \$64 billion without relying on tax increases, since the 1991 budget would start with a much lower spending baseline.

Without sequestration, tax increases in current reconciliation legislation will raise \$5.3 billion in 1990 and will cost \$26 billion over the next five years. This \$5.3 billion will be added on top of an estimated \$85 billion increase in federal revenues for 1990. Items in the \$5.3 billion tax increase include:

- o Extracting \$851 million by extending airport and airway taxes.
- o Increasing the international air-passenger departure tax from \$3 to \$6 a person, and placing a \$3 per passenger tax on international departures by commercial ships.
- o Raising an additional \$43 million by increasing existing fees charged by the Federal Communications Commission and establishing new fees.

billion over the next five years. The Ways and Means Committee plan would bring in additional revenues averaging almost \$5.5 billion each year between 1990 and 1994, supplementing the new revenue already expected.

This year's Ways and Means tax proposals may seem innocuous because they are narrow in scope. For example, the committee has proposed to raise more than \$1.4 billion next year by making employee stock ownership plans (ESOPs) more expensive to adopt. However, the tax bill increases revenues in later years and could encourage more spending as the Gramm-Rudman-Hollings targets fall from \$100 billion this year to zero by 1993. The ESOP provision alone will raise \$11.5 billion over the next five years.

Through the 1980s, tax increases have fueled spending and have failed to reduce the deficit. Since 1980, revenues grew by almost \$480 billion. The deficit remained a problem because spending grew even faster, increasing by \$553 billion.

Capital Gains Tax Cut. The best way to reduce the deficit is to reduce spending. However, a cut in the capital gains tax provides an alternative means to raise revenue to help satisfy the budget resolution without the long-term revenue windfalls typical of tax increases. Revenues will rise in the short run because high tax rates currently discourage investors from collecting profits on the investments they hold. The tax cut could also increase savings and investment, which could fuel economic growth and create new jobs.

Sequestration. If Congress still cannot reduce the deficit to \$110 billion, Gramm-Rudman-Hollings could force the fiscal discipline necessary to reduce the deficit without tax increases. A sequester could result in significant inroads on the deficit. The Office of Management and Budget's deficit estimate is \$6.2 billion above the amount necessary to trigger automatic spending restraints.

Unless Congress finds additional spending restraints, accounting gimmicks, or tax increases, the sequester will lower the deficit to \$100 billion in October. A sequester eases the task of future deficit reduction by canceling Congress' authority to spend money on certain programs. This would lower spending in the budget baseline, the starting point for computing deficit reduction each year. Without a sequester, spending can exceed the year's deficit target by at least \$10 billion. According to the CBO, the current path of spending will require Congress and the administration to reduce the deficit by \$63 billion next year.

Unless Congress and the president hold the line on taxes now, controlling the growth of spending and meeting Gramm-Rudman-Hollings deficit targets will be even more difficult over the next four years.

David Makarechian
Project Director



CAPITOL COMMENT

No. 47

September 19, 1989

A TIMELY PERSPECTIVE ON CURRENT PUBLIC POLICY.

DEFICIT REDUCTION OPTIONS

Some policymakers have renewed calls for tax increases because of pressure to fund drug programs and the Office of Management and Budget's \$116.2 billion estimate of the 1990 deficit. However, with revenues expected to grow substantially over the next five years, lawmakers can fund priority programs and reduce the deficit without a tax increase. Congress has at least three options to help reduce the 1990 deficit to avoid automatic spending restraints under the Gramm-Rudman-Hollings law. Tax increases or a cut in the capital gains tax will raise revenue and help implement this year's budget agreement, but only spending restraint will make deficit reduction easier next year.

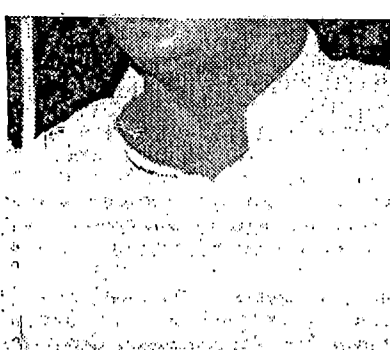
Tax Increases. Unfortunately, the Ways and Means Committee has already approved some tax increases in the budget reconciliation bill. The bill offsets a variety of tax credits, funds a new child care program, and refinances the Medicare catastrophic health care program with tax increases worth more than \$27 billion over the next five years. Tax increases to help meet Gramm-Rudman-Hollings targets will fuel the growth of spending and make future deficit reduction more difficult.

The Ways and Means Committee's tax bill will only add to the increased revenue expected from existing tax laws and economic growth. The Congressional Budget Office (CBO) projects revenue to rise by more than \$80 billion between 1989 and 1990, and to increase by more than \$72 billion annually between 1990 and 1993.

Rising revenue permits increased spending. Under the Gramm-Rudman-Hollings law, Congress can spend the sum of the annual deficit target and expected revenues in each of these years, plus a \$10 billion "margin of error." For example, in February the CBO estimated that total revenues for 1990 would be \$1.069 billion. The deficit target for 1990 is \$100 billion, plus a \$10 billion "margin of error." The sum of these figures, \$1.17 trillion, is amount that legislators agreed to spend.

The committee's tax bill will signal a continuation of growth in government spending. Since the Gramm-Rudman-Hollings law has determined the maximum deficit for 1990 through 1993, the increased revenues from the committee's tax bill will simply allow Congress to meet the Gramm-Rudman-Hollings target at a higher level of spending.

If legislators spend the maximum allowed under the Gramm-Rudman-Hollings law, the tax bill could increase spending by \$27.5



Associated Press

The Indian opposition leader, Vishwanath Pratap Singh, was expected to win in his district.

Key Technology Might Be Sold To the Japanese

By DAVID E. SANGER
Special to The New York Times

TOKYO, Nov. 26 — In a deal that would leave the United States almost wholly dependent on Japan for the chief tools used to produce future generations of computer chips, Japanese companies are negotiating to acquire one of the last American makers of the highly sophisticated equipment used to etch circuits on chips.

The Nikon Corporation is viewed as the leading bidder for the Perkin-Elmer Corporation's semiconductor equipment. Any sale of the company's operations to a foreign purchaser would require President Bush's approval. But officials on both sides of the Pacific say Washington may have little choice because so far efforts by Perkin-Elmer to find an American buyer have failed.

Perkin-Elmer's biggest customer, the International Business Machines Corporation, which is also the world's largest chip maker, has become enmeshed in the debate.

I.B.M. Is Not Interested

I.B.M. has been aiding Perkin-Elmer in its attempts to keep the company's operations, and its technology, in American hands. "I.B.M. and, I'm sure, others in the U.S. semiconductor industry are hoping that there is a scenario that keeps Perkin-Elmer viable as a source of semiconductor equipment in the U.S.," Jack D. Kuehler, I.B.M.'s vice chairman, said in a telephone interview from the company's headquarters in Armonk, N.Y., last week.

But I.B.M. says it does not have the expertise or the desire to enter the tool-making business itself and would not buy the operations, even though it has helped finance many of Perkin-El-

Continued on Page D5, Column 1

INSIDE

A Threat in Lebanon

The nation's new President, Elias Hrawi, threatened to use military force against Gen. Michael Aoun, the hard-line Christian military commander, who disputes the presidency and controls sizable forces. Page A14.

Companies Look Abroad

With some reluctance, small American companies are expanding overseas operations, moving beyond shipping goods to setting up operations in foreign countries. Page D1.

Whose Right to Die?

The Supreme Court will hear arguments Dec. 6 on whether a Missouri couple can remove a feeding tube from their comatose daughter so she can be allowed to die. Page B9.

Coalition Seems Only Chance for Him to Keep Power — Own Seat Is Uncertain

By BARBARA CROSSETTE
Special to The New York Times

NEW DELHI, Monday, Nov. 27 — Prime Minister Rajiv Gandhi and his Congress Party appear to have lost their majority in the Indian Parliament and will be out of power unless they form a coalition government, according to early results in the country's most violent national election, which ended on Sunday.

With no party likely to win a clear majority, both the Congress Party and the opposition National Front were claiming the right to try to form a government. This raised the possibility that India will face a political standoff in the next few weeks, if not a constitutional crisis, and that there will be calls for a fresh election.

A Negative Verdict

Indians delivered a heavily negative verdict on their leaders, voting against the Congress Party where it was strong, primarily in the north, and against opposition parties where they were in power in southern states. Several ministers and the Congress Party's Speaker of the House were defeated; one politician summed up the election as "an anti-establishment vote."

Mr. Gandhi's own contest in the Amethi constituency, which was marred by vote-rigging and violence, remained in doubt early today. Because of violence and allegations of "booth stealing," a practice in which polling places are raided by armed gangs and ballot boxes stuffed, the election commission invalidated 18 percent of the vote in the constituency and ordered new polling to take place today in 97 voting precincts there.

Uncertainty for Gandhi

It will not be known until late today, when the new voting is complete, whether the Prime Minister has retained his own seat. If he ends up losing it, he will not be able to lead his party as Prime Minister unless he can win a special election in another constituency. Should Mr. Gandhi lose, the Congress Party parliamentary caucus could choose another leader.

Even if the Prime Minister wins his

Continued on Page A8, Column 1



The opposition leader Vaclav Havel, left, greeting Prime Minister

Hungarians Hold First Free Vote In 42 Years, Shunning a Boy

Photo Copy Preservation
By HENRY KAMM
Special to The New York Times

BUDAPEST, Nov. 26 — In the first free national vote in 42 years of Communist rule, Hungarians went to the polls today for a referendum on when a presidential election will be held.

Contrary to pessimistic forecasts, they did so in sufficient numbers to make the referendum valid, insuring the failure of the ruling party's silent boycott of the referendum. The vote was forced by some of the country's new opposition groups, although it was opposed by others.

Initial though inconclusive returns had a majority of voters upholding the ruling party's plan to hold the presidential election on Jan. 7 while it still has the reins of Government. Opponents of the plan want the election held after free multiparty elections for Parliament next spring.

By mid-evening, a heavy snow began to fall in Budapest and the northeast of the country, delaying the delivery of ballot boxes to counting centers.

Participation of at least half of Hun-

gary's 7.8 million voters was to make the referendum valid hours after most polling closed, the national election commission announced that an estimated 60 percent of eligible voters took part.

Election officials said many voters were unfamiliar with voting procedures and asked how to fill out ballots. After four decades of rule by the Communists, some voters asked what answers to give to questions on the timing of the election and three other issues.

Parliament Election in Spring

"We wanted to take into account the possibility of deciding the people's future," Imre Lőrinc, a printer, told The Associated Press after voting. But others were skeptical about the referendum, and one unemployed man said many people considered the referendum a waste of time.

Continued on Page A11, Column 1



Nikon in Talks to Buy Key Perkin-Elmer Unit

BUSINESS PEOPLE

Apple Computer One of Its Pioneers

Continued From Page 1

mer's most advanced technologies.

The story of how the United States has gradually withdrawn from the semiconductor equipment business over the last five years is a familiar one for America's high-technology industry, with echoes of past retreats in television equipment, facsimile machines, steel and some automotive technologies.

As before, the technology was pioneered in the United States, yet the American advantage was eroded and eventually eliminated. The explanation is partly Japanese excellence in engineering and manufacturing.

But the Japanese corporations have also been aided considerably by a financial system that supplies low-cost capital and applies little pressure on companies to generate near-term profits, making it far easier for them to invest in research and development.

Some experts warn that the possible loss of the semiconductor machinery business could be the biggest loss of all, because the tools to make semiconductors are the first step in a "food chain" that leads to the production of more than \$50 billion worth of chips around the world and \$700 billion in electronic goods.

Technology Born in U.S.

The technology to mass-produce chips — a process known as photolithography, in which the image of millions of circuits is projected on a silicon wafer much the way an enlarger casts an image on photographic paper in a darkroom — was developed largely in the United States. Perkin-Elmer, based in Norwalk, Conn., was regarded as one of the industry's most stable technological leaders. But as circuits have shrunk to sub-micron widths, hundreds of times thinner than a human hair, the complexity and cost of developing the principal equipment, known as steppers and aligners, have overwhelmed American manufacturers.

Today the machines, which cost \$1 million to \$2 million each, mix sophisticated optics with precise robotics and computer controls, all areas in which Japanese companies have particular expertise. A dozen to 50 steppers are needed to equip a production line, and the pace of innovation makes each generation of machinery outdated in three years or less.

Nikon and Canon Inc., which a decade ago were not in the business, have invested heavily in the technology, at times absorbing large losses and tak-



The Nikon Corporation is viewed as the leading bidder for the Perkin-Elmer Corporation's semiconductor equipment. Nikon technicians calibrating equipment at a chip-printing plant in Kumagaya, Japan.

Mitsubishi Estate Company, which recently bought control of Rockefeller Center.

"Generally speaking, under the present political situation it will be very difficult for any company outside the United States to acquire Perkin-Elmer," Nobuo Ito, head of Nikon's semiconductor equipment division, said on Friday in his office overlooking Tokyo's Imperial Palace. "Even if we obtained the Government's permission, there is the issue of public sentiment."

People with close ties to those involved in the negotiations, however, say they believe it is now inevitable that a foreign company will purchase Perkin-Elmer's operations, or perhaps form a joint venture. That would allow Perkin-Elmer to retain the appearance of control, while a Japanese concern put up capital and research and development funds in exchange for the company's technology.

"No one questions that Perkin-Elmer's technology is quite good," said Etsuro Ogisu, an analyst for UBS Phillips & Drew in Tokyo. "Nikon and Canon could both benefit from it."

Steppers are hardly the only area of semiconductor production in which the United States is losing corporate control of the technology. Earlier this year another foreign company, Huels A. G. of West Germany, purchased the Monsanto Company's silicon wafer operations, a sale the White House approved on the theory that foreign acquisition was better than having the business shut down. Other smaller companies have also been sold to the Japanese.

Who Else But Japan?

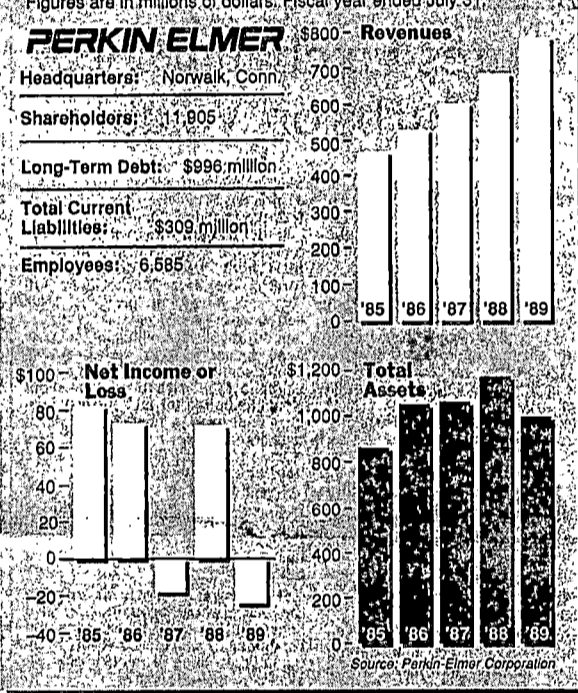
"We are heading into an era in which all sorts of rarefied technology will be needed to make chips," including the use of lasers and X-rays to make chips instead of ordinary light, an expert here said recently. "It will cost hundreds of millions of dollars in R.&D. Who can afford to do it other than Japan?"

The sudden loss of major American suppliers, however, is precisely the situation the Defense Science Board warned against in a 1987 report to the Pentagon. Board members said at the time that once the technology moved abroad, the Defense Department and American electronics makers would be forced to obtain crucial production technologies from some of the companies they are competing against for the chips themselves. While no one predicts that Japanese companies would cut off the technological pipeline, they could slow delivery long enough to assure that Japanese-made chips remain a half-step ahead.

Commission members compared the industry to the first links in a food chain, saying that if those links are cut others on the chain are doomed. Sematech, a Government-backed

A Survivor in High Technology

Figures are in millions of dollars. Fiscal year ended July 31.



consortium that hopes to revive America's skills in manufacturing semiconductors, was partly created to save the makers of chip tools. In recent weeks, however, the Bush Administration has debated ending its support for such programs, fearing that they smack of "industrial policy."

The impending sale of the Perkin-Elmer unit has drawn great concern at I.B.M., which has worked closely with Perkin-Elmer for more than 20 years. The giant computer company is the only American company now mass-producing the 4-megabit memory chip, the most advanced in the industry. And for several years it has been providing financing and technology to Perkin-Elmer for the development of a specialized stepper — called "Tool X" by I.B.M. and now installed only at its chip-making laboratories in Burlington, Vt. — that one industry executive said last year would not only regain ground against Nikon but "blow away" the Japanese makers.

"Tool X" is regarded as so sensitive that at an annual semiconductor

equipment show here in Tokyo last week, Perkin-Elmer showed only a model of the machine and gave out scanty technical details. Under its contract with I.B.M., Perkin-Elmer must fill the computer maker's needs for the hardware before selling it to any other chip maker.

The semiconductor unit represents about 40 percent of Perkin-Elmer's business. Scientific Instruments account for a good part of its other revenues.

If the Perkin-Elmer unit is sold to a foreign company, it will leave only smaller concerns, like the General Signal Corporation, with any noticeable slice of the market for steppers and aligners. And executives at those companies admit to tremendous difficulties keeping pace.

"The whole cost of capital is lower in Japan and the industry is structured so that they are free to invest without getting a short-term return," said Ray Campbell, the president of Ultratech Stepper, a unit of General Signal. "Are we falling further and further behind? There is no question about it."

Delbert W. Yocam, who held several key posts as Apple Computer Inc. rose from a perky startup concern to a multibillion-dollar computer vendor, left the company Friday after 10 years.

Mr. Yocam, who is 45 years old and most recently was head of Apple's Pacific division, announced more than a year ago that he would depart this month to pursue new opportunities.

Mr. Yocam was one of the last remaining links to the early Apple founded by Steven P. Jobs and Stephen Wozniak. His going-away party, held a week ago in a company parking lot, was attended by all three men who have served as Apple chief executive: Michael Scott, A.C. (Mike) Markkula and John Sculley, the present chief. (Neither Mr. Jobs nor Mr. Wozniak formally held the chief executive's title.)

Mr. Yocam joined Apple in 1979 as director of materials, after stints with the Ford Motor Company, the ITT Corporation and the Fairchild Camera and Instrument Corporation. In his book, "Odyssey," Mr. Sculley described Mr. Yocam as "California laid-back" and as a "precise and orderly manager who followed up on the meticulous notes he'd kept in a maroon notebook."

From 1983 to 1985, Mr. Yocam was the general manager of the Apple II division. Despite being the company's main source of revenue, the division was overshadowed by the new Macintosh division, which was run by Mr. Jobs. That led to low morale in the Apple II division and contributed to

the evolution of

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Chairman Is Named At NCNB Texas

Timothy P. Hartman, the vice chairman of the NCNB Texas National Bank since it was set up by the NCNB Corporation 15 months ago, will become chairman of the unit on Jan. 1.

As chief financial officer at NCNB, in Charlotte, N.C., he is credited with coming up with the favorable tax deal that led it in 1988 to acquire the largest banking franchise in Texas, the First Republicbank Corporation, which became NCNB Texas.

Mr. Hartman, who is 50, will succeed Francis B. (Buddy) Kemp 3d, 49, who is resigning for health reasons and returning to NCNB's Charlotte headquarters.

Kenneth D. Lewis, 42, a 20-year NCNB banker, will stay as president of NCNB Texas, which provides about half of the NCNB parent's annual earnings and \$60 million in assets. Mr. Lewis is responsible for day-by-day operations.

Mr. Kemp, who underwent neurosurgery during the summer, "will continue with the company and be available to me as needed," said NCNB's chairman, Hugh McColl, in a statement. He added: "Buddy is a wonderful man, a wonderful leader, a wonderful friend. I must, very reluctantly, respect his decision."

Mr. Hartman takes over the helm of an institution that is extraordinarily well-positioned to be the largest bank in Texas and one of the most profitable as well. Under the deal made with the Government for First Republicbank, NCNB received billions of dollars in tax write-offs and long-term incentives to manage and sell problem assets, the majority of which involve real estate.

Miffed by the Government's decision to sell First Republicbank's credit card business to Citicorp, NCNB Texas has built in one year a credit card business worth several hundred million dollars by offering rates up to 2 percent below the market, analysts said.

In October, the NCNB Corporation acquired the operations of two insolvent savings institutions, the University Federal Savings Association in Houston, and the Freedom Savings and Loan Association in Tampa, Fla. With the deals, NCNB, the nation's ninth-largest banking company, added \$4.6 billion to its deposit base of

more th \$1.2 bil assets.

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The impending sale is causing great concern at I.B.M.

ing advantage of the fact that more and more of the world's chips are produced by Japanese companies with which they have longstanding relationships.

Taken Over the Market

Nikon has taken over the market for the most sophisticated steppers, which get their name because they move across a silicon wafer a step at a time, exposing a number of chips and moving on. Nikon's semiconductor-related business has become so big that last year it accounted for more than half the company's \$1.9 billion in sales, overtaking revenues derived from the camera equipment that made the company's name world famous.

So far no formal bids for Perkin-Elmer have been disclosed, and neither Perkin-Elmer nor its Japanese suitors will confirm publicly that they are in discussions. When Perkin-Elmer first put its semiconductor unit up for sale in April, it said it was aware of the national security concerns and expected no problem finding an American buyer. When no satisfactory bids appeared, Goldman, Sachs & Company, the company's investment adviser, reportedly began looking overseas.

Nikon makes little secret of its interest but says it fears a backlash in the United States. Nikon is part of the Mitsubishi Group, also owner of the

Small U.S. Companies Are Going Global, Setting Up Overseas Operations

Continued From First Business Page

lives, Mr. Plumley contends that operating overseas is essential to stay competitive in the domestic market

The move abroad may worsen the nation's trade

Without one, foreign companies will have room to introduce similar systems and then invade Avid's American market. "By being successful, you create a big billboard that says, 'This market exists and here's how to address it,'" Mr. Warner said.

merce. "If your first experience with foreign competitors is right here at home, you might not survive."

Will-Burt's first experience with foreign competitors, in fact, almost cost the company its main business, manufacturing truck and tractor

Foreign joint ventures can be hazardous.

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WORLD WIRE

AID FROM JAPAN

Japan appears set to present the outline of its long-awaited aid program for Poland and Hungary to a meeting of the world's 24 richest democracies in Brussels this week.

The 24 nations will meet Friday under the auspices of the Organization for Economic Cooperation and Development to discuss aid for the two East bloc countries. But it remains uncertain whether Tokyo will announce the exact size of its package. "The total cost may have to be revealed gradually," said Takehiro Togo, a Foreign Ministry official.

According to Mr. Togo, the Japanese package would likely be in three parts: food aid for Poland, longer-term help for both nations to help restructure their economies, and contributions to a \$1 billion fund that Poland has requested to stabilize its economy and currency.

Mr. Togo said that among measures planned for early implementation is inviting Poles and Hungarians to Japan for management training.

VIOLENCE IN SWEDEN

The incidence of brutal robberies, rapes and assaults is growing in Sweden, which used to pride itself on the safety of its streets. Police received 4,226 complaints of outdoor assault in the first nine months of this year, 477 more than for the same period in 1988. Native Swedes point a finger at immigrants: Stockholm police figures showed that men of foreign extraction were responsible for two-thirds of assault cases solved by police. But alcohol, drugs, violence on television and parental apathy are also blamed.

ASIAN FAST FOOD

McD's

A United Nations report says American fast food has made major inroads across Asia. "Fast food is the latest megatrend in Asia . . . as the people begin to have less and less time for a formal meal," says the report. According to the study, U.S. fast-food chains are most prevalent in Japan, where there are 350 McDonald's franchises. Adds the report: "Having experienced the clean and cool atmosphere of fast-food restaurants, children refuse outright to eat at hawkers' stalls, though the food there is much more delicious and priced more cheaply."

EAST GERMAN TOURISM

East German Premier Hans Modrow selected Liberal Democrat Bruno Benthien to head the Ministry for Tourism, a new post. The appointment is seen as an indication East Germany plans to expand tourism to earn sorely needed hard currency now that its borders have been thrown open for its own citizens to travel freely. One stumbling block: Hotels are few in large cities and practically nonexistent in the rest of the country.

JET JOINT VENTURE

Japan is sending a team to France, Britain, West Germany, the Netherlands and Italy to explore possibilities for joint production of small commercial jets. The groups will comprise representatives from the Ministry of International Trade and Industry and three airplane makers—Mitsubishi Heavy Industries Ltd., Fuji Heavy Industries Ltd. and Kawasaki Heavy Industries Ltd. A ministry official said the team will visit at least one airplane company in each of the

nations and discuss collaborating on production of 75-passenger compact jets.

AUSTRALIAN AFFLICTION

Summer is coming in the Southern Hemisphere, and Australians are heading for the beach. But this land of 17 million is paying a price for its sun-bronzed image: Australians have the world's highest per capita incidence of skin cancer.

Of those who have spent all their lives in Australia, two out of three will develop skin cancer by age 70, cancer experts say. "The trouble is most of us are white, which is exactly the wrong color for living here," said Anna Voloschenko, an official of Queensland's Cancer Fund.

Australia had about 145,000 skin-cancer cases reported in 1988. The latest statistics show 1,027 Australians died from skin cancer in 1987, up from 897 in 1986 and 835 in 1983.

The incidence of malignant melanoma in Australia is nearly double that of New Zealand, three times higher than Norway, four times that of Sweden and 12 times the rate in Britain.

POSTSCRIPTS . . .

Warsaw workmen tore down a statue of Feliks ("Bloody Feliks") Dzierzynski, the Polish founder of the Soviet security police, and jubilant Poles dismembered the remains with hammers. "I've got his nose," one man shouted. . . . The Norwegian Foreign Ministry is searching for relatives of Olga Johnson, a widow of Norwegian descent from Montana who died and left an unclaimed million-dollar fortune. "We often get cases like this," said a ministry official, "but this is an unusually large amount."

—Compiled by William Mathewson

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FREE TRADE: PROTECTIONISM A Banana Into a Cage of Monkeys'

Sept. 2 was the 150th anniversary of the birth of Henry George. George is best remembered today for his advocacy of the "single tax" on land—a social reform that attracted a cult following a century ago. But he was also a brilliant propagandist for free trade, most notably in his 1886 work, "Protection or Free Trade." C. Lowell Harriss, emeritus professor of economics at Columbia, collected some of George's pithiest remarks in the July issue of the American Journal of Economics and Sociology:

It might be to the interests of [lighting] companies to restrict the number and size of windows, but hardly to the interests of a community. Broken limbs bring fees to surgeons, but would it profit a municipality to prohibit the removal of ice from sidewalks in order to encourage surgery? Economically, what difference is there between restricting the importation of iron to benefit iron-producers and restricting sanitary improvements to benefit undertakers?

To introduce a tariff bill into congress or parliament is like throwing a banana into a cage of monkeys. No sooner is it proposed to protect one industry than all the industries that are capable of protection begin to screech and scramble for it.

If to prevent trade were to stimulate in-

dustry and promote prosperity, then the localities where he was most isolated would show the first advances of man. The natural protection to home industry afforded by rugged mountains-chains, by burning deserts, or by seas too wide and tempestuous for the frail bark of the early mariner would have given us the first glimmerings of civilization and shown its most rapid growth. But, in fact, it is where trade could best be carried on that we find wealth first accumulating and civilization beginning. It is on accessible harbors, by navigable rivers and much traveled highways that we find cities arising and the arts and sciences developing.

The result [of trying to enact laws that would protect only those industries that it is theoretically justifiable to protect] is the enactment of a tariff which resembles the theoretical protectionist's ideas of what a tariff should be about as closely as a bucketful of paint thrown at a wall resembles the fresco of a Raphael.

All experience shows that the policy of encouragement, once begun, leads to a scramble in which it is the strong, not the weak; the unscrupulous, not the deserving, that succeed. What are really infant industries have no more chance in the struggle for governmental encouragement than in-

fant pigs have with full grown swine about a meal tub.

However protection may affect special forms of industry it must necessarily diminish the total return to industry—first by the waste inseparable from encouragement by tariff, and, second by the loss due to transfer of capital and labor from occupations which they would choose for themselves to less profitable occupations which they must be bribed to engage in. If we do not see this without reflection, it is because our attention is engaged with but a part of the effects of protection. We see the large smelting-works and the massive mill without realizing that the same taxes which we are told have built them up have made more costly every nail driven and every needleful of thread used throughout the whole country.

To have all the ships that left each country sunk before they could reach any other country would, upon protectionist principles, be the quickest means of enriching the whole world, since all countries could then enjoy the maximum of exports with the minimum of imports.

What protection teaches us, is to do to ourselves in time of peace what enemies seek to do to us in time of war.

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The Treasury's new economic forecasts came as a bigger surprise. Across the board, they are a good deal gloomier than those of outsiders: GDP growth next year of 1¼% (compared with the City's average guess of 2%); inflation of nearly 6% in the fourth quarter of 1990 (against a City consensus of 5%); a current-account deficit of £15 billion to follow this year's £20 billion (the City says £13½ billion on the heels of £17½ billion). That looks bad enough, but there's worse. Exclude oil, and the Treasury is expecting the economy to grow by just ¾% in 1990, after growth (on the same basis) of 3% in 1989. This is a hard landing by any standards, and a full-blown recession is well within the forecasters' margin of error.

As this vision unfolds, the holes in the government's economic strategy will again loom into view. As demand crumples, output is likely to follow, at least for a time. Indeed this is already happening: in September, manufacturing output surprised the forecasters by falling no less than 1.1%. Soon the

groans of Britain's businessmen will be howls of protest. Cut interest rates to prevent a slump, they will say, and Mr Major will be sorely tempted to oblige. To do so before inflation is beaten would risk a collapse in sterling. But if the pound falls, the Treasury's uninspiring goal of inflation at less than 6% by the end of next year will itself be in jeopardy.

In other words, the immensely damaging conflict between Mr Lawson and the prime minister over monetary policy is wholly unresolved. Mr Major might have used his autumn statement to state his position—to say, when forced to choose, whether he will use interest rates mainly to influence domestic demand, or mainly to keep the pound stable. He decided to say nothing, offering only the usual platitudes about the government's determination to get inflation down. Next spring, when he presents his first budget, he will have to say much more about his plans for monetary and fiscal policy. If the markets let him stay on the fence in the meantime, rather than punching him off it, he will be lucky indeed.

America's Japanophobia

Seeking revenge on Japan is not only mistaken, it also risks hurting America as much as it hurts the Japanese

ECONOMIC nationalism—and its modern American form, blaming Japan for everything—has long been popular on Capitol Hill. So far, the conversion of nasty words into protectionist action has been thankfully slow and rare. But the flames of anti-Japanese sentiment are now being fanned by a more worrying and dangerous group: the American press. More worrying because the press is lending credibility to quarter-baked economic thought and is turning misunderstandings and exaggerations into supposed facts. Dangerous because it threatens to influence public opinion exactly when the risk of words turning into actions becomes intense: when, after eight buoyant years, America's economy slows down and even risks sinking into recession. For it is in hard times, when unemployment is rising and profits are slumping, that the ghosts of the 1930s' depression-through-protectionism walk abroad.

In the past few months more and more American publications—including *Business Week*, *Newsweek*, the *New York Times* and the *Washington Post*—have played host to views that Japan's markets are closed, that Japanese institutions are "buying up" or "invading" America, that Japanese investment is bad and that Japanese perfidy is responsible for much of America's trade deficit. As a remedy, the latest issue of the *Atlantic Monthly* proposes a 20-25% across-the-board tariff on imports from Japan.

This, and pressure of the conventional Capitol Hill sort, is goading the Bush administration towards a tougher trade policy. No official is yet proposing a tariff, but what they seem to be touting is even less sensible than that: a return to "voluntary" export restraint by Japan and artificial attempts to make Japan import more second-rate American goods. Japanese officials already feel obliged to twist arms in the country's car industry to make it abandon or scale down new in-

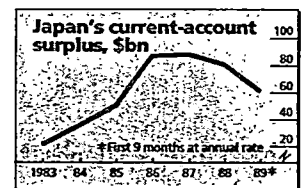
vestments that might sustain or increase exports. Mistaken though a tariff would be, at least it would go to the American taxpayer while prices would be left free to drive markets.

The view of Japan that is buzzing around America uses a mistaken premise to yield a misguided and damaging conclusion. The premise is that Japan's economy and society work in a way so different from other developed countries that Japan must be handled differently from other trading partners. The conclusion is that the method should be "managed trade", the bilateral negotiation of levels of exports and imports between governments, sector by sector. The unstated and untested assumption is that this would be good for America.

Different, but not that different

Japan is indeed different from other countries. It would be duller if it were not. But it is not so different that it has repealed the laws of economics. Its political structure is unusual: the same party in power for 40 years, a weak prime minister, bureaucrats ruling the roost, close relations between big business and the government, even a surprisingly prominent role for gangster groups. Many anecdotes show how such powerholders do their best to enrich themselves and to maintain their hold on power (nothing irrational about that), and how those efforts can involve protectionism. But listing such anecdotes and describing that power structure is reminiscent of reports about America written by Russian journalists during the cold war: accurate but grossly misleading.

The fact is that Japan's economy does respond to market forces. Japan is the most brilliant follower of market forces in the world. Its success since the 1950s has lain precisely in an ability to spot what it is competitive at making, and then to make lots of it and well. Its consumers are as eager as any other consumers to buy nice things at low prices. In a few



cases, protectionist rules (such as a ban on rice imports) deny them that option. But mostly they buy what impresses them.

That is why, now that many Japanese feel rich, they are responding to wealth just like other rich people: they are buying West German cars, Italian suits, American hand-made shoes, holiday trips to the South Pacific. The strong yen has since 1985 brought in a flood of imports of manufactures, mainly from other alert Asian countries. That is why Japan's current-account surplus has fallen by 30% from its peak in 1987. It is also why Japanese firms have been rushing to build factories abroad: faithful to market forces, conscious of the hot pursuit of Asian "dragons", they know that in many industries it is no longer competitive to manufacture in Japan.

The adjustment in Japan's trade surplus is taking place, though slower than many Americans would like. Its progress is slowed by America's own insistence on keeping its savings low and its domestic demand strong with a budget deficit that

is partly financed abroad. Once that deficit goes, or once there is an American recession, the change in the trade picture will be rapid indeed. But recession may lead misinformed Americans to respond in exactly the wrong way: by blocking Japanese imports on the assumption that this will help American industry reassert itself.

It will not. American business is not simply the victim of unfair "structural impediments" in the Japanese market. Look at the world market, which must be considered a level playing field for any industrial contest between America and Japan. That is where Japan's prowess can be fairly judged. There—and not just in the bilateral tally—is where America's trade performance disappoints. American business needs the stimulus of open competition to have any chance of keeping up with the world's best. Better to run against the reigning champions than to feel good in your own, second-rate, insulated Olympics.

Ninth time normal

Photo Copy Preservation



This Indian election is the first fought between equals, undistorted by crisis

WHEN India goes to the polls next week, it will twice give the lie to pessimists about the third world. The first way is familiar. For the ninth time since India became independent, its voters will be deciding in a free election whether to keep the present rascals in power or give a different lot a try: proof again that poverty in the form of a GDP per head of \$300 a year and a 55% illiterate population is no bar to democracy. If events turn out a bit messy, don't be too censorious: with half a billion people going to the polls, it is as though all the countries of North America and non-Soviet Europe were voting at once—which might turn out worse than messy.

The second cheering aspect of India's election is new. All those previous polls were either foregone conclusions, with the Nehru family's powerful Congress party facing a fractured opposition, or referendums on some national cataclysm (like those in 1977, after Indira Gandhi's "emergency rule", and in 1984, after her assassination). This time Mr Rajiv Gandhi's Congress party has to contend with a united opposition under one of his former cabinet ministers, Mr Vishwanath Pratap Singh. There are issues, but no crisis. This election is, in short, a contest between two credible alternative governments. India has grown up.

That does not seem to be a help to Mr Gandhi, perhaps because he has not satisfied early expectations. The India he inherited from his murdered mother five years ago was a disappointment, at least in economics. Choked by nearly four decades of socialist orthodoxy, red tape and corruption, it was performing far below the potential its high savings rate and its wealth of physical and human resources gave it.

The economy still performs beneath itself. But even the modest liberalisation that Mr Gandhi went for during his first two years in office has borne excellent fruit. Real GNP has grown each year by 6%, manufacturing output by nearly 9%, export volumes by 10% (for decades that rate had been 3%).

These are not dry figures for millions of Indians who have started to enjoy colour televisions, cars and other consumer goods they could not have even dreamed of ten years ago.

Yet the voters' material well-being does not seem to be uppermost in their minds. If President Bush had problems with "the vision thing", Mr Gandhi has problems with "the values thing". This is why he is struggling to stop the election slipping away from him (see page 35). City-dwelling Indians tell the opinion pollsters that, while they have more consumer goods, and though they believe their children's lives will be better than their own, they think their own parents led better lives than they do. This curious mix of relative prosperity, optimism and disgruntlement partly reflects the confusion that comes with any rapid change. But it also shows how Mr Gandhi has failed to stand for the kind of society and government many of his countrymen want.

Singh's song

This is where the opposition's campaign has been most effective. Mr Singh and his men talk about the subversion of institutions like the judiciary and the civil service, and about the government's manipulation of religious strife. Above all they talk about Bofors: a defence-procurement kickback scandal that has become the symbol of the corruption that stretches without interruption from the top of the Congress party to its nastier lower reaches in the poor countryside.

The hapless Mr Gandhi inherited much of this trouble from his mother's nose-in-air rule. Yet the haplessness is his own failure. He has been indecisive and inconstant. He liberalised the economy for two years, then lost interest; he agreed on a deal to solve Punjab's vicious Sikh-Hindu conflict, then reneged on it when it seemed electorally expedient to do so. Most serious, he fulminated against his own party's bossism and corruption four years ago and then did nothing

Taxed Beyond April 15

Readers feeling the bite of this week's tax deadline may be interested to know that the Tax Foundation has come up with an ingenious way to quantify their pain. The Washington-based group has calculated the number of days in the working year the average American must work to pay off the government. This year, Tax Freedom Day comes on May 5—that is, the average American will work 125 days, the equivalent of Jan. 1 to May 5, before he is free of all federal, state, and local tax obligations. And Tax Freedom Day comes later every year; you have to go as far back as 1965 to find the time when Tax Freedom Day coincided with our current tax deadline, April 15.

For masochists, the Tax Foundation has gone an additional step and listed Tax Freedom Days for individual states. Citizens of the District of Columbia and New York will find their suspicions confirmed; with the Tax Freedom Dates of May 23, these spots earn first and second place for inflicting the highest average of federal, state, and local taxes on their citizens. By the Tax Foundation count, New York lags the District of Columbia by less than a minute; Gov. Mario Cuomo's plan to postpone a tax cut means the Empire state may soon nose into first place. Envy the lucky New Hampshireite, who completes his obligation as early as April 19.

STATE	TAX FREEDOM DAY	NUMBER OF DAYS	RANK	STATE	TAX FREEDOM DAY	NUMBER OF DAYS	RANK	STATE	TAX FREEDOM DAY	NUMBER OF DAYS	RANK
U.S. Total	May 5	125	—	Kansas	May 2	122	27	North Dakota	Apr 27	117	41
Alabama	Apr 29	119	34	Kentucky	Apr 29	119	35	Ohio	May 4	124	18
Alaska	May 9	129	8	Louisiana	May 2	122	28	Oklahoma	May 5	125	16
Arizona	May 4	124	19	Maine	May 3	123	23	Oregon	Apr 25	115	47
Arkansas	Apr 25	115	45	Maryland	May 12	132	6	Pennsylvania	May 6	126	13
California	May 4	124	17	Massachusetts	May 8	128	10	Rhode Island	May 7	127	12
Colorado	Apr 27	117	40	Michigan	May 3	123	20	South Carolina	May 3	123	22
Connecticut	May 12	132	5	Minnesota	May 8	128	11	South Dakota	Apr 19	109	50
Delaware	May 18	138	3	Mississippi	Apr 20	110	49	Tennessee	Apr 29	119	36
D.C.	May 23	143	1	Missouri	May 1	121	29	Texas	Apr 28	118	39
Florida	May 2	122	26	Montana	Apr 26	116	44	Utah	Apr 28	118	38
Georgia	Apr 29	119	37	Nebraska	Apr 25	115	46	Vermont	Apr 30	120	30
Hawaii	May 17	137	4	Nevada	May 3	123	24	Virginia	Apr 30	120	33
Idaho	Apr 24	114	48	New Hampshire	Apr 19	109	51	Washington	May 5	125	15
Illinois	May 5	125	14	New Jersey	May 9	129	9	West Virginia	Apr 30	120	31
Indiana	Apr 27	117	42	New Mexico	May 10	130	7	Wisconsin	May 3	123	21
Iowa	Apr 26	116	43	New York	May 23	143	2	Wyoming	Apr 30	120	32
				North Carolina	May 2	122	25				

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Public Papers of the Presidents

The President's News Conference in Helena, Montana

25 Weekly Comp. Pres. Doc. 1398

September 18, 1989

LENGTH: 5216 words

... Affairs], with us here today; [Secretary of Defense] Dick Cheney; the Chairman of the Joint Chiefs [Adm. William J. Crowe, Jr.].

And so, I think the key point is: Does the Soviet Union understand that we want to see their perestroika succeed and see them move forward with more liberties? And I think they do understand that. And so, I don't think there's any chance of a disconnect there.

Arms Control Talks

Q. Mr. President, why hasn't there been more progress ...

2ND DOCUMENT of Level 1 printed in KWIC format.

Public Papers of the Presidents

Remarks and a Question-and-Answer Session With Reporters
Following a Meeting With Senator Robert Dole and Secretary
of Labor Elizabeth H. Dole in Kennebunkport, Maine

25 Weekly Comp. Pres. Doc. 1279

August 28, 1989

LENGTH: 2126 words

... change continues to take place peacefully -- and not only outside the Soviet Union, but in it. And we respect the kind of change that's taken place there. Said it over and over again -- we want to see perestroika succeed.

Polish Reforms

Q. I understand you don't want to put a distinct timetable on, but how much of a sense of urgency do you have? How long do you think the new leaders have in Poland ...

3RD DOCUMENT of Level 1 printed in KWIC format.

Public Papers of the Presidents

Remarks to Residents of Leiden, The Netherlands

25 Weekly Comp. Pres. Doc. 1116

July 17, 1989

LENGTH: 2418 words

... Gorbachev's recent letter 2 days ago to the economic summit is only the latest example of the Soviets moving in our direction, coming our way. I've said it many times -- that I want to see perestroika succeed. I want to see the Soviet Union chart a course that brings itself into the community of nations.

And my visits these last 2 months demonstrate how closely the United States is linked to Europe. For ...

4TH DOCUMENT of Level 1 printed in KWIC format.

Public Papers of the Presidents

Interview With Hungarian Journalists

25 Weekly Comp. Pres. Doc. 1049

July 6, 1989

LENGTH: 3369 words

... developments in Eastern Europe, and with the Soviet Union, I might add. I'm an optimist, and I will do my best as President of the United States to help facilitate change. I want to see perestroika succeed in the Soviet Union. We're not dragging our feet on it. I'll use this occasion with you leading journalists to make the point: I want to see it succeed. And I am not going to

...

5TH DOCUMENT of Level 1 printed in KWIC format.

Public Papers of the Presidents

The President's News Conference

25 Weekly Comp. Pres. Doc. 864

June 8, 1989

LENGTH: 5191 words

... encouraged by the response so far.

Having said that, in dealing with the Soviet Union, I am going to continue to keep my eyes wide open. I will also say I want to see perestroika succeed. I want to see it succeed, not fail. And I told Mr. Gorbachev that one-on-one last fall at Governors Island. So, I don't think he believes that I ...

6TH DOCUMENT of Level 1 printed in KWIC format.

Public Papers of the Presidents

Remarks Announcing a Conventional Arms Control Initiative
and a Question-and-Answer Session With Reporters in
Brussels, Belgium

25 Weekly Comp. Pres. Doc. 782

May 29, 1989

LENGTH: 2552 words

... want to reduce the imbalances that exist in all these categories, or do we want rhetoric? And so, what we're saying -- we're not changing; I'm not changing my mind. I've said to want to see perestroika succeed. I said I want to see us move forward in arms reductions. Indeed, we've set a date for the resumption of the START[Strategic Arms Reduction Talks] talks -- but ...

... Economic reform, with its emphasis on incentive and market economics, leads to more freedom. You know, I made clear to Mr. Gorbachev up there in New York -- Governors Island, when we met -- that we wanted to see perestroika succeed in the Soviet Union. And likewise, we want to see success for the economic reforms in China. Incentive, economic reforms, market economics, private ownership are indeed replacing Socialist dogma in many "...

LENGTH: 2063 words

May 1, 1989

25 Weekly Comp. Pres. Doc. 644

Remarks at the Annual Meeting of the United States Chamber of Commerce

Public Papers of the Presidents

7TH DOCUMENT of Level 1 printed in KWIC format.



660 First Avenue • New York, NY 10016 • (212) 686-3110 • Cable: PARCELUS NY

COMMUNICATIONS GROUP

Ms. Chriss Winston
Room 122
The White House
1600 Pennsylvania Avenue
Washington, DC

March 16, 1990

Dear Ms. Winston:

Attached is a Wall Street Journal story that I think might be useful in preparing speeches for President Bush.

In his 1990 Economic Report, the president calls for debt reduction, private investment and a movement toward market-oriented economies as the key to economic growth in the Third World. CARE, which has been running relief and development projects for more than 40 years, has created a subsidiary company that meets all three of these goals. CARE's Small Business Assistance Corporation (CARESBAC) will make venture capital investments in small businesses in the developing world. The operation is designed to create jobs abroad and offer an investment option to U.S. businesses with debt or other assets held in developing companies.

The fact that even a non-profit organization with purely humanitarian goals is turning to venture capitalism strengthens President Bush's point about the necessity of private investment. CARESBAC will also show that business and charity can work together to the benefit of everyone. By providing investment capital and assistance to the owners of small businesses, CARESBAC will spread the distinctly American entrepreneurial dream to the rest of the world.

I will contact you to see if you need any more information on this venture or CARE in general. Obviously, we would be delighted if Mr. Bush chose to mention CARESBAC as a model of the type of innovative strategy needed to deal with global economic problems.

Sincerely,

A handwritten signature in cursive script, appearing to read "Michael Weil".

Michael Weil

TUESDAY, MARCH 6, 1990 B1

Law: SEC weighs more active role in Chapter 11 bankruptcy cases

Page B8.

Law: Supreme Court to review Michigan's value-added tax

Page B8.

THE WALL STREET JOURNAL

MARKETPLACE



ENTERPRISE

BY ROGER RICKLEFS

Aid for Small Business in Developing Countries

CARE INC., the international aid organization, is launching a unit to finance small businesses in developing countries—and to give its own programs a CARE package in the process.

"CARE is very keen on the role of small business in development," says Donald R. Nicholson, president of the newly incorporated CARE Small Business Assistance Corp.

With former Agriculture Secretary Orville Freeman as chairman, CARE Small Business has begun scouting investment possibilities. Eligible businesses generally would have sales between \$400,000 and \$1.5 million, plus the prospect of creating new jobs and earning foreign currency through exports. The average investment would run \$150,000 to \$250,000.

Initially, most of the funding will come from Western lenders converting overseas debt into equity investment. "We have talked to a number of U.S. and European banks, and they are very receptive," Mr. Nicholson says. Multinationals with funds that can't be repatriated from developing coun-

tries will be another source of funds, he adds.

CARE Small Business will take an ownership interest in the projects it finances. Returns on the investments then will be poured into CARE's other aid programs in the same countries.

In the next year or so, the unit could invest up to \$5 million in Costa Rica, \$15 million in Poland, \$2 million to \$3 million in Ecuador and \$5 million in the Philippines, and it is looking at deals elsewhere too, Mr. Nicholson adds.

WHITE HOUSE STAFFING MEMORANDUM

DATE: 3/16/90 ACTION/CONCURRENCE/COMMENT DUE BY: ----

SUBJECT: FRIDAY ECONOMIC AND FINANCIAL REPORT (prepared by OMB)

	ACTION	FYI		ACTION	FYI
VICE PRESIDENT	<input type="checkbox"/>	<input checked="" type="checkbox"/>	MCCLURE	<input type="checkbox"/>	<input checked="" type="checkbox"/>
SUNUNU	<input type="checkbox"/>	<input checked="" type="checkbox"/>	NEWMAN	<input type="checkbox"/>	<input type="checkbox"/>
SCOWCROFT	<input type="checkbox"/>	<input type="checkbox"/>	PORTER	<input type="checkbox"/>	<input checked="" type="checkbox"/>
DARMAN	<input type="checkbox"/>	<input type="checkbox"/>	ROGICH	<input type="checkbox"/>	<input type="checkbox"/>
BATES	<input type="checkbox"/>	<input checked="" type="checkbox"/>	UNTERMAYER	<input type="checkbox"/>	<input type="checkbox"/>
CARD	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<u>BOSKIN</u>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
CICCONI	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
DEMAREST	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
FITZWATER	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
GRAY	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
HAGIN	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

The attached is for your information.

RESPONSE:

James W. Cicconi
 Assistant to the President
 and Deputy to the Chief of Staff
 Ext. 2702



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

March 16, 1990

1990 MAR 16 PM 7:16

MEMORANDUM FOR THE DIRECTOR

FROM:

Ahmad Al-Samarri *ASR*

SUBJECT:

Friday Economic and Financial Report

Current Account -- Both services and trade improve. Page 1.

Direct Investment in U.S. -- Japan remains in weak second place. Page 3.

Auto Outlook -- Transplants and other industry changes. Page 4.

A Manageable Current Account Deficit

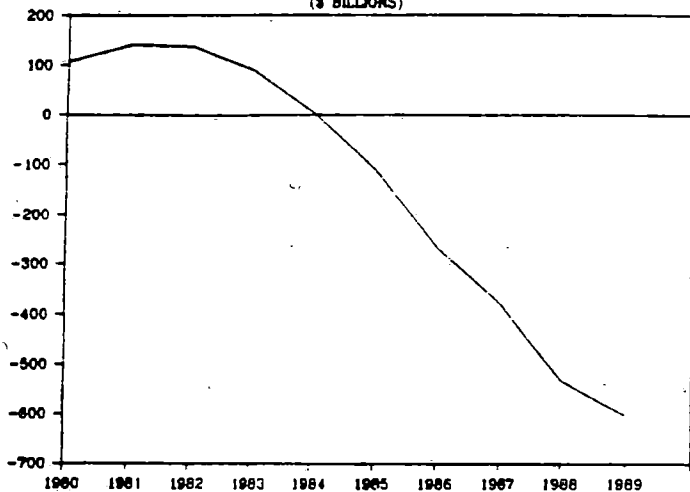
A year and a half ago, most forecasters did not expect the U.S. current account deficit to show further improvement in 1989. Any modest improvement in the trade deficit would be offset, it was thought, by increased payments to foreign investors -- an inevitable consequence of the large net foreign capital inflow in the 1980s.

Actual developments have been much better than expected for the current account. Last year, the U.S. achieved a \$14 billion improvement in the merchandise trade deficit, and a \$6 billion improvement in services, for an overall reduction in the current account deficit of more than \$20 billion. The current account deficit has declined from 3.3 percent of nominal GNP in 1987 to 2.0 percent in 1989.

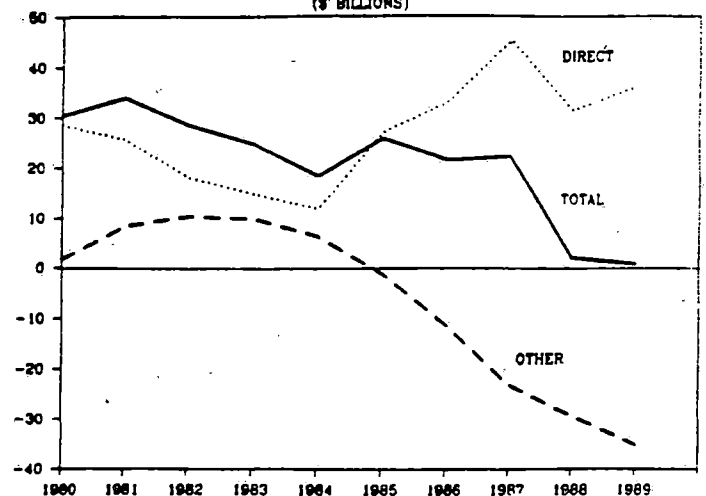
The surprisingly good performance in the current account results from a combination of two factors: a slower than expected deterioration in net investment income and a big increase in the surplus on other service items (financial services, transportation, etc.). The surplus on other services rose by \$6.5 billion last year to \$20.6 billion, while net investment income declined only slightly.

U.S. net investment income remains positive in spite of the fact that the book value of foreign investments in the U.S. now exceeds U.S. investments abroad by more than \$600 billion, a huge swing from the \$140 billion surplus position in 1981. Despite this \$740 billion shift, net investment income declined by only about \$30 billion over the same period. This appears anomalous since the decline in net income is only about 4 percent of the change in assets, much lower than any reasonable estimate of the rate of return on investment.

U.S. NET INTERNATIONAL INVESTMENT POSITION
(\$ BILLIONS)



NET INVESTMENT INCOME
(\$ BILLIONS)



The apparent inconsistency is partly due to measurement error, but it also reflects real economic factors. The measurement problem is well-known. It is a consequence of the Department of Commerce valuing direct investment (plant, equipment, commercial real estate, corporate acquisitions) at book value rather than market value. On a book value basis, foreign direct investment holdings exceeds U.S. holdings. However, much more of the U.S. investment abroad occurred in the 1960s and 1970s. Measuring it at its book value leads to an much greater underestimate of its current market value than measuring foreign direct investment in the U.S. at its book value. The foreign investment here has been concentrated more in recent years, and its book value is therefore closer to current prices.

In spite of our lower direct investment holdings as measured at book value, our earnings on these investments exceeded foreigners' earnings on their direct investment by \$35 billion last year. This provides strong evidence that the market value of U.S. direct investment exceeds the value of comparable foreign investment. Our net income on other assets has declined sharply;

indeed it has turned negative. Still, the overall balance is slightly positive because of the strength of U.S. direct investment earnings. This strongly suggests that the U.S. net debt position has been vastly overstated in the official statistics.

Another factor accounting for the discrepancy, in addition to the measurement problem, is that the U.S. earns a higher rate of return on its investments abroad than foreigners earn on their investments in the U.S. In large part, this reflects a riskier mix of assets chosen by U.S. investors (e.g. direct investment versus security holdings). But there is also evidence that the U.S. earns a higher rate of return on its direct investment holdings as well as on its private security holdings compared to earnings by foreigners in the U.S.

A Federal Reserve Board study suggests that the U.S. rate of return on direct investment overseas exceeds foreigners' returns in the U.S. by about 2-1/2 percentage points after adjusting for price and exchange rate changes. Some of the U.S. investment takes place in risky locales, such as Latin America, where rates of return are higher. Some part of the differential might also be due to the relative newness of foreign direct investment in the U.S. A period of low profits while the new plants are established may be expected. It may also reflect tax incentives for U.S. multinational firms to shift profits to foreign subsidiaries.

Over the next decade, the Fed study expects a differential in rates of return to persist. If the assumptions behind their simulation hold, net investment income will only decline by 3.8 percent of the cumulative net capital inflow. If this proves correct, a current account deficit equal to the present level of about two percent of GNP will lower net investment by only \$4 billion per year. Further declines of this magnitude may be readily offset by small improvements in the trade deficit. If that happens the current account deficit will shrink further. Instead of being on a potentially explosive path, our external deficit now appears almost manageable.

Direct Investment in the U.S.

The following table provides detailed bilateral data on foreign direct investment in the U.S. The United Kingdom continues to be the largest investor, accounting for one-third of the \$61 billion total in 1989. Japan was the second largest investor, accounting for one-fifth. Japan's share of total foreign direct investment assets rose only slightly from 16.2 percent at the end of 1988 to 16.9 percent at the end of 1989.

<u>Foreign Direct Investment in the U.S.</u> (\$ billion)			
	End-1988 Book Value	Direct Investment in 1989	End-1989 Book Value
Total	328.9	61.3	390.1
Japan	53.4	12.8	66.1
Canada	27.4	2.3	29.7
Europe, of which:	216.4	40.9	257.3
United Kingdom	101.9	20.9	122.8
Netherlands	49.0	6.7	55.7
Germany	23.8	3.1	26.9
Switzerland	15.9	1.7	17.6
France	11.4	5.7	17.1
Latin America	17.0	3.5	20.5
Other	14.7	1.8	16.5

It's a Jungle Out There

Lynx, Cougar, Mustang and Thunderbird -- judging from their names, the appropriate place for American cars is in the wild, not the showroom. After the energy shocks and Chrysler bailout of the 1970s and the recessions and high dollar in the early 1980s, it appeared that the U.S. car market had become a dangerous habitat for General Motors, Ford and Chrysler. Despite the safer impression given by the record and near-record earnings of 1987 and 1988, Detroit is not yet out of the woods.

The Big Three's biggest problem results from the Japanese auto-makers' response to the Voluntary Export Restraint (VER), which started in 1981. Faced with limits on their exports to the U.S., Japanese firms jumped over the trade barrier by producing cars in the U.S. and Canada, which has a free trade agreement with the U.S. Such "transplants," which are wholly or partially owned by foreign firms, are not new. Nor are they always Japanese. Volkswagen operated an auto assembly plant in Westmoreland, Pennsylvania, from 1978 until it closed in 1988. U.S. output from transplants, however, has increased dramatically in the past decade, rising five-fold from less than 200,000 cars in 1980 to 1.1 million in 1989. At full capacity, these plants will be able to turn out nearly 3 million vehicles.

**U.S. NEW CAR SALES
(MILLIONS OF UNITS)**

	DOMESTIC FIRMS						JAPANESE FIRMS			OTHER FIRMS
	TOTAL	BIG THREE	GM	FORD	CHRYSLER	AMC	TOTAL	IMPORTS	TRANSPLANT	
1980	9.0	6.4	4.1	1.5	0.8	0.2	1.6	1.6	0.0	0.7
1985	11.0	8.0	4.7	2.1	1.2	0.1	2.0	1.8	0.2	0.9
1989	9.9	6.6	3.4	2.2	1.0	0.0	2.4	1.7	0.8	0.8

**U.S. NEW CAR SALES
(AS A PERCENT OF TOTAL)**

	DOMESTIC FIRMS						JAPANESE FIRMS			OTHER FIRMS
	TOTAL	BIG THREE	GM	FORD	CHRYSLER	AMC	TOTAL	IMPORTS	TRANSPLANT	
1980	100.0	71.8	45.9	17.2	8.8	2.0	18.2	18.2	0.0	8.0
1985	100.0	72.6	42.5	18.8	11.3	1.1	18.4	16.8	1.7	7.8
1989	100.0	67.0	34.7	22.0	10.3	0.0	24.7	16.9	7.8	8.3

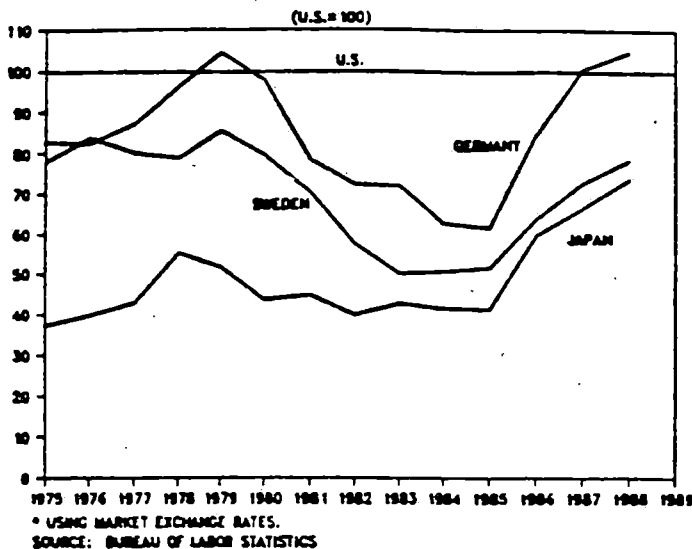
Sales from transplants in recent years have more than offset the decline in market share of imports. In 1989, Japanese manufacturers did not take full advantage of their quotas under the VER for the third year in a row, yet transplants pushed their total share up to 25 percent of new car sales: 17 percent from imports and 8 percent from transplants. Almost all of the increase in market share for Japanese firms has come at the expense of the Big Three. Since 1980, Ford's market share has increased slightly, Chrysler's has stabilized, and GM's share has contracted sharply from 46 percent in 1980 to only 35 percent last year.

Unfortunately for Detroit, the challenge from transplants is now in the context of a slow-growing overall market. Seven years of expansion have dissipated any pent-up demand for autos. Also, slower household formation will put a damper on the demand for new cars, more than offsetting favorable shifts in the age composition of the car-buying public.

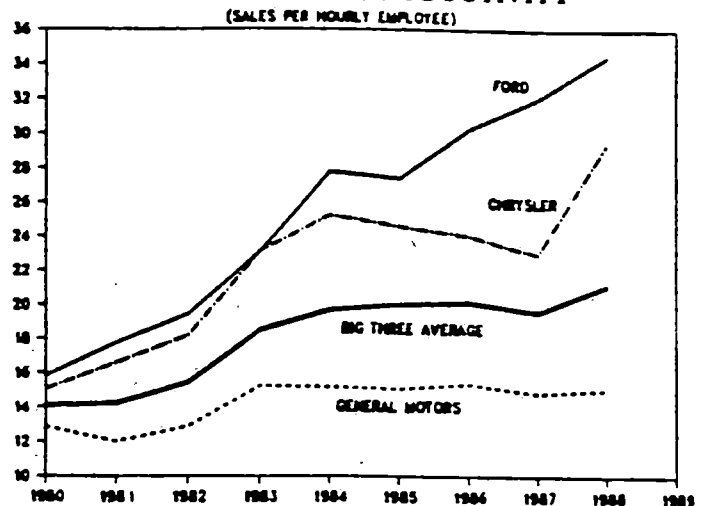
The root of Detroit's problems can be boiled down to two factors -- cost and quality. Although the dramatic fall in dollar since 1985 has put U.S. firms' labor costs on a par with Germany and reduced the gap with Japan, Japanese compensation costs are still well below those in the U.S. Fortunately for Detroit, much of this cost advantage is offset by transportation costs and import duties.

Even for cars produced in the U.S., transplants have a labor cost advantage over those made by the Big Three. Because transplants have a young work force, their health and retirement expenses are relatively small. In addition, transplants have more flexible work rules, which also restrain labor costs.

RELATIVE HOURLY COMPENSATION COSTS FOR MOTOR VEHICLE WORKERS*



MOTOR VEHICLE PRODUCTIVITY



To lower costs, the Big Three have invested in automation and closed high-cost operations. The payoff has been a substantial increase in productivity. In 1980, the average Big Three auto-worker produced 14 vehicles per year; by 1988, that had risen to 21. There is, however, a considerable divergence around this average, with Ford's workers producing 35 cars per year and GM's less than half this number. Japanese transplants are about as efficient as Ford, giving them a considerable competitive advantage against GM.

Another cost-cutting measure has been Detroit's use of "captive" imports, which are cars built outside the U.S. exclusively for one of the Big Three. These cars tend to be compact and subcompact models which are at the low price end of the market. Mexico has increasingly become a place of auto assembly for the Big Three because of its proximity to the U.S., low labor costs, and the application of import tariffs only to the value-added by Mexican assembly.

The problem of quality is much more ethereal. While the Big Three have improved gas mileage and, according to a recent study, lowered their defect rate to a level only slightly higher than the Japanese, there is still a perception that U.S. cars are noticeably inferior to foreign-built models. This prejudice is revealed in the Consumer Satisfaction Survey done by J.D. Power and Associates, which shows a large gap between the perceived quality of U.S. cars and those made by Japanese firms. The gap between U.S. and Japanese-built cars, however, has been shrinking.

Customer Satisfaction Index
(100 = 1981 total industry average)

Origin	1985	1986	1987	1988	1989
Japanese	114	119	119	122	130
European	106	106	102	110	111
Big Three	87	94	98	102	112
Japanese - Big Three	27	25	21	20	18

Source: J.D. Power & Associates

To increase their sales, Detroit has tried to create new products or revive old ones, such as the convertible. The most successful product development happened in 1983 with Chrysler's introduction of the minivan. The minivan has begun to transform the "two car" family to a car and minivan one. Light trucks, which includes minivans, have become an growing share of new vehicle purchases. The light truck market has been dominated by the Big Three, with foreign producers accounting for only 13 percent of sales in 1989. It would appear that this is one market in which the domestics have succeeded. In part, however, this is because the tariff on the imported trucks is 25 percent, while that on cars is only 2.5 percent. To get around the higher tariff and take advantage of the lucrative minivan market, some Japanese firms will begin to import minivans with four doors, which will qualify them for the lower tariff.

While U.S. firms have been having a rough time at home, exports and sales by their foreign subsidiaries have taken off. The annual percent increase in European sales by the Big Three has been in double digits since 1986. The dramatic fall of the dollar versus the European currencies since 1985 has been a boon to U.S. automakers, starting a car-buying binge that has lasted five years. Sales in Europe have been making up a growing portion of Detroit's revenue.

Reacting to the growing European market, each of the Big Three have announced plans to expand old operations and to start new ones in Europe, as well as to buy existing European carmakers. For the most part, the new operations are low-volume joint

ventures located in central and eastern Europe to take advantage of lower labor and distribution costs. If demand remains strong in Western Europe, or the Eastern European economies recover, these plants could be expanded considerably.

New Big Three Assembly Plants Planned in Europe

Company/Partner	Country	Annual Output	Start-up Date
GM/Raba	Hungary	25,000 cars	1995
Chrysler/Steyr	Austria	25,000 vans	1991
Ford/Mazda	W. Germany	120,000 cars	1992
GM/Eisenach	E. Germany	150,000 cars	1991

Boosting productivity, developing new products, and expanding sales abroad have been Detroit's response to the intensified competition of the 1980s. In the marketplace, as in the wild, new challengers are constantly jockeying for the position of leadership. As we enter the 1990s, the Big Three -- and especially GM -- must heed the lesson of Darwin: survival of the fittest.

RECENT ECONOMIC INDICATORS MARCH 16, 1990
(S.A. OR AS INDICATED)

	Feb-89	Mar-89	Apr-89	May-89	Jun-89	Jul-89	Aug-89	Sep-89	Oct-89	Nov-89	Dec-89	Jan-90	Feb-90
GNP (QUARTERLY SERIES, % A.R.)													
NOMINAL GNP	7.9			7.1			6.2			4.4			NA
REAL GNP	3.7			2.5			3.0			0.9			NA
IMPLICIT PRICE DEFLATOR	4.0			4.6			3.2			3.2			NA
FIXED-WEIGHT PRICE INDEX	4.8			5.0			2.9			3.6			NA
REAL DISP. PERS. INC.	6.6			0.8			4.4			2.7			NA
OPERATING PROFITS	-25.3			-10.3			-15.4			NA			NA
LEADING AND COINCIDENT INDICATORS													
LEADING INDEX	145.6	144.7	145.8	144.2	144.0	144.1	144.8	145.0	144.4	144.5	145.3	145.3	NA
PERCENT	-0.3	-0.6	0.8	-1.1	-0.1	0.1	0.5	0.1	-0.4	0.1	0.6	0.0	NA
COINCIDENT INDEX	132.0	132.0	132.8	132.5	132.8	132.6	133.9	133.5	133.0	133.6	133.9	133.0	NA
PERCENT	0.2	0.0	0.6	-0.2	0.2	-0.2	1.0	-0.3	-0.4	0.5	0.2	-0.7	NA
INDUSTRIAL PRODUCTION	140.5	140.7	141.7	141.6	142.0	141.9	142.5	142.3	141.8	142.3	142.4	141.0	141.8
PERCENT	-0.2	0.1	0.7	-0.1	0.3	-0.1	0.4	-0.1	-0.4	0.4	0.1	-1.0	0.6
CAPACITY UTIL. MFG.	84.3	84.1	84.5	84.3	84.4	84.0	84.2	83.7	83.1	83.1	82.8	82.0	82.4
EMPLOYMENT INDICATORS													
CIVILIAN EMPLOYMENT, MIL.	116.8	117.0	117.1	117.1	117.5	117.4	117.6	117.4	117.6	117.8	117.9	117.9	118.0
CIV. UNEMPLOYMENT RATE, PERCENT	5.2	5.0	5.3	5.2	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3
NONFARM PAYROLL EMPLOYMENT, MIL.	107.7	107.9	108.1	108.3	108.6	108.8	108.9	109.1	109.2	109.5	109.6	109.9	110.3
AVG. WEEKLY HOURS, MFG.	41.1	41.0	41.3	41.0	41.0	41.0	41.0	41.0	40.8	40.7	40.6	40.7	40.7
INITIAL CLAIMS UNEMP. INS., THOUS.	305.6	318.2	307.9	316.1	330.7	333.4	322.6	331.3	366.1	347.8	365.1	360.4	357.5
CONSUMER SECTOR													
RETAIL SALES, BIL. \$	139.5	139.5	141.4	142.5	142.5	143.6	144.9	145.3	143.4	144.4	143.9	147.9	146.5
PERCENT	-0.5	0.0	1.4	0.8	0.0	0.7	0.9	0.3	-1.3	0.7	-0.3	2.8	-0.9
TOTAL AUTO SALES, MIL. UNITS, A.R.	9.9	9.7	10.8	10.3	9.8	10.2	11.5	10.7	8.8	8.5	8.9	10.2	9.5
DOMESTIC	7.0	6.8	7.6	7.5	7.0	7.5	8.3	7.8	6.1	6.0	6.5	7.5	6.8
IMPORTED	2.8	2.9	3.2	2.9	2.9	2.8	3.1	2.8	2.7	2.5	2.4	2.7	2.7
PERSONAL INCOME, BIL. \$, A.R.	4319.5	4360.7	4387.1	4396.3	4417.5	4443.7	4456.9	4467.1	4501.8	4543.9	4566.6	4602.5	NA
PERCENT	1.1	1.0	0.6	0.2	0.5	0.6	0.3	0.2	0.8	0.9	0.5	0.8	NA
DISP. PERS. INC., BIL. \$, A.R.	3697.8	3728.8	3718.7	3747.2	3777.2	3798.5	3808.6	3813.4	3841.4	3880.7	3898.1	3934.6	NA
PERCENT	1.5	0.8	-0.3	0.8	0.8	0.6	0.3	0.1	0.7	1.0	0.4	0.9	NA
REAL DISP. PERS. INC., BIL. \$, A.R.	2891.9	2900.0	2874.0	2884.1	2904.5	2913.4	2924.0	2920.1	2922.6	2942.1	2950.8	2948.1	NA
PERCENT	1.4	0.3	-0.9	0.4	0.7	0.3	0.4	-0.1	0.1	0.7	0.3	-0.1	NA
PERS. CONSUMP. EXP., BIL. \$, A.R.	3384.7	3394.0	3432.1	3445.0	3455.4	3485.3	3521.2	3517.8	3528.1	3541.6	3578.3	3598.2	NA
PERCENT	0.6	0.3	1.1	0.4	0.3	0.9	1.0	-0.1	0.3	0.4	1.0	0.6	NA
REAL PERS. CONSUMP. EXP., BIL. \$, A.R.	2647.0	2639.6	2652.4	2651.5	2657.1	2673.3	2703.3	2693.8	2684.2	2685.0	2708.7	2696.0	NA
PERCENT	0.4	-0.3	0.5	0.0	0.2	0.6	1.1	-0.4	-0.4	0.0	0.9	-0.5	NA
HOUSING SECTOR													
HOUSING STARTS, THOU. UNITS, A.R.	1454.0	1405.0	1341.0	1308.0	1414.0	1424.0	1325.0	1263.0	1423.0	1347.0	1273.0	1588.0	1477.0
SINGLE-FAMILY	1026.0	979.0	1028.0	977.0	971.0	1029.0	987.0	969.0	1023.0	1010.0	931.0	1109.0	1166.0
HOUSING PERMITS, THOU. UNITS, A.R.	1403.0	1230.0	1334.0	1347.0	1308.0	1281.0	1328.0	1319.0	1356.0	1342.0	1376.0	1745.0	1308.0

THE WHITE HOUSE
WASHINGTON

Date: 3/20

TO: *Chris / Kristen*

FROM: **JOHN S. GARDNER**
Special Assistant to the President
and Assistant Staff Secretary

- Information
- Action
- Let's Discuss

An interesting fact on p. 2.

J.S.



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416



MEMORANDUM

DATE: March 15, 1990

TO: Frederick D. McClure, Assistant to the President
for Legislative Affairs

FROM: Michael P. Forbes, Assistant Administrator for
Congressional and Legislative Affairs

SUBJ: Status of Small Business Issues for Week of
March 12 - March 16, 1990

A) CONGRESSIONAL INITIATIVES:

1. Civil Rights (H.R. 4000)

On March 13, a joint hearing was held by the House Education and Labor Committee and the Judiciary's Civil and Constitutional Rights Subcommittee, to consider legislation that would amend the Civil Rights Act of 1964. Specifically, H.R. 4000, the Civil Rights Act of 1990 would restore the Griggs v. Duke Power Co. rule by providing, once a person proves that an employment practice has disparate impact, the employer must justify the practice by showing that it is based on business necessity.

Last year the Supreme Court overruled the Griggs decision in the Wards Cove Packing Co. v. Atonio case stating that victims of discrimination must bear the heavy burden of proving that the employer has no legal justification for its discriminatory practices.

Testifying on behalf of the business community, Marshall Babson representing the U.S. Chamber of Commerce said, enactment of H.R. 4000 "would substantially increase the burdens and risk of liability for every employer in this country, including the most exemplary." Furthermore, he added, the bill "would leave employers with little choice but to adopt quota systems in order to protect themselves from substantial liability." Babson concluded by saying, "...Although the substitution of quotas for merit can never be justified, it is particularly inappropriate in this time of intense and growing international competition."

2. Payroll Taxes

The House Small Business Committee met today to explore whether payroll taxes have a disproportionate impact on small businesses. Chairman LaFalce (D-NY) and a panel of tax experts discussed the reasons for the recent increases in payroll taxes, the role of payroll taxes in the economy and the extent to which they are regressive.

LaFalce noted that "it could well be that small businesses are paying an unfair share of the nation's taxes." This is due in large part to the labor-intensive role of small businesses.

Finally, LaFalce said the whole issue of payroll taxes revolves around ending the deficit. As someone said today, "it's time we get off the dime on the deficit," he added. LaFalce also announced plans to co-sponsor Rostenkowski's proposal.

3. Women-Owned Businesses

A field hearing chaired by Sisisky (D-VA) of the Subcommittee on Exports, Tax Policy and Special Programs (House Small Business Committee) was held on March 12. The hearing focused on the problems women business owners have in gaining access to credit. At Lancaster's (D-NC) request, Members examined the effectiveness of Federal policy and state and local efforts in enhancing the ability of women-owned businesses to compete both at home and in the international market.

Sisisky said the remarkable increases and success of women's business enterprise in America has been described as "the most significant economic development in recent years." Furthermore, he said, in 1986 the contribution women business owners made to the nation's economy resulted in \$71 billion in revenue, an increase of 97 percent since the beginning of the decade. These businesses continue to grow despite the barriers of discrimination that still exist, he added.

Based on a study conducted by SBA's Office of Advocacy, more than 36 percent of all sole proprietorships in the United States will be owned by women by year 2000.