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Sprinkel, Beryl W.: Files
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Tax Reform Letters
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FORUM GROUP, INC.

Charles

November 27, 1985

Mr. Beryl W. Sprinkel
Chief White House Economist
United States Department of Treasury
15th and Pennsylvania Avenues
Washington, D.C. 20220

Dear Beryl:

One of our companies, Forum Group, Inc., builds and operates retirement living centers. We finance these by selling completed centers to limited partnerships, and we pay substantial taxes on both the gain and our operating income. (1985 taxes were $17,580,000.) We presently have $400,000,000 of new construction underway or planned.

The proposed tax reform law will put those projects on indefinite hold, and eliminate over 10,000 jobs, and the taxes Forum would have paid.

Our business is not alone in feeling the effects of this proposed law. Many businesses are now delaying capital projects due to the uncertainty of a change in the law. Business activity and employment will certainly suffer.

In my opinion, only a quick burial of this legislation will avoid deep and lasting damage to the economy.

Sincerely yours,

Fred

J. Fred Risk
Chairman

JFR:ck

enclosure

8900 KEYSTONE CROSSING, SUITE 1200 INDIANAPOLIS, INDIANA 46240 317 846-0700

FORUM GROUP, INC.

REPORT TO SHAREHOLDERS 1985

Consolidated Financial Highlights

Year Ended March 31	1985	1984	1983
Net revenues	**$177,206,541**	$115,809,460	$ 89,597,265
Income from continuing operations	**$ 33,893,402**	$ 7,437,436	$ 3,850,724
Per share	**$ 1.46**	$ .38	$ .26
Working capital	**$131,815,681**	$ 7,935,604	$ 7,189,528
Net worth	**$ 98,683,016**	$ 71,885,314	$ 44,796,007
Book value per common share	**$ 4.80**	$ 3.37	$ 2.58
Dividends per common share	**$ .06**	$ .055	$ .05
Average number of common and common equivalent shares	**24,555,075**	24,469,361	15,778,284

About Forum

Forum Group, Inc., is a healthcare services company with operations in ten states. During the past three years, Forum's revenues increased from $34,447,000 to $177,207,000. Growth has come primarily from acquisitions and mergers.

On March 31, 1985, Forum sold substantially all of the assets of its acute care division (principally psychiatric and medical-surgical hospitals) for $200 million cash and realized a net pre-tax gain of approximately $38 million. The proceeds received from the sale largely account for Forum's $124 million increase in working capital during fiscal 1985.

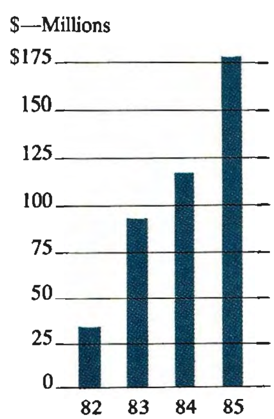
Forum's remaining operations are focused exclusively on the long-term healthcare services market. Forum's principal focus for the foreseeable future will be the aggressive development of luxury retirement living centers.

Forum's Common Stock is traded over the counter, NASDAQ symbol: FOUR. The approximate number of shareholders of record at July 1, 1985, was 3,463.

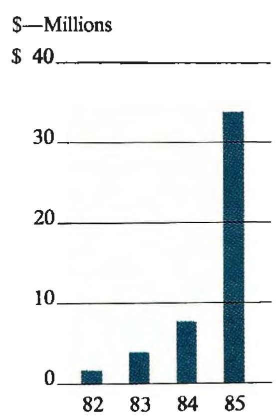
Form 10-K

Copies of Forum's Annual Report to the Securities and Exchange Commission on Form 10-K can be obtained by writing Mr. Paul A. Shively, Senior Vice President and Treasurer, at the offices of Forum.

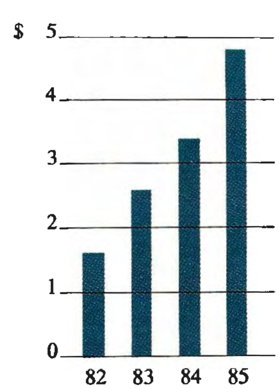
Net revenues



Income from continuing operations



Book value per share



J. Fred Risk, Chairman of the Board, and O.U. Mutz, President and Chief Executive Officer.

Report to Shareholders —

The sale of Forum's acute care division to Hospital Corporation of America (HCA) for approximately $200 million was Forum's most significant event of fiscal 1985.

During the two years Forum pursued development of the ten-hospital acute care base it acquired in August, 1982, three new hospitals were opened, two were acquired, one was remodeled and expanded, and two others were readied for construction. Forum is proud of this record. It was a key consideration in the sale to HCA. Completion of that sale permits strategic concentration of Forum's development resources on its retirement living center business.

The simultaneous development of acute care hospitals and retirement living centers offered sound future promise to Forum, but there was never a real question about which of these thrusts represented the greater long-term opportunity. With five thousand persons in the United States passing age sixty-five every day, the need for retirement living centers in every major city in the nation is self-evident.

Few existing retirement living centers provide luxury care for affluent retirees. The rapid creation of additional facilities of this kind by Forum will position Forum as the national leader in an open-end market.

Since the end of the fiscal year, Forum has acquired an existing retirement living center in Philadelphia. Forum also opened a new retirement living center in Lexington, Kentucky, and will soon begin construction of new retirement living centers in Albuquerque, El Paso and Indianapolis. Additional project starts should bring the total to nine or more new retirement living centers under way before the end of fiscal 1986. The announced target for fiscal 1987 and 1988 is to begin construction of fifteen new retirement living centers each year. Forum is rapidly progressing toward achievement of these objectives.

Forum's facilities for the developmentally disabled, its original healthcare service business, continue to provide outstanding care to a large client base.

Forum has continued to expand its base in the ownership and operation of nursing homes. Last year it leased fifty-eight additional nursing homes (fifty-six in Indiana and two in Illinois) and entered into agreements to manage two nursing homes in Kentucky and one in Indiana. Forum also acquired a nursing home near Dallas for its entry into that important market. Selective nursing home acquisitions that accelerate market entry for Forum's retirement living centers will continue as part of its future thrust.

Forum's revenues and after-tax earnings for fiscal 1985 established record levels which we do not expect to equal during fiscal 1986. We do anticipate fiscal 1986 earnings substantially above those of fiscal 1984. Forum's *current ratio* is 3.6:1 and the net proceeds from the HCA sale are invested in a variety of marketable securities which provide adequate liquidity for significant acquisition opportunities.

Forum and its predecessors have a nineteen-year history of success in the ownership and operation of retirement living centers. This experience in developing and operating luxury retirement living centers for affluent retirees exceeds that of any known competitor. We believe that Forum is the national leader in this rapidly emerging new business. It is our objective to retain that position and to widen the leadership gap in the future.

O. U. Mutz

O. U. Mutz
President and Chief Executive Officer

J. Fred Risk

J. Fred Risk
Chairman of the Board

Indianapolis
July 5, 1985

Strategy for Growth
Luxury Retirement Living Centers

Underlying Forum's strategy is a conviction that change is a welcome business constant and the father of opportunity, and that rapid adjustment to change is the critical ingredient to success.

This concept was the underlying force that enabled Forum's management to transform a small regional manufacturer with a net worth of $1.8 million into a specialized healthcare organization with a net worth of about $100 million and a net cash and marketable securities position in excess of $160 million — all in ten years.

Acute Care Division Sale

Until late last year, Forum had two operating divisions. Its acute care division operated psychiatric and medical-surgical hospitals, while its long-term care division operated retirement living centers for affluent retirees, nursing homes and facilities for the developmentally disabled.

Although Forum's acute care division was generating increasing revenues and earnings, the hospital industry was becoming increasingly competitive. Obtaining the certificates of need required to construct new facilities was taking longer, costing more and requiring more of Forum's personnel resources. Furthermore, the cost of acquiring or constructing new facilities was continuing to escalate.

These problems were not present to the same extent in Forum's long-term care operations. Therefore, management decided to explore the possibility of selling the assets of Forum's acute care division to permit concentration in long-term care, particularly retirement living centers.

Fortunately, Forum's acute care operations were somewhat different from most. Most of its acute care revenues were derived from the treatment of psychiatric patients, one of the fastest growing segments of the acute care market. It was this factor, combined with demonstrable quality earnings and certificates of need in hand, that made Forum's acute care division an attractive acquisition package.

When Forum received offers that would materially reduce its long-term debt, provide over $160 million net cash and yield a net profit that was more than three times Forum's net worth three years ago (when it entered the healthcare business), Forum accepted.

Long-Term Care

Following the sale of the assets of its acute care division, Forum's remaining operations were solely in the long-term healthcare service market. This provided management a simplified operation and a sharper focus to its strategy.

Forum now operates eleven luxury retirement living centers with capacity of 2,204 residents, seventy-seven nursing homes with 4,539 beds, and five facilities for the developmentally disabled.

Retirement Living Centers

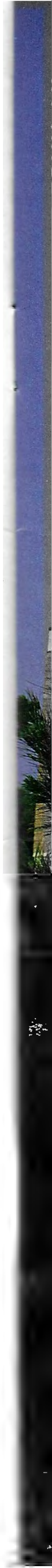
Retirement living centers, which management described in Forum's 1984 Annual Report as "the Company's greatest long-term growth opportunity," will be Forum's principal focus for the foreseeable future. Priorities are: (1) construction of new facilities, (2) acquisition of existing facilities that meet Forum's standards, and (3) acquisition of superior quality, private-pay nursing homes as a supplement to retirement living center development.

Forum's luxury retirement living centers provide an enjoyable living environment. They feature luxury rental apartment or condominium accommodations, round-the-clock security, elegant dining service, maid and laundry service, tastefully appointed common rooms and a wide variety of recreational programs that meet the requirements of their discriminating clientele.

The principal difference between one of Forum's retirement living centers and a first-class resort hotel is an added value service — immediate on-premises healthcare, including the assurance of space in the nursing home component of the facility, should the need arise.

Market Leadership

When it acquired Retirement Living, Inc. (RLI), in 1981, Forum gained access to a management organization



THE LAFAYETTE AT COUNTRY PLACE IN LEXINGTON, KENTUCKY. A 100-UNIT APARTMENT COMPONENT OF THIS LUXURY RETIREMENT LIVING CENTER OPENED IN MAY, 1985.

The elegant dining room at Stonegates, a retirement living center near Wilmington, Delaware.

Strategy for Growth, continued

with a fifteen-year history of successful operations that were focused exclusively on luxury retirement living.

Subsequent expansion by Forum proved the essential soundness of RLI's concepts and operating techniques. Four retirement living centers opened since the 1981 RLI acquisition have achieved full occupancy within the first year of operation. Two were opened in fiscal 1985, and their occupancy levels are moving up on a par with the previous centers.

Management believes Forum's focus on the luxury retirement living center market puts it in a class by itself. Forum knows of no other organization with more experience. A leading New York Stock Exchange member firm's analyst described Forum as having "the most advanced commitment to retirement care among publicly-held companies."

Market leadership is important. Others, attracted by Forum's success, will undoubtedly follow. Forum's detailed studies currently identify one hundred prime markets where at least one prototypal 120-apartment unit retirement living center could be sustained. It is imperative that Forum move boldly and quickly to position itself in these major markets.

Compared with the acute healthcare service market, the luxury retirement living center market is in its early growth stages. In many states, no time-consuming certificates of need are required; the demand for such facilities currently exceeds the supply; government interference is negligible; and the market is largely private pay.

The Affluent Retiree

Forum's retirement living center market is made up of persons in the 65-85 age group, having a minimum liquid net worth of $250,000 and a minimum annual income of $25,000. Approximately 5% of the persons over the age of sixty-five (about 1.4 million), currently meet these standards. Actually, the average resident at a Forum facility has income and net worth comfortably in excess of these minima.

The number of persons meeting these standards is expected to double within the next five years. The elderly are steadily increasing in number, and the level of affluence of those over age sixty-five is projected to increase sharply as higher pension benefits from the 1960's begin to pay out and as two-income families begin to enter the retirement market. Adding to these demographic trends is the likelihood of increased demand for value-added healthcare resulting from reduced government funding and from growing awareness among retirees that retirement living need not be limited to the old peoples' homes of an earlier era.

Whatever size the market might prove to be (estimates range from 1.4 million to 3 million persons in the next five years), it is so large that, if Forum were to open two prototypal 120-apartment unit luxury retirement living centers every month for the next five years, and fill each to capacity, it would have a market penetration of only 1% of the lowest projected potential market.

Stonegates, a $22 million, 164-condominium unit retirement living center, opened in the Wilmington, Delaware, area in July, 1984.

Strategy for Growth, continued

Market Studies

There are no published in-depth market studies on the living preferences of affluent retirees. To a large extent, retirement living was initially perceived as a low-cost alternative to nursing homes for elderly individuals of limited means who had no particular health problems other than the normal effects of advancing years. Not-for-profit organizations built modest retirement facilities for these individuals, but healthcare service providers largely overlooked the fact that *all* older persons, regardless of their economic status, develop very specific needs as the aging process continues.

The luxury retirement living center market is very much different from almost any other healthcare service market. Its customers are healthy and reasonably wealthy. Their affluence allows them the luxury of unhurried choice, and their education and preretirement lifestyles enable them to discern and demand real value.

In short, this is a narrow market segment where market knowledge is absolutely essential. Moreover, this kind of knowledge is not easy to acquire in an industry where urgent health needs and slim pocketbooks were once the rule.

Forum's Advantage

Forum's nineteen years' experience in the luxury retirement living center field place it in an enviable position. Its market knowledge is hard won, practical and thoroughly proven in the one arena that counts — the marketplace. Forum regards this market knowledge as proprietary and as its most understated asset.

It is not a market for the inexperienced. Instances of colossal failures are beginning to have an impact on the market. Recently, Forum was able to acquire for $11.5 million a 300-apartment unit retirement living center built at a cost of approximately $22 million! The facility went into bankruptcy and never opened. More acquisitions of this type are possible.

Financing

Despite Forum's strong net cash position, funds on hand are not sufficient to complete management's plans for nine retirement living centers this year and fifteen in each of the next two years. Various types of financing will be required.

Traditionally, the construction and subsequent operation of any real estate project generate operating losses during the start-up phase. To minimize the impact of these initial shortfalls, management intends to pursue off-balance sheet financing. It is anticipated that a substantial group of retirement living centers will be syndicated. Under this arrangement, Forum may become the general partner of the syndication partnership, and will earn initial development fees of approximately 10% of the value of the facilities plus ongoing fees to manage the facilities.

As these retirement living centers mature and begin to generate taxable income, it may be advantageous for the partnership to sell the facilities. Forum will have a right of first refusal to purchase the facilities from the partnership.

Facility Construction

Forum has already identified attractive retirement living center markets and, in some instances, has already made site selections. It intends to begin construction as soon as possible, thereby establishing a visible presence in many markets quickly.

Firm control over the construction phase of each facility is essential to controlling costs. To this end, Forum has made a $10 million investment in National Homes Corporation by purchasing that company's entire offering of adjustable rate cumulative preferred stock.

This transaction will enable Forum to bypass the lengthy and cumbersome bidding process and proceed with construction of a tested prototype at a previously agreed price. Forum estimates it will be able to reduce construction time by as much as three months on every project, move in residents sooner than would otherwise be possible and save up to $500,000 per project.

Other features of the investment in National Homes include the extension of a $5 million revolving credit facility and the purchase of warrants that

LINCOLNSHIRE NURSING HOME IN MERRILLVILLE, INDIANA, A FORUM—MANAGED FACILITY.

Strategy for Growth, continued—

Shipley Manor, an $11 million, 61-apartment unit retirement living center that opened in 1984.

enable Forum to purchase 2.5 million shares of National Homes' common stock at $4.00 per share any time during the next eight years. The dividend rate on the $10 million preferred stock issue is at 1½% above prime and the dividend income is expected to be 85% tax free to Forum.

Nursing Homes

Forum's nursing home operations are currently the largest of its three long-term healthcare services. These operations provide steady growth and predictable income.

Nursing home revenues in fiscal 1985 were $48 million and occupancy levels averaged 89.8% of capacity. Significant internal growth is anticipated over fiscal 1985 because of Forum's recent agreement to lease, on a long-term basis, fifty-eight nursing homes in Indiana and Illinois having a total of 2,376 beds.

Previously, Forum operated twenty owned, leased and managed nursing facilities with a total of 2,131 beds. In addition, each retirement living center has a full-care nursing home component. Total beds at these components aggregated 427 at fiscal 1985 year end.

Expected Growth

The demand for intermediate and skilled care nursing facilities is expected to increase sharply over the next decade. The nation's aged population is increasing rapidly, and the need for some type of medical care is inevitable. Adding to the demand for intermediate and skilled nursing care is the recent shift away from costly hospital stays. Patients no longer remain in hospitals until completely well, but seek lower cost (by approximately 75%) nursing home care as an intermediate healthcare option until they are strong enough to return to their homes.

Private pay averaged 45% of total nursing home revenues last year, with Medicaid providing the balance. Forum enjoyed a substantially higher proportion of private pay patients than the national average, principally because its facilities offer the kinds of amenities demanded by those patients who have the financial ability to provide for themselves.

Nursing Homes vs. Retirement Living Centers

To some extent, nursing homes and retirement living centers are complementary. A freestanding nursing home can provide the nucleus for a retirement living center. Similarly, the residents of the apartment component of a retirement living center should ultimately provide a reliable source of referrals to the nursing home component if the residents need such care at a later date.

There are some important differences, however, which require two distinct types of management supervision. Retirement living center apartment residents are 100% private pay. No reimbursement from federal or state agencies is involved. Therefore, no artificial limitation is placed on rates and the market determines what rates are acceptable. Further, the retirement liv-

RESIDENTS' GREENHOUSE AT STONEGATES.

Strategy for Growth, continued

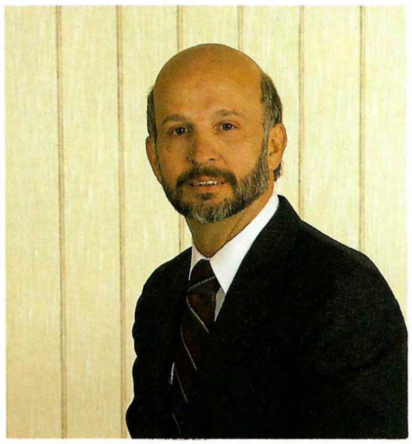
ing center apartment resident tends to be financially sophisticated, understands the effect of inflation on operations and, in general, accepts what is reasonable and rejects what is shoddy, second-class or without substance.

It is important to recognize that circumstances rarely *compel* someone to take up residence in the apartment component of a retirement living center. A resident is there by choice. Thus, the operation of a retirement living center requires the provision of services that are superior to a wide variety of alternate lifestyles and living circumstances readily available to affluent retirees. It is competition in its purest form.

By contrast, nursing home patients *need* some degree of continuing healthcare services they cannot obtain at home. These range from simple ongoing medication to more intensive care that includes assistance in walking, eating or even bathing. The primary focus of nursing homes is the development of an ability to meet specific healthcare needs. Forum's principal competitors are other nursing homes, and the selection of a nursing home is usually made on the basis of the services provided, the general atmosphere and appearance of the facility, and the cost involved.

Developmentally Disabled

Forum entered the healthcare service field in 1981 when it merged with Excepticon, Inc., the nation's largest



Fred S. Klipsch, Executive Vice President and Chief Operating Officer

for-profit provider of residential care to the developmentally disabled, a healthcare service area which, in many ways, requires the most dedicated and caring personnel in the industry. Excepticon was guided by two philosophies that have had a profound influence on management's subsequent approach to the healthcare industry: that the free enterprise private sector can consistently provide superior care at rates 30% to 60% *below* costs incurred at comparable federal and state facilities, and that a giving and cheerful attitude cannot be purchased at any price, but is a decisive factor to any healthcare operation. In a very real sense, the lessons learned from Excepticon became the standard for all Forum operations that followed.

Forum provides residential care to the developmentally disabled through five owned or leased healthcare facilities in Kentucky, Indiana and Illinois with a total licensed capacity for 555 residents. Four of these facilities are devoted to mentally and physically handicapped infants and children, and the fifth provides residential care and rehabilitation training to mentally handicapped adults. Most residents are eligible for Medicaid funds.

Forum's facilities for the developmentally disabled provide a steady source of income and render services and care of which shareholders can justly be proud.

Personnel

On November 14, 1984, Alexis Tarumianz lost his long fight against cancer. Alex was the founder of RLI and a former Director of Forum. We are deeply indebted to him for his great contribution in shaping our retirement living center business. We greatly value the friendship and counsel we shared with him.

Harold W. Mutz retired as an active Director at Forum's last annual meeting but continues to serve as an honorary Director. Mr. Mutz was a founder of Mutz Corporation, Forum's predecessor. His continuing service as a consultant to Forum is a valuable asset.

Healthcare service is a "people" business. The accomplishments achieved by Forum are the result of significant effort by over five thousand employees whose dedication has made those accomplishments possible. This is *their* report, and we are pleased to send it to our shareholders for them. □

The Scope of Forum

Total Combined Facilities						
	Number of Facilities				*Capacities*	
Description	*Owned*	*Leased*	*Managed*	*Total*	*Residents*	*Nursing*
Retirement Living Centers	4	1	6	11	1,546	658
Nursing Homes	14	59	4	77	–	4,539
Developmentally Disabled Facilities	2	3	–	5	555	–
Total	20	63	10	93	2,101	5,197

Retirement Living Centers

Number of Facilities				*Capacities*	
Owned	*Leased*	*Managed*	*Total*	*Residents*	*Nursing*
4	1	6	11	1,546	658

Location by State	Owned	Leased	Managed	Total
Delaware	3	–	2	5
Indiana	–	–	1	1
Kentucky	–	1	–	1
Maryland	–	–	1	1
North Carolina	–	–	1	1
Pennsylvania	1	–	–	1
South Carolina	–	–	1	1
Total	4	1	6	11

Nursing Homes

Number of Facilities				*Capacity*
Owned	*Leased*	*Managed*	*Total*	*Number of Beds*
14	59	4	77	4,539

Location by State	Owned	Leased	Managed	Total
Delaware	5	1	–	6
District of Columbia	–	–	1	1
Illinois	–	2	–	2
Indiana	8	56	1	65
Kentucky	–	–	2	2
Texas	1	–	–	1
Total	14	59	4	77

Facilities for the Developmentally Disabled

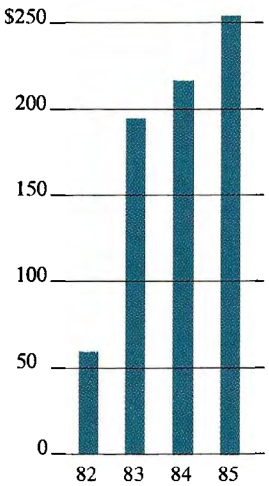
Number of Facilities				*Capacity*
Owned	*Leased*	*Managed*	*Total*	*Residents*
2	3	0	5	555

Location by State	Owned	Leased	Managed	Total
Illinois	2	1	–	3
Indiana	–	1	–	1
Kentucky	–	1	–	1
Total	2	3	–	5

Financial Review

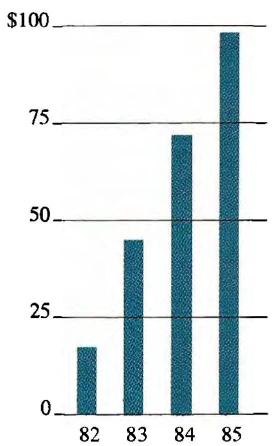
Total Assets

$—Millions



Stockholders' Equity

$—Millions



Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Results of operations for the three fiscal years ended March 31, 1983 through 1985, reflect the growth and development of Forum's long-term care division, namely retirement living centers, nursing homes and facilities for the developmentally disabled, and the acquisition, development and sale of its acute care division, principally psychiatric and medical-surgical hospitals. Net income in 1985 contains a net after-tax gain of approximately $25,000,000 from the sale of acute care division assets to Hospital Corporation of America.

Net Operating Revenues

Consolidated net operating revenues for fiscal 1985 were $21,005,000 more than consolidated net operating revenues for 1984. Acute care net operating revenues increased by $17,130,000, due principally to a 26% increase in patient days attributable to the acquisition of a psychiatric hospital in December, 1983, and the addition of three newly constructed psychiatric hospitals in late 1984 and early 1985. Average occupancy in the remaining psychiatric hospitals increased by approximately 10%, but was offset by a 15% decrease in average occupancy in the medical-surgical hospitals. Deductions from revenues for doubtful accounts and contractual adjustments increased by $8,325,000 in 1985. Virtually all of this increase is attributable to the acute care division, and a major portion is related to the establishment of reserves for sale of receivables and final settlements of Medicare and Medicaid cost reports. Long-term care net operating revenues increased by $3,875,000 in 1985, due principally to the addition of 2,376 nursing beds acquired in January, 1985, under operating leases.

Consolidated net operating revenues for 1984 were $23,130,000 more than consolidated net operating revenues for 1983. The major reason for this increase was the full year consolidation of the hospitals in 1984, as compared with the seven months consolidation in 1983. Hospital revenues for 1984 did not vary significantly from annualized revenues for 1983. A 3% decrease in patient days and a 12% increase in contractual adjustments and doubtful accounts were offset by a 13% increase in hospital charges. New beds opened in 1984 contributed approximately $800,000 to net operating revenues. The long-term care division enjoyed a 7% increase in net operating revenues, due in part to a 7% increase in resident census, in combination with a 10% increase in private pay rates. Cost-based reimbursement rates in the long-term care division increased moderately in 1984.

Other Income

Other income increased by $40,392,000 in 1985 due principally to a $38,000,000 gain from the March 31, 1985, sale of assets of the acute care division. In 1985, other income also included a $2,700,000 gain from the December, 1984, sale of a psychiatric hospital. Other income in 1984 increased by $3,083,000, of which $2,200,000 resulted from the sale of two retirement living centers to limited partnerships owned in part by officers and Directors of Forum. Forum continues to manage these retirement facilities pursuant to management agreements. Additional interest income accounted for the balance of the 1984 increase.

Operating Expenses

Operating expenses, including depreciation and amortization, as a percentage of net operating revenues were 85.9% in 1985 as compared to 82.7% in 1984 and 80.2% in 1983. The increase in 1985 is primarily related to the decline in net operating revenues caused by the previously-described (see *Net Operating Revenues*) increases in provisions for doubtful accounts and contractual adjustments in the acute care division. The percentage of increase in 1984 slightly exceeded the revenue increase for the same period, due to the inability of the hospitals to decrease staffing proportionally when census declined. The opening of new beds in both 1985 and 1984 also accounted for slight reductions in margins. Operating expenses, including depreciation and amortization, as a percentage of operating revenues before provisions for contractual adjustments and doubtful accounts, for 1985, 1984 and 1983 were 74.2%, 74.3% and 75.3%, respectively.

Interest Expense

Interest expense as a percentage of consolidated net operating revenues was 9.6% in 1985, 10.3% in 1984 and 14.1% in 1983. The decrease in 1985 is attributable to scheduled principal reductions in long-term debt, while the 1984 decline was due in part to the conversion of convertible subordinated debentures to equity. Interest expense in 1985 and 1984 was also reduced by the decline in long-term debt associated with the sale of certain retirement living centers.

Income Taxes

The effective income tax rates for 1985, 1984 and 1983 were 34.2%, 42.4% and 45.8%, respectively. These rates are less than statutory rates in each period, due mainly to lower rates on capital gain income and to investment tax credits. See Note E to Consolidated Financial Statements.

Liquidity and Capital Resources

The ratio of current assets to current liabilities was 3.6:1 at March 31, 1985, and 1.5:1 at March 31, 1984. Current financial resources, including short-term borrowing accommodations currently in use, plus anticipated funds from future operations, are expected to be adequate to meet current working capital requirements. At March 31, 1985, Forum had employed its $20,000,000 secured revolving credit under a loan agreement with a bank, but had available an unsecured credit line of $1,300,000.

Capital expenditures for the past twelve months have been significantly higher than depreciation expense. Forum continues to evaluate whether to lease or purchase capital items to obtain the best financing available relative to then-existing economic conditions.

At March 31, 1985, Forum had construction in progress on its consolidated balance sheet in the amount of $14,915,000. The estimated cost to complete these projects is approximately $28,690,000. The projects represent retirement living centers and nursing homes in varying stages of development and construction. At March 31, 1985, Forum had available $2,226,000 of cash restricted for construction. Forum expects to fund the balance of this construction from various types of long-term financing and available working capital sources.

Forum intends to retain the net proceeds, approximately $135,000,000, from the sale of substantially all of the assets of its acute care division, and to use these funds 1) for significant and unusual acquisition opportunities, 2) for repurchase of Common Stock and 1986 common stock purchase warrants, 3) temporarily, to purchase highly liquid investment instruments, and 4) temporarily, as required, to finance construction activities.

Forum intends to continue to develop and acquire healthcare service businesses which promise to contribute to growth in revenues and earnings, and to concentrate on the physical improvement and expansion of these businesses. Various types of financing will be employed. Also, Forum intends to dispose, from time to time, of certain of its healthcare facilities and to lease back or manage those facilities in order to repay indebtedness, provide working capital or provide additional capital for the expansion of its long-term healthcare services business. In addition, it is anticipated that off-balance sheet financing will also be pursued by syndicating retirement living centers. Forum will manage the facilities and may participate as a general partner in the syndication partnerships.

Impact of Inflation and Changing Prices

Forum consistently seeks ways to mitigate the effects of inflation on its performance. To the extent possible, increased costs are recovered through increased rates. See Note M to Consolidated Financial Statements.

Forward-Looking Information

A continuing management effort is being directed to the acquisition of other healthcare service entities. Forum seeks to fill areas of specific need that offer growth opportunities and to avoid direct competition with the primary business development thrusts of the major healthcare service firms. The specific need areas targeted are:

1. Retirement living centers.
2. Nursing home and protected care facilities in support of retirement living centers.

*Selected Financial Data **

Five–Year Summary	1985	1984	1983	1982	1981
	Year Ended March 31				
	(In thousands of dollars except per share amounts)				
Revenues	**$177,207**	$115,809	$ 89,597	$34,447	$ 258
Income from continuing operations	**33,893**	7,437	3,851	1,551	69
Income (loss) from discontinued operations	—	(592)	(267)	20	1,236
Extraordinary charge	—	(2,692)	—	—	—
Net income	**33,893**	4,153	3,583	1,571	1,305
Total assets	**253,598**	217,077	195,524	58,399	22,047
Long-term obligations	**96,356**	120,770	132,415	31,856	6,745
Common stockholders' equity	**98,683**	71,885	44,796	17,825	11,030
Per common and common equivalent share:					
Income from continuing operations	**1.46**	.38	.26	.15	.01
Income (loss) from discontinued operations	—	(.03)	(.02)	—	.21
Extraordinary charge	—	(.11)	—	—	—
Net income, primary	**1.46**	.24	.24	.15	.22
Net income, assuming full dilution	**1.39**	.24	.23	.15	.20
Dividends declared per common share	**.06**	.055	.05	.05	.03
Book value per common share	**4.80**	3.37	2.58	1.62	1.37

Quarterly Financial Data

The following quarterly financial data summarize the unaudited quarterly results for the two years ended March 31, 1985:

Quarters Ended	Net Operating Revenues	Operating Profit	Net Income	Net Income Per Share: Primary	Net Income Per Share: Fully Diluted
	(In thousands of dollars except per share amounts)				
June 30, 1983	$ 28,082	$ 7,107	$ 1,510	$ .08	$ .08
September 30, 1983	26,208	5,811	(1,299)	(.03)	(.03)
December 31, 1983	27,314	5,605	2,151	.10	.10
March 31, 1984	29,023	6,174	1,791	.08	.08
June 30, 1984	30,615	7,968	2,005	.10	.10
September 30, 1984	30,495	6,234	2,269	.11	.11
December 31, 1984	30,564	5,581	2,474	.12	.12
March 31, 1985	39,958	5,581	27,145	1.13	1.06

The above financial information reflects (i) discontinued operations, (ii) the August 31, 1983, acquisition of Grant Acquisition Corp. ("Grant") which was accounted for as a pooling-of-interests, (iii) the extraordinary charge attributable to the incentive value of the early conversion of Forum's 8¼% Convertible Subordinated Debentures, and (iv) the 2-for-1 stock split declared by the Board of Directors in July, 1983. Previously reported quarterly information on Form 10-Q for the quarter ended June 30, 1983, differs from amounts shown above due to the acquisition of Grant which was accounted for as a pooling-of-interests. See Notes B, C, D and I of Notes to Consolidated Financial Statements.

Net operating revenues related to discontinued operations for the quarters ended June 30 and September 30, 1983, were $1,838 and $2,658, respectively.

Market Price & Dividend Information

	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Total
Fiscal year ended March 31, 1984:					
Highest bid-lowest bid	11⅞-6⅞	11¾-8¼	10-5⅝	7½-4⅞	
Cash dividends per common share	$.0125	$.0125	$ .015	$.015	$.055
Fiscal year ended March 31, 1985:					
Highest bid-lowest bid	6⅜-4¾	8-5⅛	7¾-6⅝	11-6⅞	
Cash dividends per common share	$.015	$.015	$.015	$.015	$ .06

*Adjusted for all stock splits through March 31, 1985, inclusive. Not adjusted for 10% stock dividend declared during May, 1985.

Report of Independent Accountants

The Board of Directors and Stockholders
Forum Group, Inc.:

We have examined the consolidated balance sheet of Forum Group, Inc. and subsidiaries as of March 31, 1985 and the related consolidated statements of income, stockholders' equity and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The consolidated financial statements of Forum Group, Inc. for the years ended March 31, 1984 and 1983 were examined by other auditors whose report dated May 14, 1984 expressed an unqualified opinion on those statements.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Forum Group, Inc. and subsidiaries at March 31, 1985 and the results of their operations and the changes in their financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

Indianapolis, Indiana
July 5, 1985

Consolidated Balance Sheets

March 31		1985	1984
Assets			
Current Assets			
Cash and interest bearing deposits		$ 697,482	$ 3,122,313
Accounts receivable, less allowances for doubtful accounts and contractual adjustments (1985, $726,585; 1984, $3,899,109)		7,387,279	15,945,193
Notes, interest and other receivables — Note C		174,246,189	3,651,201
Inventories		503,611	1,539,264
Prepaid expenses		398,366	956,785
	Total Current Assets	183,232,927	25,214,756
Other Assets			
Notes receivable — Note F		7,002,592	4,705,055
Deferred loan costs		2,013,391	3,136,104
Sundry		1,759,246	8,533,209
		10,775,229	16,374,368
Property and Equipment — Notes F and K			
Land and improvements		2,814,635	7,144,675
Buildings and leasehold improvements		38,442,753	137,279,619
Furniture and equipment		6,346,429	12,059,605
		47,603,817	156,483,899
Less allowances for depreciation and amortization		5,154,548	9,104,008
		42,449,269	147,379,891
Construction in progress (estimated cost to complete of $28,690,000 in 1985)		14,914,539	13,490,259
Cash restricted for construction		2,226,363	14,617,638
		59,590,171	175,487,788
		$253,598,327	$217,076,912

See Notes to Consolidated Financial Statements.

March 31	1985	1984

Liabilities and Stockholders' Equity

Current Liabilities		
Notes payable	$ —	$ 279,390
Accounts payable	7,501,171	2,875,852
Employee compensation and payroll taxes	3,204,978	2,880,304
Accrued expenses	14,671,556	3,291,962
Income taxes payable	2,456,028	3,166,190
Deferred income taxes	18,965,857	127,321
Current maturities of long-term debt and capital lease obligations	4,617,656	4,658,133
Total Current Liabilities	51,417,246	17,279,152
Long-Term Debt, less current maturities—Note F	45,820,338	54,218,552
Capital Lease Obligations, less current maturities—Note K	3,513,279	16,923,737
Deferred Income Taxes—Note E	2,330,647	4,866,171
Senior Subordinated Notes—Note G	31,657,401	31,727,586
Convertible Subordinated Debentures—Note H	13,034,000	13,034,000
Preferred Stock, at redemption value—Note B	7,142,400	7,142,400
Common Stockholders' Equity—Notes B, F, G, H, I and J		
Common Stock, no par value—authorized 35,000,000 shares, issued 23,256,659 shares (1984, 22,648,075 shares)	71,454,502	68,987,143
Paid-in capital	2,031,200	2,634,981
Retained earnings	40,019,145	7,355,190
	113,504,847	78,977,314
Less treasury stock, at cost (1985, 2,698,225 shares; 1984, 1,340,000 shares)	14,821,831	7,092,000
	98,683,016	71,885,314
Commitments and Contingencies—Note L		
	$253,598,327	$217,076,912

Consolidated Statements of Income

Year Ended March 31	1985	1984	1983
Operating revenues	**$152,446,074**	$123,116,746	$ 93,183,880
Less provisions for doubtful accounts and contractual adjustments	**20,814,344**	12,489,809	5,686,566
Net Operating Revenues	**131,631,730**	110,626,937	87,497,314
Other income — Notes C and K	**45,574,811**	5,182,523	2,099,951
	177,206,541	115,809,460	89,597,265
Costs and expenses:			
Operating expenses	**106,267,904**	85,929,898	66,301,231
Depreciation and amortization	**6,842,248**	5,572,131	3,873,719
Interest — Note F	**12,622,987**	11,403,995	12,314,204
	125,733,139	102,906,024	82,489,154
Income From Continuing Operations Before Income Taxes	**51,473,402**	12,903,436	7,108,111
Income taxes — Note E	**17,580,000**	5,466,000	3,257,387
Income From Continuing Operations	**33,893,402**	7,437,436	3,850,724
Loss from discontinued operations, net of applicable income taxes — Note D	—	(592,000)	(267,403)
Extraordinary charge with no related income tax effect — Note H	—	(2,692,084)	—
Net Income	**$ 33,893,402**	$ 4,153,352	$ 3,583,321
Average number of common and common equivalent shares — Note I	**24,555,075**	24,469,361	15,778,284
Net income (loss) per common and common equivalent share			
Primary:			
Continuing operations	**$ 1.46**	$ .38	$ .26
Discontinued operations	—	(.03)	(.02)
Extraordinary charge	—	(.11)	—
Net income	**$ 1.46**	$ .24	$ .24
Fully diluted:			
Continuing operations	**$ 1.39**	$ .38	$ .24
Discontinued operations	—	(.03)	(.01)
Extraordinary charge	—	(.11)	—
Net income	**$ 1.39**	$ .24	$ .23

See Notes to Consolidated Financial Statements.

Consolidated Statements of Common Stockholders' Equity

	Common Stock					
	Number of Shares	Amount	Paid-in Capital	Retained Earnings	Treasury Stock	Total
Year ended March 31, 1983:						
Balances at April 1, 1982	10,988,040	$ 8,908,973	$4,204,877	$ 4,710,717	$ —	$17,824,567
Net income	—	—	—	3,583,321	—	3,583,321
Cash dividends - $.05 per share	—	—	—	(582,273)	—	(582,273)
Cost of increasing authorized shares	—	(10,006)	—	—	—	(10,006)
Exercise of stock options and warrants	174,806	593,019	(143,256)	—	—	449,763
Tax benefit from early disposition of stock by optionees	—	15,996	—	—	—	15,996
Stock issued in acquisitions—Note B	3,904,000	11,470,500	—	—	—	11,470,500
Stock issued under employee stock purchase plan	5,610	31,639	—	—	—	31,639
Issuance of Units—Note I	2,200,000	11,937,500	—	—	—	11,937,500
Conversion of convertible subordinated debentures	62,500	75,000	—	—	—	75,000
Balances at March 31, 1983	17,334,956	33,022,621	4,061,621	7,711,765	—	44,796,007
Year ended March 31, 1984:						
Net income	—	—	—	4,153,352	—	4,153,352
Cash dividends - $.055 per share	—	—	—	(1,062,856)	—	(1,062,856)
Cost of increasing authorized shares	—	(40,006)	—	—	—	(40,006)
Exercise of stock options and warrants	1,419,175	5,919,658	(1,426,640)	—	—	4,493,018
Tax benefit from early disposition of stock by optionees	—	62,350	—	—	—	62,350
Stock issued in acquisitions—Note B	159,102	971,792	—	—	—	971,792
Conversion of convertible subordinated debentures	3,734,842	29,050,728	—	—	—	29,050,728
Distribution of former subsidiary to shareholders—Note D	—	—	—	(3,282,407)	—	(3,282,407)
Adjustments to conform fiscal year of subsidiary to parent—Note B	—	—	—	(164,664)	—	(164,664)
Purchase of 1,340,000 shares for treasury—Note I	—	—	—	—	(7,092,000)	(7,092,000)
Balances at March 31, 1984	22,648,075	68,987,143	2,634,981	7,355,190	(7,092,000)	71,885,314
Year ended March 31, 1985:						
Net income	—	—	—	33,893,402	—	33,893,402
Cash dividends - $.06 per share	—	—	—	(1,229,447)	—	(1,229,447)
Exercise of stock options and warrants	608,584	2,455,451	(603,781)	—	—	1,851,670
Tax benefit from early disposition of stock by optionees	—	11,908	—	—	—	11,908
Purchase of 1,358,225 shares for treasury—Note I	—	—	—	—	(7,729,831)	(7,729,831)
Balances at March 31, 1985	23,256,659	$71,454,502	$2,031,200	$40,019,145	$(14,821,831)	$98,683,016

See Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Financial Position

Year ended March 31	1985	1984	1983
Sources of Working Capital			
Income from continuing operations	**$ 33,893,402**	$ 7,437,436	$ 3,850,724
Items not affecting working capital:			
Depreciation and amortization	**6,842,248**	5,572,131	3,873,719
Other amortization	**934,875**	1,046,972	—
Deferred income taxes	**(2,535,524)**	2,080,961	1,401,846
Total From Continuing Operations	**39,135,001**	16,137,500	9,126,289
Loss from discontinued operations, net of items not affecting working capital	—	(515,980)	(113,853)
Total From Operations	**39,135,001**	15,621,520	9,012,436
Net assets of discontinued operations	—	—	3,125,446
Issuance of Common Stock	—	—	11,937,500
Issuance of Preferred Stock	—	7,142,400	—
Additional long-term obligations and capital lease obligations	**30,730,605**	34,077,662	150,897,388
Working capital obtained in acquisitions	**8,620**	372,119	2,356,230
Proceeds from conversion of convertible subordinated debentures, net of extraordinary charge of $2,692,084 in 1984	—	26,358,644	75,000
Proceeds from exercise of stock options and warrants	**1,851,670**	4,493,018	449,763
Disposals of property and equipment	**130,433,588**	7,340,503	96,273
Disposals of other assets	**6,213,525**	—	—
Ascribed value of Common Stock and warrants issued in connection with acquisitions	—	971,792	11,470,500
Decrease in notes receivable	**1,400,238**	2,630,527	—
Other	**182,566**	—	37,629
	209,955,813	99,008,185	189,458,165

(Continued on following page.)

Consolidated Statements of Changes in Financial Position, continued

Year ended March 31	1985	1984	1983
Applications of Working Capital			
Acquisitions:			
Working capital	**8,620**	372,119	2,356,230
Property and equipment and other assets	**4,268,798**	7,775,898	112,485,933
Less long-term obligations	**(1,019,128)**	(3,636,954)	(30,256,247)
	3,258,290	4,511,063	84,585,916
Net assets of discontinued operations	**—**	—	3,125,446
Increase in other assets	**2,458,415**	1,737,344	6,843,217
Additions to property and equipment	**16,733,549**	28,820,781	8,490,172
Payments and transfers to current maturities of long-term debt and capital lease obligations	**29,376,897**	24,252,946	81,917,739
Long-term debt and capital lease obligations assumed by buyer in sales of assets	**23,712,008**	—	—
Conversion of convertible subordinated debentures	**—**	26,456,214	75,000
Senior subordinated notes used to exercise warrants	**1,016,322**	489,596	—
Cash dividends	**1,229,447**	1,062,856	582,273
Distribution of subsidiary	**—**	3,282,407	—
Purchase of Common Stock for treasury	**7,729,831**	7,092,000	—
Other	**560,977**	556,902	—
	86,075,736	98,262,109	185,619,763
Increase In Working Capital	**$123,880,077**	$ 746,076	$ 3,838,402

Changes In Components of Working Capital			
Increase (decrease) in current assets:			
Cash and interest bearing deposits	**$ (2,424,831)**	$ 1,040,353	$ (151,611)
Accounts receivable	**(8,557,914)**	(980,330)	11,896,144
Notes, interest and other receivables	**170,594,988**	1,662,537	312,653
Inventories	**(1,035,653)**	(2,189,252)	867,120
Prepaid expenses	**(558,419)**	178,583	509,485
	158,018,171	(288,109)	13,433,791
Increase (decrease) in current liabilities:			
Notes payable	**(279,390)**	(667,610)	947,000
Accounts payable	**4,625,319**	(2,307,361)	3,104,963
Employee compensation and payroll taxes	**324,674**	424,475	726,010
Accrued expenses	**11,379,594**	(199,086)	2,054,660
Income taxes payable	**(710,162)**	2,124,780	225,926
Deferred income taxes	**18,838,536**	127,321	—
Current maturities of long-term debt and capital lease obligations	**(40,477)**	(536,704)	2,536,830
	34,138,094	(1,034,185)	9,595,389
Increase In Working Capital	**$123,880,077**	$ 746,076	$ 3,838,402

See Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Financial Position, continued

Year ended March 31	1985	1984	1983
Applications of Working Capital			
Acquisitions:			
Working capital	**8,620**	372,119	2,356,230
Property and equipment and other assets	**4,268,798**	7,775,898	112,485,933
Less long-term obligations	**(1,019,128)**	(3,636,954)	(30,256,247)
	3,258,290	4,511,063	84,585,916
Net assets of discontinued operations	—	—	3,125,446
Increase in other assets	**2,458,415**	1,737,344	6,843,217
Additions to property and equipment	**16,733,549**	28,820,781	8,490,172
Payments and transfers to current maturities of long-term debt and capital lease obligations	**29,376,897**	24,252,946	81,917,739
Long-term debt and capital lease obligations assumed by buyer in sales of assets	**23,712,008**	—	—
Conversion of convertible subordinated debentures	—	26,456,214	75,000
Senior subordinated notes used to exercise warrants	**1,016,322**	489,596	—
Cash dividends	**1,229,447**	1,062,856	582,273
Distribution of subsidiary	—	3,282,407	—
Purchase of Common Stock for treasury	**7,729,831**	7,092,000	—
Other	**560,977**	556,902	—
	86,075,736	98,262,109	185,619,763
Increase In Working Capital	**$123,880,077**	$ 746,076	$ 3,838,402

	1985	1984	1983
Changes In Components of Working Capital			
Increase (decrease) in current assets:			
Cash and interest bearing deposits	**$ (2,424,831)**	$ 1,040,353	$ (151,611)
Accounts receivable	**(8,557,914)**	(980,330)	11,896,144
Notes, interest and other receivables	**170,594,988**	1,662,537	312,653
Inventories	**(1,035,653)**	(2,189,252)	867,120
Prepaid expenses	**(558,419)**	178,583	509,485
	158,018,171	(288,109)	13,433,791
Increase (decrease) in current liabilities:			
Notes payable	**(279,390)**	(667,610)	947,000
Accounts payable	**4,625,319**	(2,307,361)	3,104,963
Employee compensation and payroll taxes	**324,674**	424,475	726,010
Accrued expenses	**11,379,594**	(199,086)	2,054,660
Income taxes payable	**(710,162)**	2,124,780	225,926
Deferred income taxes	**18,838,536**	127,321	—
Current maturities of long-term debt and capital lease obligations	**(40,477)**	(536,704)	2,536,830
	34,138,094	(1,034,185)	9,595,389
Increase In Working Capital	**$123,880,077**	$ 746,076	$ 3,838,402

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Note A - Summary of Significant Accounting Policies

Principles of Consolidation: The consolidated financial statements include the accounts of Forum and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Inventories: Inventories are comprised of medical supplies and are stated at the lower of cost (first-in, first-out method) or market.

Start-Up Costs: Certain direct costs incurred prior to and in connection with commencing operations of newly-constructed healthcare facilities are capitalized. These costs are amortized over a five-year period by the straight-line method beginning with the month that operations commence.

Deferred Loan Costs: Deferred loan costs are amortized by the straight-line method over the terms of the related loans.

Property and Equipment: Property and equipment is carried on the basis of cost and includes certain costs incurred prior to and in connection with the development of healthcare facilities. Capital leases are recorded at the lower of fair market value or the present value of the minimum annual payments. Depreciation and amortization are computed by the straight-line method at rates calculated to amortize the costs over the estimated useful lives of the respective assets.

Federal Income Taxes: A consolidated federal income tax return is filed. Investment tax credit is included in income when realized (flow-through method).

Income Per Share Data: Net income per common and common equivalent share is based on the weighted average number of common and common equivalent shares outstanding each period. Common equivalent shares consist of stock options and common stock purchase warrants. In determining the number of common equivalent shares, Forum includes average common shares attributable to stock options and common stock purchase warrants using the treasury stock method.

Net income per share amounts have been adjusted to include interest on notes, net of tax, applicable to senior subordinated notes that may be used in payment of the exercise price of common stock purchase warrants (primary and fully diluted), and convertible subordinated debentures (fully diluted).

Healthcare Services: Operations consist of one segment, the healthcare services industry. Through March 31, 1985, healthcare services principally included the providing of acute and long-term care through the operation of psychiatric and medical-surgical hospitals, retirement living centers, nursing homes and facilities for the developmentally disabled. During its fiscal year ended March 31, 1985, Forum disposed of substantially all the assets of its acute care division in two transactions, the latter of which was consummated on March 31, 1985 (*see* Note C). Forum intends to concentrate its resources and future efforts on accelerated growth and development of the three businesses formerly comprising its long-term care division, namely retirement living centers, nursing homes and facilities for the developmentally disabled, with particular emphasis on the acquisition and development of retirement living centers.

Advance payments are received, in certain instances, for services to be provided. Recognition of these payments as income is deferred until the related services have been provided. Net operating revenues include amounts estimated by management to be reimbursable by Medicare, Medicaid and other cost-based programs under the provisions of cost-reimbursement formulae or, for Medicare cost reporting periods beginning after October 1, 1983, under a fixed price payment system based upon the individual Medicare patient's diagnostic related group. Amounts received for treatment of patients covered by cost-based programs are generally less than established billing rates. The difference between established billing rates and amounts received is accounted for as a contractual adjustment. Cost-related reimbursements are subject to examination by agencies administering the programs, and provisions are made for potential adjustments which may result from examinations. To the extent those provisions vary from the amount of settlement, earnings are charged or credited in the period in which the adjustment becomes final.

Note B—Business Combinations

On August 31, 1983, Forum acquired all of the outstanding shares of capital stock of Grant Acquisition Corp. ("Grant") for 1,992,000 shares of Forum Common Stock. Grant was formed on February 12, 1982, and is a provider of psychiatric care to children and adolescents. This transaction was accounted for as a pooling-of-interests and, accordingly, the consolidated financial statements for fiscal 1984 and 1983 have been restated to include the financial results of Grant.

Grant previously reported on the basis of a fiscal year ended June 30. In the consolidated statements of income, Grant's results of operations for the year ended June 30, 1983, have been combined with Forum's results for the year ended March 31, 1983. Retained earnings have been adjusted by $164,664, representing the net income of Grant for the three months ended June 30, 1983, that is duplicated in the consolidated financial statements. A reconciliation of net operating revenues, net income and net income per share for periods prior to acquisition follows:

Notes to Consolidated Financial Statements, continued

	Year Ended March 31 1984	1983
Net operating revenues:		
Forum	$105,674,194	$78,803,324
Grant	4,952,743	8,693,990
Restated	$110,626,937	$87,497,314
Net income:		
Forum	$ 3,746,674	$ 3,433,429
Grant	406,678	149,892
Restated	$ 4,153,352	$ 3,583,321
Net income per common and common equivalent share:		
Forum	$ .22	$ .23
Grant	.02	.01
Restated	$ .24	$ .24

Subsequent to the acquisition of Grant, Forum issued 320,000 shares of non-dividend, non-voting, convertible preferred stock in exchange for a note payable to a former shareholder of Grant. The note had a book value of $6,870,000 (net of unamortized discount). The preferred stock is convertible into shares of Forum Common Stock at the option of the holder at any time at rates ranging from 2.075 to 2.79 shares of Forum Common Stock for each share of preferred stock, or may be tendered for redemption at the option of the holder between September 1, 1993, and six months thereafter at $22.32 per share. Also subsequent to the acquisition, Forum borrowed $10,000,000 at interest rates ranging from 10% to 15% from the same former shareholder of Grant (*see* Note G).

During fiscal 1984, Forum acquired the remaining 70% ownership of a psychiatric hospital and two nursing homes from Health Care, Incorporated ("Health Care"), for an aggregate cost of $8,148,000, including $4,373,000 of liabilities assumed.

On August 25, 1982, Forum acquired all the assets, and agreed to pay, perform and discharge all the duties, obligations, contracts and liabilities, of American Medical Centers, Inc. ("AMC"). The assets acquired consisted of five psychiatric hospitals located in Florida, Texas and Virginia, and five medical-surgical hospitals located in Alabama, Georgia and Texas. This transaction was accounted for as a purchase with an effective date of August 25, 1982. Consolidated operating revenues for 1983 include management fees of $660,000 for deemed value of services performed by Forum for AMC. The total purchase price of approximately $76,560,000 consisted primarily of $70,800,000 in cash and 1,920,000 shares of Forum Common Stock. Forum has guaranteed that the Forum Common Stock received by the former AMC shareholders will have a value of $7.50 per share at the third anniversary date of this transaction. Forum may satisfy any deficiency in the guaranteed value obligation by a supplemental payment in cash or in shares of Forum Common Stock.

On August 10, 1982, Forum acquired Somerset Corporation ("Somerset"), which was principally owned by certain officers and Directors of Forum. Somerset is an owner-operator of seven nursing homes located in Indiana having an aggregate licensed capacity of 611 nursing home beds. This transaction was accounted for as a purchase with an effective date of July 1, 1982. The total purchase price of approximately $5,650,000 consisted primarily of $250,000 in cash and 1,800,000 shares of Forum Common Stock.

On June 9, 1982, Forum acquired Medical Corporation of America ("MCA"). This transaction was accounted for as a purchase with an effective date of June 1, 1982. The purchase price consisted of 184,000 shares of Forum Common Stock. The excess of the purchase price over the net assets acquired has been amortized over forty years.

Assuming the above-described business combinations had taken place as of the beginning of the respective years prior to their consummation, certain unaudited *pro forma* income information from continuing operations for the year ended March 31, 1983, would be as follows:

Net operating revenues	$111,349,000
Net income	2,983,000
Net income per common and common equivalent share:	
Primary	.18
Fully diluted	.17

Note C — Sale of Assets of Acute Care Division

On March 31, 1985, Forum disposed of substantially all of the assets of its acute care division (principally psychiatric and medical-surgical hospitals) for an aggregate consideration of approximately $200,000,000. Included in *Current Assets — Notes, Interest and Other Receivables* at March 31, 1985, is $171,500,000 due from the sale, which was received on April 3, 1985. The net pre-tax gain from this transaction was $38,000,000, and is included in *Other Income* at March 31, 1985. During the quarter ended December 31, 1984, Forum realized a net pre-tax gain of $2,700,000, from the sale of a psychiatric hospital, which is also included in *Other Income*.

Operating results of the acute care division (in thousands of dollars) amounted to net operating revenues of $83,684, $66,554 and $45,995, and operating profits of $19,476, $17,125 and $13,001 for the fiscal years ended March 31, 1985, 1984 and 1983, respectively.

Notes to Consolidated Financial Statements, continued

Note D - Discontinued Operations

On May 23, 1983, Forum adopted a plan to discontinue ownership in its air distribution systems and products manufacturing subsidiary, Capital Industries, Inc. ("Capital"). Under the plan to discontinue ownership, one share of Capital Common Stock was distributed to each shareholder of Forum for every twenty shares of Forum Common Stock held. Amounts included in the consolidated statements of income have been reclassified to set forth separately the results of the discontinued ownership in Capital under the caption *Loss From Discontinued Operations.*

Note E - Income Taxes

The provision for income taxes is comprised of the following:

	Year Ended March 31		
	1985	1984	1983
Federal:			
Current	**$ 1,351,000**	$1,059,000	$ 37,531
Deferred:			
Installment reporting	**11,936,000**	—	—
Cash basis of reporting	**1,746,000**	1,561,000	1,574,052
Accelerated depreciation	**718,000**	1,469,000	1,529,492
Minimum tax	**262,000**	—	—
State income taxes	**(1,463,000)**	2,000	(27,153)
Reserve for losses	**(480,000)**	—	—
Lease adjustments	**(53,000)**	673,000	—
Other	**(56,000)**	(112,000)	(75,223)
State (including $2,749,000 of deferred in 1985)	**3,619,000**	814,000	218,688
	$17,580,000	$5,466,000	$3,257,387

A reconciliation of the difference between the expected provision (computed by applying the statutory federal income tax rate to income from continuing operations before income taxes and extraordinary charge) and the actual provision for income taxes is as follows:

	Year Ended March 31		
	1985	1984	1983
Expected provision	**$23,678,000**	$5,936,000	$3,269,730
Add (deduct) tax effect of:			
Investment tax credit	**(206,000)**	(508,000)	(151,900)
Investment tax credit recapture	**136,000**	—	—
Contribution carry-forward	**—**	(110,000)	—
Capital gains rates	**(8,305,000)**	(456,000)	—
Minimum tax	**415,000**	—	—
Other	**138,000**	164,000	21,557
State tax	**1,724,000**	440,000	118,000
Actual provision	**$17,580,000**	$5,466,000	$3,257,387

Note F - Long-Term Debt

Details of long-term debt are as follows:

	March 31	
	1985	1984
Revolving credit agreement	**$20,000,000**	$ —
Term notes payable to bank	**2,502,743**	4,478,124
Term note payable to insurance company	**1,890,000**	2,330,000
Industrial development bonds, 8% to 13%, payable in varying installments from 1992 through 2008	**11,131,106**	31,866,500
Mortgage loans, 7.5% to 15.38%, payable in varying monthly installments through 2007	**14,601,055**	15,454,632
Other notes, 7% to 15%, payable in varying installments through 1996	**271,213**	4,009,316
	50,396,117	58,138,572
Less current maturities	**4,575,779**	3,920,020
	$45,820,338	$54,218,552

Forum has a seven-year, $20,000,000 revolving credit agreement with a bank. The agreement provides for a three-year revolving line (revolver) that converts into a four-year term loan, both collateralized by a pledge of certain Forum subsidiaries' stock and guaranteed by those subsidiaries. The loan agreement contains covenants limiting, among other things, cash dividends, the pledge of assets and additional borrowings. The agreement also provides for a standby fee of ½% per annum on the unutilized portion of the revolver. The revolver is to mature on April 1, 1986, and bears interest at ½% above the bank's prime rate. The term note is to be dated April 1, 1986, and principal payments are to be made in sixteen consecutive quarterly installments commencing July 1, 1986, the first twelve of which are each to be in the amount of 5% of the original principal amount and the last four of which are each to be in the amount of 10% of the original principal amount. Interest is to be paid quarterly commencing July 1, 1986, at ¾% above the bank's prime rate from April 1, 1986, through March 31, 1988, and 1% above the bank's prime rate from April 1, 1988, through March 31, 1990.

The term notes payable to a bank represent borrowings under a five-year loan agreement dated November 20, 1981. The principal is payable in twenty equal quarterly payments plus interest at the bank's prime rate (10½% and 11½% at March 31, 1985 and 1984, respectively). The term note payable to an insurance company bears interest at 10½%, payable quarterly. The principal is payable in the amount of $110,000 per quarter through 1988 and $240,000 on March 15, 1989. Collateral for the term notes consists of notes receivable ($4,162,000 at March 31, 1985) and the assignment of payments due Forum under a noncompete agreement. The loan

Notes to Consolidated Financial Statements, continued

agreements contain covenants which, among other things, require minimum working capital and limit cash dividends, the pledge of assets and additional borrowings. Cash dividends are limited to 15% of net income for the year ended June 30, 1985.

The industrial development bonds and mortgage loans are collateralized by substantially all the property of Forum, and the other notes payable are collateralized by certain equipment. In addition, Forum had outstanding letters of credit in the amount of $18,000,000 at March 31, 1985, issued in lieu of collateral.

During 1985 and 1984, Forum incurred interest costs of $14,252,522 and $13,382,200, of which $1,629,535 and $1,978,205 was capitalized, respectively. Capitalized interest for 1983 was not material.

Maturities of long-term debt and senior subordinated notes during the five years subsequent to March 31, 1985, are as follows: 1986 - $4,575,779; 1987 - $2,523,514; 1988 - $1,810,794; 1989 - $5,302,257; 1990 - $6,487,843.

As of March 31, 1985, Forum may borrow, at the option of the bank, up to $1,300,000 under a line of credit arrangement. The agreement provides for average annual compensating balances of $130,000 and for interest to be paid at the bank's prime rate.

Note G—Senior Subordinated Notes

During March, 1983, Forum issued $25,000,000 of ten-year, 10% senior subordinated notes, the proceeds of which were used to prepay a portion of the debt incurred in connection with the AMC acquisition. These notes have been discounted by $3,789,205 and $4,467,370 at March 31, 1985 and 1984, respectively, to yield an effective interest rate of 13.875%. Interest is payable on March 15 and September 15 of each year and the notes may be redeemed by Forum, in whole or in part, at any time on or after March 15, 1988, at 100% of the principal amount plus accrued interest. Mandatory sinking fund payments sufficient to retire $2,500,000 principal amount of notes annually, commencing March 15, 1988, are calculated to retire 50% of the issue prior to maturity. Forum has the non-cumulative option to increase the sinking fund payment in any year by up to an additional $2,500,000. Forum may also deliver notes in lieu of cash in making mandatory sinking fund payments.

During September, 1983, Forum issued $10,000,000 of senior subordinated notes with interest, per annum, at 15% to September, 1986, 10% thereafter to March, 1989, and 13% thereafter. Interest is payable semi-annually commencing September, 1984, with principal payments, payable semi-annually, commencing March, 1989, and a final maturity date of September, 1991.

The notes are subordinated to all senior indebtedness of Forum as defined in the note indentures and are senior in right of payment to the convertible subordinated debentures. On or before July 1, 1985, for the $25,000,000 notes, and at any time prior to maturity for the $10,000,000 notes, the notes, valued at their principal amount, may be used to exercise the 1985 or 1986 common stock purchase warrants.

Note H—Convertible Subordinated Debentures

During March, 1983, Forum also issued $40,000,000 of fifteen-year convertible subordinated debentures which bear interest at 8¼% payable March 15 and September 15 of each year. The proceeds were used to prepay a portion of the debt incurred in connection with the AMC acquisition. These debentures are convertible into Forum Common Stock at the rate of one share for each $8.44 of principal amount and may be redeemed at the option of Forum, in whole or in part, at any time on or after March 15, 1985, at 108% (decreasing 1% per year through 1993) of the principal amount plus accrued interest (except that no redemption may be made prior to March 15, 1988, using borrowed funds having an interest cost of less than 8¼%). Mandatory sinking fund payments sufficient to retire $3,750,000 principal amount of these debentures annually, commencing March 15, 1990, are calculated to retire 75% of the issue prior to maturity. Forum has the non-cumulative option to increase the sinking fund payment in any year by up to an additional $3,750,000. Forum may deliver debentures in lieu of cash in making mandatory sinking fund payments. These debentures are subordinated to all senior indebtedness of Forum, and Forum has reserved 1,544,312 shares of its Common Stock for conversion of these debentures.

On July 18, 1983, Forum reduced the conversion price on these debentures from $8.44 per share to $7.81 per share for any conversions into shares of Forum Common Stock on or before August 15, 1983. At August 15, 1983, $26,901,000 of these debentures had been converted into shares of Forum Common Stock. It was determined that APB Opinion No. 26, Early Extinguishment of Debt, was applicable to this incentive conversion transaction and that Forum was required to record the incentive value of the early conversions as an extraordinary charge. The amount of the extraordinary charge is the difference between the market value of the shares of Forum Common Stock and the carrying value of the debentures. This accounting treatment had no effect on income from continuing operations, cash flow or net worth.

Note I—Common Stockholders' Equity

During May, 1985, the Board of Directors declared a quarterly cash dividend of $.015 per share and a 10% stock dividend, both payable August 5, 1985, to shareholders of record on July 15, 1985. The Board of Directors also proposed to the shareholders that Forum's Articles of Incorporation be amended to increase the number of authorized

Notes to Consolidated Financial Statements, continued

Note I—Common Stockholders' Equity, continued
shares of Forum Common Stock from 35,000,000 shares to 50,000,000 shares. References to numbers of shares and per share amounts have *not* been adjusted for these transactions.

The Board of Directors has authorized management to repurchase up to an aggregate of 5,000,000 shares of Forum Common Stock and up to all of Forum's 1986 common stock purchase warrants, at any time and from time to time in accordance with applicable securities laws and after obtaining any required approvals from Forum's lenders. During 1985 and 1984, 1,358,225 and 1,340,000 shares of Forum Common Stock, respectively, were repurchased and placed in treasury. No 1986 common stock purchase warrants were repurchased.

During July, 1983, the Board of Directors declared a two-for-one stock split for distribution on August 5, 1983, and the shareholders approved an increase in the number of authorized shares of Forum Common Stock from 15,000,000 shares to 35,000,000 shares. All references to numbers of shares and per share amounts have been adjusted for these transactions.

During December, 1982, Forum issued 1,100,000 units for net proceeds of approximately $11,937,500. The proceeds were used to prepay a portion of the debt incurred in connection with the AMC acquisition. Each unit consists of two shares of Forum Common Stock and a 1985 common stock purchase warrant. Each 1985 common stock purchase warrant enables the holder to purchase two shares of Forum Common Stock at $7.92 per share if exercised during 1984 and at $9.12 per share thereafter until December 31, 1985, the warrant expiration date. At March 31, 1985, there were 1,088,895 of the 1985 common stock purchase warrants outstanding.

In September, 1981, Forum issued 1,529,874 of 1986 common stock purchase warrants, each to purchase 2½ shares of Forum Common Stock for $8.00 ($3.20 per share) during the next five years. These warrants are redeemable in cash at $2.75 per warrant if not exercised. At March 31, 1985, there were 738,618 of the 1986 common stock purchase warrants outstanding.

On August 5, 1981, shareholders authorized 1,000,000 shares of non-voting preferred stock and 1,000,000 shares of voting preferred stock, all without par value. At March 31, 1985, there were 320,000 shares of non-voting preferred stock, and no shares of voting preferred stock, outstanding.

Note J—Stock Option Plan
Stock options have been granted to certain officers and key employees to purchase shares of Forum Common Stock in accordance with the terms of an incentive stock option plan. The options are exercisable beginning with the date of the grant through the fifth year at the cumulative rate of 20% per year. The options are at prices not less than the fair market value of Forum Common Stock at the dates of grants, and are nonassignable.

The following summarizes option data relating to the stock option plan:

	Number of Shares	Option Price Per Share
Options outstanding:		
March 31, 1983	716,646	$ .85 to $7.02
March 31, 1984	629,286	1.60 to 9.25
March 31, 1985	667,350	1.60 to 9.25
Options exercisable:		
March 31, 1983	142,970	.85 to 7.02
March 31, 1984	133,053	1.60 to 9.25
March 31, 1985	133,620	1.60 to 9.25
Options exercised:		
Year ended March 31, 1983	22,910	.90 to 3.24
Year ended March 31, 1984	102,980	.85 to 7.02
Year ended March 31, 1985	59,892	2.10 to 7.02

At March 31, 1985, a total of 700,614 shares were available for future grants. The aggregate market value of all shares of Forum Common Stock covered by outstanding stock options was $6,590,081 ($9.875 per share) and $3,146,430 ($5.00 per share) at March 31, 1985 and 1984, respectively.

Note K—Leases
Certain operating facilities and equipment are leased. The leases expire on various dates but generally may be renewed for additional periods. Certain of the leases also contain options to purchase.

Total rental expense for all leases amounted to $3,678,222, $1,230,335 and $1,670,444 for 1985, 1984 and 1983, respectively. Future minimum payments under noncancelable leases are as follows as of March 31, 1985:

Fiscal Year	Operating	Capital
1986	$ 7,757,799	$ 354,607
1987	7,454,167	354,607
1988	7,259,159	354,607
1989	7,134,748	354,607
1990	7,134,748	354,607
Thereafter	$39,405,331	7,900,661
	$76,145,952	9,673,696
Less amount representing interest		6,118,540
Present value of minimum lease payments		3,555,156
Less current portion		41,877
		$ 3,513,279

Included in property and equipment are amounts for capital

Notes to Consolidated Financial Statements, continued

leases of $4,323,882 and $57,082,375 (consisting principally of buildings and leasehold improvements), and related accumulated amortization of $414,184 and $2,717,882, as of March 31, 1985 and 1984, respectively.

Forum leases fifty-eight intermediate care nursing homes from entities which are owned by officers and Directors of Forum. The term of each lease commenced December 21, 1984, and expires on December 31, 1995, and each lease is on an absolutely net basis. Certain other operating facilities and equipment are leased from entities in which officers and Directors of Forum have ownership interests. Rental payments to these entities were $2,175,000, $230,000 and $381,000 for 1985, 1984 and 1983, respectively.

During 1985 and 1984, Forum sold one and two retirement living centers, respectively, to limited partnerships in which officers and Directors of Forum have ownership interests, at net gains to Forum of $2,188,000 and $2,228,000 in 1985 and 1984, respectively, which are included in other income. Forum now manages these facilities for fees, and operating revenues include $449,600 and $210,000 in 1985 and 1984, respectively, related thereto.

Note L – Commitments and Contingencies

Consultation Agreements. In connection with two of Forum's business combinations accounted for as purchase transactions, Forum entered into consultation agreements with entities owned in part by the former owners of the acquired businesses. Under the terms of the agreements, Forum is to make payments aggregating $612,500 through 1990. Payments made under the agreements are charged to earnings in the year services are performed.

Norfolk Lease Litigation. Prior to the acquisition of AMC, DePaul Hospital ("DePaul"), the lessor of Virginia Center for Psychiatry-Norfolk ("VCP-N"), one of the psychiatric hospitals acquired by Forum from AMC, instituted proceedings against National Medical Care of Norfolk, Inc. ("NMCN"), AMC's predecessor-in-interest, and others, in the Circuit Court of the City of Norfolk, Virginia, alleging that NMCN had breached the lease by discontinuing use of a portion of VCP-N as a nursing unit and seeking termination of the lease as a result thereof. In connection with the acquisition of AMC, Forum and AMC entered into an indemnity agreement pursuant to which AMC agreed to indemnify Forum against any loss resulting from this lease litigation on the basis of Forum's having acquired VCP-N from AMC for $10,000,000. AMC's indemnity obligation to Forum is secured by a pledge and escrow of shares of Forum Common Stock. This lease litigation was also pending at the time of the sale of substantially all of the assets of Forum's acute care division to HCA. Consequently, in connection therewith, Forum and HCA entered into a second indemnity agreement pursuant to which Forum agreed to indemnify HCA against any loss resulting from this lease litigation on the basis of HCA's having acquired VCP-N from Forum for $12,500,000. Forum's indemnity obligation to HCA is secured by an irrevocable letter of credit. The net effect of the two indemnity agreements is that, if DePaul prevails in this lease litigation, the proceeds of the sale to HCA will be diminished by $2,500,000. Management believes that there are substantial defenses to the claims asserted by DePaul and that the outcome of this lease litigation will not materially adversely affect Forum's financial condition or operating results. On May 17, 1985, the trial court entered a decree in favor of NMCN and against DePaul, finding that the act of closure of the nursing unit did not amount to default by NMCN triggering the right of termination available in such case to DePaul. To date, no appeal from the trial court's decree has been filed.

Haber Claims. On June 29, 1984, Lee L. Haber ("Haber") and Charles Hirsch, Trustee of T/J Trust ("Hirsch"), former shareholders of Grant, instituted an action against Forum in the United States District Court for the Southern District of Florida, alleging that Forum committed fraud and breach of contract in connection with its acquisition of Grant and seeking compensatory damages, punitive damages, attorneys' fees, costs and interest in an unspecified amount, and rescission of the acquisition agreement as to the plaintiffs. Management believes that Forum has substantial defenses to the claims asserted, and that the outcome of the proceedings will not materially adversely affect Forum's financial condition or operating results.

In February, 1985, Haber and Hirsch instituted a second action against Forum and others in the United States District Court for the Southern District of Florida, alleging that Haber has been damaged in that he has not received benefits due him under Grant's profit-sharing plan and that Haber and Hirsch have been damaged in that they have not received escrowed stock to which they are entitled under an indemnity, pledge, security and escrow agreement executed in connection with Forum's acquisition of Grant, and seeking an accounting, declaratory relief, delivery of the escrowed stock, distribution of the plan benefits and damages. Management believes that, to the extent Forum has a stake therein, Forum has substantial defenses to the claims asserted, and that the outcome of the proceedings will not materially adversely affect Forum's financial condition or operating results.

Ridgecrest Lease Litigation. On March 18, 1985, Ridgecrest Medical Center, Inc. ("RMC"), the lessor of Ridgecrest Hospital ("Ridgecrest"), one of the medical-surgical hospitals sold by Forum to HCA, and other plaintiffs, instituted proceedings against Forum in the Superior Court of Rabun County, Georgia, seeking a declaratory judgment that Forum had failed timely to exercise the option to purchase contained in the lease. In connection with the sale of Ridgecrest to HCA,

Notes to Consolidated Financial Statements, continued

Note L—Commitments and Contingencies, continued
Forum and HCA entered into agreements pursuant to which Forum agreed to accept payment for the non-current assets of Ridgecrest, pending the outcome of this lease litigation, in the form of a purchase money note in the amount of approximately $3,500,000, and further agreed to cancel the note if RMC prevails in this lease litigation. Management believes that there are substantial defenses to the claims asserted by RMC and that the outcome of this lease litigation will not materially adversely affect Forum's financial condition or operating results.

Malpractice Claims. Forum has been named as a defendant in several medical malpractice actions and may be subject to other claims arising from service provided to residents and patients of its healthcare facilities. Forum maintains comprehensive general liability insurance and other typical insurance coverage on its healthcare facilities. Management believes that these claims are adequately insured or, to the extent they are not insured, if any, will not materially adversely affect the financial condition or operating results of Forum.

Note M—Supplemental Information on the Effects of Changing Prices (Unaudited)
The following supplemental information is supplied in accordance with the requirements of Financial Accounting Standards Board Statement No. 33, as amended, Financial Reporting and Changing Prices (Statement 33), for the purpose of providing certain information about the effects of changing prices.

Statement 33 requires the disclosure of the impact of specific price changes on property and equipment and on depreciation and amortization expenses. The presumption is that measuring certain assets and expenses at current cost will provide better information to assess current economic resources and future cash flows.

The current cost method of measurement adjusts for "changes in specific prices." The objective of this method is to reflect the effects of changes in the specific prices of the resources actually used in operations, so that measures of these resources and their consumption reflect the current cost of replacing these resources, rather than the historical cost amounts actually expended to acquire them. Adjustments for changes in specific prices of property and equipment are based on the applicable Consumer Price Index for All Urban Consumers, which is closely related to the changes in the replacement values of the resources being measured.

The methodology prescribed by Statement 33 inherently involves the use of assumptions, approximations and estimates and, therefore, the resulting measurements should be viewed in that context and not as precise indicators of the effects of inflation.

Depreciation and amortization expense is calculated using the same methods and rates as used in the historical Statements of Income. As prescribed in Statement 33, income taxes are not adjusted.

The difference in net income purports to indicate the extent to which inflation affects a particular company.

Selected unaudited financial data, adjusted for changing prices utilizing the procedures described above, are presented below. The reader should interpret the data with extreme caution, however, as they are experimental in nature and may not represent the best reporting thereof that may eventually evolve after an extended period of experimentation by both preparers and users of the data. Management nevertheless believes that it is important for financial statement users to develop an understanding of the more significant impacts of inflation through this supplemental reporting procedure, even though the dominant focus should continue to be on financial statements based on historical prices.

Pursuant to Statement 33, the information regarding the effects of changing prices as presented herein has not been reflected in the historical financial statements.

Continued on the following page.

Notes to Consolidated Financial Statements, continued

Statement of Income
Adjusted for Changing Prices

Year Ended March 31, 1985

(In Thousands of Dollars)

	As Reported	Adjusted for Changes in Specific Prices (Current Costs)
Net operating revenues	$ 131,631	$ 131,631
Other income	45,575	45,575
	177,206	177,206
Operating expenses	106,268	106,268
Depreciation and amortization	6,842	7,843
Interest expense	12,623	12,623
	125,733	126,734
Income before income taxes	51,473	50,472
Income taxes	17,580	17,580
Net income	$ 33,893	$ 32,892
Effective income tax rate	34%	35%

Other Information

Year Ended March 31, 1985

(In Thousands of Dollars)

	Adjusted for Changes in Specific Prices (Current Costs)
Purchasing power gain from holding net monetary liabilities during the year	$ 5,871
Increase in specific prices (current costs) of property and equipment held during the year*	55,038
Less effect of increase in general price level	8,596
Excess of increase in specific prices over increase in general price level	$ 46,442

*At March 31, 1985, current cost of property and equipment, net of allowances for depreciation and amortization and excluding construction in progress and cash restricted for construction, was $49,733 (historical amount—$42,449). *See* Note C.

Notes to Consolidated Financial Statements, continued

Note M—Supplemental Information on the Effects of Changing Prices (Unaudited), continued

Five-Year Comparision of Selected Supplemental Financial Data
Adjusted for Effects of Changing Dollars
In Average 1985 Dollars

	Year Ended March 31				
	1985	1984	1983	1982	1981
	(In thousands of dollars, except per share data)				
Total revenues	**$ 177,206**	$ 120,738	$ 96,415	$ 39,341	$ 325
Current Cost Information					
Income from continuing operations	**32,892**	7,253			
Per share data—primary	**1.42**	.37			
Excess of increase in specific prices of property and equipment over increase in general price level	**46,442**	7,869			
Net assets at year end	**105,107**	80,500			
Other Information					
Purchasing power gain from holding net monetary liabilities during the year	**5,871**	4,070			
Cash dividends declared per common share	**.060**	.057	.054	.057	.037
Market price per common share at year end	**9.88**	5.21	7.80	2.71	2.58
Average Consumer Price Index	**311.1**	298.4	289.1	272.4	246.8

Directors, Officers and Corporate Data

Directors

J. Fred Risk
Chairman of the Board
Forum Group, Inc.

O. U. Mutz
President and Chief Executive Officer
Forum Group, Inc.

Fred S. Klipsch
Executive Vice President and
Chief Operating Officer
Forum Group, Inc.

Bert T. Combs
Partner
Wyatt, Tarrant & Combs
Attorneys-at-Law
Louisville, Kentucky

Arnold H. Leon
Partner
Cooper, Davis, Kilgore, Parker,
Leon & Fennell, P.C.
Attorneys-at-Law
Portsmouth, Virginia

Willis P. McKee, M.D.
Surgeon (Retired)
Shelbyville, Kentucky

Thomas R. Mutz
Chairman of the Board
Unique Indoor Comfort
Management Company, Inc.
Chicago, Illinois

John D. Peterson
Chairman of the Board and
Chief Executive Officer
City Securities Corporation
Investment Bankers
Indianapolis, Indiana

Robert H. Reynolds
Partner
Barnes & Thornburg
Attorneys-at-Law
Indianapolis, Indiana

Directors, continued

John W. Swann
Managing Partner
West Jefferson Place
Lexington, Kentucky

Lewis F. Wood, Jr.
President
National Rehabilitation Centers, Inc.
Brentwood, Tennessee

Harold W. Mutz
Honorary Director
Forum Group, Inc.

Officers

J. Fred Risk
Chairman of the Board

O. U. Mutz
President and Chief Executive Officer

Fred S. Klipsch
Executive Vice President and
Chief Operating Officer

Paul A. Shively
Senior Vice President, Treasurer and
Chief Financial Officer

Bruce R. Karr
Senior Vice President,
General Counsel and Secretary

Wayne S. Tush
Vice President and Controller

Robert S. Decker
Vice President

David B. Ferguson
Vice President

Royce D. Harrell
Vice President

C. Lynn Redmond
Vice President

Corporate Data

Auditors
Peat, Marwick, Mitchell & Co.
One Merchants Plaza
Indianapolis, Indiana 46204

General Counsel
Barnes & Thornburg
1313 Merchants Bank Building
Indianapolis, Indiana 46204

Transfer Agent & Registrar
(Common Stock & 1985 Common Stock
Purchase Warrants)

The Indiana National Bank
Corporate Trust Division
One Indiana Square
Indianapolis, Indiana 46266

Transfer Agent & Registrar
(1986 Common Stock Purchase Warrants)

Merchants National Bank & Trust Company
of Indianapolis
One Merchants Plaza
Indianapolis, Indiana 46255

Transfer Agent & Registrar
(1993 Senior Subordinated Notes)

Manufacturers Hanover Trust Company
600 Fifth Avenue
New York, New York 10020

Transfer Agent & Registrar
(1998 Convertible Subordinated Debentures)

Commerce Union Bank
One Commerce Place
Nashville, Tennessee 37219

Dividend Agent
(Common Stock)

The Indiana National Bank
Corporate Trust Division
One Indiana Square
Indianapolis, Indiana 46266

Corporate Headquarters

Forum Group, Inc.
8900 Keystone Crossing, Suite 1200
Indianapolis, Indiana 46240
(317) 846-0700

Annual Meeting

August 27, 1985
3:00 P.M., Eastern Standard Time
Radisson Plaza Indianapolis
8702 Keystone Crossing
Indianapolis, Indiana 46240

Dr. John M. Albertine
President

Noted by BWS

AMERICAN BUSINESS CONFERENCE, INC.
A Coalition of Growth Companies

December 9, 1985

The Honorable Beryl Sprinkel
Chairman
Council of Economic Advisors
Old Executive Office Building
17th Street & Pennsylvania Avenue, NW
Washington, DC 20500

Dear Beryl:

While we are not terribly enthusiastic about the Ways and Means Committee's bill, please know that we are enthusiastic about helping the Administration get the bill through the House of Representatives. Please know we will go all out to help you in this effort.

Best wishes,

Jack Albertine

John M. Albertine
President

JMA:lcj

1730 K Street, N.W., Suite 703, Washington, D.C. 20006 (202) 822-9300

Robert J. Genetski
Senior Vice President
and Chief Economist

Noted by ...

HARRIS
BANK

December 5, 1985

Dear Beryl:

I saw your comments on the Ways and Means tax proposal, and as usual they're in line with my own. I thought you might be interested in the following charts which extend our marginal tax rate analysis to the Ways and Means proposal. Our somewhat startling conclusion is that Ways and Means has raised the effective marginal tax rates for the middle income taxpayer, i.e., the family with a gross income in the $43,000 vicinity.

I suppose the President is correct in saying that if the House doesn't approve the Ways and Means bill, tax reform is dead, and so he has no alternative but to do what he did. Our conclusion of the bill's impact on the middle class might help to get the Senate to correct this particular problem. It seems to me to be absolutely ridiculous to have individuals hit with a 35 percent marginal tax rate with income in the vicinity of $43,000. I much prefer the President's proposal where that rate isn't reached until taxable income is $70,000.

Incidently, our latest work on capacity utilization that served us so well in tracking the economy's deterioration in the 1970s is pointing in the opposite direction. The third chart shows the latest implications of our updates. It now appears that structural productivity growth is advancing somewhere between 2 and 2 1/2 percent. The labor force is growing 1/2 percent faster than demographics alone would suggest, and people have tended to work longer hours than prior trends would have indicated. All this adds up to a potential GNP that is growing almost 4 percent per year. Best of all, this places current capacity utilization at a lower rate than experienced in the recession year of 1970. You must be doing something right!

Best always,

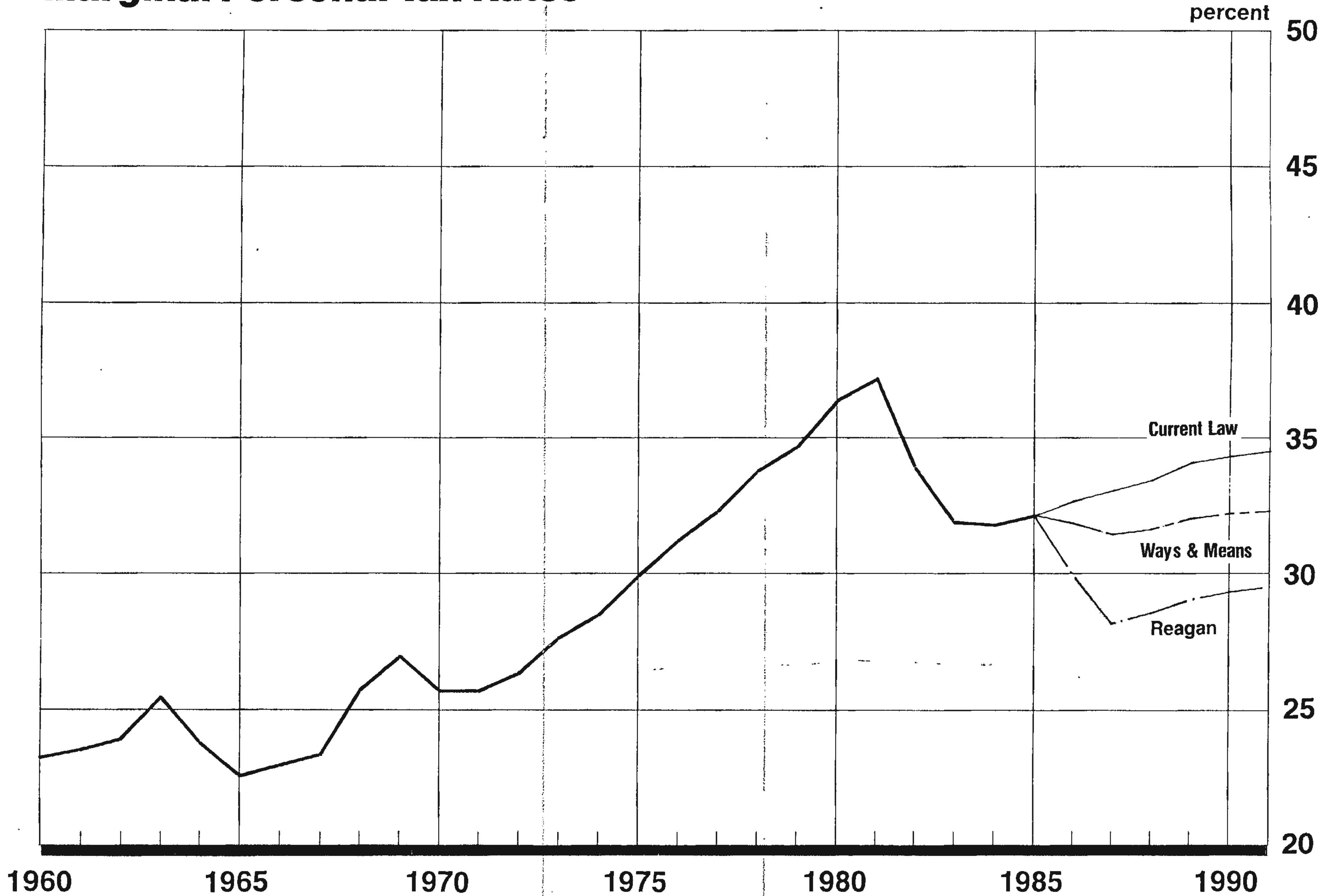
Bob

NLW

Enclosure

Dr. Beryl W. Sprinkel
Chairman, Council of Economic Advisers
Room 314
Old Executive Office Building
Washington, DC 20500

Marginal Personal Tax Rates

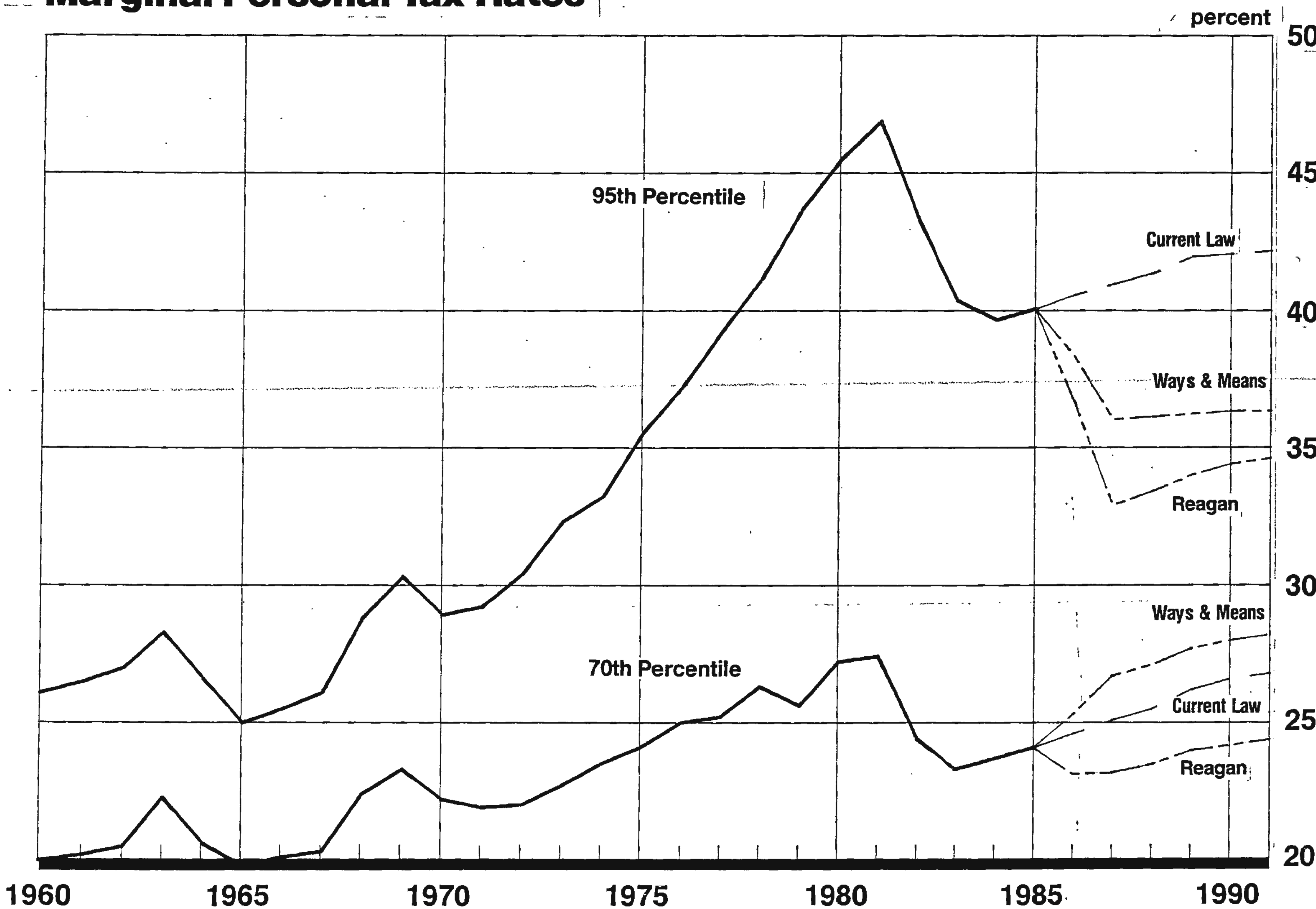


Tax rates on additional income paid by a married couple filing jointly with income in approximately the 80th to 85th percentile of tax returns.

HARRIS BANK

Source: Harris Bank Economic Research Office

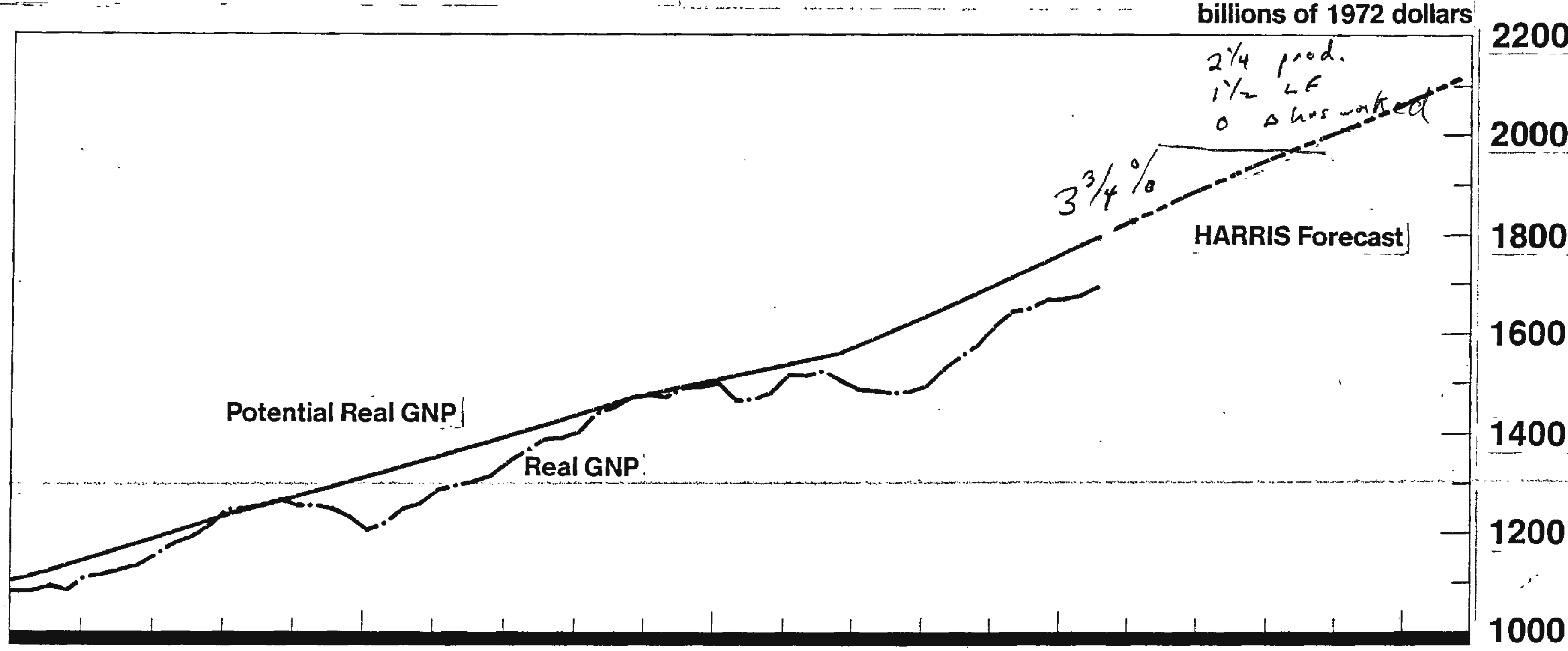
Marginal Personal Tax Rates



Source: Harris Bank Economic Research Office

HARRIS BANK

Actual vs. Potential Real GNP



Actual as a percent of Potential Real GNP

Potential real GNP trend of 3 percent for 1972-1978 assumes potential real GNP was attained at the end of 1972 and again at the end of 1978.

Source: U.S. Department of Commerce, Harris Bank.

HARRIS BANK

Noted by BWS

Smolan, Kans 67479
Nov 28, 1985

Mr. Beryl Sprinkel
The White House
Wash. D.C.

Dear Mr. Sprinkel - I urge you to make a negative recommendation on the Ways & Means Tax proposal.

We raise and sell registered Hereford breeding cattle. Investment tax credit, faster depreciation and current capital gains provisions are necessary to keep our business going and to help insure an abundant food supply. Agriculture needs Outside Investment Capital.

This summer we established a cattle limited partnership which we are trying to market. The idea being to raise capital to help hold together our farm and cattle operation. We can do it; however, this ways & means proposal will destroy all hope of selling this partnership plus taking our farm to insolvency.

Please urge the President to say no to tax reform. It will hurt so many more than it will help.

Thanks for your help.

Sincerely,
Don B. Johnson

U.S. Chamber of Commerce
1615 H. St., NW
Washington, DC 20062

News Department (202) 463-5682

NEWS

FOR IMMEDIATE RELEASE

Contact: Winston Leavell

WASHINGTON, Nov. 26 -- Following is a statement by Dr. Richard L. Lesher, president of the U. S. Chamber of Commerce, at a news conference today discussing the impact of the tax bill that has been produced by the House Ways and Means Committee:

THE U.S. CHAMBER OF COMMERCE HAS BEEN AN EARLY AND STRONG ADVOCATE OF TAX REFORM. OUR GOALS FOR TAX REFORM HAVE BEEN.

1. SIMPLIFICATION -
2. FAIRNESS -
3. ENCOURAGEMENT OF CAPITAL FORMATION -
4. TECHNOLOGICAL ADVANCEMENT AND INTERNATIONAL COMPETITIVENESS, AND
5. MOST IMPORTANTLY, LEAD TO INCREASED ECONOMIC GROWTH AND JOB CREATION.

UNFORTUNATELY, THE WAYS AND MEANS PACKAGE FAILS TO MEET ANY OF THESE GOALS AND WE, THEREFORE, URGE MEMBERS OF THE HOUSE AND THE ADMINISTRATION TO DISCONTINUE EFFORTS AT TAX REFORM.

cc: De Mane
C. Stuart

CONTINUED EFFORTS AT REFORM IN 1986 WOULD, IN ALL LIKELIHOOD, PRODUCE EVEN MORE NEGATIVE IMPACT ON THE ECONOMY SINCE 1986 IS AN ELECTION YEAR AND THE TEMPTATION TO SEEK VOTES WITH INDIVIDUAL RATE REDUCTION AT THE EXPENSE OF THE ECONOMY WOULD BE EVEN STRONGER.

IN THE MEANTIME, THE NEGATIVE IMPACT OF UNCERTAINTY ~~WOULD CONTINUE TO SLOW THE ECONOMY.~~

CREATING CONDITIONS CONDUCIVE TO ECONOMIC GROWTH AND JOB CREATION IS THE SINGLE MOST IMPORTANT GOAL OF TAX REFORM. THIS BILL DOES JUST THE OPPOSITE.

THE DRIVING FORCE BEHIND THE CURRENT ECONOMIC RECOVERY -- NOW IN ITS FOURTH YEAR, HAS BEEN NEW INVESTMENT. UNDER THE PROPOSED CHANGES TO CAPITAL COST ALLOWANCES, INVESTMENT WOULD BE SEVERELY IMPACTED.

I'VE ASKED JOEL PRAKKEN OF WASHINGTON UNIVERSITY TO JOIN US. HE'S RUN WAYS AND MEANS PLAN THROUGH ECONOMETRIC MODEL. AS NUMBERS IN HANDOUT SHOW, PLAN WOULD HAVE A DAMAGING EFFECT ON ECONOMIC GROWTH.

IN LONG RUN, WAYS AND MEANS PLAN COULD, IN EFFECT, DE-INDUSTRIALIZE AMERICA AND COULD RETURN US TO THE STAGNATION WE FACED PRIOR TO 1980.

OUR MEMBERS INDICATED THAT PROCESS IS ALREADY BEGINNING.

A RECENT SURVEY OF CROSS-SECTION OF CHAMBER'S MEDIUM AND LARGE BUSINESS MEMBERS SHOWS 41 PERCENT HAVE CHANGED INVESTMENT PLANS BECAUSE OF UNCERTAINTY SURROUNDING BILL.

AS LONG AS TAX REFORM IN CURRENT FORM IS BEFORE CONGRESS, IT WILL CONTINUE TO HANG LIKE A BLACK CLOUD OVER MILLIONS OF DECISIONS BY BUSINESSES AND CONSUMERS ALIKE, INTERUPTING THE COURSE OF ECONOMIC RECOVERY.

CONGRESSIONAL ATTENTION TO TAX REFORM WILL DISTRACT FROM CONCENTRATING ON REDUCING FEDERAL SPENDING, WHICH IS THE NUMBER ONE CONCERN OF MOST AMERICANS INCLUDING THE BUSINESS COMMUNITY.

THERE ARE 4 WAYS A BUSINESS PERSON CAN LOOK AT TAX REFORM.

1. PERSONAL IMPACT
2. IMPACT ON HIS COMPANY
3. IMPACT ON HIS CUSTOMERS
4. IMPACT ON THE ECONOMY

IN RECENT TIMES -- OUR ECONOMY, HAS BEEN THE MODEL OF THE WORLD. WE OUGHT TO TAKE SPECIAL CARE TO SEE THAT IT CONTINUES. SO WE ARE CONVINCED THAT THE IMPACT ON THE ECONOMY SHOULD BE THE DECIDING CRITERION.

WE HOPE AND BELIEVE THAT MOST MEMBERS OF CONGRESS, THE EXECUTIVE BRANCH AND THE BUSINESS COMMUNITY WILL EVENTUALLY COME TO THAT SAME CONCLUSION.

FOR THESE AND MANY OTHER REASONS, OUR BOARD HAS VOTED BY A 7-1 RATIO THAT (AND I QUOTE)

"IT IS APPROPRIATE AND TIMELY FOR THE U.S. CHAMBER OF COMMERCE TO URGE THE ADMINISTRATION AND THE CONGRESS TO SET ASIDE ALL ATTEMPTS AT TAX REFORM AT THIS TIME."

cc: Chris Stuart, Dr. [illegible], Dr. [illegible]

CJGC

COALITION FOR JOBS, GROWTH AND INTERNATIONAL COMPETITIVENESS

Noted by RWS

One Thomas Circle
Suite 325
Washington, D.C. 20005
Telephone (202) 223-3002

December 2, 1985

Mr. Beryl F. Sprinkel
Chairman
Council of Economic Advisers
Room 314
Old Executive Office Building
Washington, D.C. 20500

Dear Mr. ~~Sprinkel:~~ Beryl -

During the course of your review of the House Ways and Means Tax Reform proposal, I would urge you to take a look at its implications for America's ability to compete in international markets.

The Coalition for Jobs, Growth and International Competitiveness has asked Arthur Andersen and Company to compare the capital cost recovery system found in the Ways and Means bill with that of 16 of America's major industrial competitors.

The results of this study are disturbing. A review of the treatment of class 4 equipment shows that the Ways and Means proposal will be a sharp blow to America's ability to compete in international markets, regardless of whether a discounted present value analysis or a nominal cost recovery analysis is used. Under the discounted present value analysis, our capital cost recovery system drops from fifth to fifteenth, or second to last in the world. Using nominal cost recovery analysis, we drop from sixth to sixteenth, or dead last.

My reason for emphasizing the consequences to class 4 is twofold. First, class 4 is manufacturing equipment, and over half of America's involvement in international trade comes in manufactured goods. Thus, despite talk of America's evolution into a service economy, much of the world's trade still involves manufactured goods. Second, America is not a low wage economy. Our future in the international marketplace will be determined by out productivity as a nation. Investment in new class 4 machinery is thus critical to insuring that we are productive enough as a nation to compete in the international arena. Deliberate policy steps such as the Ways and Means proposal that reduce America's ability to compete in the world marketplace jeopardize America's future.

Mr. Beryl F. Sprinkel
December 2, 1985
Page 2

I have taken the liberty of attaching the results of the Arthur Andersen study for your review. In addition to Arthur Andersen's work, Dr. Joel Prakken of Lawrence H. Meyer and Associates has analyzed the impact of the Ways and Means proposal on the domestic economy. Although Dr. Prakken's work has received widespread press attention, I am taking the liberty of attaching the material in case you have not seen the actual results of his study.

The Coalition believes that this combination of negative consequences on America's ability to compete in world markets along with the risks t the domestic economy are large enough to give any American second thoughts on the merits of the Ways and Means proposal.

If you have any questions, please do not hesitate to call. All my best,

Sincerely,

Charly

Dr. Charls E. Walker,
Senior Adviser

CEW/wrc
Attachments

Table 1: Comparison of the Present Value of Cost Recovery Allowances for Computer Equipment in the United States and Other Countries[1]

4 Percent Real Return

Country	Present Value	Rank
Luxemburg	137.8	1
Spain	118.9	2
Belgium	97.7	3
US-ACRS/ITC	96.7	
Hong Kong	88.6	4
Italy	87.7	5
Denmark	87.3	6
Sweden	83.9	7
US-W&M	82.4	
France	82.4	8
Switzerland	81.4	9
West Germany	80.6	10
South Korea	80.6	10
Taiwan	80.6	10
Japan	77.9	13
Canada	76.6	14
United Kingdom	76.4	15

8 Percent Real Return

Country	Present Value	Rank
Luxembourg	130.5	1
Spain	110.9	2
Belgium	94.8	3
US-ACRS/ITC	89.4	
Hong Kong	84.7	4
Italy	83.1	5
Denmark	79.1	6
Sweden	78.2	7
US-W&M	76.1	
France	76.1	8
Switzerland	75.1	9
South Korea	74.0	10
Taiwan	74.0	10
West Germany	73.8	12
Japan	70.8	13
Canada	69.3	14
United Kingdom	69.3	14

12 Percent Real Return

Country	Present Value	Rank
Luxembourg	124.2	1
Spain	104.0	2
Belgium	92.1	3
US-ACRS/ITC	83.2	
Hong Kong	81.5	4
Italy	78.9	5
Sweden	73.1	6
Denmark	72.5	7
US-W&M	70.8	
France	70.8	8
Switzerland	69.7	9
South Korea	68.4	10
Taiwan	68.4	10
West Germany	67.9	12
Japan	64.8	13
United Kingdom	63.6	14
Canada	63.2	15

[1] Class two of the Ways and Means Committee (US-W&M) Staff tax reform incentive depreciation system includes, for example: computer equipment, data handling equipment, telephone switching equipment, heavy trucks, equipment used in construction, drilling of oil and gas wells, and cutting timber. Calculations for the comparison were made with respect to computer equipment. Class two equipment is subject to double declining balance depreciation over a five-year recovery period, switching to straight-line at the optimal point.

NOTE: The computations assume an inflation rate of 5 percent and a 4, 8, or 12 percent real rate of return. Depreciation is computed on an asset placed in service by a calendar year taxpayer on July 1, 1986 without regard to the mid-month convention. The present value of the depreciation allowances is calculated by discounting for both the given inflation rate and the real after-tax rate of return. Allowances in the first year have been discounted for a half year. All allowances, investments credits and deductions are included in the cost recovery allowances. Tax credits or grants were included in the depreciation allowance of the initial year for the following countries: Belgium, Luxemburg, Spain and the United States. In certain countries, a range of useful lives may be available depending on the particular type of asset. Where such a range exists, the midpoint was used to determine the depreciation allowance.

Source: Arthur Andersen & Co.

Table 2: Comparison of Nominal Cost Recovery Allowances for Computer Equipment as a Percent of Cost for the United States and Other Countries[1]

1 Year			3 Years			5 Years		
Country	Amount	Rank	Country	Amount	Rank	Country	Amount	Rank
Luxembourg	85.4	1	Luxembourg	122.7	1	Luxembourg	151.3	1
Belgium	71.0	2	Belgium	105.0	2	Spain	122.4	2
Hong Kong	68.5	3	Spain	101.2	3	US-ACRS/ITC	117.4	
Spain	57.9	4	Italy	99.0	4	Belgium	105.0	3
Italy	33.0	5	Hong Kong	84.6	5	Italy	100.0	4
US-ACRS/ITC	32.4		US-ACRS/ITC	75.4		Sweden	100.0	4
Sweden	30.0	6	US-W&M	71.2		West Germany	100.0	4
Denmark	25.0	7	France	71.2	6	US-W&M	94.2	
United Kingdom	25.0	7	Switzerland	71.2	6	France	94.2	7
US-W&M	20.0		Sweden	71.0	8	Hong Kong	92.4	8
France	20.0	9	South Korea	67.5	9	Switzerland	89.6	9
Switzerland	20.0	9	Taiwan	67.5	9	Denmark	88.1	10
South Korea	18.5	11	Denmark	66.0	11	South Korea	87.1	11
Taiwan	18.5	11	Japan	61.0	12	Taiwan	87.1	11
Japan	16.0	13	West Germany	60.5	13	Japan	81.9	13
Canada	15.0	14	Canada	58.4	14	Canada	79.6	14
West Germany	15.0	14	United Kingdom	57.8	15	United Kingdom	76.3	15

[1] Class two of the Ways and Means Committee (US-W&M) Staff tax reform incentive depreciation system includes, for example: computer equipment, data handling equipment, telephone switching equipment, heavy trucks, equipment used in construction, drilling of oil and gas wells, and cutting timber. Calculations for the comparison were made with respect to computer equipment. Class two equipment is subject to double declining balance depreciation over a five-year recovery period, switching to straight-line at the optimal point.

NOTE: Rank shown for all foreign countries assumes current law for the United States (ACRS/ITC).

Source: Arthur Andersen & Co.

Table [illegible]: Comparison of the Present Value of Cost Recovery [illegible]
in the United States and Other Countries[1]

4 Percent Real Return			8 Percent Real Return			12 Percent Real Return		
Country	Present Value	Rank	Country	Present Value	Rank	Country	Present Value	Rank
Luxemburg	143.8	1	Luxembourg	138.5	1	Luxembourg	133.7	1
Spain	118.9	2	Spain	110.9	2	Spain	104.0	2
South Korea	102.0	3	Belgium	94.6	3	Belgium	90.1	3
Belgium	99.6	4	South Korea	94.3	4	South Korea	87.7	4
US-ACRS/ITC	96.7		US-ACRS/ITC	89.4		US-ACRS/ITC	83.2	
Canada	89.8	5	Canada	82.6	5	Canada	76.7	5
Denmark	87.3	6	Italy	80.8	6	Hong Kong	76.7	5
Italy	86.0	7	Hong Kong	80.3	7	Italy	76.2	7
Hong Kong	84.8	8	Denmark	79.1	8	Sweden	73.1	8
Sweden	83.9	9	Sweden	78.2	9	Denmark	72.5	9
France	82.4	10	France	76.1	10	France	70.8	10
Switzerland	81.4	11	Switzerland	75.1	11	Switzerland	69.7	11
Japan	80.2	12	West Germany	73.7	12	West Germany	69.0	12
West Germany	79.7	13	Japan	73.6	13	Japan	68.0	13
United Kingdom	76.3	14	United Kingdom	69.3	14	United Kingdom	63.6	
Taiwan	71.9	15	Taiwan	63.5	15	Taiwan	56.9	15
US-W&M	70.4		US-W&M	61.7		US-W&M	54.8	

1 Class four of the Ways and Means Committee (US-W&M) staff tax incentive depreciation system includes, for example: mining equipment, rail cars and assets used in manufacture of pulp and paper, glass products, primary nonferrous metals and foundry and steel mill products. Calculations for the comparison were made with respect to mining equipment. Class four equipment is subject to double declining balance depreciation over a ten-year recovery period, switching to straight-line at the optimal point.

NOTE: The computations assume an inflation rate of 5 percent and a 4, 8, or 12 percent real rate of return. Depreciation is computed on an asset placed in service by a calendar year taxpayer on July 1, 1986 without regard to the mid-month convention. The present value of the depreciation allowances is calculated by discounting for both the given inflation rate and the real after-tax rate of return. Allowances in the first year have been discounted for a half year. All allowances, investments credits and deductions are included in the cost recovery allowances. Tax credits or grants were included in the depreciation allowance of the initial year for the following countries: Belgium, Luxembourg, Spain and the United States. In certain countries, a range of useful lives may be available depending on the particular type of asset. Where such a range exists, the midpoint was used to determine the depreciation allowance.

Source: Arthur Andersen & Co.

Table 4: Comparison of Nominal Cost Recovery Allowances for Mining Equipment as a Percent of Cost for the United States and Other Countries 1/

1 Year			3 Years			5 Years		
Country	Amount	Rank	Country	Amount	Rank	Country	Amount	Rank
Luxembourg	119.8	1	Luxembourg	137.0	1	Luxembourg	154.2	1
Hong Kong	64.0	2	Spain	101.2	2	Spain	122.4	2
Spain	57.9	3	Belgium	97.0	3	US-ACRS/ITC	117.4	
Beligum	53.0	4	Italy	87.0	4	South Korea	114.2	3
West Germany	52.5	5	South Korea	80.5	5	Beligum	113.0	4
South Korea	35.5	6	Hong Kong	77.0	6	Italy	100.0	5
Canada	33.4	7	US-ACRS/ITC	75.4		Sweden	100.0	5
US-ACRS/ITC	32.4		Canada	73.7	7	France	94.2	7
Sweden	30.0	8	France	71.2	8	Canada	93.4	8
Italy	29.0	9	Switzerland	71.2	8	Switzerland	89.6	9
Denmark	25.0	10	Sweden	71.0	10	Denmark	88.1	10
United Kingdom	25.0	10	Japan	67.5	11	Japan	87.1	11
France	20.0	12	Denmark	66.0	12	Hong Kong	85.3	12
Switzerland	20.0	12	West Germany	62.5	13	United Kingdom	76.3	13
Japan	18.5	14	United Kingdom	57.8	14	West Germany	72.5	14
Taiwan	11.3	15	Taiwan	46.9	15	US-W&M	63.1	
US-W&M	10.0		US-W&M	42.4		Taiwan	68.2	15

1 Class four of the Ways and Means Committee (US-W&M) staff tax incentive depreciation system includes, for example: mining equipment, rail cars and assets used in manufacture of pulp and paper, glass products, primary nonferrous metals and foundry and steel mill products. Calculations for the comparison were made with respect to mining equipment. Class four equipment is subject to double declining balance depreciation over a ten-year recovery period, switching to straight-line at the optimal point.

Source: Arthur Andersen & Co.

November 21, 1985

Table 5: Comparison of the Present Value of Cost Recovery Allowances for Manufacturing Equipment in the United States and Other Countries[1]

4 Percent Real Return			8 Percent Real Return			12 Percent Real Return		
Country	Present Value	Rank	Country	Present Value	Rank	Country	Present Value	Rank
Luxembourg	139.4	1	Luxembourg	132.6	1	Luxembourg	126.8	1
Spain	114.2	2	Belgium	105.5	2	Belgium	99.1	2
Belgium	110.1	3	Spain	104.3	3	Spain	98.4	3
Canada	100.3	4	Canada	95.6	4	Canada	91.4	4
US-ACRS/ITC	96.7		US-ACRS/ITC	89.4		US-ACRS/ITC	83.2	
Hong Kong	88.6	5	Hong Kong	84.7	5	Hong Kong	81.5	5
Denmark	87.3	6	Denmark	79.1	6	Sweden	73.1	6
Sweden	83.9	7	Sweden	78.2	7	Denmark	72.5	7
Italy	83.1	8	Italy	77.1	8	Italy	71.9	8
France	82.4	9	France	76.1	9	France	70.8	9
West Germany	78.3	10	West Germany	71.0	10	West Germany	64.9	10
Switzerland	76.5	11	United Kingdom	69.3	11	United Kingdom	63.6	11
United Kingdom	76.4	12	Switzerland	69.2	12	Switzerland	63.2	12
S. Korea	74.7	13	S. Korea	67.1	13	S. Korea	60.8	13
Japan	71.6	14	Japan	64.2	14	Japan	58.3	14
US-W&M	70.4		US-W&M	61.7		US-W&M	54.8	
Taiwan	68.5	15	Taiwan	60.4	15	Taiwan	53.9	15

[1] Class four of the Ways and Means Committee (US-W&M) staff tax incentive depreciation system includes, for example: mining equipment, rail cars and assets used in manufacture of pulp and paper, glass products, primary nonferrous metals and foundry and steel mill products. Calculations for the comparison were made with respect to light manufacturing textile equipment. Class four equipment is subject to double declining balance depreciation over a ten-year recovery period, switching to straight-line at the optimal point.

NOTE: The computations assume an inflation rate of 5 percent and a 4, 8, or 12 percent real rate of return. Depreciation is computed on an asset placed in service by a calendar year taxpayer on July 1, 1986 without regard to the mid-month convention. The present value of the depreciation allowances is calculated by discounting for both the given inflation rate and the real after-tax rate of return. Allowances in the first year have been discounted for a half year. All allowances, investment credits and deductions are included in the cost recovery allowances. Tax credits or grants were included in the depreciation allowance of the initial year for the following countries: Belgium, Luxemburg, Spain, and the United States. In certain countries, a range of useful lives may be available depending on the particular type of asset. Where such a range exists, the midpoint was used to determine the depreciation allowance.

Source: Arthur Andersen & Co.

Table 6: Comparison of Nominal Cost Recovery Allowances for Manufacturing Equipment As a Percent of Cost for the United States and Other Countries.[1]

1 Year			3 Years			5 Years		
Country	Amount	Rank	Country	Amount	Rank	Country	Amount	Rank
Luxembourg	89.7	1	Luxembourg	133.7	1	Luxembourg	149.6	1
Hong Kong	68.5	2	Canada	112.5	2	Belgium	125.9	2
Spain	55.4	3	Belgium	105.7	3	US-ACRS/ITC	117.4	
Belgium	54.6	4	Spain	93.7	4	Spain	115.2	3
Canada	42.7	5	Hong Kong	84.6	5	Canada	112.5	4
US-ACRS/ITC	32.4		US-ACRS/ITC	75.4		Sweden	100.0	5
Sweden	30.0	6	Italy	75.0	6	Italy	95.0	6
Denmark	25.0	7	France	71.2	7	France,	94.2	7
Italy	25.0	7	Sweden	71.0	8	Hong Kong	92.4	8
United Kingdom	25.0	7	Denmark	66.0	9	Denmark	88.1	9
Japan	20.6	10	Switzerland	58.4	10	West Germany	80.8	10
France	20.0	11	West Germany	58.4	10	Switzerland	79.6	11
Switzerland	15.0	12	United Kingdom	57.8	12	United Kingdom	76.3	12
West Germany	15.0	12	South Korea	54.1	13	South Korea	75.6	13
S. Korea	13.6	14	Japan	49.9	14	Japan	68.4	14
Taiwan	10.3	15	Taiwan	43.4	15	Taiwan	64.3	15
US-W&M	10.0		US-W&M	42.4		US-W&M	63.1	

[1] Class four of the Ways and Means Committee (US-W&M) staff tax reform option incentive depreciation system includes, for example: mining equipment, rail cars and assets used in manufacture of pulp and paper, glass products, primary non-ferrous metals and foundry and steel mill products. Calculations for the comparison were made with respect to light manufacturing textile equipment. Class four equipment is subject to double declining balance depreciation over a ten year recovery period, switching to straight line at the optimal point.

NOTE: Rank shown for all foreign countries assumes current law for the United States (ACRS/ITC).

Source: Arthur Andersen & Co.

Table 7: Comparison of the Present Value of Cost Recovery Allowances for Electric Utility Transmission and Distribution Plant in the United States and Other Countries1/

4 Percent Real Return			8 Percent Real Return			12 Percent Real Return		
Country	Present Value	Rank	Country	Present Value	Rank	Country	Present Value	Rank
Luxembourg	124.1	1	Luxembourg	114.1	1	Luxembourg	106.2	1
Spain	107.2	2	Spain	97.4	2	Beligum	90.1	2
Belgium	99.6	3	Beligum	94.6	3	Spain	89.8	3
South Korea	91.1	4	South Korea	81.1	4	Sweden	73.1	4
Sweden	83.9	5	Sweden	78.2	5	South Korea	73.1	4
Italy	82.0	6	Italy	75.8	6	Italy	70.4	6
Denmark	76.5	7	United Kingdom	69.3	7	United Kingdom	63.6	7
United Kingdom	76.3	8	France	66.0	8	Fance	59.5	8
US-ACRS/ITC	74.3		US-ACRS/ITC	63.7		US-ACRS/ITC	56.0	
France	74.0	9	Denmark	61.9	9	Denmark	51.5	9
Hong Kong	66.5	10	Hong Kong	56.9	10	Hong Kong	49.4	10
Taiwan	61.5	11	Taiwan	52.0	11	Taiwan	45.1	11
Switzerland	54.4	12	Switzerland	45.1	12	Switzerland	38.6	12
West Germany	52.4	13	West Germany	42.9	13	West Germany	36.4	13
US-W&M	43.1		US-W&M	33.8		US-W&M	27.8	
Japan	40.3	14	Japan	31.7	14	Japan	26.1	14
Canada	39.1	15	Canada	30.9	15	Canada	25.5	15

1 Class nine of the Ways and Means Committee (US-W&M) Staff tax reform incentive depreciation system includes, for example: electric utility transmission and distribution plant, railroad structures and gas utility distribution facilities. Class Calculations for the comparison were made with respect to electric utility transmission and distribution plant. Class nine equipment is subject to a double declining balance depreciation over a thirty-year recovery period switching to straight-line at the optimal point.

NOTE: The computations assume an inflation rate of 5 percent and a 4, 8, or 12 percent real rate of return. Depreciation is computed on asset placed in service by a calender year taxpayer on July 1, 1986 without regard to the mid-month convention. The present value of the depreciation allowances is calculated by discounting or both the given inflation rate and the real after-tax rate of return. Allowances in the first year have been discounted for a half year. All allowances, investment credits and deductions are included in the cost recovery system allowances. Tax credits or grants were included in the depreciation allowance of the initial year for the following countries: Beligum, Luxembourg, Spain and the United States. In certain countries, a range of useful lives may be available depending on the particular type of asset. Where such a range exits, the midpoint was used to determine the depreciation allowance.

Source: Arthur Andersen & Co.

Table 8: Comparison of Nominal Cost Recovery Allowances for Electric Utility Transmission and Distribution Plant as a Percent of Cost for the United States and Other Countries 1/

1 Year			3 Years			5 Years		
Country	Amount	Rank	Country	Amount	Rank	Country	Amount	Rank
Luxembourg	76.8	1	Belgium	97.0	1	Belgium	113.0	1
Belgium	53.0	2	Luxembourg	94.0	2	Luxembourg	111.2	2
Spain	51.6	3	Spain	80.8	3	Spain	100.6	3
South Korea	30.2	4	Italy	72.0	4	Sweden	100.0	4
Sweden	30.0	5	Sweden	71.0	5	Italy	90.0	5
United Kingdom	25.0	6	United Kingdom	57.8	6	South Korea	78.2	6
Italy	24.0	7	South Korea	54.2	7	United Kingdom	76.3	7
US-ACRS/ITC	22.4		France	50.8	8	France	72.3	8
France	12.5	8	US-ACRS/ITC	41.4		US-ACRS/ITC	56.4	
Hong Kong	10.0	9	Taiwan	31.6	9	Hong Kong	50.0	9
Denmark	8.0	10	Hong Kong	30.0	10	Taiwan	49.7	10
Taiwan	7.1	11	Denmark	25.2	11	Denmark	44.2	11
Switzerland	5.5	12	Switzerland	25.1	12	Switzerland	40.7	12
West Germany	5.0	13	West Germany	23.1	13	West Germany	37.7	13
US-W&M	3.3		US-W&M	15.8		US-W&M	26.6	
Japan	3.1	14	Japan	14.7	14	Japan	25.0	14
Canada	3.0	15	Canada	14.3	15	Canada	24.3	15

[1]Class nine of the Ways and Means Committee (US-WUM) Staff tax reform incentive depreciation system includes, for example: electric utility transmission and distribution plant, railroad structures and gas utility distribution facilities. Calculations for the comparison were made with respect to electric utility transmission and distribution plant. Class nine equipment is subject to a double declining balance depreciation over a thirty-year recovery period switching to straight-line at the optimal point.

NOTE: Rank shown for all foreign countries assumes current law for the United States (ACRS/ITC).

Source: Arthur Andersen & Co.

Table I: Lawrence H. Meyer and Associates
Economic Effect of the Ways and Means Committee
Tax Bill

(Difference from Current Law in Billions of Dollars & Percent)

	1986	1987	1988	1989	1990	1991
General Indicators						
Real GNP						
Billions 1972 dollars	-3.0	-5.0	-14.0	-27.0	-41.0	-54.0
Percent change	-0.2	-0.3	-0.8	-1.4	-2.1	-2.7
Federal Deficit						
Billions current dollars	16.0	11.0	15.0	21.0	24.0	26.0
Percent change	7.6	4.7	6.4	8.3	8.7	8.4
Personal Consumption						
Billions 1972 dollars	2.0	8.0	8.0	3.0	-3.0	-11.0
Percent change	0.2	0.7	0.7	0.2	-0.2	-0.8
Gross Priv. Domestic Inv.						
Billions 1972 dollars	-5.5	-13.2	-23.3	-34.7	-44.6	-52.7
Percent change	-1.8	-4.1	-7.0	-9.9	-12.3	-14.2
Producers' Durable Equip.						
Billions 1972 Dollars	-3.0	-11.0	-19.0	-27.0	-35.0	-40.0
Percent Change	-1.8	-6.4	-10.6	-14.3	-17.6	-19.0
Nonresidential Structures						
Billions 1972 Dollars	-0.1	-1.0	-3.0	-5.0	-6.0	-8.0
Percent Change	-0.2	-1.6	-4.5	-7.4	-8.7	-11.6
Unemployment Rate						
Percent Change	0.0	2.9	5.9	12.7	16.7	24.1
GNP Deflator						
Percent Change	2.6	2.5	2.6	5.3	2.6	-4.9
Treasury Bill Rate (90 day)						
Percent Change	0.0	0.0	-1.4	-2.9	-4.3	-5.7
Money Supply (M1)						
Percent Change	1.7	0.0	0.0	-1.7	-3.3	-3.3
Cost of Capital						
Producers Durable Equip.	18.3	18.1	17.6	18.4	17.7	17.4
Nonresidential Structures	11.3	10.7	9.8	9.2	8.7	7.7
Inventories	1.4	0.0	-1.5	-3.2	-4.8	-5.0
Consumer Durables	1.4	1.0	1.0	1.0	0.5	0.5
Single Family Housing	4.2	4.5	3.7	3.7	2.9	2.2
Multiple Family Housing	7.3	7.2	7.2	6.5	6.4	5.1

Source: Dr. Joel Prakken, Lawrence H. Meyer and Associates, St. Louis Missouri November 25, 1985. Sponsored by the Coalition for Jobs, Growth and International Competitiveness (COJAC).

Noted by BWS

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430 North Michigan Avenue
Chicago, Illinois 60611-4091
(312) 670-6760

Mary Walker Fleischmann
Executive Vice President

November 27, 1985

Honorable Beryl W. Sprenkel
Chairman, Economic Advisor
The White House
1600 Pennsylvania Avenue, N.W
Washington, D.C. 20500

Dear Mr. Sprenkel:

Enclosed is a copy of a study developed by the Wharton School of Business which evaluates the impact of the current tax proposals on the real estate industry and economy of the United States. The report provides an analysis of commercial real estate, focusing on the impact of tax changes on capital costs and rents. The analysis then proceeds to residential real estate, including multiple unit rental housing and single family housing. Overall, market effects on investment and rents are estimated using the Wharton long-term model of the U.S. economy. Finally, the overall impact of the proposals is estimated for the economy as a whole.

A variety of models have been used to estimate the cost and benefits of these proposals on individual real estate investors, renters and homeowners. The study concludes that these proposals would raise capital costs for investment and commercial real estate by approximately fifty-four percent. The capital cost of conventionally financed rental housing would rise by an estimated forty-four percent, leading to a large reduction in investment in such projects. In addition, the proposed tax changes would increase the after-tax cost of home ownership by ten to twelve percent making it even more difficult for a young renter to purchase a home, and thereby increasing the demand for rental housing. Increases in the cost of home ownership would reduce construction of single units, producing a reduction in investment in total new housing units of all types. The importance of real estate investment is illustrated by the fact that in 1984, investment in new business and residential structures constituted approximately fifty-four percent of total investment in the U.S. economy.

I welcome your questions and can be contacted at the address and telephone number listed on this letterhead.

cc: Dr. [illegible] w/o enclosure
C. Stuart w/ enclosure

Sincerely,

Mary Walker Fleischmann

Mary Walker Fleischmann
Executive Vice President

cc J. [illegible], Dr. Moore, Dr. Mussa

NEW CASTLE/HENRY COUNTY
ECONOMIC DEVELOPMENT CORPORATION

Noted by BWS

327 South 14th Street
New Castle, Indiana 47362
Telephone (317) 529-4635

R. Scott Hayes
Chairman

R. D. Thrasher, Jr., C.I.D.
President

November 29, 1985

Mr. Beryl Sprinkel
The White House
Washington, D.C.

Dear Mr. Sprinkel:

The Wall St. Journal issue of November 26, 1985 reports that you are critical of the proposed tax reform plan expected to be reported out of the House Ways and Means Committee.

Please continue your opposition to this thing. The Reagan administration has done so much to spur economic revitalization since 1981, it would be shameful to punish the private sector now.

This horrid bill has no place in a nation trying to restore full employment a favorable balance of trade, and a growing economy. Please continue your opposition.

Sincerely,

Richard D Thrasher

Richard D. Thrasher
President

RT:do

cc. [illegible]

Noted by BWS

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

RICHARD L. LESHER
PRESIDENT

1615 H STREET, N.W.
WASHINGTON, D.C. 20062
202/463-5300

November 26, 1985

The Honorable Beryl Sprinkel
Chairman
Council of Economic Advisors
Executive Office Building
Washington, D. C. 20506

Dear Beryl:

It was good talking to you on the telephone. Thanks for returning my call.

Attached are the results of an analysis made by Laurence H. Meyer and Associates, of St. Louis, the same group that did CEA's analysis of Treasury I.

As you can see, the overall impact of the Ways and Means Committee package on the economy is quite negative.

Our Board of Directors, by nearly seven to one, strongly urges the administration and the Congress to set aside tax reform for the foreseeable future -- at least through 1986. In discussions with Members of Congress of both parties, we believe that any tax reform measure now would eliminate much of the progress made by the administration in 1981 to establish a tax structure conducive to economic growth.

Also attached is our Tax Committee report to our Board on November 13 requesting approval of a policy statement in support of consumption taxes. Our Executive Committee, meeting the day before, unanimously opposed the report, and the chairman of the Tax Committee, Bill Kanaga, withdrew the report during our Board meeting. We, therefore, have no position at the moment, although sentiment is strong in opposition.

Sincerely,

Dick

Richard L. Lesher

Attachments

U.S. Chamber of Commerce

Washington, D.C. 20062

WAYS AND MEANS TAX BILL LEADS TO SLOWER ECONOMIC GROWTH

WASHINGTON, NOVEMBER 26 -- "Real GNP growth will be slower if the House bill is enacted," said Richard Lesher, President of the U. S. Chamber of Commerce. "The plan would result in an average annual increase in economic activity of only 2.9 percent during the next six years compared to a projected growth rate of 3.5 percent under present law. The plan's capital cost recovery allowances would dramatically increase the after-tax cost of capital and thus reduce investment levels." (See accompanying charts)

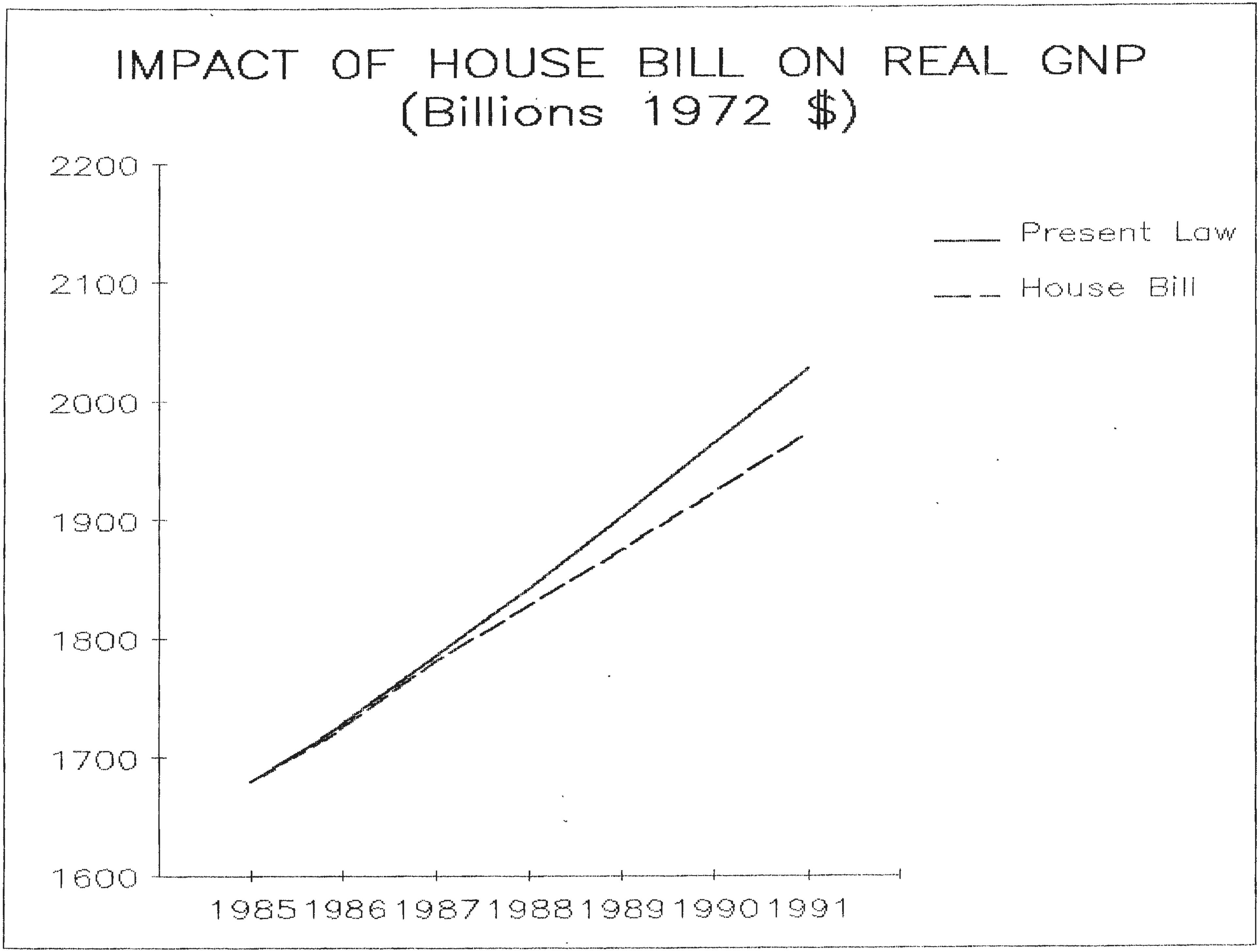
Lesher said that higher capital gains tax rates and corporate tax increases will reduce economic growth. The analysis, indicated that if the bill is enacted, the unemployment rate would be 1.3 percentage points higher by 1991 than would otherwise have been the case. Likewise, the budget deficit would be $26 billion higher in 1991.

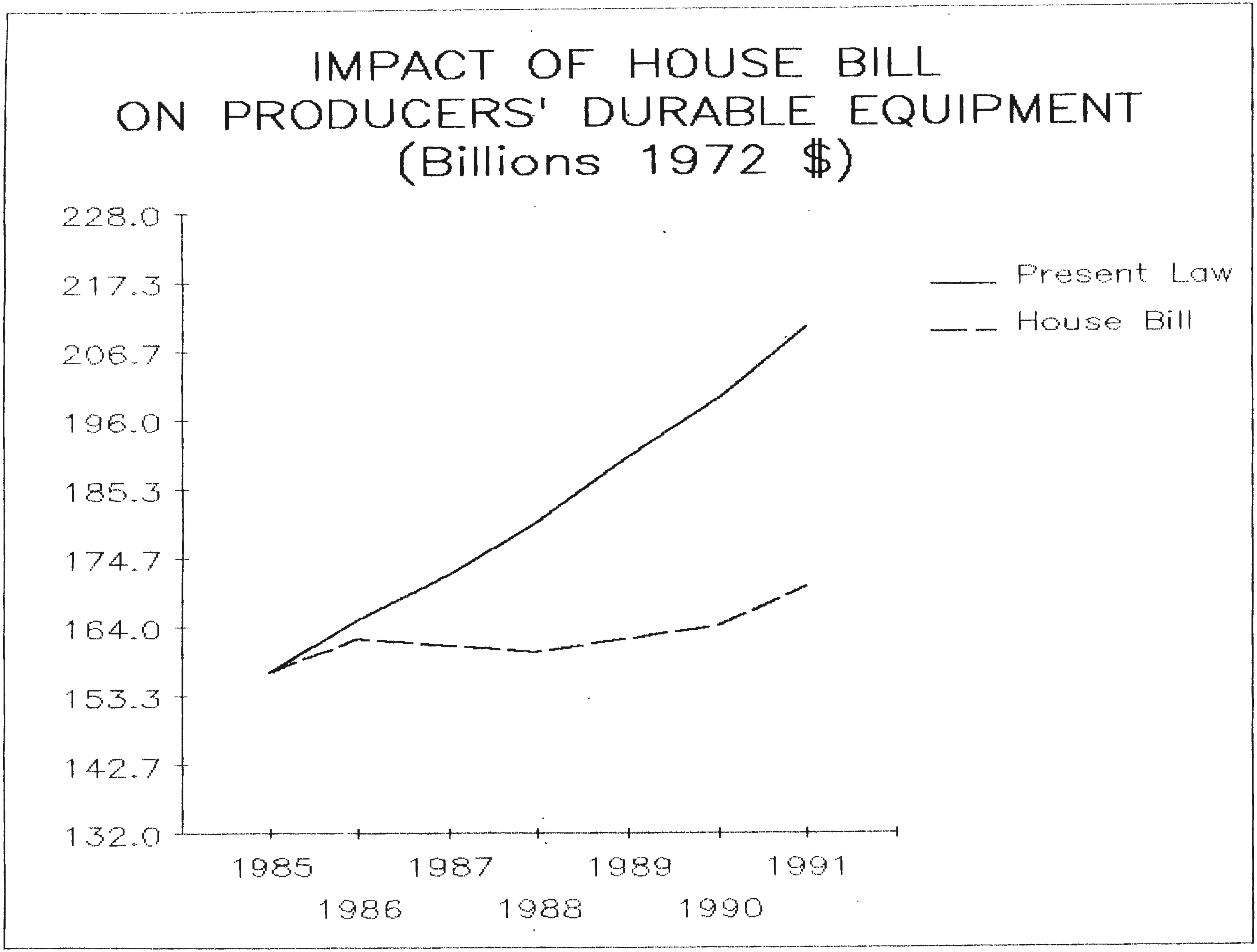
"Rapid economic growth is essential for job creation and an improved U.S. standard of living. The Ways and Means Committee bill would curb the economic recovery and contribute to more unemployment," continued Lesher.

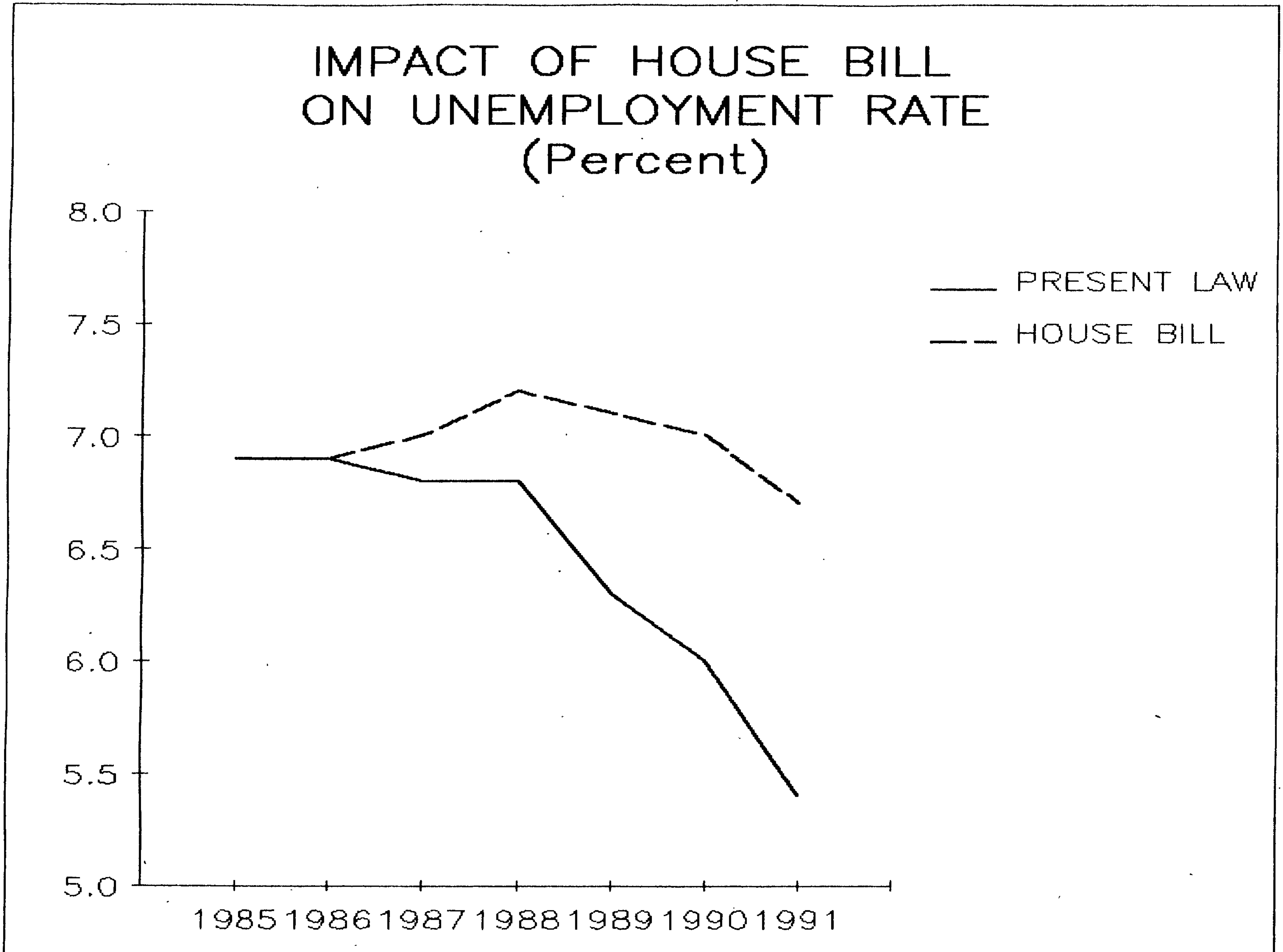
The analysis is based on simulations performed by the econometric consulting firm of Laurence H. Meyer and Associates using the Washington University macroeconomic model. Details of the findings are shown below:

ECONOMIC IMPACT OF HOUSE WAYS AND MEANS BILL
(Difference from Present Law in Billions of Dollars and Percent)

	1986	1987	1988	1989	1990	1991
GNP						
Billions of 1972 $	-3	-5	-14	-27	-41	-54
Percent change	-0.2%	-0.3%	-0.8%	-1.4%	-2.1%	-2.7%
Unemployment Rate						
Percentage Points	0.0	+0.2	+0.4	+0.8	+1.0	+1.3
Investment In Producers' Durable Equipment						
Billions of 1972 $	-3	-11	-20	-28	-35	-40
Percent change	-1.8	-6.4	-11.1	-14.7	-17.6	-19.0
Budget Deficit						
Billions of Current $	+16	+11	+15	+21	+24	+26


IMPACT OF HOUSE BILL ON REAL GNP
(Billions 1972 $)
2200
2100
2000
1900
1800
1700
1600
1985
1986
1987
1988
1989
1990
1991
Present Law
House Bill


IMPACT OF HOUSE BILL
ON PRODUCERS' DURABLE EQUIPMENT
(Billions 1972 $)
228.0
217.3
206.7
196.0
185.3
174.7
164.0
153.3
142.7
132.0
Present Law
House Bill
1985
1986
1987
1988
1989
1990
1991


IMPACT OF HOUSE BILL
ON UNEMPLOYMENT RATE
(Percent)
8.0
7.5
7.0
6.5
6.0
5.5
5.0
1985
1986
1987
1988
1989
1990
1991
PRESENT LAW
HOUSE BILL

LAURENCE H. MEYER & ASSOCIATES, Ltd.

Dr. Joel Prakken is Vice President and principal of Laurence H. Meyer & Associates, a Saint Louis based private consulting firm specializing in econometric modeling, forecasting and policy analysis. He is also an associate adjunct professor of economics at Washington University in Saint Louis.

Dr. Prakken received his PhD in economics from Washington University, and took his undergraduate training at Princeton University. Before forming LHM&A, he held the position of Senior Economist at the IBM Corporation, where he was responsible for both long term forecasting and the development of the IBM macroeconomic model. Prior to joining IBM he served as an economist with the Federal Reserve Bank of New York, and was an adjunct professor of finance at New York University's Graduate School of Business.

7030 Maryland Avenue
St. Louis, Missouri 63130
(314) 721-4747

REPORT TO THE BOARD OF DIRECTORS

No. page

Date Mailed to Board Members: October 25, 1985 Date of Board Meeting: November 13, 1985

Report of: Taxation Committee

On: Consumption Taxes

The Board is requested to approve the statement on Consumption Taxes as shown in the Attachment.

Background

A consumption tax as an alternative means of raising revenues has been receiving increasing interest within Congress. A manufacturer's excise tax was passed by the Senate to fund an expanded Superfund program ($7.5 billion). A similar Superfund bill recently passed House Ways and Means and has yet to be considered by the full House ($10.1 billion). The Superfund Excise Tax would be applied to all manufacturers with sales over $5 million ($10 million in the House version), on 0.08% of the sales price of, or gross lease payments for, tangible personal property in connection with a trade or business. Chamber policy opposes new or increased Superfund taxes, and supports funding of $5.3 billion over 5 years with reliance on general revenues.

Senator Roth (R-DE) has introduced the Business Transfer Tax (BTT). Tax liability would be gross receipts minus all purchases of raw materials and other inputs. Salaries, interest payments and dividends are not deductible. In the original version, BTT would be credited against the FICA payroll tax with the tax rate at 5%. In October, Roth introduced a new version which would be part of a comprehensive tax reform package. It would eliminate the FICA credit, allow BTT to be fully deductible from income tax, include a rate of 8-10 percent, and use the revenues to further reduce corporate and marginal income tax rates and improve capital formation provisions. The BTT is receiving considerable interest within the Senate Finance Committee and may be introduced in Ways and Means in the near future as a part of comprehensive tax reform. Senator Roth sent out inquiries to the business community as to their opinion of the BTT, and interest within the business community has been increasing.

On October 23, the Taxation Committee adopted the attached statement expressing support for the concept of consumption taxes. Although the Committee expressed support for the usage of consumption taxes, it listed a number of concerns to be expressed to the Board: 1) The effect of consumption taxes on retail industries with respect to their use of imports; 2) Concern that the tax rate under a consumption tax is too easily raised after it is implemented; 3) Exemption of tax on resources of limited availabilty, or products not readily available in the domestic market; and 4) Invisibility of some types of consumption taxes, and the possible advantages of taxes that are easily seen by all.

Applicable Policy: "Federal Taxes," Policy Declarations, pp. 177-179.

Action Requested: That the Board interpret policy as an adequate basis to approve the statement on consumption taxes as shown in the Attachment.

Rachelle Bernstein Committee Executive Taxation Committee	William S. Kanaga Chairman Taxation Committee

Other Board Members

Donald C. Alexander	Robert D. Kilpatrick
Peter M. Flanigan	Norma Pace

ATTACHMENT

STATEMENT ON CONSUMPTION TAXES

The U.S. Chamber supports the usage of broad-based consumption taxes. Consumption taxes should be used as a replacement tax for other sources of federal government revenues and not as an additional source of revenue. Any consumption tax adopted must enhance international competitiveness.

Noted by BWS

D. WALTER ROBBINS, JR.
1114 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10036

November 26, 1985

The Honorable Beryl W. Sprinkel
Chairman
Council of Economic Advisers
The White House
Washington, DC 20500

Dear Dr. Sprinkel:

The recent performance of the House Ways and Means Committee in crafting a new tax bill is a grotesque example of why the program for tax reform should be dropped. This bill represents nothing but deal cutting between politicians representing special interests. The top 10% of taxpayers based on adjusted gross income who pay 50% of the total U.S. personal income taxes simply have no representation in Congress on tax matters.

The House Ways and Means Committee tax proposal reverses the business tax provisions in the 1981 tax bill that were crucial in getting the country out of an economic malaise. It adds massively to the complexity of the tax code, which has already been revised three times in the past five years. In fact, we now have to prepare two different tax return forms each year with completely different rules.

The tax uncertainty created by Treasury I, Treasury II, and now the Ways and Means tax bill proposal, is enormous, with taxpayers not knowing the rules until perhaps the middle of 1986.

As a taxpayer, one feels like a ping pong ball being hit perpetually back and forth by so-called tax reformers. It is time to call a halt to this destructive exercise.

Respectfully yours,

D. Walter Robbins, Jr.

DWRJr/mg

cc Dr [illegible]
C Stuart

AMERICAN MINING CONGRESS
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SUITE 300
1920 N STREET NW
WASHINGTON
DC 20036
202/861•2800
TWX 710•822•0126

Noted by BWS

November 26, 1985

The Honorable Beryl W. Sprinkel
Chairman
Council of Economic Advisers
314 Old Executive Office Building
Washington, D. C. 20506

Dear Beryl:

Your presentation at the meeting yesterday was--as always--excellently structured, interestingly delivered, and highly informative.

It was also most encouraging.

I was pleased to have the opportunity to express to you the carefully developed initial reactions of the mining, minerals and minerals processing industry to the tax proposals developed by the Ways & Means Committee in its reported measure, which would increase significantly the mining industry federal income tax burden--further visiting upon this beleaguered industry adversities that it is not now positioned to assimilate.

We are soliciting your good offices and those of your informed colleagues intimately involved in the President's decision-making processes to weigh in against the enactment into law of these adversities to the minerals base of the United States.

The tax bill is anticompetitive (domestic and internationally), is antijobs and antibusiness, i.e. mining capital-intensive industries including our mining equipment manufacturers such as Caterpillar of Illinois.

In part, the unassimilable oppressive amendments removing current incentives for mining from the tax law are:

> The percentage depletion allowance, with few exceptions, would be substantially reduced. The rate for most minerals would be reduced in steps from present levels to 5 percent in 1988. The net income limitation

on the percentage depletion allowance would be reduced in steps from the present 50 percent to 25 percent in 1988.

Eighty percent of hard mineral exploration and development expenses would remain currently deductible; however, when the mine comes into production, the expenses would have to be recaptured and restored to income. The recaptured amount and development costs after the mine comes into production would be depreciable over a three-year period.

Percentage depletion deductions and 90 percent of exploration and development expense deductions would be tax preferences for purposes of the new 25-percent corporate alternative minimum tax.

Finally, capital gains treatment for coal and iron ore royalties would be repealed effective January 1, 1986.

When the bill reaches the House floor, it probably will be considered under a "closed" or modified rule, which would limit consideration of amendments.

The current tax reform bill affects the mining industry more severely than any other business area and raises the industry's taxes by about 50%. This is documented by an A. D. Little report completed in September--copy of executive summary attached.

Thank you so much for providing me the opportunity at The White House meeting to express the view of the industry that I represent.

With warmest personal regards and best wishes for a happy holiday season, I am

Sincerely,

Allen

J. Allen Overton, Jr.
President

AMERICAN
MINING CONGRESS
NEWS
SERVICE

SUITE 300 1920 N STREET NW WASHINGTON DC 20036 202/861·2800
J. ALLEN OVERTON, JR., PRESIDENT

FOUNDED 1897

FOR RELEASE:
WEDNESDAY, SEPTEMBER 4, 1985

AMC CONTACT:
Joseph A. Jeffrey
202/861-2836

REPORT SAYS PRESIDENT'S TAX PROPOSAL WOULD SEVERELY AFFECT MINING INDUSTRY

WASHINGTON, D.C. -- The Administration's tax proposal may affect the mining industry more severely than any other business area and raise the industry's taxes by about 50%, maintains an independent report prepared for the American Mining Congress.

The report responds to a request from Treasury Sec. James Baker III for an analysis of the impact of the President's tax proposal on the mining and mineral processing industry. The independent report, released today by AMC President J. Allen Overton, Jr., is based on the study conducted by Arthur D. Little, Inc. (a multinational management and technology consulting firm), and the law firm of Jones, Day, Reavis and Pogue.

The report says the proposed tax program would eliminate the major incentive to mining firms--percentage depletion--as well as the investment tax credit and accelerated depreciation allowances, which are especially important to the mining industry. In addition to substantially raising the industry's taxes, the proposal would result in a 15% decline in actual investments.

Other highlights from the report include:

- The mining and support industries would lose over 380,000 jobs, many in regions offering few other employment opportunities.

(more)

- U.S. reliance on imports would increase, compromising the reliability of the nation's supply of mineral-based products.

- The tax proposal would raise the industry's taxes by about 50% while actual investment would decline by about 15%.

- Over the past few years, mining companies have been beseiged by growing international competition, the high dollar and weak product demand. As a result, cash flows have barely sustained efficiency of existing operations.

- The proposed law would discourage new investment immediately and have a major impact on mining output over the next 10 years.

- By the mid-1990s the proposed reform would result in about 76,000 fewer direct mining jobs and about 308,000 fewer jobs in support industries.

- These impacts would be felt most severely in Appalachia, Minnesota, Arizona, Missouri and the Rocky Mountain states.

- The consequences of the proposal would contradict both the National Minerals Policy Act of 1970 and the National Critical Materials Act of 1984, both of which support mining self-sufficiency.

(A copy of the Executive Summary is enclosed.)

A Report to
The American
Mining Congress

Impact of the President's Tax Reform Proposals on the United States Mining Industry

Executive Summary

Arthur D. Little, Inc.
Jones, Day, Reavis & Pogue

September 4, 1985

This executive summary presents the results of a report entitled *Impact of the President's Tax Reform Proposals on the United States Mining Industry*, which was prepared by the consulting firm of Arthur D. Little, Inc., and the law firm of Jones, Day, Reavis and Pogue for the American Mining Congress. Copies of this report are available to qualified parties. For more information, please contact:

Mr. Joseph A. Jeffrey, Vice President
American Mining Congress
1920 N Street, N.W.
Washington, D.C. 20036
(202) 861-2836

Impact on Mining Output

In the short term, especially during the transition period from current to proposed tax law, the changed tax liabilities would have a modest impact on the output of the mining industry. The phase-out of percentage depletion would reduce the short-term tax impacts for profitable firms and many firms have accumulated losses and credits which would offset their taxes for some time to come.

Mining firms, however, would react immediately to the longer term changes in taxation, particularly as they affect future return on investments. They would have increased difficulty finding attractive investment opportunities and obtaining investment capital because the relative after-tax profitability of mining versus other types of business for multi-industry firms would be reduced substantially.

The proposed law would discourage new investment immediately and have a major impact on mining output over the next 10 years

In the longer term, the proposed tax program would increase mining industry taxes by approximately 50% and would reduce cash flows by approximately 6%. This decline would inhibit both investments financed internally and investments financed from outside sources, resulting in a 15% reduction in capital spending in mining. This reduction in capital investment represents economic capacity which would not be in place in the future. As a result, we estimate that mining industry output would be at least 20% lower after a decade of the proposed tax program than it would be under the current law.

Impact on Employment

By the mid-1990s the proposed reform would result in about 76,000 fewer direct mining jobs and about 308,000 fewer jobs in support industries

By the mid-1990s the lack of investment and reduced mining output resulting from the proposed tax program would cause direct mining industry employment to be approximately 76,000 jobs lower than it would be under the existing tax laws. In addition, the effects on supplier industries, local support economies, and capital goods and services suppliers would eliminate approximately 308,000 more jobs. Thus, the total employment loss would exceed 380,000 jobs by the middle of the next decade. This does not include the potential impacts in industries which use raw or processed mining products, which may be affected by the declining availability of domestic ores and minerals.

Geographic Impact

These impacts would be felt most severely in Appalachia, Minnesota, Arizona, Missouri and the Rocky Mountain states

We did not measure the potential impact on state and local government revenues, governmental expenditures for human services and related items, but they, along with employment losses, are likely to be particularly acute in the Appalachian coal fields, the Lake Superior iron range and the non-ferrous metal-mining areas in Arizona, Missouri and the Rocky Mountain states. Other impacts — such as increased imports, the decline of suppliers of mining and minerals processing equipment and services, and the security of minerals and metals supplies to domestic consumers — would be widespread.

Impact on Domestic Minerals Supply and Import Dependence

Thus the consequences of the proposal would contradict both the National Mineral Policy Act of 1970 and the National Critical Materials Act of 1984, both of which support mining self-sufficiency

Reduction in output of the domestic mining industry would inevitably increase U.S. dependence on imported commodities. In 1983, non-fuel minerals exports equalled $12 billion and U.S. consumer imports equalled $24 billion. The $10 billion reduction in domestic output projected to occur by 1995 would have to be made up by increased imports.

This would subject the domestic economy to increased uncertainties over the supply and cost of mineral-based products. Congress has addressed this subject many times — notably in the National Critical Materials Act of 1984 and the Mining and Minerals Policy Act of 1970. These Acts recognize the importance of a sound domestic mining and minerals industry to the nation's economic well-being and national security.

Mineral products continue to provide the basis for the industrial sectors which form the core of the nation's economic and defense capabilities. Engineering, transportation, capital goods and construction, as well as a large portion of the nation's energy supply, all depend on mined products.

Over the past decade, the U.S. economy has become increasingly dependent on foreign suppliers of certain mineral and metal commodities which exist in economically viable deposits in the U.S. In addition, many producers have continued to operate in spite of depressed business conditions because they believed that their facilities would become profitable again in the future; if they closed their plants and mines they would be unable to benefit from the recovery.

Without the promise of a recovery, however, fewer producers would continue this practice, increasing the reliance on imports. This trend would extend beyond those metals for which import dependence is already a fact of life. U.S. coal also would become less competitive in both the international markets and in certain domestic regions. Other metals, including uranium, titanium and those required for electronics applications (such as silicon, germanium and precious metals), also face reduced domestic production and increased dependence on foreign suppliers under the proposed law.

Thus, the reduction in mining activity brought about by the tax reform proposal would compromise the reliability of the nation's supply of mineral-based products.

Summary of Results

Study results indicate that the President's tax reform proposal, if enacted, would severely damage the already-weakened U.S. mining industry

Investment would decline by 15%, leading to a 20% reduction in output by the mid-1990s

The mining and support industries would lose over 380,000 jobs, many in regions offering few other employment opportunities

U.S. reliance on imports would increase, compromising the reliability of the nation's supply of mineral-based products

In 1984 domestic mines and processing plants produced $50 billion worth of metal ores, non-metal minerals and coal, forming the backbone of many of the nation's basic industrial activities. This critical industry, however, finds itself besieged by growing international competition and, for the last several years, has suffered from the high dollar and weak product demand. The results of this study — conducted jointly by Arthur D. Little, Inc. (a multinational management and technology consulting firm) and the law firm of Jones, Day, Reavis and Pogue — indicate that the President's proposed tax reform, if enacted, would severely undercut the mining industry's already-weakened ability and incentive to compete in world markets.

- Tax liabilities would increase by about 50% for profitable firms, perhaps the largest increase in any business sector.
- Cash flow for typical firms would decline by about 6% and total investment in the industry would decline by about 15%.
- Rates of return on mining investments would decrease by 10 to 20%, while returns in many other industries would increase.

The domestic mining industry would find it difficult to absorb this damage.

- Domestic mining companies generally cannot pass increased costs — including increased taxes — along to their customers because prices are set in the world market.
- The U.S. mining industry has lost world market share in virtually every important mineral product over the last decade. Developing nations have proved to be extremely aggressive competitors. Their need for foreign exchange and employment often drives them to set prices lower and produce more than a conventional free-market approach would dictate.
- The removal of established tax incentives would place U.S. mining firms at a further disadvantage to foreign producers.
- Domestic metal mining employment has declined by 43%, nonmetallic minerals employment by 11%, and coal mining employment by 20% since 1980.
- Imports of principal non-fuel minerals and products have increased to nearly $25 billion, while exports have declined to $12 billion. Coal exports have fallen by 30% since 1981.

The 20% reduction in industry output anticipated to occur under the President's tax proposals would aggravate these problems. By the mid-1990s it would result in:

- 76,000 fewer direct mining jobs than under current law.
- Nearly 290,000 fewer jobs in sectors which supply goods and services to mining firms and their employees.
- 18,000 fewer jobs in sectors which supply mining equipment and other investment-related goods and services.
- In total, over 380,000 fewer domestic jobs.
- An increase of over $10 billion (1984 dollars) in imports of ores, non-fuel minerals, and coal.

The reduction in domestic minerals production also would contradict the goals of the National Minerals Policy Act of 1970 and the National Critical Materials Act of 1984. In these Acts, Congress recognized that an economically sound and stable domestic mining industry is vital to assure the fulfillment of the nation's industrial, national security and other needs.

- The proposed tax program would erode American mining self-sufficiency and increase dependence on foreign suppliers.
- It would compromise the reliability of the nation's supply of mineral-based products.
- It would substantially reduce the incentive to find and develop new deposits in the United States and elsewhere.

Tax Proposal Analysis

The tax proposal would raise the industry's taxes by about 50% while actual investment would decline by about 15%

In this study we analyzed the tax impact of the President's proposals on mining firms in three ways:

1. Several companies, which collectively represent nearly 20% of mining output, recalculated their tax liabilities on their mining activities for the period 1979 through 1983 under current law and under proposed law. Including the effects of losses during this period (which were major), these firms would have had their tax liabilities increased by 30% overall, weighted on a commodities-produced basis, if the proposed program had gone into effect in 1979.
2. We analyzed, on a pro forma basis, changes in taxes for typical mining companies under profitable business conditions and without regard to accumulated losses or the transitional provisions of the proposal. Such firms would face tax increases of approximately 50%.
3. We set up a model to analyze the financial returns to the owner of a new mine under current and proposed tax law. This analysis, done on both constant dollar and inflated dollar bases, shows that the proposed tax laws would result in a substantial reduction in the long-term financial attractiveness of such investments. For the project analyzed, the rates of return fell between 10 and 20%, and the net present value of the after-tax cash flows dropped over 25%. Such a decrease in returns would substantially undercut corporations' willingness and ability to invest in mining in the long term.

The tax proposal may affect the mining industry more severely than any other business area. The proposed program would eliminate the major incentive to mining firms — percentage depletion — as well as the investment tax credit and accelerated depreciation — allowances which are especially important to the mining industry. Other elements of the proposal likely to hurt specific mining sectors include expansion of the minimum tax, the change in the tax treatment of coal and iron ore royalties and the imposition of a "windfall" depreciation recapture tax. The dividend-paid deduction and the reduction in the maximum tax rate would only partially offset these factors.

These increases in tax liabilities would impact mining output, domestic minerals supply and dependence on imports.

The Mining Industry Today

Over the past few years, mining companies have been beseiged by growing international competition, the high dollar and weak product demand

As a result, cash flows have barely sustained efficiency of existing operations

The U.S. mining industry provides a broad range of important basic raw materials, fuels and industrial commodities to the domestic economy and the world market. The industry traditionally has been influenced strongly by the business cycle and has relied on relatively brief periods of high profitability to generate the capital and sustain the incentive it needs to replenish exhausted reserves.

Over the past few years, however, weak demand, depressed world commodity prices and escalating foreign competition have made life difficult for most, if not all, sectors of the industry. Cash flows have barely been sufficient to sustain, much less improve, efficiency at existing facilities.

During this period, foreign producers, especially in developing countries, have increased production, in many cases based on their needs for foreign exchange and employment rather than on the free-market economics of supply and demand.

At the same time the mining industry faces an unusual degree of risk when it explores for and develops new deposits. Long development periods and large, up front investments are necessary to establish new mines and plants, and cost recovery is subject to the uncertainties of international commodity markets. Mining firms have very little control over prices.

The mining industry, therefore, labors under great pressure to improve its efficiency and to increase its profitability and cash flows in order to remain viable in the longer term. Failure to improve financial performance when world market conditions improve will inevitably result in a permanent and significant shrinkage in domestic mining production.

Further reductions in cash flows, therefore, would cut the amount of capital available for investment at a time when such investment is critical. In addition, reduced after-tax returns for the industry in general, and for new projects in particular, would reduce investor incentives substantially.

CATERPILLAR TRACTOR CO. Noted by BWS

November 27, 1985

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

Nearly two years ago, you initiated the current effort to reform federal tax laws when you announced that the Treasury was to develop "a plan for action to simplify the entire tax code." You also added the important goals of fairness and economic growth to the tax reform debate.

Regrettably, the Ways and Means Committee has developed a proposal which meets none of these objectives you established. Instead, the Committee measure will mean continued complexity, and an inappropriate, massive shift of tax burden to capital goods industries.

Perhaps most important, the proposal would give many advantages to foreign companies competing against U.S. manufacturers. It would lead to a loss of U.S. jobs at Caterpillar -- and, we believe, throughout the manufacturing sector of the U.S. economy. Slower economic growth would result.

After 49 consecutive years of profitability, Caterpillar accumulated about $1 billion in losses from 1982 through 1984. Shrinking markets and the overpriced dollar hurt -- and changed -- our entire industry. Today, our toughest competition by far comes from foreign-based manufacturers.

We have undertaken vigorous actions necessary to maintain our competitiveness. These actions are showing good results. But there's a lot more to be done, and the Ways and Means proposal would undermine our efforts.

The Committee's tax plan would significantly increase the cost of investing in the productive machinery and equipment absolutely vital to making Caterpillar's U.S. facilities more competitive. If these plans for U.S. investment become more expensive, they may have to be scaled back or stretched out over a longer period of time. In either event, the competitiveness of U.S.-based manufacturing would suffer, requiring shifting of operations -- and jobs -- offshore.

Caterpillar is also modernizing its non-U.S. facilities. Increasing the cost of the U.S. element of this corporate-wide process will tend to make the foreign-based projects more attractive, relative to those in this country. I'm sure you agree U.S. tax policy should have just the opposite effect.

Mr. President, we have attempted to work with Treasury and Congressional officials in the effort to forge a good tax reform plan. We are certainly willing to continue to do so. But we believe it would be a big mistake for the House to approve the measure that has been produced. You can help ensure that this mistake doesn't happen.

We urge you to oppose the Ways and Means proposal.

Sincerely,

George A. Schaefer
sm

cc: The Hon. Donald T. Regan
Chief of Staff and Assistant
to the President
The White House
Washington, DC 20500

The Hon. Beryl Sprinkel
Chairman
Council of Economic Advisers
Old Executive Office Building
Washington, DC 20500

cc: Dr. Moore
C. Stuart

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

Noted by BWS

RICHARD L. LESHER
PRESIDENT

1615 H STREET, N.W.
WASHINGTON, D. C. 20062
202/463-5300

November 27, 1985

The Honorable Beryl Sprinkel
Chairman
Council of Economic Advisors
Executive Office Building
Washington, D. C. 20506

Dear Beryl:

Yesterday I sent you a one-page summary of an analysis of the Ways and Means Committee tax bill made by Laurence H. Meyer and Associates. Enclosed is a more detailed summary of that same study.

If you have any questions about the study, or wish additional information, please let me know.

Best wishes for a happy Thanksgiving Holiday.

Sincerely,

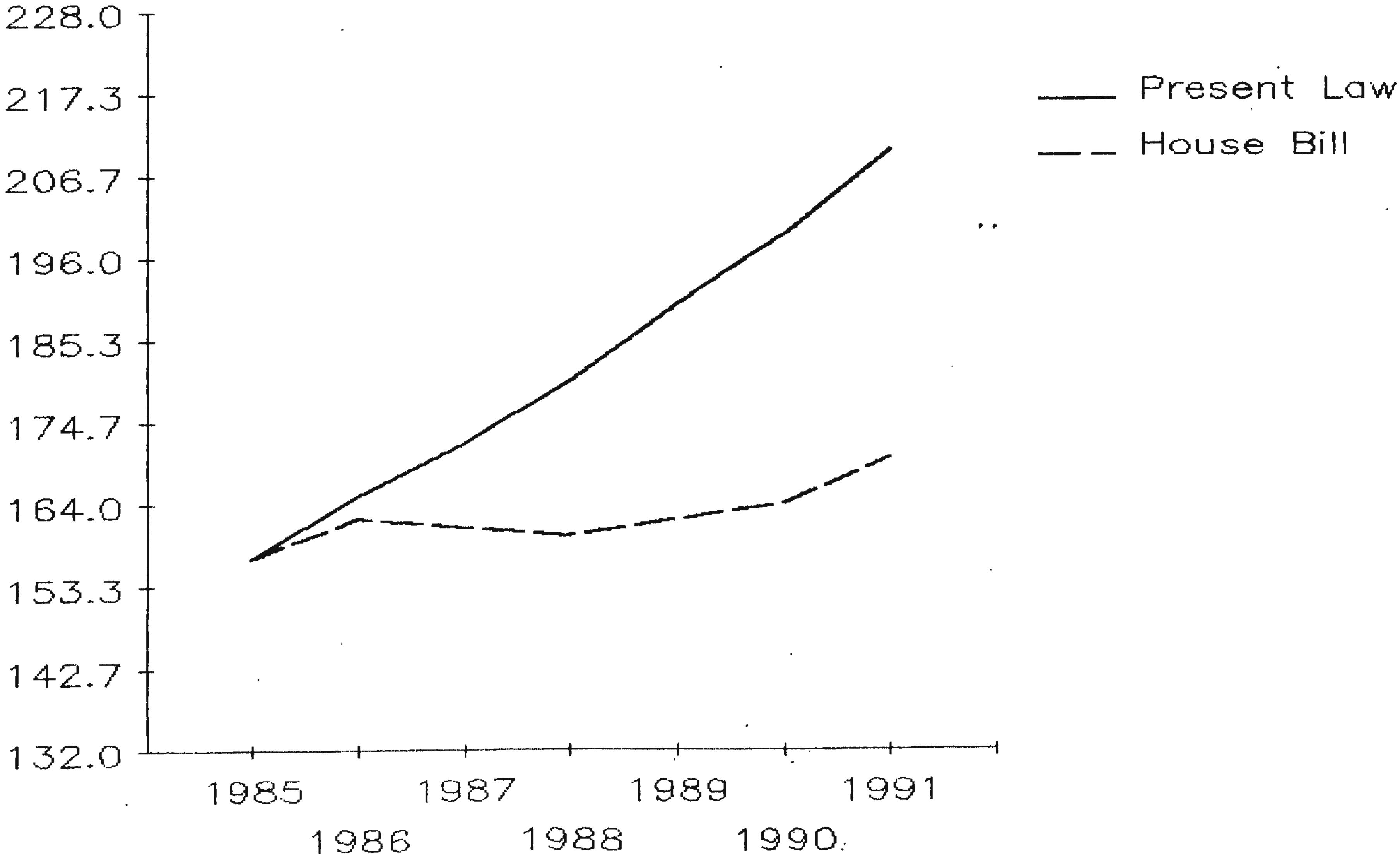
Dick

Richard L. Lesher

Enclosure

cc: [illegible]
C. Stuart

IMPACT OF HOUSE BILL
ON PRODUCERS' DURABLE EQUIPMENT
(Billions 1972 $)



U.S. Chamber of Commerce

Washington, D.C. 20062

ECONOMIC IMPACT
OF THE HOUSE WAYS AND MEANS COMMITTEE TAX REFORM BILL

SUMMARY

A recently completed econometric analysis of the House Ways and Means Committee's tax reform bill, performed for the U.S. Chamber of Commerce by the consulting firm of Laurence H. Meyer and Associates, shows that implementation of the bill will result in significantly lower rates of economic growth.

The study estimates that the enactment of the bill would result in a cumulative decline in real gross national product of $145 billion between 1986 and 1991. The nonresidential investment sector will suffer a $158.9 billion cumulative decline as the after-tax cost of capital investment rises substantially. Most of this decline is borne by investment in producers' durable equipment which falls by a cumulative $136.3 billion over the six year period. U.S. exports are projected to fall by $14.2 billion, while consumer spending enjoys a small $5.1 billion increase.

Both the civilian unemployment rate and the federal budget deficit would rise if the House bill is enacted. In 1991, the unemployment rate will be 1.3 percentage points higher than if the bill were not enacted. Similarly, the federal budget deficit will be $25.3 billion (current dollars) higher than under present law.

SIMULATION DETAIL

While the U.S. economy is expected to continue on a path of relatively healthy growth under current tax law, this outcome will not be achieved if the House Ways and Means tax reform bill is enacted. The bill returns to a depreciation system similar to the Asset Depreciation Range (ADR) system that was in effect prior to the enactment of the Economic Recovery Tax Act of 1981. The changes in depreciation made by the Administration's 1981 tax program have been credited as being a major contributing factor to the strength of investment growth during the current recovery. Moreover, the Ways and Means proposal includes higher capital gains tax rates, corporate tax increases and other items which will reduce U.S. economic growth.

The accompanying tables and charts compare the impact of this bill on the national economy to the baseline forecast of the Congressional Budget Office (CBO). The after-tax cost of capital for equipment, residental buildings and consumer durables is expected to rise significantly if the House bill is enacted. Consequently, substantial declines in investment, particularly investment in producers' durable equipment, will result in significantly lower rates of economic growth and higher unemployment. The plan would result in average annual increases in economic activity of only 2.9 percent during the next six years compared to a projected growth rate of 3.5 percent under present law.

Detailed results of the simulation are shown below:

-- Real gross national product would be $145 billion lower cumulatively between 1986 and 1991 than would otherwise have been the case. Averaging $24.2 billion per year, the declines in economic activity range from $3 billion during the first year to $53.9 billion by the sixth year after implementation of the tax reform plan.

-- Because of the decline in individual tax rates, the composition of gross national product shifts away from investment toward consumption. As a result, real consumer spending would account for 65.8 percent of total output compared to 64.6 percent under present law. On the other hand, nonresidential investment falls from 13.8 percent of total GNP under present law, to only 11.7 percent under the House bill. While consumer spending rises by a cumulative $5.1 billion during the six years following implementation of the bill, the bulk of the increase in consumption occurs during the first four years after the plan is enacted. During the fifth and sixth years following implementation of the House bill, real consumer spending falls by a cumulative $14.3 billion as the decline in investment results in higher unemployment and a lower standard of living for all Americans.

-- Increases in the after-tax cost of capital investment contribute to a cumulative $158.9 billion decline in nonresidential investment during the six years following implementation of the bill. The bulk of the deterioration is borne by the producers' durable equipment sector which suffers a cumulative decline of $136.3 billion, or an average yearly shortfall of $22.7 billion. Investment in nonresidential structures falls by $22.5 billion during the same period, while residential investment declines by $2.4 billion.

-- By sharply increasing domestic capital costs and reducing domestic investment, the House bill will worsen the competitive position of U.S. goods. Consequently, real exports suffer a $14.2 billion cumulative decline between 1986 and 1981.

-- The American economy's ability to create new jobs has been the envy of the industrialized world. By restricting investment, the House bill will seriously hamper the U.S. economy's ability to create new jobs. Consequently, the civilian unemployment rate is higher throughout the simulation interval. In 1991, the unemployment rate is 1.3 percentage points higher than would otherwise have been the case.

-- Enactment of the House bill does not have a significant impact on inflation and interest rates. The implicit deflator for GNP is approximately one-tenth of a percentage point lower under the House alternative. Similarly, both short- and long-term interest rates are, on average, only 10 basis points lower.

-- The House bill will also have a negative impact on the federal deficit. Although the bill is structured to be revenue neutral on a static basis, this ignores the dynamic interaction between economic activity and government receipts and expenditures. Lower rates of economic growth reduce the tax base, and as a result, lower receipts, while higher unemployment increases expenditues. Consequently, in 1991, the federal deficit is $25.3 billion higher than under current CBO assumptions.

Strong rates of economic growth are essential for job creation and an improved U.S. standard of living. The Ways and Means Committee bill will clearly slow the economic recovery we are now enjoying.

Impact of House Ways & Means Tax Reform Bill
on the U.S. Economy

	Years from Implementation							
	1	2	3	4	5	6	Average Impact	Cumulative Impact
	1986	1987	1988	1989	1990	1991		
GNP								
CBO Base	1728.2	1785.3	1840.6	1901.3	1963.2	2025.6	1874.0	
HW&M	1725.2	1780.2	1826.6	1873.8	1921.7	1971.7	1849.9	
Difference(1)	-3.0	-5.1	-14.0	-27.5	-41.5	-53.9	-24.2	-145.0
Percent(2)	-0.2	-0.3	-0.8	-1.4	-2.1	-2.7	-1.3	
Consumption								
CBO Base	1132.1	1162.4	1191.5	1225.7	1265.1	1308.4	1214.2	
HW&M	1133.7	1169.9	1198.7	1228.8	1261.8	1297.4	1215.1	
Difference(1)	1.6	7.5	7.2	3.1	-3.3	-11.0	0.8	5.1
Percent(2)	0.1	0.6	0.6	0.3	-0.3	-0.8	0.1	
Nonresidential Investment								
CBO Base	226.5	235.5	245.1	257.2	268.2	279.0	251.9	
HW&M	222.4	223.3	223.1	225.2	227.4	231.2	225.4	
Difference(1)	-4.1	-12.2	-22.0	-32.0	-40.8	-47.8	-26.5	-158.9
Percent(2)	-1.8	-5.2	-9.0	-12.4	-15.2	-17.1	-10.5	
Equipment								
CBO Base	165.3	172.2	179.5	189.5	199.0	210.2	186.0	
HW&M	161.7	161.3	160.1	161.8	164.3	170.2	163.2	
Difference(1)	-3.6	-10.9	-19.4	-27.7	-34.7	-40.0	-22.7	-136.3
Percent(2)	-2.2	-6.3	-10.8	-14.6	-17.4	-19.0	-12.2	
Structures								
CBO Base	61.1	63.3	65.7	67.7	69.1	68.8	66.0	
HW&M	60.7	62.0	63.1	63.4	63.0	61.0	62.2	
Difference(1)	-0.4	-1.3	-2.6	-4.3	-6.1	-7.8	-3.8	-22.5
Percent(2)	-0.7	-2.1	-4.0	-6.4	-8.8	-11.3	-5.7	
Residential Investment								
CBO Base	60.6	65.5	66.0	65.6	66.3	66.8	65.1	
HW&M	59.8	65.1	66.4	65.7	65.8	65.6	64.7	
Difference(1)	-0.8	-0.4	0.4	0.1	-0.5	-1.2	-0.4	-2.4
Percent(2)	-1.3	-0.6	0.6	0.2	-0.8	-1.8	-0.6	
Exports								
CBO Base	141.5	144.8	148.8	153.9	160.0	166.5	152.6	
HW&M	141.4	144.4	147.6	151.5	155.9	160.5	150.2	
Difference(1)	-0.1	-0.4	-1.2	-2.4	-4.1	-6.0	-2.4	-14.2
Percent(2)	-0.1	-0.3	-0.8	-1.6	-2.6	-3.6	-1.6	
Unemployment Rate(%)								
CBO Base	6.9	6.8	6.8	6.3	6.0	5.4	6.4	
HW&M	6.9	7.0	7.2	7.1	7.0	6.7	7.0	
Difference(3)	0.0	0.2	0.4	0.8	1.0	1.3	0.6	NA
Implicit Price Deflator for GNP(%ch)								
CBO Base	3.9	4.0	3.9	3.8	3.9	4.1	NA	
HW&M	4.0	4.1	4.0	4.0	4.0	3.9	NA	
Difference(3)	0.1	0.1	0.1	0.2	0.1	-0.2	NA	NA
Treasury Bill Rate(%)								
CBO Base	7.4	7.3	7.1	7.0	7.0	7.0	7.1	
HW&M	7.4	7.3	7.0	6.8	6.7	6.6	7.0	
Difference(3)	0.0	0.0	-0.1	-0.2	-0.3	-0.4	-0.1	NA
Corporate Bond Rate(%)								
CBO Base	9.8	9.2	9.1	9.0	9.0	8.9	9.2	
HW&M	9.8	9.2	9.0	8.9	8.8	8.6	9.1	
Difference(3)	0.0	0.0	-0.1	-0.1	-0.2	-0.3	-0.1	NA
***NIA Deficit(bill. current $)**								
CBO Base	-204.6	-226.3	-226.9	-241.1	-262.4	-293.3	-242.4	
HW&M	-197.1	-238.0	-240.4	-260.0	-285.5	-318.6	-256.6	
Difference(4)	7.5	-11.7	-13.5	-18.9	-23.1	-25.3	-11.9	NA

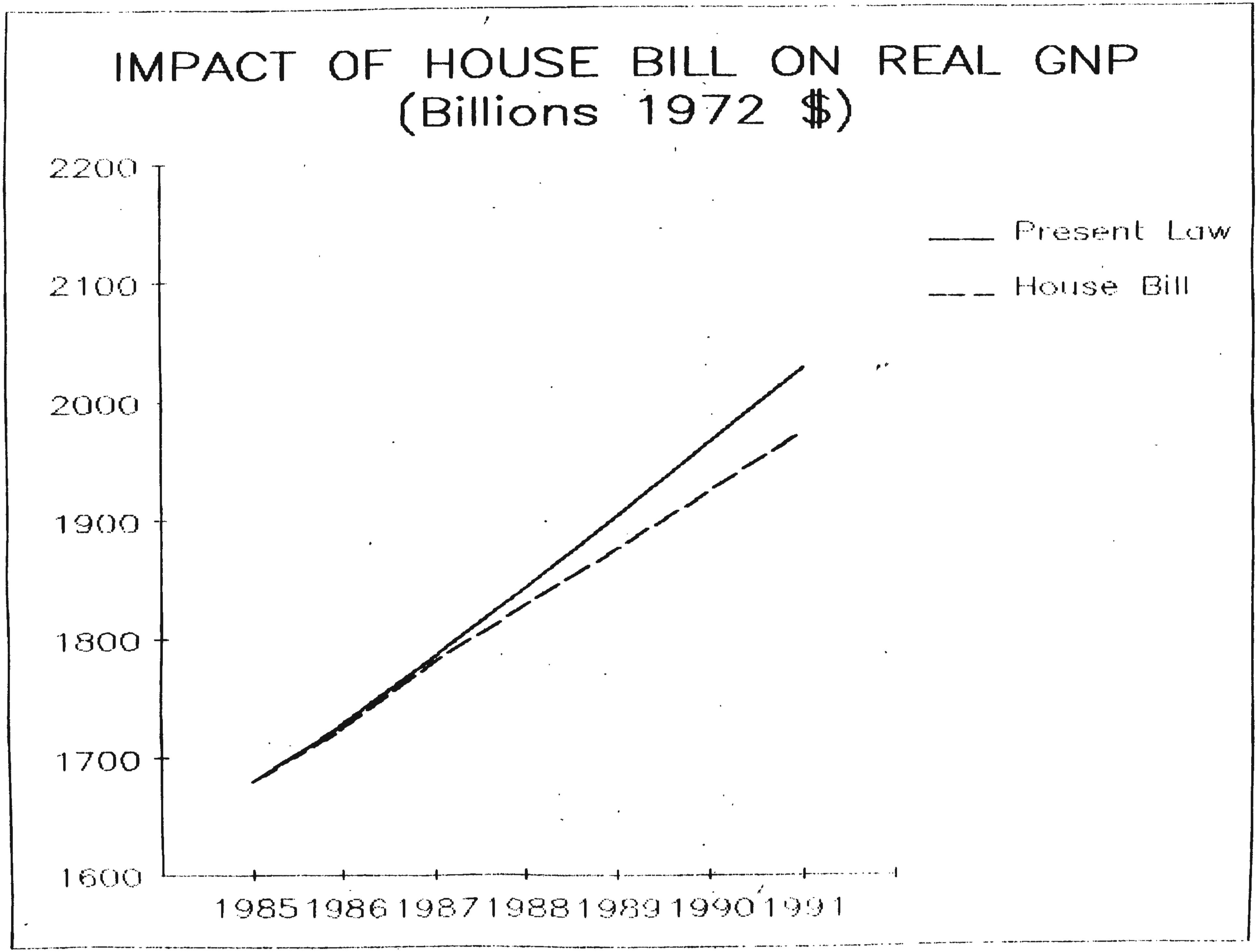
(1) Difference from base in billions of real (1972) dollars.
(2) Percent difference from base.
(3) Percentage point difference from base.
(4) Difference from base in billions of current dollars.
NA Not applicable or not available

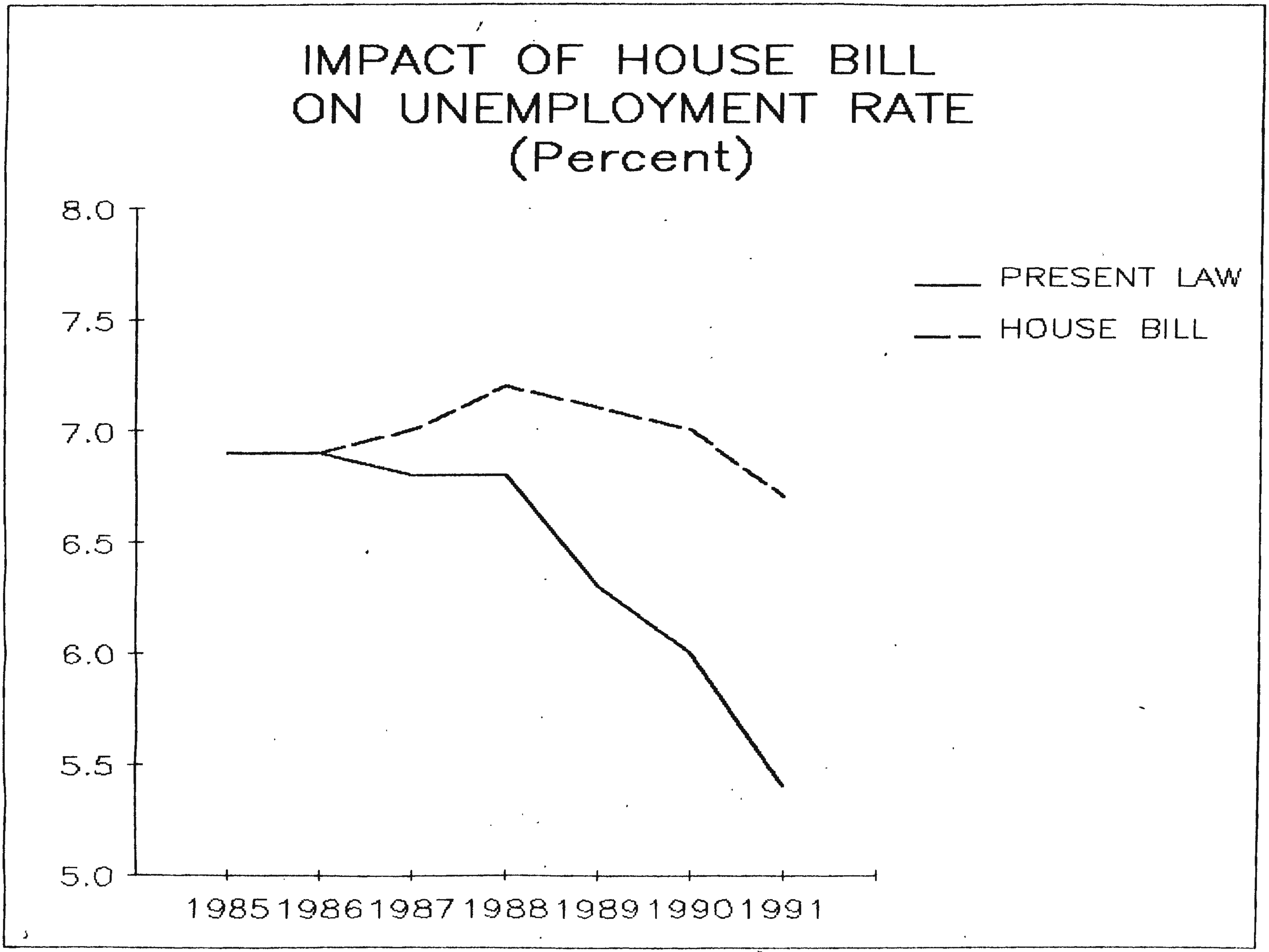
Source: Laurence H. Meyer & Associates.
*National Income Accounts

Impact of House Ways & Means Tax Reform Bill
on the Rental Price of Investment

	Years from Implementation					
	1	2	3	4	5	6
	1986	1987	1988	1989	1990	1991
Business Capital						
Equipment						
CBO Base	18.6	18.8	18.8	18.5	18.1	17.8
HW&M	22.0	22.2	22.1	21.8	21.3	20.9
Difference	3.4	3.4	3.3	3.3	3.2	3.1
Percent	18.3	18.1	17.6	17.8	17.7	17.4
Structures						
CBO Base	18.6	19.6	20.4	20.6	20.6	20.8
HW&M	20.7	21.7	22.4	22.5	22.4	22.4
Difference	2.1	2.1	2.0	1.9	1.8	1.6
Percent	11.3	10.7	9.8	9.2	8.7	7.7
Residential Buildings						
Single Family						
CBO Base	14.4	13.3	13.4	13.5	13.6	13.6
HW&M	15.0	13.9	13.9	14.0	14.0	13.9
Difference	0.6	0.6	0.5	0.5	0.4	0.3
Percent	4.2	4.5	3.7	3.7	2.9	2.2
Multi Family						
CBO Base	16.5	15.2	16.3	15.5	15.6	15.7
HW&M	17.7	16.3	16.4	16.5	16.6	16.5
Difference	1.2	1.1	0.1	1.0	1.0	0.8
Percent	7.3	7.2	0.6	6.5	6.4	5.1
Consumer Durables						
CBO Base	21.3	20.9	20.3	19.8	19.3	18.8
HW&M	21.6	21.1	20.5	20.0	19.4	18.9
Difference	0.3	0.2	0.2	0.2	0.1	0.1
Percent	1.4	1.0	1.0	1.0	0.5	0.5
Inventories						
CBO Base	7.0	6.9	6.5	6.3	6.2	6.0
HW&M	7.1	6.9	6.4	6.1	5.9	5.7
Difference	0.1	0.0	-0.1	-0.2	-0.3	-0.3
Percent	1.4	0.0	-1.5	-3.2	-4.8	-5.0

Source: Laurence H. Meyer and Associates


IMPACT OF HOUSE BILL ON REAL GNP
(Billions 1972 $)
2200
2100
2000
1900
1800
1700
1600
1985
1986
1987
1988
1989
1990
1991
Present Law
House Bill


IMPACT OF HOUSE BILL
ON UNEMPLOYMENT RATE
(Percent)
8.0
7.5
7.0
6.5
6.0
5.5
5.0
1985
1986
1987
1988
1989
1990
1991
PRESENT LAW
HOUSE BILL