Write Leavitt

Jim Riche

Washing DC
Dr. Ralph Blideal
about the seed

October 29, 1987

1988 DISCRETIONARY FREEZE OPTIONS - OMB ESTIMATES 1/
($ billions)

		Defense	Domestic	Total
Nominal Totals				
GRH Baseline...............	BA	303.1	150.3	453.4
	O	289.9	182.3	472.2
GRH BA Freeze with 1988 Pay and FERS 2/..........	BA	294.3	144.1	438.4
	O	286.4	179.5	465.9
GRH BA Freeze without 1988 Pay and FERS.............	BA	291.3	142.1	433.4
(1987 Current Rate)	O	283.4	177.5	460.9
Adjustment for BA/outlay ratios.................	O	288.4	---	---
Reductions from GRH Baseline				
GRH BA Freeze with 1988 Pay and FERS 2/..........	BA	-8.8	-6.2	-15.0
	O	-3.5	-2.8	-6.3
GRH BA Freeze without 1988 Pay and FERS.............	BA	-11.8	-8.2	-20.0
(1987 Current Rate)	O	-6.5	-4.8	-11.3
Adjustment for BA/outlay ratios.................	O	+5.0	---	---
Reductions from CBO Baseline				
GRH BA Freeze with 1988 Pay and FERS 2/..........	O	-4.9	-9.1	-14.0
GRH BA Freeze without 1988 Pay and FERS............. (1987 Current Rate)	O	-7.9	-11.1	-19.0
Adjustment for BA/outlay ratios.................	O	+5.0	---	---

1/ OMB and CBO estimates for savings from the freeze options differ only slightly for defense outlays but differ significantly for nondefense budget authority. These differences will be examined by OMB and CBO staff.
2/ Estimates for this option are based on OMB's estimates of 1987 current rate and adjustments for pay and FERS based on CBO estimates.

Prepared by Senate Budget Committee Staff

HB Oct 29

ENTITLEMENTS AND MANDATORIES BY AUTHORIZING COMMITTEE
($ in millions)

	1987 Outlays	1988 Baseline Outlays	GRH Status	Growth Factor
Agriculture, Forestry and Nutrition:				
Farm Price Supports (350)..	22,480	21,042	S. Rule	Schedule/Economic
Food Stamps (600)..........	12,499	13,449	Exempt	Eligibility/Price Index/ Economic
Child Nutrition (600)......	4,124	4,398	Exempt	Economic/Eligibility/ Price Index
Armed Services:				
Military Retirement (600)..	18,126	19,108	Exempt	Cola Index/Eligibility/ Economic
Finance:				
Aid to Families with Dependent Children (600).	10,244	10,595	Exempt	Economic/Eligibility/ State action
Child Support Enforcement (600)........	735	775	Sequester	Economic/Eligibility/ State action
Earned Income Tax Credit (600).............	1,420	2,987	Exempt	Economic/Cola Index
Family Social Services (500)...........	236	248	S. Rule	Eligibility
Medicaid (550).............	27,323	30,046	Exempt	Eligibility/Economic
Medicare (570).............	71,877	81,187	S. Rule	Eligibility/Economic
Social Security (650)......	203,446	216,263	Exempt	Eligibility/Cola Index/ Economic
Supp. Security Income (600).............	11,005	12,580	Exempt	Eligibility/Cola Index/ Economic

	1987 Outlays	1988 Baseline Outlays	GRH Status	Growth Factor
Finance (cont.):				
Title XX (500).............	2,686	2,716	Sequester	Capped
Unemployment Compensation (600).......	17,125	18,297	Mostly Exempt	Eligibility/Economic/ State action
Finance & Labor and Human Resources:				
Black Lung/Special Benefits Disab. Coal Miners (600).	1,602	1,579	Exempt	Eligibility/Economic/ Cola Index
Railroad Retirement (600)..	8,417	8,790	Exempt	Eligibility/Economic/ Cola Index
Labor and Human Resources:				
Rehabilitation Services (500)...........	195	212	S. Rule	Economic/Price Index
Student Loans (500)........	2,686	3,016	S. Rule	Eligibility/Economic
FECA (600).................	1,160	1,200	Exempt	Eligibility/Cola Index
Governmental Affairs:				
Federal Retirement (600)..	25,612	27,415	Mostly Exempt	Cola Index/Eligibility/ Economic
Federal Annuitants Health Payments (550)...	1,533	1,984	Sequester	Eligibility/Economic
Civiliian Pay Raises (920 & 050).............	---	1,552	Exempt	Economic
Veterans Affairs:				
Veterans Compensation (700).....	10,465	10,688	Exempt	Eligibility/Cola Index
Veterans Pensions (700)..	3,807	3,813	Exempt	Eligibility/Cola Index
GI Bill (700)...........	764	636	Sequester	Eligibility
Veterans Life Insurance (700)........	1,046	1,170	Exempt	Eligibility

Other Relatively Uncontrollables

Power Marketing Administrations (270)
Banking Institutions (FDIC, FSLIC, NCUA) (370)
Postal Service Fund (370)
FHA & VA Housing Funds (370 & 700)
Forest Service & Mineral Management -- Payment to States (850)
Uranium Enrichment Receipts (270)

HB

11/3/87

Howard —

Yesterday I had a very good meeting with Bob Michel. He said he had "no problem" with me, but did give me some good pointers for dealing with other Republican Members. We also discussed the matter of the Speaker.

I am still trying to schedule a meeting with the Speaker. (I spoke briefly with him about a visit.) I have talked to Tom Loeffler about my approach to the Speaker.

Will keep you posted.

Jack Anderson

11/3/87

THE WHITE HOUSE
WASHINGTON

- A-9

G DOWN
ite House

Howard Henry

what about asking the Wall Street activists who say Congress must act to come down to the White House to meet with the President and the Congressional Summit negotiators - THIS WEEK.

Ted S

esident Reagan of placing
as deficit reduction talks
ional leaders appeared to

Congress agree to deeper
ses and defense spending
to cut the deficit by the

inistration) the talks are
iliar with the closed-door
but they're not going to
n, Washington Post, A1)

On Ways To Trim Deficit

House and congressional
ching a deficit-reduction

k market appear to have

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sal, now apparently set
s for Social Security

anged their fundamental
Wall Street Journal, A4)

DIRECTS BLAME

scal weight of popular
ner the White House and
on while keeping hands
and military retirement

analyses by several House and Senate committees and the labor-backed Citizens for Tax Justice suggest that President Reagan has misconstrued the cause of runaway deficits by blaming them on increasing federal spending levels approved by Congress and claiming that his Administration has held to a traditional rate of taxation.

"The percentage of revenues is about...19 percent every year of the gross national product," Reagan said in a news conference last month soon after the stock market plunge. "...The spending is roughly 23 to 24 percent, so that is what is increasing while revenues are staying proportionately the same."

However, the recent studies show that domestic, discretionary spending in fact has shrunk markedly as a proportion of federal outlays during the Reagan years, even as total government expenditures have reached a historic high. And the proportion of federal revenues for discretionary domestic programs is approaching a longtime low.

(Dale Russakoff & Tom Kenworthy, Washington Post, A14)

-more-

NEGOTIATIONS ON DEFICIT BOG DOWN
'Arbitrary Restraints' Laid To White House

House Speaker Wright indirectly accused President Reagan of placing "arbitrary restraints" on his budget negotiators as deficit reduction talks between the Reagan Administration and congressional leaders appeared to have bogged down.

White House negotiators are insisting that Congress agree to deeper cuts in domestic spending and smaller tax increases and defense spending reductions than Capitol Hill is prepared to accept to cut the deficit by the $23 billion both sides have set as a goal.

"Until there's more leeway (within the Administration) the talks are not going to get anywhere," said one person familiar with the closed-door negotiations. "They're not going to break down, but they're not going to go anywhere." (Tom Kenworthy & David Hoffman, Washington Post, A1)

White House, Congress Don't Get Far In Agreeing On Ways To Trim Deficit

After one week of budget talks, White House and congressional negotiators have made little progress toward reaching a deficit-reduction accord.

And five days of a quiescent or rising stock market appear to have removed pressure on policy makers to act quickly.

The two sides have complied a long list of options about how to reduce the budget deficit, including one proposal, now apparently set aside, that would limit cost-of-living increases for Social Security beneficiaries.

But the participants don't appear to have changed their fundamental positions... (Jeffrey Birnbaum & Alan Murray, Wall Street Journal, A4)

BUDGET ANALYSES INDICATE REAGAN MISDIRECTS BLAME FOR RUNAWAY DEFICITS

Recent studies documenting the growing fiscal weight of popular entitlement programs are raising questions of whether the White House and Congress can accomplish significant deficit reduction while keeping hands off such political untouchables as Social Security and military retirement benefits.

Analyses by several House and Senate committees and the labor-backed Citizens for Tax Justice suggest that President Reagan has misconstrued the cause of runaway deficits by blaming them on increasing federal spending levels approved by Congress and claiming that his Administration has held to a traditional rate of taxation.

"The percentage of revenues is about...19 percent every year of the gross national product," Reagan said in a news conference last month soon after the stock market plunge. "...The spending is roughly 23 to 24 percent, so that is what is increasing while revenues are staying proportionately the same."

However, the recent studies show that domestic, discretionary spending in fact has shrunk markedly as a proportion of federal outlays during the Reagan years, even as total government expenditures have reached a historic high. And the proportion of federal revenues for discretionary domestic programs is approaching a longtime low.

(Dale Russakoff & Tom Kenworthy, Washington Post, A14)

-more-

November 1, 1987

The Wall Street Journal/NBC News poll released last Thursday contained the following results:

- On the stock market decline, only 33% believe that the President has shown leadership in handling the situation: 53% say that he has not.
- Only 34% rated the President's general handling of the economy as excellent or good (down from 41% a month ago).
- To the question: "How likely do you think it is that there will be a major economic downturn in the next 12 months?", 64% answered "very likely" or "somewhat likely."
- A significant number of the respondents, 38%, reported that the current situation in the stock market makes it "less likely" that they will make major purchases in the next few months.

The Legacy: A Successful Two-Term Presidency

- Strong Economy
- Reduced Size of Government
- Deficit Reduction
- Strong Defense
- Reform Tax Code and Cut Rates

The Opportunity

- Strong Presidential leadership could achieve an agreement that will secure and sustain this legacy

Failure To Act

- Defense would be cut severely, the deficit would increase, economic growth would be endangered, and tax rate reductions and other achievements would be threatened in the next Administration

Strong Economy

The Legacy

- We are in the midst of the longest peace-time economic recovery in history, producing millions of jobs for Americans

The Opportunity

- A large, enforceable deficit reduction package could:

  —help lower interest rates

  —reassure investors and consumers

  —maintain economic growth with low inflation

  —enable us to secure a G-7 agreement to reduce international economic imbalances

Failure to Act

- Could undermine confidence in government, reinforcing investor and consumer insecurity
- Could lead to further instability and decline in the financial markets
- Could lead to an economic downturn next year
- Could play into the hands of those who would reverse Reagan policies in 1989 by increasing spending, reducing defense, and raising tax rates

Reduced Size of Government

The Legacy

- For the first time in years, federal spending increased less than the rate of inflation last year
- Government regulation has been reduced dramatically

The Opportunity

- For the next two years, all major categories of spending would be restricted below inflationary increases
- This restriction would cover major COLA's
- Domestic spending would be $38 billion below projections over the next two years
- Restraining the COLA's would by itself achieve over $30 billion in savings for the first three years, as well a permanent $15 billion savings each year thereafter
- Much of the spending restraint will occur in entitlement programs, insuring lasting savings

Failure to Act

- Without this agreement, there would be no opportunity to achieve the $30 billion in entitlement savings
- Even with an aggressive veto strategy, domestic appropriations will almost certainly exceed inflation the next two years

Deficit Reduction

The Legacy

- After years of record deficits, the 1987 deficit is down to $148 billion

The Opportunity

- The agreement would secure continued deficit reduction, not only in fiscal year 1988, but in 1989 and beyond
- Unlike past agreements, Congress would agree in legislation to lock in cuts in discretionary spending over a two-year period
- Congress could not reverse entitlement cuts without new legislation

Failure to Act

- Continued deficit reduction would be in grave danger
- The sequester would, at best, maintain past progress
- Supplemental appropriations, part of which the Administration could not resist (such as for defense), would undermine the sequester

Strong Defense

The Legacy

- Our military is once again second to none
- The quality of men and equipment is at an unprecedented peace-time level
- Strong defense has increased respect for the U.S. abroad and strengthened our hand in negotiations

The Opportunity

- Preserve the fundamental basis of the defense build-up through 1989
- 1988 and 1989 defense spending would increase slightly, reversing the downward trend since 1985
- The most optimistic post-sequester scenario is a significant 1988 supplemental ($5-8 billion) and a slight 1989 increase over 1988 (but only if Congress refuses to allow a 1989 sequester)
- This agreement would produce about $25 billion more in budget authority over two years compared to this optomistic scenario
- The levels in the agreement, although not all that we wanted, retain a strong base on which the next President can build

The Failure to Act

- Before the end of the Reagan presidency, Carter policies of inferior training, maintenance and supply, would re-emerge

Reform Tax Code and Cut Rates

<u>The Legacy</u>

- The top personal income tax rate has been cut from 70% to 28% and the tax code has been dramatically reformed, closing myriad loopholes

- Tax reform has drastically reduced the role of tax considerations in business and investment decisions, freeing the market to operate more efficiently

<u>The Opportunity</u>

- The agreement preserves the fundamental elements of tax reform and tax rate reduction achievements: <u>rates would not change</u>

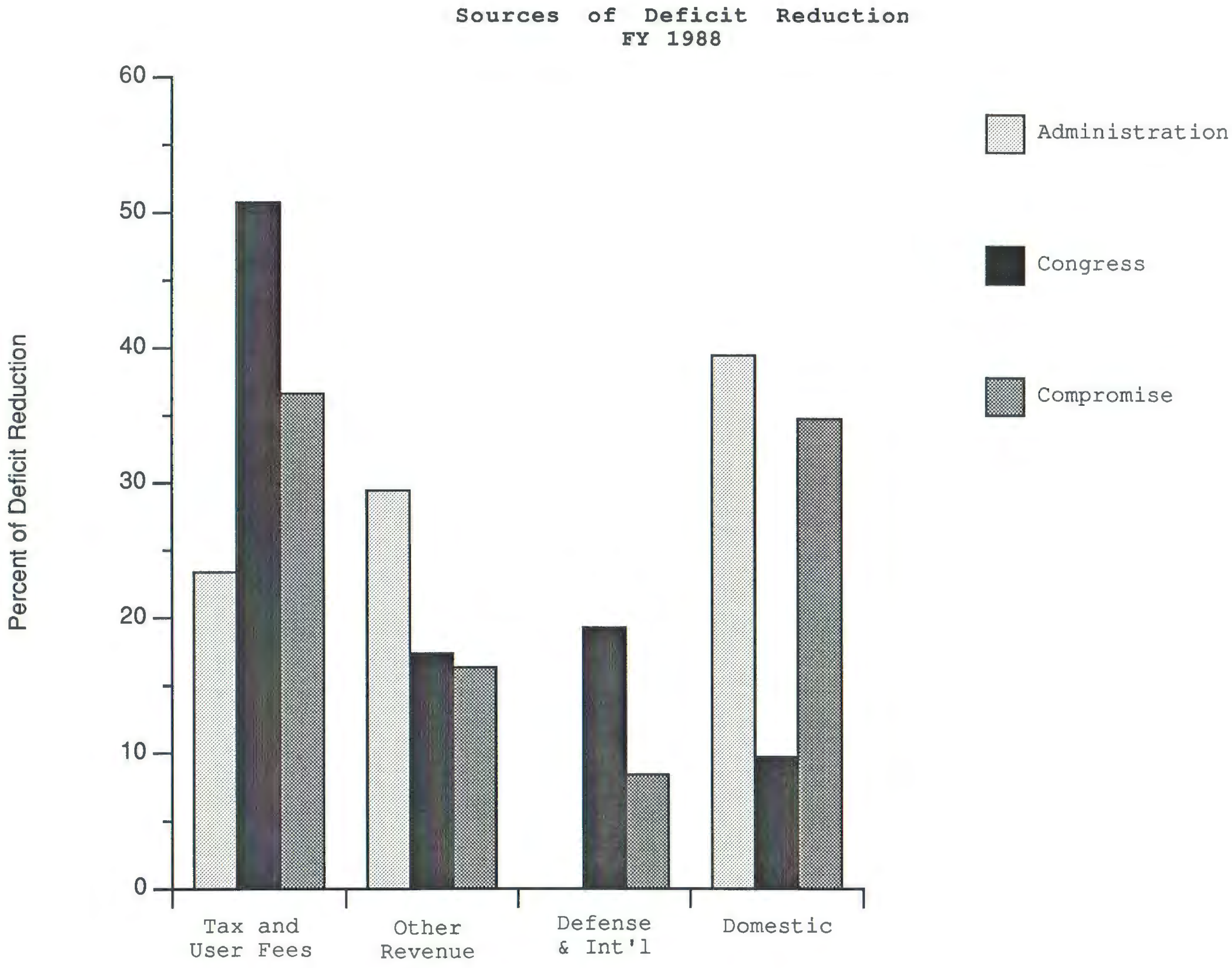
- A modest increase in tax receipts above those in existing Administration proposals might be necessary

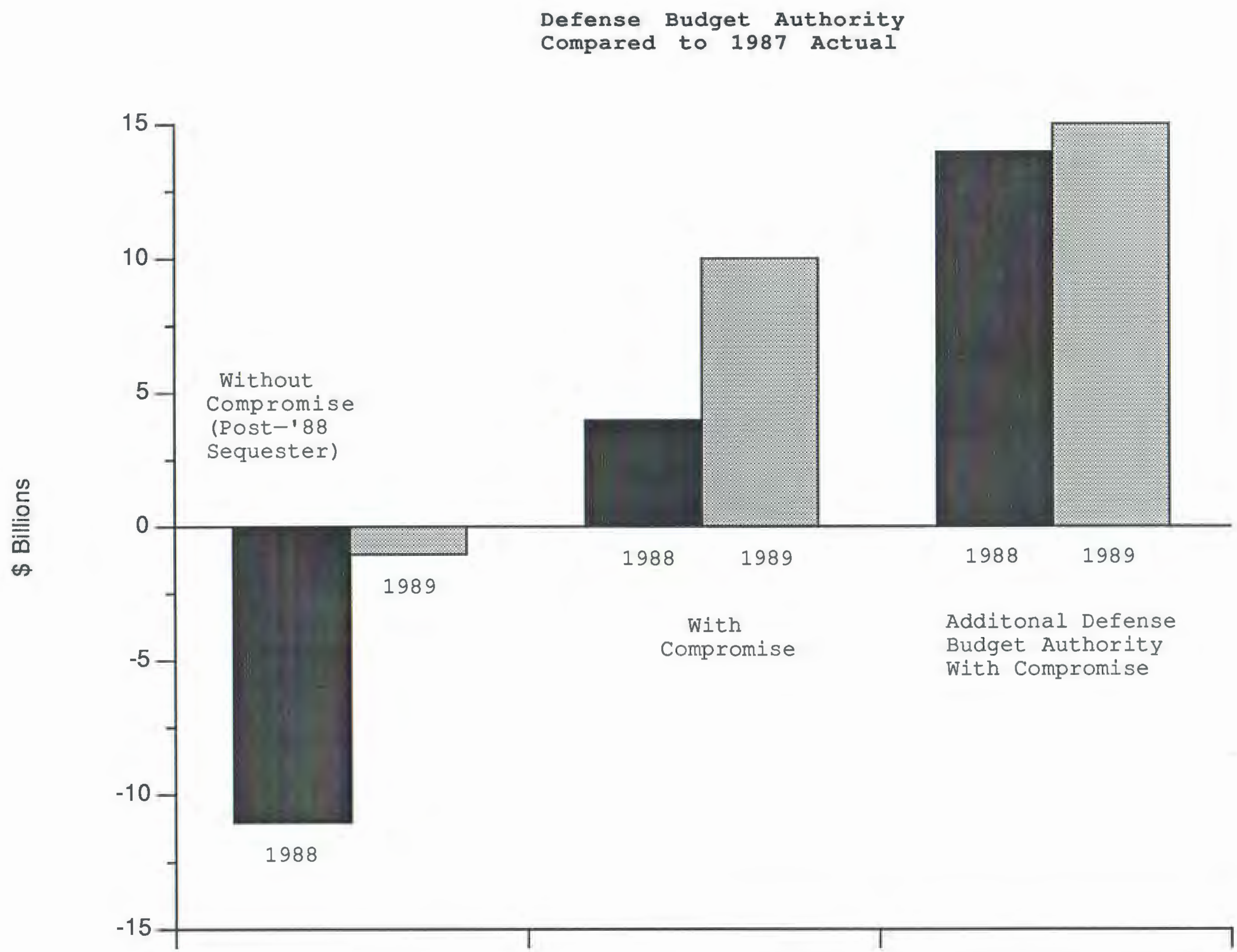
- These tax receipts would come from user fees, compliance measures, extensions of existing taxes, and some further reform consistent with past initiatives to enhance fairness

- Total new revenue would be below the amounts in the current budget

<u>Failure to Act</u>

- The unresolved deficit problem would almost certainly force the next President to reverse course: to consider significant tax increases, increasing rates and dismantling tax reform


Sources of Deficit Reduction
FY 1988
Percent of Deficit Reduction
60
50
40
30
20
10
0
Administration
Congress
Compromise
Tax and
User Fees
Other
Revenue
Defense
& Int'l
Domestic



Defense Budget Authority
Compared to 1987 Actual
$ Billions
15
10
5
0
-5
-10
-15
Without
Compromise
(Post-'88
Sequester)
1988
1989
With
Compromise
1988
1989
Additonal Defense
Budget Authority
With Compromise
1988
1989

DEFICIT REDUCTION ALTERNATIVE 1/
(savings from G-R-H baseline, in billions of dollars)

Item	FY 1988	FY 1989
Revenue increases:		
Receipts and user fees 2/	11.0 3/	15.5
Asset sales/privatization	4.9 4/	4.9
Subtotal, revenues	15.9	20.4
Outlay Reductions:		
Discretionary programs:		
Defense (050) 5/	2.3	2.4
International (150)	.2	.5
Domestic	2.5	5.9
Subtotal, discretionary	5.0	8.8
Entitlement programs:		
COLA's	4.5	11.7
Other	3.4	5.1
Subtotal, entitlements	7.9	16.8
Subtotal, outlays	12.9	25.6
Debt service	1.2	4.0
Total deficit reduction	30.0	50.0

1/ 2.0 percent discretionary increase and 2.0 percent COLA's for non-means-tested entitlement programs for both FY 1988 and FY 1989

2/ To be matched, dollar-for-dollar, by real domestic spending cuts—which will be locked-in by law

3/ This amount approximates the total of the proposed receipts and user fees in the Administration's budget (including the Mid-Session update)

4/ Compares with Administration proposals for asset sales, privatization, and credit reform that total $10.9 billion

5/ BA of 294 in FY 1988 and 301 in FY 1989

~~CONFIDENTIAL~~
SECOND DRAFT
5:00 PM

BUDGET CONFERENCE
MAJOR DISCUSSION ITEMS

I. PROCESS

The Administration's negotiating team is:

- Howard Baker
- Jim Baker
- Jim Miller
- Will Ball (?)

. Each Republican and Democrat leader will name four members to represent them in the negotiation:

- Leader representative
- Budget
- Appropriations
- Ways/Means and Finance

. The Administration's team will meet with the Congressional team on Tuesday, October 27th at 3:00 PM, and the second meeting of the negotiating teams will be scheduled ASAP.

. Appropriation bills will be held up pending results of negotiations since the "302-b" levels may have to be revised. The reconciliation bill will be held pending the CR. A short-term CR will have to be passed next week.

. The negotiations will not be carried out in the press -- there will be a "close hold" on all discussions and agreements. Negative comments will be avoided.

II. NEGOTIATION PARAMETERS -- DEFICIT REDUCTION

. Everything is "on the table" except for Social Security.

. A two-year agreement covering FY 1988 and FY 1989 is desirable, but there should be an agreement on enforcing the agreement through next year's budget process. This would include both discretionary appropriations, entitlements, and revenues. Defense should receive a two-year appropriation now.

. The minimum deficit reduction should be $25 billion in FY 1988 and $40 billion in FY 1989, and we should shoot for $30 and $50 billion. Aset sales from loans and physical assets will be added to obtain additional savings in both FY88 and FY89.

. A "discretionary freeze" concept (nominal in FY 1988 and inflation adjusted in FY 1989) will provide a general framework for reductions in appropriation accounts.

- Revenues proposed by the Administration and included in either the House or Senate reconciliation bills will provide the general base for revenue increases.

- There should be no new programs or expansions in the reconciliation bill -- nor should there be any legislative language provisions in the CR.

- The FY 1988 and FY 1989 supplementals should be limited to only actual emergencies, and any outlay cuts should not include timing shift.

- General "categories" of deficit reduction should be agreed as "maximum reductions" to be achieved at the Tuesday meeting of negotiating teams:

Category	FY88 - billions		FY89 - billions	
- Revenues	$16.0B		22.0B	
. Receipts		8.0		10.0
. User Fees		2.0		3.0
. Net Interest		1.0		4.0
- Asset Sales		5.0		5.0
- Defense & International Outlays	5.0		11.0	
- Discretionary Outlays	5.0		8.0	
- Entitlements	5.0		10.0	
Total	$31.0		$51.0	

- Since the negotiations will focus on reducing the deficit by a specified amount ($25 billion or more) rather than reaching a "target" -- baseline socring differences between OMB and CBO are not that important. However, OMB will include any differences in its analysis and position papers.

III. NEGOTIATION PARAMETERS -- PROCESS REFORM

- Budget process reforms will be included in the negotiations. While mentioning balanced budget amendment and line-item veto -- there should be a major effort to achieve separate enrollment, enhanced rescission, and credit reform.

- A capital gains tax reduction should be considered towards the end of the negotiation -- perhaps without any savings associated to the change.

- The FY 1989 President's Budget and CBR should reflect all agreements reached in these negotiations.

IV. SUGGESTED STRATEGY FOR MEETINGS

- There are several approaches that the Administration can take in the early negotiations. One is to start with the Congressional Reconciliation bills, the CR, and the CBR 302-b levels. This is probably a bad idea -- the Administration will be on the defensive from the start.

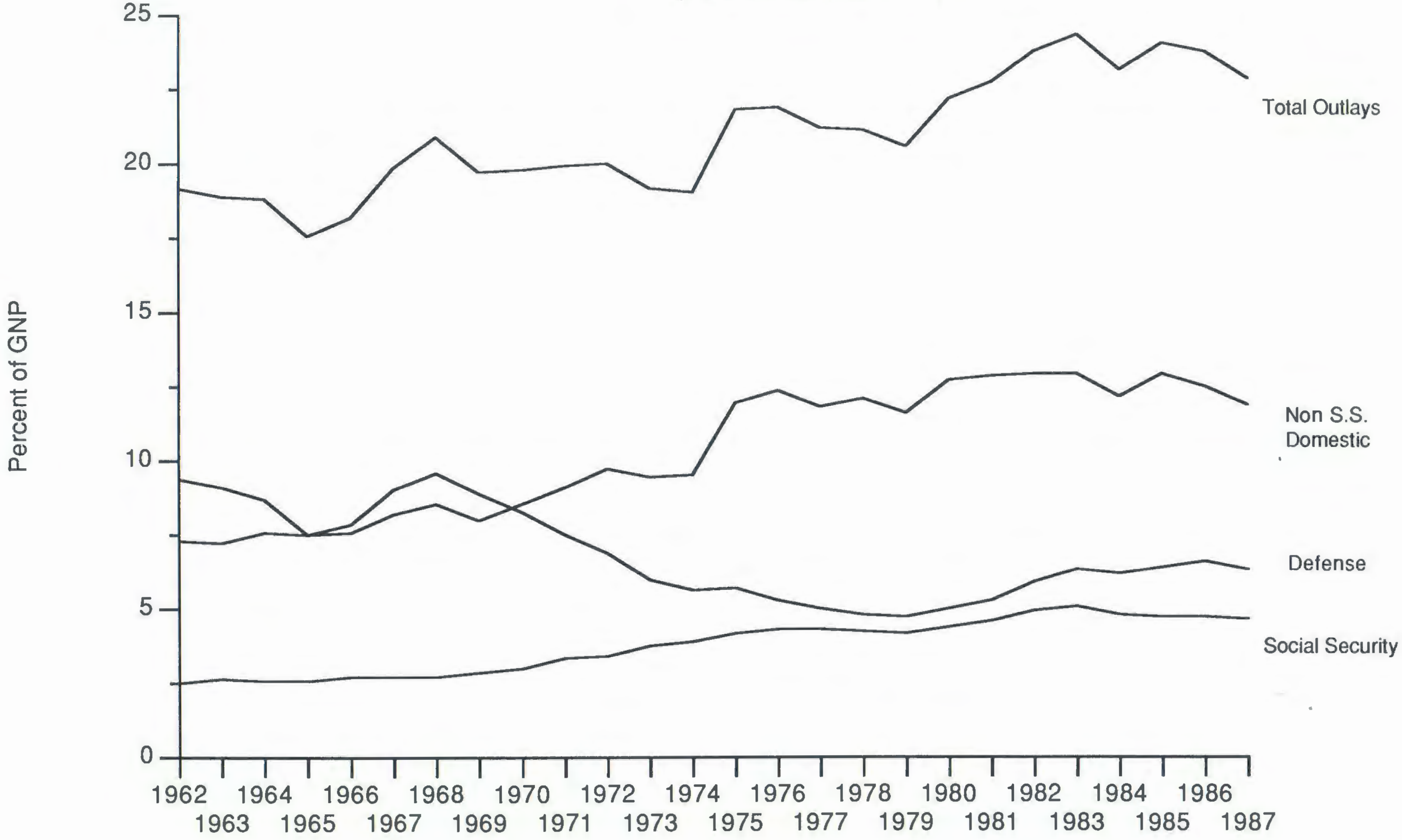
- Another alternative is to "start from scratch" and negotiate an entire new package. This is also a bad idea -- there isn't enough time.

- The Administration team should seriously consider trying to establish the "general parameters" of an agreement, by category, at the very first meeting. These parameters could be:

  - Two-year agreement.
  - \$25-\$30 billion in the first year, \$40-\$50 billion the second year.
  - Total revenues of no more than 50% of package.
  - Freeze concept for outlay reductions.
  - No new programs and emergency supplemental only.
  - Asset sales over the \$23 billion level.

- If a general agreement can be reached at the first meeting -- a smaller group should be tasked to add the details which should be kept to only major items. We should try for an agreement quickly.

Federal Outlays by Category
(as a Percent of GNP)



October 29, 1987

SUGGESTED COMMENTS BY PRESIDENT

--I HAVE BEEN BRIEFED BY MY BUDGET NEGOTIATORS ON THE PROGRESS SO FAR.

--PROGRESS IS BEING MADE AND I URGED THEM TO CONTINUE WORKING FOR A SOLUTION WITH CONGRESS ON THE BUDGET DEFICIT AS SOON AS POSSIBLE.

//--EVERYTHING IS ON THE TABLE ON BOTH SIDES AS IT SHOULD BE.

Charles Schumer

85 mins contemporaneous Hong Kong

63 mins Sen. [illegible]

2 mins.

5.4 Defense freeze

4.8 Domestic discret. freeze

3.0 Entitlements

8.0 Taxes

5.0 asset sales R3

1.0 Interest

$27.2

[illegible]

4

3.8

4.5

12. — R1 & R2

5.

2.

THE WHITE HOUSE
WASHINGTON

10/28/87

NOTE TO HHB

FROM: Ken D.

RR thought you should see the attached.

Attachment

KENNETH M. DUBERSTEIN
DEPUTY CHIEF OF STAFF

October 28, 1987

<u>Negotiating Pitfalls</u>

- Political

  - (House) Democrats will define 50/50 in an unacceptable manner—making the failure of negotiations to us—blaming the subsequent sequester on the President

- Tactical

  - Opening the meeting to staff will slow progress and not allow the "politcal" solutions that are necessary to a resolution

- Technical

  - defense BA/O mismatch can be "resolved" in a manner which removes outlays for DOD next year

  - baseline issues to determine <u>levels</u>, rather than deficit reduction or policy changes; e.g., discussions of the <u>levels</u> of the deficit will disintegrate into arguments over economic assumptions, etc.

October 28, 1987

FY 1988 FREEZE OF ENTITLEMENTS

Entitlement expenditures increase for three general reasons:

1. The number of eligible participants increases. For example, more people became eligible or, for programs like Medicare, more services are demanded as the population ages.

2. Benefits paid to new beneficiaries exceed those paid to departing beneficiaries. For example, in retirement programs, the benefit calculation for new retirees generally reflects a higher wage base.

3. Adjustments are made for inflation. Direct adjustments include cost of living increases and higher rates paid to hospitals under Medicare. Indirect increases include paying more for services rendered because of general inflation.

An entitlement freeze would allow for increases of the first two types. Otherwise, beneficiaries might receive less under a freeze than in previous years. Eliminating inflation, however, would not reduce benefits. Preliminary estimated FY 1988 savings from a freeze on inflationary increases are about $6 billion, growing to over $10 billion dollars in FY 1989.

Tom Carper

DRAFT

PRINCIPLES FOR DEFICIT REDUCTION

1. Package must be self-enforcing--i.e. cuts and tax increases are to be enacted in the same legislation.

2. Package to achieve $40 billion in deficit reduction.

3. Ongoing reductions only to be counted as deficit reduction. (Asset sales or other one time events will not be counted.)

4. Burden of reductions to be shared equally; "no exceptions" no matter how worthy.

5. Spending reductions to be based upon a nominal freeze at FY87 levels: both appropriated items and entitlements.

6. Revenue increase to be no more than $12 billion, including increased compliance.

7. Social Security payments to be sufficient to hold recipients harmless for Medicare premium increase.

8. Package to achieve at least a 2 for 1 spending-to-revenue ratio in deficit reduction.

TAUKE/PENNY APPROPRIATIONS TASK FORCE
BUDGETARY SUMMIT PROPOSAL

Throughout this year we have worked on a bipartisan basis to restrain the growth in federal spending and bring fiscal responsibility back into our budgetary process. The economic developments of the past week reaffirm our conviction that we need to make significant changes in our nation's spending and taxing policies to reduce our federal deficit.

To this end, we urge you to provide leadership for a deficit reduction package totaling over $40 billion. We find significant support from our colleagues for a proposal which:

$ 12.3 B	o	freezes all discretionary spending at FY87 spending levels;
3.5 B	o	eliminates the price inflation index for Medicare and Medicaid provider payments and makes other reforms in entitlement programs;
2.9 B	o	eliminates civilian and military pay raises for FY 1988;
9.5 B	* o	eliminates Cost-of-Living Adjustments on all federal programs for FY 1988 and
12.0 B	o	includes $12 billion in new revenues.
2.0 B	o	interest savings
41.2 B		TOTAL SAVINGS

* EXCEPT FOR AMOUNT NEEDED TO OFFSET MEDICARE PART B PREMIUM INCREASE.

October 28, 1987

FY 1988 FREEZE OF DISCRETIONARY BUDGETARY RESOURCES

Two super categories

All discretionary budgetary resources would be frozen at the FY 1987 enacted level in two super categories: (1) defense and international accounts in one category; and (2) all non-defense in the other category. "Defense and international" is defined as all accounts in budget functions 050 and 150.

Baseline for the ceilings

The reference for budgetary resource and outlay levels would be the OMB August 20 G-R-H report, which is based on FY 1987 enacted levels. The budgetary resource ceilings would apply to discretionary budget authority, obligation limitations, direct loan obligations, and guaranteed loan commitments.

Discretion within the super categories

The budgetary resource and outlay ceilings would be applied at the super category level only. No controls on the program mix within the two categories would be imposed.

Scoring legislation under the freeze

Scoring actual appropriations would be based on the same technical assumptions used in the OMB August 20 G-R-H report. These are the same assumptions OMB was required to use in the October 20 G-R-H report.

Budget authority/outlay mismatch for defense

The budget authority/outlay mismatch for defense that was incorporated in the CBR and G-R-H baseline for FY 1988 would be corrected.

Estimated budget impact

Current OMB estimates of budgetary resource and outlay ceilings under a freeze are shown in the attached table.

FREEZE ON DISCRETIONARY BUDGETARY RESOURCES
(in billions of dollars)

Function 050	Freeze 1987 Enacted with October 20 Spendout	Benchmark October 20 GRH Baseline	Senate Armed Services 1/	Outlay Savings
Total 050:				
Budget authority..........	291.0	302.7	303.3	
Outlays new...............	172.5	173.0	178.1	
Outlays prior.............	116.7	116.7	116.7	
Outlays total.............	289.2	289.7	294.8	-4.9 2/
Total 150:				
Budget authority..........	18.3	19.0		
Ob/loan limits............	0.5	0.5		
Outlays new...............	10.6	11.1		-0.5
Total Super Category #1:				
Budget authority..........	309.3	321.8		
Ob/loan limits............	0.5	0.5		
Outlays new...............	185.7	184.1		-5.4
Total Super Category #2 (Domestic):				
Budget authority..........	124.9	131.3		
Ob/loan limits............	41.1	41.5		
Outlays new...............	82.9 3/	87.7		-4.8

1/ The Senate Armed Services Authorization bill levels are included as a realistic BA/O program spendout for FY 1988.

2/ Savings based on correcting mismatch by using Senate program mix.

3/ Freeze estimates are preliminary.

October 28, 1987
251:120,101

October 26, 1987

General Negotiating Points

- Our objective is to achieve at least enough deficit reduction to avoid a sequester this year
- We would not rule out a two-year deal
- Any agreement must ultimately include the means of implementation and enforcement over all aspects of the deal
- Any agreement must be balanced—[revenues and defense levels (the President's priorities) vs. domestic discretionary and entitlements (Congressional priorities)] or [50% revenues vs. 50% domestic spending] or [50/50 in the first year]
- We believe that it would be a show of good faith on your part to delay consideration of any reconciliation bill until we see how these negotiations proceed

October 26, 1987

Opening Remarks

- The meeting yesterday between the President and the leaders of Congress set precisely the right tone—everything but Social Security is on the table—as one participant at yesterday's meeting said, we need to look forward and not backword—we hope that includes your current reconcilation bill

- We have some difficult decisions before us—but for the sake of the country, we need to make those hard choices together

- We need to work as quickly as we can and conclude these negotiations as early as possible

- We need to reach an agreement—an agreement that all sides can support

- But we also need to ultimately also agree on a procedure to implement and enforce any agreement—a procedure that provides for full performance by all sides—for any deal to be meaningful, it must be lasting

- As most of you know from previous encounters with me, I am not an expert on the details of the budget or arcane budget procedures—Jim Baker and Jim Miller are our resident experts—I will work with them in our joint efforts to reach an accord

- Let's review some of our basic objectives and alternatives to see if we can begin there

October 27, 1987

Calls to Congress

- HHB to JAB III to discuss list and divide up
- <u>HHB</u> / <u>JAB III</u>

<u>HHB</u>	<u>JAB III</u>
Domenici	Rostenkowski
Packwood	Lott
Michel	Bentsen
Cheney	Chiles
Gramm	Bill Gray
Dole	Gradison
Hollings	Frenzel

- Attempt to feel them out on basic concepts

  —freeze

  —2-year package

  —level of revenues

  —use of non-tax revenues

  —House reconciliation—go forward?? Will it pass??

October 26, 1987

<u>General Negotiating Points</u>

- Our objective is to achieve at least enough deficit reduction to avoid a sequester this year
- We would not rule out a two-year deal
- Any agreement must ultimately include the means of implementation and enforcement over all aspects of the deal
- Any agreement must be balanced—[revenues and defense levels (the President's priorities) vs. domestic discretionary and entitlements (Congressional priorities)] or [50% revenues vs. 50% domestic spending] or [50/50 <u>in the first year</u>]
- We believe that it would be a show of good faith on your part to delay consideration of any reconciliation bill until we see how these negotiations proceed

8

For internal reference only

Outline of a Joint Package

	FY88	FY89
	(billions)	
Discretionary Spending Freeze		
-- Domestic Discretionary	5	8
-- Defense and International	5	12
Other Domestic Spending Cuts		
-- Entitlements	(Match revenues. FYI, a $5 billion entitlement cut in FY88 could produce $10 billion in FY89)	
-- Other Domestic		
Revenues		
-- Core Receipts (In the President's budget and agreed to by one or both Houses)	4.6	6.3
-- Other Receipts (e.g., President's budget, Ways & Means, or Finance bills)	3.5	4.0
-- Other Revenues from the President's budget (possible $16 billion -- from user fees, asset sales, credit reform, privatization)	8	8
Interest	1	4

HOUSE RECONCILIATION

The House Majority claims that implementation of its reconciliation/appropriations will produce the necessary savings ($24.8 billion) to avoid a sequester. This claim is inaccurate. The requisite savings are not provided. More important, the only reductions are from increased taxes and defense cuts; on net, domestic spending is increased above the baseline, primarily for welfare. (This analysis is preliminary, because we only recently received the House reconciliation language; neither OMB nor Treasury have completed scoring.)

The House would change revenues/outlays relative to the G-R-H baseline as follows (in billions of dollars):

-14.0 (1) Receipts

Includes $2 billion from increased IRS enforcement.

- 6.5 (2) Defense and International

Assumes CBR low-tier outlay levels.

+ 2.0 (3) Domestic Appropriations

Net increase over G-R-H baseline.

- 0.9 (4) User Fees

New user fees.

0.0 (5) Entitlement Reductions in Reconciliation

On net, reconciliation appears to produce no more than $1 to $2 billion in outlay reductions. If "reductions" are removed that merely shift spending from 1988 to 1989 and other years, there are probably no net savings at all. Moreover, numerous provisions would increase spending in 1989 and beyond.

- 1.0 (6) Interest

-$20.4 (7) Total

October 26, 1987

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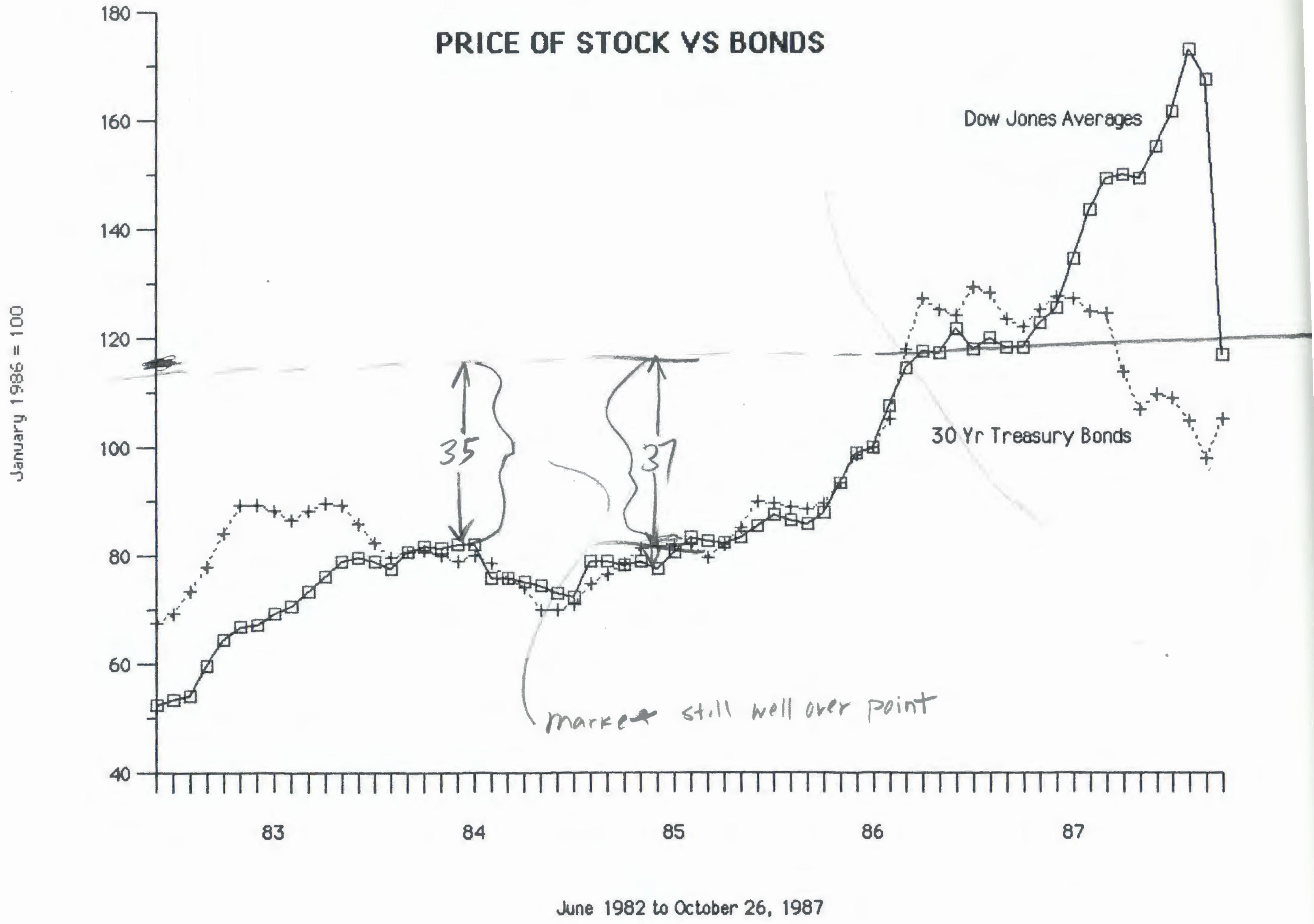
PRICE OF STOCK VS BONDS
Dow Jones Averages
30 Yr Treasury Bonds
January 1986 = 100
180
160
140
120
100
80
60
40
83
84
85
86
87
35
37
market still well over point
June 1982 to October 26, 1987

October 25, 1987

Basic Plan

FY '88 -- Discretionary freeze plus entitlement reductions

FY '89 -- Discretionary programs increased by inflation and no additional entitlement changes or user fees

Components	FY '88	FY '89
Spending—		
Defense	-5.2 (291 BA)	-9.6 (302 BA)
Non-defense discretioanry	-4.8	-7.7
Entitlements	-4.0	-8.0
Subtotal	-14.0	-25.3
Revenues—		
Receipts	8.0	12.0
User Fees	2.0	2.5
Asset Sales	3.0	3.0
Subtotal	13.0	17.5
Net Interest	-.9	-3.1
Total Deficit Reduction	-27.9	-45.9
Resulting Deficits	148	132
G-R-H Targets	144	136

CBO would estimate '157

October 25, 1987

Negotiating Considerations

Basic Parameters

- Two-year agreement on discretionary appropriations with specified levels of both BA and outlays
- Separate levels for defense, international affairs, and domestic discretionary appropriations
- Reconciliation after all appropriations in place—and other enforcement mechanisms such as passage of amendment to budget resolution with new levels and dates
- Take reconciliation off House calendar??
- No change in sequester date of Nov. 20
- No program expansion in reconcilation
- No legislative language in appropriations
- No new programs (except catastrophic??)
- No '88 supplementals except for true emergencies
- Budget process reform, especially in absence of 2-year deal, including separate enrollment, enhanced recission, credit reform ??
- Require "some" program terminations ??

Other Considerations

- Baseline issues—

  —use of Gradison baseline

  —correction of BA/outlay mismatch for defense

  —role of CBO

  —economics

  —no gimmicks; e.g., payment shifts, pre-payments, counting user fees and asset sales as negative outlays
- Preserve the possibility of continued Contra funding
- Allow base closings

October 25, 1987

Budget–Next Steps

- President's meeting with bipartisan leadership

  –statement by President after meeting??

- Plan for assessing Republican support for basic parameters

  –calls?

  –separate meetings?

- Hill meeting of all negotiators

  –full discussion of basics, such as separate levels for defense, international affairs, and domestic discretionary and specified levels of both BA and outlays

- Separate negotiations if tentative agreement on basic parameters ??

  –J. Baker with Bentsen and Rostenkowski

  –Miller with Chiles and Domenici ??

- Links to McKay group?

United States Department of State

Washington, D.C. 20520

October 26, 1987

TO : The Secretary

FROM: D/P&R - Skip Boyce
Bob Bauerlein

SUBJECT: Implications of a Freeze for 150

One of the ideas being discussed for the budget summit is a freeze on all discretionary programs at FY 1987 levels. Such an approach would apparently save around $11 billion of the $23 billion being sought. (The $23 billion reduction is from the "Gradison baseline," which is an artificial construct composed of FY 1987 levels adjusted for inflation and increased pay-related costs.) Proponents of such a scheme argue that most of the balance in deficit reduction measures could come from selected revenue measures, leaving most programs at current nominal levels.

The beauty of such an approach lies in its simplicity. The alternative would be to negotiate, program by program, the adjustments to current Congressional budget resolution ceilings which the Administration would receive in return for agreeing to a tax increase.

Under a freeze, 150 as a whole is likely to do better than it would under any other scenario (sequester or negotiations). However, most of the benefit would be in security assistance, which has taken the brunt of the budget resolution cuts. State S&E is a different matter.

For the security assistance accounts, the freeze approach would be extremely attractive, since we could never realistically hope to recoup through negotiations the major cuts from freeze levels already assumed under the budget resolution. In the draft Inouye mark, for example, we face a $1.3 billion cut in ESF, FMS and MAP from freeze levels.

However, for the salary accounts, the freeze approach would be much less beneficial. State S&E under a freeze would be $1,589 million. Both House and Senate marks are around $1,630 million -- levels which themselves leave us $89 million short of current services, as you know. Under the worst-case scenario of a sequester (which is what the negotiations are trying to avoid), State S&E would probably be no lower than around $1,550 million. We might therefore do better under a negotiated approach in this area, seeking to get funding added to the House/Senate levels as part of the Administration's deal on revenues.

In summary, under a freeze, we would be in good shape on the security assistance accounts but would have to seek relief for State S&E through a supplemental and/or further restructuring. Under a negotiated settlement, we would have to get the summit negotiators to agree to add-backs for all our accounts.

THE WHITE HOUSE

WASHINGTON

October 23, 1987

MEMORANDUM FOR THE PRESIDENT

FROM: GARY L. BAUER GLB

SUBJECT: Issues Update - Taxes and the Budget

In the wake of Monday's stock market collapse a number of pundits and politicians, defying logic, stepped forward to blame your failure to raise taxes as an explanation for the 500 point drop in the Dow Jones Industrial Average. Democrats in Congress quickly called for a "summit" between you and congressional leaders to work out a deal on cutting the deficit. What liberals futilely hope for, of course, is that such a summit would result in your adoption of Walter Mondale's view that the American people are undertaxed. While we should be willing to talk about everything, we should not agree to sign onto the tax and spending policies that the American people so soundly rejected in 1980 and 1984 - as you so well expressed in last night's press conference.

The fact is that higher taxes would not ultimately reduce the deficit, in any case, but would instead fuel increased spending.

Many of us in the White House well remember the "deal" we cut with congressional leaders in 1982, in which we were promised $3 of spending cuts for every $1 of new taxes. Subsequently, you signed into law the Tax Equity and Fiscal Responsibility Act, which raised taxes by $18 billion the first year, rising to over $63 billion this year, according to estimates made at the time. As was clear, we fully expected a total reduction in the deficit of $380 billion over three years, with only $99 billion representing higher revenues.

We all know what happened, however. Like Lucy, who pulls the football out from under Charlie Brown, the Congress reneged on its end of the deal and not only failed to deliver the spending cuts but actually increased spending. Many of the savings never materialized. The following figures compare your budget requests for FY '83-'86 with the actual outcomes, adjusted for technical and economic changes for each year. The column entitled "policy" shows the true difference between your request and what Congress passed.

Year	Request	Economic and Technical Changes	Policy	Actual
1983	773	+16.2	+18.7	808
1984	863	-25.3	+13.8	852
1985	940	-8	+14.0	946
1986	974	+6.8	+9.3	990

Over these four years, Congress added a total of over $50 billion to outlays. These totals disguise the further fact that Congress spent a total of $98 billion more on domestic programs and $42 billion less on defense than you requested over the four years. Thus the American taxpayer was forced to bear higher taxes without ever receiving the promised benefit of lower spending.

Interestingly, economists have recently begun to study the whole question of whether higher taxes lead to lower deficits or higher spending. Although there is no consensus view, some of the evidence supports your view that higher taxes only lead to higher spending.

A study by Neela Manage and Michael Marlow published in the prestigious Southern Economic Journal concluded that "tax increases to close the Federal budget deficit do not necessarily offer permanent solutions to underlying fiscal problems" because higher taxes often stimulate additional spending. Indeed, their tests "indicate a unidirectional causality from receipts to expenditures."

Another academic study by Professor Paul Blackley of LeMoyne College, published in the Public Finance Quarterly, came to the same conclusion. According to Blackley, analysis "leaves no doubt that revenue increases lead to spending increases and not to smaller deficits."

In short, there is a body of academic research indicating that higher taxes are not a solution to the budget deficit. Only lower spending brings lower deficits, as recent experience shows. Preliminary estimates show federal spending for fiscal 1987, which ended on September 30, coming in just 1.4 percent above 1986, bringing federal spending as a share of GNP down to 22.7 percent -- the lowest level since 1981. As a result we are seeing major improvement in the deficit of about $70 billion.

You know these numbers and know what they mean: only spending restraint produces lower deficits. Nevertheless, there are those on the Left who would attempt to exploit the current situation to press their cherished goal of higher taxes.

The causes of the stock market collapse are many and complicated, and we may never understand all of them. But one thing we do know is that the market did not fall because it suddenly decided that taxes are too low. Indeed, there is some evidence that the tax bill working its way through Congress, with its irresponsible tax on corporate takeovers, may have been a major culprit. Nor does it make sense to blame the budget deficit, which has been around for years and is dramatically improving. Those who would make this argument, therefore, ought to be seen for what they are; not as people genuinely concerned about the budget deficit and the health of financial markets, but as liberal opportunists willing to use any crisis, any opportunity to expand government's share of the national wealth and income.